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Public Expenditure Management

Capacity Building Workshops-in-the-Field
20—23 September 1999, Cambodia
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Executive Summary of Proceedings

CONTENTS

Macroview

[¶] References are to paragraphs.

Public expenditure management (PEM) is a central instrument of economic and development policy. The three overall goals of PEM are **fiscal discipline, strategic resource allocation** and **good operational management**. [¶ 4]

Effective PEM is also a key component in good governance, which rests upon what the ADB has termed the four pillars of **accountability**, **transparency**, **predictability** and **participation**. Accountability holds officials responsible for their actions. Transparency involves ensuring access to relevant information at low cost. Predictability results from an environment in which laws and regulations are clear, known in advance, and uniformly and effectively enforced. Participation requires the existence of channels through which reliable information is provided, enabling all stakeholders at all levels to be involved in the consultation and decision-making process. [¶ 5]

A **comprehensive budget** is needed (i) to assure that resources are allocated to priority programs; (ii) for legal control and public accountability; and (iii) to reduce uncertainties. [¶ 11]

A good public investment program can strengthen both the impact of aid and the PEM process. [¶ 13]

Cash-based line-item budgeting is suitable for developing countries, Accrual budgeting and program-based budgeting systems should probably be avoided, because of their cost, unclear benefits, and great risk of corruption and resource misallocation. [¶ 15]

A **clear distinction between capital and recurring expenditures** is necessary for analytical purposes (assessing the operating cost efficiency of government investments), transparency (determining future cash requirements) and policy decisions (ensuring the necessary degree of focus in planning and policy formulation). [¶ 16]

Multi-year spending projections allow governments to evaluate cost effectiveness and to determine whether they are attempting to undertake more than they can afford. The annual budget should take into consideration (i) future recurrent costs resulting from capital expenditure, (ii) funding of entitlement programs, and (iii) contingencies that may result in future spending requirements. [¶ 19]

Annual budget preparation should be organized through (i) a **top-down approach** defining the resources available, and communicating sector spending limits to ministries; (ii) a **bottom-up approach** whereby ministries formulate and cost sector spending programs within the set spending limits; and (iii) **iteration and reconciliation** to enable preparation of a consistent overall expenditure program. [¶ 20]

Budget execution is the phase in the overall PEM process where resources are used to implement policies incorporated in the budget. The role of the central agencies with respect to budget administration must be clear, and spending agencies must be able to rely on a predictable flow of funds, conforming to budget authorizations. [¶ 23, 25]

Accounting for commitments is essential to good budget implementation, and includes contracts for ongoing programs and for legal commitments such as debt servicing. Budget implementation should be subject to **regular reviews**. [¶ 28]

Decentralized procurement under the supervision and guidance of a central Public Procurement Office is recommended. [¶ 29]

The financial management function of the Treasury should cover **cash management**, including all government bank accounts, financial planning and forecasting of cash flows, public debt management, administration of foreign grants and aids, and government-owned financial assets. **Foreign grants**, in cash or kind, should be included in the budget. [¶ 30, 34]

Cash basis accounting recognizes transactions and events only when cash is received or paid. Therefore, it should be supplemented by commitment accounting, accounting for outstanding liabilities at the verification stage (including arrears), and accrual accounting for debt. [¶ 36]

The **budget reporting** system should assess how the government is performing, and answer questions of budgetary integrity, operating performance, stewardship, and control systems. [¶ 38]

Management control, or internal control, assures the economic, efficient and effective achievement of the government s objectives, and the basis for reliable accounting and financial reporting. [¶ 39]

External audits should review and identify weaknesses in internal controls. Cooperation between internal and external auditors is important for both efficiency and financial integrity. [¶ 40]

Information technology (IT) is an enabler of public sector reform and performance improvement. The Internet can be used to improve social services provision, consumer transactions with government, direct feedback and information flow, and outreach programs. [¶ 43, 44]

Electronic commerce also provides opportunities for governments. It can enable individuals and groups to purchase government documents electronically. Conversely governments are also increasing e-procurement, through electronic linkages with their suppliers. [¶ 46]

Workflow systems can facilitate such government tasks as:

- Integrated financial management systems (budget, accounts, treasury)
- Tax management and revenue collection
- Claims processing and management
- Human resource recruitment and hiring, etc. [¶ 48]

Enterprise resource planning systems integrate with Internet (email, messaging), electronic commerce and workflow systems. ERP systems present governments with opportunities to improve areas such as:

- Financial management integration
- Human resource management
- Facilities resource management [¶ 49]

Developing countries, have same advantages in levering the benefits of information technologies. They are not laden with existing legacies, they often have fewer bad habits to overcome, best practices are available for them to review, and the technology that can be used is readily transportable, even generating leapfrogging opportunities. [¶ 50]

Many governments around the world, aware of the **lack of responsiveness and accountability** of public sector organizations, have taken active steps to introduce performance management processes into their organizations. [¶ 52]

