



Asian Regional Seminar on Public Financial Management

PFM Reforms: The lessons learnt -promises and tears

Session 3: Modernizing Budget Execution
Indonesia's PFM Reform

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MINISTRY OF FINANCE
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Getting the right performance: The Indonesian experience

Cambodia, 25-26 November 2014



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The PFM characteristics prior to the 2003 PFM reform

- The budget: line item, **administrative compliance** for procuring over 50,000 items (combination of inputs, processes, and some outputs);
 - a. What the 'centre' **instructed** the line agencies to do
 - b. Auditors **made sure** that the 'instructions' were executed and spending units did not need to be flexible in managing the program/activities.
- Difficult to see who was doing what, what was being done, and how well it was being done;
 1. 80 MDAs with 24,000 spending units executing around 1,000 programs*
 2. Each Directorate General (echelon one) managed **more than one** program
 3. Programs were **not linked** to the organizational structure
- Development and recurring budget were separate; MOF managed the recurring budget and the Planning Ministry managed the development budget;

It was quite common to find **duplication** of programs, activities and processes being funded
- **Decline** in the quality of public service delivery since the start of the decentralization

*there were only central government programs



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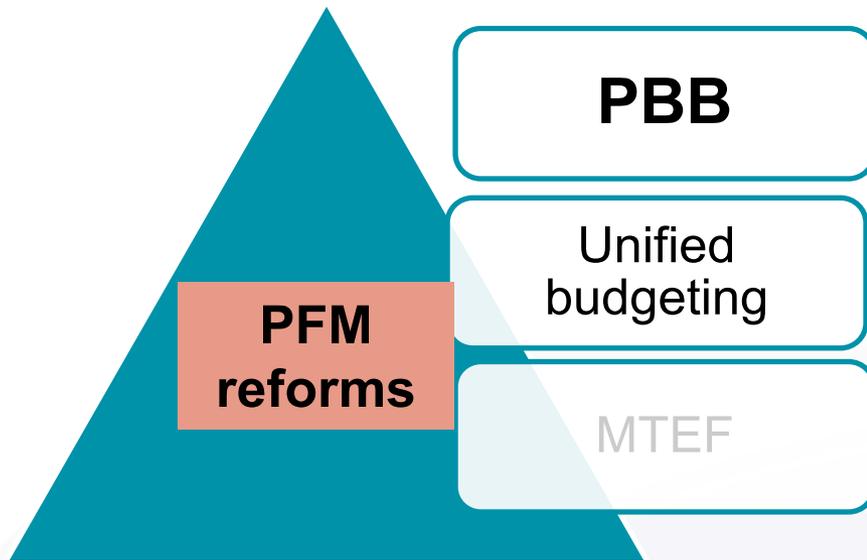
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Lessons learnt



2003 PFM reform goals

- Laws on performance based budgeting (PBB), medium term expenditure framework (MTEF) and unified budgeting
The development of a fully operational MTEF and PBB, with well-articulated medium-term fiscal targets and detailed indicative revenue and expenditure figures at the line ministry level, should help to bolster aggregate fiscal discipline, expenditure prioritization and the efficiency of spending



The unified budgeting was specifically to integrate decisions on the recurring and development budget.



2003 PFM reform goals

- Government's focus was turning towards improving the delivery of public services and infrastructure to support development

This includes both the setting and monitoring of high-level objectives, as well as mechanisms of downward accountability, such as performance reports for line ministries along with greater flexibility in managing their programs (reform spirit was 'let the managers manage')

- Improving budget transparency level to parliament

Prior to the PFM reforms, parliament can only engage at the program level, while activities were government's discretion. The PFM reform abolished this 'rule of engagement' with the goal of opening up the budget to the 'output' level

In practice, parliament engaged at the input level, which contradicted the reform goals



