Public Financial Management Reform in Ethiopia (1996-2007)

Lessons from the HKS DSA Project

Stephen Peterson
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Policy Issue

Financial Reform in a Rapidly Decentralizing Poor Country

2 questions

• How to decentralize with limited capacity at center and locale

• How to ‘Get the Basics Right’ in a poor decentralizing country
Snapshot of the DSA Project

- 12 month design (8 in country)
- $34.5 million over 11 years
  - 5 phases
    - $2.8 + $1.5
    - $3.8
    - $7
    - $14.7
    - 4.7
- Funded by USAID throughout
  - Irish Aid in phases 3, 4, 5
  - Netherlands Aid in Phase 4 and extension
- Staffing
  - Total: 63
  - 5 expatriates
  - 32 Ethiopian professional staff
  - 26 Support staff
Environment of the Reform

- Extremely poor country (99 of 103 of UN development index for developing countries)
- Recovering from years of internal conflict
- 3 serious droughts (a 50 year 2002/2003—13 million at risk)
- 2 wars (Eritrea 98-00); (Somalia 2006-?)
- Weak political legitimacy (2 elections, one near coup)
- Large and geographically isolated
- Little infrastructure and limited human resource capacity
- Ambitious policy of administrative decentralization
- Ambitious and inchoate agenda by foreign aid agencies
## Poverty Indicators

<table>
<thead>
<tr>
<th>Indicator</th>
<th>Eth</th>
<th>Sub-Africa</th>
<th>LDCs</th>
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<tbody>
<tr>
<td>GNP per capita (USD)</td>
<td>100</td>
<td>480</td>
<td>420</td>
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<tr>
<td>Life expectancy at birth (years)</td>
<td>43</td>
<td>47</td>
<td>59</td>
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<tr>
<td>Infant mortality (per 1000 live births)</td>
<td>107</td>
<td>92</td>
<td>77</td>
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<tr>
<td>Child malnutrition (% of children under 5)</td>
<td>47</td>
<td>32</td>
<td>43</td>
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<tr>
<td>AIDS prevalence rate (% of adults)</td>
<td>10.8</td>
<td>8.6</td>
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<tr>
<td>Access to improved water source (% of pop)</td>
<td>30</td>
<td>43</td>
<td>64</td>
</tr>
<tr>
<td>Illiteracy (% of population age 15+)</td>
<td>62</td>
<td>38</td>
<td>38</td>
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<tr>
<td>Gross school enrollment rate (% of school-age population)</td>
<td>57</td>
<td>78</td>
<td>96</td>
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The DSA Strategy of PFM Reform: ‘Platforms’ of PFM
(Penrose and Peterson, 2001)

Sequence of Implementing Financial Reform

Control (Inputs)

Manage (Outputs)

Plan (Outcomes)

Transaction Platform
- Budgets, Accounts, Commitments, Disbursement (Treasury), Financial Information Systems

Policy/Planning Platform
- Macro Economic Fiscal Framework
- Budget Policy and Strategy
- Medium Term Frameworks
- Intergovernmental Transfers
- Performance/Program Budgeting

Legislative Platform
- Financial law/regulations
- Policy
- Appropriation
- Expenditure Evaluation
Pathway of Ethiopia’s PFM Reform

- Multi-year budget planning
- Performance budgeting
- Financial Statements
- Trained to date: 70,500
- IT: (Custom, Int’l Standards, S/A, LAN, WAN)

- Line Item Budget
- Single Entry Bookkeeping
- Cash Accounting
- IT (Spreadsheets, S/A)

- Cost Center Budget
- Double Entry Bookkeeping
- Modified Cash Accounting
- Trained to date: 47,000
- IT: (Custom, Relational databases; S/A, LAN)

- Accts Reform Somali
- Post-Implementation Support—small regions
- IT: (IBEX Upgrade, Rules based, Oracle, Flexible Reporting)
- To be trained: 2,340

FY 96
FY 98-03
FY 07
FY 08
How to Introduce the ‘Basics’ of PFM Sustainability at Each Stage

