The Non-Technical Context of PFM Reform

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1. The importance of the non-technical context for PFM reform.

In a previous paper (Diamond, 2010), a review was undertaken of the sequencing literature that revealed that almost all experts in the field stressed how non-technical factors heavily influenced the design and the success of reform initiatives in the PFM field. Indeed, it was suggested that in designing reforms one may have to accept non-technical factors could override purely PFM technical factors in determining priorities and the sequence of reform actions, both the order in which they are undertaken and the timing required for their completion. However, while there was general agreement in the literature on the importance of non-PFM factors there was no consensus on what they were, although most agreed that they vary between countries in importance.

Unfortunately, the apparent scope of these non-PFM factors identified in the literature, mostly descriptive, is very wide. There are evident overlaps between contributors but also some differences in focus and in opinion. Recognizing this as an important area for determining the sequencing of PFM reforms it was argued that more work was required in this area. Accordingly, it was suggested that these political economy and organizational factors should be inventoried, a subset of most important factors agreed with some quantifiable indicators derived. Based on this analysis, a checklist of risks arising from these various sources could be formulated to guide reform design in countries trying to improve PFM “basics”, and to assist donor delivery of reform support. This paper should be considered a first step in this direction.

2. A three tier framework to analyze non-technical factors

The factors that have been encountered in the literature as explicators for the success or failure of PFM reforms are wide ranging, and have for the most part been presented in a descriptive rather than in an analytical way that does not easily support empirical verification. To structure this literature requires an analytical framework. A three tiered approach is proposed here in the hope

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1 This draft has benefited considerably from the extensive comments of Peter Murphy, Fiscal Affairs Department, IMF, and Daniel Tomassi, OECD consultant.
that this will prove useful, but in no way it is suggested this is the only way to impose order on the various external factors covered in the sequencing literature.

At the highest level, an environmental scanning framework is suggested to identify and order the broad external influences in the PFM system’s environment which can affect the success of reform initiatives. These conditioning factors are divided into four broad categories: political environment; economic environment; socio-cultural and general governance environment; technological and capacity environment. The four dimensions are employed to map out the external environment in which the PFM system of a country must function. On each of the dimensions specific factors are identified that are mentioned in the sequencing and general change management literature as important to influencing the success of PFM reforms. The results of this preliminary survey are presented in Table 1 A–D, shown at the end of this paper. To bring these general influences to something more quantifiable and hence useful for empirical verification, possible indicators are also presented alongside the factors.

At the middle level are grouped some relevant factors that arise from the institutional design of the PFM system itself. This covers the PFM system at its broadest definition: including critical relationships as they impact on PFM between the legislative and executive branches of government, the critical relationships with the executive, especially the role of the MOF, and the relationship between the MOF, line ministries and other relevant central government entities. The aim is to identify specific factors in these interactions that could affect the success of any reform initiative. For example, much of the sequencing literature has stressed the importance of a strong finance ministry as the driver of reform. This section identifies some qualifications that result from the type of government system, the limitations placed on the MOF’s influence over PFM issues, and its dependence on other institutions to successfully implement reforms.

At the lowest level are grouped some relevant factors that arise from internal organization of PFM processes. This covers influences on reform success that arise from the structure of organizations, the managerial culture, the limitations of leadership and skills available, and other capacity constraints often found in public institutions especially in the LDCs. The aim is to identify critical constraints on successfully implementing PFM reforms in public entities.

An outline of this framework is shown in Figure 1.
3. Change management must address the external factors

PFM reforms essentially involve introducing changes in an open system that is highly influenced both by various outside factors that impact the system at all levels as well as its structural architecture determining how these levels interact. Hence successful reform initiatives must be able to successfully navigate and overcome the constraints imposed by these external factors. To do so, it is argued, the various theories of change management offer considerable insight into how this may be accomplished.

In their extensive review of the literature on the implementation of planned change in the public sector, Fernandez and Rainey (2006) stressed that the first and perhaps most important step was to create demand for change. From this viewpoint the scope for introducing change is determined by the degree to which it is possible to demonstrate the need for change, create an alternative vision of the benefits derived from the change, and so increase the degree of dissatisfaction with the status quo. In this way the initial aim for the change management is to create demand for reform in the system. However, demonstrating benefits of reform and creating dissatisfaction with the status quo is a necessary but not sufficient foundation for change. To turn this “potential” demand for change to “effective” demand requires enlisting a powerful enough coalition around the need for change to drive the reform, with an empowered leader to steer the

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2 This they place as the first factor in managing change, as evidenced from a number of examples they quote from the private and public sectors (see pp.9ff).
reform, and the existence of credible strategies to achieve the new “vision”. Only by generating a strong enough demand for reform in this way will it be possible to overcome the resistance in the system to any change in the status quo.\(^3\)

This critical first step, creating the demand for change, is not easy in the hostile environments that often exist in LDCs. Indeed it is likely to be the most problematic for change managers. This first step in reform planning--that of analysis and diagnosis of problems, the identification of those reform areas that have local support, and the organizing of this support against the status quo--will involve more than technical considerations. The purely technocratic approach (implying a start from a tabula rasa in terms of the reform design), is first to diagnose a country’s PFM problems, through various sources of technical information available: PEFA assessments, PERs, PEMFARs, CFAAs, CPARs,\(^4\) IMF ROSCs, country surveys by regional IFIs, diagnostic documents by donors in the field, reviews of previous reform initiatives, etc. At this stage, in this somewhat idealistic view, other donors, the local authorities, and other interested domestic parties, such as important Civil Society Organizations and NGOs, ideally should all be consulted. The end result would be to identify all areas requiring reform actions that appear feasible given the specific country circumstances, and choosing reform activities that are relevant to the country’s overall priorities. These priorities, it has been argued (Diamond, 2010), would be defined by the highest level deliverables of a PFM system, which, in the order suggested here, are: financial compliance; macroeconomic stability, and efficiency and effectiveness in service delivery.

Unfortunately, this technical approach to analysis and diagnosis is unlikely to be workable in perhaps the majority of LDCs. Indeed, in can be argued that to base reform on the review of formal PFM systems could be quite misleading. In these environments even where formal systems exist, and are defined by law and financial regulations, they are often flouted by those in power and have been replaced by informal systems that allow for the extraction of rents, the widespread use of patronage, and the consolidation of political power. Perhaps more fundamentally, the existing “rules” of political engagement and mechanisms of power brokering in many LDCs are such as to offer few incentives for those in power to adopt meaningful reform. In this environment any decision framework following a purely technical approach to PFM reform, determined solely by PFM outcomes, faces two criticisms. First, that it seeks to reform formal systems, ignoring the reality that informal systems prevail. Second, it is doomed to failure because it offers no incentive for those in power to take up the reforms in earnest, since this simply runs counter to the fundamental political “rules of the game”.

This predicament raises two critical questions for the strategy of change management in such environments: how far to accommodate informal PFM systems and how far to compromise technical PFM requirements to meet political economy considerations.

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\(^3\) This is in line with Gliecher’s view that meaningful change is derived from generating dissatisfaction with how things are now. This he expresses in his formula for change \(D \times V \times F > R\); \(D = \) Dissatisfaction with how things are now; \(V = \) Vision of what is possible; \(F = \) First, concrete steps that can be taken towards the vision; \(R = \) Resistance

\(^4\) While these are World Bank documents, they are often co-written and endorsed by other donor agencies as well as government entities such as finance ministries.
(i) The approach to informal systems.

Generally reform is usually framed in terms of moving to some more ideal way of doing things. In PFM this “ideal” is usually framed in terms of better meeting the outcomes desired from the system: stronger financial compliance, greater macroeconomic stability, more efficient and effective service delivery. These objectives can only be obtained if all participants in the system are following rules and regulations that are designed to deliver these outcomes, i.e. operating a formal system. Accordingly, PFM reforms can be expected to face a fundamental contradiction since by their nature they aim at improving the formal system at the expense of the informal one. But, runs the counter argument, if rents, confirmation of power bases, patronage etc. are supported by the informal system what incentive will there be for successful implementation of reforms that are aimed at improving financial compliance and hence reducing rents and the scope for patronage?

