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REFORMING BUDGET SYSTEMS

A PRACTICAL GUIDE

JUNE 2010

This publication was produced for review by the United States Agency for International Development. It was prepared by Development Alternatives, Inc. under the Fiscal Reform and Economic Governance Task Order, GEG-I-00-04-00001-00 Task Order No. 06.

REFORMING BUDGET SYSTEMS

BEST PRACTICES

June 2010

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ACKNOWLEDGEMENTS

This practice note is the compilation of lessons learned from counterparts and from leading practitioners in the field. In Montenegro, several key officials who spearheaded reform during various stages were generous with their time and the thoughtful advice they offered. Milan Dabovic and Miraslav Ivanisevic were Assistant Minister for Budget and Treasury and Minister of Finance, respectively, when reform began in what was then the Republic. They have both now moved on to new positions in the newly independent country of Montenegro, Dabovic as Chief Auditor and Ivanisevic as President of the Independent Audit Bureau of the Parliament. Several others contributed their insights and advice on the progress Montenegro has made in modernizing its budget system through 2009, including: Nikola Vukicevic, former Asst. Minister for Budget; Mila Barjaktarovic, Asst. Minister for Internal Audit; Boris Buskovic, Asst Minister for Treasury; Biljana Scekic, Asst. Minister for Tax Administration; and, Nemanja Pavlicic, current Asst. Minister for Budget. Their inspiration and perseverance have remained key drivers in Montenegro's progress.

In South Africa, numerous interviews resulted in deep insight and candid reflection on what has worked and how much pragmatism and operational detail is necessary to turn inspired vision into standard operating procedures and, ultimately, to effect real institutional change. The lessons of South Africa differ from Montenegro due to size, although each recently emerged from severe internal conflict, which resulted in the formation of a new state with a new constitution. Andrew Donaldson, head of Public Finance; Jann Hattingh, Chief Director of Local Government; Euody Mogaswa, Director of Budget Reform; and, Robert Clifton, now a consultant to the Government, provided thorough and thoughtful insights on using performance measurement to capture results.

With respect to Peru, the guidance of Vice Minister Jose Arista and Roxana Arce of his Cabinet was essential, as was information and cooperation from Treasurers Maria Pastore and Carlos Diaz. Their experience in creating a Treasury Single Account without benefit of a modernized financial management information system teaches important lessons. Useful perspectives on practicability and integration came from discussions with Rosanna Polastri, Jose Valderama and Xiomara Morel of the World Bank, as well as Luis Breuer of the IMF.

Two regional training organizations—CEF in Slovenia for the Balkans and CABRI for Africa—offered materials, studies and interesting perspectives that put country perspectives in greater relief and remind us that we must also look beyond the guidance of international organizations to understand and respect local conditions and practices. Special thanks to Dr. Mira Dobovisek of the CEF and Alta Fölscher of the CABRI Secretariat.

William Dorotinsky, of the World Bank, listened patiently to hypotheses and offered examples to pursue to refine the lessons learned. Duncan Last, Franck Bessette, Israel Fainboim, and Mario Pessoa of the IMF's Fiscal Affairs Department contributed experience, insight, and patient listening skills as the hypotheses developed. Kathleen Shepherd, former advisor to the Ministry of Finance in Romania, was helpful in supplying information about formation and use of key tools. Additionally, James Bennett Ruth shared his multi-country experience on personnel and wage bill control as an essential budget tool. Ilona Castro, who has worked with the IMF, World Bank and the US Treasury as well as on USAID projects, is the expert who has helped more than a dozen countries fine tune classification systems so that they are tools to make the budget simple to understand by everyone while keeping all the virtues that allow the best reporting. She generously shared her insights.

Finally, thanks go to Steve Rozner, Eunice Heredia-Ortiz and Dara Iserson for their dedication to style and substance and their attention to detail in helping to finalize this effort.

TABLE OF CONTENTS

LIST OF TABLES

LIST OF BOXES

LIST OF FIGURES

ACRONYMS

BCRP	Banco Central de Reserva del Perú
CABRI	Collaborative Africa Budget Reform Initiative
COA	Chart of Accounts
COFOG	Classification of Functions of Government
COTS	Commercial “off-the-shelf” solutions
EC	European Commission
ERP	Enterprise Resource Planning
EU	European Union
GAO	U.S. Government Accountability Office
GEMAP	Governance and Economic Management Assistance Program
GFMIS	government financial management information system
HIPC	Heavily-Indebted Poor Country
IADB	Inter-American Development Bank
ICT	Information and communications technology
IFMIS	Integrated financial management information system
IMF	International Monetary Fund
MDA	Ministry, Department or Agency
MOF	Ministry of Finance
MP	Member of Parliament
MTBF	Medium-term budget framework
MTEF	Medium-term expenditure framework
MTFF	Medium-term fiscal framework
NGO	Non-governmental organization
OECD	Organisation for Economic Cooperation and Development
PEFA	Public Expenditure and Financial Accountability (Assessment)
PFM	Public financial management
ROB	Results-oriented budgeting
SAI	Supreme Audit Institution
TSA	Treasury single account
UNDP	United Nations Development Programme
USAID	United States Agency for International Development
ZOP	Central Payments Bureau (former Yugoslavia)

EXECUTIVE SUMMARY

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.

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

First, 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 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.

Second, 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.

Third, 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.

Fourth, 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.

Fifth, be sure that the reform agenda has 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.

Sixth, 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 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.

Seventh, 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.

Eighth, 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, created an urgency for budget reforms aimed at 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.

Ninth, 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.

Tenth, understand that reform sequencing is important, but the precise ordering must and will vary depending on the country 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.

- In countries where budgeting and PFM capacity remain weak, focus first on getting the basics 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 (IFMIS) are virtually unthinkable if the basics are not yet 'right.'

- 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.

- 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.

- 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.

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.

1. INTRODUCTION

This study addresses the narrow and broader definitions of budget reform. It underscores the importance of the government budget to a country's development, reviews the basic pre-conditions for successful budget reform, and explores good or 'best' practices in implementing budget and broader public financial management (PFM) reforms, against the backdrop of three core goals of such reforms—establishing fiscal discipline; fostering efficient resource allocation; and improving operational efficiency in government spending. Importantly, our emphasis here is on budget and PFM reform at the national or central government level, although many of the principles, rules, and practices are quite relevant and applicable at any level of government, whether federal, regional/state/provincial, or local.

This study has a practitioner-focused approach to addressing budget and PFM system reform, drawing on field experience in countries around the world, with particular attention to the examples of countries as diverse as Montenegro, Liberia, Peru and South Africa. Each country's experience is characterized by different conditions, different challenges and different solutions. Commonly, however, in each case the reform envisioned "on paper" is distinct from the reforms that were actually implemented. A key lesson that emerges from these experiences is that budget reform—whether effected through new and improved laws, regulations, procedures or systems—must change the way people work and interact in order to have a lasting impact on government transparency, accountability and performance. A sound budget reform builds institutions that transcend any one individual, organization or political regime.

This study has three core purposes. First, it is meant to underscore the fundamental importance of budgetary institutions in fostering responsive, responsible, and accountable governance. Second, it is written to highlight some of the keys to successful budget and PFM reform based on international experiences. Lastly, it is intended as a practical guide for USAID and other donor agencies to inform the design, implementation and evaluation of technical assistance programs in budget reform.

Our discussion is divided into several sections. The next section provides some basic definitions and explains the importance of sound budgeting to the administration of public policy and to countries' development prospects. We then describe the essential parts of the budget process, the core components of the budget cycle, and the preconditions for successful budget reform. This is followed by several sections that examine good or 'best' practices in reforming budget systems to achieve the three basic goals of PFM—namely, strengthening fiscal discipline, enhancing allocative efficiency, and improving operational efficiency. Section 5 focuses on several elements that can help governments institute greater discipline, gain better control over expenditures, and reduce or avoid unsustainable deficits and debt: a sound legal framework; a uniform and comprehensive classification system; and, position control to regulate the largest on-going expenditure in most government budgets, the wage bill. Section 6 focuses on methods and techniques for improving expenditure prioritization and linking budget spending to results. Section 7 discusses several technical improvements (e.g., treasury single accounts, financial management information systems) than can vastly improve the use of budgeted resources—strengthening financial controls, improving liquidity, and allowing government to make better use of its cash. The final section consolidates lessons learned, drawing on experiences in several countries that have dedicated themselves to significant, on-going budget and PFM reform efforts. A listing of additional readings, useful websites, and other practical materials follows in Annex 1.

Throughout the text, country examples are used to illustrate various types and combinations of reform. Brief vignettes of budget reform in several countries appear in boxes to show how those governments chose to pursue budget reform and what worked.

2. WHY GOOD BUDGETING MATTERS

The budget is… "the only policy that counts"

– Marian Edelman Wright

The budget and budgetary institutions play a central role in fostering responsive, accountable public sector governance. At the core of public finances, some people are making decisions about spending other people's money. The nature of this dynamic creates constant tension between those spend the money (policy makers), those who stand to benefit from government spending, and those who pay the bill (generally taxpayers). Citizens, after all, do not purchase public goods from government the way consumers purchase cars; with few exceptions, the amount they pay in taxes does not really determine the amount or quality of government services they receive.

Indeed, policy makers have considerable discretion to spend money on policies and activities that may not reflect what their constituents want or need. Without effective restraints, the result is often misappropriation, "white elephants," and in the worst cases outright theft. Compounding the problem, public funds are typically spent on policies that address specific groups in society, who tend to demand more spending on those specific policies than what is optimal for society as a whole, without regard for the hard choices and tradeoffs inherent in this money grab. This tendency toward excessive spending increases the greater the number of decision makers competing for public funds.[1] Profligate spending leads to deficits, and deficits to debt. Without a hard budget constraint, these problems can spiral out of control, weakening fiscal outcomes, threatening macroeconomic stability, and impeding poverty reduction and growth.

Budgetary institutions—in essence, the formal and informal rules that govern decisions over the allocation and use of public finances—can help mitigate these problems, but only if appropriately designed and suited to local realities. This section begins by characterizing the budget and the budget process in broad terms, placing budget reform in the wider context of the international discourse on strengthening public financial management and fostering good governance in developing countries.

2.1 UNDERSTANDING THE BUDGET AND ITS CENTRALITY TO DEVELOPMENT

Simply defined, the government budget is a record of the revenues and expenditures of a government during a given period of time. Ex ante, it represents the government's financial plan for meeting its policy priorities, indicating what the government intends to do during that period, what those activities will cost, and how it intends to finance them. Ex post, it shows what the government actually did, who paid for it, and in what form (e.g., through taxes, user fees, donor assistance, or government borrowing).

The budget itself is the result of the *budget process*—specifically, the way in which decisions about the use and funding of public resources are made, from budget preparation, to drafting of a budget law, to budget implementation. This process (or set of processes) stems, in turn, from a country's *budgetary institutions*—the rules, procedures and principles governing how decisions over public

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[1] For an in-depth discussion of these dynamics, see Chapter 1 in Shah, Anwar (ed.), *Budgeting and Budgetary Institutions*, Washington, DC: World Bank:, 2007.

resources are made within and between the executive and the legislature.[2] These institutions divide the budget process into different steps, determine who does what and when in each step, and regulate the flow of information among the various actors. In doing so, these institutions distribute strategic influence and create or destroy opportunities for collusion and for holding budget actors accountable for their actions.[3]

Strong budget institutions are important from both a domestic and an international perspective. Domestically, sound budgeting and budget management signals the government's commitment to transparency and accountability, to caring for its citizens, and to delivering services that society demands.

Viewed from the perspective of outsiders—including practitioners, international monitoring groups and investors—it signals the government's commitment to stability and growth. Where those institutions are weak—as characterized by unreliable reporting, non-transparent decision-making, unchecked spending and ill-advised borrowing—accountability and predictability suffer, and confidence in the government wanes, affecting a country's desirability as a place to live, work and invest. In extreme cases, these weaknesses can also lead to domestic and regional instability.

2.2 STANDARDIZING THINKING ABOUT BUDGETING AND PFM REFORM

In part in recognition of the centrality of public financial management to good governance, stability, and development, international organizations and the international donor community have recently intensified efforts at systematically addressing weaknesses in developing countries' budgeting and PFM systems. Indeed, a recent OECD report underscores this renewed emphasis on budget and PFM reform in donor assistance strategies:

> Successful development depends in large on the efficiency, integrity, and effectiveness with which the state raises, manages, and expends public resources. Therefore, improving the formal and informal rules and institutions that govern these activities, and strengthening the related human and technological capacities, should be a major component of any development approach. Improved Public Financial Management (PFM) is at the core of good governance and lies at the heart of the Millennium Development Goals.[4]

The international discourse on what good PFM *looks like* has, in turn, led to an abundance of new methodologies, frameworks and tools for evaluating country PFM systems. Some measure a specific aspect of PFM system quality. For instance, the Open Budget Index (www.openbudgetindex.org), a product of the International Budget Partnership, measures budget system transparency, evaluating whether national governments give the public access to budget information and opportunities to participate in the budget process. Others focus on particular processes, such as the World Bank's Country Procurement Assessment Review (CPAR) for public procurement systems, and "Fiscal ROSCs" for compliance with the IMF's Code of Good Practices on Fiscal Transparency.

Still other tools attempt to measure 'fiduciary risk,' focusing on opportunities for waste, leakage and corruption due to weak expenditure controls. Indeed, external development partners, including

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[2] In this paper, the term "legislature" refers to all law-making bodies: congresses and parliaments chief among them. "Executive" is used to denote those bodies that implement laws (including the budget itself); the term executive is used synonymously with "government."

[3] Shah (2007), p. 29.

[4] OECD-DAC (2009), p.7.

USAID, are increasingly applying systematic methodologies to address fiduciary risk, especially in evaluating the use of country PFM systems as part of their strategies for developing host-country capacity to take ownership of their development priorities.

In addition to the above, the development community is actively developing and accelerating the use of new diagnostic tools, seeking to measure and assess country performance against many of the internationally accepted indicators of sound budgeting and public financial management. Efforts to standardize thinking in this regard have converged in recent years around the multi-donor Public Expenditure and Financial Accountability (PEFA) Performance Assessment Framework and its indicator set (see Box 1).[5]

Box 1. The PEFA Performance Assessment Framework

PEFA is a partnership between the World Bank, International Monetary Fund, the European Commission and numerous bilateral agencies to support integrated and harmonized approaches to assessment and reform in the field of public expenditure, procurement and financial accountability. Over the past several years, the PEFA partners have worked collaboratively to design and implement a baseline survey of 28 indicators covering all aspects of working processes known to be part of healthy PFM systems.

The 28 indicators in PEFA's Performance Assessment Framework are structured into four categories: (i) PFM system outturns, such as the comparison of executed budget with the formulated budget and the level of arrears; (ii) cross-cutting features of the system, such as basic transparency and comprehensiveness; (iii) budget-cycle issues, which capture the "performance of the key systems, processes and institutions within the budget cycle of the central government"; and (iv) donor performance, which capture "elements of donor practices which impact the performance of country PFM system." Countries are graded against each of this indicators (from 1 – 4, a "1" being equivalent to an "D" grade, and a 4 equivalent to an A), resulting in a composite score for each category and overall. These scores then provide a yardstick for comparing PFM process quality across countries, as well as over time. The assessment is accompanied by preparation of an in-depth, comprehensive report on the state of PFM institutions and processes. To date, more than 150 PEFA assessments have been completed in more than 100 countries, including several repeat assessments and a number of sub-national assessments in certain countries.

Importantly, PEFA assessments are demand-driven. A country must request a PEFA assessment and country stakeholders are invited to accompany the international team of experts that performs the survey and delivers its results to the country. The country may then choose to publish the PEFA assessment and/or ask the PEFA assessment team to help develop a technical assistance map to strengthen relatively weak areas. The PEFA reports, combined with the performance assessment, serve as a baseline against which countries can measure progress in building more robust and viable PFM systems.

The PEFA framework consists of 28 high-level indicators designed to measure the performance of national PFM systems, processes and institutions, in addition to three indicators that measure donor performance. One of PEFA's key objectives is to strengthen partner government and donor ability to measure and monitor the condition of partner country expenditure, procurement and financial accountability systems. While by no means displacing the wealth of other analytic tools, the PEFA approach is commonly regarded as a good starting point for assessment of country PFM systems, and a common yardstick for benchmarking PFM systems and engaging in high-level, cross-country comparisons.

[5] PEFA (Public Expenditure and Financial Accountability). Public Financial Management Performance Measurement Framework. Washington, DC: World Bank, June 2005.

3. THE BUDGET PROCESS—BASIC ELEMENTS AND CYCLES

This section briefly describes the budget process and the core stages of the annual budget cycle in sequence. The usual caveats hold—that processes and practices may vary from one country to the next, and the most appropriate set up for each country depends critically on local culture, institutional arrangements, and other factors. Still, the following discussion provides a useful 'primer' before proceeding with a more in-depth discussion of the elements that might go into budget and PFM reforms in developing and transition countries.

As already described, the budget document is itself a product of a budget process made up of recurring and overlapping events that interact and inform each other. Together, these events constitute the *budget cycle*, which can be roughly divided into four stages:

(1) The executive preparation stage;

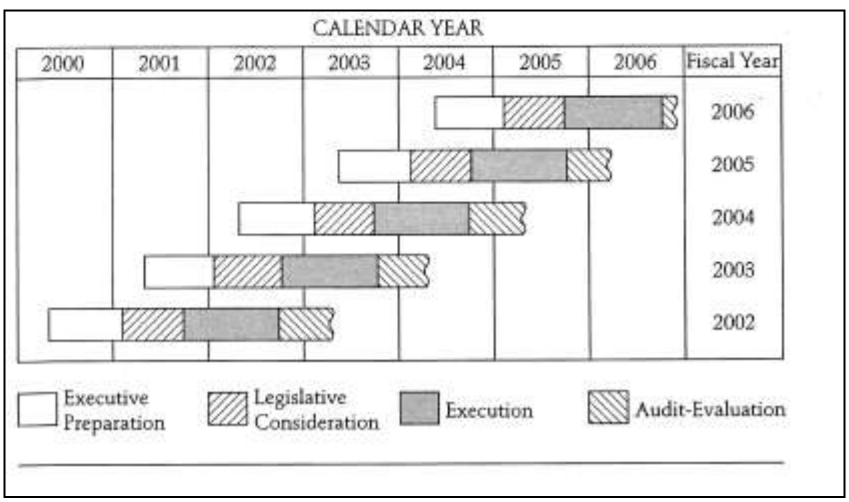
(2) The legislative consideration and approval stage;

(3) The budget execution stage; and

(4) The budget auditing and evaluation stage.

