Sequencing and Implementation of Cash Management Reforms

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Roadmap for this Presentation

I. Reform path of budgetary institutions

II. Cost of poor cash flow management

III. Environment for improving cash management in Latin America

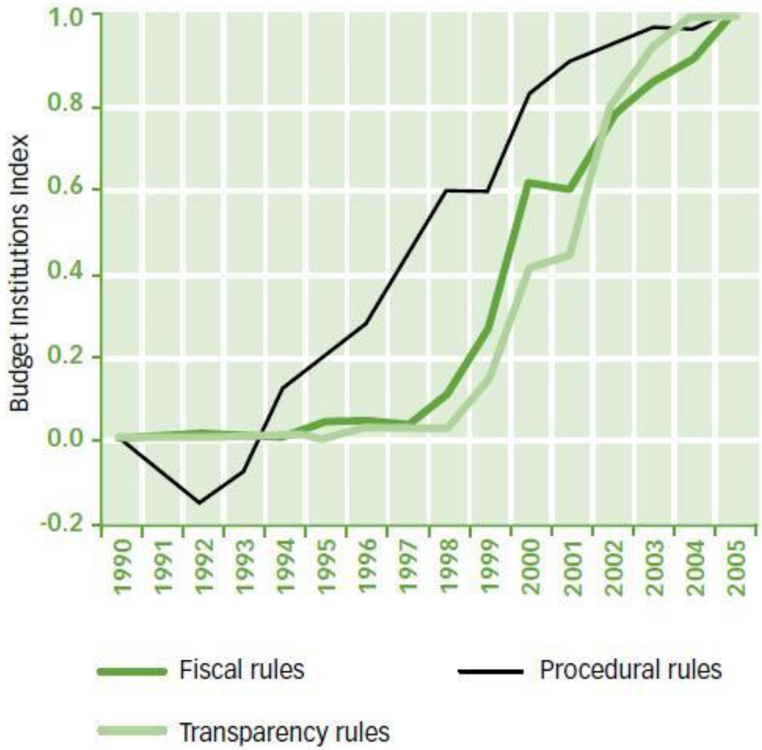
IV. Managing change

V. Towards a modern cash management regime

VI. Rules of thumb

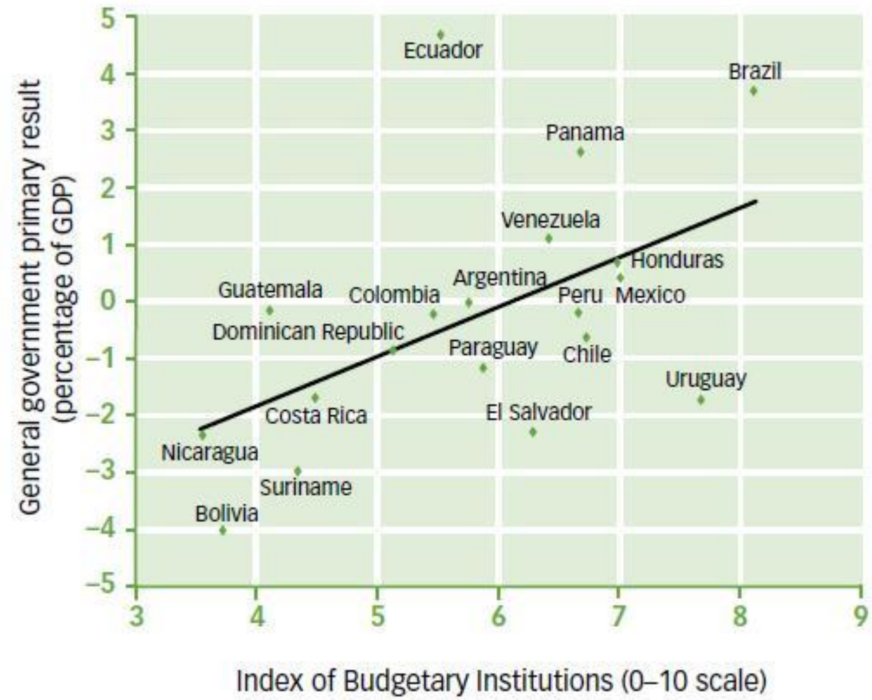
I. Reform Path in Budgetary Institutions

Path of Reforms



Source: Filc and Scartascini (2006).

