Public Financial Management (PFMx)
Module 14

PFM Reform Planning

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PFM Reform Strategy

PFM
- Enact laws and regulations
- Design business processes
- Hire staff with requisite skills
- Purchase IT systems

Reform
- Improve PFM performance

Strategy
- Framework or overall plan
- Single year or multi-year
Definition of Institutions

“Humanly designed constraints that structure economic and social interaction” - Douglas North

Institutions

Formal
- Laws
- IT Systems
- Business processes

Informal
- Customs and traditions
- Sanctions and taboos
- Code of conduct
Importance of Informal Institutions

Institutions

Formal
- Laws
- IT Systems
- Business processes

Informal
- Customs and traditions
- Sanctions and taboos
- Code of conduct
Institutional “Iceberg”

- 10% formal rules (laws and regulations)
- 90% informal rules (how officials actually behave)
High Cost and Length of Implementation

- Undertake a diagnostic assessment
- Develop the legal framework
- Design and develop a reform strategy
- Development of guidelines
- Implementation
Deficiencies of PFM Environment in Developing Countries

- **Governance**
  - Weak rule of law
  - Lack of strategy

- **Capacity**
  - Lack of trained economists and accountants
  - Weak IT systems and experts

- **Technical Assistance**
  - Unpredictable external assistance
  - Low absorption and over dependence
Schick’s “Basics First” Approach

Basic Functions → PFM → Advanced Functions

= Precondition
Examples of Schick’s Approach

Cash accounting

Control of Inputs

Annual budget

Accrual accounting

Performance budgeting

Medium-term budget framework
Gaps in Schick’s Approach

- No clear definition of “basic” PFM functions
- Poor guide to prioritizing and sequencing PFM reforms
PEFA Scores for Basic PFM Functions

<table>
<thead>
<tr>
<th>Function</th>
<th>EMC</th>
<th>LIC</th>
</tr>
</thead>
<tbody>
<tr>
<td>Aggregate expenditure outturn</td>
<td>3.0</td>
<td>2.5</td>
</tr>
<tr>
<td>Budget classification</td>
<td>3.2</td>
<td>2.6</td>
</tr>
<tr>
<td>Budget preparation process</td>
<td>3.1</td>
<td>2.8</td>
</tr>
<tr>
<td>Macroeconomic and fiscal forecasting</td>
<td>2.9</td>
<td>2.3</td>
</tr>
<tr>
<td>Internal controls</td>
<td>2.5</td>
<td>2.1</td>
</tr>
<tr>
<td>Annual financial reports</td>
<td>2.6</td>
<td>2.0</td>
</tr>
</tbody>
</table>
Platform Approach - Illustration

Platform 1: Legal framework, credible forecasts, reliable in-year reports

Platform 2: Medium-term fiscal planning, program budgeting

Platform 3: Accrual accounting, management of capital infrastructure
Illustrative Platform Approach - MTBF

Platform 1: Medium-term fiscal framework (MTFF)

Platform 2: Medium-term budget framework (MTBF)

Platform 3: Medium-term performance framework (MTPF)

Short-term perspective  Medium-term perspective  Long-term perspective
Three Reasons for Poor Performance of Platform Approach

- **Lack of prioritization**
  - Too many initiatives and activities

- **Reform fatigue**
  - Over-stretch regarding the number and magnitude of reforms

- **Incomplete reform agenda**
  - Too much focus on formal PFM rules
Lack of prioritization

Low priority reforms
- Selection insufficiently rigorous

High priority reforms

Reform fatigue

No complete reform agenda
PFM Reforms – Keys to Success

Successful PFM reforms

Gradual implementation

Supporters
- Effective leadership
- Active support

Opponents
- Persuasion
- Compensation

Stakeholders
Example of FMIS

81 FMIS projects implemented by the World Bank:

55 completed, of which

37 were less than satisfactory
Causes of FMIS Failure

Technical Challenges
- Flawed technical design
- Financing issues

Institutional Challenges
- Lack of ownership/champion
- Opposition from stakeholders
Implementation of TSA in Nigeria

