



Third International Roundtable
Managing for Development Results

Hanoi, Vietnam – February 5 - 8, 2007

Planning and Budgeting: Linking Policy, Planning, and Budgeting

A Background Paper

**Third International Roundtable on
Managing for Development Results**

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Theme: Planning and Budgeting

“A goal without a plan is just a wish.” Antoine de Saint-Exupéry

Introduction

This note summarizes the key issues related to improving planning and budgeting in public organizations, as background for the planning and budgeting sessions at the Hanoi Roundtable for Development Results.

The generally accepted reasons for reforming national planning and budgeting processes are numerous and include the facilitation of better service provision, more efficient use of resources, more targeted use of funds, and greater accountability for policy implementation. However, many governments face significant challenges trying to improve planning, budgeting, and the links between the two process areas. Typically, the challenges arise from the need to establish clear policies, ensure that budgets reflect those policies and that spending is in line with allocations, and the need to measure results and feed those back into policymaking. A number of questions arise in regard to these challenges. They include the following.

- *What are appropriate building blocks and institutional structures in a given country context and what are the appropriate tools to achieve them? What incentives are needed to build these structures? How can they be put in place?*
- *How best can effective multiyear budgeting be introduced? What are the main political, technical, and capacity issues?*
- *How can benchmarking tools such as those developed by the Public Expenditure and Financial Accountability (PEFA) program and PEFA’s “Strengthened Approach to PFM Reform” help countries improve the management of their public financial management (PFM) systems?*
- *What are the key challenges and lessons learned in introducing performance-based budgeting?*

The remainder of this note provides a short situational analysis, followed by an overview of key topics and related challenges and findings. It concludes by suggesting a few discussion points that may help to stimulate debate.

Situational analysis

The quality of PFM matters for achieving results. In recent years, the development community has increasingly recognized the critical role a country’s PFM system plays in attaining national objectives, particularly in light of the growing emphasis on governance, and it has increasingly viewed country PFM systems as a prime focus for development assistance.

Country PFM systems are gradually improving. Of the 66 International Development Association (IDA) recipient countries included in the recent Global Monitoring Report, 19 improved their IDA Country Performance and Institutional Assessment (CPIA) score for budget management between 2001 and 2004. This CPIA criterion assesses the extent to which the budget is linked to policy priorities (including the

poverty reduction strategy), as well as the quality of financial management systems and fiscal reporting. Also, data for 23 countries involved in the Heavily Indebted Poor Country (HIPC) program show a gradual progress in PFM. The performance of 23 HIPCs assessed in 2002 and 2004 along three dimensions of PFM (budget formulation, execution, and reporting) revealed a 10 percent improvement in the 15 HIPC indicators¹ over the three-year period.²

Some countries have been able to make rapid progress over a short period of time. While improving PFM systems usually takes a long time even in developed countries, some countries have been able to make rapid progress. Five of the 23 HIPC countries reassessed in 2004, showed significant improvements in PFM system performance (20 percent or more, corresponding to an increase of three or more benchmarks met in 2004 compared to 2002).

A robust results framework is now in place for country PFM systems. Going beyond the HIPC expenditure tracking exercise, countries are increasingly adopting PEFA's more comprehensive indicator-based framework, which tracks progress over time. The PEFA framework has 28 indicators, and has been applied in 34 countries; a further 50 countries expect to be covered by end-2007. The indicators cover the entire PFM cycle, and link to six objectives of any PFM system: policy-based budgeting; predictability and control in budget execution; accounting, recording, and reporting expenditure; external scrutiny and audit; comprehensiveness and transparency; and budget credibility.

