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Improving the Links between National (and Sector) Plans and Budgets for Sustainable Development in Pacific Island Countries

A Practical Guidance Note

March, 2018

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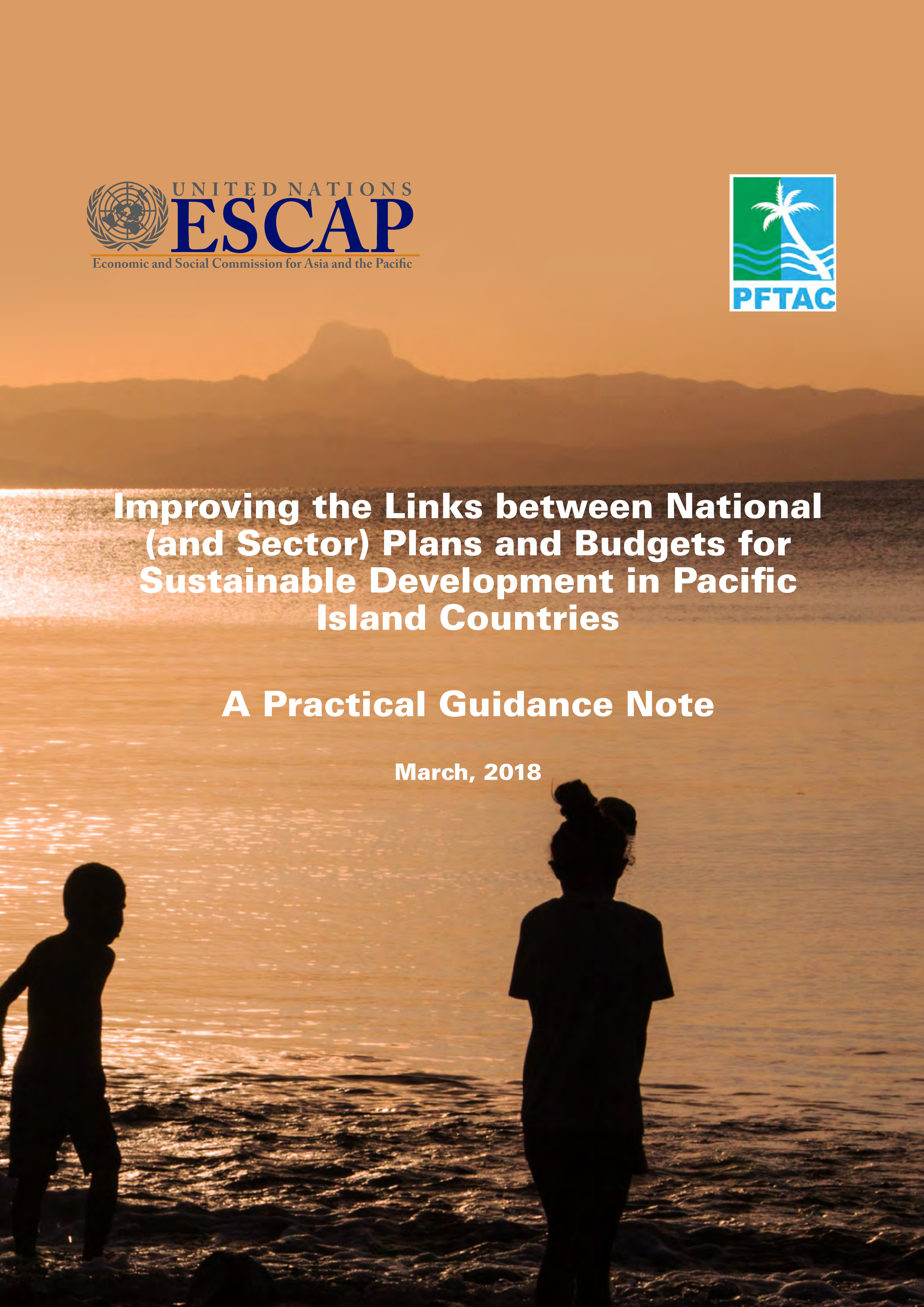

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1. Introduction and Purpose

Sustainable development requires the integration and balancing[1] of economic, social, and environmental considerations to best serve the public interest of current and future generations. To this end, public expenditure planning, and improvements in linking national development plans, sector plans and the budget are essential.[2] National and sector plans are important and remain a good policy guide for identifying development priorities, but they may be aspirational and are not meant to be implementation documents in themselves. Plans must be turned into action through the formulation of implementable policies and strategies, and linked to resource allocation through the budget process. National budgets (and their associated documents) are therefore the most powerful tool for governments to identify and implement policy priorities, create opportunities and deliver key services.

While development plans (both national and sectoral) have been produced by almost all Pacific Island Countries (PICs) over many decades, typically, these plans have been developed with few direct links to the annual budget process. This has resulted in limited resources allocated to planned priorities, and consequently there has been variable success in the achievement of development objectives. Poorly designed plans, for example, which may not necessarily reflect government priorities or are not feasible, compound the problem, as does the short-term horizon (usually the immediate fiscal year) of most budgets. Such issues combine to result in high opportunity costs in the use of resources available to countries. Strengthening the linkages between national and sector plans and national budget development has been recognised as a priority by PICs.[3] However, implementation across the region has been slow and remains in progress.

When planning and budget systems are well linked, several benefits emerge, including:

- a more coordinated implementation of planned priorities (aligned to government priorities, including the Sustainable Development Goals (SDGs)), and better development outcomes;
- improved accountability for performance by implementing departments/ministries; and
- informed monitoring of performance, to *inter alia*, allow for adapting resource allocations for improved delivery of national priorities.

This Guidance Note outlines selected areas of practice that could be applied in the Pacific context. It builds on findings of three regional workshops on medium-term expenditure planning for sustainable development, organised by United Nations Economic and Social Commission for Asia and the Pacific (ESCAP) Pacific Office and the International Monetary Fund-Pacific Financial Technical Assistance Centre (PFTAC) between 2015 and 2017.

Summaries of these Workshop discussions[4] indicate participants' interest in such guidance, and in tailoring methods and approaches to the regional context. The Guidance Note draws on other literature particularly that related to improving national systems as a means of implementing sustainable development priorities, and another published Guidance Note[5] that was primarily concerned with linking poverty reduction strategies and budgets.

1 The need for integrated and balanced policy making is recognised in key documents, including: the 2030 Development Agenda on Sustainable Development; Regional Roadmap for Implementing the 2030 Agenda for Sustainable Development in Asia and the Pacific; and the Pacific Roadmap for Sustainable Development.

2 A means of implementation recognised in: the 2030 Agenda for Sustainable Development; Pacific Roadmap for Sustainable Development; and United Nations Pacific Strategy 2018-2022.

3 Examples include: *Forum Eight Principles of Accountability,* adopted by Forum Economic Ministers' Meeting in 1997. Note *Principle 1,* is directly relevant and refers to: budget processes, including multi-year frameworks, to ensure Parliament/Congress is sufficiently informed to understand the longer-term implications of appropriation decisions. Refer also to *Medium Term Frameworks in Public Finance,* PFTAC Handbook, 2006.

