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PEFA and Policy Management

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The PFM Board Compendium is an innovative, collaborative experience, whereby individual members of the Board initiate a debate online, based on a position paper. Other members make their own contributions, posting online their views and recommendations. In the end the position paper becomes the compendium which is circulated within the community and beyond.

This compendium was sent to the PEFA Secretariat to enlarge the debate and knowledge sharing among the PFM practitioners.

February 2012

PEFA and Policy Management

Overview

From November to December, 2012, the PFM Board posted a discussion paper written by Gordon Evans, John Short and Martin Johnson entitled *PEFA and Policy Management* with a view to developing a position on this topic. Gaps in the understanding of policy-fiscal linkages and their treatment within the PEFA framework have previously been acknowledged.[1] With this position paper, the PFM Board hopes to suggest a way forward that would be welcomed by the PEFA Secretariat and, after due consideration and study, incorporated within the next update of the methodology.

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, which gauges the degree to which "the budget is prepared with due regard to Government policy", 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.

Policy-Fiscal Linkages within the PEFA Framework

The inextricable linkage between policy and financial decision-making has long been acknowledged. The World Bank's *Public Expenditure Management Handbook (1998)*, for instance, presented the institutional arrangements underpinning public expenditure management as three interdependent levels: aggregate fiscal discipline, allocation of resources in accordance with strategic priorities and efficient and effective use of resources in the implementation of strategic priorities. The second level, in particular, could only be understood by examining policy and financial planning systems together.

[1] See Andrews, M. *What Would an Ideal Public Finance Management System Look Like*? Budgeting and Budgetary Institutions: World Bank, Washington DC, 2007. Also see PFM Board's fireplace conversations with Frans Ronsholt and Gord Evans. http://pfmboard.com/index.php?board=3.0

The PEFA framework reinforced this approach, situating policy-based budgeting as one of its six core dimensions and as the first stage of the budget cycle. The table below summarizes the references in the current PEFA framework to the policy-fiscal linkage.

Key References to Policy in PEFA Framework

Location	Reference(s)
Intro	• lists policy-based budgeting as one of six core dimensions of PFM performance; defined as "the budget is prepared with due regard to Government policy." • policy-based budgeting illustrated as first step in the budget cycle
PI 1	• acknowledges that the government's ability to implement approved budgets will affect their ability to achieve desired policy outcomes
PI 2	• asserts that significant deviations in budget outturn from the composition of approved budgets will adversely affect the achievement desired policy outcomes
PI 5	• points out that core elements of the government's policy framework (e.g., poverty reduction) should be captured in the classification system (chart of accounts)
PI 6	• requires that the budgetary implications of new policy initiatives be included in budgetary documentation
PI 11	• no references
PI 12	• expenditure policy is included in the PI title • multi-year fiscal forecasts are cited as the source for policy changes • emphasizes importance of costing sector strategy policy initiatives and ensuring they can be accommodated within aggregate fiscal framework

Strikingly, despite the identified linkages, policy management institutions and policy processes are rarely identified as requiring any investigation in determining the quality of a nation's public finance management system. In the *PEFA Field Guide*, although policy is cited in the description of several PIs, the guidance on how to assess the dimensions of that performance indicator generally omits the need to examine the relevant policy management institutions or processes. Most egregiously, policy is entirely omitted as a factor to be considered in the assessment of PI 11, one of the two measures that purportedly assess the quality of policy-based budgeting.

During the PFM Board community's recent discussions on this subject, several possible reasons were cited for this analytic gap.

- The determinants of policy are often political (policy and politics are the same word in many languages). Political motivations, whether electoral advantage, coalition trade-offs, campaign contributions and/or lobby group influence, do not easily fit within a formal PEFA assessment; i.e., being reflected in indicators and scored.

- PEFA provides a high-level assessment of the quality of a country's public financial management system. Although it can serve as the basis for more in-depth analysis, the methodology itself is not intended as a tool for drilling down to assess issues such as the quality of central institution coordination or detailed policy processes and procedures. To do this, a separate methodology and manual focused on policy management would be required.

- Linkages between policy and financial planning institutions and processes, although supported in theory, are not commonly understood. Although a solid theoretical framework exists for understanding PFM reform, no comparable, widely-accepted methodologies exist for policy management. Moreover, within IFIs, donors and the consulting community, there are distinct PFM and policy management silos. Despite successful examples in practice where PFM and policy management reforms have been effectively coordinated, these silos persist and PFM and policy management projects continue to be designed without recognizing that an integrated approach should be considered best practice.

The PFM Board's response to these observations is as follows:

- The Board agrees that PEFA should not attempt to assess formally (i.e., scoring against the dimensions of an indicator) the partisan political dimension of policy decision making ("drilling up"). However, there are elements of policy management institutions and processes that would be appropriate to consider alongside those pertaining to public finance as part of the formal assessment.

