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IMPLEMENTING BUDGET SYSTEM REFORM[1]

July 2010

The last decade has witnessed a surge of interest in public expenditure issues among governments, donor agencies, and the wider development community. This reflects, in part, increasing recognition that the budget is both an instrument for controlling budget resources, and for realizing a country's economic and social priorities. The budget is important not just because it shows how limited resources will be distributed among competing demands, but also because the budget process itself—the way in which the budget is created, managed, and accounted for—signals the government's commitment to fiscal stability, to efficiency, and to delivering services that people want and need. In this regard, few institutions are as central to public sector governance as the budget.

The growing interest in public expenditure issues also reflects new understanding about what makes budget systems work, and why so many reform efforts have fallen short of expectations. Cautionary tales abound. Would-be reformers push costly, state-of-the-art technologies on to systems that barely functioned manually. Others rush to implement the latest budgeting 'fad,' failing to acknowledge both capacity constraints and the inherently political nature of the budgeting process.

Box 1. Budget/PFM reform—Recent USG experience

- Afghanistan: 2004–ongoing
- Jordan: 2006–ongoing
- Kosovo: 2001–ongoing
- Liberia: 2006–ongoing
- Montenegro: 2001–2006
- South Africa: 1996–2008

While circumstances vary from country to country, the experiences are strikingly similar. Far too often, budget reforms disappoint because they are designed to solve a technical problem, when in fact the problem lies in the institutional framework—the formal and informal rules that dictate how organizations and people interact in the budget system. If budget reforms are designed without taking these rules into account, they are likely to fail. Budget organizations can be restructured, merged and created from scratch, and sophisticated instruments implemented and automated. However, no change in behavior will result unless the basic rules, procedures, and incentives change as well. Effecting change is particularly challenging in developing and transition countries, largely because these institutions are a primary source of the rent-seeking, abuse, and mismanagement that budget reforms often attempt to overcome.

This note draws from experience in designing and implementing budget system reforms around the world. The aim is to draw lessons and provide guidance that will help developing and transition countries overcome obstacles to successful budget reform and create viable, modern budget systems that support the three core objectives of public financial management:

- Fiscal discipline,
- Efficient resource allocation, and
- Effective service delivery.

Of course, the setting, the culture, and the politics are different from one country to the next, and so what 'works' in South Africa may not work at all in Peru. While specific approaches or models may not be easily transferable, there are some generic principles and rules that can serve as a roadmap for budget and broader public financial management (PFM) reform.

Some pointers in guiding budget system reform

Those who might be in a position to design a reform strategy based on the international experience might consider the following.

Country ownership is vital. Any reform agenda must address specific problems that are clearly defined (or at least affirmed) by credible local stakeholders. If the problems are not recognized locally, any attempt at reform, even if externally financed and provided with the best of intentions, is more likely to be tolerated than embraced. Budget and PFM reforms unavoidably

[1] This note was prepared by Steve Rozner and is based on Browne (2010), "Reforming Budget Systems: A Practical Guide."

alter the institutional arrangements that determine how people interact and do their jobs. Change is always hard, and change that subjects previously opaque rules and processes to public scrutiny will invite tension and, in some cases, fierce opposition. Political and government leaders must consider the benefits of reform (or the risk of doing nothing) significant enough to spend the political capital and invest in the resources required to bring about meaningful and lasting change.

Understand existing conditions. Take time to diagnose the problems, taking into account the country's legal and institutional framework, the political and power dynamics, fiscal priorities, the state of budget accounts, ICT infrastructure, and human capital in the budget system. Such analysis will provide a detailed assessment the quality and performance of the various supporting systems and identify interconnections and institutional weaknesses in the budget process. A thorough diagnostic will help government focus on what it most wants to accomplish through budget reform, whether it is expenditure control, improved service delivery, eligibility for Heavily Indebted Poor Country (HIPC) debt relief, or something else. It will also help donors determine what potential role they might play, understand structural and procedural aspects of the reform process, and anticipate capacity building needs and implementation challenges that may influence the reform strategy, time line, and costs. The multi-donor Public Expenditure and Financial Accountability (PEFA) program provides an internationally comparable performance measurement framework for assessing and monitoring improvements in the quality and performance of country expenditure, procurement, and financial accountability systems. PEFA assessments have already been undertaken in more than 100 countries, and can provide a useful baseline for undertaking more in-depth diagnostics to inform the design and sequencing of budget reforms.

