

The “Soft” Side of PFM Reform is the Hardest

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The “hard” side of PFM Reform is often easy to specify but difficult to implement

Often it is not too difficult to:

- **Diagnose** the technical problem
- **Prescribe** the technical solution
- **Recommend** steps to implement the technical solution

This is the “hard side” of PFM reform.

BUT

a lot of dissatisfaction about the effectiveness of PFM reform programs based on this approach—and complaints that we have not got it right.

How to avoid some of the problems with previous reform programs?

Typical complaints:

- **Unrealistic in scope:** *cases of overloading*
- **Unrealistic in timing:** *systematic underestimation of the time required*
- **Not geared to country needs:** *danger of donors pushing their own solutions, “one size fits all” approach*
- **Politicians do not really support reform:** *rather support the financing that comes with it, often with donor pressure*

What are these criticisms telling us about the technical approach?

- Recognize that reforms need to be geared to specific country circumstances: ***no one standard technical solution***
- Stress non-technical factors as heavily influencing reform design: ***adverse external factors can sink good technical solutions***
- Success/failure in reforms depend critically on how they are introduced and sustained: ***change management cannot be ignored, the technical solution needs engineering***

This is the “soft side” of PFM reform

The Soft Side of PFM Reform should complement the hard side

Once the technical solution is decided, the soft side should not be ignored, requires:

- Tailoring reform to specific country circumstances
- Allowing for external factors
- Putting in place a sustainable implementation strategy

BUT what does this imply?

Design of reforms should be country specific

WHY?

- Most countries need to improve the “basics”, (concerned primarily with financial compliance), the agenda is wide at first level reforms, but not all weaknesses can be addressed simultaneously, choosing priorities is country specific
- Countries need to own reforms, determined by specific political economy considerations
- All countries have different capacity constraints, feasible pace of reform will be different
- All countries’ impacting external factors are different—and these are often critical and must be accommodated

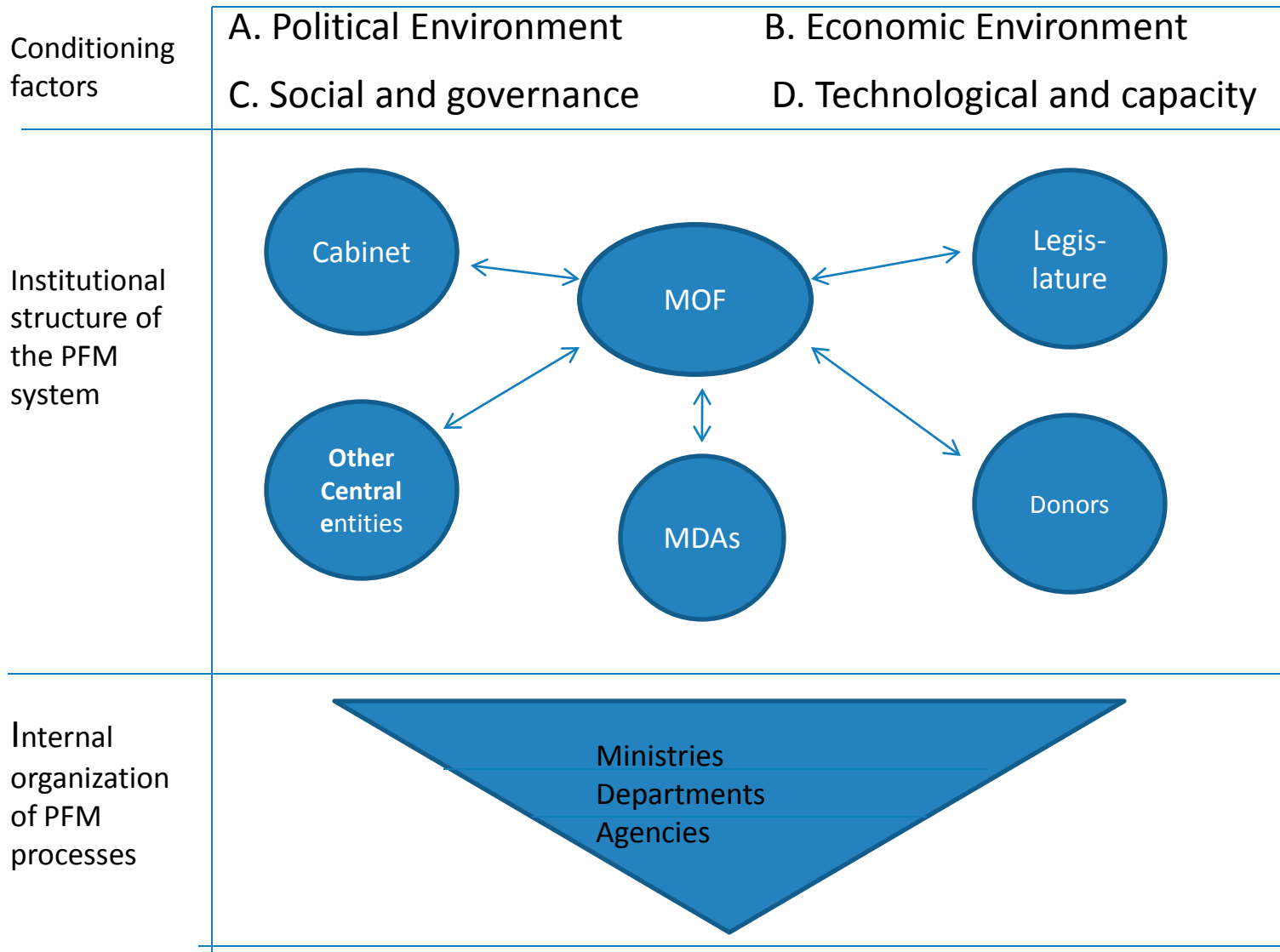
(WHY?)