- The Board agrees that a PEFA assessment should not be expected to undertake a detailed analysis ("drilling down") of policy management institutions or processes; for example, completing a labour-intensive, item-by-item assessment of the quality of costing in a sector strategy. However, there are a range of counterpart policy management dimensions that exist at an intermediate level that would inform the analysis of PEFA's public finance dimensions.

- The Board acknowledges that policy management and public finance management are often treated as separate domains. Nonetheless, the benefits of properly reflecting policy management considerations within the PEFA analysis far outweigh any discipline discomfort that may arise from venturing into unfamiliar territory.

Accordingly, the PFM Board strongly asserts that the PEFA framework's assessment of policy-based budgeting would be significantly improved by assessing, at an appropriate level, the interdependence of policy and financial planning institutions and processes. The challenge will be how to make this happen in an effective and feasible way. For certain, the PEFA methodology will need to incorporate, selectively, a review of the policy management institutions at the centre of government[2] and the policy processes that they coordinate on behalf of the Prime Minister and Cabinet, often in collaboration with the Ministry of Finance. The remainder of this paper focuses on presenting an initial way forward.

PEFA's Performance Indicators for Policy-Based Budgeting (PIs 11 and 12)

Policy-based budgeting, defined in the PEFA framework as the budget being prepared with due regard to Government policy, is meant to be supported by PIs 11 and 12. The table below summarizes current guidance on assessing these dimensions and comments on how this guidance does or does not address the policy component of the budget cycle.

Dimension	Current Guidance	Policy Linkage Issues
PI-11 Orderliness and participation in the annual budget process		
Existence of and adherence to a fixed budget calendar	A positive assessment depends on the budget calendar having sensible time lines, being followed in practice, and setting out a clear timetable that allows ministries/agencies sufficient time to prepare their detailed budget requests following release of the circular.	Although important, this dimension does not capture the policy implications of the budget calendar. In principle, a budget process that ignores policy could still score well as long as it follows clearly-stated time lines that are suitable for budget preparation purposes. From a policy perspective, the crucial issue is whether the calendar for the related policy processes (e.g., setting policy priorities; establishing the legislative plan, etc.) meshes with the budget calendar (without this, the ceilings and budget requests will not be informed meaningfully by policy). Optimally, an integrated calendar would be produced but, at minimum, the time frames of related processes would be coordinated effectively.
Clarity/ comprehensiveness of and political involvement in the guidance on the preparation of	A positive assessment depends on a clear budget circular with approved ceilings covering all expenditures and appropriate Cabinet	The implicit assumption here is that Cabinet approval and the ability to revise the ceilings ensures that policy considerations will be taken into account and duly reflected. To ensure that this is the case, the assessment would need to establish whether policy considerations actually

[2] The central institution directly serving the Prime Minister and Cabinet may use a variety of names including, Prime Minister's Office, Cabinet Office, Government Office, and Chancellery. There may also be separate offices with policy management mandates such as a Strategy Office or National Planning Office.

budget submissions (budget circular or equivalent)	involvement.	influence the ceilings. To do this, it would be necessary to examine the way in which ceilings are established by the Ministry of Finance and reviewed and approved by Cabinet.
Timely budget approval by the legislature or similarly mandated body (within the last three years)	A positive assessment depends on parliament regularly approving the budget prior to yearend.	Although delayed parliamentary approval of the state budget is unquestionably bad practice, significant policy implications arise only if the budget itself is policy-based. If the previous two dimensions have not established whether this is the case, the relevance of this indicator will be diminished.

Dimension	Current Guidance	Issues
PI 12 Multi-year perspective in fiscal planning, expenditure policy and budgeting		
Preparation of multi -year fiscal forecasts and functional allocations	A positive assessment depends on the preparation of rolling 3-year forward estimates linked in an understandable way to budget ceilings.	This essential feature of an MTEF is important to policy-based budgeting as long as the budget ceilings are influenced by policy considerations. The comments provided on PI 11ii will be relevant to this dimension.
Scope and frequency of debt sustainability analysis (DSA)	A positive assessment depends on a credible DSA being undertaken annually covering both domestic and external debt.	Although crucial to maintaining aggregate fiscal discipline and the establishment of the fiscal parameters for the MTEF, the DSA process is not typically considered alongside policy-based budgeting elements such as the preparation of the circular or establishment of ceilings.
Existence of sector strategies with multi-year costing of recurrent and investment expenditure	A positive assessment depends on the existence of approved, costed, multi-year sector strategies that are broadly consistent with fiscal forecasts and cover recurrent and investment expenditures for the majority of public expenditures.	This is the only PEFA indicator dimension which explicitly acknowledges a product of the policy process. This does raise the issue of why other core products of the policy process (e.g., annual government work plan, policy proposals) are not similarly acknowledged since they may have significant implications for the public financial management system. Moreover, the guidance should not only refer to the costing of sector strategies, but require some indication that they inform and influence budget decisions
Linkages between investment budgets and forward expenditure estimates	A positive assessment depends on the public investment process being integrated with budget and policy planning; i.e., not being conducted as an isolated process; taking into account the recurrent	The linkage between public investment choices, forward estimates and sector strategies is crucial. However, in practice, public investment planning is rarely well-coordinated with the forward estimates, let alone reflected in sector strategies. With respect to guidance on assessing this dimension, explicit mention might be made concerning the importance of having an effective

	implications of investments; and being aligned with sector strategies.	public investment management process in place, including a project cycle management process that reinforces these linkages. The common deviations between planned, budgeted (following Parliamentary approval) and actual public investments should also be considered.