The existence of informal systems cannot be doubted, nor can the distortions that they give rise to. These distortions involve costs to someone and hence are likely to be a source of dissatisfaction with the status quo that can be exploited by the change manager. For example, a government officer with powers over cash releases can gain considerable rents or political leverage in the way he exercises these powers, but this is likely to be to the disadvantage of those who are not favored by the cash releases, or who are unable to participate in an exchange of political favors. Moreover, a well functioning PFM system—enforcing the rules, procedures and principles governing how decisions over public resources are made and implemented—if well designed and transparently operated, can help alleviate many of problems that give rise to the existence of informal systems in the first place. For example, introducing more realistic budget preparation procedures or a system of financial planning is likely to undermine the power of those who extracted rents from a cash rationing system. PFM reform by strengthening the formal system should weaken the informal. It is up to the change manager to understand the nature of the gap between formal and informal systems, why informal systems persist, how this impacts different players in the system, and to help nurture a coalition around those dissatisfied with the present distortions they create in order to drive reform.

(ii) The approach to political economy realities

The standards to which most PFM reforms aspire to are those of good practice, as defined internationally (e.g. the PEFA assessment) at an “adequate” level to meet basic PFM functionality. In this way PFM reform actions are derived from a diagnosis of weaknesses defined by comparison to some international standards. It should be admitted this “technical” position may be at odds with other approaches to reform. These approaches see a much greater role for local preferences or environmental viability in determining the content of reform actions. Many advocate what they call “best fit”, “good enough governance”, and “second best solutions” as providing a better approach to reform. For example, DFID endorses an approach it calls “opportunistic”: choose activities sought by the authorities to get them involved and then once they are engaged work to turn reform to higher priority actions. The World Bank has recently raised the possibility of “incentive compatible reforms” (Hasnain, 2011), that allow for a parallel track approach: technically determined reforms alongside other arrangements to accommodate requirements for patronage and other political economy considerations.
Choosing reform activities only on the basis of what can be “sold” locally has its dangers when underlying incentives are distorting the PFM system. In many developing countries there will be a tendency for reforms to be chosen that result in the least discomfort to stakeholders in the existing (informal) system, and often priorities will be set with the incentive of maximizing rent earning potential. While not doubting that flexibility is required to engage the authorities, there should be no doubt that previously mentioned approaches are compromises to accommodate the current political economy situation in order to allow change to be introduced. However, if they are made acceptable enough, these reform solutions run the danger of being internalized by the ruling power brokers and employed for their own purposes with minimal impact on PFM outcomes. That is, “the reform” will be implemented without anything actually being reformed.

Obviously, getting the authorities to own and lead reforms is essential, but in some contexts making this the prime driver of reform could prove risky and may involve unacceptable PFM trade-offs. Given the previous concerns, donors should perhaps more explicitly re-examine how far technical PFM considerations should be compromised to fit a country’s political economy context. This is not to question the argument that to ensure success reform solutions often require political trade-offs as well as sound technical design. Rather the decision for change managers is how much to trade-off. The position taken in this paper is that reform actions should be advanced to attain certain PFM outcomes, if the risk of not attaining a significant part of these outcomes is too great, or intolerable, the reform should not proceed.

Accordingly, change managers would be guided by the objective that a PFM reform action will primarily address identified technical weaknesses, and accept this as a desirable objective in its own right rather than the means to other ends that powerful actors might want to pursue. The case for each PFM reform action should rest on the attainment of some PFM objective that represents an improvement over the present PFM outcome. If that outcome is so misaligned with the interests of the power brokers then the likelihood is very high that the reform will not succeed. If this is the case then it should be recognized we are still at the first stage of engagement with the authorities, discovering: who might be interested in PFM reform, in what area, what support is there to build on, and how to nurture common interests between power brokers, and generate dissatisfaction with the present system to drive reform. However, if we have already reached this level of engagement and moved on to decide between different reform actions then we have reached the subsequent stage of short-term design and implementation strategy where change management principles are more easily applied. It is this stage of reform planning that is primarily addressed in this paper.

Accepting the need for reform has been “sold” to the authorities and the demand for change exists: how then to accommodate the wide range of external factors indicated in the three tier framework previously outlined? Unfortunately, while the change management literature provides many insights into the factors that are important in ensuring successful changes in institutions, there are many competing analytical frameworks on offer. Although their terminology can sometimes confuse, fortunately their content, as well as the frameworks themselves, exhibit some evident overlaps. A useful way of organizing these factors is to structure them around the three “A”s suggested by Andrews (2008)—Ability, Authority, and Acceptance—factors that

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5 A useful review of this literature is contained in Fernandez and Rainey, 2006.
determine the room for reform in organizations\(^6\). Schematically the approach is summarized in Figure 2 below. His concept of *ability* is centered round the key concept of capacity\(^7\). Generally, there is agreement that successful reform requires resources, especially human resources. However, it is recognized that even with adequate resources, there are constraints in converting capacity (the potential to reform) into capability (actual reform action).\(^8\) The two most important constraints center on authority and acceptance. *Authority* describes the institution’s formal and informal rules that determine scope for action (or discretion allowed for reform), while *acceptance* describes the incentive structure to undertake that action (i.e. to undertake reform).

![Figure 2. Reform space--the three “A”s](image)

Reform space, at intersection of AAA determines how much can be achieved

Source: Andrews (2008)

The following three sections in this paper will take each of the three tiers of external factors in turn, discuss their importance for PFM reform, and examine the implications of applying this change management approach to better define the content and sequencing of a PFM reform program.

### 4. The external political economy environment of PFM reforms: a review

There has been increasing realization of the importance of the political economy setting of any substantial reform initiative, including those in the PFM area. Accordingly, many donors have recognized the value of an initial political economy analysis for any proposed reform.

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\(^6\) Or, in Andrews’ terminology, the “reform space”. It should be noted that Andrews has developed this approach by synthesizing much of the content in the ever-expanding change management literature.

\(^7\) Capacity in this sense covers a range of issues, including vision, management, and technical and leadership skills.

\(^8\) Dressel and Brumby, 2009, make much of this distinction, stressing that even when capacity is high capability may be low, see discussion in Annex 1. It should also be noted that Morgan (2006) provides a comprehensive framework that divides capability into 19 component parts.
intervention to avoid wasting scarce development resources. Notwithstanding the political sensibilities that are often raised in opening a dialogue with recipient countries on such issues, there seems little doubt that such dialogue is a crucial precondition for judging the feasibility and ensuring the viability of many developmental reforms, including those in the PFM area. There is a consensus that this dialogue should utilize a broad-based approach, that not only focuses on the constraints likely to be encountered by any reform, but also the opportunities that exist which if exploited can further the reform effort. Unfortunately, despite a number of valuable contributions and continuing work in the area, there is as yet no agreed operable approach to this risk and opportunities analysis of such broad scope. Notwithstanding the present state of knowledge, this paper encourages this gap be filled, and foresees that it will provide the foundation of the dialogue on PFM reforms with the authorities in initially identifying the need for PFM reform and agreeing the desired areas of intervention. In terms of the reform decision framework (outlined in Figure 2, Diamond, 2010), this should form an important input at the first step of analysis and diagnosis, and inform the initial engagement and dialogue between donors and the authorities in agreeing PFM priorities.