4 Found at *http://www.unescap.org/subregional-office/pacific*

5 World Bank, 2008. Linking the PRS with National Budgets: A Guidance Note, PREM Poverty Reduction Group.

This Guidance Note focuses on three important aspects of the planning/budgeting linkage:

i. identifying the gaps in the planning and budgeting cycle;
ii. highlighting ways to strengthen the links between national and sector planning and the national budget cycle, particularly through the introduction of a strategic phase and a medium-term perspective into the budget process; and
iii. strengthening performance monitoring and reporting aspects of both plans and budgets.

Guidance provided is neither exhaustive nor intended as a blueprint. Rather, selected key strategies/tools/guidelines are offered to help practitioners identify country-specific challenges, options and paths for improvement.

Initial country conditions (including public financial management and planning systems and implementation capacities), require consideration to allow for stepwise and sustainable improvements. The current state of planning and budgeting systems in the PICs is of variable quality. While each country situation is not discussed in this Guidance Note, the typical gaps, issues and constraints in PIC national planning and budgeting systems are clearly outlined. In this context, measures highlighted in this Guidance Note are broadly applicable. However, tailored and country specific actions are needed, and must be paced and sequenced, to fit local realities. As such, this Guidance Note attempts to highlight overall objectives and offers options for incrementally improving practices.

Each section of the Guidance Note covers a short introduction; a review of typical issues and problems; a commentary on emerging good practice; and options to be considered. Each section concludes with a series of self-diagnostic and improvement questions to provide a basis for adapting ideas and methods to national context.

2. Identifying the Gaps between Planning and Budgeting

Disconnects exist in nearly all planning and budgeting processes. These gaps, issues and constraints, which have been well documented, are summarised in the following paragraphs and suggestions to assist in addressing these gaps and issues are discussed.

a) Identifying the Gaps, Issues and Constraints

Gaps and weak links exist in planning and budgeting systems in most PICs. Typical issues include:

National and sector planning

- overly aspirational national and sectoral plans, paying insufficient attention to national capabilities, capacities and the availability of financial resources for implementation;
- national plans do not clearly analyse the principal challenges facing the country, hence strategic priorities are not identified accurately. A common symptom is that plans are development partner orientated, and often prepared with technical assistance from donor-funded consultants;
- no clear prioritisation in sector plans, and weak links at the strategic level to the priorities in the national plan;
- weaknesses in analysing and costing policies and priorities, meaning human and financial resources needed for implementation are not accurately identified;
- fixed-term plans that do not account for contemporary or emerging challenges and issues, which are often, therefore, ignored;

Budget systems and processes

- failure to ensure budgets reflect the identified national/sector priorities within a resource-constrained macroeconomic framework;
- poor budget management controls that do not ensure: a) budget expenditure, both capital and recurrent, is in line with approved allocations; and b) that results and deliverables are measured, monitored and fed-back into the policy and planning cycle;
- an absence of medium-term expenditure frameworks (MTEF) and well-costed and policy-aware forward estimates that account for policy decisions and the potential effects of demographic flows (e.g. growth in the number of school-age children; increases in the number aged citizens) on service delivery and investment plans;
- no systematic process for preparing, submitting, costing, reviewing, or prioritising proposals for new projects/activities from individual ministries regardless of funding source. Donor funding is often not captured in line ministry proposals and national budget documents;
- failure to consider medium-term cost requirements to operate approved capital projects or fully implement policy changes requiring several years to reach maturity;
- unrealistic budget estimates (revenues and/or costs are either under or over-estimated) reduce the credibility of the budget leading to supplementary processes, budgets then fail to be implemented as initially planned;
- budget documents have limited reference to planned priorities (and mostly contain estimates) and little narrative to explain use of current (and future direction) of estimated revenue and expenditure;

Institutional structures and decision making

- weak institutional links and coordination between the national/sector planning functions and budget functions within government, exacerbated by the common practice of separating planning and budgeting departments/ministries/staff resources;
- proposals tend to be raised and decided at any time of the year with no consideration or review by the Ministry of Finance, resulting in Cabinet and line Ministry decisions being taken without full consideration of priority among all active proposals, or the budget adjustments that may be needed to fully implement previous decisions;
- inadequate time devoted by Cabinet to discussing budget realities and deciding development priorities; and
- disconnect between performance indicators for national/sector plans and the measurement of service delivery, and budget monitoring and expenditure management.

These gaps and weaknesses in planning and budgeting systems are summarised in *Figure 1*.

Figure 1: Summary of gaps and weaknesses in planning and budgeting systems[6]

Although overall progress has been made by PICs to improve public financial management (PFM) systems and processes, only limited progress has been made in linking planning and budgeting mechanisms. Major contributing factors to this challenge include:

i. ownership over different instruments and processes is strong only in lead agencies (due to separate institutional arrangements), and weak elsewhere within government. For example, the planning agency normally leads the process for the preparation of the national plan; at the sector level, the responsible line ministries will lead the development of sector plans and strategies; while the formulation of the annual budget and MTEF (if one exists) will be led by the Ministry of Finance;
ii. consultative processes between the various ministries and agencies are not always strongly institutionalised. Budget processes tend to be based on competitive bids for resources between sectors and ministries thus providing little incentive for coordination;

6 World Bank/ PFTAC, 2013. Planning Public Financial Management Reforms in Pacific Island Countries.

iii. budget development processes are often weak in dealing with cross-cutting issues such as climate change, disaster risk management and gender where many agencies have important roles;
iv. both budgeting and planning may be viewed as largely "technical" processes, the products of which are presented to Cabinets for decision-making. Greater Cabinet involvement in learning, discussing, and prioritising in a disciplined manner needs to be instituted; and
v. no central coordinating agency/function exists, with a sufficiently strong mandate to lead and strengthen the links between stakeholders and processes.

b) Towards Stronger Links between Planning and Budgeting

Experience in the Pacific region has indicated important lessons towards overcoming these weaknesses and gaps in planning and budgeting processes, in particular:

i. improving domestic ownership of the reform agenda which extends beyond the Ministries of Finance to sector ministries/departments, Cabinet, and, where appropriate to Parliament, the private sector and civil society;
ii. building strong institutional connections between planning and budgeting – best done through strong political leadership and a clear coordinating mandate for one ministry/department;
iii. resourcing and reorganising central agency (Ministry of Finance) staff into sector groups (education, health etc.) with combined responsibilities on budget analysis, planning and resource mobilisation;
iv. ensuring sector ministries/departments produce more accurate and realistic estimates of resource requirements and are cognisant of relative priorities and capacity to implement;
v. improving budget documents to contain a narrative on direction of current and future expenditure estimates, including information on medium-term cost changes due to demographic factors, full implementation of projects/policies approved in the past, and new approved projects or policies;
vi. mandating all policy/project proposals (included those externally funded) to have reviews of budget impact before consideration by Cabinet for decision; and
vii. instituting effective and inclusive coordination and reporting processes at all levels.