Stage 1: **Comprehension** of the existing system
   — documentation, massive training, legal framework

Stage 2: **Improvement** of the existing system
   — forms, FMIS

Stage 3: **Redesign** to a new system
   -- chart of accounts, budget classification,
   cost center budgeting, double entry bookkeeping,
   modified cash accounting, MEFF,
   performance framework, unit cost/needs based transfers,
   redesigned FMIS

Stage 4: **Consolidation** of the new system
   -- freeze functional change, post-implementation support, upgrade the IBEX technical platform
Critical Success Factors

Context
- Hard budget constraint
- Effective not efficient financial control

Ownership
- Government designed Civil Service Reform
- Government participation throughout (Minister 13 years)
- Continuity of technical assistance

Purpose
- Policy (not crisis) driven:
- decentralization; rebuild civil service

Strategy
- Evolve existing system: from effective to efficient financial control
Lessons Learned
Lessons in Sequencing

• Between PFM Platforms
  – *Transaction platform then policy/performance platform*
    (note—there was an initial reform of the financial law/regs)

• Within the Transaction Platform
  – Financial Procedures: *Budget Classification, Chart of Accounts, Financial Calendar*
  – Existing Systems: *Accounts current before implementing new systems*
  – Implementation: *Budget year 1, Accounts year 2*
Lessons in Reforming Government Accounting

Developing Country Governments Can Do Double Entry Bookkeeping

**FACT:** D-Entry is working in Ethiopia in the most remote administrative areas on earth with 12th grade educated staff.

**VIRTUES of Double Entry Accounting**
- Professionalism / empowerment / building the nation
- Building on their schooling
- Better control
- Timely, accurate, comprehensive reporting
- More transparent
- First step in evolving an accounting system
Lessons in Reforming Government Accounting

• Preconditions
  – Clear backlog of accounts—manage one system
  – Simplify administrative/budget structure (reduce BIs, single pool)

• Training, Training, Training, Training, Training, Training, Training, Training
  – Did not skimp (inclusive) (78,000+) (DSA’s single largest expense)
  – Cascade model of TOT (at each level)

• Materials
  • Standardized across all regions
  • 4 local languages
  • Continuous revision based on experience, copy for each participant

• Post-Implementation Support
  – Continuous field visits
  – Creation of Wereda Support Units (WSUs)
Lessons in Developing Financial Information Systems

Financial Information Systems are often Risky and Expensive in Developing Countries

- 79% Failure Rate
- 6% Sustainability
- 7-9 years to implement in Africa (5-7 other LDCs)
- $25 million for a medium size, 3 admin tier govt

IT Works in Ethiopia and can Work Elsewhere

COST

V.1 & V.2  $3.6 million (when DSA ended January 08)
V.3  $2.6 million
Total  $6.2 million compared to…a pilot of $15 million

DSA’s FMIS Sequencing Strategy

• V.1 (yrs 1-8) (BIS/BDA). Replication (Rapid Rollout of Procedures)
  – IT System brought to the user’s system

• V.2 (yrs 9-11) (IBEX A). Reworked (new capability)
  – Distributed (WAN/LAN/S-A), low bandwidth
  – MS SQL RDBMS

• V.3 (yr 12) (IBEX B). Rebuilt (new technical platform)
  (Why an upgrade—has to run for 3 to 5 years)
  – Oracle RDBMS, Business Rules Repository
Lessons on Financial Information Systems

- COTS is not necessarily superior
- High risk of driving PFM reforms with IT
- The ‘Basics’ of PFM need only basic IT
Way Forward for Ethiopia’s Financial Systems

**Possibilities**

- Better Financial Management
  - In-Year Reporting (PBS)
  - Management Accounting/Financial Statements
- Better Expenditure Allocation
  - District performance agreements
  - Transfer formulas—need based, unit cost (equity)

**Potholes**

- Not using the Treasury system
- Expansion of administrative units
- Government staff turnover
- Star Wars—inappropriate PFM reforms (respect)
Thank you for listening