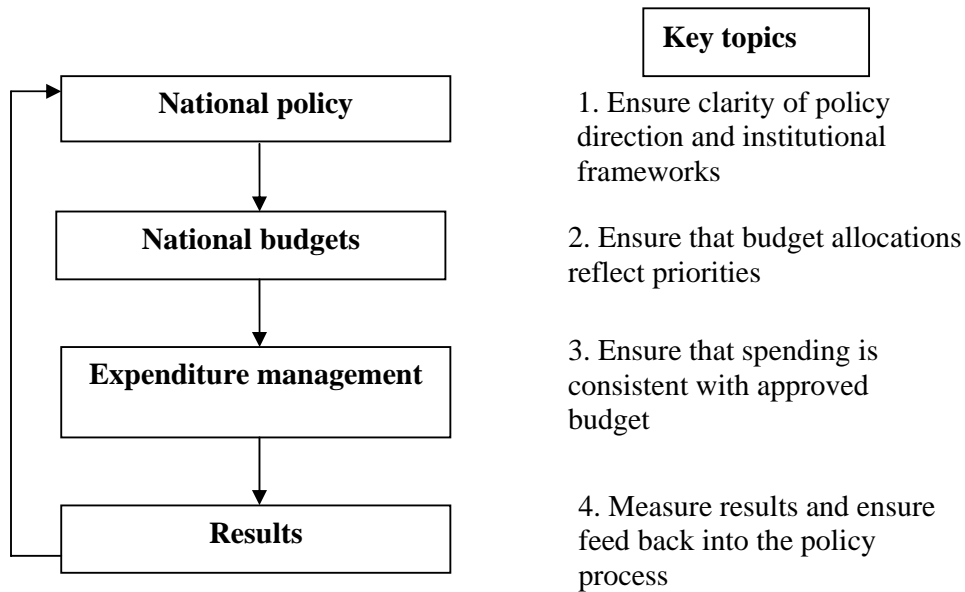
Key topics in planning and budgeting

The link between planning, budgets, and results remains weak. In spite of this progress, most developing countries that have invested heavily in trying to improve PFM systems and processes show only limited progress in linking policy, planning, and budgeting mechanisms. Why is that so? The literature addressing this question is large, and there is a multitude of possible reasons. Key issues that recur when linking policies to results are illustrated in Figure 1 below.

¹ For example, budget classification, reflection of pro-poor spending in budgets, medium-term frameworks in budget, frequency of budget reporting in-year, ex post reporting of spending, performance of internal and external audit.

² Budget formulation improved in nine countries. Six countries showed improvements in budget execution. Budget reporting showed the largest improvement, with 14 countries improving.

Budgeting and Financial Planning for Results



1. Clear policy directions and institutional frameworks

The design of coherent policies is complex and bears inherent tensions. In many countries poverty reduction strategies (PRSs) provide an overall development framework. But by virtue of their comprehensiveness, challenges arise, both in terms of coordinating with other government-wide and sectoral plans within a coherent, sustainable macroeconomic and fiscal framework, and in terms of prioritizing among cross-cutting objectives such as raising growth rates, social and environmental protection, addressing gender issues, and alleviating poverty.

As a joint World Bank/IMF 2005 PRS Review noted, close links between a country's PRS and the medium-term expenditure framework (MTEF) and budget processes can help prioritization.³ The report also highlights the need to open policy space and to strengthen domestic accountability, thereby ensuring that the opportunity is created for open debate on policy issues. This, in turn, requires evidence-based information, capacity, and political willingness.

Budget institutions are critical for implementing policies. The budget is the key instrument for translating national priorities into actions and a key instrument for domestic accountability as its implementation is subject to scrutiny by the legislature and external audits. Whether it can fulfil this role is dependent on the soundness of budget institutions and processes, as evidenced by the following.

- Planning processes need to be clear, avoiding duplication and ensuring that plans are realistically costed, time-bound, and affordable.
- Capital and operating (recurrent) budgets should be integrated in order to ensure sound resource allocation. Generally this is easier to achieve if the same institutions are responsible for capital and operating budgets.

³ "Balancing Accountabilities and Scaling Up Results."

- Lines of accountability should be clear, including clear delegation of authority and administrative reporting relationships.
- There are unambiguous lines of responsibility, with accounting officers overseeing spending of their budgets and being held to account for the procedurally correct use and value for money (VFM) of that spending.
- Strong and independent audit processes exist to provide timely feedback to the legislature on spending.

In contrast, when the processes and institutions of policymaking, planning, and budgeting are fragmented, technical fixes are unlikely to strengthen adequately the planning and budgeting system. Furthermore, major improvements take time; they require high-level support from within government and appropriate incentive systems.

Domestic accountability for policy implementation poses a challenge. Especially in heavily aid dependent countries, accountability is often biased in favour of donor requirements as domestic accountability mechanisms tend to be weak. Clear lines of accountability between Parliament, the Cabinet, and the Ministry of Finance and spending ministries and departments strengthen domestic accountability relationships. Clarity of role, levels of authority, and institutional and operational responsibility is essential. Where responsibility is divided or diffused, for example where accounting officers are unable to control the use of resources, accountability to national stakeholders suffers.

