The Challenge of Reforming Budgetary Institutions in Developing Countries

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I. Introduction

Reform of budgetary institutions[1] is a continuous and never-ending process. Interest in such reforms can be traced back for at least 2000 years. For example, Roman planners of the Claudian aqueducts considered eventual O&M costs in selecting alternative routes and designs. In more modern times, there is evidence of a stream of reforms from the "tally sticks" used to record the budget in seventeenth century England, to the latest techniques of fiscal rules, fiscal risk analysis, expenditure ceilings, medium-term fiscal frameworks, performance-related budgeting, accrual accounting and budgeting, and expenditure review. In Europe and the United States, a detailed history of the development of budget systems goes back for two hundred years or more. Yet the processes and determinants of this evolution, as societies move through varying stages of development, while critically important issues, are imperfectly understood.

> The issues addressed in this paper are as follows: first, what are the main factors that determine the development of budgetary institutions over time; second, what lessons can developing countries learn from the long experience of more advanced countries in reforming their budgetary institutions; and third, how can the international financial institutions (IFIs), especially the IMF and the World Bank, and other providers of financial and technical support, facilitate the process of reform in developing countries—what adjustments are required to the approaches and models they currently apply? These issues are complex, and the conclusions reached by the paper tentative, and to some degree subjective, and will be controversial and challenging to some readers. The paper identifies several areas where further research would be helpful.

The paper is structured as follows. Section II provides a conceptual framework for reforming budgetary institutions and an historical perspective; against this background, Section III outlines the challenges for developing countries in reforming their budgetary institutions; Section IV sets out a possible framework for such reform; and Section V provides some concluding remarks.

II. Historical Development of Budget Reforms

[1] Following North (1991), "institutions" can be defined as the laws, procedures and rules that determine and regulate the behavior of public officials and organizations.

It can be argued that the reform of budgetary institutions is closely related to the development of political and economic institutions as described by North, Wallis and Weingast (2006, 2008), drawing on the seminal work of North (1991). In this framework, societies pass through three essential stages—primitive societies, natural states (or "limited access orders") that are dominated by elites which have primary access to power and resources, and are vulnerable to violence and political conflict; and "open-access orders" that are characterized by competition in political and economic markets. North, Wallis and Weingast (NWW) conclude on the basis of extensive historical analysis that natural states tend to perpetuate for very long periods of time, and that the transition from natural states to open-access societies is problematic, and depends on the adaptation of their institutions, organizations and behavior ("doorstep conditions"). Natural states exist on a continuum ranging from fragile states, characterized by political instability and violence, at one extreme, to mature natural states—such as emerging markets—that are close to satisfying the doorstep conditions. Even today, few countries outside Western Europe, North America and some former British colonies have evolved beyond this stage, and natural states comprise approximately 95 percent of countries.

The NWW thesis can be criticized for being over-simplistic and potentially misleading, especially in its assumption that progress is linear. Other writers on public choice and rent-seeking, while not embracing the full analysis of NWW have nevertheless accepted the crucial role played by institutions—and the "rules of the game"—in determining the opportunities for, and progress of reform in the public sector, including the budget area: see, for example, Schiavo-Campo (1994), Campos and Pradhan (1998) and Tanzi (2000).[2] This literature predicts, in general, that the development of political institutions is likely to precede the development of economic institutions which, in turn, precedes the development of budgetary institutions, though there likely to be exceptions to this thesis.[3] However, while the sequence is logical it need not be chronological but can proceed on separate tracks and in fits and starts.[4] In brief:

political institutions → economic institutions → budgetary institutions

[2] Tanzi (2000), for example, argues that in the real world—as opposed to the ideal world described in classic public finance literature in which the state plays a "normative" role—policymakers assign more weight to their own welfare and that of individuals close to them than to the general population; and that policies are often greatly influenced by small groups of people who in their privileged positions as relatives, close friends, or political associates, have easy access to top policymakers so that they are able to influence them. The power of these "keepers of the gate" can be extraordinary, and can distort policies in directions that are far removed from the ideal. Often such keepers of the gate influence not so much general policies as how these policies are carried out and who benefits from them, e.g., who is exempt from a tax or import duty.

[3] The Peoples Republic of China, for example, where liberalization of economic and, to a less extent, budgetary institutions has preceded political liberalization.

[4] Salvatore Schiavo-Campo gives the example of Nazi Germany in which the postal service continued to deliver mail for several months after the death of Hitler and the collapse of the regime's political institutions.

The budget is both a central institution of the state, and a key mechanism for determining the distribution of resources, and economic rents, to the elites that dominate natural states, and to the wider groups that dominate open-access societies. As such, the development of budgetary institutions is a key component of the evolution of countries from the natural state to pluralistic, open-access societies. Good fiscal outcomes (for example, aggregate fiscal discipline and an economically efficient allocation of budgetary resources to priority sectors and areas) depend upon having in place efficient and effective processes and procedures for preparing, executing and overseeing the budget.

Evidence for such a pattern in the evolution of budgetary institutions can be found in the history of the three countries—France, Britain and the United States—that is illustrated in Table 1. In all three countries, a similar evolution can be observed: first, a period during which basic systems of accounting, budgeting and financial reporting were established, according to a uniform set of standards and procedures. In France and the U.K., these basic requirements were laid down broadly in the first half of the 19th century, a period during which modern institutions of economic and political competition were also being established. There then followed a period of approximately one hundred years in which these institutions were refined and consolidated. For example, although most funds were appropriated by the parliaments in the British system of the mid-19th century, there was no single document reporting all government expenditures, no comparison between budgeted expenditures and actual expenditures, and different accounting mechanisms used by various departments and ministries. By the end of the 19th century, the framework for modern budgeting (unity, comprehensiveness and control) had emerged in Europe. In the U.S., a broadly similar development can be discerned, but extended over a somewhat longer period: the establishment of basic budgetary institutions in the course of the 19th century, with further developments and modifications in the first half of the 20th century (partly reflecting the periodic disputes between the President, the Treasury Department and the Congress over the control of the budget).

Table 1. Selected Dates in the Development of Budget Systems: France, U.K. and the U.S

France	U.K.	U.S. (federal)
1791: Accounting Office reporting to parliament 1807: Independent “Cour des comptes” 1814-1819: First Restoration – Baron Louis’ reforms 1862: Imperial decree on rules for budgeting and treasury single account -- 1959: Medium-term budget framework for investments 1968: “Rationalization des choix budgetaires” (RCB) 2001-06: Program budgeting From 2006: Accrual accounting 2008: Full medium-term expenditure framework	1787: Consolidated Fund established 1866: Exchequer and Audit Departments Act (established modern budgeting and accounting system) 1866: Comptroller and Auditor General established -- 1960s: Public Expenditure Survey (PES) and Program Assessment Review (PAR) 1980s: Next Steps Programme 1990s: Comprehensive multi-annual budgeting 1991: Citizen’s Charter 1998: Public Service Agreements 2000-04: Resource (accrual) budgeting	1776: Treasury Office of Accounts established 1809: Appropriations Act (modified in 1870 and 1874) 1887-89: Consolidated accounting, bookkeeping, reporting procedures (Cockrill Commission) 1894: “Dockery Act” established Comptroller of the Treasury; consolidated annual statement of revenues and expenditures 1921: Budgeting and Accounting Act established Bureau of the Budget and General Accounting Office 1940: Consolidation of uniform standards and procedures for accounting and reporting 1950: Accounting and Auditing Act -------------------------------------- 1990: Accrual accounting for all federal entities

Note: Measures that established the basic framework of accounting and budgeting are shown above the line; items shown below-the-line are subsequent (“new wave”) reforms.

