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# PFM Reforms in METAC Countries: Lessons, Priorities, and the Role of Analytical Tools


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# PFM Reforms in METAC Countries: Lessons, Priorities, and the Role of Analytical Tools

*This note summarizes the results of a METAC workshop on public financial management (PFM) reforms in the region over the last decade, with a view to identify countries' reform priorities in the medium-term and their perception of past performance, and improve understanding of the key tools available to support the design and implementation of reforms. While overhauling fiscal institutions has been often deemed a key priority in the region, the achievements of the last decade remain limited and vary significantly across countries. Jordan and Morocco illustrate the importance of political stability and commitment to implement large scale modernization of PFM systems. Some countries adopted new PFM legal frameworks but need substantial work to implement them. Overall, a more agile approach to PFM reform is needed to address the challenges of today and tomorrow.*

## Why Should Countries Reform PFM Institutions?

**Key economic indicators in the METAC region have on average worsened since 2010.**[1] Growth has nearly halved (pre-COVID19 impact), while unemployment remains high—11 percent, versus 7 percent in other emerging and developing economies. Fiscal deficits and debts have increased, especially in oil-importing countries, partly a result of increased spending needs, low tax efforts, and lower oil revenue. A recent outflow of portfolio assets from the region undermined already-weak current account balances—which, coupled with lower oil prices, has impacted particularly oil-exporting countries.

**At the same time, social unrest and political volatility have persisted.** While they have diverse roots (and consequences), they share some common features such as citizens' concerns with the inefficiencies of government services (e.g. health, education, economic infrastructure, access to water and energy, telecommunication services), and with a general lack of transparency. The situation of budget institutions, often characterized by their limited ability to promote transparency and accountability in support of public policies, has drawn criticism from civil society organizations (CSOs) and other stakeholders. Some progress on these issues must be recognized and commended, but it has been limited to a few countries.

**Finally, the COVID-19 pandemic, which has already created a significant human and economic cost in the region and globally, is a reminder that "good governance" matters.**[2] It has shown that governments who acted quickly and effectively have generally gained public support, while those who have not, have seen more public discontent—and this seems to be independent of the level of development and the fiscal cost incurred. It has also shown that technical capacities, including the ability to act quickly and transparently to design and implement policy measures, is a necessary condition for effective policymaking—e.g. number of governments wanted to implement temporary cash transfer schemes to individuals but were not able to do it due to weak capacities. Moreover, as the long-term consequences of COVID-19 remain uncertain, fiscal institutions must also be able to contemplate and study policy design and implementation scenarios for the medium- to long-term, and effectively communicate the results to citizens.

## What Have METAC Countries Achieved in the Past Decade?

**The workshop used two sources to assess progress in PFM reforms: public expenditure and financial**

[1] IMF. *Regional Economic Outlook: Middle East and Central Asia,* October 2019.

[2] This note was written prior to the onset of the pandemic in the region in late January, and so does not take full account of the short-term implications on fiscal institutions.

**accountability (PEFA) scores[3] and country representatives' views and discussions.** PEFA assessments conducted in the METAC region[4] in the past decade suggest the following:

- The overall score is broadly comparable with the global average: around 70 percent of performance indicators scored between D and C+, which indicates basic or less than basic performance.
- METAC countries score slightly higher than the average on policy-based fiscal strategy and budgeting, and predictability and control in budget execution, but lower on accounting and reporting, and external scrutiny and audit.
- The evolution of scores in METAC countries shows that there has been some progress in external audit and scrutiny, but negligible changes or regression in other indicators.

**Country representatives generally confirmed that, while many initiatives have been launched over the last decade to modernize PFM institutions, their implementation has often been slow and their impact limited.** As a result, many METAC countries still rely on outdated frameworks and tools to translate policy orientations in impactful expenditure plans, collect and spend public resources, and understand the outcomes of budget execution.

**A set of factors have been identified to explain this relative stagnation of the PFM systems in the region.** The countries in situation of fragility or conflict, have often prioritized the adoption of ad hoc measures, especially in the area of cash and debt management, to ensure the continuity of the State. Countries experiencing political instability have struggled to pass reforms that often require legislative action (e.g. Lebanon) or faced a lengthy process (e.g. Tunisia, Algeria). One of the key challenges remains the limited human capital to implement the reforms. The countries that have made the most significant progress have benefitted from a more stable political environment and relatively stronger political support (e.g. Jordan and Morocco).

