

Getting More from a Fiscal Stimulus

How do you build confidence and enhance performance under a fiscal stimulus?

OVERVIEW

The severity and global nature of the current financial and economic crisis has increased the role expected of fiscal policy in stimulating national and global demand, protecting vulnerable groups, and investing for future growth (IMF 2009). For those that can afford it, this means quickly designing and implementing fiscal stimulus packages.

These new challenges have arisen while governments across the world have, for some time, been reforming their budget management frameworks to improve public sector performance to better meet complex and ever-rising obligations. While there is a risk that the short-term stimulus diverts attention from longer-term performance reforms, this note suggests that ‘*performance-informed budgeting*’ can help countries better address the challenges of the current financial and economic crisis.¹ Specifically, how governments might enhance the impact of their fiscal stimulus through three interrelated performance-informed areas:

- 🌐 Reprioritizing public spending to maximize the impact of the stimulus measures;
- 🌐 Improving the efficiency and effectiveness of operational expenditures to avoid waste and maximize the available fiscal space; and
- 🌐 Accelerating investment expenditures, to both stimulate demand and build for future growth.

Bolstering the performance orientation of fiscal policy—which encourages politicians and managers to make commitments on clearly stated, measurable, outputs or outcomes—may help to make the stimulus measures more effective, credible and durable. It may also provide Governments with more ammunition to justify politically difficult decisions. These factors can be critical to bolster confidence amongst the public, financial markets and businesses, needed to support longer term recovery.

GET Notes – Recently Asked Questions Series intends to capture the knowledge and advice from individual engagements of the World Bank’s Global Expert Team on Public Sector Performance (PSP GET). The views expressed in the notes are those of the authors and do not necessarily reflect those of the World Bank. The main author of this note is Theo Thomas, Senior Public Sector Management Specialist (LAC). For more information about the PSP GET, contact the GET team leaders Bill Dorotinsky (wdorotinsky@worldbank.org) and Nick Manning (nmanning@worldbank.org) or visit <http://pspget>.

BASIC PRINCIPLES FOR GETTING MORE FROM A FISCAL STIMULUS

The current economic crisis places significant, and often conflicting, demands on fiscal policy. Financial and real sector instability and falling commodity prices depress fiscal revenues while the demand for fiscal expenditures is on the rise as many countries try to shore up financial sectors, protect the social gains witnessed during the past decade and boost long-term investment to sustain growth. However, the degree to which Governments will be able to use countercyclical policies to temper the impact of the downturn will depend on initial fiscal conditions, particularly access to financing, and their ability to convince the public, the private sector and financial markets that their policies are prudent, well-targeted and ultimately sustainable.²

An effective international response to the crisis must be tailored to the situation of each country. The effectiveness of international fiscal actions will also be enhanced if they are concerted, and conform to the following principles:³

PRINCIPLE 1: *timely* – to have a swift impact. This requires both that the policy change can be implemented quickly, and has a rapid impact on behaviors;

PRINCIPLE 2: *temporary* – to maximize the immediate impact and protect medium-term fiscal sustainability. If action is not taken to maintain sound public finances, there is a risk that policies will not be seen and credible and higher long-term financing costs and interest rates may undermine the stimulus effect; and

PRINCIPLE 3: *targeted* – it is important that the support boosts spending, to maximize the impact on domestic economic activity.

Each of the above may be supported by a sufficiently prudent, flexible, and public medium-term fiscal framework (MTFF). For many countries, a MTFF, could be compiled relatively quickly to help articulate the Government's medium-term (3-5 years) macro fiscal and policy objectives, ideally laying-out both financial and non-financial performance measures. The MTFF could help to convince financial markets and the public that the Government's actions are well targeted and prudent over the medium to long-term and not simply delaying a (more costly) future adjustment. In some cases, such an approach might even help to build high-level political consensus around the response to the crisis.

THE ECONOMIC CRISIS AND PUBLIC SECTOR PERFORMANCE

Performance management initiatives are gradually changing the nature of fiscal policy formulation and accountability. Over the last decade or so, fiscal management in the OECD, and more recently in emerging markets, has shifted from a centralized focus on input controls and compliance, to more decentralized management arrangements and accountability associated with policy objectives (OECD 2007). This global trend also implies a political and managerial



willingness, and capacity, to make commitments based on stated, measureable outputs or outcomes, aimed at bolstering policy formulation, service delivery and accountability. Explicit performance measures also enable better understanding of the linkages between policy, funding, programs and activities, outputs, and outcomes, necessary for more refined policy, effective service delivery, and higher efficiency and impact.