The important point to emphasize in the context of this paper is that these reforms were taking place at a time when France, Britain the and U.S. were establishing the democratic and competitive economic and political institutions that mark the transition from a natural state to an open-access society. Most low-income countries and middle-income countries have not yet reached that point in their evolution, and arguably, do not have the economic and political conditions in place—they are still dominated by powerful elites and rent-seeking behavior—that permit such changes to take place.

The basic premise of this paper is that the development of a country's budgetary systems and procedures depends upon the evolution of its economic and political institutions.

A "new wave" of reforms since the 1980s

More recently, in the past 20 years or so, a "new wave" of institutional and budgetary reforms has swept developed countries. This trend was initiated in New Zealand, followed by other developed countries that are primarily in the Anglo-Saxon or Northern European tradition of public management. These countries include Australia, Canada, Denmark, France, the Netherlands, Sweden, the United Kingdom, and the United States. Many such reforms have been associated with demands from citizens for greater accountability of their political leaders, and increased access to budget information and processes. In the budgetary field, they have focused on areas such as the introduction of program and performance budgeting; medium-term fiscal frameworks; accrual accounting and budgeting; disclosure of fiscal risks; and strengthening external audit agencies, fiscal councils and other agencies that promote public accountability.

The literature suggests that the following lessons can be drawn from these recent episodes of budgetary reform in advanced economies.[5]

First, the reform process has invariably been supported and led at a high political level. In New Zealand, for example, the political leaders were successive finance ministers, with the consent of the cabinet of ministers, strongly supported by the Treasury—also a main driver of the reforms. In France, by contrast, the reforms were led by parliamentarians who demanded the restoration of budgetary powers over the adoption of the budget but were energetically taken up by the Ministry of Economy and National Finance.[6]

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[5] Relevant sources include Aucoin and Jarvis (2005), Chevauchez (2007), Schick (1996), Scott (2001), and Petrie and Webber (2001).

[6] Chevauchez (2007) notes that, prior to the LOLF, 35 proposals for budget law reform had been put forward by the members of parliament, whose limited role in the budget process had come to be characterized as "Liturgy, Litany, and Lethargy."

> Second, reform has tended to be initiated and driven by a specific political or fiscal impulse, though the circumstances have varied widely from country to country. In New Zealand, it was driven by the goal of liberalizing the economy, initially necessitated by an exchange rate and foreign reserve crisis. Changes in public administration and the budget process were part of a much broader set of reforms designed to improve overall economic performance, strengthen public finances, and reverse the well-known slippage of the New Zealand economy compared with other OECD countries. In the U.K., the reforms were strongly influenced by fiscal pressures (in the 1980s) and political goals to downsize the civil service and improve the efficiency of public services. A crucial ingredient of the reform was political opportunism and leadership—the seizing of the right moment and conditions to move ahead. This seems to have been equally as important as technical issues.

Third, the implementation period of the reforms, and their scope, has varied from country to country. In the U.K., for example, the reforms were mainly concentrated in the Thatcher period (1978-91). They may be characterized by a pragmatic, graduated, step-by-step approach, arranged around the organizing principle of the “financial management initiative”. Some important changes that were initiated as early as the 1960s (for example, the abandonment of indicative national planning and the introduction of medium-term fiscal framework) established a sound basis for subsequent reform. In addition to strengthening the institutions of budgeting and public finance, the reforms have extended into areas such as the organization and management of the civil service, the establishment of executive agencies (the “Next Steps” program), improving the quality of public services (the “Citizens’ Charter” initiative), and devolving responsibility for delivering services to spending ministries and agencies.

In France, the public management reforms in France were initiated in 2001 by a new budget law - *Loi Organique relative aux Lois de Finances* (LOLF) - which entered into force on January 1, 2006. The thrust of the changes—which included a strong emphasis on the decentralization of budgetary authority and management control from the Ministry of Economy, Finance, and Industry to spending agencies, and the introduction of budgeting by program and results—reflected many of the reforms introduced in countries such as Australia, New Zealand and the United Kingdom, but with Gallic differences.

Fourth, reforms have flourished mainly in countries with an Anglo-Saxon or Northern European system of government, where institutional factors are favorable, though the recent French experience suggests that this is not an immutable constraint. In the U.K., for example, the reform process was facilitated by the freedom granted through the constitution for the executive branch to make substantial changes in the civil service, the organization of ministries and departments, and the machinery of government without the need for either legislation or parliamentary approval; the generally bipartisan approach to reform; and the weakness of the public service unions. Local authorities and executive agencies were used as a testing ground for some of the reforms (for example, accrual accounting; output and

performance budgeting; and decentralizing management and pay structures to spending agencies).

Finally, lack of capacity may be a significant constraint on the implementation of reform (even for an advanced country) and not always foreseen. This may help explain why countries, in general, can manage only one substantial reform at a time. Denmark, for example, is introducing accrual budgeting, and has put all other reforms on hold. The introduction of performance-oriented management in Sweden in the early 1990s crowded out all other public sector reforms. Moreover, the timeframe set for such reforms needs to be realistic, and take account of unexpected developments. For example, in the U.K., the implementation of accrual (or "resource") accounting and budgeting took more than eight years to complete (1994-2002); the cost of new IT systems and the need to retrain accountants and financial managers was severely underestimated; and, recognizing the problems in implementing accrual budgeting in its pure form, the British authorities have reverted back in practice to a form of cash (or "near-cash") budgeting (Robinson 2008).

The "new wave" reforms in advanced countries have depended for their success on highly developed institutions and other enabling conditions. As explained in the following section, such reforms are generally not appropriate for developing countries.

III. The Challenges Facing Reformers in Developing Countries

In this section, we review a number of issues that are critical to the development of more efficient budgetary institutions in low- and middle-income countries. As noted above, reform in such countries—which comprise natural states—is likely to be constrained by the domination of elites that resist reform if it threatens their security. Such countries have not yet reached the point at which institutional reform took off in developed countries during the 19th century. For example, double-entry booking was introduced in the U.S. in 1907; one hundred years later, many low-income countries in Africa and elsewhere have not yet reached that stage of development. Such countries are characterized by rudimentary budgeting and systems and undeveloped public institutions; weak centers of government and cabinet systems that create problems of policy coordination and efficient planning; strong patronage systems in which heads of public agencies are filled by friends and followers of the president; and weak capacity in human resources and information systems. In addition, they have insufficient financial resources to spend on necessary technical systems and capacity building.

Finance ministers have an important potential role in coordinating and driving the reform process; indeed without their intervention and active leadership, reforms are unlikely to take place. Unfortunately, in most developing countries, finance ministers

do not enjoy the powerful status they have in the developed world.[7] Indeed, the national plan (or the PRSP) is often regarded as the preeminent policy document for planning the allocation of national resources, and for attracting donor financing. For this reason, the ministry of national economy and planning often has a more prominent role in state affairs than the ministry of finance, whose minister in extreme cases is regarded largely as the public bookkeeper and accountant-general rather than a key policymaker. The splitting of responsibility for the budget between capital investment projects (managed by the minister of economy) and recurrent expenditures (minister of finance)—another common practice in developing countries—not only fragments the budget process, but significantly weakens the role of the finance ministry as a potential leader of the reform process.