Implementation of TSA

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Savings of 2 Percent of GDP

2010

Resistance
Central Bank
Large spending ministries

2016

Support
Accountant General
Minister of Finance
President/Cabinet
Four Stages of Implementation

<table>
<thead>
<tr>
<th>Stage</th>
<th>Action</th>
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</thead>
<tbody>
<tr>
<td>Central Bank</td>
<td>Consolidate the balance of all government accounts</td>
</tr>
<tr>
<td>Smaller ministries and agencies</td>
<td>Transfer accounts from commercial banks to Central Bank</td>
</tr>
<tr>
<td>Council of ministers</td>
<td>Persuade of huge potential benefits of TSA</td>
</tr>
<tr>
<td>President of Nigeria</td>
<td>Issues a directive requiring all federal government agencies to comply with TSA</td>
</tr>
</tbody>
</table>
Four Key Lessons from Nigeria Case Study – Lesson 1

Focus on key fiscal risks

Take account of informal rules and institutional constraints

PFM clear objectives

Customize the design of the PFM reform strategy
Four Key Lessons from Nigeria Case Study – Lesson 2

- Opponents
- Change management
- Local supporters
  - Influence and authority
Four Key Lessons from Nigeria Case Study – Lesson 3

Step-by-step approach to sequencing reform

- **Step 1**
  - Objective 1 (TSA)

- **Step 2**
  - Objective 2 (Budget credibility)

- **Step 3**
  - Objective 3 (State enterprises)
Four Key Lessons from Nigeria Case Study – Lesson 4

- Development partners
- Technical assistance
- Outreach
- Mediation
- Change management
- Sustainable relationship
Importance of “Strong” Central Finance Organization

Exercise effective control of public finances

Influence the prime minister or the president

Coordinate and communicate effectively

Develop first class skills and capabilities

“Strong” Central Finance Organization
Alternative Models of Organizing Finance Functions

- “Westminster” model
- Continental Europe model
- Lusophone model
- Scandinavian model
- Hybrid model
<table>
<thead>
<tr>
<th>Entities</th>
<th>Finance Functions</th>
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<tbody>
<tr>
<td>Central Bank</td>
<td>Regulation of commercial banks</td>
</tr>
<tr>
<td></td>
<td>Management of government’s bank accounts</td>
</tr>
<tr>
<td></td>
<td>Issuance of government debt instrument</td>
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<tr>
<td>Planning Ministry</td>
<td>Planning of development projects</td>
</tr>
<tr>
<td>Agencies independent of the finance ministry</td>
<td>Revenue collection</td>
</tr>
<tr>
<td></td>
<td>Public procurement</td>
</tr>
<tr>
<td></td>
<td>Debt management</td>
</tr>
<tr>
<td>Line ministries</td>
<td>Operational functions (e.g. payment processing, internal control)</td>
</tr>
<tr>
<td></td>
<td>Accounting and reporting of their expenses and revenues</td>
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</tbody>
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### Different forms of organization

<table>
<thead>
<tr>
<th>Traditional organization</th>
<th>Modern organization</th>
</tr>
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<tbody>
<tr>
<td>Informal rules dominant</td>
<td>Formal rules, flexibility applied</td>
</tr>
<tr>
<td>Vertical silos</td>
<td>Strong horizontal communication</td>
</tr>
<tr>
<td>Concentration of decision making in top management</td>
<td>Leaner and flatter organizational structure – Layer of professional managers</td>
</tr>
<tr>
<td>Concentration of operational functions in finance ministry</td>
<td>Devolution of operational finance functions to line ministries</td>
</tr>
</tbody>
</table>
Evolution of Modern Finance Ministries

- More open and communicative
- More transparent
- Horizontal communications
- Professional management
- Focus on policy rather than operations
1 | PFM reform planning is a complex and challenging process

2 | Aspects of the “platform approach” may be helpful in determining the priorities in a reform strategy

3 | Institutional aspects of PFM reforms are a relatively neglected but critically important area

4 | Central finance functions of government should be organized around modern management principles