**Workshop participants noted the overall inadequacy of the big bang approach of PFM reforms.** In many instances, reforms were designed as a stand-alone effort to align the PFM system with the best international standards but were too ambitious. In post-conflict countries (e.g. Afghanistan, Iraq), reform strategies were key components of ambitious state-building operations that faced implementation challenges. In countries where the legal PFM framework is based on civil law systems, the adoption of an updated legal framework, covering all aspects of PFM, was often perceived as a prerequisite to any real change, but ended as what one participant called "*réformes de papier*"—i.e. legal reform on paper, but not implemented.

## WHAT ARE THE PRIORITIES GOING FORWARD?

**Fiscal transparency is a key issue in the region.** According to the latest Open Budget Index, the MENA region budget transparency have been weak and shows no progress, with the average score stagnating in the twenties out of one hundred. While this low average is in no small part due to fragile and conflict countries, the index suggests that there are sizeable gains to be had from easy-to-implement measures. One important element of the lack of transparency resides in poor data availability and data sharing across government entities, especially in relation to the coverage of government finance statistics (GFS)—

[3] The seven pillars of PEFA are: budget reliability, transparency of public finances, management of assets and liabilities, policy-based fiscal strategy and budgeting, predictability and control in budget execution, accounting and reporting, and External scrutiny and audit.

[4] In July 2019, only Libya and Djibouti in the METAC region had never undertaken a PEFA assessment. Globally, 150 countries (mostly emerging and developing) have undertaken an assessment.

without appropriate GFS systems that adhere to international standards, governments cannot be credible in their pursuit of fiscal transparency reforms.

**Workshop participants observed that fiscal transparency can be improved quickly, and without committing significant resources in some areas.** Unlike other PFM reforms that require organizational changes and new processes, transparency is usually easy to achieve quickly, especially when it requires publishing already available information. Improving fiscal transparency could yield positive effects on the policy debate, and even improve spending efficiency. For example, disclosure of fiscal risks from public-private partnerships could reassure external investors and attract better investment projects.

**While external audit and scrutiny is one of the areas where the PEFA data reveal some progress in the past decade, participants noted that the role of the legislature and supreme audit institutions SAIs) could be further enhanced in many METAC countries.** This situation often results from the preeminence of the executive branch in the institutional set-up and the very relative independence of SAIs. Nevertheless, participants stressed that the past decade has witnessed increased interest from members of parliament in fiscal issues and a need to further develop their capacity to exercise their oversight role. In this context, CSOs have played an important role in providing independent analysis of the budget and monitoring its implementation. Opportunities for the public to be engaged during the budget process are also often limited. Increased transparency is seen as a prerequisite for effective participation, and some countries are working actively to facilitate citizen engagement.

**Strengthening public investment management is another priority to deliver quality infrastructure.** While only four METAC countries (Lebanon, Tunisia, Morocco and Jordan) undertook a public investment management assessment (PIMA), the general trend is one of declining quality and insufficient level of infrastructures.[5] For example, the 2016 PIMA for Jordan[6] notes that one fifth of Jordan's public capital stock did not result in the expected quality or access to infrastructure assets or service delivery, and that strengthening the investment cycle would provide large efficiency benefits, including in the planning, allocation, and implementation phases. PIMA evaluations have helped some METAC countries better understand their reform needs, and better plan for addressing them (see Box 1 on Morocco).

**METAC countries are prone to significant fiscal risks that need careful monitoring and mitigation.** Both the sources and size of such risks have increased in the past decade, including the following: civil unrest and demonstrations, with direct costs in terms of destruction of public infrastructure, and indirect costs that are potentially large but hard to assess; increased volatility of oil and gas prices, which has meant that a medium-term perspective on budget planning is difficult to achieve, leading to governments acting on short-term impulses; opaque state-owned enterprises with operations in private markets as well as quasi-fiscal operations; large guarantees provided by government which are not integrated and managed in public contingent liabilities.

**METAC's experience in the region has shown that a gradual approach to building capacity to manage fiscal risks can yield positive results.** The informational and analytical capacity requirements for undertaking proper fiscal risk management can be daunting, especially in the presence of opacity.

[5] On a scale from 1 to 7, perception of infrastructure quality declined from 3.68 to 3.51 between 2007 and 2017 for METAC countries (World Economic Forum and IMF staff estimates).

[6] International Monetary Fund. 2017. *Jordan: Public Investment Management Assessment*.

Despite this, countries like Egypt and Lebanon have achieved progress in several areas: (1) building an internal capacity to create awareness of the issues and their complexities, and to be capable of propagating such awareness; (2) documenting the various areas of fiscal risks, even if it is not possible to provide estimates; (3) producing an internal fiscal risk statement, which eventually can form the basis of a public document.

**Box 1. Public Investment Management Reform in Morocco**

**Following a 2018 PIMA recommendations Morocco designed a public investment management reform plan around three pillars:** (1) improving project selection; (2) enhancing monitoring during the project cycle; and (3) strengthening ex-post evaluation.

