ISE DEVELOPMENT PRACTICE NOTE

What Determines the Quality of Public Finance Systems: Is it Capacity, Corruption or Culture?

Why do some ministries of finance around the world consistently deliver good results, while others cannot make much progress? When experts are asked their opinion, the most common responses are:

- Lack of capacity;
- Too much corruption;
- Problems with institutional culture.

The need to build capacity – or improve underperformance – is the "why" of development assistance; it is the central problem that needs solving. While the capacity level of an institution clearly determines quality and timeliness of results, lack of capacity should not be blamed for poor progress, since the whole aim of assistance is to build capacity. Nevertheless, advisors or supervisors who defend slow progress put that argument forward almost universally at one point or another.

Corruption – as well as capacity – is a *result*, not a *reason*. Systemic corruption is a result of weak institutional culture, which is in turn a result of underperformance, which is a result of a lack of value-based leadership. Most people want to do a good job, be part of something special, and take pride in their work. Get the culture right, and corruption will be dealt with systematically, capacity will blossom, and the institution and its people will earn honorable reputations. Obviously, dealing with systemic corruption is difficult, but trying to tackle it before the institutional culture is fixed guarantees a long and difficult road ahead.

Institutional culture is critical for good fiscal performance. Group leaders set the culture. Team members need leadership that they can believe in, and to believe they are part of something special. Performance is a critical factor in both good leadership and successful teams, which leaves little to no room for mediocrity. For the aid industry, this means zero tolerance for underperforming international expert advisers, and low tolerance for poor performing national staff (in recognition that raising performance and professional development takes time).

The starting point when building a high-performance institutional culture is the long established and still relevant "Basics First" approach to reform programming. In 1998, Schick, Holmes and the World Bank underscored the importance of "*fostering an environment that supports and demands performance*". A team-based focus helps create a high-performance institutional culture. This is now happening in the ministries of finance of Timor-Leste and Afghanistan, where a team-based performance management approach has been adopted.

Think "teams," not "themes," because teams are accountable and themes are not. Leadership groups in Afghanistan and Timor-Leste are now much more focused on the performance of teams – every team within the ministry – and not just on a range of public finance management (PFM) themes like revenue-raising and better budgeting. Focusing on how teams are performing is fundamental to accountability, because teams and team leaders can be held responsible for team performance. Theme-based plans are much more

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difficult to drive high levels of accountability, since they lack institutional structure. Planning around themes means less accountability for who is actually to deliver on the plan. Especially, if responsible teams have their own different plans and priorities.

In helping to answer the 'why' question, seven key goals for performance management and system building have been identified that are critical for any Fiscal Performance Improvement plan or MoF capacity-building plan.

Seven Goals for Performance Management in Finance Ministries

1. **Improve efficiency and effectiveness of public services** and service delivery (better education, improved health and greater confidence in government).
2. **Strengthen fiscal discipline** by doing what we say, hitting our targets, and running orderly processes.
3. **Deliver sustainable public finances** by being strategic about how resources are allocated, distributed and spent (economic efficiency).
4. **Manage an improving and stable economy** that creates jobs, increases opportunities for all and reduces uncertainty.
5. **Be more accountable** to all stakeholders in the pursuit of good governance.
6. **Be more transparent** – TO different internal and external stakeholders, ABOUT operations and held data in multiple dimensions and multiple resolutions, and BY being stakeholder relevant.
7. **Deliver continuous improvement** through integrated systems of trial and error; the budget cycle is a continuous improvement cycle.

More work is needed to understand the role of institutional culture and the influence of team-based performance management in driving higher levels of quality of public financial management. Specifically, more studies are needed to assess the cost-effectiveness of development assistance programs aimed at strengthening public finance systems. A cross-country analytical program that reviews the development cost-effectiveness of improving reducing development and fiduciary risks is recommended.

—Andrew Laing, June 2016