Proposed Approach: Strengthening the PEFA Assessment of Policy-Based Budgeting

In deciding how best to address these gaps, it is important to take into account that the PEFA framework requires stability to ensure comparative data over time. This argues against any major restructuring of the indicators and inclines towards an additive approach. We believe that the goal of properly reflecting policy-fiscal linkages can be achieved within this constraint.

It is therefore proposed that PEFA consider establishing a new indicator with three dimensions to assess the quality of policy-based budgeting. This indicator would follow PIs 11 and 12.

Dimension	Guidance
New PI - Effective linkages between policy and budget planning systems	
Budget process informed by government's desired policy changes	Assessors would need to confirm that the key products of the budget process reflect government policy: • budget ceilings issued by the Ministry of Finance, while respecting aggregate ceilings, take into account the fiscal and sectoral implications of any major policy (new, revised or rescinded) changes desired by the Government; • MDA budget requests, while respecting Ministry of Finance budget ceilings, take into account any major policy (new, revised or rescinded) changes desired by the government, internal deliberations on desired MDA policy changes and, ultimately, deliberations on these issues with the Ministry of Finance; and • the public investment management process is guided by approved policy documents (e.g., sector strategies, national development plans) and incorporates the key components of a project cycle management process.
Policy and planning processes effectively linked to budget process	Assessors would need to confirm that the processes undertaken to plan or formulate policies are effectively coordinated with the budget process and do not create significant fiscal pressures or unfunded mandates. Typical processes to be considered would include: • *formulating high-level policy strategies*: assess whether multi-year fiscal impacts (revenue; recurrent and investment expenditures) are appropriately estimated and whether they are likely to fit broadly within the

	government's multi-year fiscal plan; • *preparing the regular (usually annual) legislative/ government work plan*: assess whether the plan is used as a mechanism to authorize the submission for government approval of draft policy proposals/laws with significant fiscal impacts that have not been taken into account through the budget process; and • *developing individual policy documents and draft laws/regulations with significant fiscal implications*: assess whether they include or are accompanied by multi-year costings that have been properly reviewed by the Ministry of Finance and effectively taken into account through the budget process.
Appropriate political involvement throughout budget process	Assessors would need to confirm that Cabinet or an equivalent decision-making body has been offered the opportunity to identify and approve any desired major policy (new, revised or rescinded) changes to be explicitly taken into account in the establishment of budget ceilings. Cabinet or an equivalent decision-making body must also be provided with the opportunity to challenge the consistency of proposed budgetary allocations with Cabinet's prior policy directions before providing final approval for the budget that is submitted to Parliament. In most cases, this will involve a political review (not just rubber stamping) and approval of key budget products (e.g., budget ceilings, proposals for multi-year allocations, proposals for planned deliverables) at key junctures of the process.

By including such an indicator, the absent or poorly-defined policy components of PIs 11 and 12 could be dropped, allowing them to focus on issues specific to the budget process and multi-year planning. More specifically:

- The reference to political involvement in PI 11 ii could be removed. The dimension would thus focus on the clarity and comprehensiveness of budget guidance.

- PI 12 iii on sector strategies could be deleted, as this would be replaced by the new PI ii which would refer to a wider range of policy processes, including high-level strategies (sector strategies are one form of high-level strategy).

- The guidance on PI 12 iv on public investments could delete the reference to sector strategies which is now picked up in the new PI i, ensuring the focus of this dimension relates exclusively to the forward estimates.

Having participated in numerous assessments of policy management and public financial management systems, including PEFA assessments, the authors of this position paper believe that:

- Sufficient evidence could be obtained, through documentation review and interviews, to make an informed assessment of the proposed new PI dimensions without overburdening the PEFA analyst.

- The proposed approach is compatible with the existing PEFA framework and will not compromise the comparability of past assessments.

- By assessing, at a high level, the policy dimension of policy-based budgeting, a richer overall assessment will be provided that will enable governments to pinpoint more accurately where gaps affecting financial accountability exist in their public finance management and/or policy management systems.

In sum, the PFM Board believes that action on this proposal will further strengthen the credibility and scope of the PEFA framework as a practical, high-level diagnostic tool.