The elements of performance management include performance orientation, performance indicators, performance appraisal, performance-based pay and performance budgeting. Performance may be defined in terms of effort or in terms of results. [¶ 53]

A framework for **performance management** in the PEM process links inputs, outputs, outcomes, impact and process:

- **Inputs** are the resources used to produce a service (e.g. doctors, nurses, hospital equipment, and medicines).
- **Outputs** are actual services, e.g., the number of child vaccinations administered.
- **Outcomes** are the effects achieved by producing the service (e.g., reduction in child mortality).
- **Impact** refers to the value added through the activity (i.e. gross outcome minus the contribution from other entities or activities).
- **Process** refers to the manner in which inputs are procured, outputs produced or outcomes achieved. [¶ 54]

Good performance indicators should be clear, relevant, economical, adequate and monitorable. [¶ 56]

Performance should be assessed according to a combination of input, output, outcome and process indicators that is realistic, cost effective, and suitable to each specific activity, sector and country. [¶ 57]

Improving PEM requires both institutional reform (regulatory and procedural) and organizational development. There are two key strategies. The first is to strengthen the linkages between agencies and ministries to facilitate effective communication, coordination, and collaborative action. [¶ 59]

The second strategy is to develop the capacity for change within the organizational and systemic environment. One approach is to use ef ficient nuclei : teams functioning as supports to the change process, whose role is to spread change throughout the organization. They should be small, fiercely meritocratic, have flexible and simple procedures and adequate material and financial resources. The nuclei should be temporary, disappearing after momentum has been established. [¶ 60]

Efficient nuclei operate like a visiting team within ministries, helping them to understand reform and not posing any on going competition or threat to existing personnel and functions. [¶ 61]

Universal principles of PEM include the following:

- Strengthening the four pillars of governance (accountability, transparency, participation and predictability).
- Reinforcing their foundation in civil society by strengthening the voice of the citizen.
- Improvement in PEM should reduce opportunities for corruption.
- The strategic guidance system of PEM expenditure control should be strictly adhered to strategic resource allocation, good operational management and due process.
- A multi-year approach to budgeting is advisable. [¶ 62]

Four **practical rules** for improving PEM in specific country circumstances are also proposed:

- **Put first things first**: Get the basics right before launching into any dramatic experimentation.
- **Do not repeat others' mistakes**: Diversifying sources of advice and assistance.
- **Put the right driver in the driver's seat**: development of native or local capacity at all levels of the system.
- **Be open minded but questioning**: If the recommendation is sound, it will withstand critical challenges; if it is not, only critical challenges will reveal that fact. **[¶ 63]**

Further Reference

➢ **Managing Government Expenditure**
ADB, April 1999, Pub. Stock No. 100498
by Salvatore Schiavo-Campo & Daniel Tommasi

Introduction

1. The ADB Institute, in cooperation with the Asian Development Bank (ADB), held a pair of in-country capacity-building workshops on Public Expenditure Management (PEM), in Cambodia and Viet Nam. The workshop in Cambodia was held from 20 to 23 September 1999 and that in Viet Nam from 27 September to 1 October 1999. Each event comprised a half-day high-level conference for 20 policymakers and a week-long workshop for some 35 middle to senior-level officers. Participants in the Cambodia workshop were from the Ministry of Finance, as well as other ministries and the Central Bank, while those for the workshop in Viet Nam were mainly from the Ministry of Finance. The workshop in Cambodia was opened by H.E. Keat Chhon, Senior Minister of Economy and Finance. The workshop in Viet Nam was opened by Mr. Pham Van Trong, Vice Minister, Ministry of Finance.

Workshop Themes and Design

2. The objectives of the workshops were to enhance participants understanding of the following themes:

- The key principles, systems and tools of effective PEM.
- Policy and program linkages between PEM, governance and economic development.
- Technical aspects of PEM such as budget planning, preparation, implementation, cash management, evaluation, accounting, audit and treasury functions.
- PEM reforms adopted by more advanced countries and models of reforms appropriate for developing countries.
- Strengths, weaknesses, and areas for improvement in PEM programs at the local and central level of each host country.

3. The workshops design included presentations by experts on key issues and themes in PEM and by working groups, within which participants explored these themes in the context of their country and work settings. The presentations were divided into four parts: Part A encompassing the Budget and its Coverage: Budget Systems, Classification of Expenditure Items and the Budget Preparation Process; Part B, Budget Execution, Audit and Control; Part C, the Role of Information Technology in Public Sector Reform; and Part D, Fostering Performance in Public Expenditure Management.

4. PEM is a central instrument of economic and development policy. The three overall goals of PEM are **fiscal discipline, strategic resource allocation and good operational management**. Fiscal discipline demands control at the aggregate level, strategic resource allocation requires good programming, and operational management needs good performance management.