Short-term crisis measures may distract governments from the performance agenda. Spending more to create a fiscal stimulus can create a mindset that it is the spending, and sometimes the announcement about spending, that counts and not the results (conversely, countries that need to quickly reduce spending may target the easiest cuts, such as capital spending or recruitment freezes, without regard for efficiency or the impact on the recovery).⁴ Previous crises suggest that attention needs to be paid to both the quality and durability of adjustment and social safety net measures (IMF 2003). While short-term fiscal fixes may be necessary in some instances, their potentially negative long-term consequences need to be recognized and the risks mitigated.

However, the crisis provides an opportunity to maintain or even enhance a performance orientation to maximize the likely impact of any fiscal stimulus. The crisis has raised the demand for both the effectiveness of and scrutiny over public resources, necessitating performance-informed monitoring and evaluation systems to inform budget decision making, manage for results, and measure and report on impact. Performance reforms enable Governments to better take difficult decisions using performance information to bolster the rationale for the choices. The next section briefly considers three ways the impact of a fiscal stimulus might be enhanced by strengthening the performance-orientation of the fiscal policy.

USING PERFORMANCE INFORMATION TO MAXIMIZE THE IMPACT OF A FISCAL STIMULUS

a) Enhancing performance through expenditure prioritization

In most countries, significant reallocation of existing spending is rare. The amount of resources typically available to shift between priorities is marginal because of the extent of mandated spending, entitlement programs, political sensitivities and prior commitments. However, the crisis raises the need for, and opportunity to, reprioritize, redirect, and in some cases cut, spending.

Improving the performance orientation of policy formulation and implementation is essential to enhance effectiveness. The crisis highlights the need to focus on enhancing the institutions, processes and capacity for fiscal policy formulation (i.e. expenditure prioritization as well as fiscal discipline). OECD countries, like Australia, Canada, and the Netherlands, introduced ‘*spending review*’ processes

that effectively (and durably) consolidated spending in the 1990s (Box 1). Spending Reviews are centrally driven exercises focused on ways to improve the efficiency and effectiveness of spending across government (i.e. between and within sectors/programs), to better align spending with national priorities, under differing funding levels. Reviews commonly seek to systematically use and incorporate performance measures and evaluations and set performance targets or goals to be achieved. Other countries adopted similar mechanisms in more benign circumstances to better prioritize spending (e.g. the UK, France, and Chile).

The current crisis heightens the need to reduce budget rigidities by focusing on measures to enhance performance. Vested interests and policy inertia limit the scope to improve the effectiveness and efficiency of public spending and boost outlays for public investment and social spending. However, the current crisis creates both the opportunity and impetus to tackle some of these issues. Such measures are likely to be more efficient and durable if developed and justified in a systematic way, based on a clear elaboration of the fiscal costs and results that have been and are to be achieved. Benchmarking program costs and performance within a country or across countries has been a particularly effective device for highlighting performance issues and motivating change.

Box 1: 1994 Canadian Program Review

The 1994 Canadian Program Review was a one off exercise, which established a high level *special committee* under the Prime Minister. The Committee set performance based guidelines and managed a review process that helped to generate substantial cuts (averaging 21.5 percent across departmental budgets). The process, recently institutionalized, helped lay the foundations for the fiscal management framework that has bolstered the Canadian economy ever since.

b) Enhancing the performance of operational expenditures

Improving the efficiency of operational spending increases the fiscal space available for high priority spending. This has become increasingly important where financing is limited, and many countries are tightening government-wide value-for-money targets to try to free up additional. Many governments now collect sufficiently robust performance information to enable targeted cost-effectiveness and efficiency savings.

Fiscal adjustment is more durable when associated with maintaining or enhancing capital expenditure and selectively reducing current expenditures (World Bank 2008). Many governments are protecting or expanding investment spending to bolster short and long-term growth (OECD 2009). Investment spending is also being used to promote new long-term policies, such as sustainable energy. Governments therefore focus on reducing current annual and multi-year commitments, such as civil service wages, hiring freezes, and pension reforms among others. However, when these measures are centrally driven and not linked to some performance objective, the outcomes can be poor. For example, across-

the-board cuts may lead to a reduction in support staff in key social sectors or reduce the capacity of infrastructure ministries to implement much needed investment spending, impeding both the stimulus and long-term growth. Such reforms may also be quickly unwound once the worst of the crisis is over.

