

**Introductory Speech for the Meeting
of Senior Budget Officials
of central and eastern European Countries
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by
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Building blocks for budget reform

Ladies and gentlemen, it is a great pleasure for me to have the opportunity to make some opening remarks on this conference.

Budget policy is a recurring theme in my career. In 1975 I started my career at the Ministry of Finance in the Budget Directorate. Later, as director of the CPB – the Netherlands Bureau for Economic Policy Analysis – I participated in the preparation of important reforms in our system of fiscal rules. And now, as Minister of Finance, I am more than ever convinced of the importance of a proper national budget policy. Not – or should I say, not only – because I like figures, but because these figures have a direct and serious impact on the well-being of our citizens. Without a sound budget policy there can be no sustainable social welfare system, no funds for a proper education policy, and no base for a durable economic growth. Therefore, I think that the effort to reform and improve national budget systems is one of the best things a social minded government can pursue.

In the past years a lot has happened in the field of budget policy. Especially in the central, eastern, and south eastern European countries many things changed since the transformation from centrally planned economies to open market economies. Tremendous efforts have been made to adapt budget systems to this new environment. For some countries additional requirements had to be met since they joined the European Union this year. The far-reaching transformations offered the opportunity to fully benefit from latest innovations in the field of budgeting and to introduce the most advanced budget systems. This is an appealing prospect, but there are some pitfalls on the road that I would like to touch upon.

Like any other topic where science meets everyday policy discussions, the debate on budget policy is heavily influenced by trends and buzz-words:

- Accruals is good, cash accounting is bad.
- Budgeting on input is bad, output is better, outcomes are best.
- Do not focus on short-term solutions, use medium-term budgets.
- Abolish special funds, integrate all expenditures in one comprehensive decision process.
- Introduce strategic planning, programme budgeting, agencies, a medium-term expenditure framework, etc.

You will probably hear a lot of these phrases today and tomorrow. And don't get me wrong: I think there is a lot of wisdom in these phrases. Most of this advice prescribes in fact valuable ingredients for a sound budget system. A critical evaluation of the pros and cons of these elements and their optimal design is therefore crucial.

However, for an effective budgetary reform more is needed than a focus on the final results only. A successful transformation also requires a focus on the transformation process itself and the priorities during the transformation.

I don't think universal recipes are available for an optimal transformation process. The timing and sequencing of the necessary steps depend on the budgetary, political, and administrative state of affairs, which of course varies widely among countries. Nevertheless, I think a few separate building blocks can be distinguished.

First, I think it is absolutely crucial to get the **basics** right before any sophisticated budget tool is implemented. And with these basics, I refer to issues like accounting practices and budgetary statistics, the integrity of the budget and tax administration, the actual control of the line ministries and the ministry of finance on government liabilities and cash spending, the abolishment of "off balance" budgeting practices. These and other basics are vital to any well functioning budget system. Efforts should be focused on these issues before a lot of energy is put into the development of more sophisticated innovations.

A second block is the improvement of **macro** budget efficiency. With this I refer to issues like the optimal design of fiscal rules, the strengthening of the position of the minister of finance within the cabinet, the improvement of forecasting techniques also for the longer term, the reinforcement of checks and balances in the budget process, and the introduction of a medium-term expenditure framework. These elements contribute to a sustainable development of public finances.

The third block is the improvement of **micro** budget efficiency. This includes the transformation to programme budgeting and an increased focus on output and outcome based budgets; the use of performance indicators and a systematic evaluation of government programmes; the adoption of accrual accounting principles. Also innovations in the field of management, such as the introduction of output contracts between central government and government agencies, and public-private partnerships could be used to enhance the micro efficiency of government spending.

Although I think there is no fixed recipe for successful transformation, I do think it is useful to make a distinction between these building blocks. **First** I believe that things should be done in the proper sequence. I think that, for example, introducing accrual accounting for central government when

accounting capacity still falls short and spending controls are weak is not the way to go forward. Yes, accrual accounting can improve efficiency since it delivers better information on the actual use of production factors. But it is difficult to implement for the ministries and difficult to understand for politicians, and thereby entails a budgetary risk if spending control is not firmly organised. The same is true when budgets are primarily based on outputs and outcomes while fiscal rules are non-existent and the position of the minister of finance is relatively weak.

The **second** reason why I think it is useful to distinguish separate building blocks is the need to focus on priorities. With all these promising innovations at hand, it is tempting to bite off more than one can chew. To prevent an overburdening of the ministry of finance and the line ministries, it is necessary to phase in the various transformation tracks properly. It is vital that a proper capacity of financial staff in all relevant ministries is ensured before sophisticated and difficult budget tools are implemented. As long as that capacity is not ensured I would advise to focus on the basics and to invest in human capacity. This prevents the risk of serious fiscal turmoil or a process that gets stuck in well-meant intentions without having any real effect except perhaps a general disappointment.

Ladies and gentlemen, I do not have the intention to start this conference with warnings that may curb your enthusiasm to reform. On the contrary, as mentioned before I am impressed with all the transformations that have taken place, or are taking place, in the countries you represent. But I think transforming national budgeting and financial management systems is a difficult process. To overcome these difficulties it is vital to ensure that investment in human capacity is tailored to the demands made by the transformation process. That is what I have learned from my experiences in the Netherlands. What I have also experienced is that it is vital to learn from lessons from the past and experiences in other countries. That is why I think it is so useful to share views in conferences like this one. And I hope that this meeting is the beginning of a lasting process of mutual sharing of experiences.

Ladies and gentlemen, I would like to end my introduction and to wish you a very pleasant stay in the Netherlands and a very fruitful discussion during this conference.

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