In the absence of an agreed methodology for a comprehensive political economy analysis, it is suggested the inventory of “conditioning factors” presented in this paper, and identified by PFM experts from their discussion of reform design experiences, could make a useful contribution. It must be realized that as a sub-set of political economy considerations it is inevitably incomplete, but it should also be understood the analysis is designed to perform a different function than a full-scale political economy analysis. Unlike the political economy “scoping” analysis that should occur at the initial engagement with the country authorities, it is envisaged that this first tier analysis would be employed as a “filtering device” at a later stage in developing a detailed PFM reform strategy. As such it would act as a “reality check” on the viability of the reform design, especially with regard to its timing and sequencing of reform actions. In this way its emphasis is different from that of the full scale political economy analysis in that: it focuses on short-run political economy considerations rather than the longer-term fundamentals; it examines the viability of specific reform actions rather than broad reform areas; it focuses mostly on the risks rather than the opportunities and, because of this, it emphasizes the supply constraints rather than the enabling demand factors.

As indicated, an environmental scanning framework (ESF) was employed to review and impose some order on possible influences that could impact PFM reform initiatives as indicated in the sequencing literature. The wide scope of the resulting factors is shown in Tables 1 A-D (see Annex to this paper), which divide these conditioning factors into the four main groupings associated with the ESF approach. These tables identify some key factors, indicate how each factor is expected to influence PFM reform, and suggest how indicators could be constructed to measure the likely importance of each factor (columns 1-3). Using these indicators it is proposed that an assessment be made of the magnitude of impact on sequencing from each conditioning factor that could be expected in a particular country context (column 5). This assessment could be no more than a simple ranking consisting of minor, significant, and major. Another column (4) would contain an assessment of the likelihood of this factor coming into play for the

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10 Perhaps the slow progress is not surprising since this is an area requiring multi disciplined teams, and where political economy considerations will differ radically between countries.
particular reform contemplated (under the assumption that some reforms will be more vulnerable than others). Again no more is suggested than a simple assessment by a ranking of low, medium, and high. Between them, these assessments of the size of impact and its likelihood allow an assessment of the risk to reform sequencing posed by each conditioning factor for a particular country for the particular reform activity being contemplated. The approach is pursued further in sections 7 and 8 below.

A brief examination of Tables 1 A-D reveals a number of issues that invite further investigation. First, it is evident that some factors are more widely regarded as being important than others. This is highlighted in column (6) that shows the source reference for selecting a particular factor, and indicates the number of authors that have highlighted this influence on PFM reform. This suggests that not all factors are viewed as having equal weight or that some factors have not been explicitly perceived as significant in analyzing reform efforts.

Second, there are some evident correlations likely between the conditioning factor groupings, for example, economic instability indicators are likely to be correlated with political and social instability indicators. This inter-correlation suggests that it may be possible to either reduce the number of indicators to a few key representative indicators or to suggest important contextual linkages as a basis for identifying different types of reform environment.

Third, there are also some conflicting interpretations of a conditioning factor’s influence. For example, does more support from donors exert a positive impact on reform (through greater resource availability, sharing of knowledge, technology and experience) or negatively does it encourage dependence, undermine local reform initiative and ownership and weaken sustainability?

Fourth, it is as well to recognize that some conditioning factors could exert an influence at different levels. That is, assigning a conditioning factor to the top level of environmental influence for any particular country, or with regard to a specific reform initiative, will depend on the contextual analysis. It is possible a factor may exert more influence at the internal operational level rather than as an external environmental driver. For example, the technological capacity of a country, and in particular the extent of IT expertise, is typically assigned to the environment level in a PETS analysis. However, this influence on reform success may be more pronounced at the lowest operational level in PFM organizations (see section 5 below).

Finally, there is often an important analytical difference in the way these factors have been identified. It is as well to note that many of the factors included from the review of the literature were derived from studies, such as Andrews, which analyzed differences in the level of PFM systems between countries. Empirically it is important to distinguish results from comparative statics, or differences in levels, from the more dynamic concept implied by reform, of changes over time.

Given these issues, it can only be concluded that the conditioning factors and their indicators included in Tables 1A-D would benefit from further refinement, and, in particular, further empirical investigation as to how closely they are associated with reform success.
5. The institutional structure of PFM systems

Nearly all contributors to the sequencing literature have viewed the input of a strong MOF, acting as the leader and manager of the reform process, as essential to reform success. However, the power of the MOF in different settings is often determined by the wider institutional structure of a country’s PFM system. Although the role of the MOF is usually central to PFM reform, institutionally the span of the PFM system is much wider, also including the legislature, the Cabinet, the line ministries, departments and implementing agencies of government. The power of the MOF to initiate and implement PFM reform is often constrained by this wider institutional setting.

Just as there are many players in the PFM system responsible for ensuring the deliverables of the system, there are many that can influence the way changes are made to the system. One important influence arises from the fundamental split between the legislative and executive branches of government. The legislative branch, consisting of the politicians supposedly representing the population’s preferences, are typically charged with endorsing policies (including those regarding reforms), authorizing policy actions, and then holding the executive responsible for successfully implementing these policies. However, in some systems, (such as the USA), the legislature is more proactive in formulating policy and, more recently, independent fiscal councils, (Office for Budget Responsibility), also may have a role to play.

Within the executive branch that is required to formulate and execute policies, there is a differentiation in roles. The central policy maker, the Cabinet, approves the aggregate resource mobilization and allocation decisions that underlie the budget based on an analysis developed by the central financial agency, usually the finance ministry. The latter develops the aggregate budget strategy, is required to present budget plans to the legislative branch for approval, and then to oversee the approved budget’s successful implementation.

The detailed resource planning and actual implementation of policies is generally carried out by decentralized organs of the executive branch, typically organized in line ministries and agencies dealing with specific policy sectors. Thus in the design of any PFM system there are three main institutional relationships that are central in influencing how successfully the MOF can lead and implement PFM reforms, namely:

- Between the legislative and the executive branches of government, broadly defining the MOF’s role in the system.
- Between the central executive (or Cabinet) and the central finance agency, (usually the Ministry of Finance), defining the degree of MOF authority in driving reforms.
- Between the MOF and the line ministries and their departments and agencies, defining the degree to which the MOF can manage reforms within the system.

In many cases, the way these relationships are designed can constrain rather than support PFM reforms.

- **Relationship between legislative and executive branches**

The powers of the legislative branch over the way the PFM system functions vary widely between countries depending on their legal framework, the type of government system operated...
the reality of the underlying political control of these institutions. The formal powers granted to the legislature by law with respect to its approval, review, oversight powers, and critically its ability to change the executive’s budget proposals, are determined by each country’s legal framework often at the level of the constitution. However, it should also be recognized that mechanisms of political control which are not formally defined in the law may also significantly impact the use and importance of these formal powers. As a consequence of the interplay of both factors, there are large variations in the formal scope of legislative powers and their actual effectiveness.

In some countries, the legislative branch can submit its own budget, reflecting its policy priorities, without reference to the executive branch’s proposals. In other countries, the legislative branch has great powers to vary budget allocations, and hence policy priorities, as long as they do not exceed the total spending limits. In still other countries, they can exceed the total limits as long as they bring forth equivalent revenue increases to cover the difference. Such differences reflect deeper institutional design parameters that arise from historically determined checks and balances between institutions.

In contrast to this flexibility, there is the large number of countries which follow a parliamentary system of government where the legislative branch has only the power to formally approve or reject the budget, the latter decision typically forcing the government out of power. Differences in powers over the budget policy also are mirrored in powers over changes to the budget system. Consequently, the type of government, and relative powers (formal and informal) between legislative and executive branches, will influence the choice of channels through which PFM reforms will be initiated, the nature of the approval process required, and how reforms will be managed. In so doing, this will necessarily influence the role of the MOF in the reform process.