Fiscal Outcomes and Budgetary Institutions



Source: Filc and Scartascini (2006).

- Substantial Progress made during the last 10 years.
- De jure institutional reforms may not always be adequately implemented
- Study shows substantial gains in aspects of cash management
- Breakthroughs in macrofiscal control may be challenged by post GFC environment

Uneven Institutional Development

COUNTRIES	MTEF						
	MTBF						
	MTFF						
	GDP Projections[4]	Inflation Projections	Aggregated Expenditure Projections	Aggregated Income Projections	Expenditure Projections by Administrative Unit	Disaggregated Income Projections	Expenditure Projections by Program
Argentina[1]	✓	✓	✓	✓	✓	✓	✓
Bolivia	×	×	×	×	×	×	×
Brazil	✓	✓	✓	✓	✓	✓	✓
Colombia	✓	✓	✓	✓	✓	×	×
Costa Rica	×	×	×	×	×	×	×
Chile[2]	✓	✓	✓	✓	×	✓	×
Dominican Rep.	×	×	×	×	×	×	×
Ecuador	×	×	×	×	×	×	×
El Salvador	×	×	×	×	×	×	×
Guatemala	✓	✓	✓	✓	✓	✓	×
Nicaragua	✓	✓	✓	✓	✓	✓	✓
Mexico[2]	✓	✓	✓	✓	×	✓	×
Honduras	✓	✓	✓	✓	✓	✓	✓
Panama	×	×	×	×	×	×	×
Paraguay	✓	✓	✓	✓	✓	×	×
Peru[3 5]	✓	✓	✓	✓	×	×	×
Uruguay	✓	✓	✓	✓	✓	✓	×
Venezuela	✓	✓	✓	✓	×	×	×

Source: Filc & Scartascini

II. Real Costs of Poor Cash Flow Management

Not getting the cash to where it needs to be when it needs to be there….

A. Operational Costs
- Service delivery failures
- Interrupted construction of public investment projects

B. Financial Costs
- Direct cost caused by build-up of payments arrears to suppliers
- Opportunity cost of idle cash balances held in non-remunerated accounts
- Costs of unnecessary short-term debt issuance

C. Erosion of budget institutions and processes
- Disconnect between policy priorities (budget formulation) and policy outcomes (budget execution)
- Lower accountability of program managers
- Games i.e. hoarding cash

III.Obstacles to Good Cash Flow Management

A. Political Obstacles

- Budget allocation occurs at execution; not at formulation
- Over-reliance on cash controls as disciplinary/reward instrument
- Executive unwilling or unable to make hard budgetary decisions during budget formulation – “Passes the buck to Treasurer or MoF”

B. Opposition by Interest Groups

- Technological solutions may be resisted by some civil servants
- Banking sector may be benefiting from large floats