Implementing the reform

- Unifying the recurring and development budget into one budget to **avoid duplication**
However there were still problems in accountability and costing of program: programs were not aligned and linked with the organizational structure, and personnel and office running costs were not part of the program cost
- In 2009 programs were restructured to ensure **aligned** with the **organization structure**; every echelon one runs one program
The program cost included personnel and office running costs, but these costs were not part of the 'output' cost
- Reducing the details in the budget and **simplifying** the process to provide **flexibility**
Previously MOF (DG Budget and also DG Treasury) issues the budget warrants to all 24,000 spending units, now only DG Budget issues around 1,000 budget warrants to all echelon I units with freedom to re-allocate among the spending units
- Increase the flexibility in virement** management: letting the managers to manage;
Every year the flexibility to move money around was increased, at least on paper (*de-jure*)

** virement controls were focused on outputs



The performance information ‘gap’

However, **budget performance information** was not yet available^{***}, so in 2012 Government began collecting budget performance reports

But when performance data was collected it became clear that the reported “outputs” were not public goods or services:

- What line ministries presented as outputs were actually **inputs** and **processes**;
Total government outputs were around 50,000, which were approximately the same number as the number of inputs prior to the PFM reform
- The link between the outputs and program objectives – and hence the rationale for government engagement - was not clear
- It was difficult to measure productivity;

^{***}The 2012 repeat PEFA Assessment noted that while Indonesia had made steady progress in strengthening the quality of PFM systems and processes between 2007 and 2010, some PFM reforms were still *de-jure*: PBB, and MTEF



The performance information 'gap'...*contd*

- The budget information lacked the relevant non-financial information
- Given that the virement rules were based on outputs, using inputs as outputs did **not allow** management flexibility - as intended;

The controls on outputs were basically still controls on inputs

Other challenges:

- Program managers had limited responsibility for managing personnel costs, which resulted in the lack on incentive to ensure efficient spending

Program managers 'played' around the volume of inputs while controls were placed on the unit cost of inputs****

**** Several World Bank Expenditure studies confirmed the low productivity given poor deliverables in spite of large increases in resources



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Getting the basics right

Getting every element of the system perfect at the start is unrealistic, but there are some parts which are crucial:

- The basic structure of programs and outputs need to be right – although the application in line ministries can improve over time
- **Useful** financial information (costing of outputs) is an early priority
- Non-financial information should include both the quality and quantity of service
- The budget process needs to utilize non-financial information in **preparing** and **challenging** the budget proposals
- Performance reports are needed to **measure** against what was 'promised' in the budget - and in time identify the impact it has had
- Some controls on inputs are still needed: particularly personal benefits (honoraria, stipend, per-diems, etc), however these are very limited



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Moving forward: business process & skills

- Identifying new budgeting and planning business processes that support the performance focus;

In the context of a separate planning and budgeting institution, coordinating the different agencies (plus a ministry that focuses on the personnel and institutional performance) becomes ever more challenging

- Changing the ‘views’ at the center: getting people to understand what relevant budget information is needed and how they are going to use it;

Improving the quality of information and also train the budget analysts and planning staff on how to use the new information

- Changing the ‘views’ at the line ministry level: getting line ministries and the budget analysts to be skilled at using the new performance architecture;

Since 2013 MOF began training the line ministries on ‘what information is relevant to the budgeting process’ (around 500 program managers, across 80 MDAs)



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Lessons learnt

- Have central agency(s) take **lead** in the reform;
 1. The reformers have got to reform themselves first
 2. Maintaining a straight and determined direction of the reforms is key
 3. Important to understand the spirit of the reform
- The program restructuring helped the accountability challenge but was not sufficient. Getting the output definition **right** is now fundamental.
- Reforms are **not one-off**;
Improving the outputs, and control framework is a continuous learning process
- Building capacity needs to go along with a new business process to demand this capacity; Be prepared that it will not be applied perfectly at first
- Improving the capacity at the line ministry level is a never ending story;
 1. Line ministries were used to doing what the 'center' instructed them to do
 2. Important to maintain close engagement between MOF and the line ministry
- Resistance to change will always be there;
Inability to grasp the need to reform, inability to accept new challenges and the changing environment, and motivations from a different agenda – all are present.



Thank you

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