PFM Reform: Promises and Tears- Lessons Learnt from Reforms gone Wrong

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I have been asked to speak on lessons learned from reforms gone wrong and to share the lessons I have learned from my involvement in New Zealand's reforms in various ways over thirty years and from twenty years of working around Asia and elsewhere on various public sector reform projects.

There are lessons to be learned from a lot of reforms gone right as well as wrong. It is hard to think of a country that has achieved nothing from its efforts although a few have not achieved much.

But things do go wrong and a lot of lessons have been learned about why. So let me get to my list of causes of reforms gone wrong.

Lack of attention to managing the authorising environment

Reforms have the appearance of being 'technical' and are typically presented that way by reformers, whereas, when these concepts are being implemented they challenge institutions, leadership, culture and embedded processes. When the affected parties wake up to what is happening they commonly resist the features that are disturbing to them and sometimes have the power to stop the reforms or undermine their effectiveness.

All worthwhile reforms create winners and losers, supporters and opponents, so any program of PFM reform in a technical sense has to go in parallel with a political and administrative strategy for gaining supporters and dealing with opponents and critics. This is sometimes referred to as managing the 'authorising environment' for the reform.

Reformers can have tunnel vision and see the worth of what they want to do as self-evident, when to others it is not. Better PFM needs to gain political support by solving real problems that matter to decision makers and the public - even if this does not look tidy through the lens of a model of best practice sequencing of reform.

Ambitions beyond capability to design and deliver

Too many reforms begin with a vision of 'best practice' PFM, which emphasises an end point and can dangerously underestimate the practical challenges of taking the next steps starting from where you are today. Of course any reformer has to have a vision of what they want the future to be, but the strategy for change must be realistically grounded in what is there today – or else failure is probable. A great strategy for change combines ambition with realism.

An implication of these two points is that successful PFM reforms are always largely indigenous even though PFM systems at different stages of development have general similarities. The narrative that eventually emerges, over the years that any substantial reform takes, is about local responses to local needs, within a local political and administrative environment and culture. Pressures from development partners, international standard setting bodies or whoever for best practice solutions can be a feature of the story but is never the core of the narrative over the long haul.

Lack of commitment of the Minister and the Ministry of Finance

A PFM reform will fail without the persistent and visible commitment of both the Minister and Ministry of Finance. It may seem an obvious point but I have seen PFM reform programs where one or other of them – or even both – are luke-warm to the reform. Given that Ministers of Finance have shorter tenures than treasury secretaries generally, the commitment of the Ministry is ultimately perhaps more important. A committed finance ministry can think of strategies to attract the interest of its minister.

When the Labour Government in New Zealand was replaced by the National Party Government in 1990 it was not clear to me that the new government would support and continue the reforms. Then in 1991 the ratings agencies threatened a double downgrade of the country's credit rating. The minister and I talked them out of it by presenting them with the world's first government accounts prepared in accordance with the GAAP, which gave them far better information than they had previously seen. That minister went on to become an articulate advocate internationally for fiscal transparency and better PFM and pioneered NZ's Fiscal Responsibility Act in 1994.

Ministers of finance can be persuaded by their ministries that PFM reform will assist them in various ways:

- to get better leverage over their fellow ministers in budget arguments,
- better arguments for fiscal prudence and of its virtues,
- more visibility and attention to fiscal risks,
- better prioritisation and
- value for money

In theory ministers of finance are always interested in these things as they are the tools to help them succeed, but in practice it is not hard to point to ministers of finance whose appetite for PFM improvements is small. They are politicians not treasury secretaries, and PFM reform of a kind that strengthens the hand of a minister of finance is rarely welcome in the councils of ministers. PFM reform can be a risk to an ambitious Minister of Finance's career.

PFM reforms can be quite confronting to the power structures in a ministry of finance. In the heart of the ministry of finance, the people in the high positions sometimes do not understand what is required by way of people and associated resources to get the reform done. They can feel threatened by how the reforms will affect their careers. It was really noticeable working in the countries of the former Soviet Union that those countries where the old bureaucrats had been replaced with young educated staff with new ideas were able to make more progress – albeit with setbacks sometimes – than countries where the soviet era bureaucracy was still in place. The president of one of these countries said to me that there would only be real change in the way the government runs when the younger generation has risen into the leadership positions. For political reasons he was not going to accelerate the process however.

Failure to spread the reform beyond the territory that the ministry of finance commands.

A determined ministry of finance can usually achieve a reform of the core business of the ministry – particularly if the government accepts this is needed for achievement of a key government fiscal priority, which typically is a problem controlling expenditure. But whether the reform can extend beyond top down expenditure control into a more performance oriented system and out across the line ministries and even local government is much more difficult.

I have seen this scenario play out in many different circumstance. Countries with strong planning ministries can present obstacles to a reform driven out of the ministry of finance, particularly when it is increasing the power of the finance minister and seeking to impose top down limits on public spending and influencing spending priorities.