Annex 1: Assessing Evidence for the Proposed New PI Dimensions

Given the limited time provided to assessors to establish a score for PEFA indicators and dimensions, it is essential to identify the evidence that would be sought to assess the proposed new PI and its dimensions. The table below suggests the broad parameters of such an approach. Note that this approach focuses on the government's own policy and budget formulation processes and assumes that the government undergoing the PEFA assessment has sufficient resources to be able to plan and implement some of its policy priorities, including public investments. In cases where new policies and public investments are largely funded by donors, then the relevant planning processes that determine these expenditures would need to be included in the assessment. It is also recognized that the scores for many developing countries will likely be very poor for this PI and its dimensions. However, we believe that sufficient experience with the key aspects of policy-based budgeting exists (e.g., preparing MTEFs; multi-year budgeting; costing individual policy or legislative proposals) to justify the inclusion of this new PI at this time.

Measure	Assess by Interview	Assess by Document Review
Dimension 1: budget process informed by policy priorities		
Evidence that budget ceilings issued by the Ministry of Finance, while respecting aggregate ceilings, take into account the fiscal and sectoral implications of any major policy (new, revised or rescinded) changes desired by the Government.	• Senior MoF official should indicate how MoF reflects policy priorities in the budget ceilings (examples should be available) • Senior official in Prime Minister's Office or Cabinet Office should indicate how they work with MoF to ensure policy priorities are reflected in ceilings	• procedures for identifying government's high-level policy priorities may exist • year-to-year review of budget ceilings should indicate sector shifts that can be attributed to government policy priorities • budget circular, MTEF and/or other budget documents may describe shifts
Evidence that MDA budget requests, while respecting Ministry of Finance budget ceilings, take into account any major policy (new, revised or rescinded) changes desired by the government, internal policy deliberations on desired MDA policy changes and, ultimately, the deliberations on these issues with the Ministry of Finance.	• Senior MDA officials (e.g., general secretary, budget director) should describe how MDA develops budget request in a manner that takes government and ministry policy priorities into account • Senior MoF official should describe how MoF reviews and negotiates MDA	• budget instructions and forms should indicate how MDAs should take policy priorities into account in preparing budget requests (e.g., separate form for costing new policy initiatives or to increase funding to previously approved policy initiatives) • year-to-year review of MDA budget

	requests for funding to deliver policy priorities • Senior official from Prime Minister's Office or Cabinet Office should describe how they assist MoF, as required, to ensure government's policy priorities are appropriately taken into account in MDA budget requests	ceilings may indicate shifts that can be attributed to government or ministry policy priorities
Evidence that the public investment management process is guided by approved policy documents (e.g., sector strategies, national development plans) and incorporates the key components of a project cycle management process.	• Senior official in ministry responsible for coordinating public investment should describe how high-level policy priorities influence the process by which MDA public investment proposals are prioritized, reviewed and approved • Senior MDA official (e.g., general secretary) should describe how they align their public investment proposals with their high-level policy commitments • Senior official in MoF and senior MDA officials should explain the process for screening investment projects prior to their inclusion on a budget submission	• approved public investment management process procedures and manuals should indicate importance of linking public investment proposals to high-level policy strategies • high-level policy strategies should include public investment component wherever applicable • information requirements accompanying individual public investment requests should identify linkages to policy priorities • approved public investment management process procedures and manuals should describe how project cycle management process and or project screening works
Dimension 2: policy and planning processes effectively linked to budget process		
Evidence that high-level policy strategies appropriately estimate multi-year fiscal impacts (revenue, recurrent and investment expenditures) and a process exists to ensure that those strategies are likely to fit broadly within the government's multi-year fiscal plan.	• Senior MoF and Prime Minister's/Cabinet Office officials should confirm that high-level policy strategies are reviewed by MoF and take into account the government's multi-year fiscal plan before being submitted for government approval	• high-level policy strategies should include multi-year fiscal impacts • strategy review and approval procedures should include step where MoF can validate and challenge fiscal assumptions

Evidence that the regular (usually annual) legislative/ government work plan is not used as a mechanism to authorize the submission for government approval of draft policy proposals/laws with significant fiscal impacts that have not been taken into account through the budget process.	• Senior official in Prime Minister's Office or Cabinet Office should describe how MoF is involved in reviewing the legislative/government work plan (usually annual) before being submitted for government approval and confirm that this process does not often result in unfunded mandates • Senior MoF official should indicate that the approved annual legislative/ government work plan does not typically include items with significant multi-year costs that cannot be accommodated by the government's multi-year fiscal plan and confirm that this process does not often result in unfunded mandates • Senior MDA official (e.g., general secretary) should confirm that this process does not often result in unfunded mandates	• instructions and forms for preparing annual legislative/government work plan should include indicative multi-year costs • budget instructions should refer to the costing of planned policy or legislative initiatives with expenditure implications • review and approval procedures should include step where MoF can validate and challenge fiscal assumptions of proposed items
Evidence that individual policy documents and draft laws/regulations with significant fiscal implications include or are accompanied by multi-year costings that have been properly reviewed by the Ministry of Finance and effectively taken into account through the budget process.	• Senior officials in Prime Minister's Office or Cabinet Office and MoF should confirm that a process exists by which MoF reviews and can effectively challenge fiscal assumptions in individual policy and legislative proposals • Senior MoF official should confirm that individual policy and legislative proposals with significant multi-year costs are not frequently approved against MoF's recommendation • Senior MoF official should confirm that an effective methodology exists to take	• Cabinet regulations, procedures, manuals and forms for preparing policy proposals and/or documentation accompanying draft legislation should require multi-year costing of policy and legislative proposals • procedures for reviewing individual policy/legislative proposals should incorporate a process for the MoF to validate and challenge fiscal assumptions