It should be recognized that for many developing countries, while such formal relationships exist, there are important political influences that may override the formal system with an informal system. For example, formally, the budget should record all resources collected by the government and the different ways they are to be employed during a given period of time. This view of the budget as a policy document that is central to a country’s political decision making is one that dominates advanced countries. The reality in LDCs is that the government may pursue its policies outside the budget, either through extra-budgetary funds or through public institutions by means of quasi-fiscal operations. Implementing policies requires resources. However, resourcing decisions in the government sector are unlike those in the private sector where there is a voluntary exchange of resources, and a strong link between benefits received and resources sacrificed. The people that make public resource allocation decisions are doing so employing resources that are often coerced from the population rather than donated freely. Not surprisingly, there is a constant tension between those making the resource decisions, the policy makers, and the constituent population that pays the taxes and perhaps (or perhaps not) gains benefits from government spending. Most important there is no one-to-one correspondence between the amount paid by an individual and the benefits derived from government spending. Most political systems work to resolve resource allocation disagreements so as to promote convergence on
what policy makers decide to spend on and what the constituent population wants. But, with the inevitable comprises this requires, divergences remain even in OECD countries.

This often leads to some well recognized defects in public sector resourcing decisions. In some cases there are blatant abuses of power in resourcing decisions. For example, some political systems there are vast divergences between citizens’ demands and resource allocation decisions when resources are captured by political elites or well-connected specific interest groups. Or even cases of outright theft by policy makers who direct resources to benefit themselves and their most influential supporters as a means to perpetuate their political power. The ease with which public resources can be captured often depends on the main sources of revenue generation. This is usually less problematic when a large part of public revenue is generated from mineral resources or from the operations of specific publicly owned entities, rather than when revenues are raised much more transparently from the population as a whole.

- **Relationship between Cabinet and MOF**

For successful PFM reform ideally the relationship between the Cabinet and the central finance agency, (particularly that between the Prime Minister and the Minister of Finance), should be fully coordinated. Both should work together to develop a reform strategy and take decisions that underpin the reform. Often this close coordination is not realized. Decisions in Cabinet are made jointly, and typically are subject to extensive bargaining. Coherence in overall reform strategy often depends on the strength of the PM, or the Minister of Finance, to persuade their colleagues and ensure consensus over reforms. In some political situations, such as the case of coalition governments, this becomes even more difficult to achieve. The institutional structure for taking top-level policy decisions, hence the status of the Minister of Finance, also exerts an influence.

In parliamentary systems, where decision-making is centralized, and where the Ministry of Finance is undisputedly first among equals, there is potentially a greater possibility of reform coherence and a clearer role for the MOF as the driver of reform. In countries where there is no supreme financial authority, and there are different organizations involved in PFM this becomes more difficult. However even in parliamentary systems the role of the MOF can be circumscribed in various ways:

- *Often the coverage of MOF powers* is incomplete. For example, a large part of government policy may be executed outside the budget and the regular PFM system, through EBFs or quasi-fiscal operations. These are often areas where PFM reforms are most needed, but where the MOF has only indirect supervisory powers.

Also, there is often *an institutional dilution in its powers*. A not uncommon arrangement in developing countries is for a powerful Ministry of Planning/Development, (or perhaps a Donor Coordination Function), to exist alongside the MOF. While the latter is in charge of the recurrent budget, the former is in charge of the capital budget and longer-term development planning, and as such often acts as donors’ principal interlocutor. It has already been mentioned that often

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11 For example, a general problem is the so-called “tragedy of the commons”. Due to the disconnect between the costs of policies and their benefits, where benefits are private but costs are public, there is a tendency to over spend. In nearly all systems there can easily develop a competition for public resources and a bias to meet the demands of specific groups regardless of cost, allocating more resources in total than is optimal for the society as a whole.
important extra-budgetary or quasi fiscal activities result in resource allocation decisions that are outside the MOF’s control.

There are also likely to be a number of constraints arising from the MOF’s internal structure. For example, policy (e.g. macro, budget, development, etc) functions may be subject to checks and balances from regulatory functions (e.g. treasury management, accounting, internal audit). Much depends on the cohesion or rivalry between MOF departments. The latter in turn depends on the existence of coordinating (management teams) and integrating functions (working groups) and their effectiveness in allowing the MOF to deliver its mandates. In addition, the MOF like other ministries, (and perhaps more so given its usually elite status), faces the issue of how well human resource management frameworks support the recruitment, retention, and motivation of skilled personnel, (factors that are dealt with in more detail in section 5).

In presidential systems the central PFM functions are often fragmented, for example, between a budget office, a Treasury, and a planning and policy office answering directly to the President—all with potential significant inputs to reform formulation and implementation. A consequence of the fragmentation found in such institutional arrangements is that reform objectives and priority reform measures are often vaguely, or partially, articulated. In extreme cases there is a mismatch between reform ambitions (under one office) and the required funding (under another). Without the direct intervention of the President, the resulting success of PFM reforms can be disappointing. In these environments it is the President, or his special appointee, rather than the finance minister who is likely to be the more powerful driver of reform. Thus whatever the system of government, there are likely to be a number of challenges that can seriously impact the sequencing and effectiveness of PFM reform efforts within the MOF, as well as its ability to support reform implementation at the line Ministry level.

- **Relationship between MOF and line ministries**

The PFM relationship of the MOF to the line ministries is generally seen as one of facilitator and watch-dog. The MOF’s mission is to secure required resources for line ministries to implement their sector policies at a level that does not destabilize the economy, while assuring that resources are being used in accordance with budget appropriation. An additional function, although in many countries seldom fully pursued, is that of an oversight role to also ensure that resources are being employed efficiently and effectively in attaining policy objectives.

Unfortunately, the MOF often faces a number of challenges in fulfilling these core functions, especially in developing countries where funding year to year is often difficult to predict with accuracy and planning and budgeting processes do not confront policy choices. As a consequence the MOF’s priorities for an appropriate budget balance are sometimes difficult to reconcile with those of the line ministries. This challenge is even more difficult if these differences also reflect: broader political and policy divisions with the executive; unrealistic budget assumptions in respect of revenues, expenditure or financing envelopes; or, resource allocations that do not reflect realistic resource input costs of delivering public goods or services in line with policy objectives and service delivery standards. Specifically, when resources are not

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12 The core functions of a finance ministry are comprehensively described in Dressel and Brumby, 2009, Table 1, p.1.
forthcoming as planned in the original budget strategy, the MOF may feel compelled to focus on reconciling expenditure with attainable resource levels to ensure overall fiscal discipline.

In anticipation of this, the MOF often operates large contingency funds or reserves, or assumes levels of under-spending on certain resource categories (i.e. capital) that allow scope for substantial re-budgeting efforts during the year and, when applied, effectively undermine the official budgets of ministries. The severity and unpredictability of the funding shortfall often means that the MOF must also resort to within-year budget cuts. In some countries in periods of unanticipated or severe macro fiscal imbalances the MOF is forced into cash rationing, releasing spending authorizations and cash backing month by month, or even shorter periods, depending on resource availability. In this environment resource allocations are likely be determined by political economy considerations rather than technical ones, with some ministries favored over others. In such cases it is almost impossible for the line ministries to manage their budgets in an efficient way or to fully attain policy implementation—in effect the MOF has taken over the management of their budgets. The scale of the resource gap, and how well the MOF is able to handle this gap, determines how well sector ministries are able to implement their policies. Often, however, the resulting relationship between the MOF and ministries is adversarial and as such can spill over to MOF-led PFM reform initiatives. In this resource-constrained environment the ministry may have little ownership of the formal budget, and in its attempt to deliver services adopt “informal” procedures in complete disregard of financial regulations. This in turn usually prompts more central control, from the MOF. The result is that the way the PFM system works in practice, shows considerable deviation from that formally described by law and regulation.

The nature of the relationship developed between the MOF and the ministries has important consequences for PFM reforms that rely heavily on the cooperation of line ministries for their successful introduction and their operation. If the MOF develops a paternalistic or control mentality towards line ministries this will tend to stifle line ministry management initiative and the development of organizational and PFM skills within line ministries. In turn, this impacts negatively on a range of factors that many writers have emphasized as critical to successful PFM reform: the internal organization of the reform process within institutions; individual incentives of leaders and followers; and the development of adequate skill capacity at the operational level. These will be discussed more fully below.