**An operational roadmap for the reform was designed,** containing a detailed evaluation of the investment management system, an action plan to reform the legal framework and institutions, a process to record investment projects in a dedicated database, and communication and training of main stakeholders.

**An ex-post evaluation of the reform by the authorities identified the following main success factors:**

- A strong buy-in and participation from all stakeholders.
- A good grasp of the technical concepts and indicators to monitor project execution.
- A permanent dialogue between the reform unit in the Ministry of Finance and stakeholders.

Source: Authors, based on METAC workshop, 2019.

**PFM legal frameworks need to be reviewed and reformed, but countries need realistic implementation plans and project management.** Egypt, Iraq and Libya, who are contemplating revamping their PFM laws, can learn from the experience of Algeria and Tunisia, who recently adopted new organic budget laws, but have faced challenges implementing them. One of the lessons learned from these experiences is that the most critical success factors of such ambitious reforms is the ability to tailor design implementation to country capacities and constraints—including those related to managing large reforms. Importing the experiences of others, while useful, presents its own risks.

**The priorities mentioned above pose particular challenges in fragile states.** Fiscal institutions may not be able to reform the full range of PFM functions, particularly in the early stages of the end of conflict. Capacity development in these countries should focus on narrow and well-defined issues (e.g. centralized cash management through a treasury single account), be hands-on, and plan for long-term and sustained support. Coordination among capacity development providers is also essential, given the typically low human resource capacities in fragile states.

**Workshop participants identified three over-arching priorities for successful PFM reforms going forward.** First, political support should be visible and clear in terms of the objectives of the reforms (and their costs and benefits). It should also be reflected in written commitments on which governments can report regularly and to which they can be accountable. Second, governments need to pay more attention to institutional and human capacities, especially in terms of salaries, IT infrastructure, and work environment. Third, ministries of finance should lead PFM reforms—macro-fiscal units play a pivotal role in this regard, especially to ensure the link between policy objectives and reforms.

## The Role of Diagnostic Tools

**METAC countries are lagging in the use of diagnostic tools to help design and assess reform options.** While most countries have conducted several PEFA exercises over the last decade and have OBS data available, only Tunisia has a published fiscal transparency evaluation (FTE), and only Jordan has a published PIMA.

**Diagnostic tools provide useful benchmarks to measure progress toward objectives.** For Example, PEFA scoring provides a ranking from A to D, a clear explanation of how ranking is performed,[7] and guidance to progress to the next higher ranking. These rankings can guide the design of reform roadmaps, and implementation monitoring.

**The OBS can foster reforms on budget transparency.** Unlike PEFA, PIMA and FTE evaluations, which are performed on demand from governments, the OBS is undertaken every two years and follows a standard methodology that provides consistent assessment of budget transparency. The 2019 survey shows encouraging results in some countries (Figure 1). Countries that have difficulties improving their scores are generally fragile—in conflict or experiencing tense social and political situations. Box 2 shows how Egypt benefited from the OBS to design its own reforms.

**Box 2. How Open Budget Survey Fostered Fiscal Transparency in Egypt**

**Egypt gained 25 notches between 2015 and 2017 to reach 43 in the 2019 release of the Open Budget Survey index.** Such an improvement needed a strong buy-in from policymakers and positive engagement with strategic stakeholders. To this end, an independent Fiscal Transparency and Citizen Engagement Unit was established within the Ministry of Finance to ensure the sustainability of PFM reforms. This unit met its objectives by promoting citizen empowerment and a better communication between CSOs and government.

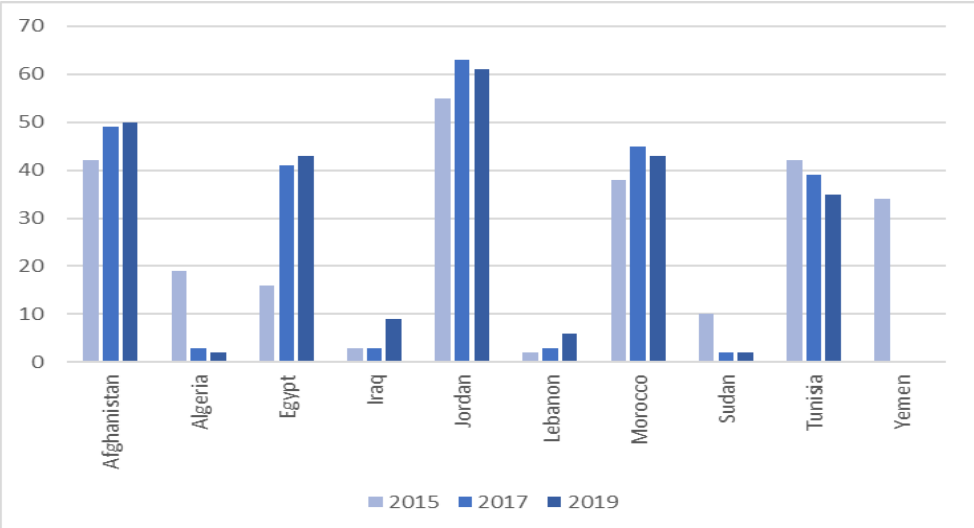
***Promoting budget transparency and disclosure of budget data**.* The unit launched an interactive online platform to provide searchable and easily accessible budget data and organized various social dialogue events (media campaigns, flyers, pre-budget consultations).