These stages are both consecutive and continual, with multiple budget cycles in progress at all times. For instance, at any moment, there are three budgets being considered by budget actors: the one being prepared for the upcoming year; the one currently in implementation; and, the prior year's budget, from which reports and analysis are providing information to inform pending and future policy and operational management decisions. Figure 1 provides a graphic illustration of this continuous process.

Figure 1. Phases of a Budget Cycle



Source: Adapted from Mikesell, John (2003), *Fiscal Administration: Analysis and Applications for the Public Sector*. Belmont: Wadsworth Publishing.

As the diagram shows, year in and year out, the various stages in the cycle repeat and overlap, distributing authority at each stage among different parts of government: the executive; the legislature; and variety of monitoring and audit bodies. This network of responsibilities, powers, and checks and balance requires, moreover, that the budget process, and the results of budget implementation, be both transparent and understandable, with complete, timely and reliable information available at each step of the way. These complexities also require universal understanding of all roles and make coordination, communication and cooperation across branches of government all the more crucial.

Below we describe each of the four stages of the budget cycle in greater detail.

3.1 BUDGET PREPARATION

Budget preparation is the stage in which a government determines the amount of resources it can afford to spend, declares its priorities and rules for spending, and then formulates its budget within those parameters.

At an operational level, budget preparation encompasses a revenue planning process and an expenditure planning process. These processes, and the rules and procedures guiding them, will vary from one country to the next, but there are some common elements in virtually all well-designed budget systems.

The process generally starts with the preparation of a macro-fiscal framework, providing projections of the government's "resource envelope"—the total revenues and other fiscal resources at the government's disposal for that period—based on detailed and consistent projections of key macroeconomic variables.[6] This step is critical. Overly optimistic projections of macroeconomic and revenue performance distort perceptions of the true resource envelope and affect budget planning, in many case leading to cash-flow shortfalls, constant budget revisions, and unplanned ad-hoc borrowing to cover budget commitments.

Given the resource envelope, the next steps are generally as follows:

- The finance ministry (or budget office) prepares the annual budget circular, articulating the government's core policy priorities, providing guidelines for the preparation of ministry budgets, and setting expenditure ceilings for each unit;
- Based on these guidelines, line ministries prepare and submit budget proposals explaining how requested funds will be spent;
- Line ministries defend and negotiate their budget submissions with the finance ministry (or budget office), competing requests are considered, and spending proposals are revised; and
- The draft budget, recommending the government's overall spending package, is finalized and presented to the legislature for debate and approval.

[6] Countries with more advanced budgeting processes provide a medium-term perspective in this framework, presenting the fiscal targets (e.g., total revenues, expenditures, surplus/deficit, and debt) and including the medium-term fiscal perspective to frame the preparation of the annual budget. The fiscal perspective generally covers three to five years and is updated annually.

Many countries impose additional conditions on budget formulation (and execution) to prevent fiscal deterioration, such as deficit rules, debt ceilings,[7] and the so-called "golden rule", which dictates that a government shall only borrow to invest and not to fund current spending.

3.2 BUDGET ADOPTION

The legislative approval stage is the set of processes through which the budget is reviewed, debated and ultimately enacted into an annual budget law. Budget adoption is usually the purview of the legislative branch and, similar to preparation of the draft budget, is often the end result of iterative and detailed negotiations, revisions and compromises.

The legislature's review and oversight powers, and its ability to change the executive's budget proposal, depends critically on the powers granted to it by law and varies greatly from one country to the next. In some South American countries, the legislature actually submits its own budget without necessary reference to the executive proposal. Other countries may give the legislature the authority to make changes in allocations, but not increase the overall total. Meanwhile, in countries with a parliamentary system of government, the legislature cannot make any changes to the budget at all: its only options are to accept the budget, or to reject it by adopting a vote of no confidence in the government (i.e., forcing the government out of power).[8] Variations on this model abound. In Bolivia, for instance, the budget proposed by the executive becomes law if the legislature does not act within 60 days.[9] In Jordan—the extreme case—the King can dissolve the Parliament at will, in which case budget adoption reverts back to the executive.

Once the annual budget becomes law, budget execution begins, with resources being deployed to implement the policies and programs incorporated in the budget. In good budget systems, any in-year amendments to the budget are then subjected to the same process by which the budget was originally approved, resulting in the adoption of supplementary budget laws. As a general rule, however, such amendments are generally limited to one or two per year, presented as a comprehensive package of proposed changes rather than a series of individual requests.

3.3 BUDGET EXECUTION

Budget execution has two distinct dimensions: the actual delivery of public services by those on the "front line" (e.g., health officers, engineers, etc.), and the public financial management (PFM) function that supports those front-line services. Here we focus on the latter dimension—that is, PFM. In this sense, budget execution is about getting the needed resources to spending agencies so that they can accomplish their mission, while at the same time ensuring that resources are used appropriately and optimally.

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[7] In the European Union, for instance, the Growth and Stability Pact sets rigid fiscal rules for eurozone members, stipulating that each state's deficit must not exceed 3% of GDP and its public debt must not exceed 60% of GDP.

[8] Lienert and Fainboim (2010), p. 15..

[9] Generally speaking, the shorter the time frame for adoption, the harder it is to conduct critical budget analysis or have a meaningful impact on the shaping of the budget package.

In most countries, budget execution is orchestrated by two core parts of the Ministry of Finance: the Budget Department and the Treasury.[10]

The Budget Department confers authority to each line ministry (Ministry of Education, Health or Public Works, etc.) to spend portions of the amounts appropriated to them in the budget law; such authorizations are generally granted for the entire fiscal year, but in many countries they are granted for shorter periods (e.g., monthly or quarterly).[11] Line ministries can then apportion the authorization to spend to their subordinate spending units. The issuance of these authorizations helps ensure that no expenditures are made unless they are part of the lawfully approved budget. It also provides an effective means of controlling the timing of spending, which must be matched with resource availability.

The government's Treasury function, meanwhile, plays a dual role in budget execution, providing both an *information service* and a *treasury service*. As an information service, the Treasury provides a flow of data on resource flows (receipts and expenditures at various stages – budgeted, allocated, ordered, delivered, paid for) and the stocks of assets and liabilities at particular times. This information is critical on many fronts. Specifically, it helps the Budget Department keep the budget within sound fiscal limits and allocate resources in accordance with national priorities. It helps program managers and agency heads live within their budgets and allocations and deliver services efficiently. Furthermore, it helps oversight bodies, civil society, and the broader public play a complementary role in monitoring for the same (and often additional) objectives.

As a treasury or *expenditure control* service, the Treasury function handles cash—both cash on hand and cash in the bank. The cash handling function is akin to a banking function: the treasurer or cashier receives cash, issues cash, holds cash balances and is responsible for their safekeeping. In many countries, Treasury personnel not only hold the purse strings, but also enforce the law by checking the legality of payments and ensuring that no expenditure is made in excess of appropriations.

Effective expenditure control requires that transactions be tracked and controlled at each stage of the expenditure cycle—commitment, payment order issuance, payment, and recording of each transaction. Governments typically accomplish this with the use of (integrated) financial management information systems (IFMIS), providing computerized and often automated tools to facilitate timely, uniform and accurate registration of every cash transaction. Such systems help ensure that each transaction is rechecked for budget inclusion; that the commitment is registered so that the government's cash can be managed well; that all purchasing rules and regulations are followed; that the proper officials have authorized each transaction; and, that all data are automatically registered, creating a full accounting of the government's cash activities, and providing a means of monitoring the cash and financial position of the government at all times.[12] Furthermore, these systems provide the basis for the periodic, ad hoc and year-end reporting that is so critical to effective, transparent and accountable public financial management.

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[10] The Ministry of Planning may also be involved (in respect of the capital or 'development' budget) in a dual-budgeting system, though for sake of simplicity we assume away this particular institutional complexity for the purposes of the present discussion.

[11] In some countries, these authorizations are termed 'allotments', while in others the term 'apportionment' is more common.

[12] For a general introduction to IFMIS, see Rodin-Brown (2008), *Implementing Integrated Financial Management Information Systems: A Practical Guide*.

It is important to understand that budget execution is not simply about ensuring compliance with the budget law. Successful budget execution also depends on numerous other factors, such as the ability to plan for cash availability, the ability to deal with changes in the economic environment, the ability to resolve problems met in program implementation, the ability to procure goods and services and manage efficiently, and the ability to execute effective controls that mitigate the risk of errors, abuse and corruption.

3.4 AUDIT AND EVALUATION

Budget audit and evaluation or monitoring occurs both within the budget execution cycle and *ex post*, following completion of the budget year. Traditionally speaking, this is the stage in which the government reports on expenditure to the external audit body, known in most countries as the Auditor General or Supreme Audit Institution (SAI). External audit is sometimes contracted out but in many countries there is an external audit function. It should and almost always is fully independent from the Ministry of Finance, and usually outside the executive branch altogether.[13]

External audits can serve various objectives. Basic financial audits attest to the accuracy and fairness of the government's year-end financial statements. Compliance audits verify, for example, that expenditures were properly authorized, and that rules and procedures were followed in carrying out expenditure. Performance audits, meanwhile, assess whether spending or program implementation is delivering "value-for-money."

Civil society groups are increasingly playing a role in auditing and evaluating government financial operations, with varying objectives and interests depending on the aims of a particular group. In essence, however, all audits, whether official or not, are intended to both hold government accountable and inform decisions about improving planning, budgeting, and program implementation in the future.

Of course, audit and evaluation cannot be effective without sound and uniform accounting, comprehensive data and timely and reliable reporting. A huge benefit of an IFMIS (when it works well – see Section 7.2) is that computerized and automated accounting removes much of the drudgery of manual reporting, and at the same time substantially improves the accuracy, allowing budget actors to focus on analysis of the data to inform and improve future decision-making.

[13] In the United States, the General Accountability Office (GAO) serves the external audit function. In Liberia, a Supreme Auditor reports to the Legislature. He and his staff were recruited, trained and continue to be mentored by international advisors who work with the department on different aspects of auditing government financial performance. In Peru, the government contracts with private international audit firms. In contrast, in Bolivia, there has been no country-wide audit for more than five years.

4. PRECONDITIONS FOR SUCCESSFUL BUDGET REFORM

Experience around the world reveals some important lessons about the conditions that must be in place to heighten the chances of successful budget or broader PFM reforms. At a minimum, such reforms must start with five basic things:

- A problem or need that is recognized by local stakeholders;
- High-level political commitment;
- Clear objectives with measurable results;
- Adequate and consistent resources; and
- A plan for institutionalizing the reform.

Granted, these conditions are certainly not unique to budgeting and PFM reform. However, they are worth considering here in more depth, since too often donor assistance overlooks one or more of these elements, increasing the risk that budget reforms will cause unnecessary disruption without ever delivering their intended outcomes.

In addition, Box 2 below presents a pre-reform checklist featuring several questions one might ask when contemplating designing a budget reform program. This checklist is by no means exhaustive, but it provides a useful starting point for engaging in thoughtful discussion about planning for such reforms.

4.1 ADDRESSING A LOCALLY DEFINED PROBLEM

Budget and PFM reforms unavoidably alter the institutional arrangements that dictate how organizations and people interact and do their jobs. They often call for changes in communication patterns, requiring more open and frequent information sharing, regular explanation/justification of requirements, and greater consultation with stakeholders at all times—both early on, and throughout the life of projects. Indeed, budget reforms change outcomes by changing inputs—the inputs being what people do when they go to work each day, and how they do it. 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.

Lofty, general principles are not enough for country leaders to spend valuable political capital making changes that challenge stakeholders' comfort zones. The problem, therefore, must be clearly defined, and it must be defined (or at least affirmed) by credible local stakeholders. The impediment or problem can be direct—for instance, Country X is concerned that it needs to establish some control over payment arrears before it loses all of its vendors. Or, it can be indirect—for instance, Country Y is seeking access to concessionary lending from the IMF and does not meet the Fund's reporting and transparency requirements. What does *not* work is an outside group insisting on a particular solution to a problem that local stakeholders do not recognize. Such "fixes" are seldom likely to stick.

4.2 HIGH-LEVEL SPONSORSHIP

The Minister of Finance, with the support of the country's political leadership, must be willing to champion the reform, with a full understanding of the political and institutional costs entailed in seeing those reforms through. Such sponsorship works best when it is active and engages stakeholders at all levels—for instance, through periodic updates on reform progress and its benefits.

To this end, a tiered approach is recommended as it combines the symbolic participation of high-ranking officials with acknowledgement of the scarcity of their time. Specifically:

- The Minister of Finance should be the clear sponsor of the reform and should delegate specific, ongoing responsibilities to trusted individuals.

- A steering group composed of high-ranking officials representing the major stakeholder groups in the budget process should be the next to hear about each important reform event and be given the opportunity to offer guidance. Its membership should ideally include participation from the legislative branch as well as from key central agencies (e.g., budget, tax, and human resources departments), line agencies (health, education, etc.), as well as the central bank (when appropriate).

- Finally, a mid-level official group, whose members are kept informed through iterative, interactive dialogues with those heading the reform effort, should in turn conduct meetings with their own personnel whose work will be affected by the change.

4.3 CLEAR OBJECTIVES AND MEASURABLE RESULTS

Budget and broader PFM reforms must start with precise objectives and expected results that can be—and are—measured and evaluated. Objectives must be realistic, reflecting the potential of the budget as a unifying instrument for translating policies into action, setting priorities and forging operating rules that make government effort more effective, while also acknowledging that even the best efforts to plan for and deal with exogenous factors (such as economic shocks) may fail in the short term.

Successful reform objectives reflect a combination of globally accepted knowledge of what makes economies work well *and* the realities of the country, including its history and cultural values. To be credible, the objectives must be translated into carefully crafted, relevant and measurable indicators that show what has been accomplished and its contribution to the country's economic progress. Moreover, they must take into account the multiplicity of role players (budget and financial officers, line ministries, etc.) involved in achieving them.

Creating useful reform objectives, linked to measurable results and timeframes, is difficult. Nonetheless, any attempt to initiate reform without first building a consensus around a clear set of objectives is far less likely to yield lasting results.

4.4 ADEQUATE RESOURCES, APPLIED LOGICALLY AND INTELLIGENTLY

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 technical efficiency in the execution of the budget. This means, in effect, that donors and reform leaders alike must be prepared to commit the necessary resources (both human and financial) at each stage, and be flexible to respond with additional support and resources 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). For instance, basic accounting systems must be in place before sophisticated cash management systems can be effective in improving operational efficiency.

Indeed, a Treasury Single Account (TSA), which experience has shown to be the most effective instrument for cash management in government, uses the classifications of the chart of accounts to perform the various functions that traditionally have been the responsibility of individual spending agency bank accounts. TSAs can take advantage of the time value of money, save borrowing costs and increase earned interest, to say nothing of allowing more prudent and predictable expenditures during the budget year. Yet, they cannot function effectively without reliable accounting classifications and standards.

Budget reforms are not as visible and tangible to voters (or to donor countries) 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 and deliver value for money.

Box 2. Look before you leap: a pre-reform checklist

1. Has the local government defined a problem it wants solved? If not, there is little chance for success unless it is a discrete, technical issue without major political ramifications.
    a. How complete is the understanding of the problem's root cause? If not, a clear, concise explanation of what is involved is essential.
    b. Has the requesting entity the power to invoke the changes? If not, the project's success will hinge on the support and collaboration of the authority possessing that power.
2. Is there high enough executive support to withstand the pressures to avoid change? Donors must understand and be able to explain to counterparts the pressure points that project implementation is likely to encounter. Senior government officials have little time or patience for detail, but they understand pressure and it must not come unannounced. Without the high-level support to overcome such pressures, success is unlikely
3. Are there sufficient resources to plan and execute needed changes in:
    a. Laws?
    b. Procedures?
    c. Forms?
    d. Work flows?
    e. Job duties?
    f. Systems (including automation)?
    g. Communications?
4. Are there sufficient resources and willingness to offer:
    a. New training?
    b. Re-training?
    c. Ongoing, on-the-job training
    d. Exchange programs?
5. Is there a clear understanding of the stakeholders whose involvement is required in each phase of the project, from design to announcement to implementation?

4.5 A PLAN FOR INSTITUTIONALIZING REFORM

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 gradually take over those roles.

Reform sequencing and phased implementation can be critical factors in ensuring that reforms will fit the absorptive capacity of the system and not cause reform fatigue. 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 challenge is in maintaining momentum for reforms that achieve permanent improvements in budget and PFM control, efficiency and performance.

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Above all, the design of any budget reform, and the overall approach to reform, should optimally be collaborative, transparent, and flexible, always accounting for the multiplicity of role players, existing systems, and local capacities. 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 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 and understanding to use them properly. Anticipating these challenges, and tailoring the reform agenda to meet the absorptive capacity in a given country, will help mitigate the risk that reforms on paper never translate to reforms in reality.

5. GETTING THE BASICS RIGHT

"Look before you leap-frog"

–Allen Schick

There is general agreement that budget and public financial management reforms are designed to accomplish one (or more) of three basic goals or outcomes:

(1) Establishing aggregate fiscal discipline;

(2) Enhancing the efficiency or resource allocations; and

(3) Improving operational efficiency in the use of budgeted resources.

These goals are often presented as PFM progress levels and often inform the sequencing of budget and PFM reform programs. In reality, experience shows that there is no critical sequence of reforms between these three PFM goals. The real issue with reform sequencing is not about which level to pursue first, but about paying adequate attention to *getting the basics right*.[14]

The above notwithstanding, fiscal discipline concerns are frequently the highest priority precisely because they relate to the fundamental goals of budget stability and viability, without which the other two PFM goals are inherently unattainable. A lack of fiscal discipline undermines the credibility of the budget and threatens the entire health of the budget system, to say nothing of the quality or efficiency of spending. These risks are most pronounced in developing and transition countries, as well as those emerging from conflict, where existing budget institutions and systems were either weak to begin with, or have deteriorated as a result of inertia, unrest, or loss of critical human capital.

We focus here in this section, therefore, on 'first-level' or basic reforms, i.e., those relating to establishing aggregate fiscal discipline, where many of the building blocks of a strong PFM system are often laid. Sections 6 and 7 of this study then take on the second and third levels (allocative and operational efficiency) in greater depth.

5.1 ESTABLISHING FISCAL DISCIPLINE

Controlling aggregate expenditure is a crucial objective of any budget system. There would be no need for governments to budget if total spending were merely the sum of all claims on public resources. Budgeting is essential precisely because claims always exceed what government is able or willing to spend. Without limits on the totals, unconstrained demands would result in unbridled spending, unmanageable tax burdens, chronically high deficits, or worse, all of these simultaneously. The pernicious effects of fiscal deficits—debt accumulation, rising inflation and interest rates, and the resulting threats to macroeconomic stability—have already been described above.

