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The 2013 CAPE Conference:
budgeting in the real world

Framing paper

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Introduction

This year's CAPE conference will explore budgeting in the real world. Real-world budgeting can have multiple meanings. First, it evokes an idea of budgeting that is messier and more political: a broadening of scope. Second, 'real world' suggests a focus on budgeting as it actually happens, as opposed to how it should be: positive instead of normative. Finally, it is a call for more realistic approaches to budgeting that take greater account of what can be achieved given a particular institutional and political setting and capacity endowment. Not all of this is new. In fact, this conference is based on an emerging body of research and country case experiences. The recent publication of two volumes of scholarship covering the whole range of PFM is testament to how much this field has grown, and how diverse the approaches have become – at least on paper (Allen et al., 2013; Cangiano et al., 2013).

Budgeting is the foundation of everything important in the public sector. Whether the task is to hire more teachers, restructure a government agency, invest in roads and hospitals or send a permanent secretary into early retirement, questions such as, 'Who pays for it?', 'Can we afford it?' and 'Will the cheque go out in time?' are never far away. The link may sometimes be more direct, and the scale may be banal, but, even if the conversation is ostensibly about something else, we cannot escape the constraints of having to think about cost, having to balance

the books and bending financial management systems to the will of policymakers.

It isn't easy to delineate the boundaries of budgeting and public finance management (PFM). Classics of the budgeting literature, like Wildavsky's *Politics of the Budgetary Process* (Wildavsky, 1964), subsume much of policymaking, politics and public administration just to explain very high-level budgetary decisions. In contrast, development agencies have traditionally opted for a much more technical, narrow definition of the PFM domain and, perhaps as a consequence, prefer the term PFM over budgeting. It is by now quite well established that development agencies in practice tend to promote a fairly uniform set of technical reforms. In Africa, this tendency is particularly well documented (Andrews, 2009).

There is a contrast between political challenges and technical solutions.
Even the first-generation handbooks of PFM paid considerable attention to challenges that are ultimately political, albeit couched in very technical language. For instance, the World Bank's 1998 Handbook (Holmes, 1998) emphasises linking policy, planning and budgeting, which is ultimately about the challenge of translating political priorities into budgetary action. A constant stream of publications has recognised the political dimension of budgeting, so the interest has never really gone away (Caiden and Wildavsky, 1974; Norton and Elson, 2002). But the standard canon of reform 'packages' tries to tackle this by adding to the complexity and sophistication of the public finance system through, say, medium-term expenditure frameworks (MTEFs), for example. This approach contrasts with the growing body of research into fiscal institutions, which investigates the appropriate match between institutional context and reforms. For instance, research on Europe has shown how institutional models relying on delegating authority to a powerful ministry of finance (such as MTEFs) depend on specific institutional conditions functioning, namely ideologically cohesive majority governments that can be credibly and regularly challenged in elections. Absent the conditions, alternative models are more suitable (Hallerberg, 2004). Much of this research has not had a noticeable effect on how PFM reforms work in developing countries.

It is time to redraw the boundaries of PFM to include institutional and political concerns. A legitimate, if often implicit, concern of PFM practitioners is that nothing can be done about institutions and politics, whereas systems and tools can be safely tinkered with. It is an oft-repeated charge that analyses containing the word 'political' are just not practical (Green, 2013). There is a point to this critique: knowing that party fragmentation hamstrings policy coordination when ministries are shared out between fragmented coalition parties doesn't have an obvious policy conclusion. The party system isn't amenable to change, and certainly not just because international experts note its negative effect on policy coordination. That said, there does seem to be a wealth of scholarship and practical experience that could be exploited to develop medium-range practical approaches. Such approaches could close the gap between limited technical solutions and impractical analysis of institutions and politics.

The conference will discuss real world budgeting through four themes. First, the practice of budgeting. This theme looks at different drivers of the form and functionality of budget systems. It will consider the perspectives of academia and practice, as well as different regions. Second, the role of capable finance ministries. This theme explores how to better study and understand finance ministries as actors in the budget process, and consider ways to improve their capabilities. Third, reforming the budget process. Here, the emphasis is equally on how reformers can deliver change and on what, if anything, external actors can do about it. Finally, linking budgeting and PFM to development outcomes. Are PFM reforms meant only to foster fiscal discipline and macroeconomic stability? If not, how can they strengthen effective states and better services?

