

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 4

What are the key explanatory factors
underlying successful PFM reform?

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Nick Manning
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Overseas Development Institute, London, UK

Good budgetary institutions and a good Civil Service: Two sides of the same coin?



Nick Manning
The World Bank
November 2007

Definitions: What do we mean by...

■ **Civil Service**

1. Capacity – Ministries and Departments
2. Fiscal weight – public domain

■ **Budgetary Institutions**

1. Aggregate Fiscal Discipline

2. Allocative tasks

3. Implementation/service delivery

Public Sector Employees: Capacity v. Fiscal Weight

Domains				Employees Contingent Fiscal Liability	
				In Principle	In Practice
Public Sector	General Government	Central Government	Ministries and departments in CG	High	High
			Schools, hospitals, etc. largely funded and controlled by central government but not owned by CG		
		State Governments			
		Local Governments			
	Social Security Funds				
	Other Public Sector			Modest	High
Private Sector in the Public Domain				Modest	High

Points of Entry

Some PFM reforms...

- are easier than most CS reforms
- must precede some CS reforms
- can be undertaken in isolation

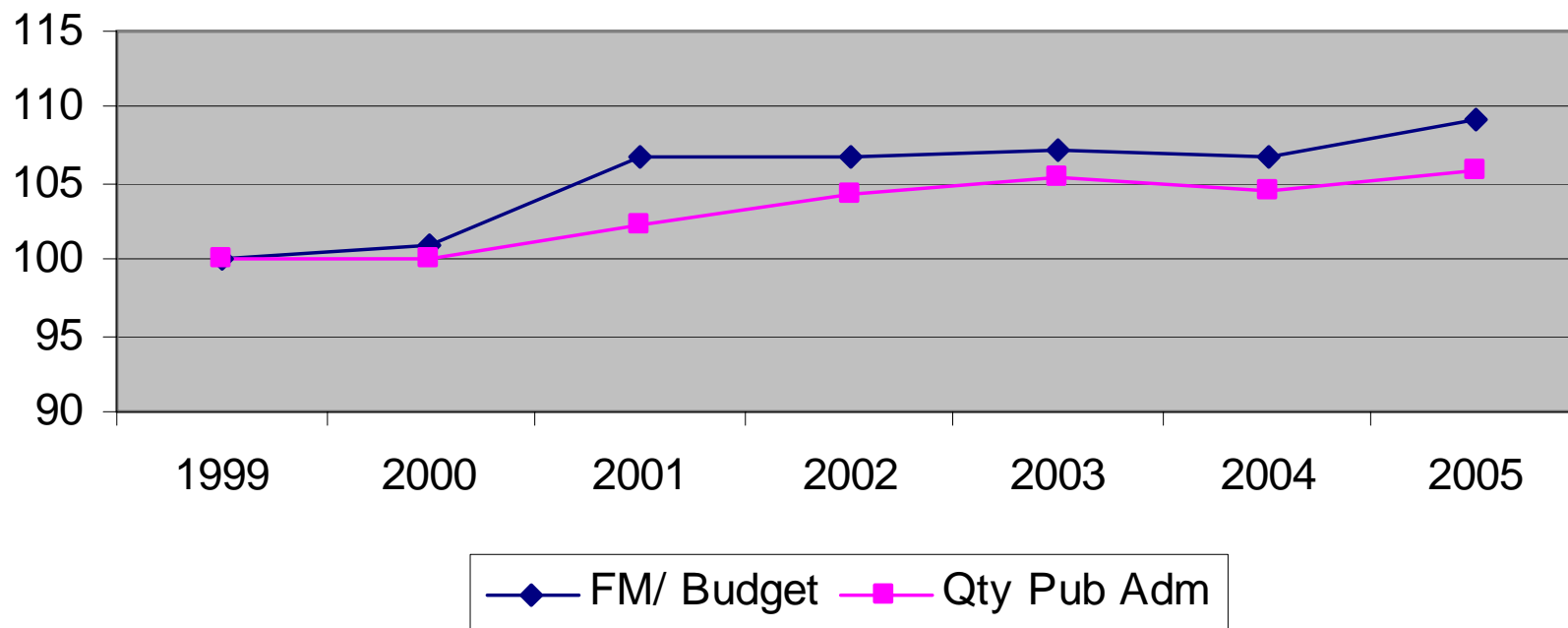
But...

PFM reforms have to be matched by complementary CS reforms, otherwise PFM reforms are pointless!!

- Budget Preparation: Wage bill determines allocation
- Budget Execution: No top-down (traditional) discipline or (NPM) quasi-contracts

PFM improvements “pull” CS reform in Lower Middle Income countries

CPIA Scores* for Lower Middle Income Countries

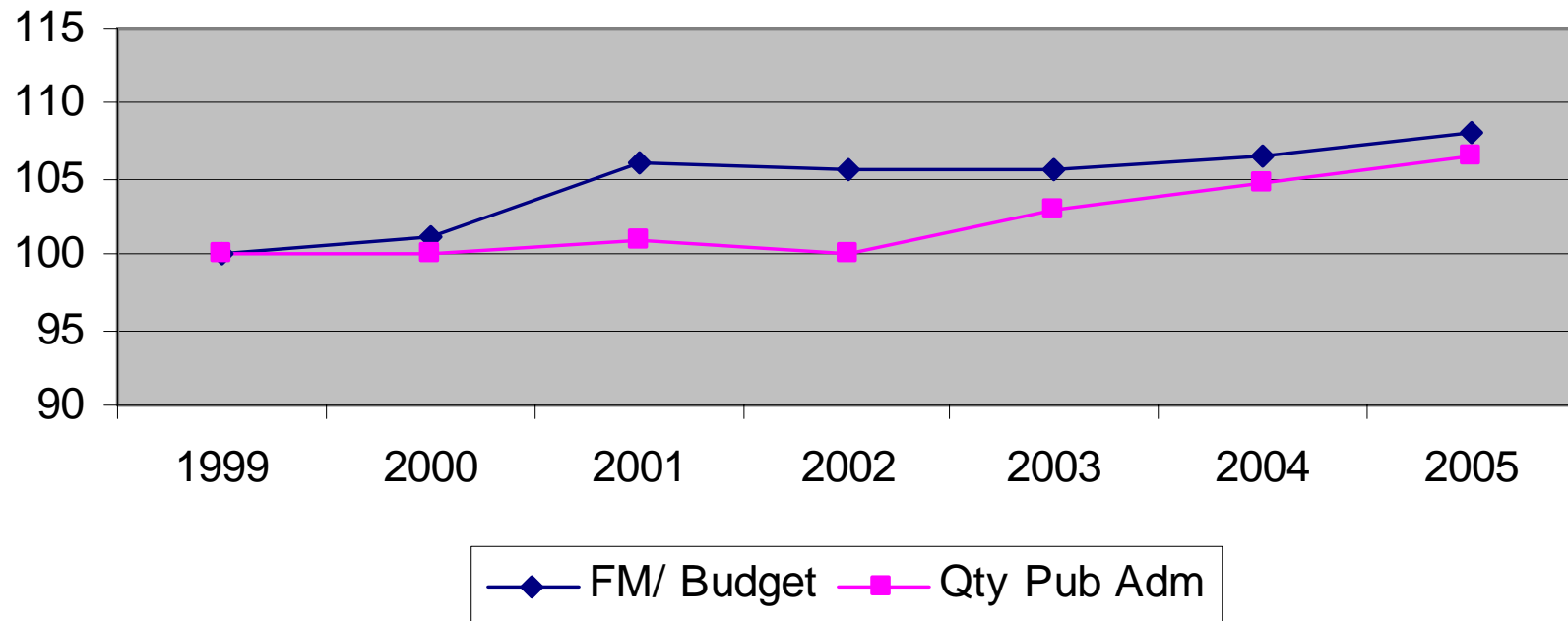


Source: The World Bank

* Country Policy and Institutional Assessment – Average Scores for questions on Quality of Budgetary and Financial Management and Quality of Public Administration 1999-2005. Normalized ratings (1999=100)

...and in the Upper Middle Income countries

CPIA Scores* for Upper Middle Income Countries

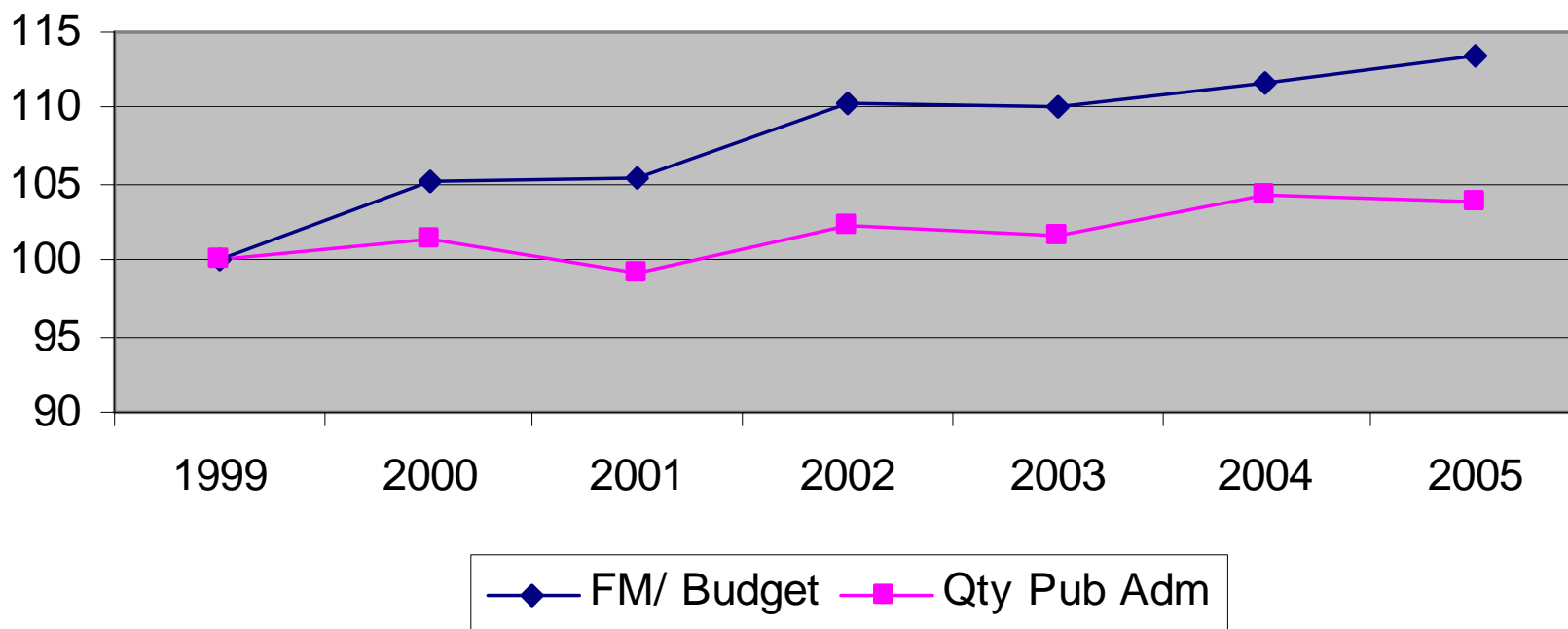


Source: The World Bank

* Country Policy and Institutional Assessment – Average Scores for questions on Quality of Budgetary and Financial Management and Quality of Public Administration 1999-2005. Normalized ratings (1999=100)