NGOs and civil society can play an important role in strengthening domestic accountability. Civil society can contribute to policy development and to monitoring the results of public expenditure. While PRS processes have typically acknowledged the importance of civil society and included large consultation exercises, the subsequent “mainstreaming” of these findings into setting enhancing governance and empowering the population and implementing programs has often proved to be more difficult. In part this reflects the challenges of prioritization, given that many civil society organisations have a specific focus, as well as capacity constraints.

2. Ensure that budget allocations reflect policy priorities

Linking policy objectives and resources is essential. It is widely recognised that most policies require a series of linked and complementary actions to achieve objectives, with cost implications for years to come. Because most budgets are structured along departmental lines and not programmatic lines it is difficult to establish direct linkages between policy objectives and the funding needed to deliver services in support of those objectives. Consequently, there are inherent weaknesses in overreliance on the annual budget for planning and implementation.

The role of MTEFs. MTEFs provide a budgeting framework which can help to improve the realism of budget planning by linking bottom-up costed plans within an affordable budget envelope. A key element of MTEFs is that they represent rolling plans, normally over three to five years, which move forward each year with the first year representing the budget and the “outer” years representing projections of spending. Although there is widespread recognition that this is a promising way

forward, in practice establishing MTEFs is difficult, and implementation takes longer than is often anticipated. Three aspects are crucial to the likelihood of success:

- reliably determining the size of the “budget envelope” (many countries face uncertainty in terms of their terms of trade and hard-to-predict commodity price earnings, as well as in the predictability of aid);
- ensuring that the sectoral plans use common assumptions (for example concerning public sector wage inflation), so that their cost estimates can be compared; and
- achieving a balanced political trade-off between different sectors and institutions.

Countries vary significantly in term of the degree of MTEF implementation. Often sectors that impact directly on the MDGs (such as health and education) receive more support and have better and more realistically costed plans than those that receive fewer donor resources. In some cases, (for example, the health sector in Malawi) narrow sectoral focus by donors contributes to the problem, with unaffordable sectoral plans being presented to the Ministry of Finance. As the 2005 PRS review noted, “development partners need to be aware of local conditions and undermining existing capacity with reform overload pursued through multiple, disconnected initiatives. This calls for coordinated demand-driven capacity-building efforts”.

Subnational planning systems present a particular challenge. Improvements to planning and budgeting systems need to reflect the tiers of government. In most countries, the government is organised in terms of two, three, or even more levels. In federal government structures—such as those in Ethiopia, India, Indonesia, Nigeria, and Pakistan—block grants are provided to the state or regional levels. It is difficult to implement national priorities when much of the execution rests with lower levels of government that have discretion in the use of financial resources. Also, harmonizing financial information systems across states or provinces can pose a challenge and may meet with resistance by those who feel their autonomy is being curtailed by standardized systems. There is a need to achieve, through inclusive planning processes, agreement on plans, processes, and goals by those expected to carry-out the plans.

Good practice in medium-term budgeting. A good example of an MTEF achieved through national efforts in an environment with a multitiered government and a significant degree of decentralisation is provided by South, which provides public access to its Medium-Term Budget Policy Statement and accompanying estimates on the internet.⁴ Furthermore, it is used on a rolling basis, providing feedback into the budget preparation process on outcomes achieved as well as financial disbursements. In addition to improving the allocation of resources, it enhances governance and empowers the population by highlights public sector objectives.

3. Ensure that spending is consistent with the approved budget

Budget credibility depends crucially on the controls required to maintain fiscal discipline as well as the quality of the public finance management system, particularly

⁴ Access <http://www.treasury.gov.za>.

budget execution, off-budget funding, and the predictability and timing of funding releases. Prerequisites include a treasury and accounting system that accurately records spending and provides timely reports; a managerial culture across government that uses regular, timely financial reports to manage spending and planning; and realistic budget revenue projections that avoid “treasury tensions” and unforeseen cutbacks in the execution of the budget. Providing the overall budget is realistic, the key requirement is to ensure that it is comprehensive and executed in a timely manner, with releases arriving at the spending ministry or agency at the right time. Several countries, such as Tanzania, have achieved dramatic improvements in budget execution. Others have found that progress has been more problematic, often because of political interference. Frequent recourse to supplementary budgets and similar in-year adjustments typically highlight problems with budget execution.