	into account the fiscal impacts of these proposals through the budget process before they are approved	
Dimension 3: appropriate political involvement throughout budget process		
Evidence that Cabinet or an equivalent decision-making body has been offered the opportunity to identify and approve any desired major policy (new, revised or rescinded) changes to be explicitly taken into account in the establishment of budget ceilings. Cabinet or an equivalent decision-making body must also be provided with the opportunity to challenge the consistency of proposed budgetary allocations with Cabinet's prior policy directions before providing final approval for the budget that is submitted to Parliament.	• Senior officials in the Prime Minister's Office or Cabinet Office and MoF should confirm that a meaningful political review, often in several stages, does occur in Cabinet and/or an equivalent decision-making body (e.g., sub-committee of Cabinet), ensuring that desired major new, revised or rescinded policies influence budget planning and, subsequently, that the policy implications of the final proposed budget are reviewed, understood and approved. • The officials should be able to describe how political direction to reflect policy changes in the budget is documented and executed	• Cabinet regulations/procedures may address this issue • (if public) Cabinet minutes may indicate political approvals at key stages of the process and may include directions on reflecting policy changes • documentation accompanying budget may describe new policy initiatives (currently part of PI 6 methodology)

Annex 2: Partial Transcript of the online debate leading to this compendium

(the full debate can be accessed at http://pfmboard.com/index.php?topic=6502.0 ; the access is free but you need to register to the Board, first)

Napodano

We start this new board with something special: **a collaborative experience by three PFM Board members, which request the sharing of experience by other members**.

Gord Evans, John Short and Martin Johnson are ready to share their experiences to explore the complex relationship between financial and policy planning and to suggest how to better address this relationship within the PEFA methodology

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Problem Statement *(full paper attached below- you need to register in order to download it)*
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.

All PFM Board members are called to share their field experience on the matter by making a post to this topic (including attachments if they feel like it). The deadline is 31 December 2012. Gord Evans, John Short and Martin Johnson will keep the discussion alive and at the end will consolidate all the contributions into a single document which potentially can become the PFM Board Compendium 01, a new product of our community. All the contributors will be acknowledged in the Compendium, which will be sent to the PEFA Secretariat for consideration.

The time for sharing is now.

Simon Groom (petagny)

A very useful initiative! I'll definitely be giving some thought to it.

In the meantime, the attached paper by Matthew Andrews could be a good stimulus to discussion (also see his archived 'fireside' discussion).
(the paper is attached to the post and downloadable)

Napodano

I received from Tony Bennett , some comments which he made directly on the Problem Statement paper (attached).

Thank you Tony.
(Tony's comments are attached to the post and downloadable)

Harnett

I've had a few initial thoughts:

Do you agree with this assessment?
This is a very good analysis of the situation. I couldn't agree more regarding the importance of the link between PFM and policy – after all what is a budget if not the main expression of a government's intent to implement its policies? However, we should be careful with respect to what the role of PEFA is, and what is likely to be feasible during an assessment.
In many areas of PFM assessed by PEFA, it is acknowledged that it is a broad-brush snapshot of the current PFM system. Areas requiring further analysis should be subject to a "drill-down" assessment e.g. procurement. Looking at policy based budgeting in more detail strikes me more as a "drill-up" and concerns me in that we are now potentially assessing government policy (in as much as it exists) – a much more sensitive topic than PFM architecture.
Of course, I would not deny that it is often a good idea to assess how government policy is transformed into a credible budget. It has been the point of PFM reform in many countries! However, we are opening a real can of worms if we are to question the linkage between the government's policy management systems and the budget.
Why? Well I would posit that much PFM reform has not been endogenous (to use Matt Andrew's phrase). In the words of Sybi Hyda, commenting on his time as a Budget Officer in Albania "many times I have experienced the situation when high officials at the MoF, including Ministers, have used the expression "we are doing it because it is required from our international advisers"." Equally, much strategy development has not been endogenous, either at national or sectoral level. This, of course is not surprising, given the priority of donors to increase levels of

spending in the social sectors, with MDG targets to fulfil in much of the world – hence the proliferation of Poverty Reduction Strategies. It would appear that most National Development Plans have been either donor led or drawn up in a manner to satisfy donor concerns. Everybody needs donor funds, especially if it is budget support!

