**PEFA & Policy Management**

**Topic**

The PFM Board has, for some time, been exploring the complex relationship between financial and policy planning and some of the benefits and challenges in pursuing an integrated approach. In various “Fireplace Conversations”, in particular those with Frans Ronsholt and Gord Evans, the issue of *how to bridge this planning and institutional divide through the PEFA methodology has arisen*. The PFM Board is now tabling this important subject for general discussion.

We would like to hear from you on this subject whether to raise an observation, provide a concrete example or propose an approach. This discussion will be moderated jointly by Gord Evans, Martin Johnson and John Short, bringing together a wealth of experience in policy, financial and integrated planning. Moreover, John and Martin have worked extensively on PEFA assignments in a range of countries.

**Problem Statement**

PEFA has developed a robust set of comparable country assessments for public financial management and accountability. One of its core measures, policy-based budgeting, is determined by Performance Indicators (PIs) 11 and 12, focusing respectively on the annual budget process and multi-year fiscal planning.

Although these PIs provide important information concerning policy-based budgeting, the exclusion from the assessment of the government’s related policy management systems and institutions may, in some cases, produce an incomplete or even inaccurate assessment. It is our belief that sufficient experience with integrated policy and financial planning exists to address this gap within the PEFA methodology.

**Context**

The primary instruments through which the Ministry of Finance implements policy-based budgeting (often using an MTEF process) include:

* multi-year macroeconomic and fiscal forecasts;
* budget policy statements;
* budget circular;
* budget ceilings;
* ministry budget requests (recurrent and pubic investment);
* analysis of budget requests and ensuing negotiations (challenge function);
* annual budget law;
* in-year budget execution/expenditure decisions; and
* output monitoring and treasury system reports.

The PEFA methodology takes all of these into account. In addition, the importance of costed sector-strategies and the links between investment and its recurrent implications are acknowledged. However, there are a number of policy instruments that most often are coordinated by the Cabinet/Prime Minister/President’s Office that can have a significant impact on the integrity of policy-based budgeting. These include:

* statements of government priorities;
* medium-term strategic or policy documents;
* annual legislative programs;
* ministry/agency strategic plans;
* existing legislative mandates with expenditure implications;
* individual policy and regulatory proposals; and
* monitoring reports for strategic documents/plans.

In principle, all of these instruments should be taken into account through the budget process and therefore should be captured by the PEFA assessment. However, for this to transpire, the assessment would need to work closely with the Cabinet Office/Prime Minister’s Office or other coordinating institutions to understand the nuances and budgetary implications of these processes. However, there is little guidance in the PEFA instructional materials on these matters.

In certain instances, what appears to be a reasonably well-managed budget process may in fact be compromised by parallel, de-linked policy or legislative processes over which the Ministry of Finance’s influence may be quite limited. The reasons for policy-legislative-budgetary planning disconnects can be diverse, ranging from Ministry of Finance capacity to coalition structures to decision-making protocols to institutional rivalries. If the PEFA assessment does not explore these processes which exist beyond the direct purview or influence of the Ministry of Finance, it runs the risk of missing or misunderstanding some key explanatory factors affecting public expenditures. Questions that should be asked include:

* How well does the Cabinet/Prime Minister/President’s Office coordinate the government’s policy and financial planning processes with the Ministry of Finance? Are the planning calendars of the two institutions consistent?
* How is political direction reflected in various priority documents? Is the budget policy statement consistent with other statements of government priorities? What processes drive the preparation of the respective priority documents? What are the relative influences of these statements on subsequent government decisions and actual expenditures?
* How well are all medium-term policy documents costed and reflected in the budget policy statement, budget circular, budget ceilings, ministry/agency budget requests, and actual expenditures? Note that sector strategies are explicitly identified under PEFA although their quality and the quality of costing is not directly addressed.
* Does the government’s annual plan for legislation, regulations and/or policies take into account the potential, multi-year implementation costs and the originating ministry’s multi-year budget ceilings? Are the instructions on preparing ministry submissions for the annual plan consistent with those in the budget circular? How are the multi-year costs of proposed legislation/regulations/policies reflected in budget requests?
* Are ministry/agency strategic plans consistent with their budget plans and requests? What are the relative influences of these documents on subsequent ministry expenditure decisions?
* How well are the individual policy, legislative and regulatory proposals approved at the regular Government meeting costed? How are the multi-year costs of these proposals reflected in the budget and MTEF processes? How effectively do decision makers take into account the multi-year expenditure and revenue implications or these proposals and their future competing claims on resources needed by other policy areas?
* Is information from monitoring the implementation of strategic documents/plans fed back into the budget planning and performance management systems?

In sum, where policy and financial planning remain poorly integrated, the existence of parallel, disconnected decision-making systems may result in under or unfunded legal obligations and political commitments that can undermine the credibility of the budget as a reliable expression of the government’s policy intent. By adding a more detailed examination of how this occurs and of the institutions which coordinate these processes, PEFA could assess more fully the quality of policy-based budgeting.

**Speaking from Experience**

Having participated in a range of PEFA reviews and MTEF assessments and after reviewing the quality and content of PEFAs for use in related PFM exercises (e.g. fiduciary risk assessments), our view is that unless the assessor fully appreciates the questions raised in the bullet points, the related assessment may overlook some key factors underpinning the quality of policy-based budgeting.

For PI-11, in practice, assessors naturally focus on the budget process and the related interactions between line ministries/agencies and the Ministry of Finance, but rarely explore in any detail the parallel processes coordinated by other central institutions that have significant downstream implications for future budgets. Although PI-11 acknowledges the importance of political involvement, there are few tools to guide assessors on how to deal with these issues with respect to analysis or scoring.

For PI-12, in practice, a reliance on the assessment of sector strategies may mask the policy planning context outside of the budget process. The sector strategies may provide the context for policy, but not necessarily whether what is in the budget has been costed and undergone a rigourous assessment to determine whether funding is available to ensure implementation can take place – i.e., is affordable. In fact, little or no information is presented in PEFA reports on medium to long-term affordability of current policy decisions (whether such decisions are ‘active’ through specification in policy documents that link to the budget process or ‘passive’ through decisions taken separately though in parallel to the budget process).

Accordingly, scoring for PI-12 can be erratic, in part due to misunderstandings or omissions related to policy-fiscal linkages and coordinating institutions. PI-12 (iii) and (iv) often score poorly, but can also be over-scored. For example, one country received a B in 2009 and an A in 2012 for PI-12 (iii) notwithstanding the absence of any current, approved sector strategies.

There may be a variety of reasons for such gaps – the absence of a standard definition and associated guidelines for what a sector strategy is and should cover, the lack or inaccessibility of necessary documents, or the failure to request and/or properly analyse such information by the PEFA assessor.

Whatever the cause, we believe that PEFA assessments could be improved if this analytic gap was addressed and the intricate relationships between policy and financial systems and coordinating institutions better understood.

Some questions to consider:

* Do you agree with this assessment?
* What is your experience in such matters?
* How should this problem be addressed in practice?
* What type of guidance would be beneficial?