5. Effective PEM is also a key component in good governance, a factor that has been increasingly seen, by scholars and government officials alike, as a key ingredient for sustainable long-term social and economic development. Good governance rests upon what the ADB has termed the four pillars of **accountability, transparency, predictability and participation**. Accountability means the capacity to hold officials responsible for their actions. Transparency involves ensuring access to relevant information at low cost. Predictability results from an environment in which laws and regulations are clear, known in advance, and uniformly and effectively enforced. Participation requires the existence of channels through which reliable information is provided, enabling all stakeholders at all levels to be involved in the consultation and decision-making process. Each of these principles functions in combination somewhat like a governance system; they mutually affect one another. While these four pillars are universal elements of good governance, the ways in which they are implemented varies considerably from one situation to another.

6. The two workshops on PEM, included substantial quantities of technical information, along with suggestions for analytic tools and best practices. They were designed to establish linkages between PEM and good governance. Indeed, a powerful way to demonstrate the principles of good governance is to illustrate their application in the performance of government functions such as the management of public expenditures.

7. **Dr. Salvatore Schiavo-Campo, Senior Advisor to the ADB on Governance and Public Management** developed these points in his presentation. A low level of predictability of financial resources, he noted, undermines strategic prioritization, makes it difficult for public officials to plan for the provision of services, and can inadvertently serve as an excuse for poor performance. High predictability of government expenditures, on the other hand, provides a signaling device for the private sector and assists them in their own planning and decision-making process on investments in a country.

8. Transparency of fiscal and financial information was also underscored as vitally important to cultivating informed managers, lawmakers and members of the public. Transparency

means that information is not only provided, but also relevant and clear. Merely increasing the volume of information available to decisionmakers or the public is insufficient. Dr. Schiavo-Campo cited, in this context, the requirements for fiscal transparency developed by the IMF.

9. Appropriate participation by concerned public officials, and by other stakeholders, is another ingredient in effective PEM. Such participation can enhance priority setting, evaluation, program quality and accountability. The specific levels of participation, and the configuration of the channels for participation, are of course matters that must reflect each country s circumstances and capacities.

10. Accountability is required both for the use of public money and for the determination of the results or impact of expenditures. Effective accountability, explained Dr. Schiavo-Campo, has two key components: answerability and consequences. Answerability entails the requirement that public officials are obligated to periodically explain where the funds went and what was achieved as a result of their being spent. In this regard, the principle of answerability is as important if not more so than the answers proffered per se. Secondly, there is the need for failures in accountability to carry predictable and meaningful consequences.

Part A: The Budget and its Coverage: Budget Systems, Classifications, and Budget Preparation Process

The Budget and its Coverage

11. The presentation by Dr. Schiavo-Campo emphasized the need for a comprehensive budget: (i) to assure that resources are allocated to priority programs; (ii) for legal control and public accountability; and (iii) to reduce uncertainties. Extra-budgetary funds (EBFs) usually threaten financial integrity and the allocation of resources, especially when transactions made with EBFs are not subject to the same criteria as budgetary expenditures.

12. Sound budgeting requires more than deciding annual expenditure programs, and should also consider multi-year commitments and fiscal risks. These fiscal risks include contingent liabilities (e.g. state loan guarantees), as well as government obligations that may not always be legally grounded but arise from public expectations.

13. The presentation also highlighted the need to effectively manage public investment programs (PIPs) in aid-dependent countries. When poorly conceptualized and implemented PIPs become a wish list for projects or a shopping list for donors money, and can thereby distort or seriously skew the overall PEM process. A good PIP, however, can strengthen both the impact of aid and the PEM process.

14. Ideally, a **strong PIP** should:

- include economically sound projects clearly related to key strategic priorities of government
- be strictly framed by limits derived from the macro-economic framework
- include in the first year only projects for which financing is certain
- ensure that adequate complementary local funding is included in the budget
- prevent over-reliance on external expertise and foster systematic improvements in local capacities

Budget Systems and Classifications

15. Budget systems can be classified according to the bases of appropriation. Dr. Schiavo-Campo explored the strengths and weaknesses of different types of budgeting systems. Cash-based budgeting is suitable for developing countries, where appropriations define limits for annual commitments with payments to be met within the fiscal year, and for the annual tranche of each multi-year commitment. This would meet the need for compliance and expenditure control. Line item budgeting is appropriate, provided that it is not excessively detailed and adequate flexibility is given to managers to reallocate funds within specified rules. Accrual budgeting and program-based budgeting systems should probably be avoided in developing countries, because of their cost, unclear benefits, and great risk of corruption and resource misallocation. An appropriate program classification, however, can be a very useful adjunct to a strong cash-based, line-item budget.

16. The budget presentation to the legislature should include all elements needed to assess tax and expenditure policy, and should present the appropriations in a manner suitable for legislative debate and control. A clear and separate presentation of capital and current expenditures is important, although the process of preparing such expenditure programs must be integrated or very closely coordinated.