There are two categories of developing country, however, for which the prospects for successful reform of budgetary institutions may be greater. The first category is the group of emerging markets that are close to attaining the "doorstep conditions" described by NWW. By definition, such countries have an environment that is favorable to institutional reform, and many have made quite impressive strides in recent years in modernizing their budget systems, especially the countries of central and eastern Europe that have also benefited from the additional financial "carrot" of membership of the European Union. Other countries in this category include Brazil, Chile, Korea, Mexico, Morocco, South Africa and Turkey. The second category comprises post-conflict countries where institutional reform is likely to be less impeded by the existence of ruling elites, some of which may have been destroyed or severely weakened by the conflict itself (though, of course, new elites and rent-seeking behaviors may arise after the conflict), and where donors may exert especially powerful financial leverage. Such countries should also be viewed as a special case, in which there is a window of opportunity to build new and more efficient budgetary institutions, as evidenced in recent years by comparatively successful reforms in countries such as Afghanistan, East Timor, and Liberia. A useful review of the issues relating to the reform of budgetary institutions in postconflict countries is provided by Schiavo-Campo (2007).

Systematic long-term data are lacking to demonstrate the long time periods required for budgetary reforms to take root in developing countries, but relevant and suggestive experience is summarized in Gupta et. al. (2007), and in anecdotal evidence drawn from the rich experience of the IMF's technical assistance work in the field, especially in Africa. In

[7] There are, of course, exceptions to this general rule. Consider the case of Mozambique. The PFM reform program, which has centered around an IFMIS project (known as e-SISTAFE) introduced in 2002, has been comparatively successful, though the project has been both costly and relatively slow to deliver results. The authorities took especial care to set up sound arrangements that included a strong project management unit in the finance minister, headed by a staff at director-general level; a streamlined procurement process; a strong focus on capacity building; a highly active and supportive donor community; a common fund for donor finance; and a peer review process comprising external experts who make missions each year to the country to assess progress. Attempts to reform the civil service in Mozambique, however, have been less successful.

some cases, isolated progress has been made—for example, in implementing a concrete provision for which an IMF program condition has been attached—but this is quite rare. In general, the reform process has been frustratingly slow, even in narrow technical areas of the budget system.[8]

This thesis receives further support from a recent study by Kohnert (2008) which reviews the history of the United Nations as a pioneering provider of technical assistance to developing countries in the fiscal area (among others). In the 1950s and 1960s, the U.N. provided assistance on topics such as program and performance budgeting, tax reform, budget classification, accounting reform and treasury systems to many developing countries. It also acted as a standard setter in these fields, publishing manuals and running international conferences on topics such as budget classification, government finance statistics and accounting issues.[9] During the same period, the World Bank was also providing advice to developing countries on economic and fiscal issues in a series of more than twenty *Economic Development Reports*. The analysis and recommendations provided in some of these reports bear an uncanny resemblance to the advice being offered by the World Bank, IMF and bilateral donors to the same countries fifty years later.[10]

It is interesting to speculate on the areas of the budget system that are especially prone to rent-seeking behavior, and hence constrain attempts to implement reforms. These areas cover a substantial part of the budget process, such as control of the allocation of budgetary appropriations by sector; planning and management of government investment contracts, including procurement operations, through the top-slicing of lucrative government contracts; control of decisions relating to the planning and management of external aid; management and control of government bank accounts (and resistance to consolidating these into a treasury single account) and the management of cash disbursed through the budget; and management of the external audit process. Many of these areas have indeed proved difficult

[8] For example, in the Republic of Congo, the IMF has provided plentiful technical assistance on introducing a new budget classification since 2003 (including four missions by the IMF's Fiscal Affairs Department). This has also been included as a program condition. However, as of November 2008, the project remains incomplete.

[9] Kohnert (2008) refers to the following interesting examples: the U.N. developed and published an economic classification of the budget (1958), a functional classification (1962), a manual on performance and program budgeting (1962), and a manual on government accounting (1964). In 1963, it encouraged member countries to adopt a multiannual approach to budgeting, and provided training on taxation issues in cooperation with the Harvard Business School.

[10] The report for Libya, for example, recommends the adoption of a single comprehensive budget, including data on both recurrent and capital expenditures; an administrative, economic and functional classification of budgetary expenditures and revenues; strengthened financial control; control by the finance ministry of budget and civil service establishments; transparent budget documents and parliamentary debate; and independent external audit. See International Bank for Reconstruction and Development, 1960, *The Economic Development of Libya*, Report of a Mission Organized by the IBRD at the Request of the Government of Libya, Johns Hopkins Press, Baltimore. Many similar elements appear in the recommendations of an IMF Fiscal Affairs Department mission to Libya conducted in 2006.

to reform in developing countries. However, all areas of the budget process are likely to be affected to a varying degree.

Interestingly, the experience of technical assistance work carried out by the IMF's Fiscal Affairs Department and the World Bank suggests that reform of tax policy and tax collection has generally proved easier in developing countries than reform of processes associated with the expenditure side of the budget. For example, several low-income countries have made reasonably good progress in recent years in introducing VAT systems, unified tax and customs authorities, and large taxpayer offices.[11] There is a plausible explanation for this observation since tax reforms may increase the opportunities for rent-seeking behavior by creating new sources of revenue, and new and more efficient methods of collection. By contrast, reforms of the expenditure side of the budget generally do the reverse, by closing loopholes, introducing new controls, enhancing transparency and eliminating rent-seeking opportunities. More research is needed, however, to determine the nature and strength of these relationships.

In addition to the institutional constraints noted above, several factors have contributed to the slow pace of developing budgetary institutions in developing countries. These are described below.

> The first factor has been the strong—in some countries, dominating—influence that the IFIs, donors and their associated international consultants tend to exert on the reform process.[12] Donors frequently provide a substantial proportion of the funds required to finance such reforms, in addition to supplying technical assistance. This may lead to a dependency on donors and their consultants that inhibits the development of local capacity. The pervasive influence of donors may distort priorities for reform by channeling finance into elaborate projects such as computerized information systems that enable donors to disburse large loans or grants, but may not be an appropriate or timely initiative for the country concerned. In some countries, donors have sponsored excessively complex and ambitious programs

[11] Salvatore Schiavo-Campo has provided the author with the following interesting example, concerning Somalia in the period 1985-87. At the urging of the IMF, the authorities introduced stronger tax collection measures before expenditure controls had been strengthened. At the same time, a new register of buildings was introduced, and the number of registered building in the state capital, Mogadishu, increased by a factor of ten, leading to a surge in real estate tax collections. Fiscal revenues increased by one-third in one year. In the following year, however, government expenditures increased by 40 percent, mostly in "opaque" categories. This debacle was a major factor in the disintegration that followed.

[12] Recently, the Paris *Declaration on Aid Effectiveness* (2005) has put in place a set of benchmarks for donors to achieve within ten years on increasing the proportion of their aid that is placed "on budget". In principle, this policy could have a useful effect in stimulating budgetary reforms in aid-recipient countries. However, there is a principal-agent dilemma for the donors who are responsible to their shareholders (i.e., taxpayers) for ensuring that funds are subject to appropriate fiduciary safeguards. Progress in moving toward the Paris benchmarks has been very slow.

for modernizing budgetary institutions, and set unrealistic expectations about the speed of reform. This is in contrast to idealized models of PFM reform, such as the "strengthened approach" advocated by the Public Expenditure and Financial Accountability (PEFA) Program,[13] in which countries are assumed to take the lead in setting priorities for reform, with donors and IFIs playing a supporting role. Continued care is needed to ensure that the prescriptions of donors are actually relevant and appropriate to the needs of each particular country.