Securing the support of line ministers and their ministries to take better PFM practices across their ministries is always a challenge. They have to see what is in it for them or they will not own the PFM system and use it, because it is seen as a finance ministry operation.

Many PFM reforms have involved delegating more discretion for spending decisions to line ministers – often, but not always, there are good grounds for this as better PFM anyway. Ministers of finance can see the political advantages to themselves in this. Just as ministries of finance can see the benefits of getting line ministry heads aligned with a PFM reform by emphasising the prospect of greater spending discretion.

In NZ it suited the situation for ministers to be given both a tight budget constraint and a much increased discretion over how it was spent. The other ministers were brought aboard in this way. To some this seemed like Treasury giving their game away, but the record shows that by giving away line item control and imposing hard budget constraints the Treasury actually increased its fiscal control and laid a platform for further reform based in efficiency and effectiveness. This remains true 30 years later.

Support for PFM reform has in some countries been garnered from civil society. In my experience, reforms that help to get teachers and books in schools, medicine in health clinics, welfare payments to the needy etc can be very popular with the public – or at least the NGOs and others in respect of their particular areas of policy interest.

Impatience and lack of persistence

PFM reform is a long game, which does not fit with the time horizons of some of its stakeholders. IFI support is evaluated for effectiveness on shorter time scales than significant PFM reforms usually take to get in place.

Fiscal policy affects the whole government and is not able to be run by a few experts like monetary policy. Inevitably, things go wrong or take longer than expected as there are a lot of moving parts in in PFM reform. A reform that fails to meet its short term objectives is not necessarily a failure in the long game. Sometimes capabilities built for one purpose end up being more useful for another.

You will all have examples from your experience of how long a reform can take. Let me share one of mine. In the late 1990s I chaired the board of the NZ Health Funding Authority, which was innovating in systems of health service coordination known as 'integrated care'. It was abolished in 2000 by the Labour Government - probably because it was contracting with alternative providers of health services other than ones owned by the State. Today I chair a board under a different government, which is charged with designing and implementing integrated care services. You need to be patient and live a long time to get some things done.

The role of outcomes in PFM is another area where I have had to learn great patience. The Public Finance Act 1989 mandated that all appropriations should be accompanied by outcome indicators. Over the 1990s a few innovators came up with really clever ways to do this but it never spread across the government. It is really hard to get outcome management to work well in my experience, but step by step it can be done.

Key person risk

It is common for a PFM reform to be critically dependent on the leadership and charisma of one or a few people who keep the reform rolling, through the sometimes tedious processes of government and give others the confidence to go along, or at least wait and see, rather than resist. In Thailand in the late 1990s a budget reform initiative was de-railed by the untimely death of its leader.

Capability shortages

The only reform any country can have is the one it can implement and then operate. For capacity-rich countries this means putting the capability plans in a prominent place in the overall reform strategy. This often means finding ways within the constraints of civil service pay structures to engage accountants, budget analysts, auditors and financial analysts. And it means careful HR strategies to train and support existing staff to do new kinds of work in new job descriptions. But without a pay scale that will retain the new skills the trainees will sell them to other employers.

A special pay scale for the new technical experts is usually a political and morale problem in a ministry but it has to be faced up to.

For capacity poor countries, my view is that the reform has to be tailored to the capacity that can reasonably be expected to be available and if necessary the reform aspirations cut back to fit within the capacity constraints. It is too common for low capacity countries to embark on reforms they do not have the capacity to implement. Turning book keepers into accountants and budget analysts is challenging and takes time and resources. Inevitably some new staff with high levels of skill are essential for operating a reformed PFM system that uses modern concepts and methods.

In fragile states and post conflict countries the capacity constraints can be so severe that it makes sense to build capability just to run the present system before thinking about how it might be reformed. I have worked in a post conflict country where a generation of public servants had missed out on a secondary school education. Some did not know what a ratio is and were baffled by a spreadsheet. Yet step by step and with the contribution of some skilled and dedicated international advisers, who located in the ministry full time, very good progress is being made.

Lack of attention in the design to central-local government financial relationships

Several countries in which I have worked have given insufficient thought to how the financial relationships between central and local government are going to be handled within the scope of a PFM reform.

The big Asian countries have all had to address complex constitutional and political issues about how the states and provinces fit into a national PFM framework of budgeting, execution, revenue raising, reporting and accountability. Different solutions have arisen in Vietnam, Australia, Malaysia, Thailand, Indonesia and the Philippines. In Viet Nam for example, so called National Targeted Programs were developed to resolve the potential contradiction between the central government's national development priorities and the extensive discretion by provincial leaders to allocate the funds they receive in the budget in accordance with local priorities.