The crisis provides an opportunity for reducing distortionary budget rigidities. Many countries have mandatory spending requirements (these can take different forms, such as legislation guaranteeing funding for particular sectors/programs or entitlement based social programs) and/or earmark revenue to specific uses. While protecting resources for a few predetermined priorities, these measures also reduce flexibility to respond to emerging demands and changing priorities, undermine incentives to contain operational costs, as well as undermine performance questions and a focus on results and accountability.⁵ Given the current crisis, Governments can use performance information (e.g. operational efficiency targets) to help switch spending between priorities and to identify and justify reductions in budget rigidities.

Performance-informed monitoring and evaluation systems can also be used to enhance operational efficiency. OECD experience suggests that sound information systems and central oversight—particularly the central setting of efficiency targets—is necessary to identify and enforce operational efficiency improvements. With political commitment, efficiency measures could be quickly introduced in many countries, particularly those with a strong tradition of program monitoring and evaluation, to enhance the impact of government spending and perhaps also to free up fiscal space for reprioritizing resources.⁶

c) Enhancing the performance of investment expenditures

A large number of countries are trying to improve the value and effectiveness of investment spending to combat the downturn and bolster the recovery. However, money is often not the only constraint, and there is recognition that without institutional reforms, investment spending is likely to remain constrained or highly inefficient, and have a lesser impact (Ferris).

While systemic reform takes time, a rapid assessment of the performance orientation of investment management might help to identify ‘quick wins.’ The World Bank (2009) has developed a diagnostic framework to assess the inputs, processes and outputs that impact the performance of public investment management.⁷ This tool can provide objective measures of inefficiency and support the design of reforms to improve Government systems, including ‘*quick wins*,’ and through the use of performance benchmarks help to guide more rapid implementation.

A standardized investment project bank can help to speed up the identification and implementation of projects. Many countries could expedite investment spending by utilizing lists of already identified and appraised projects—the UK, for example, is bringing forward the execution of approved and planned investments. Other countries have established guidelines with standards, benchmarks and processes to help budget agencies with the selection, preparation, execution and monitoring of stimulus related investment projects—these projects may also be coordinated and monitored through a central ‘*project bank*’. This approach can help to reduce the costs and time taken to identify and appraise investments, particularly where these are designed by numerous sub-national government bodies,⁸ while promoting impact and accountability. In emerging and developing countries, project banks may be supplemented with projects and assessments identified by international institutions (including regional development banks) and/or donors, once they are incorporated into government plans.

A performance focus can encourage stronger program and project management, including through greater delegation of management responsibilities to line ministries and agencies. By changing the emphasis of accountability towards results, Governments place more emphasis on improved management for results. In exchange for greater performance orientation and accountability, Governments may increasingly delegate the implementation of investment projects to line ministries, agencies and even the private sector. While the control of inputs is still important, this greater management flexibility can expedite the implementation (and improve the quality) of investments by better directing resources to where implementation capacity exists—for example the private sector is likely to have more idle resources than the public sector during the downturn. Indeed, the impetus created by the crisis may help to accelerate the adoption of such innovative forms of service delivery and performance management across the public sector, helping to change the overall culture of the public sector. Currently, weak program and project management in line agencies is a primary cause of project delays, cost escalation, and suboptimal outcomes. Delivering projects on-time and on-budget, increases their fiscal stimulus.

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¹ See World Bank (2009b) for a full description of performance-informed budgeting.

² See the IMF (2008), for a discussion of how the impact of fiscal interventions may be maximized. The paper highlights the need for policy and financial transparency to create confidence in the measures and support a positive response from consumers, firms and other economic actors, which is needed to strengthen and sustain the recovery.

³ This is a simplified version of the principles outlined by the IMF (2009b), as elaborated by the UK HM Treasury (2008).

⁴ For example, the reduction in capital spending during the 1990s crisis in Mexico is thought to have slowed the post-crisis recovery (World Bank 2001), while Brazil's stabilization efforts in the late 1990s significantly reduced the level of investment spending, and the subsequent decline in capacity has hampered recent efforts boost investment.

⁵ There are considerable budget rigidities in Brazil, with less than 10 percent of spending being determined at the discretion of the annual budget (IADB, 2005).

⁶ Many of the emerging market economies in Latin America, such as Brazil, Mexico and Peru, have developed extensive monitoring and evaluation systems that could form the basis of such a process.

⁷ For some recent examples see conference paper:

http://www.kdi.re.kr/kdi_eng/highlights/highlights_view.jsp?seq_no=8573&board_div=03).

⁸ The USA, for example, has delegated consider responsibility for executing investment projects to the States, while also strengthening it standardized guidance, monitoring and reporting systems: www.recovery.gov