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**Performance-Based Budgeting and Medium-Term  
Expenditure Frameworks in Emerging Europe**



Edited by  
Leszek Kąsek and David Webber

2009

**Current Issues in Fiscal Reform in  
Central Europe & the Baltic States 2008**

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tel. (48 22) 520 80 00  
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## ABBREVIATIONS AND ACRONYMS

BIS	Budgetary Information System
BL	Budget Law
COM	Council of Ministers, (the Cabinet)
COFOG	Classification of the Functions of Government
EBF	Extra Budgetary Fund
EDP	Excessive Debt Procedures
FLSU	First Level Spending Unit
FMIS	Financial Management Information System
GFS	Government Financial Statistics
LGU	Local and Regional Self-Government Unit
IMF	International Monetary Fund
ITC	Information Technology and Communications
KPI	Key Performance Indicator
M&E	Monitoring and Evaluation
MOF	Ministry of Finance
NGO	Non-Government organization
MTEF	Medium-Term Expenditure Framework
MTO	Medium-Term (Fiscal) Objective
NIS	National Investment System
OECD	Organization for Economic Cooperation and Development
OMB	Office of Management and Budget
PART	Program Assessment Rating Tool
PBB	Performance-Based Budgeting (often called “performance budgeting”)
PDB	Performance-Determined Budgeting
PEFA	Public Expenditure and Financial Accountability (assessment)
PEIR	Public Expenditure and Institutional Review
PEM	Public Expenditure Management
PFM	Public Financial Management
PFMCL	Public Financial Management and Control Law
PFDML	Public Finance and Debt Management Law
PFMR	Public Finance Management Reform (project)
PIB	Performance-Informed Budgeting
PPP	Public-Private Partnership
PRB	Performance-Reported
PRSP	Poverty Reduction Strategy Paper
ROSC	(IMF) Report on Standards and Codes
SAO	State (or Supreme) Audit Office
SPO	State Planning Office
TSA	Treasury Single Account
WB	World Bank

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## ExEcutive Summary: ACHIEVEMENTS, LESSONS & CHALLENGES AHEAD

### I. Introduction<sup>1</sup>

In recent years, governments in many regions have adopted a wide range of reforms to make fiscal policies more consistent and effective over the medium-term and emphasize the impact of policies and spending. Two reforms – performance budgeting and medium-term expenditure frameworks – have been central elements in improving the management of public finances. Medium-term expenditure frameworks (MTEF) have been developed and refined by many countries to help build fiscal policy credibility and predictability via a more strategic, multi-year, budget planning perspective. At the same time, performance-based budgeting (PBB) concepts and methods have been especially important in many countries in bringing an increased focus on the results sought and achieved from government spending (i.e. getting better value for money).

Both of these budget reforms have been on the agenda of most new European Union (EU) Member States and candidate countries. Six of these countries have been selected for this study: Bulgaria, Croatia, Latvia, Poland, Slovakia, and Turkey. These are referred to jointly throughout this report as either Emerging Europe or ‘the region’.

The main purposes of this study were to:

- Compile a comprehensive stock-take of the implementation of major budget reforms, including MTEF and PBB in particular.
- Identify the lessons from these experiences, including the constraints faced by these countries and some of their major challenges for the future.
- Enable these and other countries in the region to better understand and compare these experiences and to identify some of the good practices and ideas they have developed in implementing PBB and MTEF reforms.

The decision to focus on just two main public expenditure management reforms – MTEF and PBB – was taken on the basis of actual reforms strategies adopted across the region in recent years, combined with the potential opportunities and synergies these reforms provide for more generally improving public financial management (PFM). PBB and MTEF

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<sup>1</sup> The report generally covers information available as of early 2009.

reforms, implemented together, have the potential to significantly raise the quality and consistency of forward estimates of public expenditures through their common use of policy-based expenditure programs and program- and activity-based costing methodologies. The result is more credible future budget commitments, more efficient expenditure prioritization and increased consensus around what fiscal policies are seeking to achieve.

The country reports and analysis contained in this study were based on responses to a questionnaire filled out by World Bank experts, mostly in close consultation with the relevant national authorities. This questionnaire (Annex 4) was developed to help ensure consistency and coverage in the research, analysis and reporting provided from each country. The overall assessment and comparisons of progress, achievements and challenges as discussed in this report were based on the responses to the questionnaire as well as on the views and insights of World Bank staff and national counterparts.