17. Appropriate and uniform classification of expenditure items is necessary for tracking uses of appropriations, presenting the budget to the legislature, and managing budget implementation. An expenditure classification system also provides a framework for policy decision-making and accountability. The best-known classification systems are the Classification of the Functions of the Government (COFOG) of the United Nations and the Government Financial Statistics (GFS) of the IMF. A clear distinction between capital and recurring expenditures is necessary for analytical purposes (assessing the operating cost efficiency of government investments), transparency (determining future cash requirements) and policy decisions (ensuring the necessary degree of focus in planning and policy formulation).

Budget Preparation Process

18. The budget preparation process should aim at (i) ensuring that the budget is appropriate to macro-economic objectives and that expenditures are controlled; (ii) allocating resources to programs that fit the policy objectives in each sector; and (iii) securing conditions for operational efficiency. During budget preparation, trade-offs and prioritization among programs must be made to ensure that the budget fits government priorities.

19. A medium-term outlook is necessary because the time span of an annual budget is too short to permit adjustment of expenditure priorities, as most expenditures are fixed in the short term. Medium-term spending projections by economists are also necessary to demonstrate to the government and the public the desired direction of change. By illuminating the expenditure implications of current policy decisions on future years budgets, multi-year spending projections allow governments to evaluate cost effectiveness and to determine whether they are attempting to undertake more than they can afford. As a minimum, the annual budget should take into consideration (i) future recurrent costs resulting from capital expenditure, (ii) funding of entitlement programs, and (iii) contingencies that may result in future spending requirements (for example government loan guarantees).

20. Therefore annual budget preparation should be framed within a sound macroeconomic framework, and organized through (i) a **top-down approach** defining the resources available, and communicating sector spending limits to ministries; (ii) a **bottom-up approach** whereby ministries formulate and cost sector-spending programs within spending limits; and (iii) **iteration and reconciliation** to enable preparation of a consistent overall expenditure program. To choose among alternative programs and to prepare the implementation plan, spending agencies need to know early in the process the amount of resources allocated to their sector. Strictly enforced ceilings are also vitally important to an effective budget process. By giving a hard budget ceiling to ministries at the outset of the process, budget officials can effect a shift from a needs mentality to an availability mentality among spending officials.

21. The presentation concluded by highlighting certain **questionable budgeting practices** which should be avoided. These included incremental budgeting, open-ended processes, excessive bargaining, and dual budgeting which separates current and investment expenditures.

22. In both workshops participants were formed into working groups to assess the issues and topics developed in the presentations in terms of their applicability to their own country situation and gaps between the best practices presented and the operating features of their own PEM systems. The facilitator for the working group sessions was **Dr. Terry Morrison, Senior Training and Learning Methods Specialist of the ADB Institute**.

Part B: Budget Execution, Audit and Control

23. Budget execution is the phase in the overall PEM process where resources are used to implement policies incorporated in the budget. A well-formulated budget can lose its strategic thrust if badly implemented.

24. **Effective budget execution** requires at least:

- Ensuring that the budget will be implemented in conformity with authorizations granted by law, in both financial and policy aspects
- Adapting the execution of the budget to significant changes in the macroeconomic environment
- Resolving problems that arise during implementation
- Managing the purchase and use of resources efficiently and in a timely manner.

Assuring Compliance and Managing Budget Implementation

25. In assuring financial compliance, **Dr. George Russell, ADBI Program Consultant**, emphasized that the role of the central agencies with respect to budget administration must be clear, and that spending agencies must be able to rely on a predictable flow of funds, conforming to budget authorizations. Cash rationing may cause funds to be released on grounds different to budget priorities. It is important that there should be a correlation between budget implementation and cash plans, with regulation of commitments including those of an on-going nature.

26. The basic **compliance controls** during budget execution involve the following:

- Accounting for commitments (commitment stage)
- Verifying delivery of goods and service (verification stage)
- Confirming the appropriateness of the payment
- Providing for subsequent audit

27. Regardless of whether a centralized or decentralized payment system is followed, transparency and predictability are essential. Within the discipline of the overall sectoral budget, efficiency may be improved by allowing some freedom to line ministries to reallocate resources.

28. Accounting for commitments is essential to good budget implementation, and includes contracts for ongoing programs and legal commitments such as debt servicing. Good management of payables and of expenditures is important at the verification stage. Guarantees issued on behalf of government bodies and other entities should be subject to the same level of scrutiny as is applied to loans and expenditures. Payment arrears are a serious problem due to the opportunities they provide for corruption and patronage. It is important that budget implementation be subject to regular reviews. Revisions should be grounded in law and limited in frequency, with all budget requests reviewed and revised together.