[14] In a classic 1998 presentation entitled "Look Before You Leapfrog" (sometimes referred to as "Getting the Basics Right"), renowned PFM expert Allen Schick underscored that, before advancing to more sophisticated reforms (accrual accounting, multiyear budgeting, etc.), it is essential to first put in place the fundamental building blocks of a sound budget process, i.e. the "basics first" principle.

Aggregate fiscal discipline, therefore, relates to all key measures of fiscal performance: total revenues, fiscal balance, and debt, in addition to total expenditure. After all, it makes little sense to establish spending constraints without also determining targets (or ceilings) for revenue, budget deficit, and the borrowing requirement.

Beyond simply setting targets, having aggregate fiscal discipline at an operational level means that the government is aware of all the monies flowing in (taxes, fees, royalties, grants, interest payments, loan repayments, etc.) and all the monies being paid out (expenses, payments on debt, transfers, contracts, grants, etc.). Once the government has a handle on what is flowing in and what is flowing out, it can then begin to establish means of controlling future inflows and outflows, with an eye to *spending only what it can afford*, not just what it wants.

Conceptually, this is straightforward. However, establishing aggregate fiscal discipline is more than just accounting processes that ensure the proper flow of public funds. In practice, achieving such discipline means that a number of other things must be in place. These include, among others:

- An adequate legal framework;
- A stable, comprehensive and uniform accounting system;
- Realistic revenue estimates;
- A reasonable budget calendar;
- Allotment and spending controls;
- Position and payroll control;[15]
- In-year and year-end reporting, and
- External scrutiny and audit.

Together, these elements help to ensure that the government's expenditures are constrained to the limits of available resources, while the government fulfills its role in delivering services demanded by the population.

Most industrialized countries have had these practices and features in place for decades, and generations of civil servants have been trained to follow them. For many developing and transition countries, however, these concepts and tools are foreign and new. The best approach, therefore, is to start with basics—introducing rules, systems and practices that serve the country's immediate needs and capacities, while building in the flexibility to introduce more advanced tools, methods and technologies down the road as conditions permit.

In the least developed countries, capacity may be so weak, and systems so deeply in disrepair, that it may not be the overall system, but simply the processes by which budget actors operate in the system, that demand priority attention. An example from Liberia (Box 3) illustrates the need for focusing on basics first, in this case in a country that only recently began to restore integrity to its PFM system after decades of civil war.

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[15] The term 'position control' is commonly used to encompass the various practices that have the intended result of controlling the number of government positions that are funded and filled. This is an essential element of basic fiscal discipline because the public sector wage bill (the salaries and associated benefits) is often the single largest ongoing expenditure of developing country governments.

Box 3. Liberia: Restoring credibility to the budget process

Liberia's legacy, after more than a decade of armed conflict, was a government in shambles. Successive tyrants had raided the public coffers, often aided and abetted by Budget Bureau officials. The multi-donor Governance and Economic Management Assistance Program (GEMAP) was conceived in direct to response to the concerns of the Government of Liberia (GOL) and international partners (including the United Nations, European Union, the Economic Community of West African States (ECOWAS), the IMF, World Bank and the United States) about the mismanagement of public resources during Liberia's post-conflict transition and the threat it represented to the peace process. Donors reasoned that addressing systemic risks that contributed to leakage and theft would ultimately make money available for basic public services that were already in desperately short supply. Agreed to in September 2005, just months prior to the election of Liberia's first woman president, Ellen Johnson-Sirleaf, GEMAP was a multi-donor program, including key contributions from USAID as well as the IMF, World Bank, and the European Commission.

Although prior to conflict, Liberia's budget system had contained some modern elements, almost two decades of war and disorder had led to tremendous loss of human capital and rapid deterioration of PFM systems. Under GEMAP, USAID provided a broad program of technical assistance and capacity building, placing international advisors in positions of co-signatory authority in several GOL ministries, agencies and state-owned enterprises. Among others, an international advisor was assigned to the Budget Bureau to counter-sign all allotments and budget transfers that would normally have been signed exclusively by the Budget Director. Budget allotments are one of the core institutions in the budget process, providing the authority to spend a portion of the funds available to a spending unit from the approved annual budget. In Liberia (as in many recovering economies), that authority, called an allotment, is granted monthly. It might be 1/12 of the annual total, as is usual with salaries, or it might be uneven reflecting seasonal differences or the need for larger cash outlays (e.g., to purchase equipment or vaccines) at a particular time of year. Complicating matters, the allotment process was characterized by delays and informality, where spending units would have to pay Budget Bureau staff a fee in order to process allotment requests. Such transactions were ubiquitous; without a signed allotment, spending units had no way to make purchases lawfully.

On taking office, President Johnson-Sirleaf named a new Budget Director, Augustine Ngafuan. Despite opposition to GEMAP from various corners, the Budget Director committed enthusiastically to the co-signing arrangement, recognizing that it was an essential step in restoring credibility to Liberia's budget process. He viewed the international advisor provided by GEMAP to his bureau as an ally who could help him replace rent-seeking behavior with formal controls. One of the Director's first bold initiatives was to do away with the fees levied on spending units when submitting allotment requests. With USAID assistance, the Bureau then put in place clear procedures, standard forms, and systems for monitoring and reporting. Within months, each spending agency was using the same simple request forms. New rules made allotment requests subject to a two-day turnaround. Furthermore, the Bureau started keeping a log of all such transactions, allowing it to produce and distribute monthly reports for review and, if needed, remedial action. Armed with this information, the Budget Director began to approach the Cabinet to address allotment irregularities; within months of taking up his position, allotment requests and their approval regularized. Even requests from as high as the President's office were turned away if they did not follow the new protocols.

The procedural changes initiated by the Budget Bureau quickly put pressure on the Ministry of Finance to give greater attention to broader weaknesses in its budget execution system. Distributing authority to spend money was only the first step in making purchases; purchases still needed to be authorized, and bills still needed to be paid. The Budget Bureau's success in transforming the allotment process pointed clearly to inefficiencies and risks present in the GOL's procurement and payment systems.

GEMAP's co-signing experience also provided valuable lessons to inform future programming in rebuilding countries. With the right incentives, and with high-level political commitment, such arrangements may not only be made palatable to host governments; if executed properly, they might also provide the added credibility needed for government leaders to advance reforms and institute the controls required to restore budget discipline and integrity.

In the discussion that follows, we look at some of most common components of reforms geared at establishing fiscal discipline and strengthening the basic building blocks of the budget system.

5.2 BUILDING A SOUND LEGAL FRAMEWORK

The legal framework is the formal expression of rules that govern budgetary decisions made by the executive and the legislature. These formal rules—sometimes enshrined in broad terms in the country's constitution, though more often spelled out in a collection of budget laws and acts—specify *what* budgetary processes are prescribed in law, *who* is responsible, and *when* key budgetary steps must be taken.[16] More specifically, they detail the legal requirements for preparing, approving, and implementing the budget, as well as the types of information, the powers of the finance ministry and other central budget actors, the scope of changes that may be made by the legislature, and adjustments that may be made in the course of implementing the budget. The question of *how* budgetary processes are carried out can also be addressed in law, although these issues are often relegated to lower-level implementing regulations, administrative instructions and circulars.

A country's budget system laws should provide the framework that enables the government to achieve the core goals of any well-functioning PFM system—aggregate discipline, allocative efficiency, and operational efficiency—all while ensuring transparency and accountability in budget formulation, execution and reporting. In many developing and transition countries, however, these goals are impeded by gaps and inconsistencies in the legal framework governing budgeting arrangements. Below we discuss some of the most common reasons for addressing or modifying the legal framework in pursuit of broader PFM improvements.

Additionally, Box 4 presents accepted wisdom on common features of a sound PFM legal framework.

It should be noted that strong political support for public finance reform can help move legal reforms forward, but even with this support changing national law takes time, a luxury that most budget reform initiatives, donor-funded or not, do not have. Yet the legislative process need not stall reform implementation. It is very important to understand how the legal system in place functions, and then to build systems and practices that not only respond to its requirements, but also have the adaptability to respond to eventual changes in the legal framework.

5.2.1 FRAGMENTED RULES

Fragmentation is common in countries where budget-related rules are scattered among numerous different laws, regulations, and other decrees, often passed at different times, for different purposes and from differing perspectives. The resulting conflicts and contradictions can hijack the budget process, both in the formulation and in the implementation phases, causing confusion, delays, and slow (or non-) execution. Indeed, in many cases, budget actors will choose to do nothing rather than face the consequences of misinterpreting legal provisions.

5.2.2 GAPS IN COVERAGE

A legal framework that is fragmented is also susceptible to gaps in coverage. In modernizing the legal framework, following are some of the elements that might be needed to fill critical gaps:

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[16] Lienert and Fainboim (2010), p. 1.

- Setting clear deadlines for major steps in the budget process, such as when the proposed budget must go to the legislature, when the legislature must approve the budget, and when the final accounts must be published.
- Clarifying the roles and responsibilities for the major PFM functions, such as development of the economic outlook, preparation of the budget, execution of the budget, setting accounting rules and procedures, and the respective roles of the treasury and central bank in carrying out the government's banking operations.
- Requiring a contingency reserve so that the government has some capacity to respond to emergency situations.
- Establishing a proper legal mandate for external auditing by the Auditor General.
- Addressing the distinct financial responsibilities of different levels of government as well as those of state-owned enterprises (where relevant).

5.2.3 OUTDATED PROVISIONS

Changes in the institutional and organizational arrangements often take place without corresponding changes in the underlying legislative framework, leading to confusion and oftentimes serial disagreements over the roles and responsibilities in the budget process.

Modernizing (or updating) provisions often include:

- Legally chartering the presently ad-hoc role of bodies that are designed to serve a permanent role.
- Extending the perspective of budget planning and preparation out three years or more to ensure the fiscal sustainability of budget decisions.
- Controlling commitments (an agreement to spend money after goods and services are properly provided) more rigorously to avoid exceeding appropriations.
- Strengthening fiscal impact analysis of proposed legislation, ideally by requiring a multi-year perspective and approval of the finance ministry, so that the president and the legislature are well informed of fiscal sustainability issues before new policies are passed into law.
- Clarifying the roles of the main participants throughout the budget process.
- Improving the legislature's access to fiscal analysis by providing for a professional legislative fiscal staff.

5.2.4 INTERGOVERNMENTAL ARRANGEMENTS

In federally structured countries, or in countries undergoing fiscal and broader decentralization of powers to sub-national levels of government, it is important to have in place legal provisions governing the PFM responsibilities of lower-level governments. For instance, to ensure macro-fiscal stability, there should be clear legal guidelines limiting sub-national debt levels, and provisions requiring regular reporting of budgetary and debt data to the federal/central government. Importantly, the legal framework must empower sub-national governments with sufficiency authority to carry out their mandates, including spending responsibilities, revenue-raising powers and intergovernmental transfers as applicable.

Box 4. Features of a sound legal framework

Following are recommended features of a sound legal framework for the budget system, divided into several categories relating to various PFM objectives. Some of these features may not necessarily be contained in law, but instead are reserved for implementing regulations or lower-level directives. Regardless, all are considered good or ‘best’ practice elements in providing the legal and institutional underpinnings of the PFM system in a country:

Legal Framework Features to Improve Fiscal Sustainability and Stability

- *Multi-year perspective*—requires that economic and revenue forecasts and budget estimates be developed for three years, so the future impact of present polices may be seen more clearly.
- *Appropriation for emergencies*—also called a ‘contingency reserve’, requires a certain amount or percent of the budget be held and used only under specific, limited conditions and with specific written authorization.
- *Fiscal impact analysis*—requires all policy proposals, including tax reliefs and new spending programs, to be accompanied by a multi-year fiscal impact analysis.
- *Spending authority in the event of no appropriation*—provides authority to operate in case no budget is passed at the start of a new fiscal year, often with 1/12 of prior-year spending available for non-capital items.
- *Limits on transfers*—restricting the scope and size of transfers from one appropriation item (e.g., Education) to another (e.g., Health) and/or from one category (e.g., Personnel) to another (e.g., Goods and Services).

Features to Unify the Budget and Improve Overall Control

- *Treasury Single Account*—ensures the treasury can quickly secure all inflows, provide daily financial and cash position reports, and take full advantage of the time value of money.
- *Fiscal rules*—limit fiscal aggregates, such as overall spending, deficit, and indebtedness (including limits on the borrowing activities of sub-national governments); in the case of debt, additional definitions and criteria concerning borrowing, guarantees and investments are often included in a comprehensive public debt law.
- *Commitment control*—limits risk (and strengthens cash management) by prohibiting commitment of funds without proper budget authorization.
- *Strengthened control of banking arrangements*—governs and controls opening and closing of all bank accounts by requiring approval of the Minister of Finance, sometimes delegated to the Treasurer.
- *Improved budget execution planning*—defines separate roles of Budget (e.g., budget authorizations/monitoring) and Treasury functions (e.g., cash planning/management, payment, accounting and financial reporting).

Features to Improve Budget Coverage and Transparency

- *Comprehensive coverage*—defines the minimum content of the annual budget, and the requirement to include all policies and decisions that have a fiscal impact, including spending programs, tax reliefs, domestic and foreign borrowing, extra-budgetary spending, loan guarantees and other contingent liabilities..
- *Improved policy focus*—a public policy priority statement from the President/Cabinet guiding the development of the budget, preferably with indicative spending ceilings.
- *Publication requirements*—requires dissemination of budget information at various points in the process, (e.g., proposed budget, signed budget law, final accounts).

Features to Clarify Roles and Improve Coordination

- *Definitions of roles and responsibilities*—clarifies the roles of key actors in the budget process, including the president, legislature, finance minister, agency heads, financial officers, the central bank, and external auditors.
- *Consultative decision-making*—provides for a national budget committee to advise the president and the finance minister on budget formulation and execution issues.
- *Budget calendar*—defines key steps and deadlines in the budget preparation process, giving adequate time to spending agencies, central budget staff and the legislature to complete their work with due consideration.

5.3 ESTABLISHING A STABLE, UNIFORM CLASSIFICATION SYSTEM

If the legal framework provides the "rules of the game", expenditure classifications provide the basic taxonomy of the budget. Budget classification is one of the fundamental building blocks of a sound PFM system, as it determines the manner in which the budget is organized and presented, and therefore has a direct impact on the transparency and coherence of the budget. In many countries, the budget classification system also provides the foundation for the accounting classification or "chart of accounts" (COA), which provides the normative framework for recording and displaying how budget resources were actually used. (see Box 5) In this regard, a sound and stable budget classification system is one of the critical early steps in cementing expenditure control and building financial accountability into the budget system.

In countries where the budget nomenclature is weak, upgrading the budget classification system should itself be considered a basic step—indeed a prerequisite—before embarking on more advanced PFM reforms, such as introducing multi-year planning (e.g., MTEF), program and performance budgeting, or even computerized financial management information systems. Indeed, the information and reporting requirements that such enhancements depend upon cannot be met without a common budget "language". Typical reforms, therefore, tend to focus on bringing budget classifications into closer conformity with international standards for budget presentation and reporting.

5.3.1 CORE FEATURES OF A SOUND BUDGET CLASSIFICATION SYSTEM

Broadly defined, budget classification refers to the coding schemes that are used to define all revenue and expenditure transactions throughout the stages of budget planning, budget presentation and budget execution and reporting. A sound and stable budget classification system helps ensure that all revenues and expenditures are presented and accounted for in a uniform and understandable manner.

Classifying expenditures, revenues and financing correctly serves multiple purposes in the budget process—providing vital information for policy formulation, resource allocation, performance monitoring, and day-to-day administration of the budget, in addition to ensuring basic compliance with budgetary appropriations.

A good classification system is not only necessary for budget planning and formulation. It also provides critical detail on the budget resources used, when they were used, and what they were used for. Having all this information available, and in a standard budget nomenclature, facilitates dialogue with stakeholders, from executive leadership, to the legislature, to civil society and the general public. Furthermore, it facilitates analysis of national fiscal trends, comparisons across government units, as well as comparisons with regional and international trends and benchmarks.

5.3.2 BASIC CLASSIFICATION SCHEMES

Budget classifications allow budget actors across government to present and report proposed (and actual) spending in a uniform manner. To achieve this and to allow for both policy analysis and expenditure management, basic budget classifications should at a minimum provide three distinct perspectives: an economic, a functional, and an organizational classification.

- The **economic classification** identifies the type of expenditure incurred—for example, salaries, purchases of goods and services, transfers, interest payments, or capital spending. The IMF's Government Finance Statistics (GFS) Manual (IMF 2001) provides an internationally accepted framework for economic classification of expenditures that also allows countries to tailor the budget nomenclature as needed.

- The **functional classification** categorizes expenditure according to the purposes and objectives for which they are intended—for instance, education, social security, or environmental protection—providing decision-makers, oversight bodies, and international organizations with commonly understood categories for analyzing the allocation of resources among sectors.[17] The UN's Classifications of the Functions of Government (COFOG) is widely recommended as an internationally accepted standard for functional classifications.

- The **organizational classification**, meanwhile, identifies the budgetary entity that is responsible for managing the public funds concerned—such as the ministry of education, ministry of health or, at a lower level, government-operated schools and hospitals. There is no internationally recognized standard for such classification, as the categories are dependent on the administrative and organizational structure in the country concerned.

All three classifications are essential for users of budget information, whether it be budget managers, policy makers, the legislature, or the broader public.

Box 5. The chart of accounts

Just as budget classifiers are elemental to the organization and presentation of the government budget, the Chart of Accounts (COA) is elemental to the process of administering, recording, and reporting on the government's financial transactions. The COA is often (though not always) a direct offshoot of the budget classification system, adding coding schemes that incorporate relevant asset and liability accounts—mainly financial accounts with the central bank, commercial banks, and/or other financial institutions. The COA, thus, allows government to track not just budget spending, but also changes in the government's financial position. The information tags that a COA provides also form part of the data validation process, indicating whether or not a vendor exists, whether or not there is an authorized budget, and whether or not funds have been committed.

Designing a good COA is not a difficult task, but obtaining the agreement of the wide array of stakeholders is. Once there are more than a handful of stakeholders involved, then reaching consensus on structure and coverage can become very daunting. Furthermore, the COA can be compromised by the frequent changes in leadership and priorities that are characteristic of most governments. There are constant pressures to restructure or re-shuffle administrative units or shift responsibility for programs each time there is an election or a minister is replaced. Flexibility in COA design, therefore, is recommended, although the core elements of the COA should be stable and, ideally, well integrated with the budget classification system.