The practices of the IMF and the World Bank illustrate this tendency for the reform process to have a strong supply-driven influence. However, the perspective of the two institutions is different, even though PFM is designated as an area of shared responsibility between the two organizations. While the Fund approaches PFM reform from the viewpoint of short- to medium-term macroeconomic stabilization, the Bank's focus is on longer-term development objectives, promoting governance and anti-corruption reforms, as well as fiduciary issues—namely, issues related to the efficient design and management of the Bank's lending operations. These differing perspectives inevitably influence the reforms to which the Fund and Bank give greatest priority, and hence their views on the desired focus and sequencing of budgetary reforms. For example, the Bank gives emphasis to the development of national systems of accounting, reporting, internal control, audit and procurement that are sufficiently reliable to replace the Bank's traditional reliance on ring-fenced lending procedures.[14] Such systems also contribute to efforts to reduce corruption and strengthen governance in member countries. The Fund emphasizes reforms that strengthen the position of the finance ministry vis-à-vis other central government agencies (e.g., ministries of planning and development); strengthen fiscal transparency; reduce countries' exposure to fiscal risk; broaden the tax base and achieve efficient taxation of resource revenues; and improve revenue collection.[15]

[13] PEFA is a partnership comprising the World Bank, the IMF, the European Union and several bilateral donor organizations, established in 2002, with a mandate to establish a "strengthened approach" to the assessment and reform of budgetary systems in developing countries.

[14] The Poverty-Reduction and Economic Management (PREM) network of the Bank gives priority to the microeconomic and governance-related issues; the Financial Management and Procurement networks to the fiduciary issues. The different diagnostic instruments developed by the Bank—notably, the PER, CFAA and CPAR—reflect these various perspectives.

[15] This pattern is confirmed by a recent survey of the IMF's recent technical assistance operations in 81 low-income and middle-income countries. The main areas of Fund technical assistance in the PFM area have been reforms of treasury and cash management (41 percent of the countries surveyed); IFMIS systems (38 percent); accounting and budget classification (38 percent); medium-term fiscal and expenditure frameworks (37 percent); budget legislation (29 percent of the countries surveyed); fiscal transparency (23 percent); performance/program budgeting (22 percent); and commitment controls (21 percent). The author is grateful to Bill Dorotinsky for these data.

Second, there has been a tendency for the Fund and Bank, and other providers of technical assistance, to focus their efforts on "big ticket" reforms—such as the introduction of a medium-term expenditure framework (MTEF) and an integrated financial management information systems (IFMIS)—that are dependent upon large injections of external funding and technical assistance. The presumed idea behind such an approach is that the reforms concerned may act as a centrifugal force around which other reforms would gravitate. However, a recent survey of MTEF and IFMIS projects in Ghana, Tanzania and Uganda suggests that the approach has been a mixed success (Wynne 2005). Another recent study of by Schiavo-Campo (2008) notes that there have been some positive lessons from a decade of MTEF experiments in Africa—greater awareness of the need to look beyond the annual budget horizon, and to focus on the results of government spending—but also "costly failures" arising from premature implementation of MTEFs, little or no local ownership, damaging distraction from basic PFM reforms, heavy stress on limited budget capacity, and little improvement in macroeconomic balances, financial control and predictability, or spending efficiency, in projects that were often supported by the World Bank. Brumby (2008) reaches a similar conclusion. Earlier flagship projects promoted by the Bank—such as Public Investment Programs (PIP) in the 1980s and cash budgeting—also largely failed to deliver their expected benefits. PIPs, for example, perpetuated the practice of separate capital and recurrent budgets, a practice that have been described as the single most important culprit in the failure to link planning, policy and budgeting, and poor budgetary outcomes (Lienert and Sarraf 2001).

Several reasons for such resistance to progress have been put forward including failure to adapt a reform model to local conditions and administrative culture, lack of capacity in the countries undertaking the reforms, lack of government commitment, failure to institutionalize technical assistance programs, insufficient training for civil servants, insufficient domestic budget provision to maintain the systems once implemented, adverse political developments, too many project components, and opposition by staff and line ministries. In addition, it has been argued that government officials may have accepted too uncritically advice received from international financial institutions, as a condition of receiving much needed international assistance and debt relief. Moreover, such reform initiatives are frequently based on practices exported from developed countries before they have been fully developed and assessed, and without ensuring that they can be assimilated into the standard budget practices of the recipient country, or indeed whether they are relevant to the country's development needs (Schick 1998, and McFerson 2007). For example, the development of performance budgeting systems in some developing countries has resulted in the accumulation by the finance ministry of vast databases of unused information.[16] There is a good reason for this—the minister is allowed by his cabinet colleagues to collect the data but not to use them for the purpose for which they are

[16] "Data cemeteries" ("zahlenfriedhof" in German) to use Peter Kohnert's perceptive and evocative term.

> intended, namely as a tool for the finance minister to use in allocating budgetary resources on a more "rational" basis.[17] Thus, scarce resources and expertise may be wasted on initiatives whose success in practice has not been adequately tested, or which cannot be implemented because of institutional conditions in the country concerned.

Some developing countries have often been quite successful in introducing some of the mechanics and trappings of medium-term and performance-oriented budgeting, without any significant benefit to the overall quality of budgeting or improved fiscal outomes.[18] Procedures have been put in place, data produced and documents prepared. Such countries sometimes have a document called a "medium-term budget", as well as a programmatic budget structure with some indicators linked to the programs. The weaknesses tend to lie in the quality of the new processes, data sets and documents. Although countries may have a notional medium-term budget, the contents are often updated in an ad-hoc manner, with limited explanation and little documentation, and the medium-term budget has little impact on actual budget decisions, particularly beyond the budget year. Budget programs often coincide with existing organizational structures, and objectives and indicators largely reflect existing activites. For example, the "administration program" is implemented by the administration department, and the objective is to provide efficient administrative services, measured by the number of administrative reports. Many reform attempts have degenerated to ritualistic exercises, with limited impacts on cultures and behavior.

Third, there has been a strong tendency for the IFIs and donors to support—and in many cases to take a lead role in drafting— action plans for the reform of budgetary instiutution that are much too optimistic in assessing the time taken for reforms to be planned and implemented. Many of these plans assume that the reforms will be completed within a relatively short period—three to five years, say—which as demonstrated is likely to be unrealistic assumption in most cases. Little account is taken in these plans of the institutional barriers and constraints noted above. There are reasons for this optimistic bias: finance ministers have a short time-horizon and are likely to lose interest if told that a reform program will take twenty years to complete; and the IFIs and bilateral donors have programs and loans to negotiate, and want to put pressure on the countries concerned to make reforms within a time period that is commensurate with such operations. Of course, such intentions are almost inevitably frustrated.

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[17] This is not to argue that developing countries have *nothing* to learn from advanced countries in this field. For example, they may be able to establish a classification of expenditures by program, and some concept of measuring performance according to results, outputs, and outcomes, that represent progress in relation to current practices. But such benefits are *peripheral* to the core objective of a performance budgeting system.

[18] Ghana is a good example. Its budget document is entitled a Medium-Term Expenditure Framework but in reality relates to a single year only.