Employing this three “A”s approach, as outlined in section 3, it is possible to filter the most important factors determining the MOF’s authority to initiate and lead reforms (centered on the strength of its leadership role); the factors that influence acceptance of reform (including the level of support from stakeholders outside the PFM system, within the PFM system and within the MOF); and the ability of the MOF to plan and implement reforms, (focusing on its managerial and technical capacity, its current workload and commitments, and available financial resources). Table 2 describes these factors, illustrates how they could be ordered, and suggests possible indicators of their importance.

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13 It has also to be recognized that in some countries, where financial management and control has been assigned a low priority, line ministries have exploited this weakness to secure unsustainable budgets and undertake inefficient and ineffective expenditure.
<table>
<thead>
<tr>
<th>Describe factor</th>
<th>Possible Indicators how this factor impacts reform</th>
<th>How important for this type of reform</th>
<th>How likely in this country</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>AUTHORITY</strong></td>
<td></td>
<td>High/med./low</td>
<td>High/med./low</td>
</tr>
<tr>
<td>Leadership role of MOF in PFM system</td>
<td>Does MOF require approval from legislative branch for proposed reform? If so how likely will it be forthcoming? Formal status of the Minister of Finance in government: presidential vs parliamentary? If latter: majority or coalition? Is the Minister fully behind the reform and/or Is it driven from above (President?) or From below (technocrats)? Stability of minister assured or likely to be changed within reform period?</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Leadership role of the MOF in this reform project</td>
<td>How important is the MOF in resource allocation? For example, what percentage of total government expenditure does it control? Are there other important central government entities that can challenge MOF leadership? In reform implementation will MOF have operational autonomy, or will this be shared?</td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>ACCEPTANCE</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Level of support for reform outside PFM system</td>
<td>How broad is the support base? (Cabinet, legislative committees, business community, unions, NGOs)? Level of public discussion of the reform? Are donors as a group supportive or are they divided? Is there a high level steering committee in place?</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Level of support within the PFM system</td>
<td>Do the MDAs support the reform? Is the relationship between MOF and MDAs cooperative or adversarial? (friction from use of cash rationing; powers of virement etc) How much effort has MOF spent explaining the reform to other PFM managers?</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Level of support within the MOF</td>
<td>Is there a designated manager of the reform? How much of his time is dedicated to the reform? Are MOF managers in full or divided support? Degree of rivalry between MOF departments? Degree to which the reform implementation is concentrated in one MOF department? Level of morale within MOF staff?</td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>ABILITY</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>MOF Managerial capacity</td>
<td>Has the MOF assigned suitable management resources to implement this reform? How stable will MOF top and middle management be during reform period? What is the MOF’s reform record with previous reforms?</td>
<td></td>
<td></td>
</tr>
<tr>
<td>MOF technical capacity</td>
<td>Does the MOF have staff of adequate technical capacity to implement this reform? Will specialist skills be required?</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Describe factor</td>
<td>Possible Indicators how this factor impacts reform</td>
<td>How important for this type of reform</td>
<td>How likely in this country</td>
</tr>
<tr>
<td>----------------</td>
<td>--------------------------------------------------</td>
<td>--------------------------------------</td>
<td>----------------------------</td>
</tr>
<tr>
<td></td>
<td>Is there adequate outside assistance committed, in TA and training?</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
| Workload       | Is the workload of MOF top and middle management presently excessive?  
Are the MOF undertaking other parallel reforms?  
Are there likely to be major work distractions in the period, e.g. due to fiscal stress? |                                      |                            |
| Financial resources | Is the financing available/adequate for full implementation of the reform?  
How much required financing is contributed internally and how much from donors?  
What has been the past experience in mobilizing donor assistance? |                                      |                            |

6. The internal organization of PFM systems

Too often it is found that PFM reforms once launched, and even successfully pilot tested, stumble when it comes to implementing them in the line ministries and their delegated entities. This Quist (2009) has termed the “roll out effort” which he emphasizes is important to understanding reform sequence, and which he views as critical to success. Andrews (2010) has also stressed the problems involved when reforms span many institutions, or become “deconcentrated”, rather than concentrated in a single central PFM agency. One explanation of this slow-down in implementation is the increased pressure of work on central agencies guiding the reform through an increasing number of entities. However, another, and perhaps more important, explanation lies in the problems encountered in the receiving institutions and in their capacity to internalize reforms. Hence, a useful starting point for analyzing the problems faced in implementing reforms is to understand the range of internal constraints typically encountered in ministries, departments, and agencies (MDAs). Kiggundu (1989) provides a typical profile of PFM organizations in a developing country, which with some adaptation is presented in Table.3 A-C.
### Table 3A. Top management profile

<table>
<thead>
<tr>
<th>ABILITY</th>
<th>HR capacity</th>
<th>Skills high; educated; articulate, well travelled</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Systems capacity</td>
<td>Weak executive support systems</td>
</tr>
<tr>
<td></td>
<td>Capability (workload)</td>
<td>Extensive extra organizational activities; overworked and often overwhelmed</td>
</tr>
<tr>
<td>AUTHORITY</td>
<td>Decision making</td>
<td>Authoritarian, paternalistic, centralized decision-making</td>
</tr>
<tr>
<td></td>
<td>Controls</td>
<td>Top-down centralized control Politicized ; informal controls important e.g. relations with top management colleagues</td>
</tr>
<tr>
<td>ACCEPTANCE</td>
<td>Motivation</td>
<td>Long-term opportunistic (are survivors); high job turnover; Often no clear mission or direction, but style of short-term crisis management</td>
</tr>
<tr>
<td></td>
<td>Remuneration</td>
<td>Relatively low for skills compared to private sector</td>
</tr>
<tr>
<td></td>
<td>Morale</td>
<td>Poor; possible reform fatigue</td>
</tr>
</tbody>
</table>
Just as in the case of the MOF, it is instructive to take the three central concepts of authority, acceptance and ability, and apply them to Kiggundu’s profile of the typical MDA in a developing country context, as shown.

*Ability*, or the potential to undertake reforms, is most obviously constrained in most LDCs. Managerial skills, and skills of all kinds, are limited and are generally difficult to retain and develop due to poor wage scales vis a vis the private sector, and the increasing demands from this sector for these skills as development progresses. Special problems exist at the top management level where one would expect the drive for reform to be critical. While in many ways top managers have the skill capacity, this is often undermined by poor middle management
support, and considerably diluted because of overwork, job mobility and top-down centralized controls. However, even with the skills available, it is clear that in most LDCs public institutions do not get anywhere near their potential “production frontier”, i.e. do not translate this actual capacity adequately into potential capability. The reasons are not hard to find.

Part of the problem lies with the authority structure within the public sector. The formal structure in the LDC context is typically hierarchical, with decisions emanating from the center and allowing little discretion for those lower down the chain of command. As a consequence, the top staff in MDAs are viewed as administrators of public funds rather than managers per se. This is aggravated by a reward system typically based on seniority rather than ability, and where those that display ability are usually over burdened by increasing workloads caused by lack of complementary resources, especially the low skill level of the staff under them.

In this hierarchical system one could expect centrally directed reforms would meet little resistance, i.e. the acceptance level would be high. However, overlaid on the formal authority structure is an informal one. As indicated previously, MOF priorities may not be aligned with those of the line ministry and the relationship is often adversarial. Top civil servants are often political appointees or associated with a political party, often aspiring to join the political elite. Often a line ministry is captured by its clients, where key ministries pander to their constituent interest groups, often the key industry in their sector or the local politicians. Information asymmetries are very high in the LDCs context where reporting is slow and limited, and where reports are seldom audited. In this environment the authority of the central PFM institutions is often undermined, especially when trying to introduce reforms that change the relationship between the line ministry and its key stakeholders.