5.3.3 ADDITIONAL FORMS OF CLASSIFICATION

Many countries construct additional classification schemes, including classification by geographic location, by source of funding, and commonly by activity or *program*, to enhance budget

[17] At the highest level, the COFOG system divides spending into 10 broad categories: (1) General public services; (2) Defense; (3) Public order and safety; (4) Economic affairs; (5) Environmental protection; (6) Housing and community amenities; (7) Health; (8) Recreation, culture and religion; (9) Education; and (10) Social protection. These categories are independent of the government's organizational structure.

transparency and to tie budget preparation and reporting more closely to policy priorities.[18] Doing so will gradually allow the government to shift budget presentation (and budgeting itself) away from a focus on detailed inputs (e.g., number of employees, supplies, and vehicles), toward the outputs or *results* that government wants to achieve. However, doing so can also complicate matters, especially in countries where expenditure controls and capacity remain weak. Only after the basic classification structures are well understood and universally used does it make sense to consider adding program-specific detail to the classification system. Montenegro's transition to modern budgeting provides a good example of this. (see Box 7)

Box 6. Developing classifications structures for sound budgeting

A sound and stable budget classification system is an essential tool for both policy analysis and budget management, providing policymakers, government managers, the legislature, and the broader public with a common language for understanding spending choices and evaluating budget performance. To this end, the classification scheme should ensure that the budget complies with three key principles of sound budget management:

- First, the budget should be comprehensive. It should cover all government entities undertaking government operations, and it should present a consolidated and complete view of these operations.
- Second, the budget should include all revenues and expenditures of all entities undertaking government operations. This helps ensure that the budget is effective in constraining government expenditure overall and by budgetary entity, and in promoting greater efficiency in the allocation of resources.
- Third, the budget should be internally consistent between different components of the budget. In particular, the current operating expenditure needed for the operations and maintenance (O&M) of completed capital projects should be fully reflected in the budget. This principle implies, moreover, that there should be a unitary budget system in which institutional responsibilities for preparing and executing the budgets for current and capital spending are consolidated, usually under the supervision of the ministry of finance.

Different approaches to budgeting and expenditure management often have a strong influence on the structure and organization of the classification system. For example, compliance budgeting focuses on ensuring that the collection and use of resources are consistent with the budget law, which in turn depends on having an accurate classification of these transactions and the organizations responsible for receiving revenues or incurring expenditures. Policy formulation and allocative efficiency concerns are the basis of a classification of expenditure by function and program. If operational performance is being assessed, a detailed classification of programs by activity or output is required. Fiscal control, meanwhile, requires at least an economic classification based on clear concepts (e.g., separating borrowing from receipts, current from capital outlays, etc.). Meeting these different and sometimes conflicting requirements calls for a pragmatic and flexible approach; countries with weak capacity should stick to simple schemes (and simple goals) until budget systems and institutional capacity are strong enough to cope with more sophisticated budgeting practices.

Adapted from Jacobs et al. (2009).

[18] The term 'program' has no universally recognized definition. To many practitioners, a program is a related set of activities leading to accomplishment of a single goal (or a set of closely related ones). To others, however, a program may be a series of broad-reaching activities to which contributions are made by various organizational units (e.g., primary education). Governments, too, view programs in various different ways. Some governments, for instance, make no differentiation between organizational units and programs. Others define programs in terms of the functions of government. Still others may call rather small, innovative efforts programs.

Indeed, once well established, the stability of the classification system is virtually as important as its uniformity. Frequent or ad hoc changes to coding schemes can prove extremely disruptive, especially when introduced in the middle of a budget cycle. There are also cost implications to such changes, both in terms of the work required to build new coding into existing systems, and the costs of training system users to understand and implement new schemes. In the end, the costs of effecting such changes may well outweigh the expected benefits.

Of course, as budgeting methods become more sophisticated and emphasis evolves from strict financial control of budgetary inputs to evaluation of performance and eventually to impact, the coding of expenditures will require more detail. Regardless of the degree of sophistication, any set of budget and account classifications should allow any budget entity to plan expenditures, present the budget in universally understood categories, record actual commitments and payments in the detail required, record other cash transactions, and prepare comprehensive financial reports and statements. More sophisticated charts of accounts will include additional ways to show increases in the value of nonfinancial assets and other items required for purposes accrual accounting (should a government decide to pursue that option). Whatever the circumstances, budget classifications will form the basis for any such enhancements.

5.4 SCRUTINY AND CONTAINMENT OF THE WAGE BILL

Year in and year out, personnel expenditures are one of the largest single outlays for most governments. They are also one of the spending categories most susceptible to abuse, mismanagement and unrestrained growth. Therefore, scrutiny and containment of the wage bill (commonly referred to as “position control”) is often one of the early priorities in enhancing discipline in the management of public resources.

Problems with controlling the wage bill are often the result of fragmented systems and databases for payroll and personnel management. Weak controls and information mismatches between personnel and payroll databases give rise to a number of problems. For instance, posts will be created without regard to the ‘establishment’ (the number of positions an entity is legally authorized to fill) or any resource constraint. In some cases, there will be duplicate records, allowing some employees to receive multiple wages for any given period without detection. In the worst cases—and this is far from uncommon—the government rolls will be flooded with “ghost” workers, both real and fictitious, receiving government pay though not actually in the government’s employ. The consequences can be debilitating, limiting the government’s ability to deliver services and compromising the integrity of the PFM system.

Some simple measures, however, can be taken to restore order to the government rolls.

5.4.1 TAKING A PHYSICAL HEADCOUNT

Countries facing problems with position and payroll control are well advised to start with a comprehensive inventory or census of public sector employees. Since the early 1980s, many developing countries have undertaken similar personnel verification exercises, not just as a means to control the public wage sector wage bill, but also as part of reforms to right-size the public sector, and often as one of the first steps in reforming public sector pay. In Côte d'Ivoire, a staff census was conducted in 2002, where only civil servants who physically presented themselves were paid, resulting in the removal of a number of ghost workers from the rolls. The Government of Ghana undertook a similar exercise, shrinking the public sector wage bill from 33 to 26 percent of government spending between 2000 and 2003, although the gains were short-lived as old practices resumed once the headcount stopped.

To be sure, reconciling personnel and payment information may prove difficult. Compiling data on staff and their compensation, and subjecting personnel expenses to greater scrutiny, is always a sensitive affair. Getting accurate information may also be complicated where payments are made in cash, and by multiple entities in some cases. Nonetheless, this is an essential exercise if the government is to get a handle on staff, positions authorized and their costs, and a key to curbing fraud and containing the size of the wage bill.

Once such an exercise is completed, the ministry of finance and other central control agencies need to play an active role in ensuring internal controls are sufficient to keep personnel management systems in check. Among others, payroll audits should be undertaken regularly to detect irregularities, identify new ghost workers, fill data gaps, and pinpoint control weaknesses.

5.4.2 CONSTRUCTING A BASELINE PERSONNEL BUDGET

Personnel services can be one of the easiest parts of the budget to construct, and yearly incremental adjustments are straightforward and simple to execute. The starting point for a ground-up ("zero-based") analysis is to obtain an organization chart for each spending unit identifying all departments and ideally their staffing. If such an organizational map is not available, one can be created using available payroll data. If excised payroll information leads to non-payment, accuracy will follow. A clearer picture of the organization will evolve and the flaws discovered and corrected over time.

Once there is some indication of the actual number of legitimate staff on the payroll (as opposed to those who are receiving pay illegally), the remainder of the process becomes fairly mechanical.

5.4.3 INITIATING MANAGEMENT ANALYSIS

At a minimum, ongoing management of personnel expenses requires the following information:

- How many people are working and who they are;
- Job or pay classification of each;
- Pay rates and the value of fringe benefits (annual leave, health coverage, etc.);
- Predictable pay increases and/or cost-of-living adjustments; and
- Authorized vacancies and expected new hires.

Armed with this information, the government will be in a position to start asking more fundamental questions about the size, structure and quality of the work force. For instance:

- Are the positions budgeted appropriate to the spending unit?
- Are 'consultants' pervasive, and do they remain on the payroll year after year?
- Should there be fewer persons or more persons in total?
- Are there too many (or too few) managerial positions?
- Are there critical skills gaps at certain levels or in certain functions?
- Do vacancies really need to be refilled?

Box 7. Montenegro's transition to modern budgeting systems

On the heels of conflict following the disintegration of Yugoslavia, the Republic of Montenegro embarked on reforms to restore stability and credibility to government operations. The reforms were led by the Ministry of Finance, with substantial assistance from USAID and US Treasury from 2000-2005. At the time, economic activity in Montenegro was tightly controlled by the Central Payment Bureau (the "ZOP"), a vestige of the old Yugoslav command-control system. Virtually all formal transactions between individuals, companies, and the government went through the ZOP. The ZOP had the power to deduct 'tax payments due' to the government from individual accounts, and handled all disbursements in response to ministerial requests. The budget itself was little more than a bulky paper document. Real budget authority was the result of daily negotiations over available funds. Each day, the ZOP would report to the MOF on all funds collected and available that day; the MOF would then send instructions back to the ZOP telling it how much to transfer to the bank account of each spending unit. By the end of the year, some spending units had received cash distributions well in excess of their appropriation; others had received far less, though without clear justification.

The ZOP performed all the treasury functions typically found within the ministry of finance in other countries. Spending units deposited their cash balances and authorized their own payments through the ZOP. Inflows and outflows of funds were not documented—at least not publicly. The MOF knew what amounts were transferred to each spending unit, but not what bills and expenses were reckoned, or what these outlays paid for. Accounts from each spending unit were due to the MOF, but there was no enforceable penalty for inaccurate or late reporting. Nor could the MOF develop meaningful aggregate spending profiles as the classifications each spending unit used were varied both in type and in detail. One agency might code by vendor, another by purpose, another by type. Some were aggregate, others detailed, and the type of detail would vary (e.g., one ministry reporting by location, another by month). During a budget year, one agency might have had substantial idle balances in its bank account, while another agency was unable to pay vendors clamoring to collect overdue payments.

The very first accomplishment of the budget reform efforts in Montenegro was development of a simple set of budget classifiers to be used by all budget entities. For the first time, there was consistent presentation of budget requests that showed three standard characteristics: the responsible unit; the object of expenditure; and, the function or purpose for which funds were used (e.g., education, health, etc.). With the introduction of systematic budget classifications, the MOF was then able to track what each agency was spending, which sectoral objectives that spending was serving, and how much of that spending went to salaries, supplies, equipment and major capital outlays.

USAID and US Treasury then followed up with technical assistance, training and basic automation support to create a rudimentary treasury function within the MOF. The new Treasury centralized collections and payments in one authority and provided a mechanism for managing and controlling budget disbursements in reference to budget appropriations and resource availability. Initially, the Treasury authorized payments at the request of the spending agencies, but all transactions continued to go through the ZOP while the MOF worked to complete the development of its new chart of accounts. The ZOP was finally dissolved in 2003, and its treasury functions fully transferred to the MOF. The transition was slow, deliberate and lacked drama. The government phased changes in slowly, supporting spending units with training in how to operate new systems, and communicating clearly the plan to eliminate individual bank accounts in favor of centralized treasury management over time.

The Government also took initial steps to modernize the budget preparation process. The MOF developed and distributed a new budget circular setting expenditure ceilings by spending unit, and providing guidelines for spending units to present their budget requests according to the new classification scheme, with detailed plans justifying their budget requests. The MOF introduced systematic budget hearings, at which line ministers or their designees explained and defended their requests. Budget staff, meanwhile, began to develop standard analytics that facilitated comparison of new requests with historical requests and comparisons across spending units. Results varied. Some spending units showed serious commitment to the new process, others less so. Yet clear improvements were already apparent by the next budget cycle. Accounting classifications were becoming more refined. Budget analysts were monitoring expenditures to inform budget analysis. In addition, three pilot agencies had embarked on rudimentary efforts to introduce program budgeting, with key program and finance staff from central budget and spending units working side by side to define and assign funding to each program, setting the stage for a government-wide roll out in subsequent budget cycles.

These questions are more operational management than pure budgeting issues, but they form an important agenda for ongoing discussions with each spending unit. Position control makes such a dialogue possible.

5.5 REASONABLE REVENUE ESTIMATES

Fiscal discipline, as described above, depends on the government's ability to control fiscal aggregates. To accomplish this, the budget itself must be affordable. Budget preparation must, therefore, take as its starting point a good estimate of revenue. This is because the choices among different expenditure proposals—choices that are at the center of the budgeting process—cannot be made without a clear idea of how much money is likely to be available during the course of the year. An expenditure program that does not conform to a realistic limit on available resources is a wish list, not a program, and the budget that contains it is worth little more than the paper it is written on.

While fiscal marksmanship is critical to the credibility of the budget, many developing countries embarking on PFM reforms simply lack the capacity to carry out credible revenue forecasting. Some countries, oftentimes with donor assistance, have had success in strengthening analytic and planning capabilities through the establishment of government fiscal policy analysis units. Such units not only focus on forecasting revenues, but also on other analyzing other policy concerns that have an impact on fiscal sustainability, including debt policy, macroeconomic performance, and other economic variables.[19]

[19] For more on the design and establishment of such units, see Martinez-Vazquez and Heredia-Ortiz (2009).

6. IMPROVING PRIORITIZATION AND SEEKING RESULTS

Spending money on the 'right' things, and making it count

As the basic budget infrastructure takes shape and government gains greater control over public expenditure, the budgeting process affords a forum for healthy policy dialogue and competition. With stable accounting and reporting systems, the government is armed with valuable data and a historical record to inform choices about future spending. As routine tasks are systematized and automated, moreover, human resources can be redeployed to focus increasingly on strategic planning, policy analysis, and expenditure prioritization. In other words, government can begin to think not just about *how much* is spent and *how* it is spent, but also *what* it is spent on and whether alternative spending patterns would be more effective.

PFM reforms can turn at this stage to the objective of improving the *allocative efficiency* of budgetary decisions—that is, to strengthening the link between budget planning and policy priorities.[20] Importantly, efforts to strengthen and upgrade the basic infrastructure discussed in the previous section will continue, with greater emphasis on providing the tools, information and capacity to use the budget process to make better policy choices and improve government performance in producing results and delivering public services.

This section examines the issues and experience surrounding efforts to improve expenditure prioritization, budget outcomes and results accountability, and offers some perspective on how best to use budgeting and planning tools to help developing countries strengthen the budget-policy link.

6.1 MOVING FOCUS FROM INPUTS TO OUTCOMES

The fundamental function of the budget, of course, is to control public expenditure, which is typically carried out by exercising control over financial inputs. For many countries, this emphasis on fiscal discipline and financial accountability shaped budgeting practices throughout most of the 20th century. Traditional budgets were typically organized by *line item*, and every separate piece of spending had to be approved in all its particular details. Thus, for instance, a legislature would consider an agency request to build a school, input by relevant input: the number of labor hours required, the number of crossbeams, panes of glass, and so forth. The focus of budget implementation, then, was simply to ensure strict compliance with approved line items.

As the number of agencies and their activities grew, governments gradually consolidated these inputs under a limited number of standardized categories, and previously approved spending was simply "repackaged" and submitted for re-approval using the standardized line items. Rarely challenged, existing budget items effectively became the budgeting base, typically growing each year by minor increments. Only new spending proposals were considered separately as new projects or programs, to be absorbed in subsequent years into the general funding base. *Incrementalism*, thus, became the defining characteristic of the line-tem budgeting process, where the main determining factor for an agency's future budget was its current budget. Budget inputs, not budget outcomes, were paramount.

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[20] Allocative efficiency is perhaps the most elusive of PFM reform goals, in part because determining what are the 'right' things to spend on is inherently a political exercise—and the gap between political preferences and the public interest is often wide. *See* Andrews (2007), Chapter 11 in Shah (2007), p. 375.

Over the last few decades, however, the pressure to spend more effectively has led to wide recognition that budgeting is not only about planning for inputs, but also, perhaps primarily, about planning for the outcomes or results that government wants to achieve. This shift in focus from inputs to outputs, and ultimately to results, originated in the world's industrialized countries, where many governments have been experimenting for decades with new and innovative variants, often grouped together under the rubric of *performance budgeting*: program budgeting, zero-based budgeting, activity-based budgeting, output-price budgeting, and results-oriented budgeting, to name just a few. A parallel development in budget practice has been the widespread shift from budgeting for one year ahead, to planning for several years out, particularly in the context of a medium-term budget or expenditure framework (see Box 8).

Box 8. Applying a medium-term approach to budget planning

Many developing countries have introduced performance budgeting approaches as part of a larger package of PFM reforms, including the development of a medium-term expenditure framework, or MTEF. Narrowly defined, an MTEF links policy making to planning and budgeting, usually over a three-year time horizon. More specifically, an MTEF is really the product of several distinct steps—repeated every year—leading to a comprehensive, medium-term expenditure framework:

Medium-Term Fiscal Framework (MTFF): An MTFF is the first, necessary step towards an MTEF. It typically contains a statement of fiscal policy objectives and a set of integrated medium-term macroeconomic and fiscal targets and projections of revenue, expenditure and financing over the medium-term.

Medium-Term Budget Framework (MTBF): An MTBF builds on this first step by developing medium-term budget estimates for individual spending agencies. The objective of an MTBF is to allocate resources to a country's strategic priorities and ensure that these allocations are consistent with overall fiscal objectives. This gives some degree of budget predictability to spending agencies, while ensuring overall fiscal discipline. In fact, a MTBF is the most basic type of MTEF.

Medium-Term Expenditure Framework (MTEF): This last step adds elements of activity- and output-based budgeting to the MTBF. These methods seek to improve the value for money of public spending, in addition to reinforcing fiscal discipline and strategic prioritization.

Thus, the MTEF process consists of a top-down resource envelope, a bottom-up estimation of the current and medium-term costs of existing policy and, ultimately, the matching of these costs with available resources, usually in the context of the annual budget process. The key to a successful MTEF is that institutional mechanisms assist and require decision-makers to balance what is affordable in aggregate against the policy priorities of the country. Line ministries and spending agencies, in turn, are afforded greater responsibility and discretion to allocate and use resources to meet those priorities most effectively.

MTEFs have been introduced with great fanfare in scores of developing countries. Like performance budgeting, however, they have often not delivered, whether due to capacity constraints, a lack of attention to macroeconomic performance, or simply insufficient political will to accept the difficult tradeoffs that a resource-constrained framework imposes. Box 14 below offers some useful insights from the recent experience with introducing MTEFs across Africa that in many ways apply equally to similar reforms attempted anywhere in the developing world.

Over time, the use of performance budgeting as a precondition for aid assistance triggered its rapid spread to the developing world, where many governments, often with donor support, took steps to move from line items, input controls, and mindless renewal to budgeting based on programs, objectives, and results.