> In addition to over-optimistic time horizons, many plans are overloaded with hundreds or even thousands of activities and actions.[19] The IFIs and donors—and their advisors—are in many cases to blame, for this enables them to package together reform into a "public finance reform" grant or loan that gains approval from the management board, and gives the donor increased leverage in the country concerned. However, these packages too often prove unmanageable and ineffective, raise unrealistic expectations about what can be achieved, and fall into disarray within only a small fraction of the measures having been implemented. Other approaches have been tried (e.g., the "hurdle" approach in Thailand) that attempt to create an incentive for spending agencies to improve financial management in return for greater flexibility in managing their resources. However, such approaches have met with mixed success.

A fourth complicating factor is the inadequacy of existing diagnostic instruments for assessing the quality of budgetary institutions and systems. The best known of these instruments is the PEFA diagonostic tool that focuses measuring the quality of financial management systems.[20] This instrument has been widely used in developing countries and emerging markets—as of December 2008, more than 60 PEFA assessments have been completed—and is technically sound. However, in relation to its application in developing countries, the instrument suffers from a significant drawback, namely that it takes little account of institutional factors that are critical to the reform of budgetary systems, and implicitly incorporates a value system that is based on the practices of developed economies. As a result, the diagnostic information deriving from a PEFA assessment is likely to be incomplete, and potentially misleading, when it is used—as is frequently the case—as the basis for preparing an action plan to be used by national authorities in reforming their budgetary institutions.[21]

[19] In Cambodia, for example, the government's reform plan "Strengthening Governance through Enhanced Public Financial Management" (December 2004) included four platforms, covering an 11 year period. Under stage 1 (2004-6), 27 activities under 11 broad areas (budget comprehensiveness and integration, macrofiscal forecasting, streamlining spending processes, budget classification, IFMIS design, strengthening leadership within the finance ministry, redesigning the budget cycle, piloting program-based budgets, options for fiscal decentralization, IT management strategy, and designing an asset register), and 254 separate actions were included in the program. A revised plan was issued in May 2008; few of the initial activities have been completed as planned, two years after the intended completion date. In Kenya, the government's reform plan "Strategy to Revitalize Public Financial Management" (April 2006), included 12 substantive areas (macro-fiscal framework, budget formulation, management of debt, tax collection, customs and excise, budget execution, accounting and reporting, payroll and pensions, procurement, parliamentary oversight, and internal audit), three cross-cutting areas (electronic service delivery and IFMIS, legal framework, and capacity building and service delivery), and 198 separate activities.

[20] The assessment methodology is described in PEFA (2005). The PEFA instrument includes 28 performance indicators covering various aspects of PFM, and three indicators describing donor practices in providing aid.

[21] As an example of this, consider the PEFA indicator PI-19 that measures the performance of a country in using open competition in awarding procurement contracts. In many countries, the World Bank and other donor agencies have used a poor score on this indicator as evidence that more competitive procurement procedures

This weakness is most important is relation to assessing performance indicators in areas that are likely to be especially influenced by rent-seeking behavior—such as the allocation of budget appropriations, capital investment planning and procurement, the government's payroll system, and treasury operations, for example—but all of the component indicators are affected to a greater or lesser extent. In principle, these institutional gaps could be covered in tha narrative section of the PEFA assessment, or by a World Bank "institututional and governance review". However, such reviews tend to be resisted by national authorities—who have little incentive to open up their governance systems for public scrutiny—and few have been carried out in practice.

It may be objected that the scenario presented in this section—that most developing countries face severe, if not insurmountable, difficulties in reforming their budgetary institutions—is too bleak. First, it may be argued that many countries in this category have a colonial past, in which institutions derived from and implanted by the colonial power, took root and were successful, at least for the period of the colonial occupation. However, in the budgetary area, many of these former institutions and practices continue to exist in countries of the Indian subcontinent, Africa and elsewhere but have severely degraded—like a sad villa of the Victorian era, neglected and decrepit—in the hands of incompetent and corrupt officials, and elites risen powerful in the wake of the departing colonialists. Indeed, a review of diagnostic assessments of developing countries that have a colonial past, and those that have not, does not suggest significant differences in the quality and performance of budget systems and processes, half a century after the colonial powers began their retreat. Nevertheless, further research would be required to prove this observation beyond reasonable doubt.

A second possible objection is that budget reform should be much easier in the early part of the 21st century than it was one hundred years ago because there is a significantly greater awareness of what constitutes good practice in this field, international standards have been established in areas such as accounting and audit, and hugely more efficient methods of transmitting information, ideas and cross-country experiences have been developed. Such advances may indeed facilitate a process of change once a clear political imperative and will to do so has been established. However, the real issue is not one of technological conditions, or human resources, since it is relatively easy to change an accounting system if the institutional conditions and political will exist to do so. In short, this objection misses the point that the fundamental constraint on reform is not absence of tehnical understanding or knowledge, or lack of sufficient skillls or capacity in the public service, or efficient IT systems—though these issues certainly need to be addressed during the reform process—but

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need to be introduced, and have embarked on elaborate and costly projects to support the countries concerned in such reforms. However, in developing countries (and even some developed countries), procurement is a primary source of rent-seeking, and remuneration for dominant elites, and the introduction of open procurement procedures is unlikely by itself to change actual practices. Thus, procurement laws in developing countries often include a provision that ministers can overide the results of procurement competitions "in the national interest". An effective action plan for procurement reform should focus on eliminating rent-seeking behavior before it deals with inadequate competition in the procurement market. However, this is rarely done in practice.

the absence of an enabling institutional environment that makes it *possible* to move forward in the first instance.

Weak institutions—and sometimes ill-focused interventions by the IFIs and donors—largely account for the poor progress of developing countries in reforming their budget institutions, which, in many cases, remain 100-150 years behind those in advanced countries.

A strengthened approach to budget reform—the "platform approach"?

Is there a better way to plan and sequence the reform of budgetary institutions for efficient results? Schick has argued that, when reforming a budget system in countries of low capacity, the priority actions should be aimed at "getting the basics right" first.[22] For example, the government should seek to ensure that there is an effective control of inputs before seeking to control outputs; to provide good cash-based accounts before developing accrual-based accounts; and to have effective financial audit before moving to performance audit.[23] However, Schick does not present a rigorous analytical framework for selecting his ten principles, some of which could be challenged, though this goes beyond the scope of the present paper.

As noted, some reforms are technically dependent on others for success—it is difficult for a government to take measures to initiate reform in area A before it has reformed area B. This is linked to Schick's idea of getting the basics right. Pollitt and Bouckaert (2000) give some examples of what they term "natural reform trajectories" in areas such as accounting, performance budgeting and external audit. In accounting, for example, reforms have tended to move in stages from the development of single-entry to double-entry bookkeeping, to the establishment of a uniform accounting system across government, to development of accounting for assets and liabilities (a rudimentary balance sheet), and eventually the establishment of a full accrual accounting framework. Natural reform trajectories may also exist *between* different areas of the budget system. For example, the development of effective internal and external audit procedures is dependent upon the existence of reliable and timely financial reports. And the existence of a sound and credible budget classification and chart of accounts is fundamental to the development of most other areas of an efficient budget and revenue administration system.

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[22] Schick elaborated on these ideas in a well-known 1998 presentation on "Look Before you Leapfrog", which however was not subsequently published.

[23] The remaining priority actions are to foster an environment that supports and demands performance before introducing performance or outcome budgeting; to establish external control before introducing internal control; to establish internal control before managerial accountability; to operate a reliable accounting system before developing an automated financial management information system; to budget for work done before results; to enforce formal contracts in the market before performance contracts in the public sector; and to adopt and implement predictable budgets before insisting that managers efficiently use resources entrusted to them.