Moreover, recent decades have, with few exceptions, appeared to offer little policy choice to governments around the world – the neoliberal paradigm has dominated policy, not only of donors, but also competing political parties in most countries. The best we have had in terms of policy choices seems to have been whether to prioritise roads or the social sector (such as the debate between the donors and Museveni in Uganda in the 1990s in that wonderful documentary: The Bank, The President and the Pearl of Africa). Apart from that, how often do we catch a glimpse of whether the government agrees or not with the "official" policy documents? And if they don't, what is their policy in that case?

In many (if not most) countries the objective of governments has been to accumulate wealth amongst the major power brokers (for the re-election campaign as well as personal gain), keep the vote bearing civil servants happy, and hopefully be re-elected and/or avoid overthrow. It is not necessarily the aim to provide the services expressed in the "policy" documents.

As a result it will often be the case that the link between policy and budget is weak. There may well be no formal policy management systems to speak of. If they do exist they may not function well. This is of little consequence to many governments. What is of consequence is if the donors expose these truths – hence my concerns about access to assess many of the issues highlighted.

What is your experience in such matters?

Largely that policy is irrelevant in most LICs and MDCs. Governing parties do not distinguish themselves by their policies – hence the willingness to allow donors to ventriloquise their own concerns into strategy documents.

Regarding the PEFA indicators:

PI-11

(i) Existence of and adherence to a fixed budget calendar; This usually scores well, usually reflecting the legal status of the budget code

(ii) Clarity/comprehensiveness of and political involvement in the guidance on the preparation of budget submissions (budget circular or equivalent); This is more erratic in that some countries comply with a donor-suggested timetable, whilst others regard political involvement as superfluous (indeed the budget may well be superfluous!)

(iii) Timely budget approval by the legislature or similarly mandated body (within the last three years); Usually fine, although sometimes disrupted by strife or elections

PI-12

(i) Preparation of multi -year fiscal forecasts and functional allocations; If an MTBP/MTEF has been introduced then this usually scores well

(ii) Scope and frequency of debt sustainability analysis; if the IMF has conducted analyses it scores well. Also if the IMF has trained the Debt Dept. to carry out such analyses.
(iii) Existence of sector strategies with multi-year costing of recurrent & investment expenditure; this usually scores badly. There are often islands of good practice, usually in areas with significant donor funding e.g. education, health, transport.
(iv) Linkages between investment budgets and forward expenditure estimates; invariably poor
My other related experience is that policy can be ignored if political expedience requires. This can occur with little regard to budgetary implications.
Maybe the best example we have seen in that sphere was the U-turn regarding the investment budget in Albania seen in 1999(?).
After establishing reasonable processes (including political buy-in) regarding budget preparation, including the troublesome development budget, all was sacrificed when the political interests of both the Albanian government and the US conspired to build a superhighway through the mountains of Albania to link it with newly independent Kosovo (site of the largest US base in Europe without “friendly” access to the sea). Protestations (by cognoscenti such as consultants) that in design it was over engineered (and therefore needlessly expensive for the Albanian taxpayer) were ignored. Any political opposition to the road was casually swatted away with cries of “Anti-Albanian”. What’s more, although the road was not fully ready for the election campaign, the Prime Minister ensured it was ready enough for him to cut the ribbon and go on to win the election. Bystanders could only admire his political vision (whilst guardedly moaning about the position of his daughter as legal adviser to the main road contractor!).
Having said all of that, of course it is the prerogative of politicians to adapt to circumstances and rewrite policy “on the hoof”. What happened in Albania was proved to be right by the election result! Such policy swings in other countries are often motivated by more naked aggrandisement.

How should this problem be addressed in practice?

I would adopt a gentle approach to assessing the linkage between policy management systems and budget. If any changes were to be made to the indicators, I would either add a dimension or collapse dimensions (i) and (iii) of PI-11 into one dimension and introduce a new dimension on the efficacy of policy management systems where an A score indicated they existed and passed on all (or most?) the following documents to MoF at appropriate times in the budget cycle:
o statements of government priorities;
o medium-term strategic or policy documents;
o annual legislative programs;
o ministry/agency strategic plans;
o existing legislative mandates with expenditure implications;
o individual policy and regulatory proposals; and

o monitoring reports for strategic documents/plans.
A D score would indicate no policy management system.
B & C would be points in between.
Such an approach would not, one hopes, require too much interaction with cabinet or similar, but would indicate if there was such a system in place. I feel also that it has the makings of being objectively measurable.

What type of guidance would be beneficial?
I would leave this section to Mr. Gord Evans. My only comment is that we would have to define what constituted a policy management system. Is a Presidential Decree to be included? A cabinet decision relayed to MoF? Or does it have to be a formal policy institution within the cabinet office or similar?

Napodano

Interesting considerations, harnett!