Implementation, unfortunately, has not gone as smoothly as hoped. External development partners often set their sights too high, introducing sophisticated tools and practices into weak or dysfunctional PFM systems, where the basics were not yet 'right.' Many governments simply lacked trained staff members with the experience and skills needed to rework the budget and accounting classifications or to develop meaningful performance measures. In many cases, a lack of political buy-in, bureaucratic resistance and legislative apathy toward the new practices further frustrated efforts, reducing early performance budgeting experiments to futile exercises. Behind the scenes, finance and line ministries continued to budget as previously, incrementally and by line item.

Despite the early challenges, it is interesting to find that performance budgeting has endured, at least in some form, in many of these countries. To be sure, the techniques and practices that survive are often rudimentary, the performance measures hollow, and the link between spending and results tenuous. However, we have learned several important lessons from these experiences. First, developing countries need to start with basic tools; oftentimes donors rush to implement the latest budgeting fad without adequate recognition of a country's capacity to cope with its complexity. Second, reform takes time and persistent effort; it is not so much the chosen tools as it is the institutionalization of the principles underlying those tools that matters most. Third, performance budgeting, in any of its varieties, is not a mechanistic exercise but a political process, in which hard choices are made in a complex environment of competing demands. Successful budget reform requires not only attention to the technical aspects of the reform, but also an understanding of the political context, institutional arrangements, and electoral cycles and how these can influence the support, sequence and timing of such reforms. Indeed, it is critical to first generate a demand for results, notably among politicians, before decision-makers truly have a stake in spending for them.

6.2 PERFORMANCE BUDGETING: BASIC CONCEPTS

In a nutshell, performance budgeting is about results. Performance budgeting aims to improve the efficiency and effectiveness of public expenditure by linking the funding of public sector organizations to the results they deliver, making systematic use of performance information.[21] The variants, as described above, are numerous, both in the details and in the degree of sophistication. Yet, while the mechanics differ from one approach to the next, all strive to answer three basic questions in budgeting:

1. **What will we do** – the objectives for which funds are required;
2. **What will it cost** – the price tag for the programs proposed to achieve those objectives; and
3. **What will we achieve** – the outputs/outcomes to be produced or services to be rendered under each program.

6.2.1 BENEFITS OF PERFORMANCE BUDGETING

Reorienting the budgeting process in this way offers clear benefits. In particular, it changes the focus of discussion from detailed line items to the broader objectives and performance of public programs and, therefore, facilitates more informed budgetary decision-making. With its performance emphasis,

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[21] Robinson and Last (2009), p. 2.

moreover, it shifts the emphasis away from input controls and gives managers greater flexibility in using their allocations to meet their commitments more effectively, and at lower cost (see Box 9).

Public sector managers enjoy increased managerial discretion, but importantly, they are held accountable for what they achieve in service delivery performance. Indeed, performance budgeting can provide powerful incentives for spending ministries to spend more efficiently and effectively. If certain programs are not delivering their intended outcomes or are doing so at unnecessary cost, focusing the attention of budget decision makers on this information can foster healthy discussion about whether such programs need to be ceased, scaled down, or fundamentally rethought.

Box 9. Performance budgeting: balancing restraint with flexibility

Performance budgeting changes the focus of discussion from detailed line items to the broader objectives and performance of public programs—facilitating more informed budgetary decision making, increased managerial flexibility and, in turn, greater results accountability. In many developing and transition countries, however, such a culture shift is often anathema to finance ministries, budget offices and other central budget actors who remain staunch proponents of controlling public expenditures. This resistance may help explain why traditional line-item budgeting has endured despite periodic efforts to modernize the budget and introduce a performance orientation.

Despite the view that performance budgeting necessarily implies a sacrifice of input controls, in reality, performance depends on a proper balance between restraint on the one hand, and flexibility on the other. This means that budget reforms must work towards putting in place hard, but predictable, budget constraints while providing decision makers with the authority they need to do their jobs.

Indeed, virtually all performance budgeting systems feature some level of line-item input control, while at the same time offering line ministries greater managerial flexibility in using allocated funds to meet their policy objectives, program goals, and service delivery results. Thus, some budget systems provide top-down policy priorities and overall ceilings but give spending units relative freedom to translate the policy into program efforts that reach those most in need in the manners they deem most appropriate.

Where such flexibility exists, as it does in South Africa, performance measurement is more important than in, say, Slovenia, where program detail is a standard part of budget submission and review. The South African model features inter- and intra-sectoral strategic planning to define sectoral priorities, which are then translated into major funding categories for each spending unit. Once a spending unit knows its funding ceiling, it has considerable discretion to determine how to spend those funds to achieve its sectoral priorities (with certain caveats, such as limits on the wage bill). After the annual budget becomes law, the spending unit presents a translation of the overall amount to the National Treasury, indicating how much it will need each month to fulfill its spending plan. Transfers of up to 10 percent are allowed within the budget year—again, with standard limits, e.g., no money can go into or out of the unit's wage bill or contracts. The central budget authority then makes its recommendations for future funding based on spending unit performance, more so than on its detailed expenditure plan. This collaborative process relies on the expertise and vision of each spending unit to determine how best to achieve national strategies, while also giving flexibility to spending unit management to execute for efficiency and effectiveness.

Should all governments transition away from traditional line-item control practices? Not necessarily, and never precipitously. Controlling inputs is an important first step in achieving aggregate fiscal discipline, without which budgeting for performance or results is really unthinkable.

In general, however, as a government gains greater control over its expenditures, and as it faces increasing, competing demands for scarce resources, the choices over how it distributes those resources among sectors and programs become critical. Bargaining over the number of tires, socket wrenches or bags of cement a given spending unit needs is hardly productive when fundamental policy decisions are at stake. Studies have shown, in fact, that decision-makers, government managers, and legislators actually prefer a simple, program-focused presentation of funding choices, finding such budget formats easier to understand and more conducive to explaining their choices and their results to constituents than detailed line-item budgets.

Performance budgeting can also contribute to aggregate fiscal discipline. Improving expenditure prioritization means an improved capacity to make "fiscal space" for new spending initiatives without commensurately increasing aggregate expenditure. To the extent that performance budgeting succeeds in improving the efficiency of government services, it can also allow the government to do "more with less." Robinson and Last (2009) also posits that performance budgeting facilitates consolidation in times of fiscal stress by helping government target spending cuts at the least effective or least critical programs (although there is little empirical evidence to support this claim).

In many respects, performance budgeting also fits naturally with a medium-term framework for planning and budgeting (see Box 8), although an MTBF or MTEF should not be seen as a prerequisite for performance-based budgeting. Both aim to improve 'upstream' expenditure prioritization, although performance budgeting focuses additionally on improving the 'downstream' efficiency and effectiveness of public spending. Indeed, perhaps the best way to improve expenditure policy formulation is both to make maximum use of performance information and to consider the medium-term cost implications of expenditure choices.[22]

6.2.2 APPROACHES TO BUDGETING FOR RESULTS

There are numerous approaches to performance budgeting that use different mechanisms to link allocations to results. Some are very sophisticated and require the support of correspondingly sophisticated public management systems. Some designs are rather mechanistic, attempting, for instance, to convert the tool of performance budgeting into a rule.[23] Others, meanwhile, focus more on the basics.

At the basic end of the spectrum, performance budgeting simply aims to ensure that, when formulating the budget, key decision makers systematically take into account the results to be achieved by expenditure. Most basic forms of performance budgeting, thus, will involve some element of performance orientation, while also maintaining some level of line-tem focus in the development and execution of the budget. Ethiopia, for example, uses program performance information to enrich the budget dialogue, but only the line-item budget is legally binding. Such an approach is often referred to as "performance-*informed* budgeting." According to Duncan and Last (2009), performance-*informed* budgeting requires, at a minimum:

- Information about the objectives and results of government expenditure, in the form of *key performance indicators* (KPIs); and
- A budget preparation process designed to facilitate the use of this information in budget funding decisions, including a simple expenditure review process.[24]

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[22] Ibid, p. 3.

[23] The most common is formula funding, though the objectives and the mechanisms differ from one country to the next. In Liberia, for instance, 30% of the consolidated government's operating budget by law must go to Education. Australia and New Zealand practice more sophisticated versions of formula funding as part of their output-purchase agreements, whereby funding for specific programs or services goes up lock-step with increases in service demand (for instance, as a result of population growth in a given jurisdiction).

[24] Duncan and Last (2009), p. 2.

6.2.3 CASTING PERFORMANCE IN A PROGRAM STRUCTURE

Duncan and Last (2009) also recommends that performance budgeting reforms be accompanied by a restructuring of the budget on a program basis, supported by *program classification* of expenditures. A program budget relates spending more closely to service and objectives, rather than to simply the types of inputs (salaries, supplies, equipment, etc.) that government buys. The idea of a program budget is to focus spending agencies on the goal of expenditures. Thus, the budget request is their opportunity to persuade the central budget office, and in turn the legislature, that: (a) the proposed programs work directly toward the government's policy priorities; (b) they have considered various manners of meeting those priorities and chosen the programs, projects, and activities most appropriate given needs and available resources; and (c) their cost is realistic and the time requirement reasonable.

Program budgeting is a powerful tool as it helps budget decision makers compare the costs and benefits of spending options, while also revealing how much money government is directing at achieving particular outcomes for the public. As such, program budgeting is strongly recommended as part of broader performance budget reforms in countries that have the capacity and resources to introduce it. By linking planning with budgeting, moreover, it is also a logical step on the path from classical line-item budgeting to performance-based budgeting (see Table 1).

However, program budgeting and program classification require a certain degree of technical sophistication, a sound and stable accounting system, and a commitment to transparency that is not always present in countries with weaker budgeting institutions. Therefore, for those countries not yet ready to move to a program budget, the two elements outlined above—better performance information and the introduction of budget processes to use that information—can still yield significant benefits.[25]

Table 1. Features of alternative budget formats

	Line item	**Program**	**Performance**
Contents	Expenditures by object (inputs / resources)	Expenditures for a cluster of activities supporting a common objective	Presenting a results - based chain to achieve a specific objective
Format	Operating and capital inputs purchased	Expenditures by program	Data on inputs, outputs, impact and reach by objective
Orientation	Input control	Input control	Focus on results
Management paradigm	Hierarchical controls with little managerial discretion	Hierarchical controls, managerial flexibility over allocation to activities within the program	Managerial flexibility over inputs and program design but accountability for service delivery and output performance

Source: Shah and Shen (2007), at Chapter 5 in Shah (2007).

[25] Ibid, p. 6.

Box 10. Variations on linking funding to results: examples from around the world

State of Connecticut: Appropriations in this small U.S. state are made to each spending unit by (i) program and (ii) major object of expenditure (salaries, goods and services, equipment, grants, and contracts). Each spending unit is a full partner with the central budget office and the legislature in determining program structure. Monitoring and review of performance then feeds into decisions on future allocations to those programs.

Ethiopia: Two budgets are prepared in parallel: (i) a program budget covering all ministries, and (ii) a line-item budget, by ministry and by object of expenditure. Appropriations are made based on the line-item budget; the program budget is not legally binding, but serves as guidance for monitoring spending against sectoral priorities. Variations on this approach exist throughout Africa.

Romania: Appropriation is by organization and by minor object of expenditure with a cross-walk to program that is performed *ex post facto*. Program detail is used primarily for reporting to international organizations, less so to inform budget preparation, execution or analysis.

Peru: The finance ministry's macro-fiscal unit develops a set of programs for each ministry as part of the central fiscal planning process. Thus far, the central imposition of programs has not strengthened the weak bottom-up element of the budget preparation process. However, it has provided a more reliable basis for monitoring sectoral spending, and a more informed basis for determining budget cuts.

Sri Lanka: Central budget actors specify a uniform set of programs for all spending units, such as reducing poverty or increasing transparency and citizen participation. Programs, however, exclude all staffing costs, which instead are consolidated under one program called simply 'Personnel.' While such an approach largely nullifies the major purpose of program budgeting—that is, to show resource allocation among competing claims—in a capacity-constrained environment, doing so may be an acceptable compromise insofar as it avoids the complexity and time-consuming effort of estimating the staff and other 'indirect costs' that spending units must dedicate to each program.

Jordan: Performance measurement applies to 'projects' only. Current spending is not subject to the same scrutiny or targeting of desired results.

Montenegro: Government uses performance findings provided by the Supreme Audit Institution in planning for future budget allocations.

6.3 DEVELOPING PERFORMANCE INFORMATION

Systematic information about the efficiency and effectiveness of public expenditure is the foundation of performance budgeting. Performance information provides an indication of how well a given organization (or a set of organizations) is meeting its goals and objectives, and which policies and programs are working. Without reliable and timely information on the results being delivered by government actions, there is no basis for making performance-informed decisions, for incentivizing management for results,[26] or for holding government accountable for delivering on its promises.

Making performance information an effective tool, however, requires that during the budget preparation process, every spending unit:

- explicitly define the outcomes that its services (outputs) aim to deliver to the community; and

[26] Indeed, the simple act of measuring performance can incentivize managers to use results-driven tools and techniques, such as performance contracts, benchmarking and market testing.

- develop a set of performance indicators—sometimes referred to *key performance indicators*, or KPIs—by which the ministry of finance and key budgetary decision makers can evaluate the efficiency and effectiveness of its services.[27]

Box 11. Different performance measures for different needs

Different types of performance indicators or measures indicate different things about the results of spending public money. The most common include:

- *Output measures* – These are most appropriate for programs and activities that deal with physical things: e.g., number of miles of roads paved, square feet of government buildings rehabilitated, etc.
- *Outcome measures* – These include efficiency measures, indicating what has happened as a result of using the resources in the budget: e.g., number of girls reading at grade level; number of new small business start-ups, number of high school graduates employed or enrolled in further education, etc.
- *Results or impact* – These measures focus on whether longer-term, wider reaching change has been accomplished. This technique pairs clearly enunciated national priorities with measurements of performance indicators thought to lead to the achievement of those priorities. The goal of such measurement is to track long-term changes in, e.g, living standards, economic competitiveness, and so forth, by evaluating collectively the performance of many programs over multiple years.

Impact measures are arguably the most difficult to choose, measure and analyze. Progress is often the result of numerous distinct efforts, some coordinated and others complementary. Agreement on the measures themselves can be contentious, the quality of measurement by different entities may differ, and the relative contributions may be indistinguishable. Nonetheless, impact-oriented performance measurement is popularly sought as a response to perceptions that government services consistently fail to deliver either quality or value for money. The verification of a measurable impact typically requires several years, supported by continuous monitoring, reliable information systems, and sustained political commitment. Such measurement systems, therefore, are often implemented as part of a broader public sector reforms that encompass, but are not limited to, the budgeting process itself.

6.3.1 KEEPING IT SIMPLE

Many industrialized countries have spent years, even decades, practicing and refining the art of performance measurement, involving sophisticated performance information systems and elaborate performance criteria. More recent adopters of performance budgeting, particularly many developing countries, have painfully learned that introducing performance measurement is often easier said than done. In Jordan, for instance, recent efforts to introduce "results-oriented budgeting" (ROB)—one variant of performance-based budgeting—faltered due to a lack of effective planning, communication, and training. The ROB approach was rolled out to most budgetary units as part of the

[27] Introducing such requirements may necessitate changes to the legal framework governing the budget process, in particular to: (a) define the standards for performance information and indicators; (b) specify the public sector organizations subject to the system; (c) clarify the roles and responsibilities of line ministries, central budget actors, and the legislature in managing and evaluating performance information; and, (d) define the formats and periodicity for reporting performance data to key decision makers and to the public.

2009 budget process, but because most of these units did not fully understand the approach, it ultimately fell on the Prime Minister's office to assign key performance indicators for them.

Indeed, developing useful performance information, and building the systems required to track and evaluate performance data, is expensive and requires skilled human resources that may not be readily available. Ultimately, the biggest challenge for developing countries is keeping performance information simple, affordable, and usable. Starting with basic performance indicators, and perhaps also limiting each ministry or spending agency to only a handful of indicators is, therefore, strongly recommended.

In Liberia, for instance, the Government recently launched an effort to introduce performance-informed budgeting. As part of the budget cycle, the GOL began issuing an annual budget circular setting spending ceilings and explaining government priorities, accompanied by forms and instructions for submitting ministerial budget requests. Program proposals must include a narrative statement of what each program seeks to accomplish over the long term, what medium-term goals are envisioned, and what the current year's performance indicators are. To be sure, the goals, objectives and indicators are somewhat, and their monitoring and measurement remain imprecise. Nevertheless, they are clearly improving with each round of training, application, and review. Liberia's approach was pragmatic: the Government set its sights on improving the link between spending and results, but opted to keep it simple at the outset. Over time, as budgeting sophistication improves, especially among the various spending units, there may be scope to expand the performance budgeting experiment, tying future funding more closely to delivery of results.

6.3.2 MAKING USE OF PERFORMANCE INFORMATION

The availability of the right performance information is a necessary—but not a sufficient—condition for the success of performance-based budgeting. Experience shows that, in order for performance-based budgeting to work, the systematic review of spending priorities and program performance needs to be formally integrated into the budget process, through routines designed to make maximum use of available performance information. How these routines take shape will depend on the country and in part on the dynamics of the political and administrative systems. However, some common elements usually include:

- a strategic phase, early on in the budget cycle, which incorporates a preliminary consideration of the government's broad expenditure priorities (this may be integrated with national-level planning processes, such as MTEF);
- an expenditure review process—even if a very simple one—that examines existing programs in the context of policy priorities, and uses performance information to inform decisions about whether to expand, cut back, or even eliminate certain programs;
- a systematic process for scrutinizing all proposed new spending initiatives; and
- a requirement that all spending ministry budget submissions be supported by information on the effectiveness and efficiency of its expenditure.[28]

Expenditure review processes deserve special emphasis here. Without systematic spending review, it becomes much harder to make fiscal space for new priorities, or to make the most of existing spending. Indeed, it is in the assessment of existing programs that performance information is most useful.

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[28] Robinson and Last (2009), p. 5.

Box 12. Transforming South Africa's budgeting system

South Africa's challenges upon achieving independence were significant. In addition to a population scarred by years of apartheid, the country faced severe poverty and a massive debt burden. The South African Government (SAG) used various budget reform projects to help stabilize its public finances and reengineer the budget process to achieve important policy changes. The reform process continues in South Africa, as the SAG continues to identify new requirements for improving the efficiency and effectiveness of public spending. In this respect, South African reforms seem to have learned the most essential lesson of budget reform—that budget reform, like budgeting itself, is an iterative process, and success leads to demand for greater results and more sophisticated tools.

South Africa began with the development of revenue-sharing formulae to comply with the new Constitution's commitment to decentralization and equitable treatment. Strategic planning, estimated ceilings, bottom-up budget formulation from ministries are all portions of the budget development process. The South African tools are exemplary in their thoughtful composition. Their legal framework is thorough in describing central responsibilities and decentralized rights, in detailing the criteria for inclusiveness in decision-making, and in calling for transparency through various means. Unfortunately, the establishment of the governments at the same time as the revenue sharing meant that new officials in newly created organizations might have lacked the administrative experience needed to make the best use of those funds, or to keep good records of revenues and expenditures.