A more comprehensive strategy for sequencing PFM reform in developing countries is the so-called "platform approach". This approach was proposed by Brooke (2003). Rather than the traditional focus on individual PFM reform measures, Brooke proposed that PFM reforms be packaged together into groups of activities or measures ("platforms") that form a logical sequence (Figure 1). An overall reform strategy might stretch over a period of, say, ten years, and comprise four or five of these platforms. Each platform would last for a period of two or three years, and establish a clear basis for moving to the next stage.

Figure 1. Illustration of the "Platform Approach"

Platform 4. Substantial improvements in service delivery, increases in allocations in accordance with political priorities. Improved effectiveness and efficiency in the public service

Platform 3. Accountability and result-based management introduced. Improved control of payroll, fixed assets and pensions. Improved accuracy of forecast and projections. Reduced tax evasion and increases in revenue. Reduced costs of

Platform 2 Improved quality of financial records and budget execution for remaining entities at central, regional and local levels. Improved budget preparation and allocations

Platform 1. Improved quality of financial records and credibility in budget execution for central ministries. A fast improvement of service delivery. Competitive and open procurement. Improved payroll management, reliability and control. Improved collection of revenue. Improved effectiveness of the internal and external

Short Term Perspective — Medium Term — Long term

Source: Government of Kenya, *Strategy to Revitalize Public Financial Management*, April 2006

Brooke argued that the platform approach—which has much intuitive appeal—differed from existing public sector reform strategies in several ways. First, it would provide a more structured approach to sequencing, and greater clarity to governments, IFIs and donors about their respective roles and responsibilities in the reform process. Second, it would focus on the

inter-connection between specific measures and their ability to be mutually supportive. Third, it would encourage thinking about the sustainable migration path towards technical improvements that might ultimately be desirable, but which are not realistic in the short-term, and identify small steps that will create momentum for sustaining the reform process.

One of the few countries to experiment with the platform approach is Cambodia (see footnote 13 above). However, despite its theoretical attractions, and quite strong leadership from the government, the exercise has revealed some serious flaws in the practical application of the approach (Box 1).

Box 1. Failures of the "Platform Approach"

- *Insufficient emphasis on institutional constraints.* The reform program underestimated the institutional and political resistance to reform in areas such as the transfer of responsibility for managing government payroll to the finance ministry, the consolidation of government bank accounts, and measures to prevent the accumulation of new spending arrears.

- *Overloading of activities.* Platform 1 includes 27 activities (of which 14 activities are considered necessary to prepare the ground for Platforms 2-4) and more than 250 specific actions. Such a wide range of activities would constitute a challenging task even in a country with much higher capacity than Cambodia. Moreover, some of the activities selected for the first platform (e.g., piloting performance-based budgeting) seem questionable decisions in relation to the country's low level of development.

- *An unrealistic time-horizon.* As argued in this paper, developing countries do not have the institutional or human capacity to make more than a few reforms within a 3-4 year time period. The proposed platforms vastly over-estimate this capacity.

- *Poor prioritization.* Certain decisions, especially to move ahead with the implementation of an IFMIS project, seem premature before basic reforms such as upgrading the accounting system and treasury functions have been implemented.

- *Micro-management.* The complexity and technicalities of the exercise have come to dominate the implementation process. Completion of the many hundreds of deliverables and milestones, and important constraints and bottlenecks were disregarded. The crucially important issue of managing the change process was given insufficient attention. The reforms were managed at the strategic level but not sufficiently at ground level.

As a development of the platform approach, it may be suggested that the platforms might make a distinction between various *functional components* of the reform process, such as

budget laws and regulations, changes in business processes, the introduction of new technology and IT systems, upgrading organizational structures, and undertaking training and capacity building measures to strengthen human resources. This recognizes that reforming institutions is a necessary but insufficient condition for advancing public sector reforms; other important considerations are people, skills, organization and information (Schiavo-Campo and McFerson 2008). Sub-platforms can be established for each of these components and a work plan developed to ensure that improvements in each component—for example, modernizing business processes and IT systems—take place broadly in step with one another, so as to ensure that the overall objectives of the reform process are achieved. Such an analysis might indicate, for example, the existence of blockages or bottlenecks in specific areas—for example, a critical lack of skilled accountants or economists, or an unsatisfactory information system—that need to be resolved before an upgrade of business processes is introduced.

> A streamlined version of the platform approach, summarized in Table 2, which has proved quite useful in the emerging market economies of South East Europe, is based on a simple division of ten important reform areas into *basic reforms*, which are necessary to achieve a minimum level of financial management capacity, and *advanced reforms*, which will enable countries to move toward international good practice (Tandberg and Pavesic-Skerlep 2008).[24] The objectives and benchmarks are consistent with broader benchmarking frameworks for PFM systems, such as the PEFA approach. The system proposed allows progress in various areas to be monitored, and correlated with various measures of fiscal performance such as aggregate fiscal control, financial discipline, efficient resource allocation, and the cost-effectiveness of public spending.
>
> However, there are also potential difficulties to this approach, which provides an incomplete guide to efficient design of the reform process. For example, the logical basis for the distinction between "basic" and "advanced" reforms is largely subjective, and to some degree arbitrary. It is similarly unclear what criteria should be applied in determining whether a country has achieved sufficient progress in improving its basic systems to move forward to more advanced reforms. Should a government be encouraged to start work on more advanced reforms before *all* the basics are in place? Are some of the basics more important than others in establishing essential preconditions for moving on to the menu of more advanced reforms? And there is an absence of any analysis of the underlying institutional conditions that may affect the reform process. We address these issues in the following section of the paper.

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[24] The ten reform areas referred to in the paper form the basis for the IMF's regional technical assistance program to the SEE countries, and were selected on the basis of proposals from the recipient countries and IMF country teams.

While attractive in principle, the "platform approach" has drawbacks as a model for developing countries to follow. In practice, it is weighed down by complexity and an overly technocratic approach, and takes insufficient account of the fundamental institutional barriers to reform in developing countries.

Table 2. Selected public financial management objectives and benchmarks

Objective	Benchmark
Basic reforms	
Complete budget classification	Budgets are fully classified by economic, functional, organizational, program and funding codes.
Complete budget coverage	Consolidated budgets include all government financial flows, including extrabudgetary funds and foreign financing.
Capital budget integration	Capital budgets and associated fiscal risks are fully incorporated in the regular budget processes.
Consolidated TSA	Treasury single accounts cover all government financial resources, including EBFs and foreign financing.
Adequate budget controls	No systematic overspending or accrual of arrears.
Advanced reforms	
Medium-term budgeting	Medium-term macroeconomic frameworks and sectoral spending plans are fully reconciled and regularly updated.
Performance-oriented budgeting	Budget decisions reflect the performance of budget programs and the linkages are clearly identified.
Integrated cash and debt management	Financial assets and liabilities are managed as a portfolio to balance net financing costs with accepted risks.
Unified accounting framework	A single accounting framework fully that is consistent with the budget classification and chart of accounts.
Fiscal transparency	Budget systems meet the good practices defined in the IMF's Code of Fiscal Transparency, 2007.

Source: Tandberg and Pavesic-Skerlep (2008)

IV. A Suggested Approach for Developing Countries

In this section we set out a conceptual framework, really the sketch of such a framework, that illustrates the issues to be taken into account by a developing country in reforming its budgetary institutions. Such factors include the prevailing institutional environment, and political and economic conditions; the availability of the leadership, legal structures, human resources, skills and information that are required if reform is to be effective; as well as sufficient analysis of the technical systems of accounting, budgeting and financial management.