I want to make my contribution on the matter as I have often noticed a discrepancy between the analysis on the Policy-Based Budgeting dimension in the PEFA country reports and what I found in these countries when on MTEF TA missions. It should be noted that these discrepancies were consistently one-sided: the scoring and the analysis in the PEFA reports looked to me skewed to the upper-end (the situation as evinced from the PEFA report appeared better than in reality). I can propose a couple of real cases if the proponents of this initiative would consider it useful for the final document.

I like to start my comment by drawing your attention on the 'size' of the Policy-Based Budgeting dimension compared to the other dimensions of the PEFA methodology. The Policy-Based Budgeting dimension is the only one which has ONLY two indicators. In addition the PI-12 has four i's dimensions, which it shares only with PI-18 and PI-27. For me these elements are a sign that the dimension is not enough developed to expand the analysis on such a crucial link between policy and budget. And this despite the fact that the international best practice points to a reinforcement of the Policy-Budget link in the overall budget system.

What to propose
1. I would definitively add one or two Performance Indicators to the Policy-Based Budgeting dimension to analyse more in details and in a more measurable way the links between the Government policies priorities and the expenditures forecasts. In defining the new indicator(s) and its i's dimensions I would consider the need to look at both the budget planning and

implementation of the policy priorities.
2. I would advocate a dedicated indicator or at least a i's dimension on Public Investment Management process.
3. I would propose the following quantitative analysis to the (i) dimension of the PI-12 'Multi-year fiscal forecast and functional allocation':

The deviation between the MTEF expenditures allocations and the annual budget allocations at both aggregate and sector level (see the attached table and chart as example(*) - you need to be registered member of the Board to see them).
I stand ready to expand my inputs if the proponents see them useful.

(*) table and chart are attached to the post and downloadable)

Harnett

You would add 1 or 2 performance indicators on the link between policy and budget! You make me look conservative - which is rare!!! The issue is what can be objectively measured in a PEFA. The comparison between costed national and sectoral strategies and the priorities (implicitly) expressed in the budget is a major piece of work. A PEFA could not undertake this and as far as I know it is rare for such analysis to exist for PEFA to pick up on. A PEFA requires objectively identifiable evidence - hence my gravitation towards whether a policy management system exists and score on its sophistication.

Yes - I would also consider an indicator on PIM, but that is a bit outside the scope of the discussion methinks!

The idea of the deviation between MTEF (or similar) and Budget allocations I think is already captured in whether the multi-year forecasting is operational. If there is a discrepancy, then the 1st dimension scores badly. Essentially you want to know if the 1st year of the MTEF is the budget. If it is then much follows (maybe!) - if it isn't then we don't have an operational MTEF.

John Short

Harnett has raised some very points re policy coherence in the context of budgets and PFM. He cites two countries as examples of donor/government interface (and endogenous/exogenous policy generated formulation, which I would like to explore further. It is interesting that Uganda in the 1990s has been given as an example quoting the Documentary “The Bank, The President and the Pearl of Africa” relating to the policy debate. Yet very little about the debate was related to PFM. It was the time of Balance of Payment support where there was really no discussion of the use of Ugandan Shilling counterpart funds generated and used in the budget. The policy debate was about import and export licensing, import tariffs, foreign exchange liberalisation, private sector development, deregulation and export and investment promotion. If this is neoliberal policy, it looks like sound policy to me! I have not seen the documentary but was in many meetings where the camera was rolling. Public expenditure issues centred on the fact that the implicit subsidy (from losses being funded from the budget) to a textile factory employing hundreds being the same as the allocation to health! And it was not an issue of roads versus social sector. It was an issue of stimulating markets for agriculture by building roads (all roads at the time could be considered rural). To paraphrase the ST/PS Planning at the time (now Governor of the Bank of Uganda) agriculture and industry and associated policy are too important to be left to the respective ministries! There was policy coherence with the ST/PS in the vanguard and often one step ahead of the donors. Only once the economy was developing as a result, the attention turned to PFM issues as a policy with the PEAP and poverty reduction policies.

Turning to Albania, surely the example of the road shows that the Government was actually following its own policy convictions – perhaps not fully planned (later than 1999 more like 2007) and contradicts the observations of donor compliance. What policy? Foreign policy for sure, but also regional policy opening up Kukes and its surrounds to the rest of Albania, and also perhaps economic development policy realising the benefits from easy access to the sea for Kosovars. This is of course with the benefit of hindsight as all appear to be realised. Now with the R7 road completed (or almost completed) from the border to Pristina, Pristina to the coast can be travelled safely in well below 3 hours. I make the point of safety as an important one in terms of the over engineering and "high" cost for the Albanian taxpayers. I have travelled that road many times in all seasons including a snowy winter. I have also travelled on the alternative route through Macedonia and into Albania around Lake Ohrid in the snow. One thing that has always struck me is that the dual carriage road through and around the mountains is on very difficult terrain (spanning valleys etc) may have cost a lot, but it had to cost a lot to achieve what it has achieved. Has it been over engineered – would a single lane road have done the same job? I can only point to the difference in leaving the tax payers part of the road and joining the World Bank financed single lane continuation. Safety alone suggests that it was a correct decision. Can the road be justified in terms of its benefits, ex post I would thinks so, whether it was ex ante........? http://en.wikipedia.org/wiki/Albania-Kosovo_Highway

In terms of trying to assess the linkage between policy and budgets I think that these two examples that Harnett has raised justifies a closer look within PEFA if only to accentuate its importance to which the authors are drawing attention. If governments are accountable, why should the link between policy and budgets not be a factor in assessing PFM? Whether PEFA is the tool for a full examination of this, is one question that is being asked, but improving the treatment beyond the present coverage is another one. So the answer to Napodano is yes, please expand on your contribution!