Finally, the study recognizes that the MTEF and PBB reforms adopted in these in six countries are far from complete. In all cases, many of the full benefits of these reforms are yet to be realized in terms of improved budget management, more evidence-based decision-making, quality and professionalism of administrative performance, expenditure effectiveness and fiscal stability. Some international examples, from Chile in particular, of how key obstacles have been overcome, and the extent of gains that can be expected, are provided in Chapter 1. Overall, this study suggests that these Emerging Europe countries are, to varying degrees, now taking significant steps down a similar and worthwhile path.

## **II. Recent Achievements in Budget Reform**

Although not all innovations in budgeting have been successful or long-lasting, most have contributed in some way to a gradual advancement of public financial management, especially in developed countries. Many OECD and EU countries in particular have undertaken budget modernization steps in the last 30 years involving MTEF and PPB initiatives (e.g. Australia, New Zealand, USA, Canada, UK, Netherlands, France, Denmark and others). More recently, many emerging economies have followed a similar path (e.g. Chile, Korea, South Africa, United Arab Emirates, Emerging Europe and Russia). Very few countries, if any, have halted, much less turned back from, these developments in budget management and public administration. Each reform or reform effort address-

es a key challenge faced by policy officials and public finance systems in developed and emerging economies.

Progress and achievements across the region are varied although the experiences of these countries have shown many similarities in terms of critical success factors and lessons learned. In the six countries addressed by this report, budget reforms involving especially MTEF and PBB approaches have been introduced only since the late 1990s and in some cases even more recently. Some countries have made considerable advances in some areas, but for all six, there is still a long way to go. While the current global financial crisis has heightened the importance of these reforms, it has also added complexity and uncertainty to the reform environment.

In each case, the design and implementation of MTEF and PBB approaches have been part of a broader program of public finance and administrative reform (Chapter 2). Successful adoption of these budget tools is seen as vital for contributing to other positive changes in public management culture and fiscal performance. Although there has sometimes been a risk of 'reform overload' on the public service in several of these countries, in terms of implementing the financial and administrative reform agendas, most have succeeded in putting in place the basic foundations for improved budget management.

For all six countries, these principal achievements (Chapter 3) have included the following: preparation and approval of improved public finance (organic budget) laws, adoption of programmatic budget structures (rudimentary in some cases), revised budget classifications, and adoption of fiscal strategies and targets conforming to EU accession requirements. Although implementation of medium-term budgeting methods has been patchy, there is now a broad understanding across the region of how programs and performance indicators need to be determined and managed within the context of a medium-term fiscal strategy and policy objectives. Slovakia in particular has led the way in applying a more integrated approach to the adoption of these 'second generation' budget reforms. Bulgaria has made good technical progress too but needs to maximize the pay-off of reforms in terms of improved effectiveness and efficiency of public spending.

Among the other four countries – Latvia, Croatia, Poland, and Turkey – key elements of these reforms have been piloted and implemented to varying degrees. Continuing senior policy official enthusiasm and leadership has been a key factor in determining how far and how effectively

these measures have progressed. In the new EU Member States, the Convergence Programs have also given considerable impetus to these reforms.

Overall (Chapter 4), progress in the region has generally not yet reached the point of full and committed implementation in either MTEF or PBB, nor has it been sufficient to enable the expected benefits and synergies of these new approaches to become fully evident, or to engender wider interest and support within the public sector and civil society. In each country, despite the best efforts of the national ministries of finance, key elements of these reforms are not yet embedded in the annual systems of budget preparation, much less in terms of generating a 'performance culture' around public financial management.

### III. Critical Success Factors

This study identifies a number of critical factors for successful implementation of MTEF and PBB reforms. The potential list of critical factors is long and the country reports (Chapter 5) suggest that different factors may be more or less important in each country's circumstances. The clear experience from the region is that good budgeting systems evolve over many years, usually in parallel with other important improvements in public administration and management.