C. Institutional & Technical Obstacles

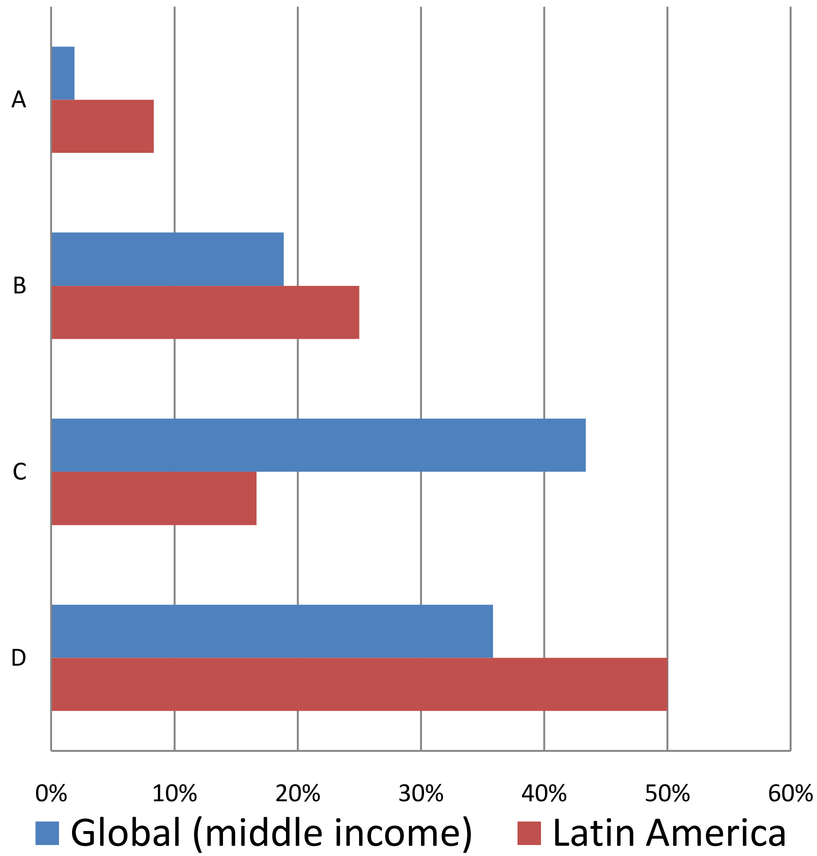
- No TSA or nominal TSA that coexists with multiple other accounts, often with slow or never remittance to treasury
- Low capacity of human resources – in government and in financial sector
- Lack of necessary data to forecast financial needs
- Weak institutional coordination and information sharing arrangements, as evidenced by irregular or rare cash flow revisions

III.The environment

D. A weak public financial management system

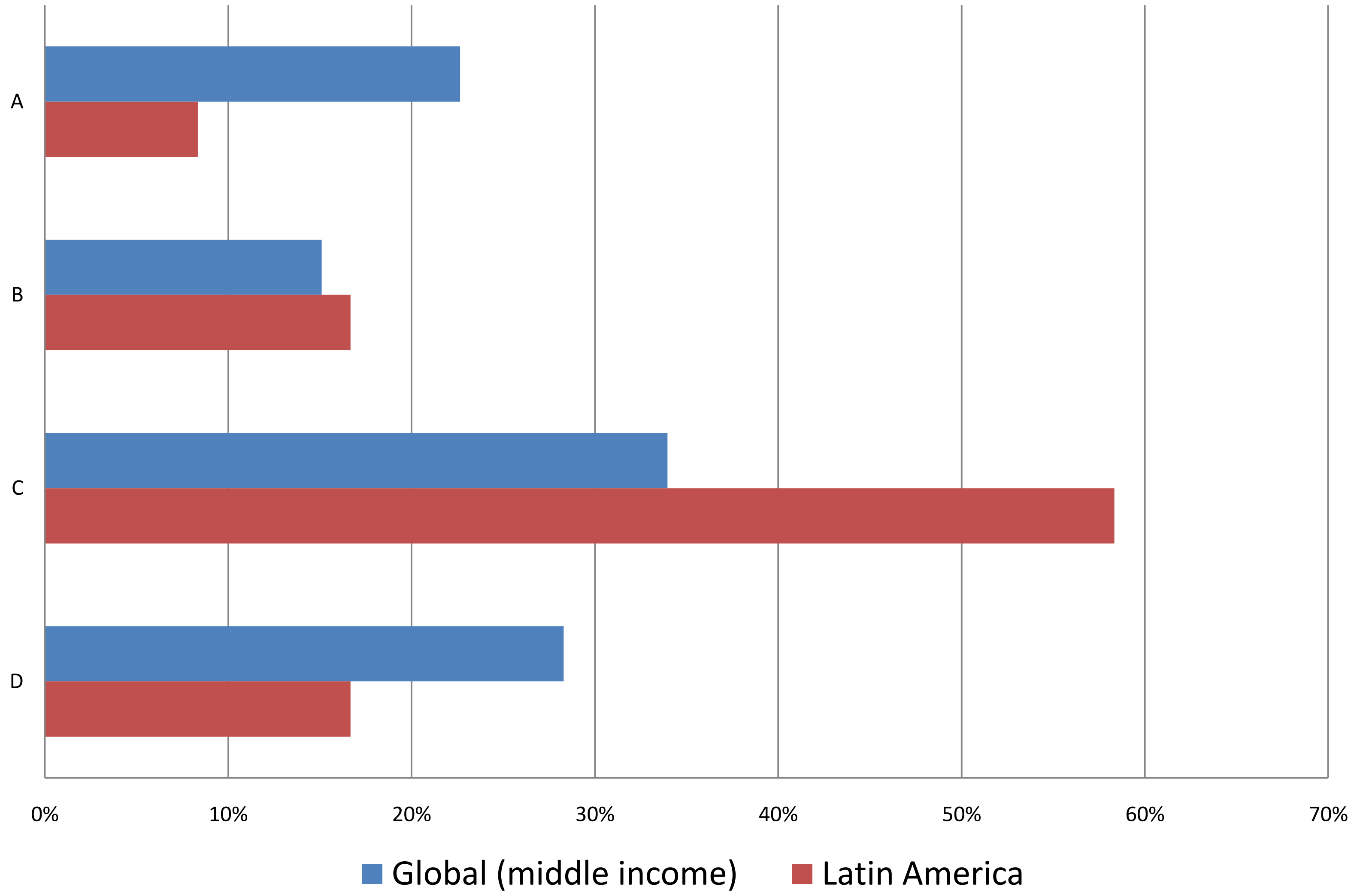
- Weak control/supervisory mechanisms
- Poor ability to formulate budget – i.e. overly optimistic assumptions
- Abundance of extra-budgetary funds and expenditure rigidities (earmarking)
- Cumbersome procurement procedures increase cash uncertainty
- Inadequate accounting and reporting procedures delay payments and receipts