1. The practice of budgeting: what drives the form and functionality of budget systems?

The simplest way of thinking about how budget systems develop is that everything evolves along a scale, from least to most developed. Whether it's a function of income, capacity or some other set of factors, PFM reform is then ultimately about moving countries along the continuum. This is a powerful image, one that is present in many different approaches to PFM and budgeting, from 'basics first' (Schick, 2012) to the 'platform approach' (DFID, 2005). There is a growing body of literature that takes a very different view and argues, from varied methodological points of view, that institutional (and cultural) fit is important, and that there is no single end-point to institutional change (Andrews, 2010a; Hallerberg, 2004). The drivers of what budget systems do, and how they look, take on a much broader meaning, as do the concepts of form and function themselves.

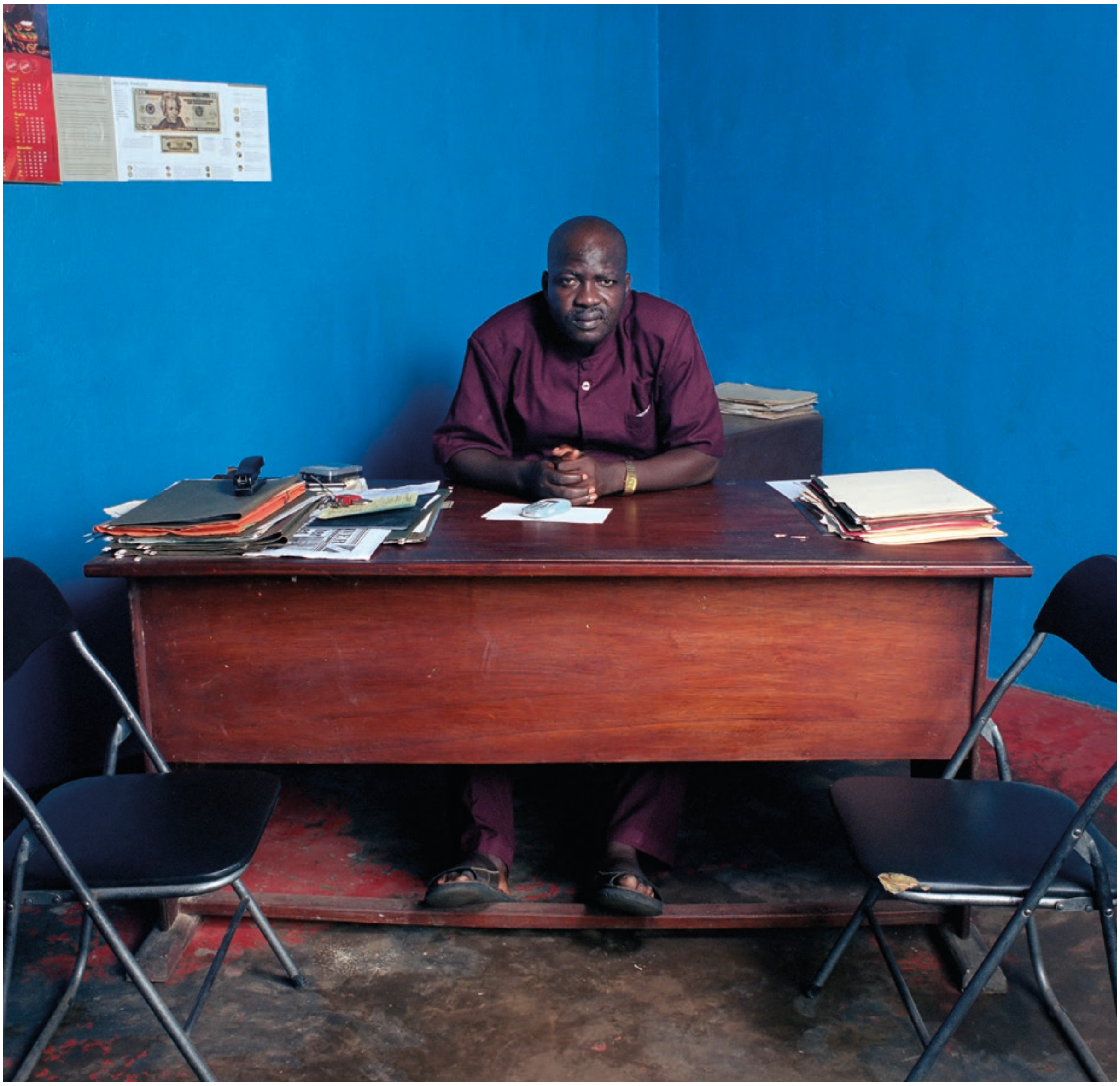
There is a meaningful distinction between formal and real budget systems. The argument is fairly old in public administration, memorably captured by Pressman and Wildavsky in the subtitle to their book on implementation, *How Great Expectations in Washington are Dashed in Oakland; Or, Why It's Amazing that Federal Programs Work at All* (Pressman and Wildavsky, 1973). If nothing ever gets implemented as planned in theory, then the entire distinction between policy (rational, sound) and implementation (political, messy) should be taken with a grain of salt. Following the work of Andrews, the World Bank's most recent public sector approach paper devotes serious attention to informal practices and the distinction between de jure and de facto institutions (World Bank, 2012). The finding of a notable and worrying implementation gap in African PFM has been widely discussed, most recently at the 2013 Annual Seminar of the Collaborative Africa Budget Reform Initiative (Andrews, 2009; 2010b; Cole, 2013). In some countries, the formal budget process is a mere theatre that diverts attention from the real budget process that happens behind closed doors (Rakner et al., 2004).