29. It is important to obtain high-quality goods and services at competitive prices and on a timely basis. Open competition and transparency are the key principles in procurement. Decentralized procurement under the supervision and guidance of a central Public Procurement Office is recommended.

Cash and Debt Management

30. The financial management function of the Treasury should cover cash management, including all government bank accounts, financial planning and forecasting of cash flows, public debt management, administration of foreign grants and aid, and government-owned financial assets.

31. Cash management requires the control of cash inflows and outflows. Concerning inflows, revenues need to be honored on time and borrowing made at the best available terms. Concerning outflows, claims should be made according to contract terms. This requires an adequate system for managing commitments. The **Treasury Single Account** and the **Passive Treasury Single Account** were examined. The latter allows spending agencies to be responsible for internal management. Whatever the institutional arrangements adopted, the centralization of cash balances should cover all government accounts including accounts managed with extra-budgetary funds.

32. Financial planning and cash flow forecasts are needed to ensure that cash outflows are compatible with cash inflows and to prepare borrowing plans. Cash planning must be done early to allow spending agencies to implement their budgets efficiently.

33. The budget implementation plan should be consistent with the budget and it should be driven by the budget, not by cash availability concerns. This is seldom possible if the budget is badly prepared or the country faces unforeseen fiscal difficulties. Revenue forecasts should be reviewed and updated regularly for good budget planning.

34. The Ministry of Finance is the appropriate agency to contract external loans and to grant guarantees, and should be responsible for all aspects of debt management. Regardless of the accounting basis for other government operations, debt management must be subject to the accrual basis of accounting, and must be the subject of a separate report to be annexed to the budget. Foreign grants, in cash or kind, should be included in the budget. Transactions should be accounted for and data collected and recorded in summary at the central level.

Accounting and Financial Reporting

35. The quantity and sophistication of the information required increases as one progresses from cash to full accrual accounting. The cash basis is the simplest and least expensive. Hence any move toward accrual accounting needs to be carefully weighed in terms of the benefits to be gained therefrom and its likely costs.

36. **Cash-basis accounting** recognizes transactions and events only when cash is received or paid. Therefore, it should be supplemented by:

- commitment accounting
- accounting for outstanding liabilities at the verification stage (including arrears)
- accrual accounting for debt

37. The government should also maintain records of selected assets, and of guarantees issued, showing anticipated losses and related risks. Major weaknesses in government accounting are often related to the treatment of commitments and the recording of expenditure. Whatever its basis, an accounting system should have adequate bookkeeping procedures, consistent classifications, and should provide reliable and timely reporting.

38. On financial reporting, in addition to demonstrating compliance with the budget, the budget reporting system should assess how the government is performing, and answer questions of budgetary integrity, operating performance, stewardship, and control systems. Financial reports should cover all government entities, and they in turn should produce their own regular financial reports.

Management Controls, Audit and Evaluation

39. Management control, or internal control, assures the economic, efficient and effective achievement of the government s objectives, adherence to its laws, regulations and policies, safeguarding of assets, and prevention and detection of fraud and error. Thus management control provides the basis for reliable accounting and financial reporting. Top management should be committed to internal controls. Management should be aware of the risks of management override and collusion. Controls may be in the nature of physical accounting, and the processes covered should include procurement.

40. The role of external audits includes reviewing and identifying weaknesses in internal controls. Audits determine the reliability of financial records, and the reports derived therefrom should cover instances and patterns of waste and inefficiency. Audits in general are a deterrent to fraud and corruption. The two most important auditing principles are independence and competence. Matters affecting an audit include an understanding of its objectives on the part of the organization being audited. Cooperation between internal and external auditors is important for both efficiency and financial integrity.

41. Evaluation is intended to provide reliable data about the effects of policies and programs for improving decision-making and resource allocation. However, evaluation can be an expensive business, and should be carried out only when its costs are likely to be outweighed by its benefits.

42. As in the case of Part A, the participants were formed into working groups to discuss the presentations of Part B in terms of their applicability to their work.

Part C: The Role of Information Technology in Public Sector Reform

43. **Dr. Clay Wescott, Senior Public Administration Specialist at the ADB**, reminded participants that government is one of the largest collectors, dispensers and users of information. In this sense, the work of governments is information and knowledge intensive. The need for information pervades all aspects of the functioning of governments. Information is needed to support internal management, public administration and regulation, and public services. Where possible, governments should make information available to the public. Dr. Wescott discussed the potential of information technology (IT) as an enabler of public sector reform and performance improvement. He divided IT Opportunities for the Public Sector into four areas of potential and actual application: the Internet, Electronic Commerce, Workflow and Enterprise Systems.

44. The reach and use of the Internet is only beginning to be understood by governments. Based on the principle of the citizen as a consumer and client, the Internet can be used to improve social services provision, consumer transactions with government, direct feedback and information flow, and outreach programs.

45. The Internet is **changing the way governments do business**. These include the following instances:
- Members of the public can file their tax returns electronically
- Additional avenues have been created to provide services to the public and promote self-help (e.g. electronic job banks)
- Governments can use the WWW to issue requests for quotation and tenders
- The public can provide feedback to governments via web-based forms, or use email to contact government officials
- The research and policy community can have direct online access to government data and in-house research
- Tools and best practices in public sector reform can be accessed by other governments, such as National Performance Review, United States, and PUMA, OECD)

46. Electronic commerce, the buying and selling of goods and services, with the digital transfer of funds, also provides opportunities for governments, which many are beginning to exploit. E-commerce can enable individuals and groups to purchase government documents electronically. Moreover, governments are also increasing e-procurement, through electronic linkages with their suppliers.

47. Workflow systems operate in all organizational environments. Workflow is a general term describing movement of images, files, documents and other types of information from workstation to workstation, using specific business rules for review, authorization, data entry, editing and task management.

48. Governments are implementing many new forms of IT **to facilitate workflow** in fields such as the following:

- Integrated financial management systems (budget, accounts, treasury)
- Tax management and tax revenue collection
- Claims processing and management
- Bid and proposal routing and tracking
- Engineering change and notice distribution
- Handling customer service and complaints
- College enrollment and student loan management
- Human resource recruitment and hiring
- Knowledge management systems

49. The final area of IT-enabled reforms highlighted by Dr. Wescott was that of enterprise resource planning systems. An enterprise resource planning (ERP) system is an integrated business system that ties all the diverse functions of an enterprise into a cohesive system using a common database. ERP systems integrate with Internet (email, messaging), electronic commerce and workflow systems. ERP systems present governments with a number of opportunities such as financial management integration (financial accounting, budget implementation, cost accounting, project accounting, grant accounting and fixed asset accounting); human resource management (organizing, sourcing, human relations, compensation, training); and facilities resource management (cash and investment, procurement, material management, maintenance, accountable property, real property).

50. Developing countries, have same advantages in levering the benefits of information technologies. They are not laden with existing legacies, they often have fewer bad habits to overcome, best practices are available for them to review, and the technology that can be used is readily transportable, even generating leapfrogging opportunities.

51. In concluding his presentation, Dr. Wescott underlined several key aspects of sustainable IT projects. IT projects are not only about technology; they are about people and processes which can be employed to support good governance. IT projects should be strategic initiatives, driven by senior government officials and designed to deliver tangible benefits. Moreover, costs are not the only factor. IT projects should be investments for the benefit of the public. They should not be factored by time and budget. Rather, they should be guided by a strategic plan focused on enhancing value. Introducing new IT is not easy, nor is it free. It is a complex, difficult, and even painful process and will require skillful management of the resulting organizational changes.

Part D: Fostering Performance in PEM

52. The final segment of the workshop was presented by Dr. Schiavo-Campo and explored the subject of performance management in the PEM process within the overall theme of reforms. Measurement of the activities and impacts of the public sector is a complex and difficult issue, and is not merely a matter of importing private sector management practices into the public sector. One of the reasons for this is that the public sector is often engaged in the provision of public goods, in which markets may be imperfect or inappropriate. In these situations, the so-called bottom line may be difficult to draw, or even define. That said, it does not follow that good performance should not be expected within public sector management. Indeed, many governments around the world, aware of the lack of responsiveness and accountability of public sector organizations, have taken active steps to introduce performance management processes into their organizations.

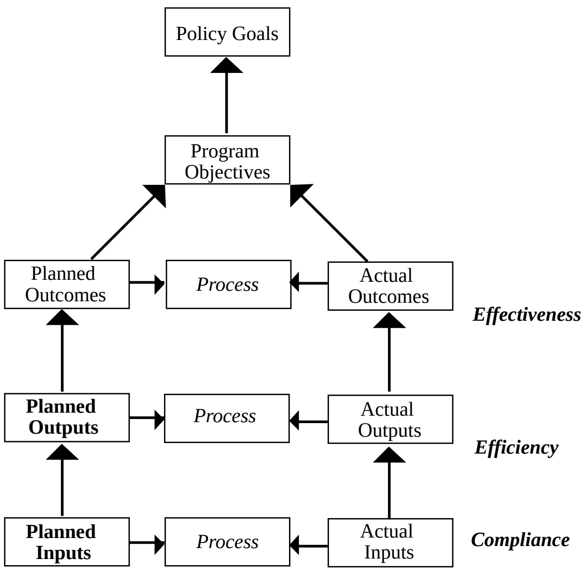
53. The presentation by Dr. Schiavo-Campo began by distinguishing between the various elements of performance management: viz. performance orientation, performance indicators, performance appraisal, performance-based pay and performance budgeting. None of these necessarily implies the other and yet they have been implemented in ways that tend to pro-

duce wasteful results. Performance may be defined in terms of effort or in terms of results. It is a mistake to ignore the subjective quality of performance the ef fort dimension for it often contributes to organizational effectiveness. At the same time, a complete focus on effort can lead to a situation in which ef fort serves as an excuse for not producing results. Basic to performance orientation, then, is the recognition that performance is instrumental and not an end in itself. It is also a relative concept relative to economic systems, country size, the role of the state, quality of governance, prevailing culture and the specific sector to which it is applied.

54. A framework for performance management in the PEM links:

- **Inputs**: These are the resources used to produce a service (for example doctors, nurses, hospital equipment, and medicines). The social value of inputs is measured against their cost.
- **Outputs**: This describes the service itself (for example, the number of child vaccinations administered). The social value of outputs is approximated either by the market price for the same service or its closest equivalent, or by total unit cost. The overall performance criterion is efficiency, i.e. minimizing total input cost per unit of output or maximizing output in relation to a given total cost of inputs.
- **Outcomes**: This describes the effects achieved by producing the service (for example, reduction in child mortality). The social value of outcomes is subjective and subject to valuation in the political and policy arena. The performance criterion relating to outcomes is effectiveness, i.e. maximizing outcomes in relation to outputs produced.
- **Impact**: This is often used as a synonym for outcomes. It should, however, refer to the value added through the activity (i.e. gross outcome minus the contribution from other entities or activities).
- **Process**: This refers to the manner in which inputs are procured, outputs produced or outcomes achieved.

55. This chart illustrates the relationship between performance criteria and indicators:



56. Basic principles of performance management can be used to determine effective performance indicators, known as CREAM :

- **Clear**: Indicators should be precise and unambiguous (though not necessarily quantitative).
- **Relevant**: They should be appropriate to the objective at hand.
- **Economical**: The data required should be obtained at a reasonable cost.
- **Adequate**: Whether by itself or in combination with other measures, the indicator must provide a sufficient basis for the assessment of performance.
- **Monitorable**: In addition to clarity and availability of information, the indicator must be amenable to independent scrutiny.

If these criteria cannot be met, then performance indicators should not be used.

57. Dr. Schiavo-Campo concluded this section of the presentation by noting how the elements of performance interact. The output of one stage is an outcome of the previous stage and an input into the next. The only general rule that applies in this systemic relationship is that performance should be assessed according to a combination of input, output, outcome and process indicators that is realistic, cost effective, and suitable to each specific activity, sector and country.

58. Adding formal performance-related elements to the budget process can reap benefits but the change must be handled with extreme care. The lessons of international experience suggest the following guidelines:

- Do not confuse the objective of better performance orientation with any one of the specific instruments for achieving it. There are many ways and means of fostering performance, and they need not include altering the entire process and rules of the budgeting system.
- If the budget process is extremely weak, then radical change may be the only remedy. However, if the PEM process is performing reasonably well, dramatic introduction of performance measures may be counter-productive.
- Consider carefully the impact on individual behavior, especially in multi-ethnic societies or very small communities.
- Understand the different meanings and uses of input, output, outcome and process indicators, and tailor their utilization to the specifics of the setting and sector.
- Assure robust monitoring with clear and deliverable consequences.
- Build in provisions for the systematic assessment of the performance measurement system itself.
- Continuously develop and reinforce a culture of client-focused service.

59. The **final session of the workshops** centered on the strategy and sequencing of budgetary reform. Improving PEM requires both institutional reform (regulatory and procedural) and organizational development. Reform strategy flows inevitably from a balance between those areas in which reform must be quick and fast paced and those in which a more gradual process is called for. Dr. Schiavo-Campo referred to this pragmatic strategy as a T ortoise-Hare approach. That is, reform should be as fast as possible when circumstances permit (the hare) and as slow as necessary when circumstances demand (the tortoise). Within this torto-hare approach, he highlighted two strategies as crucial to success. The first was to strengthen the linkages between agencies and ministries to facilitate effective communication, coordination, and collaborative action. The reason for strengthening linkages was to target efforts on strengthening the overall PEM system rather than just particular elements within it.

60. The second strategy involves the development of a capacity for change within the organizational and systemic environment. In this regard, Dr. Schiavo-Campo described the use of what he termed ef ficient nuclei : teams functioning as supports to the change process, whose role is to spread change throughout the organization. These efficient nuclei should function according to the following principles:

- They should be small.
- Initial selection of personnel should be fiercely meritocratic.
- Have flexible and simple procedures.
- Adequate compensation should be given to the staff involved. This may require fixed term and flexible contracts.
- They should have adequate material and financial resources.
- Local talent should be used, with external advisers only being called in when clearly needed.
- The nuclei should be temporary, disappearing after momentum has been established.
- As well as performing specific tasks, they should have an educational, teaching-by-doing function.

61. Efficient nuclei operate rather like a visiting team within ministries, helping them to understand reform and providing the tools to make it happen? Since the team is visiting, it has the advantage of not posing any on going competition or threat to existing personnel and functions.

62. The reform of public expenditure management rests necessarily both on principles, which are universally applicable and on practices, which must account for specific country contexts. In the case of universal principles, the following were highlighted during the workshop as being of enduring and proven value:

- Strengthening the four pillars of governance (accountability, transparency, participation and predictability).
- Reinforcing their foundation in civil society by strengthening the voice of the citizen.
- Improvement in PEM should be used partly to reduce opportunities for corruption.
- The strategic guidance system of PEM expenditure control should be strictly adhered to strategic resource allocation, good operational management and due process.
- The budgeting horizon should be stretched beyond the immediate future through a formal multi-year approach when feasible.

63. In addition to these universal principles, **four practical rules** for improving PEM in specific country circumstances were proposed:

1. **Put first things first**: Get the basics right before launching into any dramatic experimentation.
2. **Do not repeat others' mistakes**: There is no need in all cases to learn only from one s own experience. It is possible to learn from the mistakes of others, by diversifying sources of advice and assistance.
3. **Put the right driver in the driver's seat**: PEM programs introduced and designed by outsiders, or from a top down model, are just that outside, top-down models. All PEM improvements rest ultimately on the systematic development of native or local capacity at all levels of the system.
4. **Be open minded but questioning**: If the recommendation is sound, it will withstand critical challenges; if it is not, only critical challenges will reveal that fact.

BONUS

Abstract from the New Working Paper on The Institutional Foundations of Market Transition in the People s Republic of China

by Yingyi Qian

[Download full text at www.adbi.org/pdf/wp/wp09.pdf]

This paper intends to properly account for the People s Republic of China s (PRC) two decades of market transition by examining its institutional foundations. The journey of transition is analyzed as a two-stage process. In the first stage (1978-93), the system was reformed to unleash the standard market forces of incentives, hard budget constraints, and competition. The underlying institutional forms and mechanisms, however, were far from conventional: reforming government through regional decentralization; entry and expansion of non-state (mostly local government) enterprises; financial stability through financial dualism; and a dual-track approach to market liberalization.

In the second stage, PRC aimed to build a rule-based market system incorporating international best practice institutions but proceeded in its own way. Major progress was made in the first five years (1994-98) on the unification of exchange rates and convertibility of the current account; the overhaul of the tax and fiscal systems; reorganization of the central bank; downsizing of the government bureaucracy; and privatization and restructuring of state-owned enterprises (SOEs). To complete its transition to markets, however, PRC still faces serious challenges, especially in transforming its financial system and SOEs and in establishing the rule of law.

The paper concludes by reflecting on the economics of reform and institutional change from the PRC experience. The main lesson learned is that considerable growth is possible with sensible but not perfect institutions, and that some unconventional transitional institutions can be more ef fective than the best practice institutions for a period of time because of the second-best principle. Specific lessons include: incentives, hard budget constraints, and competition should apply not only to firms but also to governments; reforms can be implemented without creating many or big losers; and successful reforms require appropriate, but not necessarily optimal, sequencing.

TABLE OF CONTENTS

Advance Abstract from the New Working Paper on Financial Structur e and Financial Crisis by Franklin Allen

[Download full text at www.adbi.org/pdf/wp/wp10.pdf]

Contrary to conventional theory, financial systems that are subject to market forces seem prone to periodic financial crises. Financial crises like those in South East Asia often follow what appear to be bubbles in asset prices. The financial crises recently suffered in this region were not primarily due to the country specific factors that are stressed in the conventional analysis. They are essentially similar to crises that have occurred, both historically and recently, in many other countries with rather different financial structures.

This paper describes a model of bubbles and ensuing financial crises which is consistent with events observed in South East Asia, Scandinavia and many other countries. If the bubble bursts and asset prices collapse a banking crisis can follow. This may spill over into the real economy and lead to a fall in output.

Policy should be directed at ensuring an asset price bubble does not occur by keeping credit growth at an appropriate level and avoiding uncertainty about future financial policy. However, if a bubble does occur and the inevitable collapse in asset prices leads to a banking crisis, swift intervention in the form of recapitalization of the banking system is required to eliminate the debt overhang problem.

It is argued that financial structure does matter for growth. For countries trying to develop an economy based on manufacturing in traditional industries a bank-based system has some advantages. For economies where the main industries are knowledge based, equity and debt markets may have some advantages. Given the conclusion that financial structure is not that important for preventing financial crises the aim of long-run growth does not need to be compromised.

Yet that is not to say that financial structure is unimportant. For instance, having effective banking regulation is clearly desirable in preventing crisis. The financial liberalization necessary for moves in structures and systems needs to be handled with great care and uncertainty needs to be minimized if problems of financial crisis are to be avoided.

[Includes appendix with Allen and Gale model on asset price bubbles]

TABLE OF CONTENTS

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