Factors which determine the speed and success of MTEF and PBB reforms in particular include both the character and quality of public institutions and laws within the country, plus the degree of technical knowledge, degree of effort and experience applied to design and implementation of these methods. In most cases, these types of budget reforms are initiated in public management environments in which institutional capabilities and technical understanding are less than ideal. It is therefore invariably a major learning experience and allowances must be made for concepts and approaches that may not initially be well-suited to the situation, or well-received by officials in the spending ministries. Consequently, patience and persistence, including the courage to make good but unpopular decisions, and on-going support and encouragement for these ministries and agencies is essential. Proper attention to change management would also improve the likelihood of success.

Institutionally, it is essential for government as a whole to be dedicated to the objectives and requirements for reform and to have strong leaders, at both political and bureaucratic levels, providing guidance and direction at each stage. MTEF and PBB reforms involve a range of complex steps starting from changes to budget classifications, some complete-

ly new managerial concepts, introduction of new IT systems and changed behaviors of public servants. All of this requires a positive and determined attitude by government with good communication between the centre – invariably the Ministry of Finance – and line ministries and spending agencies. Reform efforts tend to be more successful and sustainable where the process of reform receives as much attention as the substance, and where teams spanning the Ministry of Finance and line agencies work together to design and implement the reforms (effectively, on-the-job learning and training).

Much has been written and discussed concerning the appropriate sequencing of these reforms. Unfortunately, most reforming governments don't have the luxury of time in making major fiscal adjustments, or in meeting new policy targets or the specific fiscal requirements of new multilateral agreements. In most cases, the benefits of a gradual approach, including proper sequencing of budget reforms, must be weighed against the immediate and often short-lived opportunities for implementing change that may be presented by a fiscal crisis and/or determined and effective political leadership.

In general, good strategic decision-making, accompanied by sound and enduring changes to systems and capabilities, will take considerable time to fully develop. Maintaining a specific roadmap for implementing these reforms can help prevent the gradualist approach from becoming an eternal one. Informing and encouraging line ministries to prepare for these changes also helps increase their chances of being ready to accommodate major institutional, policy and methodological improvements, many of which may be needed year-on-year for a prolonged period. Some of the countries in this study have clearly struggled to sustain and embed some of these reforms. Re-starting the implementation process may be even more difficult than taking the initial steps.

Finally, it is evident that some aspects of these new methods for budget management may have been adopted without adequate thought and preparation and may have been initially too advanced for organizations and systems that don't yet possess basic skills and competencies in budgeting, management and financial reporting. Careful assessment of these conditions, including the capacity of the public administration system for managing these changes, is important. It is not enough for the Ministry of Finance (MOF) to be ready and willing; most line ministries face a variety of unique policy, organizational and technical constraints that also need to be overcome. MOF must find and establish mechanisms for supporting

the managers of each line ministry to ensure they have the right motivation, capacity and resources to address these needs.

### **Implementation of Medium-Term Expenditure Frameworks**

Medium-term expenditure frameworks provide a link between the allocation of budget expenditures according to policy priorities and the fiscal discipline required by budget realities. Some of the concepts underpinning the MTEF also overlap with the PBB approach and help to improve program performance through better predictability in resource flows to programs, planning beyond one year horizons and by managers searching for higher value of public money.

Although formal adoption of MTEF's is relatively new in Emerging Europe, some elements of medium-term financial planning have been in place for more than a decade. Nonetheless, this approach has brought a degree of rigor to most budget planning processes and some local adaptations to the basic methodologies have gradually developed. Learning to allocate discretionary resources between competing spending agencies in an informed and policy-relevant way over a multi-year horizon has been demanding. There are still strong tendencies in most of the countries to a degree of budget incrementalism.

Most countries in the region have developed their MTEF based on a three-year planning horizon (current budget year and two years beyond) though Poland expects to introduce a four-year financial planning process in 2009. The three- or four-year time frame seems a reasonable compromise between the value of longer term planning and the shorter periods over which most government revenues and expenditures can be plausibly forecasted. For the region, longer term planning has proved especially difficult because these countries continue to face the need for large structural changes in their economies. Moreover, as a consequence of the recent global financial crisis, forecasting of most economic and financial variables has become much more complicated, even within a one-year horizon.

Regional experience has indicated that successfully combining top-down and bottom-up budgeting processes depends in part on efficient communication within government and on effective debates around spending priorities. Without good communication, national policy objectives often receive little consideration in the resource allocation process and full transparency in decision-making remains problematic.