But PFM goes it alone in Low Income countries

CPIA Scores* for Low Income Countries



Source: The World Bank

* Country Policy and Institutional Assessment – Average Scores for questions on Quality of Budgetary and Financial Management and Quality of Public Administration 1999-2005. Normalized ratings (1999=100)

Narrow approach to PFM improvements

“Get a bunch of technocrats to run the Ministry of Finance”

- Not a crazy idea
- Common in some specific situations (post-conflict)
- WB support. Low income or post-conflict countries: Paraguay, Pakistan, Laos, Tanzania, Sierra Leone, Kenya, Lebanon
- But...there's a whiff of desperation
- Just a point of entry

Capacity in the MoF is hostage to larger Forces

- (i) Macro-fiscal forecasting of revenues and expenditures – the Legislature is critically involved – **Brazil**
- (ii) Budget execution and expenditure efficiency - the quality of management and service delivery units is the constraint – **Honduras**
- (iii) Accounting and FM information – requiring significant cooperation from often reluctant agencies – **Peru**

There are some success stories in following through...

A more measured approach tries to ensure work on CS accompanying work done on PFM

- Budget execution and expenditure efficiency - When can performance contracts be made to work? **Chile**
- Accounting and financial management information. Why did an IFMIS work in **Guatemala?**

The Moral of the Story

- PFM can lead, but CS must follow
- It is often the CS issues that are the brake on progress
- The challenges are:
 - To get it right technically
 - To increase pressure for both

Getting it right technically on the CS

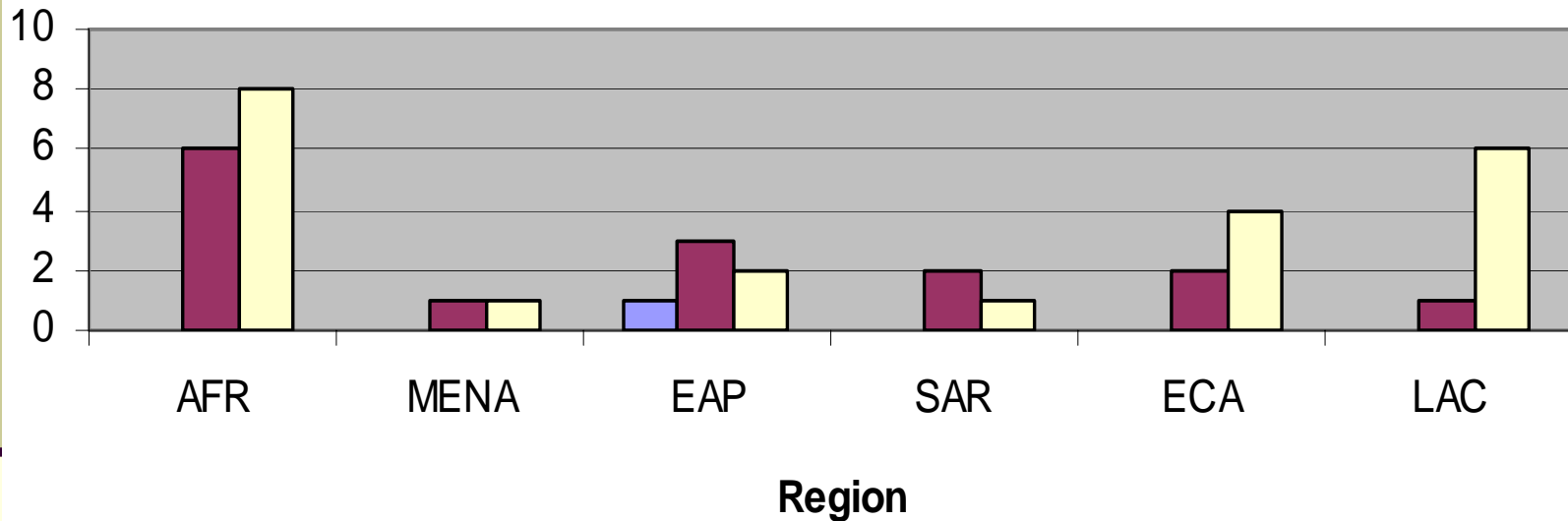
- The direction of CS reform in weaker environments is the reverse of that followed elsewhere
- Quasi-contracts very interesting in Brazil and Chile
- Hierarchical control somewhat more useful in Guyana

Generating demand for reforms

- Breaking out of the equilibrium
- Managed disappointment
- Institutionalized expectations

PEFA – a good start

PEFA* Assessments Completed



Source: The World Bank

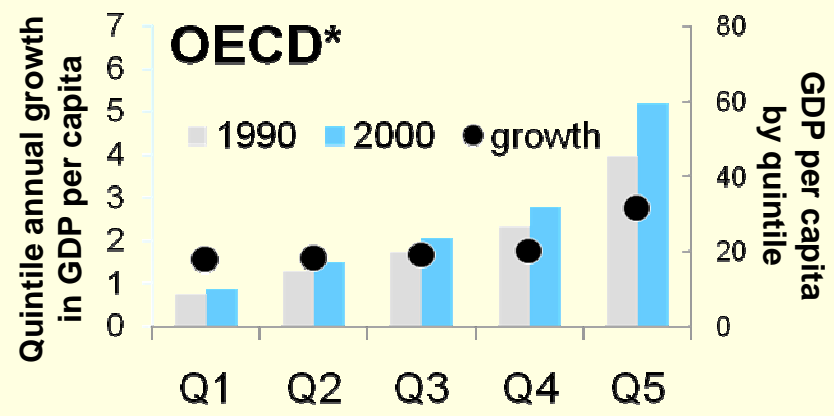
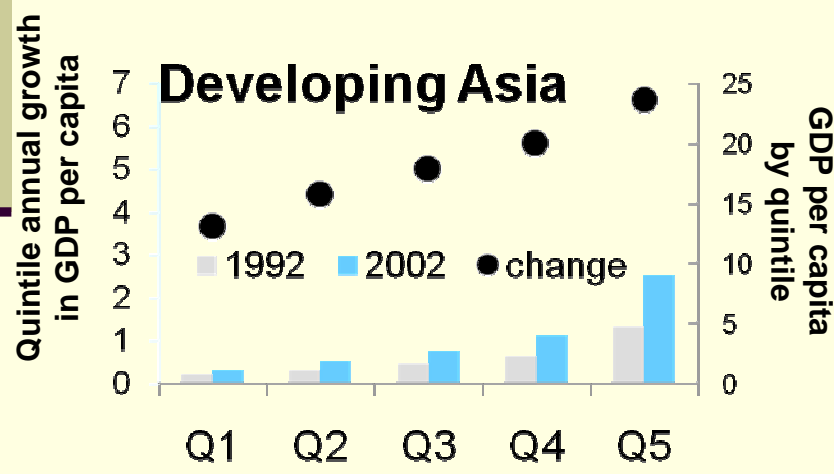
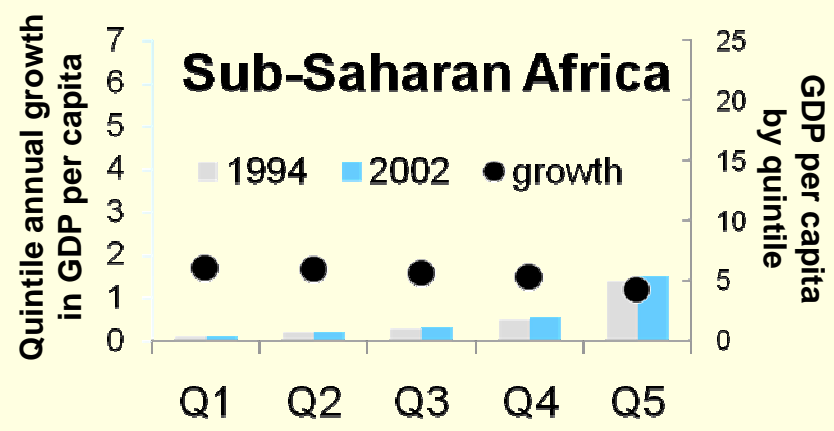
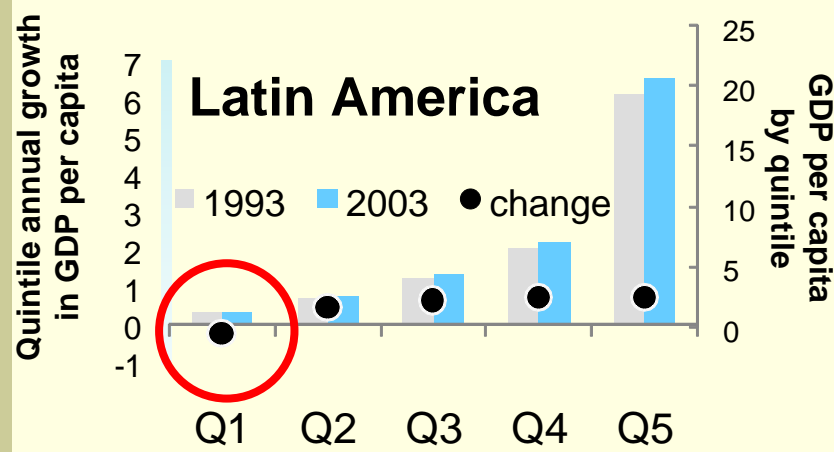
■ FY05 ■ FY06 ■ FY07