In any reform of PFM systems there are likely to be gainers and losers and acceptance of the reform will depend critically on the gainers prevailing over the losers. However, in this calculation it may not be actual gains and losses that are the important factor but perceived gains and losses. For example a top bureaucrat may be expected to gain from a computerization project (ease his workload) or external funding of reforms (increase his budget hence potentially better reward his clientele groups). But much will depend on his perception of these gains. These potential gains may be heavily discounted if there have been several failed reform initiatives in the past (often the case in LDCs), and he and his staff are suffering from reform fatigue.

Accepting this profile of MDAs’ internal organization, it is hard to disagree with Andrews that the “space” for reform can be quite limited in many LDCs by the characteristics of the “three As” encountered: ability is limited, authority is diffuse, and acceptance is likely to be very weak. Of all these problems faced in introducing and sustaining reforms at the operational level in a LDC environment, it could be argued that there are certain key elements which appear critical. Or, put another way, in increasing “reform space” three key binding constraints require to be overcome:

- Key authority factor: Internal leadership

---

14 Hence the importance of political support at the top level, often stressed as critical in the change management literature.

15 See Andrews’ finding that the time of reform period is important—the longer the time period reforms are sustained then the greater the perceived gains will be.
Leadership is deemed critical in change management. The change management literature stresses how top managerial leaders should persuasively communicate the need and vision for change; facilitate planning of an implementation strategy and develop and approve a course of action for the strategy. This will also require building external support from political overseers and key stakeholders. In the LDC environment this may not be easy since ownership may be lacking. Gauging the importance of this factor requires addressing a number of related issues. Does the drive for reform come from above? Does the minister see eye to eye with the MOF on the need for reform? Are there any mechanisms which allow the ministry management to influence the direction of the reform and respond to the challenges? Did the minister volunteer his ministry or was it selected from above (e.g. PM or president)? Does the top manager see the reform as that of the MOF rather than his ministry? Without support from below, unable to delegate, and stretched to full capacity, how will he make time for the reform workload? Is there a drive for reform from the ministry’s stakeholders, the business community, or client base?

- Key acceptance factor: Management commitment to implement reforms

The change management paradigm stresses the need to maintain the drive to guide and maintain reform momentum. Top managers are expected to build internal support and overcome resistance, and devote sufficient time and effort to encourage participation of personnel at all levels. In the LDCs environment maintaining pressure for reform internally will likely be difficult. A number of questions should be raised: How is the top manager likely to view the reform’s impact on his day-to-day work, positively or negatively? How much fiscal stress does he face in day-to-day operations? If the top manager is in fire-fighting mode dealing with uncertain and limited funding for his regular budget activities, how much time is he likely to devote to reform? Or alternatively has he been assigned work commitments outside his organization that are taking up an increasing amount of his time? How much effort will he devote if he is expected to implement other reforms at the same time, or he has just terminated an unsuccessful previous reform? How much time will he devote if he expects to be released soon for training or is due to be rotated as part of regular career development? How much effort will be required to get the reform accepted--is lower level staff likely to be willing to cooperate in reform activities or resist them?

- Key ability factor: adequate HR resourcing

It is agreed that the provision of adequate amounts of financial, human and technological resources is essential for most reforms. However, most writers have stressed the importance of adequate HR resources. In this respect it is often not the amounts but the quality of inputs that is critical in the LDC context. Trained and skilled manpower are difficult to find, and there will be resistance to deploying them from other work to bolster the reform effort. The purchase of computer hardware and software tends not to be the binding constraint, but rather the training required in new procedures and the retention of those trained personnel that will be critical to sustaining reform. This raises such questions as: Can adequate skilled personnel be found? Can suitable staff for training be identified? How long will it take to train staff, and to internalize and institutionalize new processes? Will outside donors finance and provide the training? Can it be guaranteed that trained staff will be retained for a sufficient period? Can this capacity building be realistically accomplished before shifts in political leadership cause commitment to and support for the reform to dissipate? Is there any latitude to adjust pay scales to attract staff? Is there a
parallel on-going or planned public administration reform program that may have a future impact?

Ensuring these constraints are adequately addressed will have a positive impact on the reform outcome, and is also likely to be cumulative in effect: resolving each factor will contribute to successful reform implementation and help relieve the other constraining factors. While these prescriptions seem somewhat trite, simply amounting to common sense, in practice most PFM reforms have faced severe obstacles in resolving them. Even a cursory review of reform experience in LDCs reveals how often these three constraints have been underestimated. Table 4 attempts to summarizing these factors and suggests some possible indicators to assess their importance.
Table 4. Some key factors affecting reform arising from internal organization of PFM entities

<table>
<thead>
<tr>
<th>Describe factor</th>
<th>Possible indicators how this factor impacts reform</th>
<th>How important for this type of reform</th>
<th>How likely in this country</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>AUTHORITY</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Internal leadership</td>
<td>How committed is the Minister/PS?</td>
<td>High/med/low</td>
<td>High/med/low</td>
</tr>
<tr>
<td></td>
<td>Did he instigate or volunteer for the reform?</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>Has he assigned a dedicated manager for the reform?</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>How committed are top managers?</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>How much capacity do they have to implement the reforms?</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>Do they have adequate technical skills?</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>Or will they need assistance? Is any planned/available?</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>Presently how high is their workload?</td>
<td></td>
<td></td>
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<tr>
<td></td>
<td>Can that be adjusted so they can devote adequate time to the reform?</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>How likely is top management to change during the reform period?</td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>ACCEPTANCE</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Management incentives</td>
<td>How difficult is it to execute their budgets as planned (indicated by arrears, re-budgeting, etc)?</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>Will the reform, once implemented, reduce or increase management's present workload?</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>How much is the drive for reform viewed as from MOF rather than the minister?</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>Is the regular interaction with the MOF cooperative or hostile?</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>How much support/pressure can managers expect from their staff? Are they generally hostile, indifferent, or supportive of the reform effort?</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>How much support/pressure can managers expect from their sector stakeholders (business community, client base, NGOs)?</td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>ABILITY</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Adequate HR resourcing</td>
<td>Does the MDA have adequate trained staff to operate new reform procedures?</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>Does the reform require any specialist skills presently unavailable?</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>If not are there opportunities to recruit or re-deploy staff?</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>Can suitable training be identified/financed?</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>Can staff be adequately trained to institutionalize the reforms in a reasonable time frame?</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>What incentives can be provided to staff to retain them once trained?</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
7. Analyzing the Reform Risk imposed by the External Factors

Three types of risk have previously been discussed that may impact the success of PFM reform projects: those arising from the general socio-economic environment; those from the way the PFM system is designed; and those from the internal organization of PFM operations. All three sources represent risk which may generate uncertainty over the outcome of PFM reform actions or alternatively, focus attention on opportunities where reform is likely to be supported by the task environment. It is argued that this three tiered framework, once refined through empirical testing, should then be employed to provide a risk and opportunity assessment of any PFM reform project. Such an assessment calls for identifying the significant risks (i.e. create a risk register); to then assess their level of impact and the likelihood that the impact will materialize (i.e. score these risks in some way); and then perhaps to go further and to suggest any changes to project design to mitigate those that cannot be tolerated (i.e. review the response required) or strengthen those supportive of reform.

In this way it is proposed that donor agencies engaged in financing reform projects should be in a better position to assure their regulators that they have determined the risks that are faced by these projects, and be prepared to disclose the dominant ones as well as the methods they have employed to address them in the project’s design. This should mirror the accountability requirements now included in the private sector, and increasingly endorsed by many donors, where an organization is expected to report on the risks it faces, both ongoing and in new projects, the risks it is prepared to accept, and the action necessary to manage those risks it is not prepared to accept.

To provide this assurance the first step is to identify risks in a way that permits them to be ranked in order of their impact on reform. In describing the above three categories of political economy influences, this paper has made a preliminary attempt to provide a framework for constructing this risk register. The register as a statement of risk should, along the lines of Tables 1, 2 and 4, encompass the cause of the impact, and the relationship which might arise between the impact and the reform objective (i.e. “cause and consequence”). Ultimately there can be no off-the-shelf list of threats to a reform, but rather risks should be identified (and managed) by those responsible for the project. It is hoped, however, that the lists offered in this paper could be used to guide the reform manager’s identification of risk and to check whether it is comprehensive enough.