PI-20: Effectiveness of internal controls for non-salary expenditure



12 LA countries; 55 in ECA/MNA/EAP/Caribbean

PI-16: Predictability in the availability of funds for commitment of expenditures



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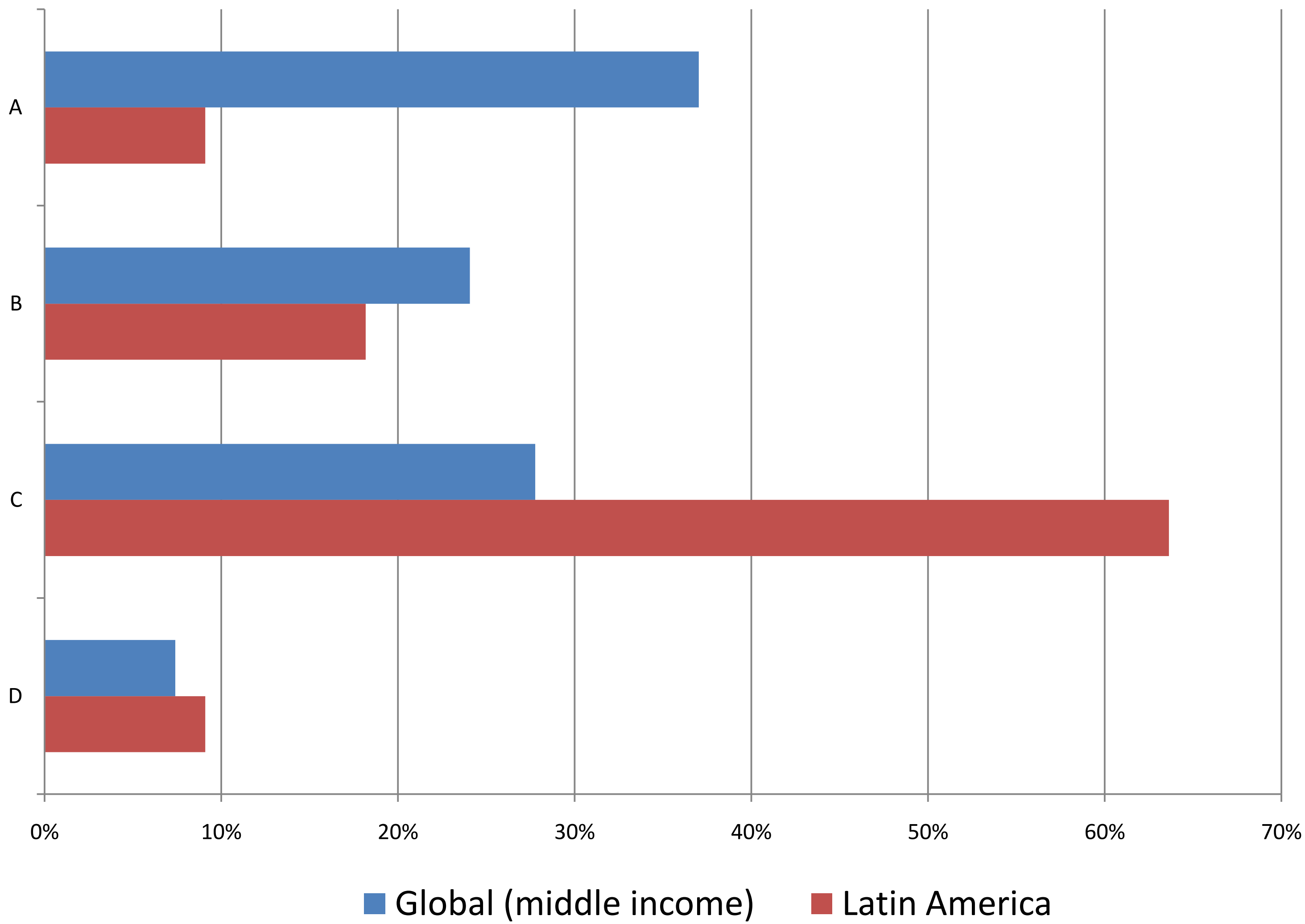
PI-16: Frequency and transparency of adjustments to budget allocations, which are decided above the level of management of MDAs.