A growing body of research studies the political and institutional drivers of budget systems. As recently as this year, a prominent study of PFM sequencing confidently declared that, 'Although different advanced countries have taken different reform routes the end result has not been too different' (Diamond, 2013: 7). This is broadly the case in some selected domains, say, fiscal transparency, or in the very literal sense that advanced countries tend to have a budget that is passed more or less regularly and is then audited by someone. However, it fails to consider the staggering diversity of budget institutions, even among advanced countries. Starting with basic political features such as party systems, electoral rules and parliamentary versus presidential forms of government, and passing to less tangible elements of national heritage or administrative culture, any number of factors have been found to shape institutional form (Hallerberg, 2004; Hallerberg and Marier, 2004; Lienert, 2003; Scartascini and Filc, 2007; von Hagen, 2004; Wehner and de Renzio, 2013). Even within presidential or parliamentary systems, there is enormous variation as to the power of legislative and executive budgetary actors (Krause, 2009; Wehner, 2006).

The implications of institutional variation for the practice of budgeting in developing countries have not yet been properly explored. All these different features interact in ever different ways in each country, making it exceedingly unlikely that any one institutional solution is equally appropriate to all, or indeed that there is ever going to be meaningful convergence of institutional forms that isn't artificially produced by isomorphic pressure. There are, for instance, excellent reasons to think that the effect of certain formal rules on how public finances are run depends on how well such rules of the game are institutionalised. If recourse to violence is a viable option, as it tends to be in fragile states, the dynamic changes dramatically (Scartascini and Tommasi, 2012). What could be an entirely sensible approach to budgeting in Organisation for Economic Co-operation and Development (OECD) countries may become counterproductive in other regions of the world, just as much as some institutional features of budgeting do not travel well within the OECD itself (Hallerberg, 2004).

Questions for discussion

- What are the main drivers that shape how budgeting works in the real world?
- Is the distinction between 'technical' and 'non-technical' a meaningful one?
- Is there an implementation gap in budgeting, and what would be the indicators to measure and tackle it?
- What are the lessons for dealing with political and institutional challenges across OECD, middle-income and low-income countries, and how might they be applied?



2. What is a capable finance ministry?

It is surprisingly difficult to tell whether or not a ministry of finance is capable, let alone why. For the public sector body that commonly sits at the apex of the public finance system, finance ministries (used here as the generic term synonymous with central finance agency) are not over-studied, to put it mildly. A minister of finance, or a permanent secretary in the ministry, will often care more about retaining competent staff who can be delegated important tasks, or about the ability to manage important priorities and get things done in time, than about an adjustment to the budget classifications to better conform to international standards. Up until recently, the organisational issues pertaining to the finance ministry would not have been considered a PFM concern, and received little attention in the literature, with a few exceptions (Schick, 2001).