After identification, the next step is then to assess the degree of risk from each factor. This requires considering two dimensions of risk: the likelihood the impact will occur and consequences if it does. At its simplest, the likelihood can be assigned three categories: low, medium, high. Similarly the consequences of the impact on reform success can also be assigned to three categories: small, significant, and major. Thus at a minimum a 3x3 matrix should suffice, see matrix below (Figure 3). In this way, however simply, a clearly structured process

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16 What is required is a structured and prioritized list of inherent risk, that is as complete as possible, always recognizing that by their nature not all risks can be know.

17 It can only be expected that the actions take in response to “inherent” risk will reduce this risk to an acceptable level (“residual risk”), not eliminate it.

18 Another approach is to assign a score to the consequence and to the likelihood of risk (e.g. 1 to 5), to give a numerical value that can then be combined to provide an overall score. Thus risks can be numerically assessed on a scale from 1 (1x1) to 25 (5x5). For a discussion of scoring see UK Treasury, 2004.
can be provided in which both likelihood and impact are considered for each factor, and can be recorded in a way that facilitates monitoring and the identification of priorities. In setting priorities it should be noted from Figure 3 that it is not the absolute value of an assessed risk which is important, but rather whether or not it is regarded as tolerable. How far the exposure of risk is away from “tolerability” is to be determined by those deciding if the reform action is justifiable. Certainly a project where there are a large number of risk factors assessed in the highly likely/ major impact range (top right hand corner in Figure 3) should be re-examined.

Figure 3. Risk Tolerability Matrix

![Risk Tolerability Matrix Diagram]

Given the large range of possible political economy factors impacting the success of PFM projects, the approach described above may appear overly burdensome. However, three dimensions of the problem may simplify the task:

- Different types of reform actions are likely to face different degrees of risk impact from the same external factor

The success of a particular PFM reform will be influenced to a different degree depending on the nature of the reform itself. Reforms can be characterized in many ways, but often the dimensions are highly correlated. For example, reforms can be characterized by their scope, whether this is wide or narrow, but this simple categorization is likely to encompass other dimensions that could be considered significant when designing and sequencing reforms. Wide reforms will involve more than one PFM institution, (or are “de-concentrated”); they are likely to involve new procedures hence changes in behavior (or are “de facto” reforms), they involve more roll-out effort and thus take longer to complete. Andrews suggests these will be more down-stream
reforms, i.e. concerned with budget implementation. At the other end of the spectrum will be the extremely narrow reforms. They are likely to be contained in one institution, (i.e. concentrated), will tend to be rule changing rather than behavior changing (i.e. de jure reforms), involve limited roll-out effort, and be faster to complete. This will tend to be more up-stream, concerned with budget preparation. The “visibility” of reform, especially to key politicians, may also be a dimension that can be included here. Due to their dispersed nature, their focus on PFM processes, and the time required for their adoption, wide reforms may not be quite so visible as narrow reforms whose reform action is more confined and immediate. Recognizing key risks will vary with the type of reform action, it may thus be possible to assign average risk assessments by type of reform project as, for example, shown in Figure 4 below. This approach is further elaborated in Section 8 below.

Figure 4. Risk impact arising from different types of reform

<table>
<thead>
<tr>
<th>Scope of reform action</th>
<th>Level of risk impact</th>
<th>Level of risk impact</th>
<th>Level of risk impact</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>low</td>
<td>significant</td>
<td>major</td>
</tr>
<tr>
<td>Narrow</td>
<td>?</td>
<td>?</td>
<td>?</td>
</tr>
<tr>
<td>Medium</td>
<td>?</td>
<td>?</td>
<td>?</td>
</tr>
<tr>
<td>Wide</td>
<td>?</td>
<td>?</td>
<td>?</td>
</tr>
</tbody>
</table>

- Different types of external factor are likely to pose different degrees of risk depending on the type of reform

At the same time, each of the three categories of political economy factors—conditioning factors, those arising from institutional design of PFM, and those arising from internal organization—will likely impact the success of PFM reform to a different degree. For example, generic factors arising from the wider political economy context (as identified through the PETS analysis) are likely to affect the climate for reform, and as such are likely to exert a diffused impact on all types of reform, but perhaps not critically for any one reform. The political economy factors that arise from the structural characteristics of the PFM system itself are likely to affect more specific types of PFM reform depending on how they are dependent on these design factors. For some reforms these may prove critical constraints to reform, but for others not so critical. The factors that arise from the internal organization of PFM institutions, are the most likely to be specific in affecting reform actions that require to be undertaken in those institutions. It may thus be possible to assign average risk assessments to different groups of factors.

Figure 5. Risk impact associated with different categories of external factors and type of reform

<table>
<thead>
<tr>
<th>Scope of reform action</th>
<th>Conditioning factors</th>
<th>PFM institutional structure factors</th>
<th>Internal PFM organization factors</th>
</tr>
</thead>
<tbody>
<tr>
<td>Narrow</td>
<td>Small</td>
<td>?</td>
<td>Major</td>
</tr>
<tr>
<td>Medium</td>
<td>Significant</td>
<td>?</td>
<td>Significant</td>
</tr>
<tr>
<td>Wide</td>
<td>Major</td>
<td>?</td>
<td>Small</td>
</tr>
</tbody>
</table>
Risk factors are likely to be highly correlated

Specific risks are unlikely to be able to be addressed in isolation from each other. One risk is likely to have an impact on another. For example, the risk of political instability (a conditioning factor) may impact the power of the Minister of Finance to drive reforms, (a significant PFM structural factor). Risk factors may be highly correlated with each other, even in the same category. For example, political instability may be highly correlated with economic and social instability. As a result, instead of dealing with the full range of external factors it may be possible when assessing the threat to a particular reform action to concentrate on a sub-set of key risk factors.

8. Employing the risk analysis to determine reform strategy

As argued previously sequencing involves two dimensions: the timing of reforms and the order in which reform actions are taken. It is envisaged that the risk analysis described above can be employed to assist in both dimensions of the sequencing problem.

- As a filtering device determining timing/pace of reforms

At the highest level, a review of the conditioning factors and the likely constraints/opportunities available, allows countries to be ranked, with some representing riskier reform environments than others. If there are certain risks that exceed tolerable levels, this is an opportunity to pause in the reforms, or to seek measures to address the major perceived risks. Often this represents a timing problem in sequencing reforms—for example, waiting for a presidential election to be held to determine the continuing commitment to reform, or a fiscal policy issue to be resolved in order to bring required stability to the public finances and create a more stable reform environment. Even if the overall environment displays an acceptable level of risk, in the short-run risks could be considered too high at a lower level and to require adjustment in the timing of reform. For example, there may be a need to complete an institutional re-organization, train/recruit suitable staff, or appoint a critical manager before these risks can be reduced to a tolerable level. Once the risk level is judged tolerable, a more detailed analysis of risks of different reform packages can take place.

- As a filtering device determining the content of reforms

From the sequencing literature certain dimensions of reform activities have been identified as critical in implementation. They would also appear to be highly correlated. As suggested above, the wider the scope of reform actions the higher the associated risk to success.

“Narrow” reforms, involving one or two specific reform actions—the passing of legislation, or new regulations, the introduction of new procedures in one central institution (i.e. more visible, take less time, are de jure and concentrated)—involve the least risk. “Wide” reforms-involving the introduction of new procedures across a wide range of budgetary institutions, with associated training and changes to IT (i.e. less visible, take more time, are de facto and de-concentrated)—face the highest risk. Employing the risk analysis, the content of the reform should be tailored to match the assessment of environmental risk. Of course, the two
dimensions--content and timing--are not independent. While the level of risk will depend crucially on the content of the reform package and the scope of its application, it is always possible to lower risk by a slower implementation of these reforms, i.e. change the pace of reform. This interdependence is evident when examining the critical dimensions of any reform action.