As a general rule, successful reforms to integrate planning and budgeting are incremental rather than major. They build on existing systems and processes. In addition to lessons from the good practice identified above, broader experience globally[7] and in the Pacific[8] indicates improving integration involved the following additional measures:

i. ensuring core PFM systems of budgeting, internal controls, accounting and reporting are in place, helping to ensure overspending does not occur and avoid supplementary estimates;
ii. complementing PFM systems with a sound macroeconomic framework, based on national priorities, enabling realistic expenditure allocations across all spending agencies;
iii. establishing a realistic overall fiscal ceiling provides a platform for credible resource allocations to spending ministries/agencies;
iv. strengthening cabinet involvement in strategic decision-making around the planning and budgeting cycle, often through the establishment of cabinet committees;
v. demanding accountability at the level of spending authority and responsibility;
vi. using 2-3 year rolling plans, with overall vision and goals at national and sector levels, revised annually into a more policy focussed medium-term budget document;
vii. introducing greater discipline into fiscal review processes for medium-term costing of policy changes/ new projects (regardless of funding source), including a mandatory Ministry of Finance assessment; and
viii maintaining information on costings of adopted policies/projects, including cost changes resulting from demographic flows, and using that information to set budget ceilings.

7 World Bank, 2008. Linking the PRS with National Budgets: A Guidance Note, PREM Poverty Reduction Group.
8 PFTAC, Ron Hackett, 2015. Tasks/Products of a Properly Functioning Integrated Budget/Planning Organization.

c. Self-Diagnostic and Improvement Questions[9]

These questions are intended to assist in understanding gaps and weaknesses in the planning and budgeting cycles, and identify applicable measures for improvement.

Links between national and sector planning documents

- Is there one overarching national planning or strategy document which has been approved/endorsed at the Cabinet level?
- Do other national strategy documents exist in addition to the approved national plan? If so, do these other strategies have distinct mandates or roles, or is there overlap?
- Does the national plan reflect the priorities of sector plans, policies and strategies and vice versa?
- Have all initiatives and activities proposed in the plans been fully costed?
- Are sector plans/strategies in place? Do these reflect national priorities?
- What consultative/coordination mechanisms were used in their preparation?
- Are both national and sector plans and strategies prioritised, costed and linked to an MTEF?

Links between planning and budgeting

- Is there a MTEF that is regularly updated and used as the underlying basis for the annual budget process?
- Do institutional links between national/sectoral planning, the MTEF and the annual budget exist?
- Do planning and budget staff meet regularly to discuss issues? Do these processes need to be strengthened and better coordinated? How can this be achieved?
- Are all new policy decisions costed and communicated to the Ministry of Finance for incorporation into the MTEF and national budget?
- Do MTEF allocations reflect costs to fully implement all approved policies/projects (at minimum) and any new policies/projects recommended by Government for start-up? Do annual budget allocations reflect the first year of the MTEF?
- Is there alignment between the national and sector planning cycles and the budget cycle?

Ownership of the institutions of budgeting and planning

- Which stakeholders are involved in planning, budgeting, and accountability (including monitoring and reporting)?
- Is there a mechanism in place for consultation among these stakeholders? If so, is the consultation mechanism a regular and institutionalised process in the budgeting and planning cycles? Do they talk to each other and share information in an agreed form that all stakeholders understand?

9 World Bank, 2008. Linking the PRS with National Budgets: A Guidance Note, PREM Poverty Reduction Group.

3. Introducing a Strategic Phase and a Medium-Term Perspective to the Budget Process

Introducing a strategic phase and a medium-term perspective into the budget process can foster a greater appreciation of priorities, and assists in building stronger links between planning and budgeting. It specifically reviews national and sector plan priorities and new policy initiatives. These can then be framed within the overall budget context. A strategic phase in the budget process also assists in facilitating the prioritisation of competing policy initiatives and helps to reconcile costs to available resources. It also enables more detailed scrutiny of budget proposals by sector ministries, the ministry of finance, and political decision makers.

a) Typical Issues in PIC Budget Systems[10]

Providing the overall budget is realistic, the next key requirement is to ensure it is comprehensive and executed credibly. This depends, most crucially, on the controls required to maintain fiscal discipline, as well as the overall quality of the PFM system, particularly the areas of budget execution and the predictability and timing of funding releases. Most PICs have achieved significant improvements in budget execution in recent years with support from a range of development partners, particularly PFTAC which is tasked to coordinate Public Expenditure and Financial Accountability (PEFA) assessments, and associated reforms under the Public Financial Management Roadmap for the Pacific, endorsed by the Forum Economic Ministers in 2010.[11]

While budget execution has improved, the typical budget processes in PICs (refer to *Box 1*) tend to lack integration with policy or planning decisions. There is often a lack of consideration of strategic priorities, or prior commitments, in the budget cycle. Therefore, there is less incentive for sector agencies to fully engage in the detail of budget preparation. Moreover, the preparation of the budget submission is often left to mid-level officials who may be unaware of all the policy decisions taken at a higher level that affect the budget. This situation is exacerbated in the absence of costed national and sector plans; lack of performance measures; a MTEF; and/or budget documents that contain little or no narrative discussion of current and future costs. Shortcomings in the preparatory phase of the budget process tend to undermine the opportunity to make clear plan and budget linkages.

Box 1: A description of a common budget processes in PICs

The focus of most ministries and spending agencies is on budget inputs – how much has been allocated in the budget and how much is available to be spent – rather than what is planned, or has been delivered in terms of service levels or quality.

The focus on inputs derives from the underlying budget process. In many PICs the Ministry of Finance develops the annual budget resource framework in isolation from sector ministries and with limited Cabinet consideration of strategic issues and priorities. A budget circular will usually be sent to all ministries informing them of the overall budget framework and resource ceiling for the coming fiscal year. Often, this will also give a general guide to all agencies that they should not expect more resources than in the previous year.

10 World Bank/ PFTAC, 2014. Planning Public Financial Management Reforms in Pacific Island Countries.

11 PFTAC/ Pacific Islands Forum Secretariat, 2010. A Public Financial Management Roadmap for Forum Islands Countries.

Typically, sector ministries and departments (and other spending agencies) then submit separate proposals for recurrent and capital expenditure which often include unrealistic (or unsubstantiated) budget bids, including for new policy initiatives. Such unrealistic bids may arise from a lack of considered review and/or sound costing of new policy interventions. Finance/planning ministries then, often seemingly arbitrarily, adjust the budget allocations of each ministry/agency to fit within the fiscal ceiling. These adjustments (frequently reductions) are often accomplished through an across-the-board standard adjustment, with little or no consideration of the underlying needs or priorities of the individual ministries.

Consequently, each ministry or department tends to receive a standard increment/decrement on their recurrent budget from the previous year, and a separate development budget allocation made up of a list of projects. The development budget is often dominated by development partner-funded projects, with scarce domestic resources dedicated to counterpart funding requirements and often inadequate consideration of future maintenance and operational costs.

Human resources costs, statutory expenditure, external commitments, subsidies to SOEs and debt servicing are often the only "protected" components of agency budgets. These "protected" costs can account for around two-thirds of the total budget leaving only one-third of the budget to cover all other operational costs. This leads to the burden of budget adjustments (reductions) falling on general operating costs and development and capital expenditure (particularly asset repair/replacement). It also means that there are few resources available for new initiatives.