Improving public financial management is critical for improving budget credibility and expenditure accountability. Following the HIPC expenditure tracking exercise, the World Bank with other partners undertook an effort to learn lessons of PFM reform. Numerous factors adversely impact country PFM progress, including the following.

- Inadequate sequencing of reforms, deriving from donor pressure or difficulties for government to determine the path of reforms.
- Fragmented approach to reforms and limited leadership in government.
- Duplicative diagnostic instruments and overburdening of countries with diagnostic products and action plans.
- Limited monitoring of progress (overly focused on inputs), which did not foster lesson learning or a focus on results on the ground.
- Capacity and capacity building.
- Frequent emphasis on narrow technical reform versus systemic change.

Drawing on lessons of success and failure, World Bank and its partners in the PEFA program developed the “Strengthened Approach to PFM Reform.”⁵ The three pillars of the approach entail:

- *A country-led agenda*—a country-led PFM reform program, incorporating reform strategy, action plan, and delivery of results. This is the leading element of the approach, and involves the development of an effective partnership between government and donors to support country leadership and ownership. For example, in Tanzania, the annual government-led public expenditure review process is managed by the joint government/donor/civil society PER working group. Each year, the PER work includes a budget review and in-depth analysis of selected policy and management issues supported by donors. The Government transferred the Secretariat supporting this work to the Ministry of Finance.

⁵ See www.pefa.org. PEFA is a partnership between the World Bank, the European Commission, the UK’s Department for International Development, the Swiss State Secretariat for Economic Affairs, the French Ministry of Foreign Affairs, the Royal Norwegian Ministry of Foreign Affairs, the International Monetary Fund, and the Strategic Partnership with Africa.

- *A coordinated program of support*—a coordinated, integrated, multiyear program of PFM work that supports and is aligned with the government’s PFM reform program. This is developed from a dialogue between government and donors, and incorporates analytic and advisory work, technical assistance, funding support, and training—all appropriately phased over a medium term time-frame. In Madagascar, the Government developed an action plan consolidating the PFM reform recommendations of different diagnosis (including the government’s own assessment; a World Bank Country Financial Accountability Assessment, or CFAA; a World Bank Country Procurement Assessment Report, or CPAR; and IMF technical assistance reports). The Government expects donors to align their programs of work around this action plan.
- *Monitoring results through a common information pool.* PEFA’s PFM Performance Measurement Framework is an objective, indicator-based assessment and monitoring tool that was developed to provide a common information pool on PFM performance for government, donors, and other stakeholders at the country level. The framework focuses on the results of the reforms in terms of actual improvements in systems performance rather than on reforms themselves.
- *Instruments for monitoring improvement.* The World Bank has for many years supported PFM reforms through assessment processes such as the Public Expenditure Review (PER), CFAA, and CPAR. The HIPC assessment process, together with the increasing role of budget support, highlighted the need for a lighter touch tool that could be applied to assess PFM systems. This led to the establishment of the PEFA unit, which was tasked with developing a Performance Assessment Framework (PAF).⁶ PEFA uses 28 indicators to assess PFM systems (and a further 3 that focus on donor indicators). The scoring system has been made as specific as possible, so that it should make little difference who is undertaking the assessment.

4. Measuring results and feeding them back into policymaking processes

Generating incentives. A strong planning and budgeting system is likely to create positive incentives for all key stakeholders, and will:

- encourage and reward rational planning and needs-based resource allocation;
- provide realistic and timely information flows to decisionmakers and those responsible for ongoing monitoring and evaluation of results;
- create incentives to achieve value for money, through effective procurement processes;
- help to manage public sector staffing and payroll systems effectively; and
- reward good performance and penalize poor performance, including providing effective sanctions for those who misuse public funds.

Performance management and budgeting can be approached in different ways. Various tools have been developed to assist with the process, including the use of

⁶ See www.pefa.org.

zero-based budgeting, the introduction of various forms of performance agreements, the introduction of checks and balances, and general efforts to enhance transparency. A survey of selected high- and middle-income countries shows general trends in budget reform (see Box 1), some of which are likely to gear budgets toward greater performance orientation.

Performance management and budgeting involve many actors. To achieve effective performance-based approaches, a wide range of actors need to be supportive, including the Cabinet, Civil Service Commission (or its equivalent), and line ministries and other spending departments. It cannot therefore be left to technical staff in the Ministry of Finance alone. Moreover, it takes time for this cross-cutting agenda to develop momentum, and development partners need to appreciate the requirement for sustained support in this area.