Cash Management, 2005

Country	*Central budget authority can withhold allocated funds*	*Central budget authority can withhold allocated funds where the legal obligations have already been assumed on behalf of the state*
Argentina	No	No
Bolivia	No	No
Brazil	Yes	No
Chile	Yes	No
Colombia	Yes[a]	No
Costa Rica	Yes	No
Dominican Republic	Yes	No
Ecuador	No	No
El Salvador	Yes	Yes
Guatemala	No	No
Honduras	Yes	Yes
Mexico	Yes	No
Nicaragua	Yes	No
Panama	Yes[a]	No
Paraguay	No	Yes[a]
Peru	No	No
Uruguay	Yes[a]	Yes[a]
Venezuela	No	Yes[a]

Source: Filc and Scartascini (2006)

- In 11 countries, budget authority has power to hold back funds already allocated to expenditure units.
- If budget formulation is based on overoptimistic assumptions or suffers from excessive discretion, then adjustment via cash controls may become inevitable.
- Cash rationing will occur despite the fact that good/sound treasury procedures might be in place.

Diagnostic Tool

1. What are the precise *symptoms* of the cash shortage?
2. At what stage(s) of the budget year do these symptoms emerge?
3. Do cash shortages for agencies occur as an occasional, temporary disruption to budget execution or is it a chronic feature of the budget process?
4. Which scenarios most accurately describes the cash shortage problem?
5. What is the nature and degree of the authorities "intent" in their recourse to cutting back on cash releases?
6. Based on this information, should the underlying cause(s) of the rationing policy be defined as macro-fiscal, political, institutional or technical, or a combination of these?

Source: D. Webber, 2010.

World Bank CFAAs show

•Brazil - frequent cash rationing, often associated with ‘overly optimistic revenue forecasts because of legislative amendments’. PEFA notes recent improvement.

•Costa Rica and Panama – ex ante controls imposed by SAI constrains the timeliness of actual release of cash

•Colombia – timeliness compromised by government using ‘earmarks and commitments to frustrate budget stringencies’

•Jamaica – severe budget constraints make it ‘difficult for the treasury to make cash available as needed’

•Dominican Republic, Honduras and Paraguay – ‘agencies receive less cash than allocated, on a schedule that is difficult to predict’

Source: Accountability in Public Expenditures in Latin America and the Caribbean, 2009

Case 1: Periodic use of cash cutbacks

Occasional and unexpected shortages of cash force temporary (in-year) adjustments to spending programs.