It is proposed that the technical dimensions of any reform action that are likely to most influence the risk of failure in implementation are:

i. **Scope of the reform**, describing the number of required reform actions, their degree of complexity, their interconnections in the PFM system. Risk can be mitigated by re-designing the reform program, by reducing the number of individual actions, simplifying their complexity by a longer period of phasing in, and strengthening other related PFM processes.

ii. **Time required to complete the reform actions**. Risk can be mitigated by a slower phasing in of reform actions, and building in consolidating pauses in their introduction to allow time for learning on the job.

iii. **Number of institutions involved** (i.e. concentrated or de-concentrated). Risk can be mitigated by the often employed pilot approach that allows phasing in the coverage of institutions and by a strategic choice of pilots to demonstrate success.

iv. **The degree to which procedures and behavior must be changed**. Choosing between reform actions that require changing rules or changing behavior (de jure or de facto) is not easy, but risk will be mitigated by concentrated on the first category, even though this may lead to biases in reform impact.

v. **Visibility of reform actions**. From the political economy and change management viewpoints, it could be very important how easy (or hard) it will be to demonstrate success in implementing a reform action. This is often dictated by the time lag before benefits are seen. Risk will be mitigated by choosing high visibility reform actions with a short time lag. Again the price may be paid in reform impact: biasing reform actions to up-stream, de jure, concentrated, short-run reforms.

This review of the technical dimensions of reform actions indicates a trade-off is likely between risk and reform impact, as shown in Figure 6 below:
Figure 6. The trade-off between reform impact and risk

Matching the reform strategy to the risks implied by the associated reform actions implies resolving this trade-off between reform impact and the level of risk. *The guiding principle is a high risk reform should only be attempted in a low risk environment.* Applying this guiding principle it is possible to re-examine the different reform strategies encountered in the sequencing literature:¹⁹

- **Strategic or “low-lying fruit” approach:**
  This approach will cover reforms narrow in scope, de jure, concentrated in one institution, implementable fast, but most likely narrow in overall PFM impact. This is a low risk approach to reform, and a good strategy in a high risk country.

- **Local demand:**
  While country commitment is important for success, this should not be a blanket endorsement of any reform action. Demanded reforms could be narrow in scope, if country adopts an approach to least disturb the status quo, or could be wide in scope if the country is ambitious to move to more advanced PFM procedures as fast as possible. Depending on the country’s risk profile both approaches could be encouraged: narrower reforms for high risk countries and wider reforms for low risk countries.

- **Weakest link first:**
  In this approach chosen reforms actions are directed at identified bottlenecks. The nature of the bottleneck will determine the type of reform. Some bottlenecks can be removed by introduction of simple systems in one central agency, for example with a centralized payroll linking HR data to the payroll is less problematic than the same problem with

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¹⁹ These have been identified and discussed in Diamond, 2010.
decentralized payrolls, that involves a number of ministries. Some bottlenecks can be solved by recruiting one or two skilled personnel in a central agency (e.g. introducing a macroeconomic policy unit in the MOF). Other bottlenecks require time-consuming recruitment of suitable personnel and training/retraining programs across a wide spectrum of institutions (e.g. upgrading accountancy standards in government). Some bottlenecks can be removed by introducing procedures that use manual systems or simple Excel solutions, while others require more sophisticated IT solutions. The suitability of this approach will depend on the country’s risk profile: in a high risk country the approach is viable if the weakest link can be resolved with narrow, concentrated, time efficient reform actions (i.e. low risk reforms); in a low risk country it is viable even if the solution is wide in scope, de-concentrated and time-consuming (i.e. high risk reforms).

- The platform approach:
  As indicated this is a strategic approach to reform, that attempts to maximize reform impact by programming reform actions in a sequenced way to support further reforms and is cast in a multi-year framework. In terms of the risk profile, the platform approach is wide in scope, it usually includes both de jure and de facto reforms, in a de-concentrated way, and necessarily allows a longer time period for their completion. This approach is probably only viable in low risk countries.

- The composite approach:
  In practice it is likely that this trade-off between risk and reform impact can be resolved by pursuing a mixed strategy. For example, in high risk countries by concentrating reform actions on “low lying fruit” that are also locally demanded. Since it is likely bottlenecks will exist in more than one area, it is possible to choose to address those weakest links which match the country’s risk profile: narrow reforms in higher risk countries and wider reforms in lower risk countries. Similarly, the high risk platform approach can be made less risky by allowing re-programming of reform actions on a rolling basis depending on reform experience. Its high risk nature can also be reduced if it is front loaded by low risk reforms, providing a basis for subsequent higher risk reform actions. This could imply, for example, adopting a “low lying fruit” approach in the first platform.

9. Concluding remarks

The principle objective of developing the above approach to the identification and the analysis of the external factors that may have important impacts on PFM reform is to assess the risk they pose to successful reform implementation. Once this risk level is determined the approach can be used in three main ways to define an approach to reform that will either mitigate their negative impact or facilitate successful support for reform. The first is by allowing a better understanding of how external factors impact reform actions and so refine the choice between reform actions and better determine their sequencing. The second is that once reform actions are identified it can help improve the design of the overall reform strategy. The third is it can be used as a tool to manage risk.
As an aid in the choice of suitable reform actions within a given environment this methodology most probably only makes explicit the risk analysis that in practice is normally carried out implicitly. It is clear that this methodology requires further refinement. Empirical investigation of PFM reforms could be used to identify the most important factors determining success or failure, discover how they are interrelated, with an aim to reduce the number of indicators required for this analysis. Once the key indicators have been identified, then an agreed scoring system could be constructed that allows some standardization in rating the degree of risk, and the impact of that risk on specific PFM reforms. This will allow cross country comparisons of reform experience and, more importantly, assist in determining a viable reform design, including sequencing. As with the PEFA instrument, the approach could be used by the authorities in the form of a self-assessment, jointly in co-operation with development partners, or as part of an analysis of the task environment for a development partner or other stakeholder interested in PFM reforms.

As an aid in improving reform strategy, the methodology will assist in matching risks associated with different reform actions to the risks inherent in the reform environment. The approach should prove useful when determining a suitable strategy in improving PFM “basics” in countries which exhibit multiple areas in need of improvement. It is envisaged that parallel work in identifying technical PFM weaknesses, for example, through the use of the PEFA indicators, should allow the identification of required areas of reform in a country’s PFM system. To address these weaknesses various reform interventions will suggest themselves. It is argued that these reform initiatives will differ in their scope, in the time required for their completion, in the number of institutions involved and the degree to which PFM processes rather than rules will have to be modified. As a consequence, each will have a different risk profile. The risk analysis provided by the above methodology could then be used as a filtering device in reviewing alternative reform proposals, their proposed sequencing, and assessing the likelihood of achieving the desired reform outputs and outcomes. As argued above, the guiding principle in choosing a reform strategy should be to match low risk reform actions to high risk environments and vice versa.

As an aid in managing risks identified, the methodology allows a further degree of flexibility in improving reform design. When the risk analysis is undertaken questions are likely to arise over the next steps once the risks have been identified. An obvious next step is to determine a strategy towards those external non-technical elements that are felt to pose either too much of a threat to the proposed reform (or alternatively which are considered supportive of reform). This aspect, not much emphasized in the literature, should pose questions such as: What, if any, actions would counter perceived risk or bolster supportive reform activities? How feasible are they and when do they need to be undertaken? How long would they take to complete and at what cost? If the cost is too high should the reforms wait, or be modified, or should other less ambitious reforms be selected? In this way the risk analysis becomes a risk management tool, and one which has a proactive role in determining the sequencing of reforms.

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20 The first step of this work has been carried out by D. Tomassi, May 2011.
REFERENCES

Most references in this paper are to be found in:

Additional references are:


