“Financial Management Reform in Latin America: An Institutional Perspective”

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Introduction

The World Bank’s approach to supporting public sector reforms in Latin America has been evolving over the past two decades. While there has not been any systematic evaluation of the Bank’s approach to public sector reform, cursory observations indicate that the record is at best mixed. This paper discusses potentials and limitations of one particular approach that has gained currency since the late 1980s, use of integrated financial management systems to support improvements in public expenditure management.

World Bank Support for Public Sector Reform in Latin America

Early-mid 1980s: Fiscal Adjustment Focus. The Bank began its involvement in public sector/institutional work in Latin America and the Caribbean in the early 1980s to support fiscal adjustment and economic liberalization. During the 1980s, paired operations of structural adjustment and technical assistance took place in several countries.1 These operations typically addressed improving “public sector efficiency” in economic management, and reforming industrial and sectoral policies in such areas as agriculture and mining. Some TA loans were implemented without accompanying SALs.2 These projects also concentrated on strengthening the core government functions in economic management (investment planning, budgeting, debt management, public enterprise management), and on supporting the government’s policy management capacities to promote economic liberalization. In limited instances, bold reform attempts were made, such as the (unsuccessful) introduction of a senior executive service (SES) in the 1982 Peru Public Sector Management Project or the introduction of a performance budgeting system in the 1984 Jamaica Public Administration Reform Project. But such attempts tended to be exceptions rather than the norm, and have not been sustainable.

Late 1980s – Early 1990s: Public Sector Modernization. Once strong fiscal pressures subsided between the late 1980s and the early 1990s, many of the region’s public sector operations began to adopt what may be called a “modernization” approach. The fundamental objective of modernization has been to improve the efficiency, effectiveness, and transparency of government operations through the adoption of coherent procedures and norms supported by modern information technology. These projects invested heavily in improving the performance of existing bureaucratic institutions by modernizing the legal framework for government functions such as financial and personnel management, by updating management tools through new computer and information systems such as an integrated financial management system or a computerized taxpayer registry, and by developing more streamlined operational procedures. Training government personnel on the new tools and procedures was a central component of these projects. A series of public financial management operations

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in Bolivia, Colombia, and Guatemala, as well as some tax administration projects fall into this category.

**Mid-1990s – Today: Growing Emphasis on Institutional and Governance Factors.** In the 1990s, representative governments consolidated and economic stabilization programs enjoyed considerable success. These advances led client governments to seek Bank support for changes in new areas. Since the mid-1990s, the Bank has begun to get involved in judicial reform, decentralization, and anticorruption efforts. With the entry into these potentially more “political” areas, and coinciding with the Bank-wide recognition of corruption and poor governance as obstacles to development, the Bank began to add to its operations increasing dosage of institutional and governance concerns. This new approach emphasizes far more explicitly than in the past approaches the importance of incentives operating in the public sector to promote or obstruct changes and reforms. Especially on the analytical front, the Bank has begun to carry out country studies that explicitly address institutional and governance matters (e.g., Institutional and Governance Reviews in Bolivia and Peru, corruption study in Argentina). But this new orientation co-exists with the continuing need to address fiscal adjustments in several of the countries in the region, and the continued and widespread use of the modernization approach, which is receiving additional impetus from the technological development and the e-government movement of recent years.

The Bank’s knowledge and understanding about operational implications of the institutional analysis are still limited. But there is a growing recognition that “supply-driven,” technical approaches to public sector reform are unlikely to be successful and sustainable and that deeper reforms of public sector institutions would require addressing underlying incentives, including political incentives. The challenge is how to make such an insight operational. One area in which the trend toward “informatization” and the enhanced interests in governance (e.g., transparency and accountability) converge is public expenditure management.

**IFMS and Public Expenditure Management: Modernization or Institutional Reform?**

One of the most commonly used forms of Bank support for public sector reform within the modernization paradigm is the introduction of computerized integrated financial management systems. An IFMS is fundamentally an approach to improving public financial management from a narrower accounting and automation perspective. This contrasts with broader approaches that place greater emphasis on reforming institutions of planning, budgeting and financial management such as introduction of performance budgeting or medium-term expenditure framework, organizational and management reforms of ministries, and/or institutionalization of fundamental program reviews to directly identify options for fiscal retrenchment. While the broader approaches are based on the premise that institutional reform of the budgetary system is fundamental to improving the quality of public expenditure management, the IFMS approach aims at improving the quality and availability of information necessary at various stages of public financial management (budgeting, treasury management, accounting, auditing, etc.).
While a good IFMS operation is also designed to reengineer and rationalize financial management processes, the relative emphasis is decidedly on improving the quality of information and its flow between different aspects of government financial management. The premise is that better information will lead to developing better institutions that facilitate better decisions and, eventually, better outcomes. For example, one Project Appraisal Document maintains that “the productive use of information should lead to a progressive improvement of processes, promote institutional change and ultimately, allow the government to move forward on its policy goals on more solid footing.” Thus IFMS operations are sometimes seen as building blocks or catalyst for broader institutional reforms of the public expenditure management systems. In the Latin America & the Caribbean Region, the World Bank has generally eschewed a broad approach to reforming budgetary systems and more or less focused on promoting the IFMS approach. This pattern contrasts with a more ambitious approach pursued in Africa and parts of Europe, for example, with the widespread efforts to introduce a medium-term expenditure framework, performance-based budgeting, or New Zealand-style new public management practices.

IFMS as a Means to Improving Public Expenditure Management (PEM)

A good public expenditure management (PEM) institutional arrangement aligns formal organizational roles, incentives, and information in such a way as to maximize the effectiveness of and coordination among different actors involved in the budget and financial management process and to increase the likelihood of producing the desired budgetary outcomes. Governments, especially those in developing countries that suffer from resource constraints, need to maximize the efficiency of its resource use both in terms of areas in which they are allocated and in terms of the “value for money” they get from executing the allocated resources, and they need to do so without jeopardizing the macroeconomic stability and sustainability of the expenditure programs.

Good budgetary institutions would allow governments to attain the three inter-related PEM objectives of (1) aggregate fiscal discipline (“level 1”), (2) efficient allocation of resources according to the government’s policy priorities (“level 2”), and (3) efficient use of resources to achieve program objectives (“level 3”). Simultaneous achievement of these three levels of budgetary outcomes is a key goal of any PEM institutional reform. In addition, governments in developing countries, especially are now expected to demonstrate a minimum capacity to track public resources that are allocated to poverty reduction purposes. This depends on the extent of overall transparency in the budget and financial management, and the robustness of the existing accounting and reporting mechanisms.

<table>
<thead>
<tr>
<th>Aggregate Fiscal Discipline</th>
<th>Budget totals should be the result of explicit, enforced decisions; they should not merely accommodate spending demands. These totals should be set before individual spending decisions are made, and should be sustainable over the medium-term and beyond.</th>
</tr>
</thead>
</table>

Table 1: Basic Elements of Public Expenditure Management: “Three-level” Analysis
**Allocation to Strategic Priorities**

Expenditures should be based on government priorities and on effectiveness of public programs. The budget system should spur reallocation from lesser to higher priorities and from less to more effective programs.

<table>
<thead>
<tr>
<th>Operational Efficiency</th>
</tr>
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<tbody>
<tr>
<td>Agencies should produce goods and services at a cost that achieves ongoing efficiency gains and (to the extent appropriate) is competitive with market prices.</td>
</tr>
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</table>


Reliable and timely information is crucial for effective decision-making. Budgetary decision-making is no exception to this rule. Thus IFMS can be a useful tool to improve the quality of budgetary decision-making by improving the quality of financial information made available to public managers and politicians. Some of the potential benefits of IFMS in improving budgetary performance at the three levels are summarized in Table 2 below.

**Table 2: Potential Benefits of IFMS**

<table>
<thead>
<tr>
<th>Level</th>
<th>Potential Benefits</th>
</tr>
</thead>
</table>
| Level 1: Macofiscal Stability | • By providing *comprehensive* data across government, a clear picture of the state of the budget is possible, enabling financial management.  
• By providing more "*real time*" data during the fiscal year, opportunities for corrective intervention within year exist. Emerging budget threats can be identified and corrected.  
• By providing data in *greater detail*, managing total spending is possible in a more flexible way. The sources of overspending can be more clearly identified, and specifically redressed.  

  Based on prior 3 points, the government can better control spending and stay within planned fiscal targets. |

  • By supplying in-year data to line Ministries and agencies in a real time fashion, an IFMIS can enable them to better manage their own resources and stay within budget. An IFMIS can thus help agents to operate within a hard budget constraint. Collectively, this supports better macrofiscal discipline. |
| Level 2: Strategic Allocation of Resources | • In budget execution, an IFMIS allows more active in-year monitoring and management of public funds. This enables the elected officials and center of government agencies to better enforce strategic choices made in the annual budget process, and ensure strategic allocations are implemented.  
• In budget formulation, IFMIS can supply data on current year spending as well as prior year, which should form the basis for the proposed subsequent years’ budget. This helps assure more realistic budgets tied to actual trends.  
• By automating data, IFMIS enables data to be analyzed in different ways more readily, supporting better information, analysis, and decision-making during budget formulation (for both the Ministry of Finance and line Ministries). The cost and implications of proposed policy changes should be better understood, and estimates more accurate. |
| Level 3: Operational Efficiency | • By helping assure money gets to where it was intended, IMFIS can at a very basic level support operational efficiency. (Similarly, an IFMIS provides potential for better *ex poste* auditing, and detecting corruption or waste of funds.)  
• If collected in sufficient detail, IFMIS information can help identify and manage cost-drivers for activities, and allow comparison of alternate service delivery modes.  
• If tied to a program structure, with definable outputs or outcomes, the cost of... |
activities, modes of production, and management thereof, are enabled. It allows benchmarking of efficient practices for similar activities, another vehicle for evaluating and encouraging operational efficiency.

- If revenues and accounts receivable are incorporated, improved cash flow forecasting, cash management, and lower debt service costs (or floating debt) are enabled.
- An IFMIS offers opportunities for integration of personnel and payroll, procurement, investment and inventory management with financials. This enables improved information and controls, improved management and potential cost reduction.

In addition to providing good information, there are other prerequisites for an IFMS to achieve its potential. Information has to be available the key users, and in a user-friendly format. Ministry of Finance staff must have access for analytical purposes, and line Ministry managers must have access for management purposes. Moreover, staff must have the capacity to analyze the data and use it in decision-making, and policy officials and managers must understand the usefulness of the information and demand it.

Making financial data widely available can also improve outcomes, as civil society and its organizations (e.g. media, private enterprises, associations, interest groups, think tanks, academic researchers, and non-governmental organizations) review and detect problems or trends that might otherwise be overlooked. But fulfillment of this potential depends on the readiness of the external agents to play a constructive watchdog role. In many developing countries, these agents’ capacities to monitor and understand their governments’ budget management are still limited.

Call for government transparency is a relatively new phenomenon. There may very well be resistance by government or its agents to producing good financial information: transparency and the existence of information can reduce administrative discretion in fund use, and certainly opens agents to criticism or, in the worst case, prosecution. In developing an IFMS, change management techniques, attention to how the information will be used and by whom, and even how the project is planned and implemented (e.g. end-user involvement in design and piloting) must be taken into account to improve the likelihood of successful implementation.

Core technical issues in IFMS include developing standards for system operation (timeliness with which data must be entered into the system), standards for accounting (how to code transactions), training and provision of manuals and guidelines, and an accountability regime for financial staff (ethics standards, professionalism, and clear sanctions for material nonperformance).

For the full benefit to be realized, effective budget and financial management institutions must exist, each fulfilling its unique role. These include:

- internal control regimes in spending ministries;
- internal audit to assure system integrity, internal control integrity, provide management accounting support, reduce waste, fraud and abuse, and monitor compliance with management policies (e.g. pay and promotion policies);
• external audit to provide independent verification that internal control and audit systems are working, test IFMS system integrity, and recommend improvements; and
• a well-trained budget staff in the Ministry of Finance and line ministries capable of utilizing the information for planning and decision-making purposes.

Chart 1 illustrates some of the systems that should be in place and functioning for an IFMS to fulfill its potential.

**CHART 1: IFMS within PEM systems**

Since the late 1980s, the World Bank has supported efforts by various governments to modernize their public financial management systems. One of the predominant methods of assistance, particularly in Latin America, has been introduction of an integrated financial management system (IFMS). Countries such as Argentina, Bolivia, Ecuador, El Salvador, Honduras, Guatemala, Nicaragua and Venezuela have received World Bank technical assistance loans to install IFMS, and other donors, including IDB and USAID, have also promoted IFMS in the region. Experiences so far are varied, however. Argentina and Guatemala, for example, have implemented IFMS with relative success,
while others have struggled to make noticeable progress in improving public financial management practices.\(^3\)

The Bank’s support for financial management reforms in the Latin America Region emerged from the realization that macro fiscal stability requires basic tools such as treasury systems (including an IFMIS), and later on the growing emphasis on improved cost-effectiveness and quality in public resource use. The latter realization coincides with the rise of market economies and stable democracies, and the realization that public spending must move from “extensive development” (an ever increasing share of GDP) to “intensive development” (increasingly efficient use of limited resources).

Most projects have focused on modernizing outdated rules and systems or on creating appropriate rules and systems where none existed. Two IFMS projects (Guatemala 1995 and 1997, and Argentina 1991) stand out because of their considerable success using the modernization approach. In both cases, reform efforts moved quickly and took advantage of “windows of opportunity,” including strong political support.

In the case of Argentina, when the project began in 1991 the budget was merely a formality and the government was unable to program and control public spending. Prior to that, high inflation and limited human capital and information technology capacity had made budgeting irrelevant, and the government limited public expenditure management to producing ex post reports of what was spent. After the peso-dollar peg (fiscal convertibility) helped reign in inflation, the Bank helped the government draft a new legal framework that clearly delineated financial responsibilities within the public sector. The project also financed a modern control and auditing system that integrated financial management functions, and in 1991, for the first time in 50 years, the federal budget for 1992 was submitted on time and approved before the start of the fiscal year.

In the case of Guatemala, a 1994 Bank review concluded that “serious administrative deficiencies relating to nearly all aspects in the formulation and execution of the budget were impeding the attainment of targets.” Financial management laws and systems were outdated, inconsistent, and uncoordinated. The government passed new laws and regulations, and the Bank financed a state-of-the-art integrated financial management system, which provides on-line, real-time, accurate information on all financial transactions within the national public administration to government leaders as well as to citizens.

The 1994 Ecuador Modernization of the State (MOSTA) project also tried to modernize public financial management in accordance with a new Budget Law. The most apparent obstacle to modernization in Ecuador was a proliferation of rules and controls; public managers spent a great deal of energy trying to circumvent these constraints. One way in which the MOSTA project proposed to modernize public financial management was by changing the focus of controls from ex ante to ex post, and altering mechanisms for rule enforcement (for example, automatic enforcement through the computerized System of Payments by Bank Networks, instead of discretionary enforcement by top officials).

During implementation, the project encountered stiff opposition from some top officials

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\(^3\) In spite of these observations about apparent performance of the IFMS operations in different countries, the World Bank has yet to conduct an objective and systematic evaluation of these operations.
who resisted losing power through the proposed change in enforcement mechanisms. Progress on the MOSTA project has been slow, in part due to political and bureaucratic resistance.

In Bolivia, the Bank has been supporting financial management reform since 1987, with limited results. The 1987 SAFCO project aimed to establish the basic financial administration and control systems and capabilities, and train staff to use the new systems. After some delays, the SAFCO law was passed in 1990, outlining the principles and standards of a modern financial management system for the entire public sector. Since the new system was not successfully implemented in all public entities, the Bank approved a second financial management project in 1991. The primary aim of the second project was to ensure that SAFCO would be adopted throughout government, and policymakers would use that the information it generated. A third financial management project was approved in 1997 to support the government in implementing SAFCO at the regional level, although after almost a decade its use still had not been consolidated in the central government. In 1999, the third project (ILACO II) received renewed push from both the Bank and the Government, and with a new project director in place, it finally began to move ahead with its implementation. The SAFCO projects provide a classic example of how the modernization approach often overlooks key bureaucratic and political issues that can hinder fundamental institutional reforms. Resistance within various units inside the Finance Ministry, a lack of project ownership by some Finance Ministers, and an unclear reform vision all undermined the project. All three credits in Bolivia focus on technical improvements to make the system faster and easier to use. However, they pay little attention to the underlying problem: a change in formal rules does not necessarily translate into a change in the informal norms that define actual behavior.

Box 1: Public Financial Management Reform in Guatemala

While the implementation record of IFMS projects in the Region is mixed, there have been a few well-known successes. Perhaps the most well recognized is the series of Integrated Financial Management Projects (I & II) in Guatemala. “IFML has revolutionized transparency and efficiency in the flow of funds in this post-conflict country. Emerging from three decades of civil war, Guatemala had a desperate need not only to improve service delivery, but to restore confidence in the integrity and efficiency of the public sector.” After five years into implementation, the achievements of the Guatemala IFMS projects include:

- Widespread reduction in prices paid for supplies (e.g. x-ray film down 60 percent and pharmaceuticals drastically reduced) due to modernized procurement and payment systems that have substantially cut the time and procedural steps (and thus premiums built into prices to reflect inflation and/or bribes by suppliers to speed payments).
- Arrears to suppliers have been eliminated. Before, the so-called “floating debt” used to linger up to three months into the next fiscal year preventing the “opening” of the new budget.

5 “1999 Awards for Excellence: Guatemala Financial Management Reform Team.”
Rationalization in government financial management procedures and practices such as an increased use of electronic funds transfers from near zero in 1996 to 50 percent of public sector payments in 1998; the reduction in the number of government bank accounts from 1,300 in 1996 to 600 in 1998, with the aim of keeping one Single Account by 2000; the reduction in the number of budget line items from 7920 to 887 during 1997-1999, permitting a greater focus on programs while providing executing agencies increased flexibility to adjust their budgets without requiring time consuming prior approval from the Finance Ministry.

For the first time, the 1999 budget was presented to the Congress on CD ROM on September 2, 1998, along with actual 1998 expenditures current through August 28, 1998 (i.e., only four days old). This provides more manageable information for congressional deliberations and promotes a focus on results of the current versus future budget priorities.

Legislators, private citizens, NGOs, and any other stakeholder can access proposed and executed national budgets at several computer sites in Guatemala and through the internet (www.siafsag.gob.gt).

Physical as well as financial indicators are now included in the budget to better measure performance and promote a result-oriented focus, and line ministries have timely and accurate information to improve physical programming and service provision.

The World Bank and Inter-American Development Bank teams implementing projects in the education and health sectors report stark improvements in project implementation due to the decentralization of financial management responsibilities and the improvement in financial management policies and procedures and information availability.

The UN Peace Commission supporting the implementation of the Peace Accords signed in late 1996 ending 30 years of civil war in Guatemala sees the project as contributing directly to improved governance in Guatemala. More recently, the project made it much easier for Guatemala to manage and account for reconstruction assistance being provided in the wake of Hurricane Mitch than was the case for neighboring countries. The Guatemala project has been observed by delegations from throughout Latin America (including Argentina, Bolivia, Costa Rica, and Nicaragua) and presented as a model system at international conferences and internally within the Bank.

Effects of IFMS on PEM Performance: The Case of Nicaragua

Although there has not been a very systematic evaluation of impacts of IFMS on the three levels of PEM performance, we have at hand one preliminary assessment for Nicaragua. There IFMS implementation has made marginal contributions in terms of aggregate fiscal discipline and allocative efficiency, and limited but more substantive contributions to operational efficiency at the central level.

Has aggregate fiscal discipline been achieved? In Nicaragua, the constitutional and legal framework for budgeting, as well as the SIGFA-developed budgeting standards and procedures are generally viewed as providing a sound regulatory base, as well as a clear definition of the roles of executive and legislative branches, the MOF as the budget administrator at the central level, line-agencies and spending units.

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As solid as may be the institutional arrangements for public expenditure management, the same are frequently defeated by disputable management practices at the higher level of government. Some examples:

- One recent and very important example is that in 1999, without the approval of the National Assembly the administration exceeded the authorized budget allocations by 10.4% (equivalent to approximately US $82 million), of which 16.1% in current expenditure and 83.9% in capital expenditure. It was only in December 1999, after expenditures had already taken place, when the executive branch requested post facto legislative increase of budget allocations, based on equally post facto incorporation to the 1999 budget of external resources received during the year.

- Poorly supported payment orders are still frequently given by top GON officials to the central treasury, subject to future regularization. When the SIGFA-Central system came on stream mid-1998, approximately US $20 million in outstanding transactions of this type (classified as “anticipos” or advances) were detected by the system. Notice was given of this situation to senior GON authorities, accelerating regularization actions. However the practice continues, and frequently results in a rush of budget modifications at the end of the fiscal year in order to regularize this type of transactions.

- In 1999-2000, the top tax authorities financed expenditures outside the budget system with funds raised by way of a complex arbitrage between tax credits and tax obligations of public sector entities. This was subject to intense public debate during the first half of 2000, and eventually caused the resignation of two very senior GON officials.

Are resources being allocated efficiently according to strategic priorities? In a poverty stricken country like Nicaragua, with a persisting low resource base and requiring strong external aid for its development activities as well as to finance its primary budget deficits, allocation of resources in accordance to strategic priorities is even more essential than in richer countries. It is also extremely difficult to achieve because whatever resource envelope may be reasonably expected it will always be extremely small in relation to the nation’s basic and competing needs, so an allocation balance is critical. A very strong fiscal policy formulation framework is required even for limited success in this area, but this is an area in which Nicaragua demonstrates particular weaknesses and for which it has not received systematic donor assistance, including from the World Bank.7

However, IFMS implementation could improve budget formulation by improving the level of information required for monitoring and evaluating performance. Effective evaluation should, in theory at least, eventually result in a more efficient resource allocation. But for IFMS to make a real difference, another requirement would be

7 The World Bank is now supporting strengthening of “the formulation, execution, and supervision of macroeconomic, fiscal, and investment policies” by addressing “organizational overlap and gaps, poor human resources, and a lack of coordination across the various agencies.”
extensive IFMS deployment to the spending unit level in order to support an efficient bottom-up budgeting process. This has not happened yet in Nicaragua as SIGFA-Local deployment has been repeatedly delayed, thus IFMS implementation has had relative little direct impact to date on more efficient resource allocation.

Within this broader fiscal policy context, the impact of IFMS implementation on allocative efficiency in Nicaragua has not been significant to date, though IFMS-related improvements in budgetary information systems will no doubt become very useful when appropriate institutional arrangements for sound fiscal policy formulation are strengthened, and provided there are parallel improvements in governance.

*Have financial management operations improved so that resources are used more efficiently and effectively?* The implementation of IFMS standards and information technology integrating budgeting, accounting, and treasury operations has created an increasing demand for coordination between the budgeting and cash management functions, improves operational efficiency at the central, MOF level.

Notwithstanding limited deployment, IFMS implementation has resulted in a number of very important operational improvements, conductive to more efficient use of resources, including:

- **Formal operating standards have been developed for all IFMS areas: treasury, budgeting, accounting, public debt and procurement.** The new standards are of obligatory application throughout the central government. The new information systems are programmed to follow these standards.

- **Extensive training on IFMS has been provided to financial management staff of the MOF and of the central financial and administrative units of line-agencies.**

- **The establishment of effective operating system at the central treasury (Caja Unica del Tesoro or CUT), has concentrated in central treasury accounts cash previously dispersed throughout the central government, strengthening central level liquidity for more rapid settlement of payments to suppliers.** This is a key IFMS development, also conductive to system-wide improvement in operating efficiency as it allows for more timely response to the needs of spending units. The introduction of CUT has reduced the time for payments to suppliers of goods and services from several weeks in the past to an average of two days from the moment the accounting department releases a payment authorization to the treasury.

- **Automated programming of budget execution forces spending units to program operations during any given period on the basis of predetermined quotas for placing purchase orders (comprisos), commitments (devengados), and making payments (pagos), thus improving resource predictability;**
• On-line determination of the availability of budget appropriations significantly reduces the time required to confirm purchase orders made by spending units for the procurement of suppliers of goods and services automated registration.

• On-line processing of requests for reallocations (modificaciones presupuestarias) made during the fiscal year by the financial management units of line ministries also contributes to more expedient budget execution and to more rapid adaptation to changing budget execution priorities.

The main factor that limits the impact of IFMS implementation on budgetary outcomes so far is that the system has not reached to date line-ministries and agencies or spending units, but is constrained to the MOF. However, even if IFMS implementation is extended down to the spending unit level, its impact on budgetary outcomes will continue to be conditioned by other contextual constraints of a political and cultural nature, as well as by the GON’s continuing poor capability to formulate sound macroeconomic and fiscal policy and to set strategic priorities beyond mere political discourse.

Needless to say, without full implementation, IFMS cannot fulfill its potential for improving PEM performance. We argue that there are at least three kinds of conditions that designers of IFMS reform should pay attention to even when IFMS has more or less successfully installed. These are (i) basic general principles of good budgeting; (ii) incentives of bureaucratic actors who will implement and use the IFMS; and (iii) broader political incentives that may affect the quality of PEM with or without an IFMS.

“Get the basics right”: IFMS is no panacea, and it is unlikely to produce significant and lasting improvements in PEM unless certain basics of good budgeting are simultaneously addressed by the reformers. Five general principles of public finance have emerged over the years to guide developments in public expenditure systems. These are:

1. Comprehensiveness – include all revenue and expenditure, and all government agencies

2. Accuracy – record actual transactions and flows

3. Annuality – cover a defined period of time (e.g. one year)

4. Authoritativeness – only spend as authorized by law

5. Transparency – information on spending should be publicly available, on a timely basis, in an understandable or common format

When some of these basic elements of a good budget are missing, an IFMS cannot fulfill its potential in improving public expenditure management.
For example, Honduras has made significant progress improving the quality of the expenditure data with the gradual introduction of the Integrated Financial Management System (SIAFI) and the accompanying procedural and presentational improvements in its budget. In this regard, the country now produces very detailed line-item budget data including broad functional and economic classifications as well as broad breakdowns by programs. The budget is available on CD-ROM and on the Ministry of Finance’s website. However, there are still some shortcomings that obfuscate the tracking of spending programs, particularly poverty-related programs. The use of opaque budget categories which obscure the actual allocations of significant portions of the budget make monitoring difficult. One example is the use of the so-called asignaciones globales as a spending category in the budget, which accounts for about 14 percent of the total 2000 budget and 20 percent of the budgets of the ministries of education and health. Even in the executed budget “global allocations” accounted consistently for more than 10 percent of the total expenditures (except 1999).

Table 3 “Asignaciones Globales” and Their Probable Agency Destination in 2000

<table>
<thead>
<tr>
<th>Agency</th>
<th>Asignaciones Globales as % of agency budget</th>
<th>Share of total Asignaciones Globales</th>
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<tbody>
<tr>
<td>Secretaría de Educación</td>
<td>19.0</td>
<td>28.1</td>
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<tr>
<td>Secretaría de Salud</td>
<td>20.0</td>
<td>14.9</td>
</tr>
<tr>
<td>Poder Judicial</td>
<td>100.0</td>
<td>13.2</td>
</tr>
<tr>
<td>Poder Legislativo</td>
<td>100.0</td>
<td>10.2</td>
</tr>
<tr>
<td>Ministerio Público</td>
<td>100.0</td>
<td>5.2</td>
</tr>
<tr>
<td>Presidencia de la República</td>
<td>86.8</td>
<td>5.0</td>
</tr>
<tr>
<td>Organismo Electoral</td>
<td>100.0</td>
<td>3.9</td>
</tr>
<tr>
<td>Procuraduría General</td>
<td>100.0</td>
<td>0.9</td>
</tr>
<tr>
<td>Servicios Centralizados</td>
<td>12.0</td>
<td>15.9</td>
</tr>
<tr>
<td>Other</td>
<td>---</td>
<td>2.8</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>14.4</strong></td>
<td><strong>100.0</strong></td>
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Table 4 “Asignaciones Globales” as Percent of Total Executed Budget

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<tbody>
<tr>
<td>1990</td>
<td>13.7%</td>
<td>13.0%</td>
<td>10.9%</td>
<td>11.4%</td>
<td>10.8%</td>
<td>10.5%</td>
<td>12.7%</td>
<td>13.8%</td>
<td>13.6%</td>
<td>8.9%</td>
</tr>
</tbody>
</table>


While these spending categories give the Government considerable flexibility, this practice seriously undermines the transparency and accountability of the budget process.

“Get the incentive right”: Another important consideration is that installation of an IFMS without corresponding procedural and behavioral changes does not result in better public expenditure management. It will simply re-produce sub-optimal budgeting and financial management practices with more transparency and perhaps even with somewhat greater efficiency.
A case in point is a continued reliance on a mechanistic historical budgeting in Honduras. Data from the Health Secretariat indicates that there may be an “institutionalized” pattern of budget modifications due to the mechanical incremental budget formulation. Table 5 shows budget allocations to ambulatory and hospital programs. In each of the six years reported here, there is a significant re-allocation of the budget from the hospital programs to ambulatory programs through budget modifications. One plausible explanation for this repeated phenomenon is that the Secretariat of Health does not take into account the previous year’s budget execution level as a base line for formulating a given year’s budget proposal. Rather the budget proposal appears to be an incremental adjustment to the previous year’s approved budget (or possibly the ministry’s budget proposal to SEFIN). The Health Secretariat also reported that it requested 460 modifications in 1999, which took about one and a half months for SEFIN approval. This is clear evidence that line ministries do not see the approved budget as authoritative means for budgetary resource allocation.

Table 5: In-year Budget Re-allocation – Ministry of Health, 1994-1999

<table>
<thead>
<tr>
<th>Year</th>
<th>Allocation</th>
<th>Approved</th>
<th>Modified</th>
<th>Executed</th>
</tr>
</thead>
<tbody>
<tr>
<td>1994</td>
<td>102 Enfermed. Trans. y c. ambi</td>
<td>22,900,000</td>
<td>80,556,279</td>
<td>79,767,609</td>
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<tr>
<td></td>
<td>103 Atención medic. Hospitalar</td>
<td>51,652,076</td>
<td>9,480,073</td>
<td>9,198,143</td>
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<tr>
<td>1995</td>
<td>102 Enfermed. Trans. y c. ambi</td>
<td>32,949,496</td>
<td>117,533,382</td>
<td>115,124,122</td>
</tr>
<tr>
<td></td>
<td>103 Atención medic. Hospitalar</td>
<td>70,790,205</td>
<td>9,420,806</td>
<td>9,310,320</td>
</tr>
<tr>
<td>1996</td>
<td>102 Enfermed. Trans. y c. ambi</td>
<td>42,858,000</td>
<td>140,204,827</td>
<td>139,658,659</td>
</tr>
<tr>
<td></td>
<td>103 Atención medic. Hospitalar</td>
<td>95,757,912</td>
<td>26,857,854</td>
<td>26,814,872</td>
</tr>
<tr>
<td>1997</td>
<td>102 Enfermed. Trans. y c. ambi</td>
<td>57,533,232</td>
<td>168,178,486</td>
<td>160,469,006</td>
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<tr>
<td></td>
<td>103 Atención medic. Hospitalar</td>
<td>111,333,484</td>
<td>9,155,593</td>
<td>9,119,535</td>
</tr>
<tr>
<td>1998</td>
<td>102 Enfermed. Trans. y c. ambi</td>
<td>64,497,377</td>
<td>184,450,930</td>
<td>180,580,542</td>
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<td></td>
<td>103 Atención medic. Hospitalar</td>
<td>136,112,974</td>
<td>9,852,650</td>
<td>9,417,506</td>
</tr>
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<td>1999</td>
<td>11 Atención ambulatoria</td>
<td>70,545,265</td>
<td>190,327,038</td>
<td>188,731,047</td>
</tr>
<tr>
<td></td>
<td>13 Atención hospitalaria</td>
<td>160,541,933</td>
<td>32,774,016</td>
<td>31,633,535</td>
</tr>
</tbody>
</table>

Source: Secretaría de Salud

“Get the politics right”: No amount of technical improvement is immune from politically motivated abuse of government systems. IFMS is no exception. No matter how technically well-designed, an IFMS will ultimately prove powerless if and when politicians choose to take decisions with fiscal and budgetary implications irrespective of the quality of financial information generated by the IFMS. Good information and analysis does not assure good decision-making. In democratic systems, poor decisions, from technical points of view, are possible and permissible, and no technical judgment should supercede those of democratically elected officials. But even in these cases, the bad technical judgments should be informed judgments made as political decisions of the democratically accountable policy-makers: the consequences were known and communicated. This points out a little emphasized aspect of budget systems: education. Well-functioning finance offices provide objective, neutral competence to policy officials. They educate political cadres in public finance and economics, inform of
potential consequences to different courses of action, and for any given policy goal, identify least-cost or most effective options for attaining the objective.

For example, Honduras currently faces a risk of non-sustainable fiscal policy due to the ballooning government wage bill. The Bank has been supporting Honduras’ effort to install an IFMS in selected ministries over the last few years, and steady progress has been made on that front. In the meantime, however, some of the most serious threats to the soundness of the country’s fiscal and budgetary policies, unrestrained power of Congress to make policy decisions with significant fiscal implications, have been left untouched. Because of the fiscally irresponsible awards of salary increases to social sector workers (i.e., teachers, doctors, etc.), Honduras may face a stark choice between using the “savings” from the HIPC debt relief to finance poverty reduction programs or to pay salaries of public sector employees.

In Peru under Fujimori, a well-functioning, modern IFMS was implemented that improved financial management and executive control of the career bureaucracy. However, the executive over-ruled its own controls in selected cases to attain its own ends: the external audit institution was under funded; internal auditors were limited in the scope of their duties, and executive urgency decrees were widely abused to amend the budget and transfer funds non-transparently. It is interesting to note that the two Ministries where much of the waste and abuse of public funds is alleged to have occurred (Interior and Defense) were deliberately kept out of the IFMS. Nonetheless, the existence of IFMS allows auditors to trace abuses where the system was implemented, and even moderately functioning institutions (internal and external audit) can delve into non-IFMS agencies to root out past corruption.

Conclusions

IFMS is not a panacea – for it to be an effective tool of public expenditure management, certain basics of budgeting should be taken care of first. IFMS can enhance transparency but the budget should be transparent with or without IFMS. However, there is a risk that when IFMS operations are prepared in haste or without sufficient prior diagnostic work, some simple basics that could relatively easily be tackled are ignored, leaving with it persistent weaknesses in aspects of PEM.

Good information is a necessary condition for improving PEM, and IFMS can contribute greatly, though whether the system needs to be fully integrated or even computerized in all circumstances can be questioned. Marginal costs should be weighed against marginal benefits, and phasing system development may be preferable to trying to implement a complete package in one go. Further, relative prices of labor and capital should be weighed in deciding the degree of computerization, as well as the relative cost of highly skilled and less skilled financial management staff, for each country.

It is important to moderate expectations of what an IFMS can achieve, and the limitations to it attaining its full potential. A PEM system is a complex human system, and the objective is really to develop a self-sustaining, self-correcting financial management
system in the country. Sound institutions will increase the tendency and likelihood of better PEM outcomes. An IFMS is but one component of this complex system.

PEM reform is an institutional reform, and as such broader governance and institutional factors need to be taken into account in its design and implementation.

- How to create effective demand for good information?
- How to create incentives for responsible use of information?
- What other supplementary mechanisms are needed to take advantage of IFMS?

Re-engineering of budgeting and financial management processes is almost always a necessity in implementing an IFMS-driven PEM reform. But in a typical Latin American environment of bureaucratic informality, where formal rules and regulations are not always followed, effective process re-engineering would require sophisticated understandings of incentives behind public officials’ behavior. If some of the reform efforts within what we call the modernization paradigm have failed to produce desired results with a new legal framework and modern IT platforms, it may partly be because of their failure to recognize these informal institutional dimensions of the bureaucratic reality in Latin America. The uneven and partial implementation (at best) of Bolivia’s SAFCO Law, which some external experts have considered of very high quality, is a telling example.

Finally, it is important to bear in mind that even a perfect technical solution would be powerless before overwhelming political incentives against sound PEM. The growing awareness of and concern about governance and institutional factors as they affect reform dynamics should inform design and implementation of IFMS reforms just as much as they should guide a more overtly political change processes such as decentralization. Specifics will vary from one country to another, and operational knowledge of how to use technical solutions to discipline political decision-making is still under-developed. The recent literature on fiscal institutions and political economy of fiscal management could shed some light on aspects of this challenge, and so can the more traditional approach to studying budgeting from political science and public administration perspectives. But donors also need to pay greater attention to the political economy of PEM reform and accumulate operationally relevant knowledge of conditions that facilitate reform implementation and of effective reform strategies. One of the interesting promises of IFMS is that it can reveal hitherto unrecognized problems and obstacles, and thus be a catalyst for additional and broader reforms.