Some large expenditures – e.g. capital outlays – may be delayed, or spending agencies may be instructed to hold back, temporarily, on non-essential items.

Usually, cash shortage causes no significant departures from planned expenditures – i.e. deviations from budget appropriations – by the end of the year.

There is little pressure on the fiscal authorities to implement changes to budget execution procedures for subsequent years, for example instituting a regime for more tightly controlled release of funds.

Case 2: Chronic use to cash cutbacks

•Regular shortages of cash which cannot be covered by ST financing.

•Cash controls are used as a primary control.

•Spending plans are disrupted and full budget execution is not possible.

•Some spending agencies, or programs or items, may be given preference over others.

•Payment arrears appear and become a constant feature. Informality used.

•Spending agencies and the public doubt the intent to implement and achieve stated policies.

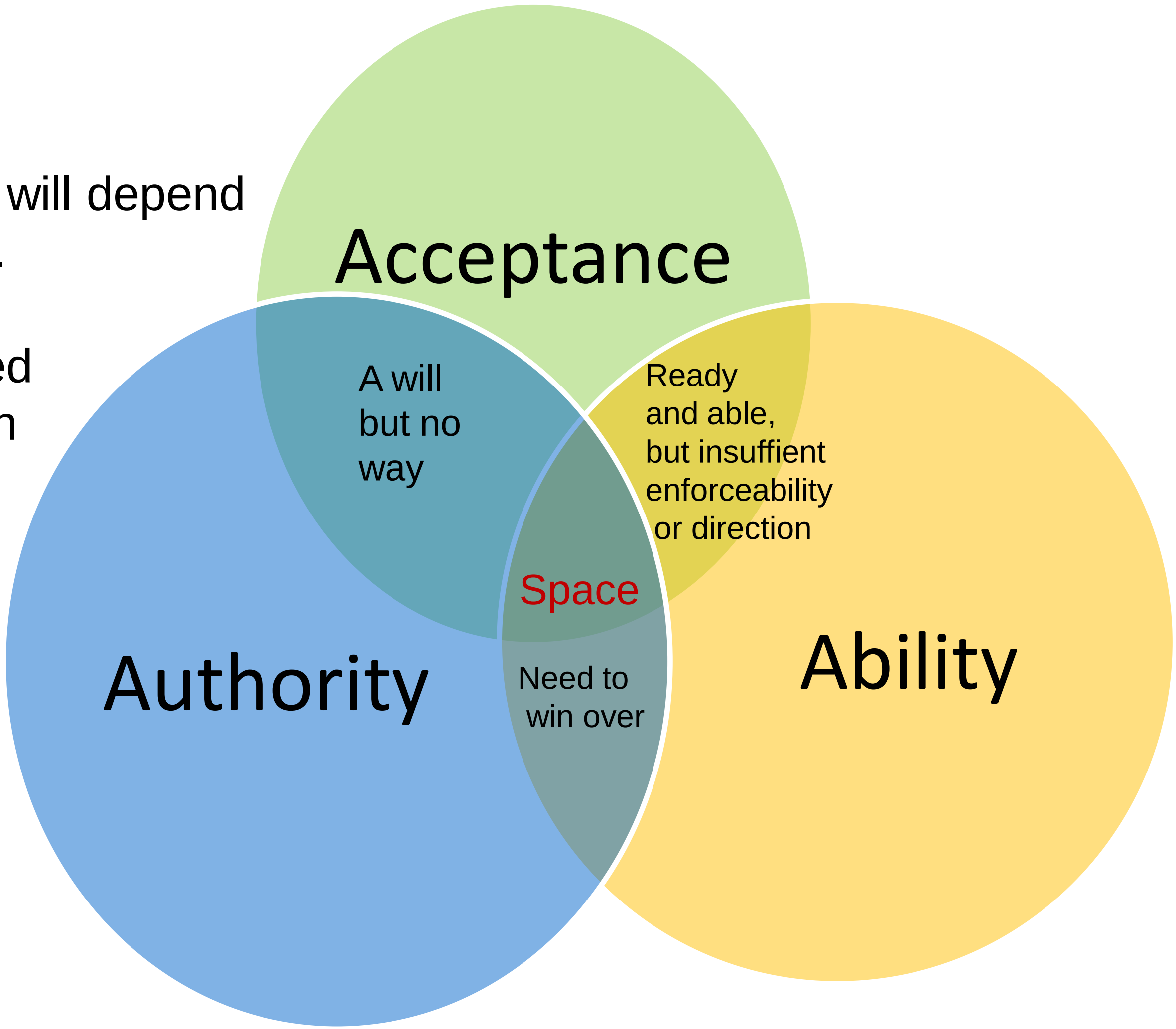
•Spending agencies use off-setting behaviours.