The structuring of many major efforts emphasized power sharing to minimize the ability of one group to exercise power arbitrarily over other groups. For example, to address the poverty problem, the SAG developed transfer formulae earmarking tax monies collected by the national government to support sub-national government priorities. Under the arrangement, municipalities receive amounts based on a formula that estimates the cost of providing basic services (e.g., housing, water, sanitation, utilities) linked to the size of the low-income population in that municipality. Similar block grant formulae were developed for the nine provinces, which are also eligible to get money to provide specific services.

Did the establishment and practice of an equitable distribution formula for funding sub-national government activities comprise a successful budget reform? The formula was developed with input and participation of stakeholders, it was reviewed publicly, it was adopted legally, and it was administered equitably. Yet, the housing promised has not materialized in anywhere near the numbers promised. Public schools face increasing problems, with falling graduation rates and a lack of qualified teachers in classrooms. South Africa, it seems, is still struggling to bring decentralized capacity to a level commensurate with delivering effective decentralized services.

On other fronts, South Africa's experience has been remarkably successful. South Africa's MTEF is one of the most successful in South Africa. As highlighted above in Box 9, the SAG's medium-term planning process provides an effective blend of top-down and bottom-up planning and prioritization and links directly with the annual budgeting process. In strengthening its program budget, meanwhile, the SAG has worked (and continues to work) assiduously to develop meaningful performance measures to inform future allocations and provide feedback to program managers at both national and sub-national levels on opportunities to improve administrative efficiency and effectiveness. Moreover, having established aggregate fiscal control has allowed the country to pay off its massive debt, including concessionary loans made by the IMF and World Bank, and consequently free itself from the mandatory program requirements of those organizations.

The key lesson to take from South Africa is that success occurs when reform efforts are well integrated recognize the interdependence of various processes and actors in the budget system. South Africa provides a salient example of the many things done well and stringent self-assessment that points to weaknesses in order to strengthen them. It is also a cautionary tale that even the most sophisticated budget tools cannot be sustained unless their users get all the training and support they need. Even then, budget processes are iterative. To expect overnight perfection is to invite disappointment.

6.4 PROGRESSING FROM BASIC TO ADVANCED PERFORMANCE BUDGETING

The newer performance budgeting is to a given country, the more resistant central budget actors will be to relinquish the input-control emphasis with which they traditionally approached the budget. Thus, for instance, an untested spending unit might be asked to prepare a detailed plan, with resources grouped by program (e.g., primary and secondary education, adult education, testing and evaluation, administrative support and oversight) in the major categories of expenditure (e.g., personnel expenses, good and services, capital outlays, transfers and contracts). For each program, the plan would also indicate the number of positions, sometimes by broad category (e.g., teacher, curriculum developer, administrator, support staff), along with the amount of money requested for each program. In short, the finance ministry and central budget office continue to wield significant power in decisions over how the budget takes shape, how it is executed, and ultimately what gets cut or renewed. Peru (see Box 13) is one example of a country struggling to overcome a tradition of centrally driven budget processes, and to fully embrace the principles of performance-based budgeting.

Box 13. Performance budgeting in Peru: a work in progress

Several years ago, the Government of Peru adopted a new set of processes modeled on program and performance-based budgeting. Under the new system, the budget process is tightly controlled by the Ministry of Finance. Both programs and performance indicators are defined centrally, and are based on fairly general policy statements, which are distributed early in the budget cycle to MDAs. The MOF then convenes with top leadership of the various MDAs to develop sectoral ceilings and come to an informal agreement on likely expansions and cuts of existing programs.

Considerably later, the Budget staff sends out computerized forms and instructions to MDAs to use in developing their annual budget requests. Some MDAs do not submit requests and MOF creates budget requests for them. The Council of Ministers (i.e. the Cabinet) then reviews the proposals, making modifications as desired, after which the MOF presents the formal budget to Congress. Hearings are often delayed and contentious, with the MOF responding to questions and challenges with additional information. Worth noting, a recent, World Bank -supported *Presupuesto Participativo* initiative worked to increase the participation of traditionally under-represented populations in debates over local public works budgets, but the initiative lost steam as economic conditions deteriorated in 2009.

Once the Congress passes the Annual Budget Law, the Budget staff translates it into annual and quarterly ceilings for budget authority, and the Treasury then manages cash to ensure that approved bills submitted are authorized for payment within 48 hours. Should revenue collections exceed revenue estimates in the approved Budget in any given year, Ministerial policy determines what portion of those excess receipts should be used to retire debt and what portion to allocate to other expenditures. This was the case over several consecutive years preceding the recent economic meltdown. With higher than expected revenue collections, the Budget staff were able to award additional funding to a number of program efforts it determined were strategic government priorities.

Peru exhibits various attributes of budgeting that links allocations to priorities. However, in many ways it represents a case of form triumphing over substance. Central fiscal staff continue to control the setting of program categories and performance targets and do so in ways that do not adequately reflect differences in objectives and missions from one MDA to the next. The budget process cannot achieve true links to performance for several reasons, but the most important is a failure to incorporate a vibrant bottom-up component to its budget preparation process. As a result, the real “meat” of programs is designed late, well after the details of the budget have already been decided, and when MDA options and managerial discretion are already limited by budget realities.

As countries gain more experience with performance budgeting, and capacity deepens both within the central fiscal agencies and across the spending units, the latter may be entrusted to translate the policies enunciated by the executive leadership into programs of their own choosing, without the need for central approval. In such systems, the focus changes to expenditure prioritization and performance monitoring. Thus, performance in delivering agreed-on outputs or outcomes, more so than budget inputs, influences subsequent years' budget discussions. Of course, giving public managers this level of discretion, and establishing this explicit link between funding and results, of course, requires development of more sophisticated information systems, clear operating procedures, and sound macro-fiscal policy management, so that spending unit budgets have some level of certainty about the funding they will receive during the course of the budget year.

Some OECD countries have taken performance budgeting to another level, setting comprehensive performance *targets* for all line ministries as part of the budget process. The most notable example of this approach is the UK's system of "Public Service Agreements" (PSAs).[29] However, such an approach is difficult to apply in most developing countries because it requires (a) a well-developed performance measurement system, and (b) a solid information base on the relationship between funding levels and the results that a given ministry can be expected to achieve.[30]

Even more sophisticated measurement systems allow a type of budgeting for results which links funding not simply to results (e.g., higher graduation rates), but also to longer-term *impact* (e.g., a professional, internationally competitive workforce). Impact-oriented budgeting is usually part of a multi-year planning process, in which lively policy debates are essential, and the measures of impact require wide agreement. In reality, many developing countries—not to mention some industrialized countries—are simply not yet in a position to fund the evaluation systems required to make impact measurement an effective tool for planning and budgeting. Proponents, however, point out that the mere establishment of an active dialogue on impact and its measurement can serve as a powerful tool for encouraging more concerted action toward achieving policy goals.[31]

Table 2 illustrates how countries at various stages of budget system development can and do strengthen the budget-policy link, and gradually improve the link between funding and results, adopting the set of tools and practices most appropriate for their needs and capacity.

It is also important to note that extensive review of performance budgeting throughout the world has shown that establishment of a multi-year perspective, reasonable and affordable measurement systems and the importance of results on future funding are the most important conditions for success. Various systems have failed when there was more effort to develop measurements so rigorous that its automated collection would replace the need for policy dialogue and competition based on various other factors. Good measurement is important; seeking perfect measurement diverts energy from making good budget decisions.

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[29] PSAs detail the aims and objectives of UK government departments, typically for a three-year period, describing how targets will be achieved and how performance against these targets will be measured. Once agreements are in place, each department works closely with HM Treasury to review performance, examine international practice, and identify opportunities for meeting PSA targets more effectively, and at lower cost.

[30] Robinson and Last (2009) suggest that while comprehensive target setting would generally be inappropriate for developing countries, selective target setting may be highly desirable (e.g., targets for vaccination rates or literacy levels). See Robinson and Last (2009), p. 9.

[31] See Rose (2003), which compares and contrasts performance budgets in countries as diverse as Bolivia, Burkina-Faso, Cambodia, Ghana, Mali, Tanzania and Uganda.

Table 2. Adopting budgeting tools appropriate to the level of budget system sophistication

Stage of Budget Development	Budget Proposal	Budget Execution	Evaluation	Example
Basic	Programs with spending detail – reviewed by MOF	Controlled by program and type of spending with little flexibility	Input control and budget monitoring	Montenegro
Intermediate	Programs designed by agencies within comprehensive MTEF[32] to fulfill national vision w/i MOF guidelines, but no content approval	Controlled by program and major spending category with some (e.g., 10%) flexibility between major categories of expenditure	Performance measurement of outputs and outcomes, if possible	South Africa (excellent medium-term framework; performance measurement still a work in progress[33])
Advanced	Programs designed by agencies/sector to meet cross-cutting strategies as well as legal mandates with allocations based on results increasingly on results	Controlled in total in terms of budget authority and in detail for accounting and audit purposes. Significant flexibility to adapt to opportunities to improve outcomes[34]	Sophisticated performance measurement of (multi-year) impact indicators, supported by reliable, interlinked automated systems	New Zealand and Australia have the most advanced systems, but some countries (e.g., Jordan) have begun to develop KPIs and are working on building reliable measurement tools

6.5 IMPROVING PATTERNS OF ALLOCATION

Decisions about whether to spend more money on education than roads, on safety than health, on investments than salary are at the heart of budget making. Decisions about whether to cover pensions, provide health care, cut spending or raise taxes—these are all influenced by the values, the cultural norms, and the political traditions that define a country and its vision of what role the public sector plays in providing for its citizenry. These choices are also frequently affected by exogenous factors, and because resources are finite, expenditure choices are necessarily political.

[32] Medium-term frameworks provide a multi-year fiscal and expenditure perspective to budget planning, reflecting the major policy priorities of the government in power. MTEFs, like other budget reform tools, exist in varying degrees of sophistication. South Africa's MTEF is exemplary in this regard.

[33] Following the elimination of apartheid, South Africa's new Constitution and legal framework reinforced the principles of decentralization and decentralized accountability. Performance measures were visionary, but in some cases the cost in time and building of data retrieval systems has delayed verifiable performance measurement. Currently, National Treasury is working to develop bottom-up understanding and agreement on relevant measures that will allow the spending units to deliver more and better targeted services.

[34] Changes, however, may require legislative amendment.

It is the role of the budget process to provide politicians and other key decision-makers with a coherent menu of options for meeting both their own priorities, and those of society as a whole. Experience has shown that there is no one-size-fits-all approach to improving this budget-policy link. Indeed, as shown above, even 'performance budgeting' comes in many varieties and varying degrees of sophistication. Ultimately, the key to any good budget is good policy. The question then becomes how to leverage budgeting practices to make the best policy choices given both political realities and resource constraints. In this context, increasing allocative efficiency depends not so much on the choice of budgeting tool, but on the ability to secure buy-in, particularly political buy-in, and to cultivate a demand (and an appetite) for disciplined, policy-based decision making. Tools such as performance budgeting and MTEF have the potential to improve budgetary decision making, but they can never replace the political process of making those resource choices.

With the above in mind, following are several recommendations for countries embarking on reforms to improve efficiency and effectiveness in the allocation and use of public resources. These apply even in situations where capacity is still weak or uneven across government:

- **Start with an appropriate set of programs for each spending unit.** While each program should be somewhat similar in size and complexity in order to allow comparison, it is essential that programs reflect each unit's translation of government-wide policies as well as that unit's statutory programmatic responsibilities. A 'one size fits all' approach, assigning the same set of programs to all spending units, weakens the link between a unit's spending and its mandate and, ultimately, undermines the purpose of program and performance budgeting.

- **Introduce performance-*informed* budgeting before linking funding to performance.** Start with a limited number of basic performance measures that begin to focus program managers on desired end-goals. Piloting key performance indicators first in a select few agencies can be an effective approach. Even countries without sophisticated costing and tracking systems can still choose measurable goals—their mere selection will help ensure that as tracking systems are built, they will begin to capture critical information about performance and, ultimately, the results delivered. Over time, countries can begin to set performance targets that gradually become a factor in allocation decisions. However, the establishment of performance targets will not be useful unless the performance becomes a credible factor in reward systems and subsequent funding decisions. Where it is risky to innovate, and there is little risk of punishment for ignoring problems, employee incentives are an effective means of validating that a new culture is being formed.

- **Increase the frequency, content and quality of communications.** Communications within the finance ministry should be open and frequent between all players in the budget cycle, as all the portions are interdependent. The macro-fiscal department should share and discuss economic assumptions with budget, treasury and debt departments. Treasury, debt and budget staff should also communicate openly and regularly. Finance ministry and budget staff must develop fuller, two-way communications with MDAs. And, briefings to higher officials should be routine, concise, and clear.

  Communication to and with the public, meanwhile, should become a regular part of the budget cycle. Many developing countries have introduced periodic public hearings, at which voters can voice their concerns and opinions. Furthermore, finance ministries are increasingly posting monthly budget execution data on their websites, and many also publishing a Citizens' Guide to the Budget, making the budget more accessible and clear to the general public.

Box 14. Lessons learned from MTEF experience in Africa

The MTEF experience in Africa demonstrates a broad agreement on the fundamentals of the concept. However, the lessons learnt point to: (i) significant divergences between the expectations of MTEFs and their actual impact; (ii) the fact that while MTEFs may be useful and necessary, the tool alone does not provide a solution to the PFM problems; and (iii) the conclusion that MTEFs alone cannot improve budget preparation and management in cases where key aspects of the basic PFM system remain weak. The following are important prerequisites for implementing an MTEF approach:

Get the basics right. An MTEF should be seen as a complement to, not as a panacea or substitute for basic PFM reforms. It is imperative for a government to engage in a comprehensive and in-depth diagnosis of the basic systems—focusing on budget coverage, classification structure, expenditure control systems, accounting and reporting, and internal and external audit that are vital for introduction of basic components of an MTEF.

Get the macro-fiscal context right. Transparent and technically sound macroeconomic forecasts, coupled with realistic resource envelope projections, are essential to smooth implementation of an MTEF. In Namibia, the MTEF was first implemented as a fiscal and aggregate expenditure framework, in order to give effect to fiscal policy choices. South Africa and Uganda initially focused on making the macro-fiscal implications of spending more robust and clear to all stakeholders.

Adapt the MTEF to the existing capacity. The reform should be properly sequenced subject to the existing capacity, in order to institutionalize the process. Many MTEFs have been phased over time. In Mozambique, the first phase saw the estimation of the aggregate resource availability, while the second phase focused on the sectoral expenditures. South Africa and Kenya introduced MTEF on a government-wide approach, but allowing gradual development of quality sectoral strategic plans and investment programs. Tanzania and Rwanda, meanwhile, used a pilot approach by beginning with a few key sectors.

Integrate the MTEF within the existing budget process from the start. The approved budget should constitute the first year of the MTEF. Tanzania's experience prior to 2000 in implementing MTEF in parallel with the budget led to the production of two sets of budget numbers (budget guidelines and the MTEF), which caused confusion and undermined both processes. In South Africa, the MTEF is part of the Medium-Term Budget Policy Statement of the finance minister and is issued as a public document. In Kenya and Uganda, the MTEF is issued as part of the budget framework paper, which is approved by cabinet and sent to Parliament. In Tanzania and Uganda, the MTEFs are coordinated with development partners through mechanisms like sector-wide approaches and public expenditure reviews.

Provide appropriate incentives and political support. Incentives for ministries of finance and planning, as well as line ministries, deserve careful scrutiny. Adequate attention must be paid to the politicians who have real incentives to either support or resist the reform. Taking the case of revenue estimation, the incentives for the politicians to overestimate future revenues are strong, which is likely to undermine the desired hard choices to rationalize expenditures.

Source: World Bank, CABRI and IMF/East AFRITAC

7. RAISING EFFICIENCY THROUGH TECHNICAL IMPROVEMENTS

Providing the tools to do the work of government better

In the previous two sections, we looked first at reforms aimed at 'getting the basics right', and then at reforms designed to improve resource allocation and the link between spending and results. As capacity deepens and budgeting practices become more sophisticated, there are greater demands for technical enhancements and upgrades to help administrators in developing country governments do their jobs better and deliver services more efficiently. There are a number of small-scale, short-term and often low-cost efforts that fit into this category: for instance, upgrading forecasting software, sending key budget and finance staff to advanced coursework, or contracting with outside experts to bring in specialized knowledge. Donors and other external development partners often finance such activities, sometimes as part of a larger reform effort or simply as a stand-alone activity.

There are also, of course, very large efforts, often involving mass computerization and process automation, the two best known of which are:

(i) the centralization of cash management through a Treasury Single Account (TSA); and

(ii) the introduction of integrated financial management information systems (IFMIS) that automate key aspects of budget execution and accounting operations across government.

Donors and international organizations, including USAID, the World Bank, and the IMF, frequently play a critical role in shaping these systems, often through a combination of financial and technical assistance, training, and procurement support.

IFMISs and TSAs fit naturally together, as both provide governments with the information and controls needed to facilitate both sound and efficient budget management. Furthermore, both trigger fundamental changes in the institutional arrangements that shape the public finance system and, thus, also fit naturally with efforts at broader public sector reform. To be sure, experience suggests that both IFMIS and TSA implementations can be very costly,[35] involving significant numbers of stakeholders, requiring frequent adjustments, and often taking years—for some IFMIS projects, more than a decade—to complete. Nonetheless, if properly implemented, both can be critical tools for improving expenditure control and for delivering the financial and performance information governments need to make better-informed decisions, increase budgetary transparency, avoid routine errors, and make the most of limited resources. It is important to reiterate, however, that until good practices are in place for budget development, such budget execution improvements can only increase the speed and accuracy of budget implementation. They cannot substitute for good budget policy.

7.1.1 CENTRALIZING CASH PLANNING AND MANAGEMENT: THE TREASURY SINGLE ACCOUNT

Control of cash is a key element in budget and macroeconomic management. The primary goal of prudent cash management is the security of funds entrusted to the government, closely followed by

[35] One USAID study (see Rodin-Brown (2008)) suggests that a rough guideline for estimating the cost of installing the complete hardware and software platforms for a comprehensive GFMIS is to estimate about US$6 per capita. Ancillary costs such as training and reorganization can double these base costs. As an example, the study cites the case of the Slovak Republic, which incurred a base cost of US$30 million, and a total cost of US$60 million, for implementation of its IFMIS.

liquidity, i.e. having those funds available when needed, which in turn contributes to budget efficiency. The third goal of cash management is to minimize the cost of government borrowing and maximize the return on any temporary cash surpluses. A TSA, built on the principal of centralizing cash balances, is the most effective way to accomplish all three goals.