Capability to do what? It depends on what the tasks are. At its core, the finance ministry is a control agency. It oversees the execution of the budget by the bureaucracy on behalf of the executive leadership and, it is often claimed, ultimately the taxpaying citizens. This used to mean control over spending discipline. It has only more recently taken on an expansive definition, where the finance ministry doesn't just control other's spending but is also 'in control' – of fiscal outcomes, or even 'the economy' (Krause, 2012a). The tasks a finance ministry takes on in pursuit of these overarching goals have varied a great deal over time, and also vary between countries. They range from high-level policy functions to the very transactional details of managing cash, payroll and tax collections. It isn't uncommon for the more imperious finance ministries to wield influence beyond fiscal and monetary matters, deep into

sector ministry affairs (Allen and Kohnert, 2012; Allen and Krause, 2013). Capabilities can only be sensibly evaluated (and improved) in reference to the tasks set for the ministry to perform. One ministry might be entirely capable of breathing life into a narrow set of responsibilities. In contrast, another ministry might have a highly ambitious mandate, but lack the capability to turn its ambition into practice.

For finance ministries, capability is a relational attribute. This is best illustrated by contrasting finance ministries with central banks. A central bank's capability expresses itself first and foremost through its analytical skills. Its leadership will need political finesse, but central banks can grow in capability on their own. Finance ministries are very different in this respect. They need to coordinate a highly complicated administrative process – the budget process – and regulate the financial behaviour of a large number of spending units. They need analytical skill as well, but can never be 'in control' of outcomes on their own. Fragmentation of the central finance function can greatly exacerbate the challenge of coordination. OECD countries, with very few exceptions, tend not to have separate central finance ministries, instead opting for semi-autonomous agencies reporting to a central ministry. In developing countries, separate planning ministries and more intricate institutional rivalries are more common. Dressel and Brumby (2009) rightly put the relationship between the finance ministry and its environment at the heart of their capability approach. Perhaps not surprisingly, Andrews (2013b) finds that reforms are much harder going once they cannot rely just on working within the ministerial core. A greater emphasis on the capabilities of finance ministries (and, by necessity, of other budgetary actors) would shift the debate from the tools of budgeting towards the administration and civil service aspects of PFM.

Organisational capacity can be a critical constraint, especially in fragile states. In a global economy, facing the demands of a modern state system, there are many tasks a central government cannot escape. Running a fiscal policy, collecting and expending public funds, while liaising with international agencies and domestic stakeholders, all place a heavy administrative burden on finance ministries. Fragile states are often stretched to maintain or restore these capacities, especially in a post-conflict situation. There are no easy solutions to this challenge. A recent study of PFM reform in fragile states found that some countries relied more on outright capacity substitution to be able to act quickly, whereas others were more reluctant and employed mostly internal means. No country seems to have found an easy way to transition out of substitution arrangements or to switch seamlessly between internal and external capacity (Fritz et al., 2012; Hedger et al., 2012).

A more realistic approach is to be selective about where to deploy scarce capacity. Recent papers have suggested that finance ministries could do much more to prioritise PFM functions. However, they acknowledge that tackling some PFM performance dimensions (and the corresponding Public Expenditure and Financial Accountability (PEFA) scores) will be beyond the reach of some governments for the foreseeable future, possibly for decades or more (Haque et al., 2012; Welham, Krause et al. 2013). Even within a given capacity endowment, however, there are great differences in the stability of organisations, civil service career paths and the viability of civil service pay. For instance, senior public finance officials in Uganda tend to stay in post for several years and spend long careers in the finance ministry, whereas comparable offices in Nepal rotate civil servants every few months (Krause et al., 2013; Simson, forthcoming).

Questions for discussion

- What are the institutional, organisational or human characteristics that make some ministries of finance more capable than others?
- To what extent can capability be identified separately from the wider context in which the ministry is operating?
- If you can review and measure ministry of finance capability – so what?

3. How can reformers deliver change in the budget process?

An implicit assumption of international agencies' engagement in reform is that the status quo of PFM systems in developing countries should change. PFM systems either need to change to be fit for purpose, or to change in order to fulfil their potential to deliver more. This is not a trivial assumption. By definition a critical mass of domestic actors support the status quo and, therefore, will actively or passively disagree with the developmental point of view. Even if public finance officials agree with the professional opinions of their international peers, their political masters and civil service colleagues elsewhere might not. A greater appreciation of institutional and political factors that shape budgetary systems and a stronger emphasis on actors' capabilities could make reforms more realistic, and more useful, but that is only part of the story.