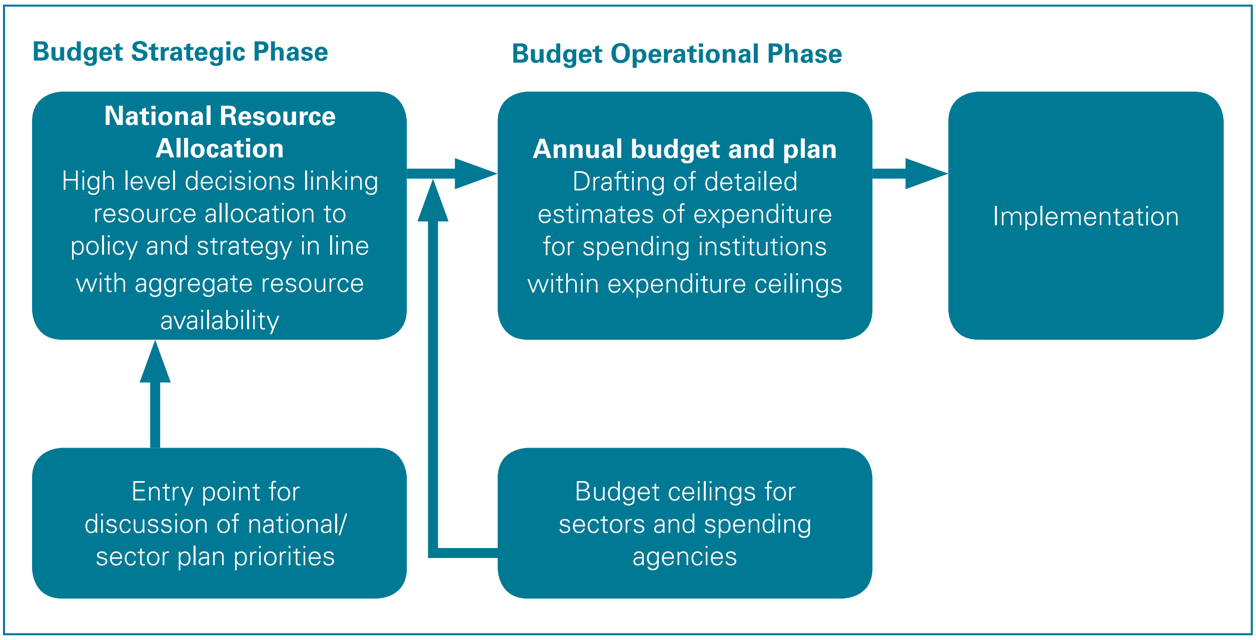
Once the adjustments have been made a consolidated budget proposal, which is generally compiled by the Ministry of Finance, is then forwarded to Cabinet and Parliament for approval - sometimes without further reference to sector agencies. This process may provide only a narrow window-of-opportunity for effective review and consideration by Ministers. Further, the draft budget may be presented to Cabinet only a week or two before it is tabled in Parliament. The scope for change in the budget is therefore limited, and the draft budget may be presented to Cabinet for virtual "rubber-stamping" towards the end of the budget cycle. There is, therefore, often little detailed overall Cabinet review of new policies/initiatives or priorities within the national/sectoral planning frameworks. Thus, while the budget bill is debated in Parliament the scope to change allocations is limited.

In practice, sector agencies can only make relatively incremental changes to their recurrent budgets and have limited control over their investment choices. This compounds the ability of agencies and Ministries to link resource allocations to specific policies, or to the implementation of comprehensive national/sector plans.

b) Towards a More Effective Budget System

The current approaches to PIC budget formulation tend to lack a strategic phase. A strategic phase, early in the budget process, assists to link the national/sector plan policies and priorities to the budget. These two phases in the budget process, led by the strategic phase is shown in schematic form in *Figure 2*.

Figure 2: Schematic form of the two phases in the budget process[12]



During the strategic phase, the Cabinet (in conjunction with ministry heads) needs to consider the following issues:

- review the macroeconomic situation and expected economic and demographic drivers;
- cost requirements for past approved projects/activities for the coming fiscal year and at least the following two fiscal years (such a review must be done with clear explanations of the fiscal situation, special issues/problems facing individual ministries, national/sectoral priorities, and other statutory and external commitments);
- agree an overall annual fiscal ceiling and individual budget ceilings for all agencies;
- identify priority expenditure areas based on national/sectoral priorities, for example, in health and education; and
- highlight any new policy decisions already taken that would impact on the forthcoming fiscal years.

Improved information, a better understanding of the underlying fiscal parameters and greater discipline to maintain agreed ceilings, will provide less motivation for spending ministries and agencies to engage in ad hoc bidding and irresponsible requests during the preparatory phase of the budget. There will also be a greater incentive to allocate resources effectively towards the achievement of policy objectives.

c) Medium-Term Expenditure Framework (MTEF)

An MTEF assists in integrating priorities into the budget process by taking into account the multi-year nature of most development, and cross-cutting, activities.

Given capacity challenges in PICs, a full MTEF process may not be immediately feasible and a phased approach will be needed. Whatever the approach, the critical issue is to ensure that a medium-term budget outlook is formulated, and that it includes consideration of all committed (current and future) policy and investment initiatives. Furthermore, with significant reliance on development assistance in many PICs, it is important that the MTEF process factors in development partner funding commitments.

12 World Bank, 2008. Linking the PRS with National Budgets: A Guidance Note, PREM Poverty Reduction Group.

Combined with the introduction of a strategic phase in the budget process, consideration of future expenditure commitments (even in a "lite" MTEF approach), can achieve greater coordination and integration of planning and budgeting systems.

The purpose and key elements of a MTEF are outlined in *Box 2*.

Box 2: Purpose and structure of medium-term expenditure frameworks[13]

A MTEF should incorporate realistic projections of spending by individual ministries and other agencies under the national budget. These projections should reflect the costs of implementing the policies/projects that are either already approved or committed to by the Government, with appropriate recognition of cost impacts from future anticipated demographic changes. The projections should also include consideration of future development assistance flows, as well as the domestic revenue envelope. Finally, projections should be consistent with identified priorities within national and sectoral plans.

Achieving this requires a consultative and carefully considered process for allocating resources between competing agencies in line with clear priorities over a multi-year horizon.

The allocation of resources within the overall budget therefore aims to:

- support macro-fiscal stability (country maintains a steadily increasing level of economic activity, while avoiding high inflation, unsustainable debt levels and volatility in exchange rates);
- meet the increasing demands for public services within a general environment of fiscal constraints; and
- promote cost-effectiveness, value-for-money and higher levels of productivity of public expenditure.

A MTEF then extends this analysis with more detailed costing within sectors supported by performance indicators and measurement. When fully implemented, MTEFs can help to:

- identify and promote incentives for better, more cost-effective, public-sector performance;
- shift government bureaucracies from an administrative to a more managerial culture; and
- ensure that national and sectoral plans are effectively incorporated into a realistic forward-looking budget by linking costed plans within an affordable budget envelope.

A key element of MTEFs is that projections of both capital and recurrent expenditure can be captured, rolling forward from year-to-year, over a two to three year time horizon.

Establishing MTEFs can be difficult unless there is a full understanding of what the MTEF aims to achieve, and stakeholders are clear of respective roles in implementing the MTEF.

13 PFTAC, 2016. Medium Term Frameworks in Public Finance, Handbook No.1.

MTEFs also require effective public financial management and planning systems, with associated implementation capacity in place. Here, three issues are crucial to the likelihood of success:

i. improving ability to reliably determine the size of the "budget envelope" over the medium-term. Many PICs face uncertainty in forecasting non-tax revenues including fishing licences and other resource-based revenues which form a large proportion of budget revenues. Difficulties also exist in forecasting aid flows which are important in supporting current and capital expenditure in many PICs;
ii. ensuring that national and sectoral plans use common assumptions (e.g. in relation to inflation, public-sector wage rates and demographic change) helps forward budget estimates to be realistic; and
iii. capturing and managing political-economy considerations and pressures to achieve informed decision-making within fiscal constraints, ensures resources are targeted towards national priorities.

A MTEF requires sector ministries to prepare budget proposals, setting out what is achievable given the medium-term resource allocations. During the preparation of these proposals, bottom-up costing of sector policies and strategies will help answer two questions:

i. what are sector ministries currently delivering, and what will it cost financially and in other resources, to maintain this level of delivery over the medium-term?
ii. what will be the costs associated with implementing new approved policy objectives and/or expansions in existing services?

The results from PEFA assessments in the PICs, show very low ratings on the development and implementation of multi-year perspectives in fiscal planning and budgeting. Practices contributing to these low ratings, and workable solutions are summarised in *Box 3*.[14]

Box 3: Summary of PEFA findings in PICs

Practices that diminish expenditure quality	Solutions to improve expenditure quality
Notions that planning and budgeting are separable processes.	Integrate planning and budgeting processes, documents and staff teams.
Separation of recurrent and development budgets.	Integrate the relevant processes, documents and staff teams.
Undisciplined Cabinet procedures, particularly, approving policy changes throughout the year without fiscal reviews or medium-term prioritisation.	Require Ministry of Finance 'budget impact reviews' of all proposed Cabinet policy advice, considering: • immediate and longer-term costs of the proposal and opportunities for revenue raising; and • effect on the medium-term fiscal balance.

14 ESCAP Pacific Office/ PFTAC, 2016. Summary of Workshop on Expenditure Planning for Sustainable Development. Found at http://www.unescap.org/subregional-office/pacific

Inadequate time for Cabinet/Parliament debate on budgets, underlying policy objectives, and long-term impacts.	Start budget process earlier, including introducing a strategic phase, to give attention to medium to longer-term objectives.
Multi-year focus not taken seriously by Cabinet/Parliament.	All advice to Cabinet reviewed relative to medium to longer-term consequences on priority national goals.
Numerous supplemental budgets for non-emergency matters and consequent reallocations.	Final action on all non-emergency proposals delayed until annual budget preparation so they can be properly weighed and prioritised in the context of: • longer range plans to develop and maintain critical infrastructure and improve public services; • previously adopted policies with "built-in" cost increases; and • new policy proposals that have arisen during the year.
Lack of proper commitment controls forces reallocation during the year to cover costs incurred by overspending.	Greater use of the commitment control capabilities of financial management information systems.
Diversion of appropriations for other purposes than originally intended.	Careful monitoring to limit reallocations.
Procurement system failures and rent-seeking behaviours.	Raise transparency in processes, including requiring start-of-year procurement plans with publicly-available estimated prices for services.

While a MTEF can be a valuable tool to facilitate the discussion and consideration of priorities during the strategic phase of the budget process, preparing a MTEF of reasonable standard requires significant effort and should not be embarked on lightly.

Some PICs have already introduced MTEFs including with a view to trying to better link planning and policy to the budget. But incentives and capacities to use the MTEF as a rolling budget framework are often weak. In those PICs where MTEFs are purportedly in place, a few key problems are evident,[15] including:

- a three-year time horizon is usually adopted simply as an extension of the current year's budget with an inflationary factor for the out-years; and
- often little attempt is made to undertake an assessment of the future policy agenda (which requires costed sector policies and strategies, and clarity over national and inter-sectoral priorities).

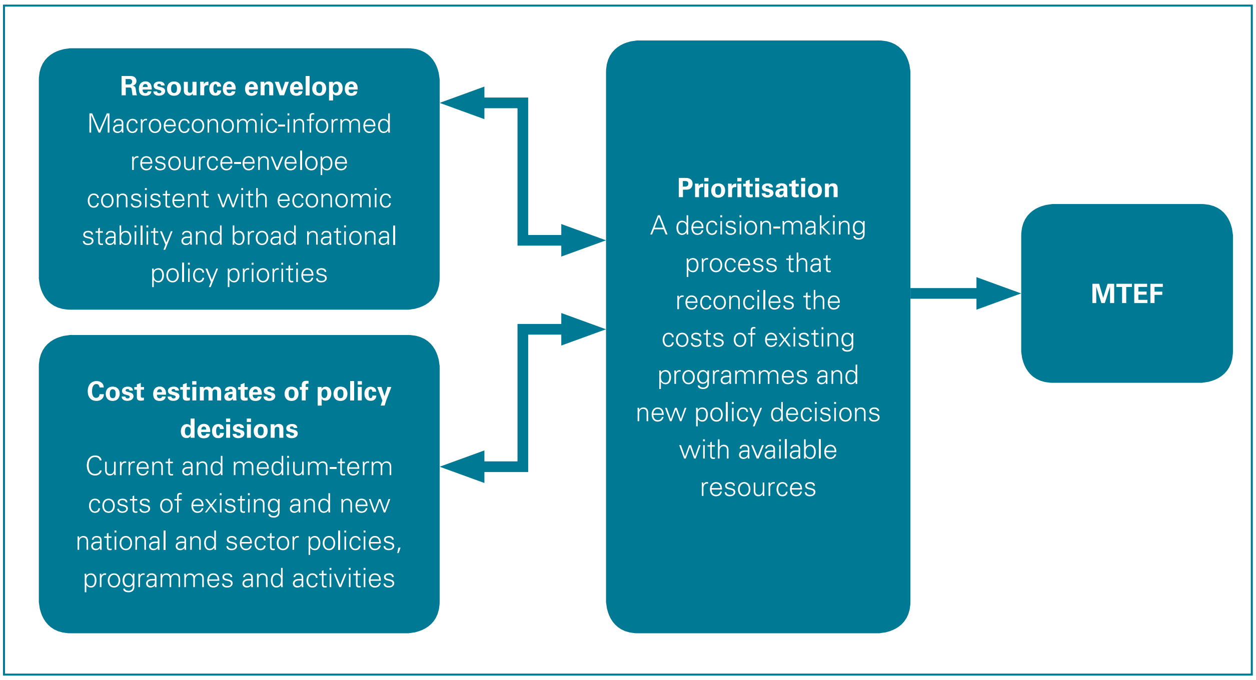
A strategic phase of the budget process, combined with the use of an MTEF can help to translate longer-term policy and plan objectives into shorter-term resource allocation decisions.