7.1.2 TREASURY SINGLE ACCOUNTS: BASIC CONCEPTS

A treasury single account is an account or a set of linked accounts through which the government deposits all collections and makes all payments. A TSA can help address the serious cash management problems faced by many developing countries, where spending units maintain their own bank accounts. Before the advent of sophisticated software to create such central systems, bank accounts were a logical way to separate funds and keep track of them. G governments may have had hundreds or even thousands of accounts into which revenues flowed. Once the revenue was distributed into an agency account, it was no longer available for use by other legitimate government users. These arrangements can and often do result in idle cash balances, which are inaccessible to the finance ministry. As a result, the government is often forced to borrow to finance the payments of some agencies, even while other agencies have excess cash in their bank accounts. A well-designed TSA can put these idle balances to better use and minimize borrowing costs, freeing up cash to cover approved spending or to take advantage of interest-bearing investment options.

More specifically, a TSA is meant to do four things:

1. **Provide security.** A TSA helps the treasury protect public monies, depositing all inflows into a single account (or a set of linked accounts) with built-in safeguards to prevent waste or abuse. Usually, the central bank is the safest place to create such an account and offers the most security.

2. **Improve liquidity.** A TSA contains data on all the flows into the account and thus enables better planning and management of cash and the ability to take advantage of the fungibility of funds. Because bank accounts are no longer the method of controlling cash (a good chart of accounts, underpinned by sound accounting rules, allows better control), the Treasury can do better cash planning, thus helping to ensure that cash is available when it is needed. Liquidity allows the government to make payments on time, avoid costly arrears, and in the best cases secure better terms from its vendors (e.g., early payment discounts).

3. **Lower transaction costs.** A TSA consists of a set of agreements between all users and usually requires collections to be deposited more promptly into the central account. It also allows central authorization of payments in a transparent manner, again without a delay that would allow the payment agent to hold cash. Banks tend to compete to participate, thus lowering the transaction costs (bank fees, etc.) and improving vendor relations. Using all the cash available to government allows the Treasury to pay less interest as well as pay smaller bank fees.

4. **Maximize returns on liquid assets.** The treasury can put idle balances to work, working with the banking sector to develop a portfolio of short- and medium-term interest-bearing investment vehicles that yield additional, secure revenues for the government.

In other words, a TSA allows the treasury to act as the government's banker—making the best use of available cash and ensuring its availability when needed, all while guaranteeing its safekeeping. Of course, the story becomes more complicated when one considers what is needed to accomplish these goals. Yet, most TSA efforts go awry when one or more of these goals is supplanted by some other imperative, or when one or more is omitted.

7.1.3 DIFFERENT TSA MODELS

Within the broad concept of a TSA, there are various approaches to centralizing cash management. The precise design will depend on several factors, such as the quality of the country's technological and banking infrastructure, and the nature of the control functions that are assigned to the treasury department, which is generally responsible for managing the TSA (see Box 15). The institutional arrangements can vary. In some countries, the TSA consists of only one central account, through which all payments are made. The treasury department controls all transactions and makes payments on behalf of spending agencies, supported by justifying documentation. In others, the treasury department may set cash limits but spending agencies have the power to transact payments directly, though still through the central TSA. Others still focus purely on the centralization of cash balances. Spending units may hold individual accounts either at the central bank or with authorized commercial banks, into which money is transferred as specific approved payments are scheduled. These accounts are then automatically swept, and the government's cash position consolidated, at the end of each day. Of course, donors and the international financial institutions often urge developing countries to restrict their banking arrangements to the central bank, in part out of concern for security, and in part because of the crucial link with macro-fiscal policy.[36]

Box 15. Modernizing treasury management

The main role of the modern treasury function is to ensure both efficient implementation of the budget and sound management of financial resources. For efficient budget implementation, the treasury must ensure that claims are paid according to contract terms and that revenues are collected on time. It cannot choose among bills waiting to be paid or schedule payments according to when cash receipts come in. The treasury must ensure that transaction costs are minimized, that borrowing is at the lowest available interest rate, or that additional cash is generated by investing excess cash balances in revenue-yielding instruments. In other words, modern treasury management is about having the right amount of money in the right place in time to meet the government's obligations in the most cost-effective way.

In support of these objectives, the modern treasury undertakes a variety of activities. It plans cash flows for the year, updating to more detailed levels as the year goes on. It concentrates cash deposits, pools resources, calendars payments and manages risk. It handles banking relationships, identifying the most optimal banking arrangements and determining which kinds of services to contract out under what conditions. In some countries with more advanced treasury operations, the treasury function will also oversee various investment and borrowing plans, including issuance of short-term treasury notes. In the most sophisticated systems, state-of-the-art cash management will include daily executive reporting on the cash position, flow reports, variance analyses, and forecasting updates. Each of these treasury functions requires developing a policy, including limitations and exceptions, developing regulations, and developing operational procedures, forms and instructions, not to mention building staff capacity to cope with their complexities.

Whatever the precise model, there are clear advantages to moving from streamlining cash management through the creation of a TSA. To underscore this point, Figure 2 illustrates schematically the difference in collection, interest earning and payment arrangements between Montenegro before its modern treasury system was constructed (Case 1), and Peru, which created its TSA in 2003 (Case 2).

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[36] The main concern being that commercial banks have fewer incentives to manage the government's cash well. Bad cash management will lead to increased debt, which if left unchecked may ultimately threaten macro-fiscal balances.

Prior to the Montenegrin reform, all inflows flowed directly into the central payment bureau (the "ZOP"), which first collected its processing fee and then informed the MOF of available balances at the end of the day. There was no explicit requirement that ZOP transfer the money within a certain timeframe, nor was there a complete accounting in real time of the sources of the payments. In other words, the MOF never really knew the government's true cash position.

Payments were shrouded in similar obscurity. The MOF had no effective control over cash balances, no authority to sweep idle balances or make interest-bearing deposits. Indeed, the MOF's role in the cash management system amounted to little more than that of the 'bagman', moving money from the various collection accounts to the bank accounts of individual spending agencies. There was not telling how much time might elapse between the release of payments from the MOF and receipt by vendors. And, there was no record of when monies were actually paid out of the agency bank accounts to vendors until well after the budget year ended.

Contrast this scenario to that of Peru. In Peru, all collections—both national and sub-national—are credited to the centralized Treasury account within 1 working day of receipt, which is held at the Banco Central de Reserva del Perú (BCRP), the country's central bank. BCRP manages a set of highly secure, interest-earning investment accounts paying rates often far exceeding other banks. Investments are then made based on estimated need for cash (based on cash forecasts and cash plans). For payments, spending agencies and sub-national governments alert Treasury of the need for a payment, upon which the Treasury reviews, verified and authorizes release of said amount from the BCRP TSA to the designated payment bank. The payment bank must issue payment to the vendor within one business day or return the money to BCRP. The new TSA has yielded numerous important benefits for the Peruvian Government:

- Spending units no longer held idle balances while others struggled to pay their bills;[37]
- The need for debt financing decreased, as did payment penalties to vendors;
- The consolidation of operational balances allowed for structured investment in revenue-yielding instruments, often at higher than market rates as both the size and the term of the deposits expanded. Indeed, interest earnings more than tripled after the launch of Peru's TSA;
- The Government ceased to pay interest on short-term borrowing as the concentration of cash eliminated that need; and
- The MOF benefited from more complete and timely information about its cash position, facilitating liquidity planning and providing early warnings of deviations from cash forecasts or expenditure plans.[38]

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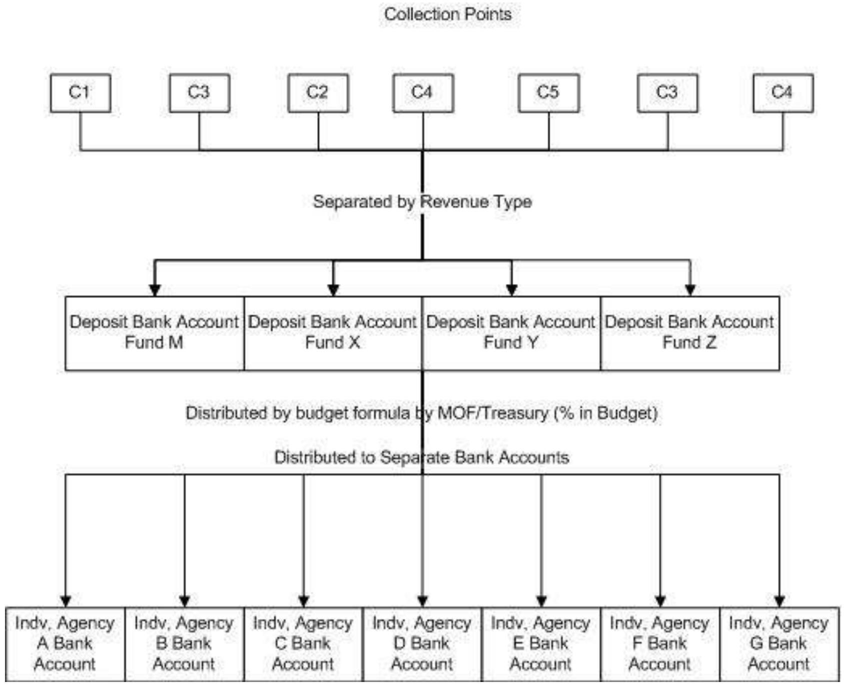
[37] The costs of keeping separate spending unit bank accounts were both direct and indirect. The bank accounts themselves substituted for accounting structures in treasury. Therefore, each project and office had individual accounts, each paying a fee to a bank for its existence. Lower interest rates were paid to accountholders on idle balances, in contrast to the premium rates offered to large depositors. Some government entities paid short-term borrowing fees or bank penalties while other balances sat idle. Spending units often faced difficulties paying vendor invoices, not to mention penalties. The government would then face stiff cost increases, as vendors would build a premium into their prices for the risk of repeat default.

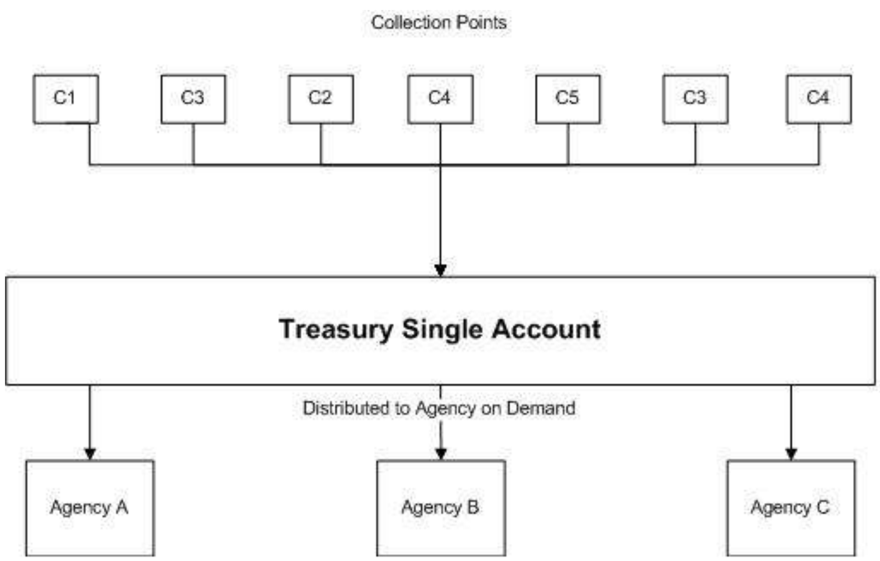
[38] When introducing new taxes, for instance, this is especially important to test the forecast and understand whether a surplus or a deficit is likely. During turbulent times, as during the final quarter of 2008, the daily cash balance reports allowed Peru's MOF to continue prudent spending, taking economic changes into account while avoiding a deficit.

Figure 2. Contrasting payment systems: Montenegro vs. Peru

Case 1. Pre-reform Montenegro: Tyranny of the 'ZOP'



Case 2. Peru – Centralized cash management via TSA



For the sake of further comparison, we can also consider the case of Bolivia, which illustrates what can happen when one of the four core objectives of a good TSA is omitted. Inflows and outflows operate in much the same way as they do in Peru, except that the government contracts out all collections and payments to a handful of commercial banks, as opposed to using the central bank for this purpose. The other main difference between Peru and Bolivia is with respect to the investing cash balances: in Bolivia, banks are prohibited by law from paying interest to the government. While there are no cash shortfalls, the government has no opportunities to earn interest on its holdings—missing out on a prime opportunity to strengthen its liquidity.[39]

7.1.4 MANAGING THE TRANSITION TO A TSA

The design and implementation of a TSA involves various stakeholders and requires considerable education and negotiation among them. Central banks are not always willing to cede their central role in cash management to the treasury. Real efforts need be made to assure liquidity planning remains the province of the central bank. Similarly, efforts to convert informal relationships with commercial banks into formal ones, established through competitive processes, often encounter resistance, particularly from those who stand to benefit more from the opacity of the traditional arrangements. Spending units and sub-national governments that are accustomed to decentralized cash management practices can also see a TSA as a 'money grab' by the treasury unless good operating conventions are brokered.

In summary, a TSA is an excellent tool for modern treasury management, allowing government to manage its finances far more efficiently and securely. However, a TSA alone cannot solve all the government's budget execution problems. On the contrary, there are many other elements that are essential to sound budget management and to managing the three main dimension of government financial risk—that funds are not used for the intended purposes; do not achieve value for money; and/or are not properly accounted for. With or without a TSA, a modern treasury must have established systems and procedures for managing these financial risks. It must define acceptable risk, and set parameters and rules with limits and measures. It must build controls into its procedures and operations and issue reports at various levels: daily executive snapshots that acquaint the highest officials with the daily cash position; weekly, monthly, quarterly and annual reports on cash flow; payment records; banking arrangements, etc. It must provide analysis that includes explanations of variances, recommendations for forecasting improvements, and other technical concerns. Strengthening a government's capacity to handle these various treasury responsibilities can easily for a project of its own, but it best considered as part of an integrated approach to modernizing treasury management that includes a well-designed TSA.

7.2 INTEGRATED FINANCIAL MANAGEMENT INFORMATION SYSTEMS

In recent years, integrated financial management information systems have formed a core component of public financial management reforms in many developing, transition and even post-conflict

[39] In Bolivia, the collection and banking arrangements are opaque at best. The contracted banks are allowed to delay the payment of pensions (usually made in cash as few individuals hold bank accounts that can be instantly credited) up to 10 days when it is difficult to distribute payments in outlying areas. The banks charge no fees for these transactions and yet they vie fiercely for the contracts to collect and distribute money. Without clear terms defining the costs of these banking relationships, there is little incentive for the Treasury to adjust its processes and procedures to strengthen controls or generate greater efficiencies.

countries. Box 16 provides a brief overview of the core features and functionality of government IFMIS systems.

Box 16. Understanding IFMIS

An IFMIS is an information system that tracks financial events and summarizes financial information. In the private sector, such systems provide critical support for management and budgetary decisions, fiduciary responsibilities, and the preparation of financial reports and statements.

In the government realm, IFMIS systems must be designed to support distinctly public sector functions. They must be able to handle and communicate all the financial movements for the complex structure of budget organizations. Moreover, they must be designed to ensure compliance with budget laws and public finance rules and restrictions. *Integration* is critical to the operation of an IFMIS. Integration, using a common "data warehouse", ensures that every unit and every user adhere to common standards, rules, and procedures and helps safeguard against unauthorized or imprudent uses of budget funds. Integration also enables real-time reconciliation with bank accounts, allowing the government to manage its cash more efficiently while leaving a complete audit trail. Indeed, the potential information benefits can be tremendous. Users anywhere within the IFMIS network are able to access the system and extract the specific information they need, in the reporting format required, at any given time. A variety of reports can be generated to address different budgeting, funding, treasury, cash flow, accounting, audit, and day-to-day management concerns.

The scope and functionality of an IFMIS can vary, from basic General Ledger accounting application to a comprehensive system covering budgeting, accounts receivable and payable, cash management, commitment control, debt, assets and liability management, procurement and purchasing, revenue management, human resources management and payroll. "Soup-to-nuts" enterprise resource planning (ERP) solutions that integrate all of these functions into the IFMIS system architecture have become the standard for large commercial organizations, but full integration is rare in the government realm. In many cases, where other "legacy" systems already exist but operate on separate "platforms", a minimum is for all of these systems and their databases to be able to interface with the IFMIS.

The scale of the IFMIS will also vary depending on whether its operation is limited to selected central-level institutions, such as the finance ministry and treasury, or is implemented more broadly, to include line ministries, their spending agencies, and even regional and local governments and municipalities. These variations will have implications far beyond the cost of hardware and software installation.

Source: Rodin-Brown (2008).

Many new IFMIS systems have come in response to pressures for improved fiscal management and reporting. As budgeting and PFM practices become more systematized and sophisticated, governments find they need more and more readily available information to support a variety of objectives, including:

- improving policy formulation and implementation;
- increasing transparency and accountability; and
- enhancing performance in the provision of goods and services.

Indeed, information systems are not just tools for strengthening financial control over public funds. In addition, measures to link funding to performance, to link spending to achievement of policy priorities, and to cast budget planning and preparation in a medium-term framework all demand timely and comprehensive data that can be reliably manipulated to track progress and inform decisions. It is inevitable, therefore, that governments have increasingly sought computerized financial management information systems to help satisfy the increasing demands triggered broader public finance and governance reforms.

7.2.1 THE POTENTIAL, AND POTENTIAL PITFALLS

An IFMIS can improve public sector governance by providing real-time financial information that financial and other managers can use to formulate budgets, control spending, manage resources, and administer programs. Sound IFMIS systems not only help governments gain effective control over public finances, but also enhance transparency and accountability, reducing political discretion in budget management and serving as a deterrent to corruption and fraud.

Unfortunately, for many developing countries, IFMISs have not met the high expectations that seem to have been attached to them. There are many studies and dozens of cautionary tales of automation efforts gone awry. For instance, an oft-cited 2003 review of 34 IFMIS projects supported by the World Bank over nearly two decades estimated that only 6 percent of the systems (2 out of 34) were likely to be sustained after donor support ceased.[40] Donors and international organizations are responsible, at least in part, for perpetuating the belief that automation, in particular the installation of an IFMIS, can solve the financial management problems of countries with weak PFM capacity. IFMIS proponents often overlook or underestimate the obstacles to IFMIS implementation. In fact, the road to implementing successful, *sustainable* IFMIS systems in developing countries is paved with difficulties: among others, bureaucratic resistance; lack of top-level commitment; weak human capital; poor ICT infrastructure; and, in the case of conflict-ravaged countries, the instability and violence that impair any efficient long-term work. A lack of attention to sequencing, to the presence of "legacy" systems, and to scaling systems to meet current capacities and needs, further compound the difficulties of IFMIS implementation. Combine these factors with the cost, the capacity and the discipline required to manage and maintain sophisticated information systems, and it becomes clear why IFMISs often fail to deliver and ultimately fall into disrepair.