***Participatory budgeting**.* The ministry of finance held workshops to engage with the public and discuss policy—e.g. budget allocation issues; new tax measures.

***Capacity building.*** Training was offered to a wide range of stakeholders (e.g. municipalities, universities, Central Bank of Egypt), in the context of an extensive capacity building program.

Source: Authors, based on METAC workshop, April 2019.

## Figure 1. Open Budget Index Scores Since 2015




Source: Open Budget Survey.
Note: Scores for Yemen are not available for 2017 and 2019.

[7] PEFA Secretariat. 2019. PEFA 2016: Framework for assessing public financial management (EN); second edition.

**Box 3. The Citizen Budget in Lebanon**

**The Institut des Finances Basil Fuleihan (the training arm of the ministry of finance and other government entities) launched the citizen budget in March 2018,** following its participation to the regional workshop on "Budget Transparency in the Middle East and North Africa", organized by METAC and the International Budget Partnership in February 2018.

**The document summarizes the budget law using a transparent and simple style with graphics and other visuals.** It informs citizens of how money will be raised and spent by the government, raises awareness on the country's fiscal situation, and offers a retrospective outlook.

**The collaboration with METAC paved the way for several initiatives led by the Institut,** aimed at improving budget openness, such as advocating for the publication of budget documents and training CSOs, the media and youth groups on budget transparency and accountability.

**The publication of the citizen budget had positive repercussions on collaboration between Lebanon and other countries.** For example, the Institut shared its experience and provided technical assistance to the ministry of finance of Cameroon, to produce its first citizen budget in 2019.

Source: Authors, based on METAC workshop, April 2019.

## Conclusions and Lessons Learned

**PFM reforms in the region have been timid over the past decade.** Jordan and Morocco appear as outliers, as they have been able to implement ambitious PFM reforms and meet many of their objectives. In Algeria and Tunisia, the decade ended with the adoption of revamped legal frameworks for managing public finance, but their implementation will require strong political will and significant capacity development. Some countries have seen a degradation of their capacities due to conflict and political instability.

**Reform strategies should be based on more agile approaches**. Well-targeted reforms aiming at achieving well-defined and relatively narrow objectives provide better return on investment. In Iraq, the development of capacities for improving cash management and strengthening control on budget execution, supported by the IMF and METAC, produced quick and tangible results.

**The quality of data and their transparency should be a cornerstone of any PFM reform.** They condition effective accountability and credibility of government policies. Moreover, the effectiveness and quality of policy design depend on information underlying decision-making processes. In many countries statistical and accounting systems remain weak, and budgetary and financial data remain too often secret information.

**Increase in economic and political volatility calls for a more systemic and integrated approach to fiscal risk management.** Many countries have started work on this issue, using a gradual approach, with the objective to publish fiscal risk statements in budgets—or as stand-alone documents.

**The lessons from regional and international experiences are useful to consult, but reforms should be designed with more attention to local needs and constraints.** The region is very diverse in politics, economics, and capacity of fiscal institutions. Importing models from other countries without attention to local imperatives has several drawbacks and should be avoided—e.g. delays or impossibility of implementing reforms, misallocation of capacity development resources, loss of credibility in the eyes of citizens and international partners. This is particularly the case of ambitious and large reform projects, such as rewriting organic budget laws.

**Rebuilding fiscal institutions and strengthening capacity in fragile states is particularly challenging**. Reform strategies should focus on measures that provide direct gains without overburdening limited institutional and human resources. The workshops highlighted the importance in context such as Iraq or Afghanistan of focusing on cash management and budget execution, capabilities that are necessary to ensure the basic functions of the states. In addition, the availability of a realistic budget is a priority for internal management purpose and to engage effectively with the donors.

**Countries should use more systematically diagnostic tools to assess the needs for reform and design options.** Such tools provide credibility to the process and allows governments to anchor it in quantitative benchmarks that are comparable with other countries and over time.

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