What is meant by “external factors”?

Three levels:

- At highest level, ***conditioning factors***: political environment; economic environment, socio-cultural and general governance environment; technological and capacity environment
- At middle level, factors that arise from ***the institutional design of the PEM system*** itself: critical relationships between legislative and executive branches; within the executive branch, the role of the MOF and its relationship to the MDAs
- At the lowest level factors that arise from ***the internal structure of PFM organizations***, the managerial culture, the limitations of leadership and skills and other capacity constraints.

Classification of external factors important in PFM reform



Why are the external factors important?

Because they pose risks to reform.

- **It is possible to classify countries by the degree to which the external environment imposes risks on PFM reform**
- **It is also necessary to recognize that these risks will depend on the type of reform—we can classify reforms by their degree of risk**

i.e. recognize that different external factors will affect a given reform action differently

Dimensions of risk in different PFM reforms

- **Scope of reform:** number of reform actions, their degree complexity, their interconnections
- **Time required** to complete the reform actions
- **Number of institutions involved** (concentrated or de-concentrated)
- **Degree of change implied:** degree to which procedures (de jure) and behavior (de facto) must be changed—the latter more difficult/riskier

As a result deciding on available reform options is never purely a technical matter, but a trade-off



Reconciling the three determinants for a feasible reform agenda

- How far to compromise technical considerations, with authorities' desired reforms?
- How adapt technical considerations to the external constraints faced?

***i.e.* The balance between hard PFM and soft PFM decisions?**

(Life is messy: must recognize may not be possible to converge on a perfect solution).

Should the authorities' demands always dominate?

This, it is argued, will ensure maximum political commitment, BUT:

- what if the politician's choice is over-ambitious?
- what if choice is motivated more by politics or rent seeking rather than impact on PFM reform?
- What if this biases reforms: those that are highly visible or fast to implement (because politician's time horizon may be short)?
- what if a reform is associated with one prominent individual who might change?

How to Resolve the Trade-off between the technically desired and the possible?

Different options have been tried:

- **Strategic**

- choose reform activity that will easily show success, **but** “low lying fruit” may not be the most productive

- **Weakest link first**

- identify bottlenecks and remove them first, **but** how to identify?

- **Local demand**

- may ensure political commitment, **but** has dangers

- **Timing required**

- choose reform activity to match the country’s feasible time horizon for successful implementation, **but** reforms nearly always underestimate the time required

A risk based approach?

- **To determine timing/pace of reforms**

A review of external factors allows countries to be ranked in terms of the risk to reform success.

If risk exceed tolerable levels: opportunity to pause in the reforms, or to seek measures to address major risks perceived.