Harnett

Ah - I thought my cynicism regarding policy might elicit some response! Sure the Uganda example was not a PFM issue - just a rare example of a genuine policy debate - the documentary is well worth watching - this should get it - http://www.youtube.com/watch?v=cRNn-DbS6gk
The debate if I recall correctly was more along the lines of donors wanting to support the social sector and Museveni wanting roads - which he indicated was for economic reasons but the donors were concerned that the roads were also for military reasons given the war he was fighting at the time. But if you were there at the time it would be interesting to hear your views on the documentary. I used to use it in my lectures in Liverpool!

As for Albania, yes the government followed its own (and that of the US?) policy convictions - just interesting how it panned out in the PFM sphere. Here's a quote from the Wikipedia entry as in Short's message: "The highway project is the biggest road infrastructure project ever done in Albania. Its initial cost was estimated at €600m but during the course of construction this has more than doubled. The project is being financed by the government of Albania and some foreign lending institutions. The total cost of the highway is estimated to be over €1bn ($1.4bn).[citation needed] amid allegations of corruption and a growing public debt."

And as for the link between policy and budgets - I think the choice is between altering PEFA to accommodate this or establishing a new measure as intimated in Matt Andrew's look at "What a perfect PFM system should look like" - which can be downloaded on Petagny's comment below. I'm really not sure which is the way to go, but given the history of PEFA, I can't see any radical alteration - just a tweak here and there.

Napodano

As we are talking about major infrastructure I 'd like to have my second input on Public Investment Management.

The Albanian road is a good example. In my opinion the problem there was not 'Road yes or no'. A policy choice was made by the Government: debatable but legitimate . The MANAGEMENT of the project was the real problem as it had significant (doubling?), unplanned cost increases. Leaving outside corruption charges (behind the scope of this debate), this is a well know phenomenon in PIM, known as 'Optimism bias'. This should be gauged in the PEFA country

reports in my opinion for major infrastructural sectors. Below attached is a table(*) I used for an assessment of PIM in Brazil together with Professor Scandizzo.
(*) table is attached to the post and downloadable)

Napodano

Quote from: harnett on November 30, 2012, 08:20:50 GMT

And as for the link between policy and budgets - I think the choice is between altering PEFA to accommodate this or establishing a new measure as intimated in Matt Andrew's look at "What a perfect PFM system should look like" - which can be downloaded on Petagny's comment below. I'm really not sure which is the way to go, but given the history of PEFA, I can't see any radical alteration - just a tweak here and there.

harnett,

I am aware that the PEFA Secretariat is wary of too drastic changes of the PEFA structure. This is legitimate.

What could be proposed is to have 'add-on expansions' on specific dimensions: one definitively on policy-based budget; another for example could be on taxation (which was considered in the past but then abandoned by the PEFA Secretariat – attached(*) - see page 24). These 'add-on expansions' could be considered to be added before launching the PEFA exercise in a country on the basis of its perceived PFM shortcomings and need for analysis.
(*) PEFA Feasibility Study on Taxation attached to the post and downloadable)

Napodano

Two more considerations:

1. a (i) dimension within a PI could compare the composition of Government's budget submissions and the final budget appropriations as approved by Parliament. In some countries in which I worked (e.g. Mongolia and Kyrgyzstan) Parliamentarians have the right to introduce significant, last-minute changes to the Government policy priorities and the related expenditures, thus invalidating any policy management effort pre-budget. This create a disincentive to build up a systematic process for policy management and MTEF.

2. PI-24 addresses the quality and timeliness of in-year budget report and this is fine. What I would add in a PEFA policy-based budget dimension is a review of actual spending on a monthly basis by Central Government as whole and key sector ministries. Often there is a spike in

spending at the end of the year (see attached chart(*) from WB Albania PEM - You need to register in order to see it). The reasons for this spike are multiple and interesting to analyze as all are related to policy implementation.
(*) chart attached to the post and downloadable)

<u>Napodano</u>

Chandra Bhandari <bhandarick@gmail.com> provided the following input via email:

QUOTE
Dear Gord Evans, John Short and Martin Johnson,
Please find my views attached(*) here on the topic of Policy Based Budget of PEFA ,PMF.
Thanking you.
With Best Regards,
Chandra Kanta Bhandari,FCA
UNQUOTE
(*) paper attached to the post and downloadable)

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