Local government finance has arisen as an add-on to PFM reforms in many countries and in some cases awkwardly. I worked in one country where a regionally based political uprising had been ended in a settlement giving a large degree of fiscal autonomy to the region in question. But then the PFM advisers proposed that this autonomy was withdrawn as it was inconsistent with the principles of the MTEF framework they were developing. Definitely the cart getting in front of the horse.

Lack of attention to how public enterprises and other autonomous bodies come into better PFM

The latest IMF code of fiscal transparency focuses on identifying and managing risks. Public enterprises and certain kinds of semi-autonomous bodies are a major source of fiscal risk almost everywhere.

The PFM system needs to respond to the legislative and practical realities of the public enterprises and not try to shoe-horn them into an ill-fitting PFM model. For example, the accounting conventions for control in consolidation policies are not entirely satisfactory, as they focus on the percentage of ownership as an indicator of whether the government has control.

The real question for finance ministers is where the residual risks lie and these are not always reflected in the proportion of shares owned. Typically when a public enterprise fails, creditors out of the money head for the 'deep pockets', which is almost always the government. If a failed bank needs to be re-capitalised in a financial crisis the chances are that the other shareholders cannot provide any funds. So a measure of the contingent liability in the bank would be larger than the formal proportion of the funds that the government would seem to be up for from looking at the consolidated balance sheet.

Problems with large scale ICT projects

All large scale IT projects anywhere in the world – public or private – carry big risks of disappointment and failures are commonplace. I don't think PFM based IT projects in Asia are any more or less prone to failure than what is normal everywhere and there are notable successes e.g. the TABMIS platform in Viet Nam seems to have come to a successful conclusion after many years of effort and with difficulties to be resolved along the way. But hard lessons have been learned in many countries – including my own – about the risks in major IT projects in government. These are never problem free.

Inflated expectations of what PFM can do to promote better government performance

While the PFM system can usefully support a system of performance management it cannot substitute for one. PFM tools will not work well in isolation from a wider system of performance management that integrates planning, institutional reform, capability development, governance and accountability systems and incentives of some kind - not necessarily financial.

Adorning the budget with performance indicators will not achieve much on its own.

There are examples of countries that use the PFM system as the backbone of a performance management system, but in order for this to work well, the ministry of finance has to be very well connected to the Prime Minister and the core of senior ministers, so that they are using the PFM tools in cabinet decision making. Other sources of performance information from the planning ministry, the line ministries and elsewhere need to be aligned with the PFM process.

Ineffective relationships with donors

While I do not see much evidence that this is a problem in the more advanced Asian countries today, it can be in countries with low capacity for taking control of the design and implementation of PFM reform. In these circumstances I have seen major donors successfully supporting the development of this capability to manage donor relationships as part of their policy dialogue.

Limited project planning and management capability

I have seen ministries of finance setting out a PFM reform program that is beyond their capability to plan, organise and deliver. Project design and management is a discipline that is not part of the normal professional training of most finance ministries. PMUs are only a partial answer and can have difficulty in their integration with the host ministry. A great looking program can crash because of poor project management. Resistance to the reform gathers and focuses on the shortcomings in implementation, political will for the reform fades as expected milestones and results are not achieved.

A simple incremental reform done in manageable steps that does not overstretch project management capability can be a wise approach. Even though it does not promise a lot in the early stages, a lot can be learned about how to do reform, which can sustain more ambitious further reforms, as the reformers get better t project management.

The lesson from 30 years of change in New Zealand

I was asked by the IMF to comment on the long view of New Zealand's PFM reforms. The main message is that 30 years on, reforms are still happening in response to new challenges and opportunities. But the energy has ebbed and flowed. There were periods in the later 90s and again in the noughties when not much was happening. Notable recent changes have been:

- 40 year fiscal scenarios to assess long term fiscal risk from demographic and other trends and risks.
- A government wide investment statement as part of a deepening commitment to managing capital investment and the government's balance sheet.
- New provisions for virements that enable ministers to move money between appropriations that are linked within multi-appropriation strategic result areas – e.g. reducing child poverty
- PFM changes to support innovation in integrating social service delivery through public private partnerships of many different kinds
- Developing government IT systems that integrate across traditional delivery systems to increase data matching, incorporate advanced analytics using big data systems, integrating the tax and welfare expenditure platforms
- Merging financial data with other data into integrated management information systems
- Experimenting with population based budgets.

The work of the PFM reformer is never done.

Conclusion

Every country has disappointments on the road to better PFM and across Asia there are examples - but in very few cases has the quest for better PFM been abandoned for long and the successes are as apparent as the setbacks. The message I would leave you with is that, while there are great sources of advice available from IFIs, consulting firms and others, much of the skill in PFM reform is what economists call 'tacit knowledge' – the knowledge embodied in a person that is not easily passed on to others. The way to accumulate tacit knowledge is to learn it on the job by trying, sometimes failing and sometimes succeeding on the path to your vision of what great PFM looks like in your circumstances.