15 PFTAC, 2016. Medium Term Frameworks in Public Finance, Handbook No.1.

As indicated in *Figure 3,* the introduction of a "strategic-phase" in the budget will lead logically to the development of a MTEF. This process will usually involve three stages:

i. top-down process of estimating available resources over the medium-term;
ii. bottom-up process of estimating the cost of achieving policy objectives; and
iii. final reconciliation of costs with available resources.

Figure 3: Medium-term perspective in the strategic phase of the budget[16]



The following three steps outline how the addition of a strategic phase to the budget process, combined with a MTEF, could help to strengthen links between planning and budgeting.

Step 1: Estimating top-down budget ceilings for a MTEF

The Ministry of Finance should prepare an estimate of the overall resource ceiling for the medium-term (two to three years) which is consistent with a medium term fiscal policy framework and sound macroeconomic projections.

The overall resource ceiling should be disaggregated into an initial set of multi-year budget ceilings for sector ministries and agencies. These need to consider the costs of:

- legal obligations (e.g. debt service);
- implementing projects/policies already adopted by government;
- responding to demographic pressures to maintain service quality and costs of inflation; and
- new policies/projects contained in national/sectoral plans approved by government should be identified.

As a MTEF involves rolling baselines, once established, projections in the previous year's MTEF can form the basis of these initial budget ceilings.

16 World Bank, 2008. Linking the PRS with National Budgets: A Guidance Note, PREM Poverty Reduction Group.

Step 2: Sector strategies and bottom-up costing

Although national plans, almost by definition, require central agreement of policy objectives and priorities, sector level processes are an important mechanism in developing ministry/agency ownership and accountability. Key elements include the:

- development of sector strategies and/or plans, which clearly link recurrent and development spending to outputs and outcomes; and
- costing of (and assessment of capacity to implement) these strategies and/or plans.

Whilst thorough costings are an important input into the budget process and medium-term planning, it can be overly burdensome in terms of the analytical capacity and resources available to PICs. Focussing the strategic phase on priority service delivery sectors, e.g. health and education, can mitigate this, and consideration can then be made as to whether the introduction of the full costing exercises is warranted in other sectors, recognising the constraints faced.

Once a MTEF is established, sector ministries (initially, perhaps only key ministries such as health and education) should prepare medium-term budget proposals outlining what is realistically achievable given the medium-term resource allocations. Bottom-up costing of sector policies and strategies helps answer two questions in consideration of these proposals:

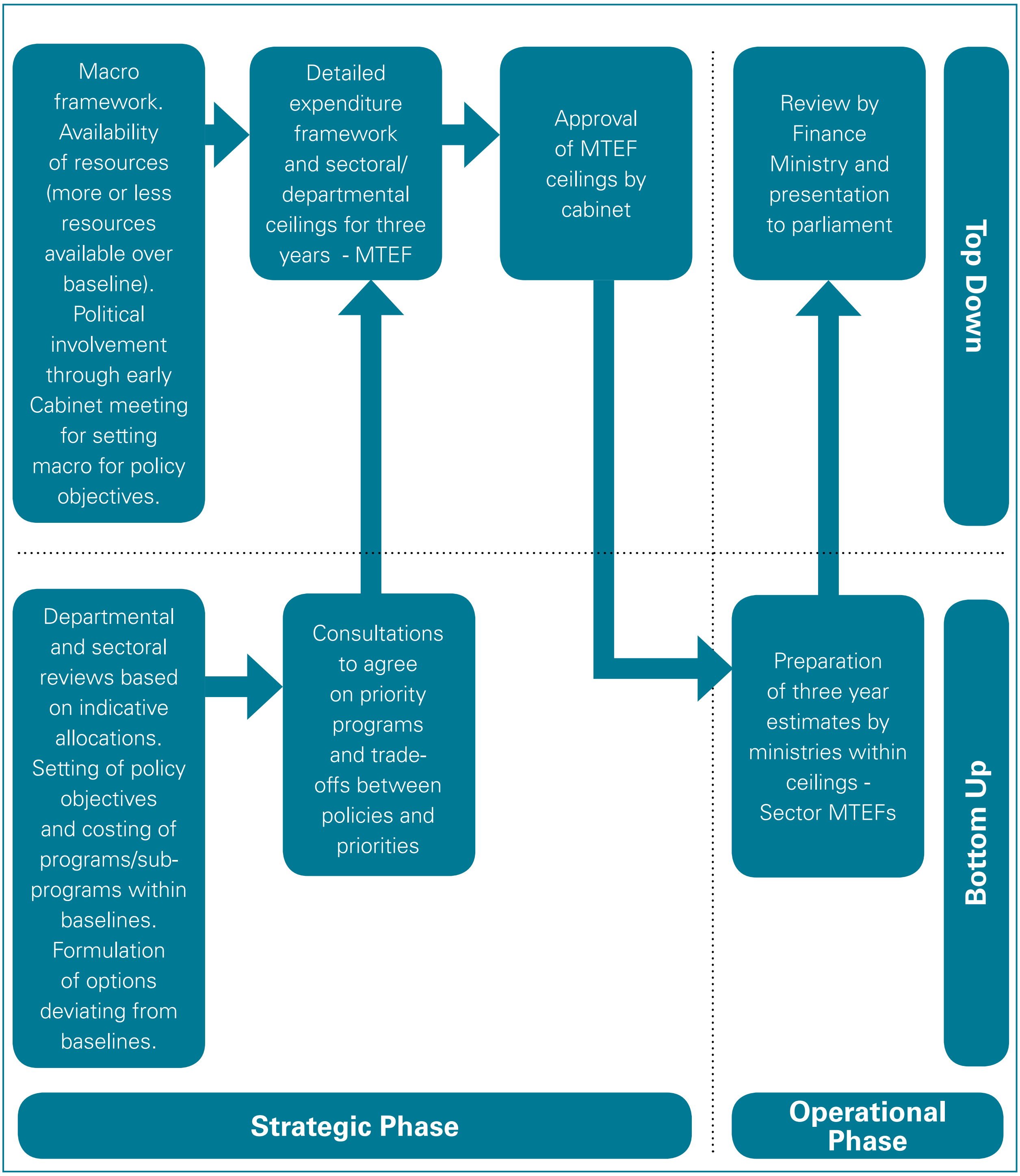
i. What services/activities/investments are sector ministries currently delivering and what will it cost to maintain this level of delivery over the medium-term?
ii. What is the cost of achieving any new policy objectives or expanded services?

Step 3: Reconciling priorities and costs with available resources

The strategic phase in the budget process needs to reconcile the cost of delivering services with budget ceilings.

Figure 4, depicts a schematic form of the budget cycle utilising policy processes to reconcile sectoral objectives with limited resources. Budget hearings, conducted between the finance ministry and sectoral ministries, help to scrutinise spending plans and promote agreement on priorities.

Figure 4: Combining the strategic phase of the budget process and the MTEF[17]



17 World Bank, 2008. Linking the PRS with National Budgets: A Guidance Note, PREM Poverty Reduction Group.

d) Self-Diagnostic and Improvement Questions[18]

These questions are intended to assist in understanding current gaps and weaknesses and to identify improvements that may be applicable to implement a strategic phase and medium-term perspective of the budget.

Strategic phase in the budget process

- Are senior officials (including those in finance and line ministries) and members of Cabinet provided with the medium-term costs of: i) delivering on projects/activities already promised; and ii) maintaining the quality of service delivery, considering demographic changes and macro-economic conditions?
- Are links between planning and budget allocations addressed, and, if so, at what stage in the budget process is this done?
- Is there a strategic phase in the budget process, i.e. does the Ministry of Finance hold strategic consultations with sector ministries on the over-arching macroeconomic/fiscal framework together with the national/sector priorities and other commitments?
- Are sector ministries provided with budget ceilings to prepare the detailed budget estimates, or do they bid ad-hoc for resources?
- If ceilings are provided, are they derived from a strategic phase which allocates resources according to performance and policy priorities?

Medium-term perspective

- Is there a rolling macroeconomic framework which projects the resources available to the public sector over the medium-term?
- Is the macroeconomic framework translated into indicative budget ceilings for sectors ministries?
- Are sector strategies in place? Are sector strategies costed and are these costings realistic given the availability of resources?
- Does the budget document provide medium-term estimates at the activity level, at least for important basic services (e.g. primary and secondary education, public health, and medical clinic services)?
- Do the estimates make it clear what funding changes are due to demographic changes, past decisions, inflation, or new policy proposals?
- Does the budget narrative clearly explain the direction of current and future expenditure and linkages to planned priorities?

Reconciling resources with costs

- Is there a process of consultation between sector ministries and the Ministry of Finance on medium-term sector spending plans?
- Does this involve rigorous scrutiny of proposals and spending options?
- Is there a medium-term budget strategy document prepared by the Ministry of Finance to facilitate decisions by Cabinet?
- Does that strategy present explicit expenditure choices, and are they linked to the achievement of stated policy objectives?

18 World Bank, 2008. Linking the PRS with National Budgets: A Guidance Note, PREM Poverty Reduction Group.

Ownership

- At what stage in the budget cycle do sector ministries and Ministries of Finance and/or Planning consider budget proposals? Is consensus on priorities reached early in the process?
- Are there committee structures within Cabinet and Parliament to facilitate engagement in the budget process?
- How much time do Cabinet and Parliament have to scrutinise proposals?
- Is the layout of the budget document easy to understand by citizens in terms of clearly connecting policy promises with funding decisions? Are wider public and civil society stakeholders consulted?

Improvement questions

- Does the budget process need to be adjusted to allow space for strategic phase involving prioritised resource allocation and improved medium-term perspectives? If so, how?
- How should sector strategies and costing at the sectoral level be strengthened? Should incremental phases be adopted, targeting major spending sectors, for example, education and health?
- What steps can be taken to ensure effective reconciliation of available resources and costs of new policy decisions?

4. Measuring Performance of Plans and Budget Implementation for Informed Decision-Making

Appropriate performance measures of plans tied to budget allocations can help to strengthen the links between planned priorities, resources and results, and highlight trade-offs between expenditure choices. It also has the potential to strengthen accountability, especially if the budgets of sector ministries are clearly linked to the results and services they are expected to deliver. Integrated indicators for measuring both plan and budget performance can improve monitoring and reporting quality, and reduce duplication.

a) Typical Issues

Institutional separation between national/sector plans and budget reporting mechanisms is common in most PICs, evidenced by:

i. budget reporting which is usually limited to monitoring expenditure against allocations and led by finance ministries. Such reporting focuses on aggregate expenditure, expenditure against the budget allocation by agency and type (e.g. salaries, wages). It is difficult to ascertain the effectiveness of actual expenditure on specific policy and planned priorities within individual sectors; and
ii. national/sector plan reporting which is led by planning agencies and sector ministries, and typically focuses on broad development outcomes, without drawing any strong links between these outcomes and government spending.

Given these circumstances, there are often gaps in the monitoring and reporting processes between: i) the national and sector plans; and ii) between these plans and the budget. The three principal weaknesses in performance monitoring in PICs are:

i. lack of appropriate and comparable indicators in both the plans and the budgets. For instance, indicators may not be specific, measurable, achievable or relevant. More so, inconsistent indicators can mean an increased burden of reporting of similar indicators on different bases with little added-value in terms of performance reporting. To this end, contextualised development indicators (including relevant Sustainable Development Goal indicators) could offer specific budget and planning outcome indicators in many cases, and have been already applied in some PICs;
ii. lack of capacity to collect, apply and analyse indicators (and partial and proxy measures) and to report on performance; and
iii. limited use any performance measures to inform future planning and budget development.

While there are internal requirements for production of annual budget reports (all PICs have statutory requirements to present financial statements to Parliament), the demand to produce national/sector plan progress reports often tends to be driven primarily by the need to satisfy international reporting and development partner requirements. The challenge of integrating national/sector plans and budget reporting is not therefore simply a technical one, but depends also on the political and policy incentives to produce and use such information.

b) Strengthening the Links between Budget and National/Sector Plan Reporting

An important step in building stronger links between budget and national/sector plan reporting mechanisms is to review the current systems for:

i. What can be measured and monitored?
ii. What is being measured and monitored - plans or budget performance or both?
iii. Which stakeholders are involved in each aspect of reporting?

Several initiatives in both the planning and budgeting processes are needed. For instance, greater results orientation into budgeting can be introduced by taking gradual yet decisive steps. These steps include:

i. sector ministries identifying their results as part of the budget process. The identification of these results should provide decision-makers with two key insights:

   - in the strategic phase (described earlier), results should indicate what spending ministries and departments plan to achieve with their budget allocations (in terms of service standards and delivery performance) over the next fiscal year (and subsequent two to three years of a MTEF); and
   - during the operational phase, ministries and departments should identify the quantity and quality of core services to be delivered utilising the annual budget allocations. By promoting a transparent link between public spending and services, the identification of results can facilitate the oversight functions of the Ministry of Finance, Cabinet and Parliament.

ii. identifying a set of common and comparable indicators for both plans and budgets. Commonality of indicators will enable any associated monitoring and evaluation framework to track both plan and budget performance in an integrated manner (rather than as parallel processes). In addition, the development of common indicators will help focus performance on both deliverables as well as finances, thereby supporting consideration of resource efficiency and cost-effectiveness. These indicators should:

   - be specific, measurable, and relevant; and
   - include specific localised indicators (and/or partial and proxy measures) with aim to measure national development priorities (and where applicable other international reporting commitments, including Sustainable Development Goals).

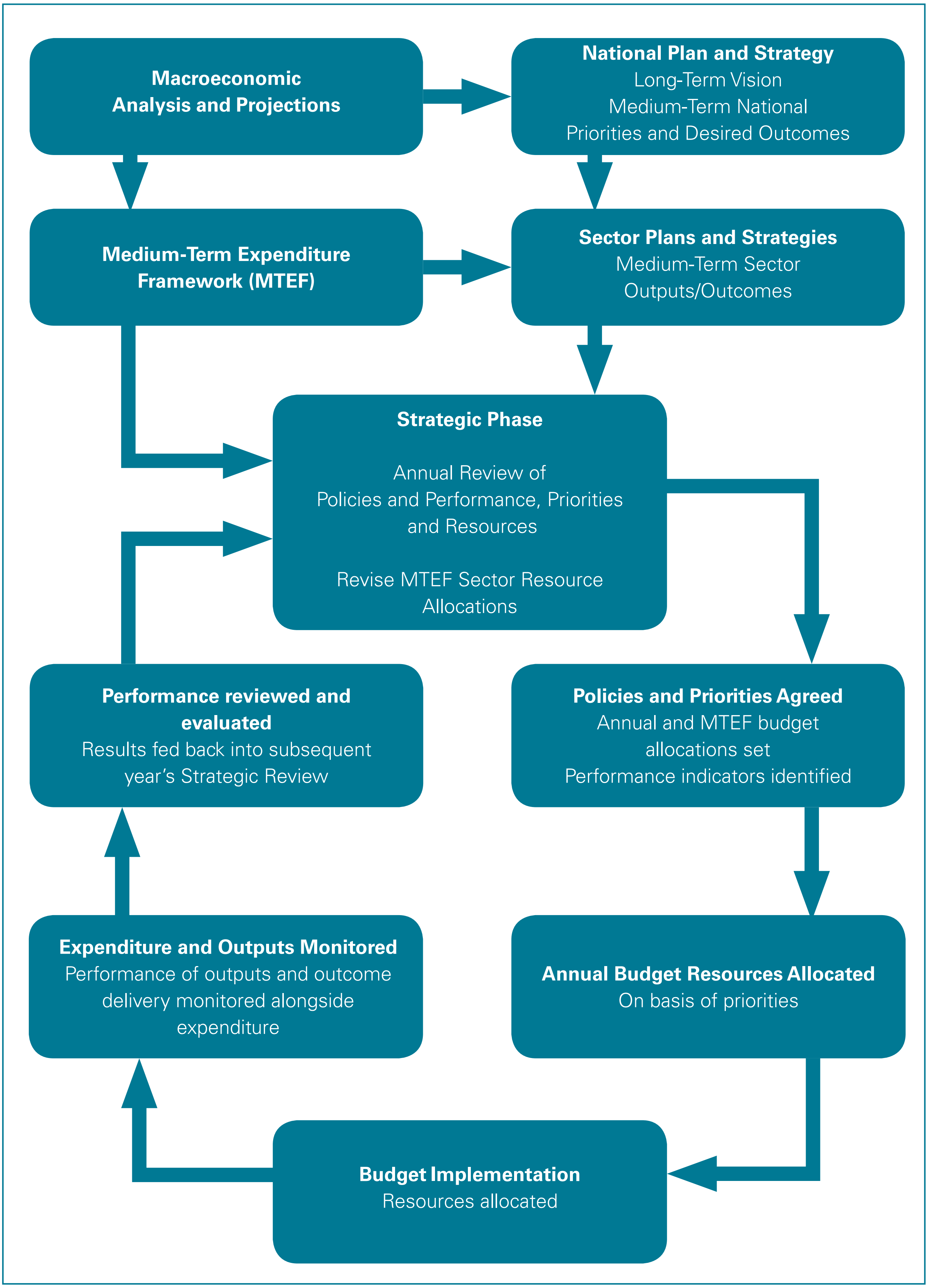
iii. inclusion of simple policy direction and performance information in the budget documents. A few PICs have introduced detailed narrative in budget expenditure estimates explaining the current and forecast expenditure linkages with national plans, policies, and priorities. The budget documentation can then be used to build demand for greater accountability in the implementation of national development plans.

Concurrent and simple changes to the national/sector plan and budgeting cycles (illustrated in *Figure 5*) can aid joint reporting. Several practical initiatives have been discussed earlier, including:

- national/sector plan reports be prepared in advance of the start of the annual budget cycle (and ahead of the MTEF) so that relevant findings may feed into the formulation of the budget;
- a MTEF process is established and: a) clearly linked to sector plans, so that each sector has a good indication of its medium-term resource ceiling and other constraints, and b) integrated into a strategic phase of the budget process so that all sector ministries can collectively see how their resource allocations integrate with the rest of government;
- national/sector performance indicators should be linked to budget sectors and programmes to make them compatible with the categories used in the budget; and

- national/sector plan reporting should, where possible, contain specific reference to the budget results, and draw a firm link to development outcomes (since budget documents tend to focus on the lower levels of the results chain e.g. projects and activities).

Figure 5: Cycle for planning and budget integration



This is not a one-way process, and careful consideration of result indicators in both the plans and the budget is required to ensure consistency and compatibility. Greater leadership and commitment to consolidate management information systems at all levels is also required.

Improved compatibility between the budget and national/sector plan reporting processes will allow for better integration of the two systems. If the two reporting systems are sufficiently aligned, then a single annual (or two to three year) report, may be sufficient to feed into domestic policy-making and performance monitoring processes, and regional and international reporting commitments (e.g. SAMOA Pathway reviews and Voluntary National Reporting on the 2030 Agenda for Sustainable Development) and other development partner requirements. A consolidated report could be structured around the budget/ MTEF (containing information on the allocation of expenditure and the resulting activities) and national development plans and associated priorities, with emphasis on measuring implementation performance.

c) Self-Diagnostic and Improvement Questions[19]

The following self-diagnostic questions are intended to provide a basis for understanding existing planning and budget reporting systems. The questions help determine how current systems function and whether it serves its purpose in providing meaningful indicators for measuring both planning and budget performance. The questions provide a basis for identifying how the current system can be improved.

Stocktaking of current systems

- What data is reported in routine administrative reports, sectoral reports, and/or national surveys?
- Can budget data on inputs, expenditures, actions, and activities be better used for measuring national/ sector plan results?
- What information contained in budget reports, sector reports or other plan documents?
- Is adequate attention given to the monitoring of results, for both budgets and plans?

Links between reporting systems and domestic policymaking processes

- What reporting systems are used to inform decision-making at the sectoral, Cabinet and Parliamentary levels?
- Is there performance information available that could be used decision-making processes?

Domestic and international stakeholder roles in promoting accountability

- Are cabinet ministers engaged in the reporting process?
- What is Parliament's role in monitoring the budget and national/sector plan reporting mechanisms?
- Are donor reporting requirements based on domestic systems? Is there scope for donors to reduce parallel demands?

Extent of integration

- Have performance measures been introduced into plans and budgets, and are these reflected in current reporting documents?
- At what point in the budget/MTEF cycle are the national/sector plan reports published?
- Is reporting on development outcomes annually feasible? Can or should the frequency change?
- Is there sufficient compatibility between national/sector plans and budget reporting systems to merit integration into a single report?

Improvement questions

- What actions are needed to use indicators relevant to measuring both budget and development plan results? Can relevant partial and proxy indicators be used?
- How can reporting mechanisms be better aligned with decision-making processes?
- What simple improvements are feasible to ensure the better integration of national/sector plan and budget reporting?
- How might national budget and plan reporting be better used for development partner reporting requirements?

19 World Bank, 2008. Linking the PRS with National Budgets: A Guidance Note, PREM Poverty Reduction Group.

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