Box 17. Kosovo: Restoring financial control after conflict

Reconstruction places immediate demands on post-conflict governments to distribute and account for massive amounts of resources, many of them flowing in from international donors. Getting control over the expenditure process is the highest priority in such situations. In post-conflict Kosovo, the transitional administration started with a basic, MS Excel expenditure tracking system. This allowed authorities to get an immediate handle on government spending and donor disbursements, providing a temporary solution while donor-funded technical assistance teams worked on the system architecture for a more robust financial management system. The new IFMIS, with basic accounting and reporting functionality, was in place in the treasury in just 26 days. The system has been expanding in scope and scale ever since. Today, it covers a wide range of sophisticated functions and operates government-wide. All 80+ Kosovo budget organizations, including some 30 municipalities, are connected to the system, with close to 1,000 active users.

On a positive note, we have learned valuable lessons from experience and these lessons, if heeded, can increase chances for success. Without a thorough understanding of what an IFMIS is meant to contribute, which organizations and processes will be affected, and who will benefit, there is little

[40] See Dorotinsky and Cho (2003).

chance of success. Yet, there are no mysteries, and success has been achieved even in the most challenging of environments (for example, see Box 17). If the concepts are clearly defined, and responses properly tailored, implementers will be able to assess and plan for the relevant costs and risks.

7.2.2 THE IMPORTANCE OF THE CONCEPTUAL DESIGN

One of the many reasons for IFMIS 'failure' is the lack of appreciation that the implementation of such systems is a complex and lengthy process that demands sustained commitment of financial and human resources. Reflecting this tendency to underestimate the complexities, in some cases little effort is made to adequately define the scope, objectives, and coverage of such information systems prior to proceeding with implementation. The pressure to have something in place as soon as possible has sometimes led to a precipitous rush into development and implementation of sophisticated IT solutions, without first understanding the environment, articulating a clear vision of the system, and identifying the overall framework it is intended to support.

Box 18. Planning well for TSAs and IFMISs

Neither a TSA nor an IFMIS is a "silver bullet":

- Neither can exist in the absence of a well-developed, properly understood classification system that has been expanded into a valid chart of accounts.
- Neither can function without a clear legal framework defining roles, responsibilities, and requisite reports.
- Neither can work effectively without undertaking the process change needed to address previous weaknesses in operational rules, relationships and procedures.
- Neither will be effective nor sustainable without clear provisions for external audit.

Yet at the same time, ongoing reforms of other aspects of the budget system need not stall implementation of a TSA or an IFMIS. For instance, both can operate and add value even in a system that does not yet link funding to performance. The sheer value they add in increasing transparency, accountability, and spending efficiency is justification enough for introducing them as and when ready. For many developing countries, the initial goal should be to establish simple information systems and payment arrangements that address the basic accounting, reporting and financial control needs of the treasury. Once operating effectively, and once sufficient capacity exists to increase sophistication and functionality, the government can gradually upgrade or expand these systems as resources and conditions permit.

Conversely, those IFMIS projects that have been successfully implemented and sustained most often started with the articulation of a clear view or model, referred to here as a *conceptual design*.[41] Khan and Pessoa (2009) defines the conceptual design as a detailed specification of the objectives, scope, and coverage of an IFMIS along with an overview of the PFM framework, user requirements, and key business processes that the system is intended to support. A well-developed conceptual design is an effective tool for clarifying and reaching agreement on fundamental issues that define the ultimate

[41] See Khan and Pessoa (2009) for a nice discussion of the importance of conceptual design to the successful implementation of IFMIS efforts.

'look' of an IFMIS and guide the work of the IFMIS implementation team in reaching that vision.[42] It also greatly reduces the need for costly modifications once implementation begins.[43]

7.2.3 KEYS TO IFMIS SUCCESS

Building on the discussion above, following are several recommendations for donors and international organizations to consider when designing or supporting the design of an IFMIS project, particularly in a developing country context. These pointers build on Rodin-Brown (2008), which provides an excellent overview of the issues to consider and steps to take when designing and structuring IFMIS reform efforts.[44] Of course, there are few hard and firm rules. Requirements and choices vary depending on the country, and flexibility, understanding and patience are essential.

- **Get the facts.** Designers should conduct a careful assessment of the current environment, including the political and power dynamics, fiscal priorities, the state of budget accounts, ICT infrastructure, and human capital. This analysis should lead to clear recommendations on what is needed, the scope of activities, and estimated costs. It should also point up training needs and likely implementation challenges.

- **Establish clear objectives.** Whether the objective is to improve the quality and integrity of financial information, improve the efficiency of budget execution, or something else, a well-developed conceptual design, supported by top-level decision makers, should clearly lay out what stakeholders want to achieve. A clear mission statement will help control the project direction, participant expectations and, ultimately, project costs. Support from high-level champions, especially the finance minister, will shield the project from forces of resistance and ensure local ownership of the reform.

- **Create a roadmap.** The roadmap should cover immediate, medium- and long-term IFMIS tasks and objectives. It should clearly define parameters including the system objective and scope; expected impact and benefits; critical milestones and success factors; project implementation methodology; risk assessment/mitigation strategy; estimated costs; and the financing arrangements. Agreement on these and other concerns should lead to a written commitment from the cooperating government and corresponding commitments from donor institutions.

- **Manage the change.** Change management is one of the most critical, but also one of the most neglected, aspects of IFMIS reforms. Resistance will come from all angles: vested interests who benefit from existing arrangements; civil servants who see new systems as a threat to their jobs; and, people who resist change simply for fear of the unknown. Any reform that ignores these forces tempts failure. As soon as an IFMIS project is conceived, a change management strategy should be developed, taking into consideration the change

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[42] Importantly, the conceptual design is very different from the engineering design, which specifies the architectural, technological and programming details required to implement the system that has been conceived. This point is critical, as it underscores the importance of completing a comprehensive conceptual design before choosing the IT solution, whether it be a bespoke system developed locally or one purchased commercially-off-the-shelf (COTS).

[43] Some studies indicate that changing the scope and requirements of automation during the course of implementation can multiply the system costs as much as ten times compared to original estimates.

[44] See: http://www.fiscalreform.net/index.php?option=com_content&task=view&id=19&Itemid=41 for Rodin-Brown (2008), as well as a brief note based on the same.

implications for diverse stakeholders, from politicians and senior officials to department heads, civil servants and the IT personnel who will support the new systems. Overcoming resistance will happen through clear communication, education, and training, as well as through "quick wins" that demonstrate the benefits of the change.

- **Integrate training.** Like change management, training should begin as early as possible, especially for treasury staff and IT personnel who will be affected most immediately by the IFMIS reform. A broader, permanent training program with curricula tailored to different types of system users (e.g., budget, financial, and program staff) should be developed, implemented, and provide the resources to ensure sustainability.

- **Cultivate and utilize local talent.** Whether the country elects to build its own 'bespoke' system or purchase an 'off-the-shelf' solution available commercially, attention should be paid to transferring knowledge and capacity to local team members and counterparts, who should assume increasing responsibilities for delivering project results. This will not only contribute to in-country capacity, but also will strengthen local ownership of the system.

- **Establish project oversight.** A regular Steering Committee (SC), headed by a high-level figure, such as the finance minister, should be formed to oversee the IFMIS reform, review project progress, address risks and ensure that stakeholders' needs continue to be met by the system as it develops.

- **Shop around.** Selecting the right tools, equipment and technology requires a good deal of shopping around. It is very costly to procure a new system, only to discover later that the recurrent costs are too prohibitive, the structure is too rigid, or the system is otherwise incompatible with the government's needs. Survey the marketplace, evaluate the different options, and identify the solution that best suits system and user requirements.

- **Test the system.** Resist pressure to roll out the system before it is ready. This means pre-testing the working model with real data—proving the functioning of the Chart of Accounts,[45] the software and integration processes, recording real transactions, and producing real reports. Running the new and old systems in parallel during the test period will allow implementers to resolve hidden problems and make adjustments before 'switching off' old systems in favor of the new.

- **Phase implementation.** IFMIS implementation requires patience. The full project life cycle—from definition of objectives, to system specifications, to system procurement, configuration, testing, pilot installation and rollout—can take years to complete. Phasing IFMIS implementation, by separating the reform into manageable pieces, will allow for "quick wins" that help sustain or renew commitment from the government and donors alike. As each phase is completed, stakeholders can carefully assess project progress and make adjustments as needed.

- **Set modest, achievable goals.** For many developing countries, the capacity is often too weak, and the need often too urgent, to aim for a complex IFMIS right off the bat. The initial goal should be to establish simple information systems that address the basic accounting and reporting needs of the treasury. (The example of Kosovo, presented briefly in Box 17 above, illustrates this approach well.) Once operating effectively, the government can gradually expand the system as resources and conditions permit.

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[45] Indeed, a comprehensive and properly designed COA is an essential precursor to an IFMIS.

It should come as no surprise, given the common focus on combining *automation* with *process change*, that the majority of these recommendations apply equally to the case of a TSA implementation, which may and often does happen in parallel with the introduction of an IFMIS.

8. CONCLUSIONS

The core premise of this paper is that, while the reform of budget systems is a slow and challenging process, meaningful reforms *are* possible provided that they are well designed, tailored and scaled to country conditions, and backed by strong and sustained commitment, both from key country stakeholders and from their external development partners.

There are no guarantees of success, and to be sure, the precise recipe for success will vary from country to country. Nevertheless, following are several lessons that emanate from a review of the experience with budget reform in developing and transition countries. Donors and would-be reformers are encouraged to heed these lessons before embarking on costly and potentially disruptive reform efforts:

Budget system reform has to solve a problem perceived as crucial by the country. Political and government leaders must consider the risks (or the reward) significant enough to spend the political capital and invest in the resources required to bring about change. The more the change aims at curbing or minimizing opportunities for rent-seeking, corruption, and fraud, the more likely resistance. Even changes that reorder communications, approval processes, or replace individual discretion with formal rules tend to cause discomfort, especially among those who have benefited most from the status quo. The Liberia case provides an excellent example of what can be accomplished when top-level commitment to reform is present. In a matter of just a few years' time, the Liberian Government has risen from African 'poster child' for corruption and mismanagement, to one of the region's most promising reformers, thanks in large measure to a dynamic new political regime.

Countries with weak PFM capacity countries should focus on their basic needs first. Such fundamentals are likely to include putting in place a reliable basic classification, accounting, and financial reporting system supplemented by simple but efficient cash and commitment controls, and a clear assignment of responsibilities in budgeting as prerequisites for more advanced reforms. Indeed, more sophisticated reforms such as performance budgeting, MTEFs, and IFMIS implementation are virtually unthinkable if the basics are not yet 'right.' Reformers in Montenegro recognized the importance of the basics, focusing first on establishing the core classification structures it needed to get a handle on public sector spending, before taking steps to dismantle an entrenched payments system that had dominated the economic landscape in the republic for the good part of a century.

Reformers should adopt simpler strategies that target a few key areas of the budget system at a time. Seasoned practitioners have concluded that 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 practitioners, users, and other stakeholders time to learn and gain confidence in the new systems and practices. Montenegro's experience with introducing program budgeting provides an illustration of precisely this point. It was only after spending units had had time to familiarize with new classifications and budget preparation guidelines, that the Government began to experiment with program budgets. The approach was pragmatic: key program and finance staff from central budget unit first worked with a small set of pilot agencies to define programs and allocate funding based on them. These 'demonstration' projects set the stage for a government-wide roll out of program budgets in subsequent budget cycles.

Reforms designed to improve prioritization and enhance results 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. Of course, neither MTEFs nor performance budgets can substitute for the basic budget infrastructure needed to ensure macro-fiscal stability and budget credibility.

IT 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.

Box 19. Signs of budget reform success

Reflecting on decades of reform experience in a diverse array of developing and transition countries provides some interesting observations about what defined budget reform success. Here are some signals on which there is general agreement:

1. A legal framework that provides stability and predictability in assigning roles and responsibilities.
2. A chart of accounts that meets globally accepted standards, is understood by the users in the country, and is used by all public entities covered by the budget.
3. A publicly available budget, preferably including both the President’s proposal as well as the budget law.
4. A timely, publicly available final account that is subject to annual audit.
5. A legislative adoption process characterize by informed review and lively debate.
6. Public presentations of budget details, preferably with channels for meaningful participation.
7. Continuously improving budget coverage with the ultimate goal of incorporating all public funds and presenting a full picture of public finances.
8. Budget execution that conforms to a large extent with the budget as passed into law.
9. Public expenditure that is comprehensively accounted for and subject to rigorous internal controls.
10. Budget monitoring and evaluation that assesses both financial execution and program performance.
11. A system of internal audit that aims at transparent and equitable budget execution and sound budget management.
12. Public participation through websites, public hearings, ‘Citizen’s Guide to the Budget’ presentations, *Presupuesto Participativo*, etc.
13. Regular opportunities to turn budget units into learning organizations and centers of excellence.

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ANNEX I. ADDITIONAL RESOURCES

In addition to the articles mentioned directly in the text and footnoted, there are several sources that provide excellent general and specific guidance on reforming to achieve good budget practice. They fall into several categories:

- Books that have become so widely used, they are considered practitioner handbooks or manuals;
- Websites that offer information in multiple forms, usually with very good search capacity built in;
- Journals of organizations focusing on particular portions of public financial management;
- Articles or essays of particularly practical use;
- PowerPoint presentations, of which a small selection of excellent ones are noted below;
- Blogs – one of the newest forums for delivery of opinions and experience, and a forum that facilitates exchange of ideas within a community of practice;

Widely respected books & manuals

Schiavo-Campo, S. and D. Tommasi, *Managing Government Expenditure*, Asian Development Bank, 1999. See www.abd.org/documents/manual/govt expenditure.

Potter and Diamond, *Guidelines for Public Expenditure*, Washington, DC: IMF, 1999.

Forsythe, Dale, *Memos To The Governor –Role of Finance Director*, Washington, DC: NGA, 2004.

GFOA, *Recommended Budget Practices*, GFOA, Chicago, 1998

Vinod, Thos., ed., *Quality of Growth*, World Bank, Washington, DC, 2000

Bartle, John, ed., *Evolving Theories of Public Budgeting*, JIA, Volume 3, 2003

Robinson, Marc, ed., *Performance Budgeting- Linking Funding and Results,* IMF, Palgrave, 2007

Websites – and what they offer

www.fiscalreform.net – A website created by USAID which makes available papers on specific aspects of fiscal reforms, along with shorter Best Practice Notes that are easily absorbed and distributed. Free and easily searchable site.

www.imf.org – The International Monetary Fund website offers articles, reports, data and statistics by subject, author and country. In addition, there is a specific site for IMF-published books (www.ELibrary.imf.org) and a blog focused on current thinking on Public Financial Management issues, at www.blog-pfm.org. The IMF also offers two series of papers authored by its experts: ‘Working Papers’ (several of which are referenced in this paper) and ‘Occasional Papers’ (one of which is referenced).

www.worldbank.org – The World Bank website is organized similarly for the user to that of the IMF. It can be searched by subject, author or country. There are broadcast newsletters for various subjects, often pertaining to good PFM practice.

www.oecd.org – Like the IMF and World Bank sites, the OECD site can be searched by author, subject and country. Its studies are not confined solely to OECD members, although that is their focus. Their journal, the OECD Budget Journal, contains articles of interest, one of which is referenced in this paper.

www.abd.org – The Asian Development Bank also maintains a website at which many of their research materials are made available by author, country and subject.

www.afdb.org – Here, many of the African Development Bank's research materials are made available by author, country and subject.

www.iadb.org – Here, the Inter-American Development Bank's research and other materials are available by author, country and subject.

www.aspanet.org – The official site of the American Society of Public Administration, featuring a wealth of literature produced by noted public administrators.

www.aabpa.org – This is the website of the American Association for Budget And Planning Analysts and provides access to practitioners' views on various PFM issues. It also provides access to a set of publicly available training materials.

www.abfm.org – This site provides access to the journal of the Association for Budgeting and Financial Management, edited by Gerald Miller, former budget director for various U.S. state governments and former head of the National Association of Budget Officers (NASBO). See, for example, www.uic.edu/cuppa/pa/academics/ABFM database/index.html.

www.internationalbudget.org – The International Budget Partnership is a non-governmental organization that encourages good budget practices, especially through the inclusion of local NGOs in the budget dialogue. IBP works toward open budgets and increased transparency and publishes an index each year ranking countries by the degree of openness in their budget processes and practices, available at www.openbudgetindex.org.

www.pefa.org – PEFA provides a framework for assessing and evaluating countries' budget and broader PFM processes, using published standards and uniform methodologies. The program is organized and sponsored by a consortium including the World Bank, EU, DFID, Swiss and Norwegian governments, and the IMF. PEFA helps creates a baseline measurement of the effectiveness of budget processes, and then assists governments in updating the survey if and as requested. The website contains information about the performance evaluation framework as well as information about countries that choose to make their results public.

Journals

Finance and Development, Journal of the IMF

Journal on Budgeting, OECD

Policy Sciences Journal, OECD

Public Finance PRC, ABD

Articles of Particular Note and Relevance

Diamond, Jack, *Performance Budgeting: Managing the Reform Process*, IMF WP/03/33

Diamond, Jack, *Budgeting Reform in Emerging Economies*, IMF OP/06/245
Dorotinsky & Junghun Cho, *World Bank Experience with FMIS Projects*, World Bank, Washington, 2003 draft

OECD Conference Presentations, *Models of Public Budgeting and Accounting Reform*, Journal on Budgeting, Vol 2, Supplement 1

Potter & Diamond, *Building Modern Treasury Systems*, Finance and Development Journal, Vol 37, #3

Schick, Allen, *Analytic Tools vs. Decision Rules for Policy*, blog-pfm.org, IMF, Washington 2007

Schick, Allen, *Incremental Budgeting in a Decremental Age*, blog-pfm.org, IMF, Washington 2008

Schick, Allen, *Why Efforts to Integrate Planning & Budget Usually Fail*, IPAA Lecture, Australia, 2007

Shadwick, Michael, *Budget Classification: Concepts and Issues*, Public Finance PRC 21 ABD 2008

Useful PowerPoint Presentations, by subject and web address

Position Control – http://iienet2.org/shs/details.aspx?isd=19052

IFMIS – http://www.rpcdata.com/IFMIS

Treasury Single Account –
http://www.euchinawto.org/index.php?option=com_docman&task=doc_download&gid=203