In OECD countries, fiscal institutions have developed over very long periods and in response to particular functional needs. The elements of that evolution are well established. Feudal governments needed money for war; fiscal states grew from the need for powerful taxation mechanisms and control over fast-growing spending bureaucracies; eventually, internal accountability for funds was followed by external accountability towards parliaments and taxpayers. As budget processes became formalised and democracies became established, spending grew into ever more sectors and took its present form (Krause, 2013a; Moore, 2004; Schick, 2002; Tilly, 1992; Wehner, 2010). The functional needs of developing countries today are clearly different from this model, and each other. This is true specifically with regard to the accountability dimension of budgeting (Khagram et al., 2013; Simson, 2013), but also more generally.

The practice of external reform support has faced strong criticism. In a generally rather mixed review of the World Bank's public sector lending, PFM reforms do relatively well – at least in comparison with other sectors, such as civil service reform (World Bank, 2008). Analyses of PFM performance as measured by PEFA scores, however, struggle to find much evidence of external support leading to improvements (de Renzio, 2009; de Renzio et al., 2011). According to Andrews, externally supported PFM reforms are limited to fostering formal changes without addressing functional needs, often leaving governments with systems that are not fit for purpose while tying up valuable capacity and reform space (Andrews, 2013b).

To copy or not to copy? Based on the critique of Pritchett et al. (2012), isomorphism does not have a good name in institutional development. Whether through normative pressure, the allure of best practice or financial coercion, many governments seem to follow unrealistic institutional models instead of reforming according to their actual needs (ibid.). On the other hand, many successful developmental states over the past century and earlier have been avid isomorphic copiers of models they picked up elsewhere. However, instead of doing so uncritically, they have been capable of adapting and rejecting elements until they are fit for purpose (Krause, 2013b). Implicit here is the idea that the governments engaging in reforms are purpose-driven collective actors capable of planning and prioritising – a problematic issue in many countries, especially fragile states. To some extent, successful reforms may be supportable only after a certain degree of cohesion exists in government, so it is realistic to speak of 'the government', as opposed to a loosely coupled network of bureaucratic actors working at cross purposes.

Can the world wait for the muddling to come through? Channelling Lindblom (1959), Andrews (2013b) proposes that governments 'muddle through' instead of copying best practice, a process he labels 'problem-driven iterative adaptation'. In order to realistically tackle the status quo and change de facto institutions, reformers need to link up into forms of distributed leadership, rather than waiting for the hero-reformer with credibility abroad who can turn a country around by force of will (Andrews, 2013a). Development agencies may not have the patience to wait for these processes to yield tangible results. Especially in very poor countries, the needs of the population might be such that it becomes difficult to wait for governments to finish muddling through (a process that has taken today's rich countries a great deal longer than most development experts wish to contemplate). Many fragile states are stuck in capability traps where sustained improvements could take so long that constraints are effectively permanent (Pritchett et al., 2010). At the same time, 'platform approaches' and other reform plans that seek to take low-income countries to the budget systems of Sweden or New Zealand (or to the idealised 'best of' version of the two) in the space of eight to ten years are hopelessly naïve and are rightly being criticised (Allen, 2009). There might not be a middle ground between prematurely overloading governments with unsuitable models and governments muddling through at their own pace, but the debate is still wide open.

Questions for discussion:

- What is the latest theory and evidence on approaches to government-led budget reforms?
- What factors do government reformers consider when attempting policy and institutional reforms linked to the budget?
- What can external actors do to support reform?
- How can external models and frameworks be used more effectively?

4. How do budget reforms link to development outcomes?

Budgeting and PFM used to serve fiscal objectives first and foremost. The textbook objectives of budgeting (fiscal discipline, operational efficiency, allocative efficiency) are more than just narrowly fiscal, but the practice of reform in OECD countries does not quite reflect that. From the response to the oil crises of the 1970s to the current response to the financial crisis, budgetary reformers have been most active in times of austerity, and reform decisions have been taken in this context. Whether new budgetary institutions (say, a fiscal rule) have actually caused deficits to drop or whether the determination to reduce the deficits has led to the adoption of the rule but would have reduced the deficit anyway is an endogeneity problem successful reformers may not always wish to investigate too closely.