*Public Expenditure Financial Accountability Tool

But we need public engagement

- This means some degree of confidence in government – about something other than pork and patronage
- Latin America shows the challenges

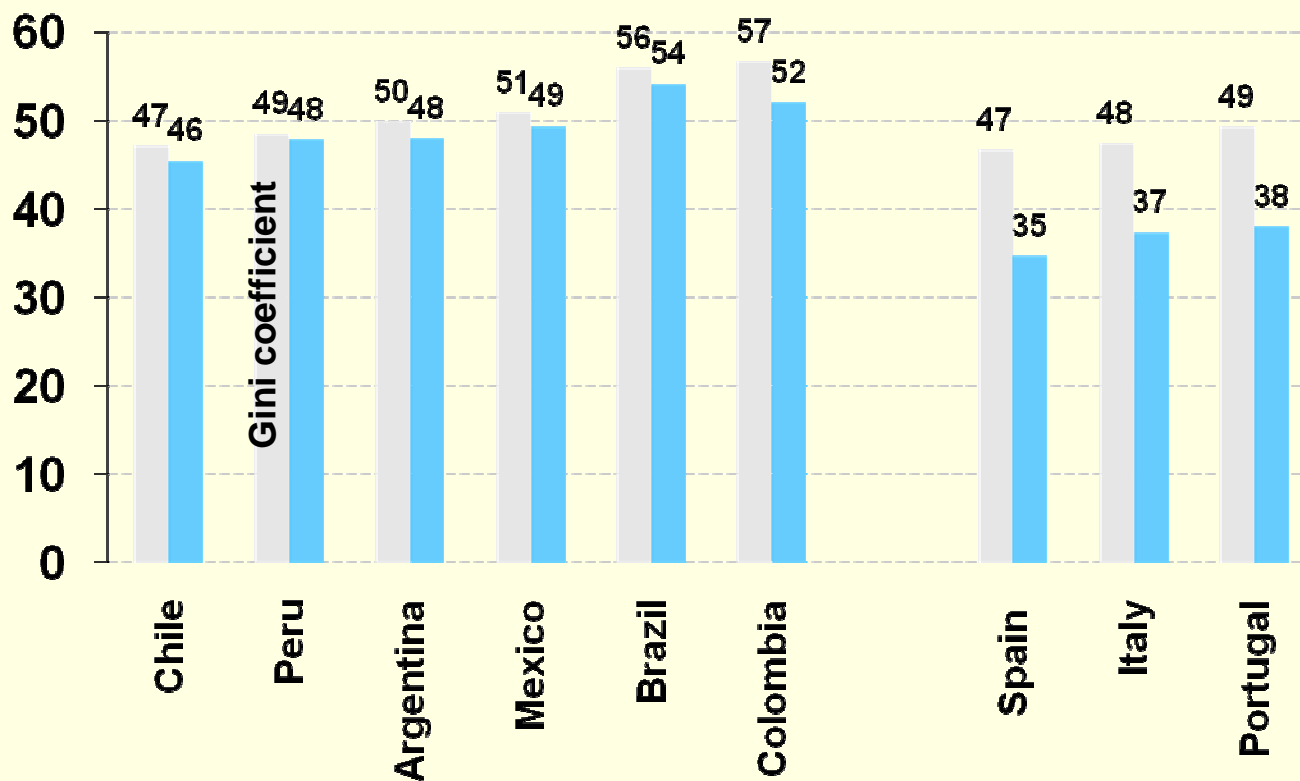
Some of the poor in Latin America have little reason to trust economic policy



Source: OECD Development Centre, 2007. Based on IMF, *Globalization and Inequality*, 2007. OECD* includes: Australia, Austria, Belgium, Canada, Denmark, Finland, France, Germany, Ireland, Israel, Italy, Japan, Korea, Netherlands, Norway, Singapore, Spain, Sweden, UK, US., from Javier Santiso's presentation: Fiscal and Democratic Legitimacy in Latin America (2007)

Many of the middle class have little reason to trust tax policy...

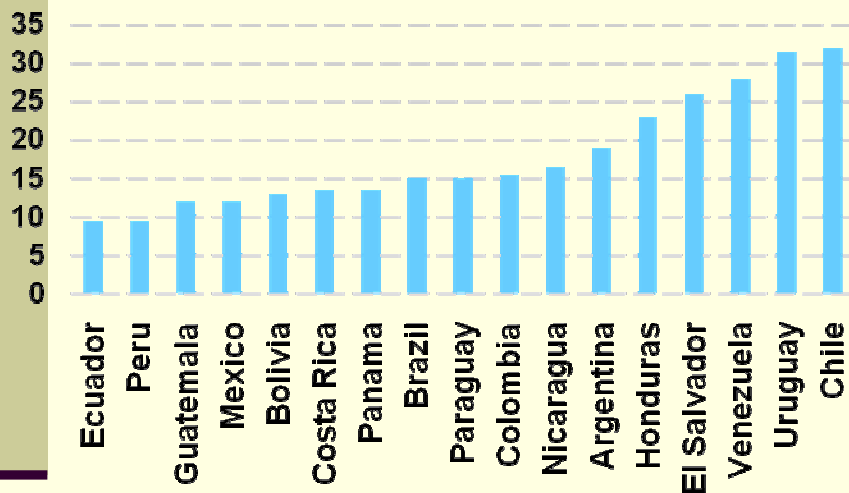
Inequality before and after taxes and transfers



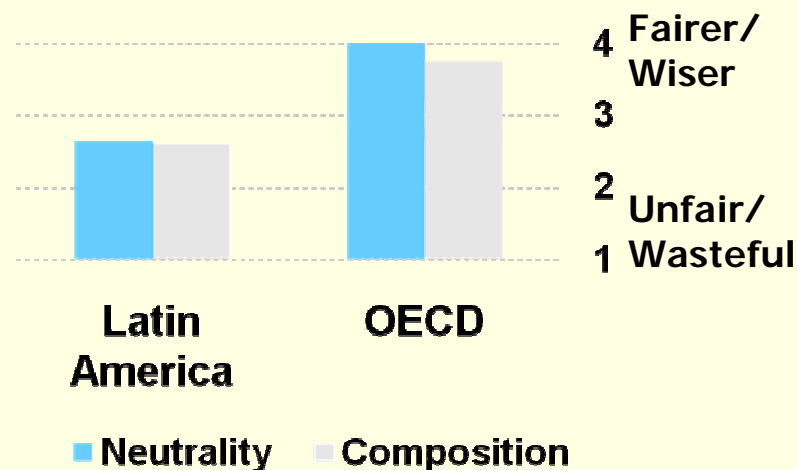
Source: OECD Development Centre, 2007. Based on data by Goñi, López, and Servén (2006), from Javier Santiso's presentation: Fiscal and Democratic Legitimacy in Latin America (2007)

...and many have little confidence in the government's fiscal wisdom

% of citizens who trust tax revenue is well spent (2003-05)



Firms' assessment of the neutrality/composition of government decisions/spending (2003-2006)



Source: OECD Development Centre, 2007. Based on Latinobarómetro (2003, 2005) and World Bank Institute, Governance Indicators Database. Based on World Economic Forum, Global Competitiveness Report, 2003-2006, from Javier Santiso's presentation: Fiscal and Democratic Legitimacy in Latin America (2007)

Conclusion

- As institutional plumbers, we need to keep our skills up to date – let's get it right technically
- But we also need to work more imaginatively to manage public expectations upwards

Tales of the unexpected: PFM reform in difficult environments

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14 – 15 November 2007

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Influences on PFM Reforms other than that of executive branch of government

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CAPE conference, ODI, London
November 15, 2007

Outline of this presentation

- Potential influences on PFM reforms from non-executive branch actors
- Areas of PFM reforms susceptible to non-Government influence.
- Who influences PFM reforms in OECD countries?
- Who influences PFM reforms in developing countries?

Potential influences on PFM reforms from non-executive actors

- Parliaments
- External audit offices
- “Independent” agencies
- Civil society groups, NGOs
- Media
- Donors

Parliament's potential for influence depends (in part) on separation of powers

One extreme: Westminster system: Where the government is selected from Members of Parliament and Cabinet Ministers continue as parliamentarians:

- The Executive effectively controls the Legislature.

Other extreme: Presidential system: Where the Legislature and the Executive are independent of each other.

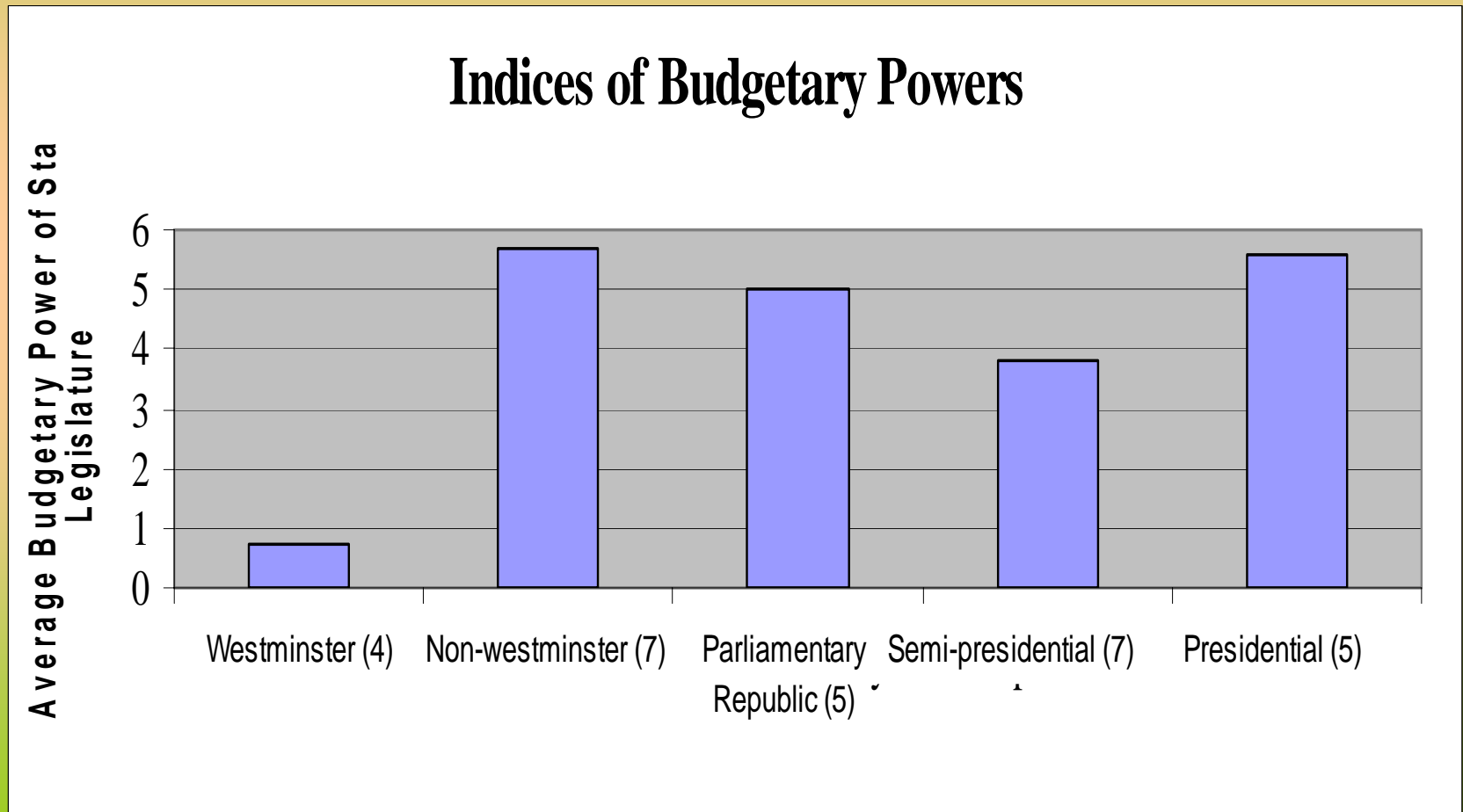
- The Legislature of USA is in the driver's seat for determining the shape and size of annual budgets, as well as PFM reforms (for which it adopts laws).
- Other presidential countries: less budgetary power

Political considerations—electoral system, party cohesion, etc.—are important

Is it a coincidence that USA has adopted many major laws relating to budgetary processes, whereas in other countries, budget-related laws are fewer?

Budgetary Powers of Parliaments vary considerably

Source: Author, based in IMF WP/05/115



Three main PFM areas of parliamentary influence

- **Budget approval.** Parliament is more likely to strengthen its own powers where it has greatest clout, notably during budget adoption:
 - (1) amendment powers of draft budget
 - (2) structure, type, and duration of appropriations
 - (3) time allowed for parliamentary discussion
 - (4) support to parliament for budget analysis
- **Budget reporting.** Parliament, which is sometimes “out of the loop”, may require fuller reporting of:
 - (1) in-year budget developments and fuller annual reports
 - (2) more comprehensive information to accompany draft budget (medium-term fiscal strategy; debt strategy; rationale for fiscal measures; fiscal risks..)
- **External audit follow-up**
 - (1) Parliament forces Executive to act on external audit report.
 - (2) Parliamentary resources are strengthened to do this.

Areas of PFM systems where external audit office exerts influence

- **Budget execution.** External auditor recommends improvements in internal control, internal audit, treasury payment or IT systems.
- **Budget reporting.** External auditor may recommend improvements in quality and timeliness of government (annual) accounts.
- **The 3 Es.** If value-for-money audits, the executive needs to act on auditors' recommendations to improve efficiency.

Influence of Other Actors (*civil society, NGOs, media*) **is largely indirect**

“Non-governmental groups are now investigating how budget work can help achieve their goals. In recent years, a wide range of groups in dozens of countries have begun to engage in budget work, including:

- *Writing general reviews of government budgets;*
- *Advancing budget literacy in their countries through budget trainings and other educational efforts;*
- *Seeking to make budget systems more transparent and participatory;*
- *Conducting budget analyses, often with a particular concern with policies affecting the poor.”*

Source: “Guide for Applied Budget Work”, International Budget Project

Who influences PFM reforms in advanced countries?

Executive may initiate reforms to improve its operations and credibility:

- **Macro stability:** concern to attain macro-fiscal targets, debt objectives, and reasonable stability in tax rates.
- **Internal organization and responsibilities for PFM:** change: (a) the roles of spending ministries and the “ministry of finance” (MOF); (b) responsibilities within the MOF; (c) reporting by budget managers to the political executive. Such reforms aim at **improving budget management and accountability.**
- **Internal control:** more (or less) autonomy for agencies; depends on extent of delegation of authority.
- **Performance:** of government agencies, who must achieve specified outputs/outcomes (performance indicators).
- **Transparency:** including provision of fuller and more-useful budgetary information

Who influences PFM reforms in advanced countries (continued)?

Parliament may initiate reforms to strengthen budget powers:

- **Require more time** to consider the draft budget proposals.
- **Restrict flexibility of executive:** (a) no “hidden” spending without parliamentary approval; (b) appropriation limits as lower limits (e.g., USA); (c) earmarking of expenditures in budget “programs”.
- **Impose stronger accountability on Executive:** (a) require enhanced clarity of fiscal policy intentions and justification of budget outcomes; (b) increase hearings before parliamentary committees; (c) more serious follow-up and monitoring of external audit reports; (d) demand gains in budget performance and clarity/usefulness of P/indicators.
- **Transparency:** require fuller information on budget, including for annual budget (fiscal risks), medium-term budget objectives, and long-term scenarios.
- **Internal organization of Parliament:** (a) to strengthen parliamentary committees (budget and sectoral); (b) to create a Congressional (parliamentary) Budget Office.

Reforms in Budget Systems Laws

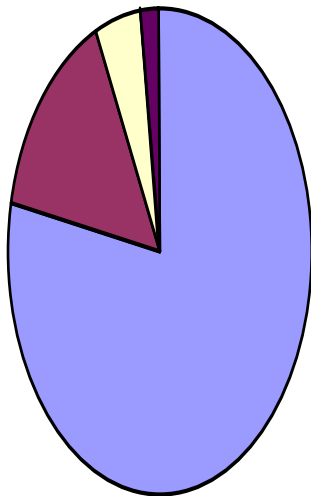
Selected OECD countries

PFM areas covered in the new law(s)	France	Germany	New Zealand	Sweden	United Kingdom	United States
1. Improve macroeconomic stability in general (reduce fiscal deficit)		1967-69	As from 1986	Early 1990s		As from 1985
1a. Qualitative fiscal rules			In 1990s	mid-1990s	(but not by law)	
1b. Quantitative fiscal rules		Golden rule				1985-89* 1991-02
2. Enhance fiscal transparency	2001		1994		1998	
3. Introduce a medium-term budget framework		1967-69	1994	1996		
4. Introduce performance-oriented budgeting	2001		Late 1980s		2001	1993
5. Introduce more flexibility in budget appropriations	2001	Late 1990s	Late 1980s	1996		
6. Introduce accrual accounting or possibility of accrual accounting	2001		1989		2001	
7. Reduce off-budget activity	2001					
8. Weaken the authority/powers of the executive in budget processes	2001					1974, 1990

Who influences PFM reforms in developing countries?

Are the key differences as depicted below?

OECD countries

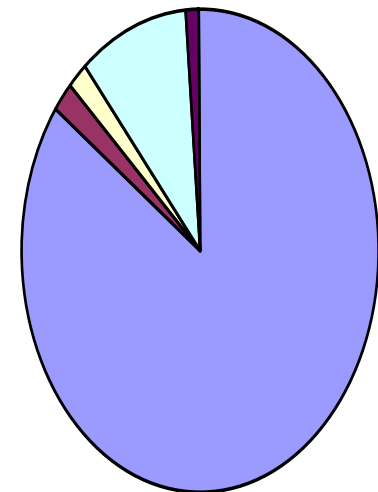


Executive Parliament

Audit Office Donors

"Watchdogs"

Developing countries



Developing Countries: Role of Parliaments in PFM system

Parliaments in developing countries often lack:

- Involvement in budget priority setting.
- A transparently presented budget.
- Ability to change draft budget proposed by the government.
- Analytical capacity, for examining the ex ante budget and ex post outcomes (which may differ substantially from approved budget).
- Follow-up on external audit reports (Public Accounts Committees, if they exist, are often not effective).

Developing Countries: External audit offices

- Independence may be compromised e.g., with appointment (often) or dismissal (infrequent) by executive.
- Executive branch “controls” e.g., content of published audit reports.
- Lack of capacity: both infrastructure and human resources.
- Inadequate budget for audit office; not all budgeted funds released.
- Lack of cooperation with civil society/media.
- Statutory deadlines missed (in part because government does not provide timely final accounts, thereby resulting in an audit that is too late to influence new budget).
- Executive: little incentive to follow-up auditors’ recommendations.

Developing countries’ “Independent” agencies

- *Anti Corruption Agencies* have been created in many countries.
- In francophone countries, *Inspection Générale des Finances (or de l’Etat)*, firmly under the executive and less independent than in France.
- Inspectorates in anglophone countries not well developed.
- These organizations are mainly “guardians or enforcers of existing rules” rather than initiators of changes in the PFM rules.
- Nonetheless, in some cases, changes, or at least reviews, of existing rules have resulted, e.g., Nigeria’s civil service rules, Financial Regulations, and Procurement procedures

Developing Countries: Role of civil society groups, NGOs, Media

- Can be instrumental for increasing awareness of budget policies and their consequences.
- Suggestions/recommendations can be ignored by strong governments.
- Links with budget decision-makers not strong.
- More public dialogue implies more indirect influence. Politicians listen to voices!
- But: “we-serve-the-president” mentality persists.

Who then influences government budgets in developing countries?

- Conclude: Parliaments, civil society groups, NGOs, the media, and “independent” official organizations have not had much influence on reforming PFM systems.....although their role is gradually increasing.
- Propose: Donors have a strong influence on PFM systems and budgetary policies:
“The foundations of budgetary policies represent the view of a small group of transnational professionals based in key government ministries and donor agencies, which occlude the possibilities for deepening democratic oversight of policies of national development” (Gould and Ojanen)
- Is this an overstatement? What are the channels of donor influence?

Developing Countries: Multilateral institutions' conditionality

- IMF – Structural benchmarks, structural performance criteria, and government declarations of proposed PFM action, as contained in IMF programs.
- World Bank – loans/grants include conditionalities, including in PFM.
- Development banks – also include conditionality in PFM.
- Examples range from a few isolated “key” measures (e.g., present new PFM law to Parliament) to a whole program of PFM reforms (e.g., see annex to 2002 IMF staff report for Laos)
- Impact: depends on: (1) whether conditionality is met; (2) effective implementation (mixed record), and (3) whether authorities would have taken PFM measures even without the multilaterals' programs.

Bilateral Donors

- Government to government support – usually contains less conditionality than multilaterals.
- Participate in donor coordination groups that dialogue with government on budget priorities/policies.

But:

1. Bilaterals must report to home-country legislatures on accomplishments in recipient countries (and may not adhere to Paris Declaration principles for harmonizing aid).
2. As donors pool resources, increasingly via budget support operations, “policy reform matrices” – conditionality – is becoming more common (e.g., in Burkina Faso, where non-BWI donors exert more influence in PFM system than multilaterals).

Donors' Technical Assistance (TA) Activities

- IMF – Resident or peripatetic TA to implement specific parts of a PFM reform program and strengthen capacity.
- World Bank and Development Banks – consultants.
- Bilaterals – Resident experts (e.g., France), donor financing of experts (foreign and/or local), salary top-ups for selected staff involved in PFM reforms.

Impact:

- Mixed results from TA, especially for *permanently* improving capacity (see e.g., <http://www.ieo-imf.org>)
- Best results when strong local “ownership”, skills are transferred (both technical and management), and good donor coordination with authorities.

Conclusions

- Government policy-makers dominate budget-making and PFM reforms in all countries, except those where the Legislature is strongly separate from the Executive.
- Executive-dominance for PFM reforms is pronounced in developing countries, especially in Africa (in part a reflection of colonial inheritance + adoption of strong presidential regimes).
- Parliaments and external audit offices have potential to increase their influence on PFM reforms, but this will be a long process (democracy is young).
- Civil society groups' influence on PFM system is low, but very slowly increasing.
- Donors exercise considerable influence on governments in developing countries, through financial assistance, TA, and direct dialogue.

Tales of the unexpected: PFM reform in difficult environments

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14 – 15 November 2007
Overseas Development Institute, London, UK

Fiscal Reforms in Latin America. A “New” Political Economy Perspective.

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Senior Research Economist
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**CAPE PFM Conference 2007
“Tales of the Unexpected. PFM Reforms in Difficult
Environments”
London - 14th and 15th November, 2007**

Opinions expressed in this presentation do not necessarily reflect the view of Bank management or member countries.



Outline

1. Fiscal Reforms in Latin America:
Budget Institutions
2. Reforms in practice
3. Some lessons learned
4. A “new” framework



Fiscal Reforms in Latin America

- What has happened in terms of fiscal reforms in Latin America?
 - Basically, a lot.
 - As described in *The State of State Reform in Latin America* (Lora (ed), 2007), a “silent revolution” of “second generation” reforms has swept the region.
 - Regarding fiscal reforms, the tax structure has changed, most countries have increased their level of decentralization, and they have introduced more restrictive **budget institutions**.
 - This presentation will present the evidence on the latter.



The Role of Budget Institutions

- ***Budget Institutions*** are the set of rules, procedures and practices according to which budgets are drafted, approved and implemented (Alesina and Perotti, 1996).
- Budget institutions impose restrictions on the actions of the budget process participants, and define the rules of engagement.
- These rules may take various forms, such as numerical rules, procedural rules, and transparency rules.



The Role of Budget Institutions

- **Numerical rules**

- *Laws and/or regulations which establish ex ante constraints on deficits, debt, and/or expenditures.*
- Numerical limits, MTFE, debt constraints, etc.

- **Procedural rules**

- *Norms and regulations that indicate the prerogatives of the actors involved in the budget process.*
- Prerogatives of the legislature, of the line ministries, of the Ministry of Finance, etc.

- **Transparency rules**

- *Norms and regulations that establish the conditions under which budgets are prepared and presented to society.*
- Comprehensiveness of budget documents, extra-budgetary funds, etc.



The Role of Budget Institutions

- Caveat: understanding fiscal reforms by looking only at the evolution of budget institutions has some problems:
 - Based on formal rules, rather than actual practices.
 - Linked to fiscal sustainability.
- However, it provides a framework to understand their origin and classify them, based on an established literature.



Do Budget Institutions affect fiscal performance?

- International experience suggests that the impact of Budget Institutions is robust, and economically important
 - **US:** States with more stringent balanced budget rules have better fiscal outcomes (lower deficits, lower debt, adjust more quickly to adverse shocks) (Eichengreen (1992), Bohn and Inman (1995), Alt and Lowry (1994), Poterba (1994), Bayoumi and Eichengreen (1996))
 - **EU:** More hierarchical Budget Institutions reduce deficits and debt, without affecting capacity to stabilize output. Von Hagen (1992) and von Hagen and Harden (1995), Hallerberg and others (2001)
 - **LAC:** More restrictive, hierarchical and transparent budget institutions are associated with smaller deficits (Alesina et al 1996, Filc and Scartascini 2005, 2006).



Reforms to Budget Institutions

- Studying the role of budget and fiscal institutions has provided invaluable insights for understanding fiscal results for Latin America.
- In part based in that research, during the last two decades, most countries in Latin America have been actively engaged in the process of reforming their budget institutions.



Reforms to Budget Institutions

- Reform efforts have come in different waves
 - Early 1990s, main feature was adoption of integrated financial administration systems, which have increased transparency, as well as the flow of information available to the budget authorities
 - Since 2000, one of the main features has been the adoption of numerical fiscal rules, often within the context of broader fiscal responsibility laws (7 countries adopted FRL's in this period)
 - More recently, increased emphasis on performance budgeting (shifting the focus from fiscal sustainability to efficiency of public expenditures)

Reforms since 1990

Table 5.1 Summary of fiscal reforms in Latin America

	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005
Argentina			N, F		U, E ¹					R(N,C,T), SP, r(c), S, E, F ²	r(n), S					R(N,S,C)
Bolivia				S							U					
Brazil								N			R(N,S,T), P					
Colombia		f ³			F ⁴	C					N	S		R(N,P,T)		
Chile											R ⁵ (N,C)			e ⁶ , T		
Costa Rica												U, A				
Ecuador						U		E ⁷	N	C			R(N,P,C,T)		T	r(n)
El Salvador				U			A									
Guatemala											P, N, U					
Honduras														P, U		
Mexico									C				C ⁸ , P, T			
Nicaragua													S, F ⁹ , A			P
Panama									U				R(N), S, T		r(n)	P, U
Paraguay			e ¹⁰								U			P		p ¹¹
Perú					U						R(N,P,C,T)		r(n), C, T			
Dominican Rep									F ¹²							T
Uruguay									U, E ¹³							
Venezuela									C, U		P			R(N) ¹⁴		
	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005

Notes:

N: Numerical rules; C: Contra-cyclical Fund; P: Multiyear framework; R: Fiscal Responsibility Law: Subnational Govts; U: Single account; E: Increase in Executive power; F: Increase in power of Finance Ministry; T: Transparency, and; A: Principles of transparency.

Italic lower case means that the previously established reforms were reversed or the restrictions weakened.

R(X,Y) means that the Fiscal Responsibility Law included restrictions to X and Y.

Source: Filc and Scartascini (2006)

Numerical Rules

Country	Low restrictions	Medium restrictions	High restrictions	Main reform
Argentina		→		Fiscal Responsibility Law
Bolivia	█			
Brasil		→		Fiscal Responsibility Law
Colombia			→	Fiscal Responsibility Law
Chile			→	Structural Balance Rule
Costa Rica	█			
Ecuador		→		Fiscal Responsibility Law
El Salvador	█			
Guatemala	█			
Honduras		→		Multi-annual framework
Méjico		→		
Nicaragua	█			
Panamá		→		Fiscal Responsibility Law
Paraguay	█			
Perú		→		Fiscal Responsibility Law
Rep. Dominicana	█			
Surinam	█			
Uruguay		█		
Venezuela		→		Fiscal Responsibility Law

Source: Filc and Scartascini (2006)

Procedural Rules

Country	Low hierarchy	Medium hierarchy	High hierarchy
Argentina			
Bolivia			
Brasil			
Colombia			
Chile			
Costa Rica			
Ecuador			
El Salvador			
Guatemala			
Honduras			
Méjico			
Nicaragua			
Panamá			
Paraguay			
Perú			
Rep. Dominicana			
Surinam			
Uruguay			
Venezuela			

Source: Filc and Scartascini (2006)

Transparency Rules

Country	Low transparency	Medium transparency	High transparency
Argentina		+	
Bolivia		+	
Brasil			+
Colombia		+	
Chile		+	
Costa Rica		+	
Ecuador		+	
El Salvador			+
Guatemala		+	
Honduras		+	
Méjico			+
Nicaragua	+		
Panamá			+
Paraguay			+
Perú		+	
Rep. Dominicana			+
Surinam		+	
Uruguay			+
Venezuela			+

Source: Filc and Scartascini (2006)



How do we explain reforms?

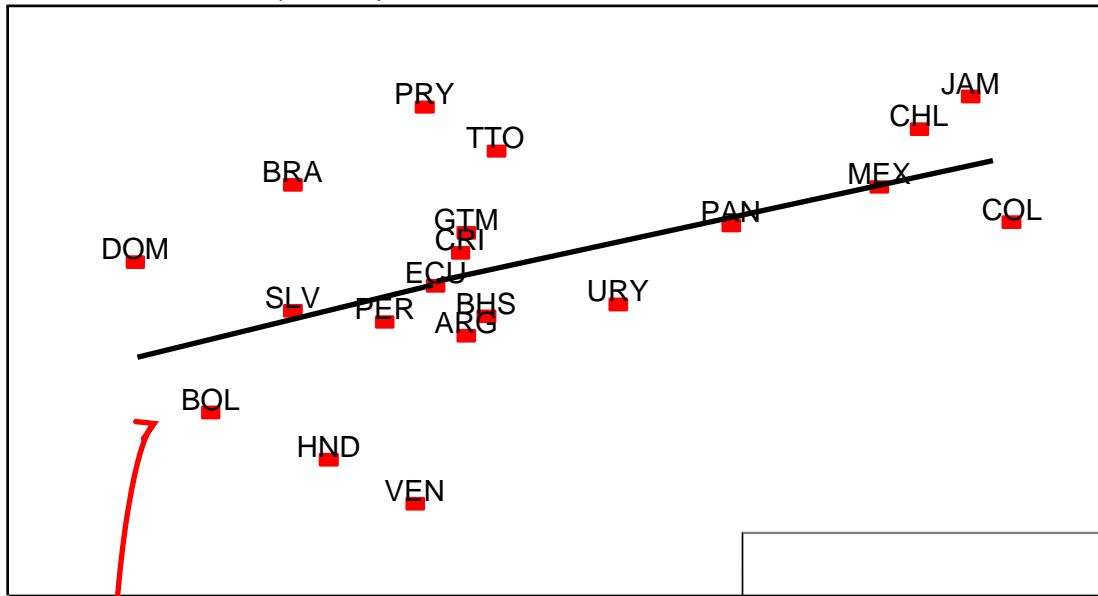
- The literature has focused on economic reforms in general and fiscal reform in particular. Some of the determinants of reform are:
 - Economic crises (Hirschman 1965, Haggard and Kaufman 1992, 1995, Weyland 1996, 2002)
 - Availability of policy ideas (Skocpol and Weir 1985, Hall 1989, etc)
 - Bureaucracies (Skocpol and Weir 1985)
 - Regime type (Olson 1982, 2000, Haggard and Kaufman 1995)
 - Veto players (Tsebelis 2002)
 - Power of the executive (Mainwaring 1999)
 - Polarization (Haggard and Kaufmann (1992, 1995)
 - Degree of electoral competition (Geddes 1994, Corrales 2002, Hallerberg 2004, Wibbels 2005)
 - Identity of initiators of reform (Tommasi and Velasco 1996, Cukierman and Tommasi 1994)



Could we really explain reforms?

- This literature has helped to understand certain stylized facts of the process of reform.
 - For example, following the financial crises of the mid to late '90s, those countries with stronger executives tended to pass stricter numerical rules. The introduction of these rules accompanied the consensus in the literature regarding their relevance.
- Still, we have to construct on its findings in order to explain better:
 1. Why certain reforms have not prospered.

Alesina et al (1998)



1990-1995

2000-2004



Scartascini and Filc (2005)



Do we really explain reforms?

2. The success (or lack of success) of the reforms.
 - For example, Argentina, Brazil, Chile, and Peru introduced numerical restrictions in order to improve their fiscal results.
 - While Argentina, Brazil, and Peru did it using Fiscal Responsibility Laws, Chile introduced a Structural Balance Rule.



Some Results of the Reforms

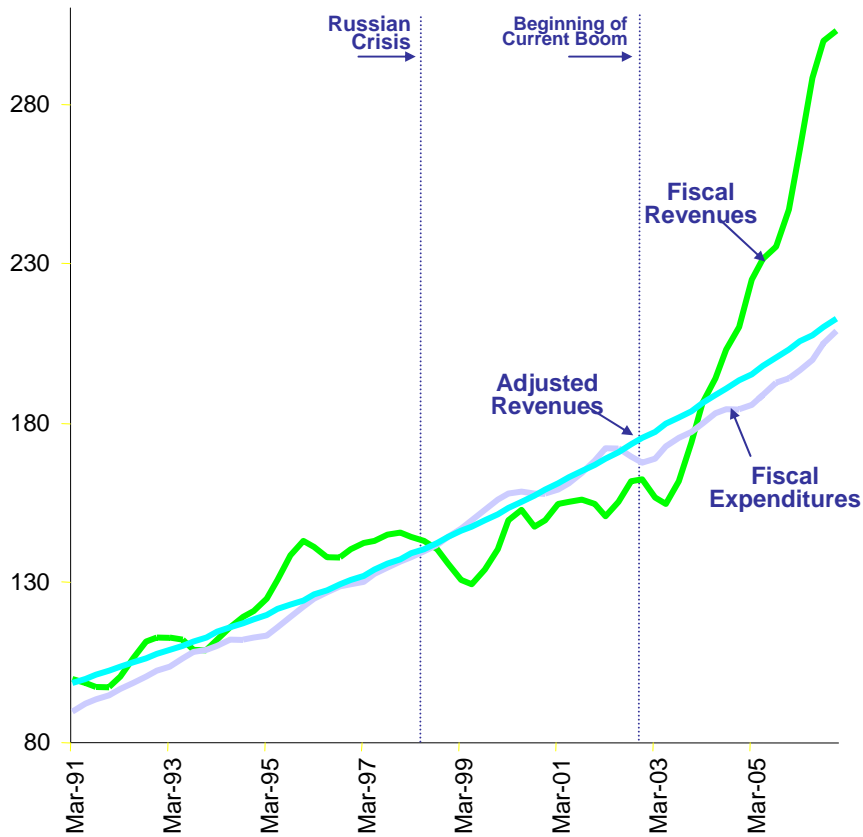
- Regarding their results, one of the main objectives of the reforms was to reach fiscal sustainability (and reduce volatility).
- Chile has had the most success using the less stringent type of norm (*political commitment*).



Chile: Structural Fiscal Balance*

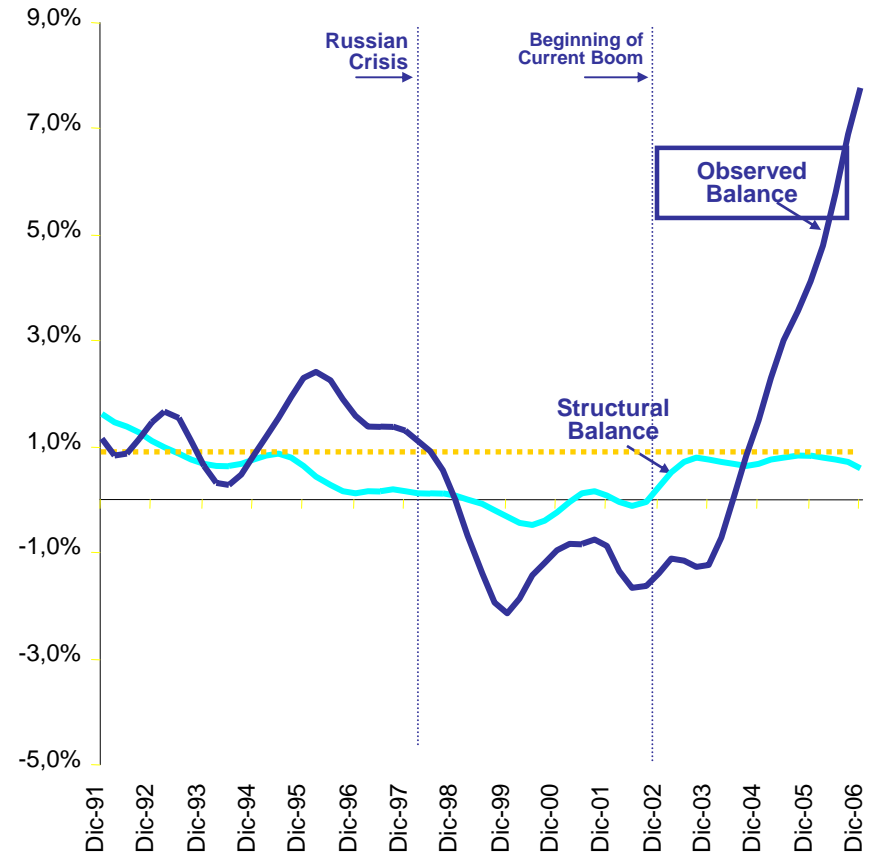
Fiscal Revenues and Expenditures

(Fiscal Revenues, Mar-91 = 100)



Fiscal Balance

(% of GDP)



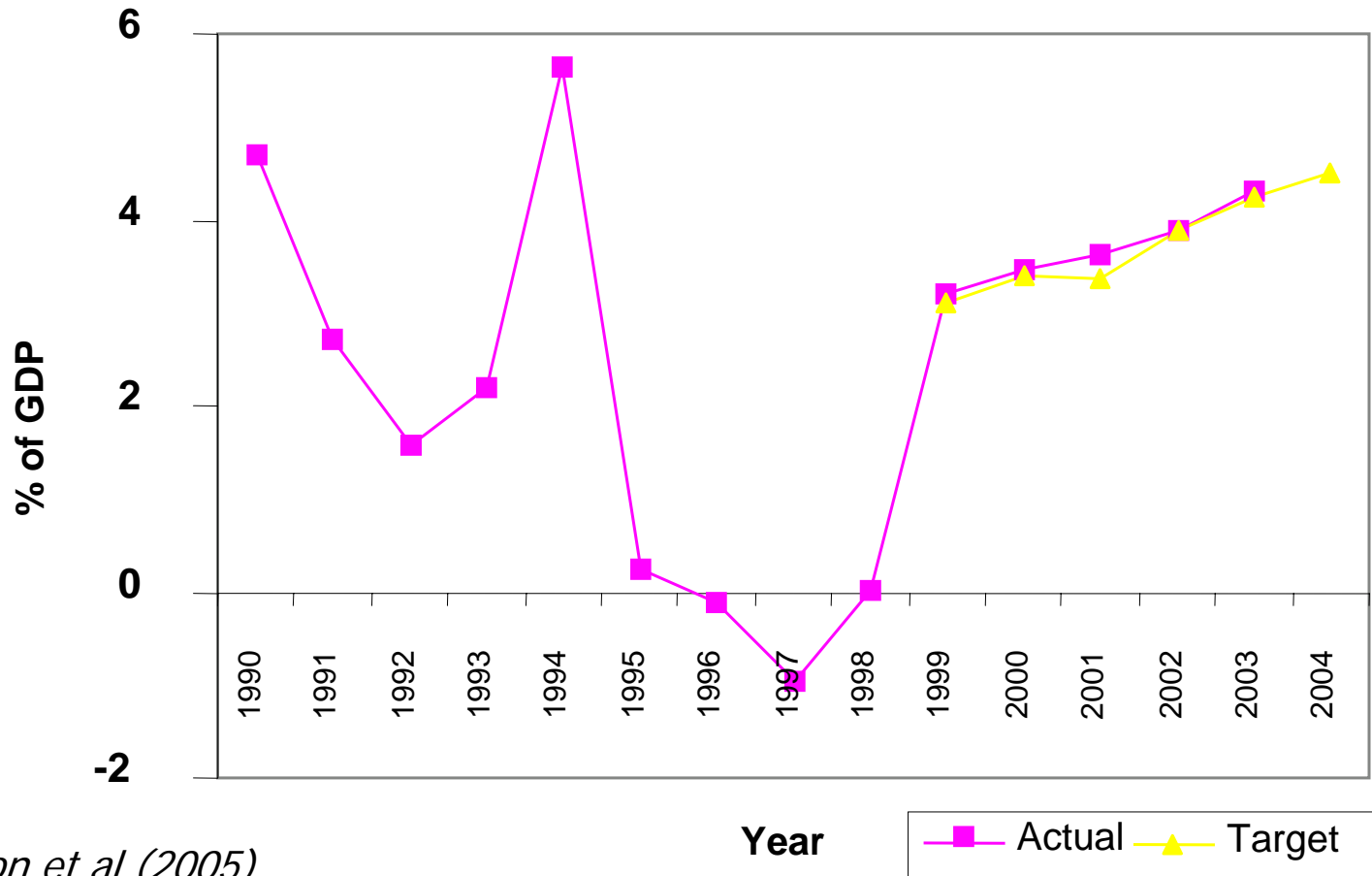
*Talvi, Ernesto (2007), "If Latin America Were Chile: A Note on Structural Fiscal Balances".



Some Results of the Reforms

- Brazil: it may be too early for definitive conclusions, but so far results have been encouraging.
- Its experience is quite different to Ecuador's (a country with similar characteristics of political institutions).

Brazil: primary deficit and targets



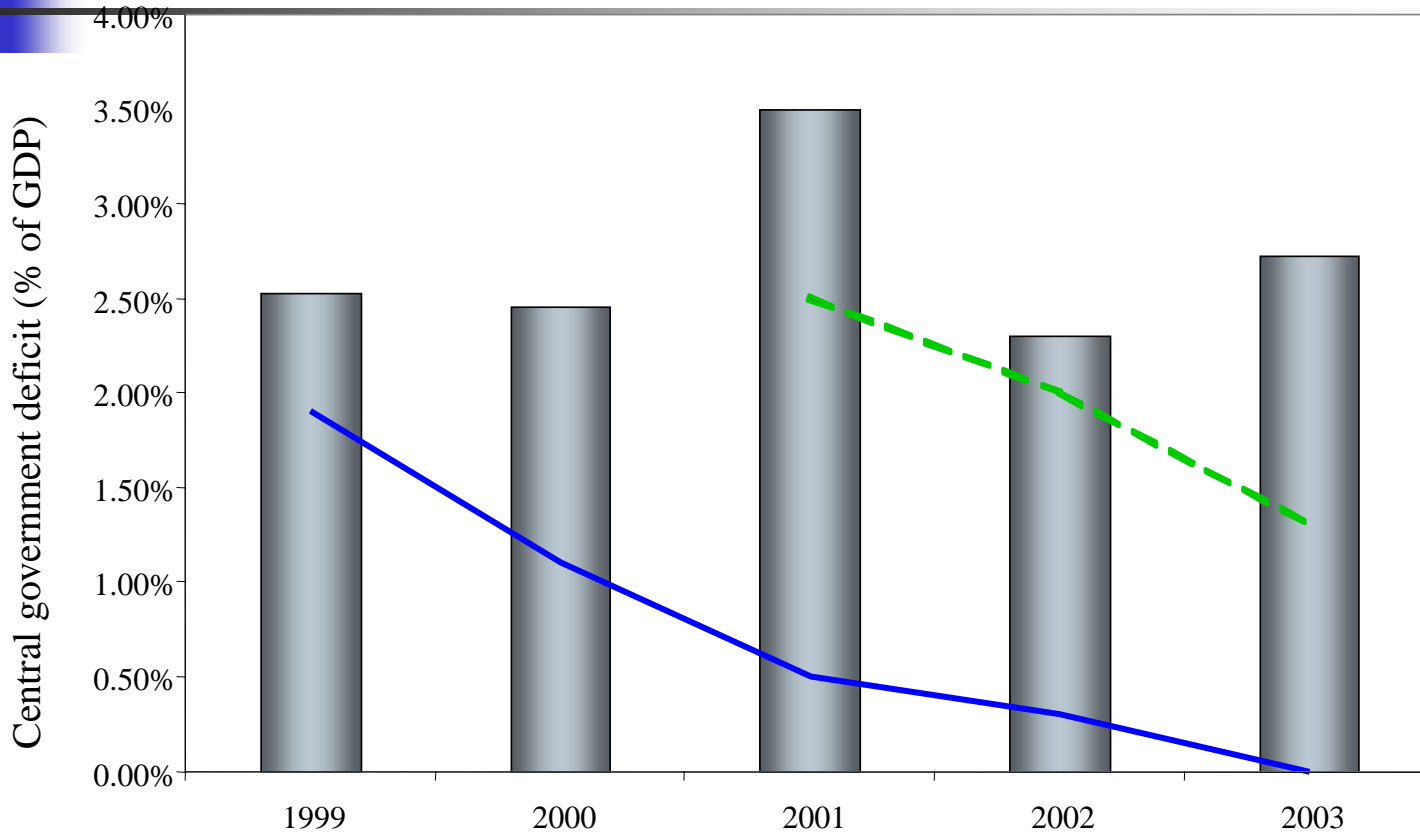
Source: Alston et al (2005)



Some Results of the Reforms

- In Argentina it took several years (and reforms) to finally comply with the (several times revised) law.
- Current good performance could be deceiving...
...as well as past low performance
- The approved budget law could mean little at the end of the year in terms of actual appropriations (*superpowers*).

Argentina: Deficits and the Fiscal Solvency Law



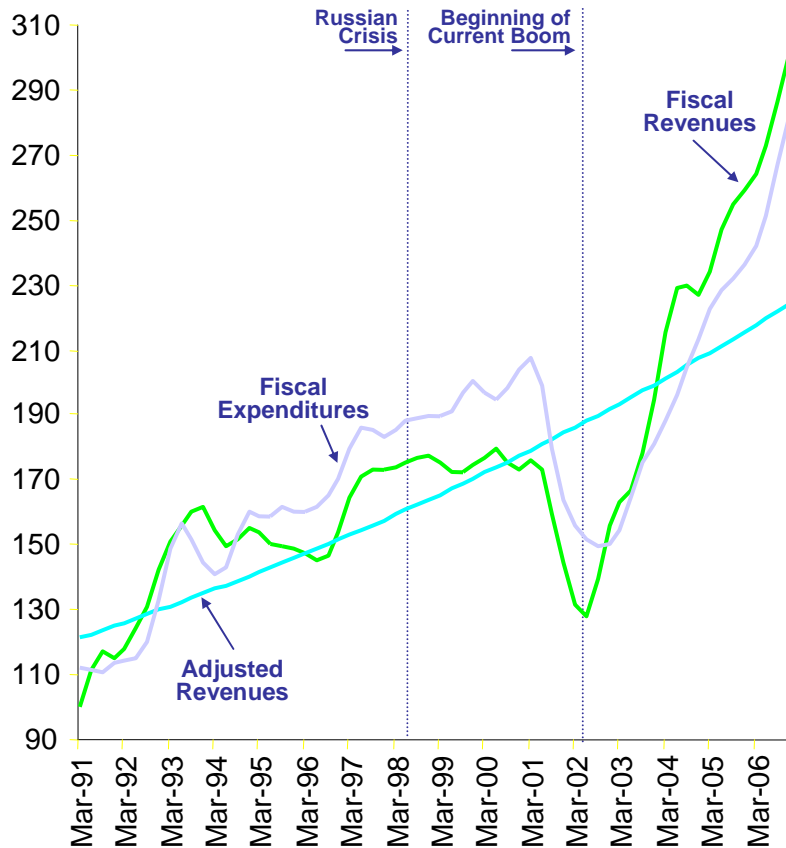
Source: Braun and Tommasi (2005), Filc and Scartascini (2006)

- Actual central government deficit
- Deficit limit according to 2001 Fiscal Solvency Law
- Deficit limit according to 1999 Fiscal Solvency Law