The suggested framework might seem to bear a superficial resemblance to the "platform approach" described above. However, such a comparison would be

misleading. The framework is intended to guide the authorities towards the selection of a *few specific areas* in which reform would be both beneficial and practicable in relation to the political, institutional and capacity constraints facing the country concerned. The intention is not to develop a series of platforms on the basis of which reforms should be developed since we have argued in this paper that the institutional constraints, and extremely slow pace of reform, in developing countries makes such an approach of limited value.

The proposed logical framework comprises the following main components.

First, the approach recognizes that there is a natural order of sequencing PFM reforms, in the sense described earlier in the paper. This order can be illustrated by the four different levels shown in Figure 2. As noted above, certain categories of PFM reform depend on other reforms for their success so that, for example, an efficient system of financial reporting depends for its success on having an adequate accounting system and budget classification scheme in place. Similarly, internal audit cannot be performed without having reasonably well developed systems shown at levels 1 and 2 in place since, if accurate and timely accounts and financial reports do not exist, they cannot be audited. Also, in general, countries should focus attention on getting basic systems in place before moving on to higher level or more "advanced" reforms. By "advanced" in this context we mean reforms that depend on having other systems in place for their success. Thus, in a technical sense, the PFM system can be considered as a hierarchical structure in which, *ceteris paribus*, reforms should be built up from secure foundations, as with a building or other physical structure. This sounds both logical and self-evident, though it is surprising how often such a basic principle is disregarded by would-be reformers and their advisors.

Of course, such an approach should not be interpreted too literally. In the practical circumstances of a developing country, given its political and institutional drivers, there may be situations in which reform x is initiated before reform y, despite x's "inferior" position in the hierarchy. While technically sub-optimal in relation to the logical framework described in Figure 2, such a reform may make sense in political and institutional terms. Similarly, the existence of the technical hierarchy does not preclude a country from establishing, say, an external audit authority even though its systems of financial reporting and internal control may be very weak. Such an initiative may be demanded politically, to satisfy the requirements of a burgeoning parliamentary system, or a special interest group, or to pay-off a political supporter, for example, but may still be helpful in adding the potentially influential voice of the auditor general to the pressure for reform in other areas of budgeting.[25]

[25] In several middle-eastern countries, for example, an external audit agency has been established under the direct control of the state president or the prime minister, rather than the legislature, in order to reduce its power of independent action.

The second component of the framework is illustrated in Figure 3—only two areas of the budget system only (accounting and budget classification) are shown, but in principle all areas should be systematically covered. This breaks down the overall issue of efficient design of the budget reform process into a series of steps. Reforms should be given priority—in other words, introduced at an early stage in the reform process—if they meet certain principles or criteria. The first criterion, already noted, is that, *ceteris paribus,* areas of the budget process that are lower down in the hierarchy shown in Figure 2 should be dealt with before areas that are at a higher level. The second criterion is that areas that are weak in terms of a diagnostic assessment should be given priority over areas that are relatively stronger. "Weakness" and "strength" in this context should take account of the five functional dimensions noted above—namely, the legislative framework, the existing organizational structure and business processes, human resource issues such as developing appropriate skills and training facilities, and IT systems. The third criterion is that an institutional assessment should be carried out to identify the institutional and political drivers in the country that that will shape and influence the reform process, and may be obstacles to reform unless adequately dealt with.

Third, it should be stressed that the ultimate goal of budget reform is much broader than simply improving the efficiency of budget systems and processes. Reformers need to take a view on the core fiscal objectives which their proposed reforms are designed to achieve, and build these into the development of their reform strategies and action plans. Core objectives for a developing country might include the following:

- Protecting public money from theft and misappropriation;
- Budgeting in a transparent way;
- Ensuring that public funds are spent consistently with the approved budget;
- Strengthening the link between public priorities and the budget, for example integration of capital and recurrent budgets, and improved multiannual programming;
- Providing sufficient flexibility of decision-making and program management, combined with accountability, within the public administration to improve the efficiency with which public services are delivered;
- Monitoring the results of spending in terms of the access to, and quality of public services, and injecting some external accountability through citizens and public sector users for effectiveness ("social accountability").

Other factors may also need to be taken into account. For example, is external finance and technical assistance available to support the development of the proposed reform? Is the reform dependent on government decisions to institute other changes in the public sector—for example, a new civil service law, or recruitment and training arrangements; or a reorganization of ministries that may affect the role and responsibilities of the finance ministry and its staff?

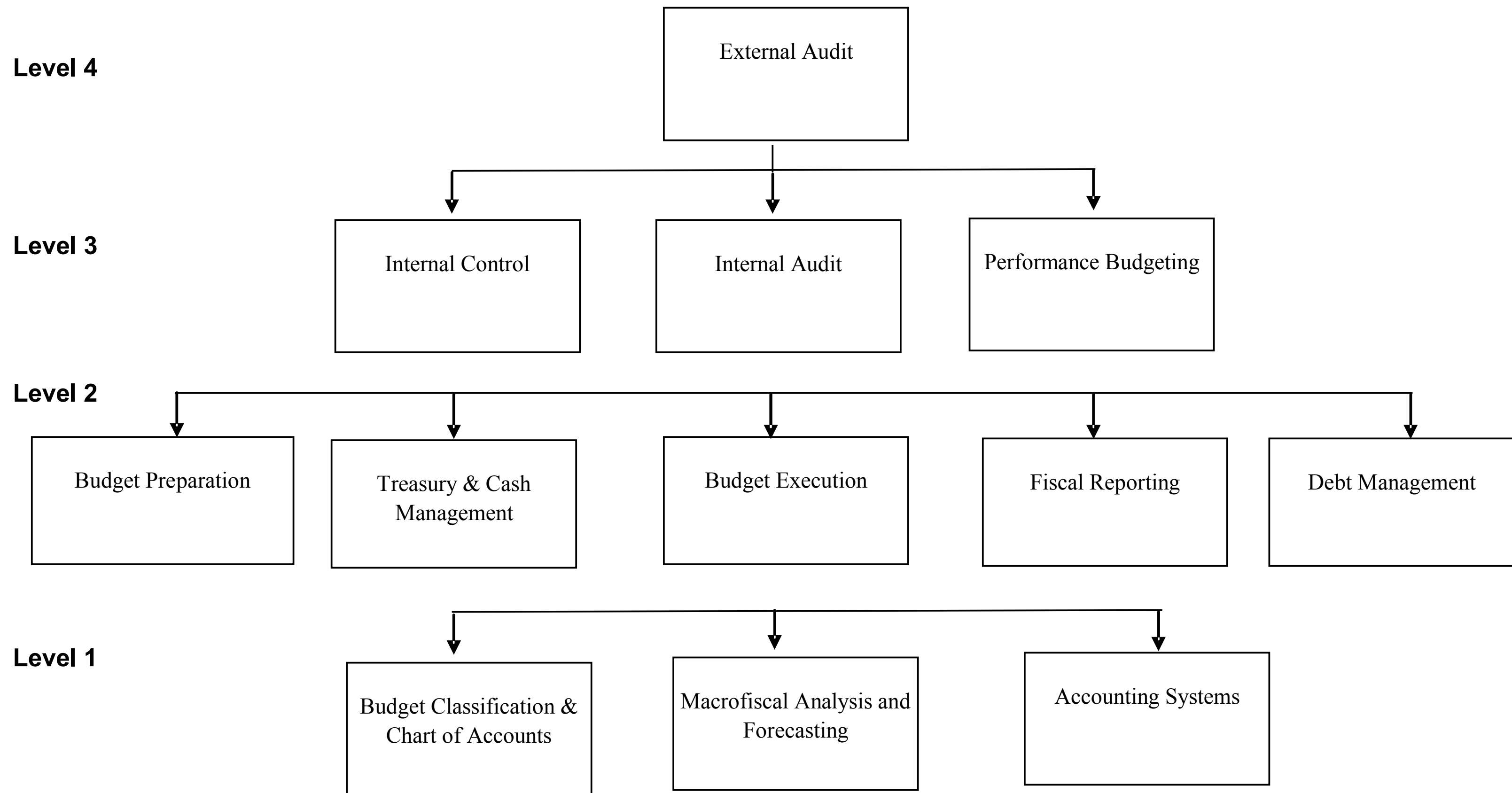
On the basis of such an analysis, the various reform areas can be assigned various rankings, or priority levels for reform—in Figure 3, for example, these are shown as "short-term", medium-term" and "long-term" priority.