Professional standards also matter. Senior officials have considerable influence over the kinds of reforms they develop and put before the political leadership. There is evidence that bureaucrats can 'bureau-shape' their offices according to their professional preferences, which often involve more attractive, policy-oriented work at the expense of menial and repetitive work (Dunleavy, 1992). Through professional networks and other elements that make up the epistemic community of PFM professionals, the image of a 'modern' or 'advanced' budget system changes over time. From the 1980s onward the New Public Management left a heavy impression on budgeting, and a large part of the 'best practice' package is closely related to this. Since then, it has lost much of its shine among early adopters, and the appropriateness of wholesale adoption in developing countries has never been free of criticism (Dunleavy et al., 2006; Manning, 2001; Schick, 1998). Whatever the professional standards may be, very often officials adopt certain institutions and tools because it is the thing to do, not because there is firm evidence to show a certain effect on a particular objective.

There is increased pressure to justify investing in PFM as a means to developmental ends. The trend builds from several sources. There is the inherent difficulty of measuring progress in institutional matters, as compared with sectors involving direct services. In those sectors, such as health and education, the great expansion of impact evaluations and other forms of results measurement have only increased the contrast. In particular, the greater attention paid to fragile states by development agencies has prompted an appreciation of the relationship between PFM functionality and objectives other than fiscal discipline and control. A PFM system focused on fiscal discipline may well prioritise different things from one that expects quick and substantial improvements in service delivery (Welham et al., 2013). Different yet again might be a PFM system that is expected to be a critical part of a state-building strategy, such as, for instance, in West Bank and Gaza (Krause, 2012b). So far, the evidence is not very strong.

Is there a danger of producing 'doughnut states'? A more rigorous standard for reform proponents to use to demonstrate how PFM reforms might contribute measurably to development outcomes (whatever they are) surely is a good thing. It does carry its own set of risks, however. Those governments that are less dependent on development actors for advice and support, that is, richer and larger countries, will continue to pursue reforms that appeal, whether or not they are immediately developmental. For the remaining governments, attention might shift away from the executive core towards frontline services (delivered by governments or alternative providers, funded privately, via government or by donors) where improvements in Millennium Development Goal (MDG)-type objectives can be easily measured and quickly achieved – relatively speaking. For some donors, this is precisely the point. This risks creating a set of 'doughnut states'

(Dunleavy, 2011), however: all frontline and empty at the centre. To the extent that development is about an institutional transformation of the state to achieve the capabilities of modern government, this would be a problem, and a classic case of putting the urgent before the important.

Governments could be better-informed customers. Perhaps a more productive area for future work would be to strengthen the evidence base of what governments might want, instead of demonstrating results preferred by donors. Governments might, depending on time and context, want PFM reforms to support different things. In some instances, the case for prioritising a certain area is always going to be straightforward: zero-balance accounts lead to lower interest payments, for instance. In other areas, from strategic budgeting, to performance orientation, to frontline services, the arguments are much less clear. But the evidence base could be much stronger, and at least some governments could take better decisions if they knew more about what they were getting into (Nunberg and Manning, 2013).

Questions for discussion:

- Do reformers assume links between budget reform and the development outcomes they aim to achieve?
- What are plausible causal hypotheses for how PFM systems link to developmental benefits?
- How do we know if interventions succeed?
- Are PFM reforms inspired by the view that all good things go together? What is the role for prioritisation?

Conclusion: where to go from here?

Each of the four themes that the conference will consider contains arguments that have been with the PFM community for some time. At the same time, they are four live debates that are still very much unresolved. If there is value in extending the boundaries of PFM as a subject of academic inquiry and professional practice beyond its narrow technical confines, then the questions of what drives the form and function of budget systems; how to understand and strengthen capability; how reforms happen and how they can be fostered; and what difference the PFM system makes will be part of that extended domain. There is no canon of opinion, but it might be possible to stake out an agenda of common interest that can inform practical action in the near future. Perhaps not too much to expect from two days of collective work?

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