Box 1: A survey of recent reform trends

Work has been undertaken recently to benchmark PFM systems and examine reform trends. A 2003 McKinsey Study of seven dimensions of seven country finance ministries (Australia, Brazil, Malaysia, Singapore, Thailand, UK, US) revealed an enhanced focus on performance orientation in budget management. The study found that:

- All had taken steps to ‘empower’ line ministries and professional managers
 - All had made substantial efforts to strengthen external audit
 - All had taken measures to move away from input budgeting toward performance or output budgets
 - Most had taken measures to improve transparency of processes and information
 - Six had made substantial effort to separate policy development and oversight from implementation
 - All had taken strong measures to consolidate similar functions, especially cash and debt management
 - Most had taken some measures toward greater checks and balances in Ministry of Finance functions.
- Source:* “Transforming MOF: Organizational Recommendations and Implementation,” confidential report to Indonesian Ministry of Finance, June 18, 2003.

Developing indicators. The use of SMART (specific, measurable, achievable, relevant, and time-bound) indicators is widely understood. However, in practice it can be difficult to develop outcome indicators and intermediate indicators that link spending to outcomes, even within one ministry. Many high-level indicators (such as reducing the incidence of absolute poverty) involve more than one sector and create problems of attribution. Frequently, reliable base-line data is not available or comprehensive: household surveys are generally undertaken every few years rather than annually, and differences in design or execution hinder effective analysis of results. Information that could feed into policymaking is also based on poverty monitoring tools that assess the achievement of physical outcomes. Most of these are not linked to the budget information on financial execution, so it is difficult to link disbursements to service outcomes.

Links to decisionmaking. A key weakness is monitoring outcomes in developing countries is the missing link with decisionmaking processes.⁷ It is therefore important that the assessment of indicators is undertaken at the right time in the financial year. Typically the assessment needs to be sufficiently far into the financial year to ensure that statistics from the previous year have been collated and analysed, yet early enough to ensure that they can inform the priority setting and budget preparation

⁷ See “Beyond the Numbers,” Bedi, T. Coudouel, A. Cox, M., Goldstein, M. Thorton, N., World Bank, 2006.

process for the following year's budget. This is normally in months 4 to 6 of the financial year. To feed effectively into the policy cycle, indicators must be selective and well targeted to decisionmaking processes.

Conclusions

This paper has explored key issues of budget reform and some of the emerging messages. Underpinning all of these issues is that systems can only be strengthened and used effectively if there is a genuine desire within the country to do so. A key challenge in the reform agenda is to address the issues relating to the underlying incentives needed to create more predictable and reliable budgets that are more aligned with national priorities. External facilitation may help, but national consensus building is required to tailor the process to each country. The overview session and subsequent break-out sessions at the Hanoi Roundtable provide an opportunity to share experiences and identify best practice and appropriate ways to move forward.

Suggested Discussion Points

Budgets and Institutional Structures

What improvements in institutional arrangements do governments consider to have the greatest benefit, and how should development partners support these improvements? How to build broad-based consensus behind budget reform?

Multiyear Budgeting

There is considerable scope for the sharing of experiences among countries about how to develop a successful MTEF. What works and what should be avoided? Who should take the lead? To what extent is this a technical process, and to what extent a political process? What should be the role of central ministries, sectoral ministries, civil society, and donors?

Improving Public Finance Management

Used effectively, the PEFA approach should enable countries to monitor their PFM performance over time and benchmark it against regional comparators. Is this happening at present? Do countries believe that it is being applied in a positive manner or does it represent a return to externally imposed PFM monitoring, frequently linked to conditionality? How can ownership of the PEFA process be maximized at the national level, and linked to national strategies and processes? More specifically:

- Can countries take the lead in coordinating donors for more effective PFM system performance, as has been done in Tanzania, Uganda and Vietnam?
- Can countries develop their own, realistic PFM reform strategy reflecting their immediate reform needs, as has been done in Ghana and Tanzania?
- Can countries better harness all national resources, inside and outside of government, to build more effective, self-corrective, PFM systems?

Rewarding Results

What are the key challenges in introducing performance-based budgeting? What represents "good practice?" Are donors providing adequate support in this area?