In applying the framework sketched out above, the technocratic excesses and failings of budget reform that have bedeviled would-be reformers in many developing countries (not only in the Cambodia example referred to above) need to be avoided. Budget reform is an art not a science. There is much merit in the guidance given by Hirschman (1958), namely to focus on changes that either impel or facilitate further changes. Moreover, a critical failure in the design of most budget reform strategies is to build in appropriate tests of the success or failure of the reforms themselves. In doing this, the right questions need to be asked of the right people, including middle- and low-ranked government officials in the budget "trenches"; and these people need to be held to account for failures to implement the required measures.

Such a framework differs from the existing approach to planning a budget reform process in four important respects. First, it gives priority to institutional issues as the basic *leitmotiv* of reform, and subordinates (or at least qualifies) the existing predominant emphasis on technical issues. Second, it provides a logical framework for the sequencing of reform according to the proposed technical hierarchy of the four levels. Third, it breaks down each technical component into a series of functional categories, thus emphasizing the importance of business processes, human resources and skills, financial information systems and other components being developed according to a balanced reform agenda. Fourth, rather than building elaborate platforms, it encourages reformers to focus on a small number of concrete reforms that can realistically be developed on the basis of a country's institutional and technical capacity.

Reforming budgetary institutions is an art not a science. Overly technocratic approaches should be eschewed. Reform programs should focus on a few core measures that, if possible, impel or facilitate further change, and reformers should be held to account for their decisions. Institutional factors are key. The paper presents a possible framework for developing such an approach.

Figure 2. Hierarchical Structure of a Budget System (Illustrative) 1/



1/ Level 1 represents the most basic PFM systems; Level 2 more developed requirements that depend for their effective implementation on the existence of sound Level 1 systems; and so on up to higher levels.

Figure 3. Illustrative Framework for Prioritizing Reforms of Budget Systems and Processes

	Accounting System					Budget Classification/Chart of Accounts				
	Legislative framework	Organizational framework	Business process	HR system	IT system	Legislative framework	Organizational framework	Business process	HR system	IT system
Diagnostic rating[1/] (1= low, 4= high)	1	2	3	1	2	4	1	1	3	2
Institutional rating[2/] (1=low, 4=high)	3	3	3	3	3	2	2	2	2	2
Level in PFM hierarchy (see Figure x)	1	1	1	1	1	1	1	1	1	1
Priority for reform (ST = short-term) (MT = medium-term) (LT = long-term)	ST	MT	MT	ST	LT	LT	ST	ST	MT	ST
External finance available	No	No	No	Yes	Yes	No	No	No	Yes	Yes
Other relevant factors	No	Yes[3/]	No	Yes[4/]	Yes[5/]	No	No	No	Yes[3/]	No

1/ Based on a PEFA assessment or similar diagnostic analysis of technical issues affecting the budget system.
2/ Based on an institutional assessment: a low/high rating indicates that institutional factors are unfavorable/favorable to reform.
3/ Reform of the accounting profession is planned.
4/ Introduction of an IFMIS is planned.
5/ A planned civil service reform will include a new regulatory framework and the establishment of a Civil Service Bureau.

V. Summary and Conclusions

The present state of evolution of budgetary institutions in developing countries today resembles that in today's advanced open-access economies more than a century ago. In assessing the prospects for, and likely speed of, reform in developing countries, this important fact should be taken into account. It is unrealistic to expect that such countries will be in a position to implement reforms in a period of three, five or even ten years that took advanced countries several decades to achieve in the 19th and early 20th centuries. Change is likely to be slow and incremental, and evidence suggests that this indeed has been the experience of most developing countries in the past forty or fifty years. Reforms need to focus on areas that do not threaten the existence and stability of the existing institutions and ruling elites. Attempts to take approaches that have been successful and effective in advanced countries—including "new wave" reforms—and implant them in the alien environment of a developing country are usually unsuccessful and sometimes both disruptive and chaotic. While there may be some exceptions to this general principle (such as emerging markets, post-conflict countries and a few developing countries with special institutional characteristics and strong finance ministers) they are rarely found in practice.

The central thesis of this paper—namely that the prevalence of weak institutions and rent-seeking behavior in developing countries (natural states) creates an environment that is fundamentally hostile to the reform of budgetary institutions, and results in the slow progress that is commonly observed in the implementation of such reforms—has not been proved beyond reasonable doubt in this paper. However, we believe that the available evidence points strongly in its direction, and that it provides fertile ground for further research.

The paper further argues that technocratic solutions to the design of reform strategies in developing countries—such as the platform approach—have a certain logic, but their sheer weight, extensive timelines and complexity may vitiate against them in the context of developing countries. They are also prone to capture by the agencies who fund and provide the technical assistance. Many reform plans – even ones that have been successful - have a relatively short-term focus, no formal structure or plan, focus deliberately on a quite narrow and specific set of objectives (for example, how to correct a fiscal imbalance or a problem of arrears, or to improve budgetary reporting) and involve a large element of trial and error, learning from mistakes, and "fumbling around in the dark". This may make such plans more manageable and realistic. It also requires deliberate selectivity in the choice of topics on which to focus the reform effort. The structured reform agenda, with platforms, sequenced steps, coordination and participation of the authorities, donors and other stakeholders, may to some extent give a false impression of order in a fundamentally chaotic process.

> The uncomfortable truth of the analysis above is that much of the support for budgetary reform currently provided by IFIs and donors through loans, grants and technical assistance is inappropriate and unlikely to be effective. Nevertheless, donors show little inclination to modify their existing practices—despite accumulating evidence of poor results and low returns—since, as noted, fashions in reform are created and hard to throw aside, and project managers have a strong incentive to disburse loans and a much weaker incentive to ensure that the long-term impact of such lending (and related technical assistance) is positive. This paper has argued that some rethinking and retooling of existing approaches and priorities is required.

Finally, the paper suggests that the foundations of good advice to developing countries on the essential ingredients of a successful budgetary reform strategy should rest on a number of pillars. First, countries should not be overly ambitious in their reform efforts. They should have clear goals and objectives and focus on a few specific reform initiatives that can realistically be achieved within a time period of three or four years. Second, reforms should only be undertaken if they satisfy the institutional and technical tests described this paper. Third, countries should assess how they are going to build a consensus for reform, how to manage opposition, and how to find local champions. Alliances and partnerships, including with providers of technical assistance, should be formed where they are needed. Finally, countries should be prepared to learn from their experience and make adjustments to the action plan along the way, using ex post evaluations and reviews for this purpose.

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