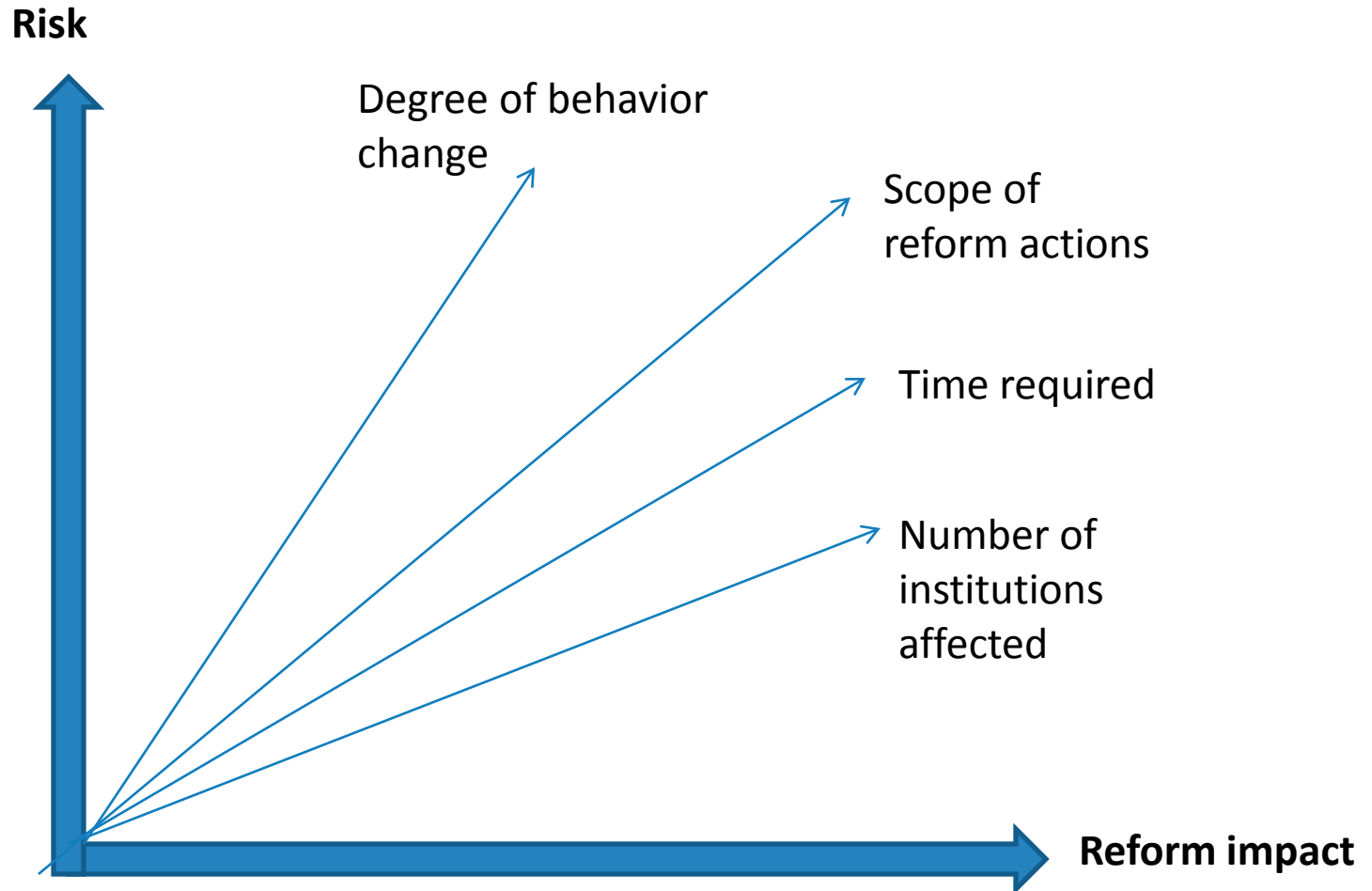
- **To determine the content of reforms**

Consider if reform actions fit the context: the scope of reform? introduces new procedures? across a wide range of budgetary institutions? involves behavior change? takes more time?

i.e. Consider the degree of risk implied

AND recognize a trade-off between the level of risk and the impact of reforms

The trade-off between reform impact and risk



Examples of different risks (1)

An IFMIS: Undisputed large reform impact

BUT

- High degree of procedural & behavior change
- Technically wide scope of reform actions
- All budget institutions involved—
"deconcentrated"
- Takes a considerable time to implement

i.e. Classic **high risk reform**

Examples of different risks (2)

Introduction of a macro economic policy unit in MOF : medium impact

- Low level of behavior and procedural change
- Technically narrow in scope
- Primarily MOF involved—concentrated
- Can be accomplished relatively fast

i.e. Low risk reform

Matching reform priorities to risks implied by reforms

- **Strategic or “low lying” fruit approach:** covers reforms narrow in scope, de jure, concentrated, implemented fast: a low risk strategy for a high risk country
- **Local demand.** Depends on a country’s risk profile: accept narrow reforms for high risk countries and wider reforms for low risk countries.
- **Weakest link first.** Depends how bottlenecks arise, but in a high risk country this approach is viable only if the weakest link can be resolved with narrow, concentrated, time efficient reform actions.
- **Platform approach:** usually wide in scope, includes both de jure and de facto reforms, in a de-concentrated way over a longer time period i.e. high risk ,therefore only viable in low risk countries.

Design principle: a high risk reform should only be attempted in a low risk environment

A mixed strategy?

How to approach resolving this trade-off between risk and reform impact?

- In high risk countries concentrate reform actions on low-lying fruit that are also locally demanded
- With bottlenecks in more than one area, choose to concentrate on those that can be solved by narrow reforms in high risk countries, and vice versa
- Make high risk platform approach less risky by allow re-programming of reform actions on a rolling basis; or front load with low risk reform actions, providing a basis for later high risk reform actions.

The choice of reform agenda must avoid some dangers already flagged

No one approach likely to dominate

BUT whatever approach taken should be:

- **Realistic in scope:** *danger of overloading*
- **Realistic in timing:** *danger of underestimation*
- **Truly geared to country needs:** *danger of donors pushing their own solutions*
- **Ensure that politicians really support reform:** *avoid danger of their being too acquiescent*

AND perhaps most important aspect on the soft side: Putting in place a sustainable delivery mechanism

- **Adopting an adequate change management strategy**
 - **competent managers of the reform process ensured?**
 - **degree of stability in change managers?**
 - **is there a continuity plan in place?**
- **Ensuring constraints are removed and resources are in place**
 - **are all constraints fully identified?**
 - **is there a strategy on how they are to be managed, during the reform process and after?**
- **Ensuring local participation, ownership and pressure for reform**
 - **how to provide incentives for reform?**
 - **how to widen ownership of reform?**

DISCUSSED IN NEXT PRESENTATION