Take stock of reforms that are already underway, surveying both country-led and donor-supported reform efforts. In many cases, a donor may not have joined the dialogue until well into the reform process, after decisions have been taken or policies designed and given legal effect. Donors are often called on to support implementation activities, such as training of budget and finance officers, procurement and rollout of information technology, or information outreach, only to find that the underlying problem was poorly defined, the diagnosis was flawed, or implementation just got off to a bad start. Understanding the analysis and decisions taken at earlier stages is critical to ensuring that any new donor support is both constructive and complementary. It may also point up opportunities to review decisions already taken before proceeding with further implementation.

Establish clear objectives. Whether the goal is to improve the quality and integrity of financial information, improve the efficiency of budget execution, or link allocations to results, budget and broader PFM reforms must start with precise objectives and expected results than can be—and are—measured and evaluated. Articulating a clear mission statement will help control the project direction, stakeholder expectations and, ultimately, reform costs. Defining clear objectives, with targets and milestones, will provide both a baseline and a trajectory against which to monitor reform progress and adjust course as needed.

LIBERIA: BUDGET CHIEF VISITS CITIZENS IN OUTLYING AREAS

Source: USAID/Liberia GEMAP Project

Secure high-level stewardship. Particularly important is the support and commitment of the Minister of Finance, who must be willing to champion the reform, with a full understanding of the political and institutional costs entailed in seeing those reforms through. The Minister should be the clear sponsor of the reform and should delegate specific, ongoing responsibilities to trusted staff, who will then coordinate and communicate with a broad array of stakeholders throughout the reform process, including the legislature, key central agencies (budget, tax, and human resources departments, etc.), line agencies (health, education, etc.), and (when appropriate) the central bank. These organizations, in turn, will assign specific individuals to lead internal efforts throughout the reform process, and to keep departmental managers and personnel informed about reform progress and how their work will be affected by the changes.

Make realistic commitments, backed by adequate resources. Successful budget reforms take a long time. In many cases, it will take several years just to develop the basic tools for budgeting and public financial management. It will take even longer to achieve real fiscal discipline, and longer still to create the conditions for truly policy-based resource allocation or to enhance technical efficiency in the execution of the budget. This means, in effect, that donors and reform leaders alike must be prepared to commit adequate resources (both human and financial) at each stage of the reform, and be flexible to respond with additional support and resources when new demands arise, or when reforms hit unexpected hurdles.

It also means that reform designers must first be able to explain the need for the basic tools, whose development can be tedious and time-consuming, and whose application is seldom very visible to politicians, and even less so to taxpayers. Budget reforms

MONTENEGRO: PROGRAM BUDGETING FROM THE GROUND UP

Source: Eileen Browne.

are not as concrete or tangible as are school-rooms, hospitals, medical supplies, or roads and bridges. However, getting to these 'front-page' reforms usually depends on having in place the basic fiscal 'infrastructure' (accounting systems, budget classifications, and staff trained to use them) that allows government to keep its promises, protect the public finds, and deliver value for money.

Institutionalize the change. The best and most lasting budgeting reforms are designed with careful attention to how they will change behaviors, and how they will evolve from reform efforts to 'standard operating procedure' before donor assistance ends. In countries with the weakest capacity, where international experts often find themselves in decision-making roles with respect to budget formulation and execution, it is particularly important to design reform plans to include an explicit 'hand-over' period, in which local staff that have been trained and mentored throughout the reform process to gradually take over those roles. This will not only contribute to in-country capacity, but also will strengthen local ownership of the reform.

Be flexible. Reform efforts must be designed with flexibility to respond to changing priorities—whether triggered by a leadership change, an economic shock, or even a natural disaster. Rebuilding after the 2007 earthquake in Peru, for instance, forced policy makers to refocus spending on disaster recovery. While such events cannot be fully planned for, the ability to respond and change course if and when crisis hits is critical. More generally, it is advisable to conduct periodic reviews of reform goals and progress to determine whether and where adjustments may be required.

Phase implementation. Budget reforms should be phased in a way that is consistent with the ability of the authorities and the economy to cope with them. While an overall strategy is essential, budget reform should be broken down into a variety of inter-related steps, allowing time between each level of sophistication for adoption by the public sector workforce. A phased approach allows staff first in the central fiscal unit(s) and then in the spending agencies to replace old techniques with new ones. It also allows finance officers, as well as line ministry program staff, the legislature and other stakeholders, time to learn and gain confidence in the new systems and practices. To this end, designing the reform strategy with periodic digestion and consolidation periods is recommended. This will help ensure that local stakeholders have understood and internalized the changes. It will also give local counterparts occasional breaks from the stress and volatility of a reform program, and provide a useful opportunity for reform designers to review, assess, and make adjustments to the course or speed of specific reforms. Starting budget reforms is seldom difficult. The difficulty is in maintaining momentum for reforms that achieve permanent improvements in budget and PFM control, efficiency and performance.

Sequence reforms carefully. Understand that reform sequencing is important, but the precise ordering must and will vary depending on the context. While circumstances and responses differed from country to country, international experiences reveal considerable commonalities upon which USAID officers and others can develop and sequence future budget and PFM reform assistance programs.

- *Adopt a "basics first" approach*. In countries where budgeting and PFM capacity remain weak, focus first on getting the basic fiscal infrastructure right. Such fundamentals are likely to include securing control over the wage bill, clarifying roles and responsibilities in the budget process, and putting in place a reliable basic classification, accounting, and financial reporting system, supplemented by simple but efficient cash and commitment controls. More sophisticated reforms, such as performance budgeting, multi-year budgeting (e.g., MTEF), and implementation of integrated financial management inform systems are virtually unthinkable if the basics are not yet 'right.'
- *Set modest, achievable goals as reforms advance*. Reforms designed to improve prioritization and enhance results may be elusive in the early reform stages, but are not beyond reach. Many countries, including South Africa, Jordan, and even Liberia, have had some success in recasting the national budget dialogue in policy and performance terms. The key is to set modest goals and build on small successes to cultivate a demand for deeper reform. A sound MTEF, for instance, can start with the development of credible estimates of available resources, before getting into the complex business of defining sectoral strategies and costing programs based on them. Similarly, introducing performance-informed budgeting can provide a framework for spending units to begin to define performance measures, without the expectation that future funding will hinge on results they can (or cannot) deliver today. Yet neither MTEFs nor performance budgets can substitute for the basic budget infrastructure needed to ensure macro-fiscal stability and budget credibility.

This note was produced for USAID under contract no. GEG-I-06-04-00001-00.

- *Computerization and automation should facilitate budget system reform, not drive it.* Information technology is rapidly changing the way information is captured, processed and communicated. However, IT is only a support tool and not an effective reform strategy of its own accord. Simply automating inefficient processes will not make them any more efficient; nor will anything be gained from automating tasks that were not needed in the first place. Any PFM reform, in order to have lasting impact, must fundamentally change how things are done. In this regard, the introduction of an IFMIS, a TSA or similar tools should not be viewed merely as an IT solution. Such tools require changes in management and organizational structures, changes in workflows, and changes in roles and responsibilities. These changes, in turn, affect the broader institutional arrangements in the public finance system. Institutional, organizational and procedural reforms must, therefore, be the reform drivers. Computerization and automation can then follow, as conditions and resources permit.

- *Understand the interdependence of budget system participants*. At any stage in the reform process, the overall approach to reform, should be collaborative, transparent, and flexible, always accounting for existing systems, local capacities, and the multiplicity of role players, both within outside government. Indeed, civil society engagement in policy making will be more effective where the budget has clear linkages to government policy. Participation and transparency in budget preparation will be enhanced where there is a system to compare actual expenditure to budgets. And, supreme audit institutions will be more effective in holding the government to account where basic record keeping and financial systems are in place.

Some final thoughts

The continuing lesson seems to be that budget reform, like the budget itself, is cyclical: improving the execution stage of the budget cycle often requires adjustments to the budget preparation process, which, in turn, necessitates enhancements to budget execution, and so on. Therefore, the budget process is not static. It either is improving or deteriorating, making budget reform an iterative and ongoing exercise.

Throughout this process, it is important to manage and temper expectations. To be sure, it is best when reforms are based on policy priorities that are clearly articulated by the country itself. Nonetheless, local decision-makers may not have substantial experience beyond the methods traditionally used in their country. They may be unaware of the various options at their disposal, or otherwise inclined to seize on the most sophisticated technologies on the market, even when they are starting from a very low base, and even though doing so might be simply 'modernizing' existing, dysfunctional practices. Such situations often involve significant effort and investment in return for an imperfect or even counterproductive solution. When donors or their host-country counterparts insist on 'state of the art' solutions, the tools are often left untouched or fall into disrepair when experts depart the country, frequently because the intended users lack the training, understanding or the desire to use them properly. Anticipating these challenges, and tailoring the reform agenda to meet the absorptive capacity in a given country, will help ensure risk that reforms on paper translate into reforms in reality.

Suggested readings:

Browne, Eileen (2010), "Reforming Budget Systems: A Practical Guide," USAID-funded Fiscal Reform and Economic Governance project, Contract No. GEG-I-06-04-00001-00.

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