Argentina: Structural Fiscal Balance*

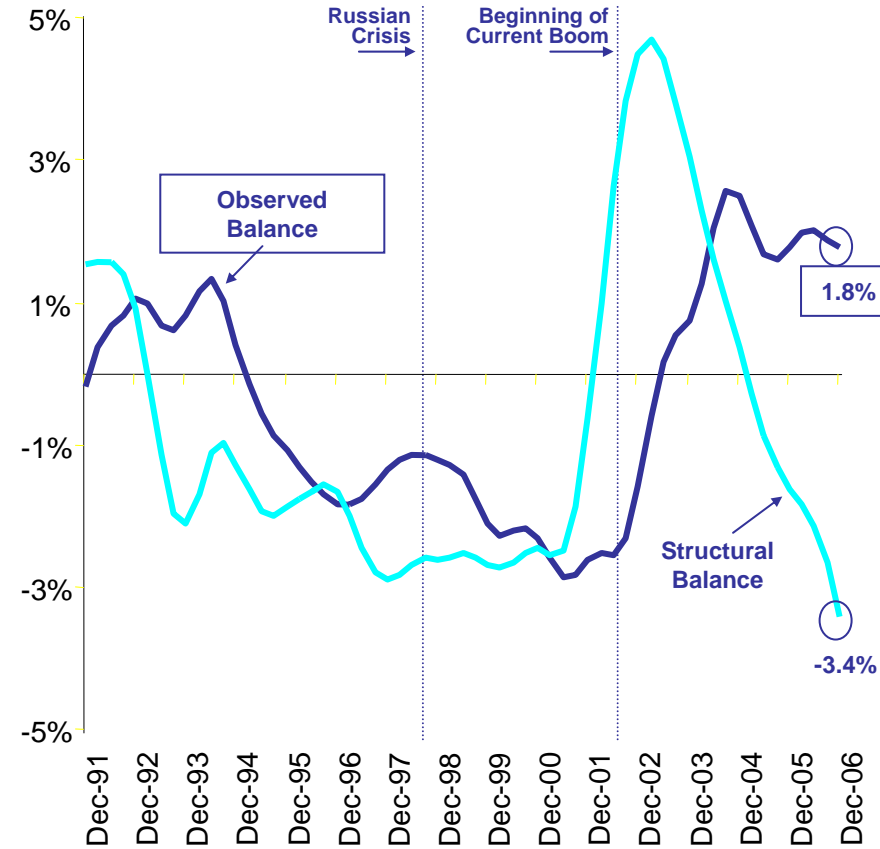
Fiscal Revenues and Expenditures

(Fiscal Revenues, Mar-91 = 100)



Fiscal Balance

(% of GDP)



* Izquierdo, Ottonello, Talvi (2007), "If Latin America Were Chile: A Comment on Structural Fiscal Balances and Public Debt".

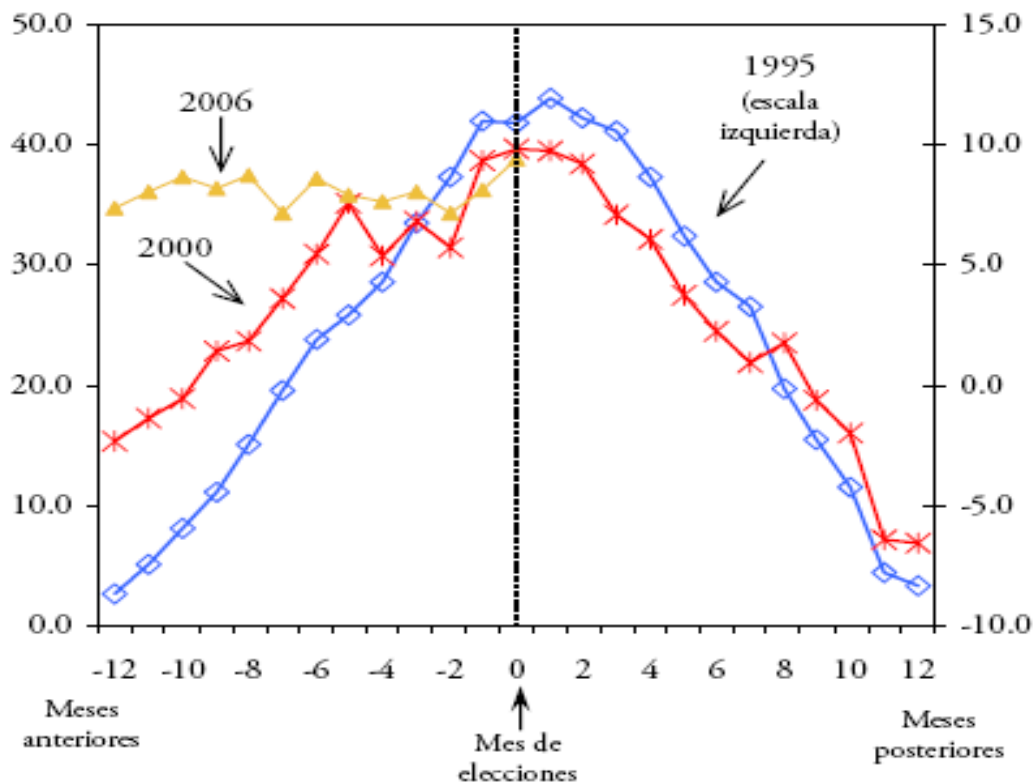


Some Results of the Reforms

- In Peru, the numerical rules component of FRL's has only recently been complied (partially) with.
 - Peru has complied with the deficits rule the last couple of years, it has diminished the electoral business cycle, but has yet to comply with the rule that limits the real increase of expenditures.
 - Other aspects of the law (e.g. multi-annual macro program, increased transparency and budget cycle) have positively changed the dynamic of the budget discussions.

Electoral Budget Cycle in Peru

Gasto no financiero del Gobierno Central
(variaciones porcentuales, promedio móvil de últimos 12 meses)



Source:
Valderrama et al
(2006)

Fuente: BCRP



Other Reforms

- Other rules and regulations have had partial success in Latin America. For example,
 - Restrictions on increases in spending by the legislatures are usually circumvented.
 - Changes in the estimations (e.g., sudden increases in government revenue agencies while budget discussions take place in Congress)
 - Reallocation of expenditures from rigid accounts (e.g., from repayment of debt to current expenditures)
 - Budget laws are not complied with during execution and final allocations differ greatly from the law approved by Congress.
 - Impact of financial administration systems?



Changes to the Budget During the Year and Actual Execution

- The budget law is modified during the year and final appropriations differ greatly from the original and modified law. Changes and execution are highly variable across Ministries and years.

	2001	2002	2003	2004	2005	2006
Education Ministry						
Mod/Appr	184%	191%	126%	163%	204%	148%
Acc/Appr	126%	97%	73%	96%	136%	59%
Health Ministry						
Mod/Appr	124%	124%	120%	154%	180%	121%
Acc/Appr	87%	91%	83%	109%	127%	58%
Labor Ministry						
Mod/Appr	132%	112%	128%	106%	116%	109%
Acc/Appr	117%	63%	111%	93%	92%	58%

Source: updated from Scartascini and Stein (2005). Data from ILACO-Bolivia.



Some lessons learned

- The experience with fiscal reforms in Latin America generates a number of important lessons.
 1. Measuring reforms is very complicated.
 - “Institutional” reforms take place (almost) everyday as the president gain or losses bargaining power.
 2. Measuring success is even trickier.
 - Argentina’s example of failure and success.
 3. Not all the countries that are relatively successful have the most sophisticated financial systems.
 - Some developed countries would not qualify very high under certain criteria (and the donor community?).
 4. Certain outcomes can be reached even using the most rudimentary systems.
 - Balaquer’s Dominican Republic.



A New Framework

- Therefore, we should:
 1. Understand the incentives of actors from a general equilibrium perspective
 - Most of the previous attempts have been characterized by looking at reforms from a partial equilibrium framework
 2. Take into account that the budget process is part of the core of the general policymaking process.
 - Fiscal policy and institutions have a major role in the policymaking process (funding for any policy has to go through the budget)
 - Reforms to fiscal institutions can have feedback to the more general policy game.
 - For example, what happens with the equilibrium in the policymaking process if the Executive gains (loses) power (or discretion) in the fiscal game? (Scartascini et al 2005)



A New Framework

3. Understand reforms (or lack thereof) as the outcome of the bargaining among many actors.
 - Each actor behaves according to their own incentives and preferences given the rules that bind their interaction.
 - (Sustainable) Changes happen when actors try to alter a status quo they find unbearable or try to adapt to an exogenous change in the status quo.
 - External changes are not sustainable if they do not change incentives, the number of actors that intervene in the policymaking process, their discount factors, or the arenas in which they interact.



A New Framework

4. When studying reforms it is important to understand what is that reforms (or lack of reforms) are showing about the polity.

Reforms, policymaking process, and drivers of reforms			
		Reform	No reform
Nature of the shock	“Real” shock (economic)	Adaptability	Rigidity
	“False” shock (political)	Volatility	Stability



A New Framework

5. Then, when studying reforms the key is not to see **if** they did happen or not but **why** was that they did or didn't.
 - Clearly, in Latin America, the reforms that had the most impact were those that were either introduced “endogenously” (Chile) or modified the incentives of those in power (Brazil).
 - If they didn't modify incentives, then they had no impact.
 - In some cases, they could have long term results as the politics evolve within the new institutional framework (but they are not bulletproof) (Peru?, Colombia?)



A New Framework

6. Therefore, the key to understand the processes is to have an in-depth knowledge of the countries before attempting reforms.
- We have used this general equilibrium framework to understand the policymaking process (IDB 2005, Stein et al 2007), and the budget process (Scartascini et al, forthcoming).
- We hope we will be similarly successful to explain fiscal institutional reform (Braun et al, forthcoming).

**Fiscal Reforms in Latin America.
A “New” Political Economy Perspective.**

Thank you

Tales of the unexpected: PFM reform in difficult environments

14 – 15 November 2007

Overseas Development Institute, London, UK