IV. Managing change

The right approach will depend on the local factors.

LAC is characterized by some variation in institutional starting point.

Binding constraints to reform differ from country to country.



Source: Matt Andrews

Divergence in starting positions

Lower capacity start within government and financial markets, with notable technical gaps. Measures may include:

• More accurate and timely forecasting of cash flows and the resulting balance.
• More efficient and responsive cash management processing and service provision.
• Integration of cash and debt management—minimizing the cost of government borrowing and maximizing the opportunity cost of resources.
 - Mutually beneficial development of financial markets.
• More efficient implementation of the budget complemented by an adequate system for managing commitments.

Higher capacity start, with technical components in place. Measures may include:

• Ex-ante controls could be streamlined to gradually allow managers greater predictability and freedom to allocate funds within each program.
• In-year amendments could also be consolidated, perhaps in a single mid-year review.
• Strengthened consolidation of accounts, either within the TSA and between TSA and other accounts.
•Broadening range of financial instruments and institutional options to smooth cash position.

Starting with politics and institutions

- Unwilling or unable to make hard choices upfront during budget formulation
- Heavy use of supplementary appropriations; or virement (where allowed)
- Budget formulation may be based on unrealistic assumptions regarding revenue targets, economic growth and commodity prices
- Generally weak PFM system

Approach/Solutions:

- Capacity building important, but solely technocratic likely to fail
- Updated diagnosis of PFM systems useful
- Consider political economy aspects
- Increasingly more ambitious objectives, i.e. rule-based cash disbursement plans coupled with agencies' convergence towards a real TSA
- Particularly difficult environment for large scale IT development

A technocratic path

- Cash cutbacks used as a temporary measure to cope with shocks
  - Basic rules may exist for prioritizing cash disbursements in such context
- A TSA exists, but may not be a "single" account
- Insufficient or imperfect data for forecasting cash flow/requirements
- Financial sector may still be developing
- Inadequacy of information sharing arrangements/platform across agencies
  - May reduce confidence of treasury

Ability within government and financial sector needs to increase through four phases

TSA – integration

- use incentives when necessary

Strengthen forecasting capability

- focus on improving the forecasts of inflows and outflows

So-called rough tuning

- cash forecasting and liquidity management
- specialized management of longer term balances

Fine tuning

- drawing on wider range of instruments

V. Towards a modern cash management regime

A. What is the root of poor/inadequate treasury performance?

- PEFA Methodology could certainly provide assessment of PFM system
- DEMPA framework
- Others: See Lienert 2008 or Williams 2004 and how to address challenges with a more technocratic root; David Webber (2010) also provides a useful path.

B. Reform Path: Sequencing or Phases in Treasury reforms

- Each reform path is unique and should respond to the specific challenges and existing barriers in the country.
- Opportunistic timing of reform (circumstances) can be particularly important; i.e. economic downturn might focus the mind.

C. When technocratic solutions may not look like working…

- *Cash shortages* should not always be treated as a *cash management problem*

VI. Rules of Thumb

1. Clear identification of roots of problem is critical. Imitation has limits.
2. Technocratic solutions may be challenged in some settings.
3. There are no silver bullets, although there are necessary conditions. While the broad phases are fixed, there will be significant variation around the precise arrangements
4. The great should not be the enemy of the good; but risks should be identified and managed.
5. Patience and commitment are key. Big IT projects and budget formulation reforms do take a long time.

End