Slovakia, Turkey and Croatia are further along in their implementation of MTEFs. In the remaining countries in the region, this reform is

still in the early stages of development and positive impacts on the quality of budget decision-making have so far been limited.

### **Implementation of Performance-based Budgeting**

On the technical level, this study has identified many factors for successful implementation of PBB concepts and methods. These start with a logical, robust and transparent program architecture for budget expenditures, to setting realistic and managerially-relevant performance measures, through to more difficult and comprehensive changes in the management culture. These cultural changes involve particularly a firm understanding and acceptance, at each level of the budget organization, of the new results-oriented framework for allocating, managing and reporting on the use of budget resources.

Regional experience has emphasized the importance of a sound programmatic structure as a basis for effective allocation and management of resources. Well designed programs and sub-programs provide the essential linkages between policy, funding, and activities, and serve as the foundation for a successful performance-based budgeting system. Initially, most major programs have been designed to embody core functional responsibilities and government policy objectives for each sector. However, these program and sub-program structures have developed further over several years to provide a more accurate and informed framework for expenditure policies and strategies and for performance measurement purposes.

With experience, each of the countries has come to appreciate the importance of realistic and measurable performance indicators. Initially, there was a tendency to concentrate too much effort on defining large sets of possibly relevant performance measures and indicators, rather than defining a small set of indicators that are able to clearly and specifically measure progress against the core policy objectives and strategies that government aims to achieve. Increasing attention has also been paid to finding performance indicators that are comparable with those used by other EU country members and which facilitate these regional comparisons.

For these reasons, performance indicators that enable the budget and line ministries to measure progress against clear policy objectives are important. In most countries of the region, this performance information has so far not been well used, and it the process of improving performance measures continues. Quality of information, and its effective use in

making better-informed budget management decisions, is much more important than quantity of indicators. Performance measures may point to strengths or gains in policy implementation, but also to areas of weakness or inefficiency that need to be addressed and improved by budget managers. As in the more advanced countries, however, much more work is required for the countries in this region to interpret indicator information accurately and to use this information to inform future policy and budgeting decisions accordingly.

Good indicators must therefore be carefully selected and information on them must be accurate, timely and regularly monitored. The introduction of performance-based budgeting practices requires a basic capability for data and information collection and reporting. There must be an underlying acceptance of the need for good information within sectors and robust technology for collecting and analyzing it. Systems for achieving this performance reporting function need to be established in each line ministry. However, some proposals for combining performance monitoring and reporting with the development of a modern integrated financial management and information system (IFMIS) for improved financial management purposes have proved overly ambitious and unnecessarily complicated.

Full understanding and acceptance of the new performance orientation within the public sector is still to be achieved in most of the countries covered by this study. Gains made so far in these six countries have been useful, but remain tenuous. Existing practices and staff expectations in the form, especially, of lifetime tenure, seniority-based promotion and salaries and limited managerial flexibility and accountability create a difficult environment for the introduction of performance concepts. New and improved budgetary arrangements require changing many of these institutional rules and practices within government, as well as building new managerial and analytical capabilities in MOF and the spending agencies.

#### **IV. Lessons from the Region**

This study of six countries in Emerging Europe has produced a number of potentially valuable lessons in the design and implementation of budget reforms. As well as helping these countries progress their reform programs, these lessons may be valid for other countries entering, or perhaps just considering, similar developments in their public financial management systems.

#### **1. Duration of the reform process**

Country authorities adopting these reforms should be prepared for a long implementation path – in truth, they are embarking on a process of continual improvement in systems and performance. It is a complex learning process for all concerned. A number of obstacles are likely to be encountered en route and the commitment of key stakeholders is required to overcome these difficulties and ensure success. Similarly, the complexity of some aspects of these reforms can be easily underestimated. For example, more attention needs to be paid to understanding how the concepts and tools of performance budgeting need to be applied at different stages of the budget process, such as at budget formulation and execution.

#### **2. Leadership**

Strong leadership, backed up by political commitment and consensus, are essential for sustaining budgetary reform. Without this, there are inevitably weaknesses in the link between the government's strategy and the budget, including the effects of historical inertia in spending allocations that can reduce the focus on new and more important strategic priorities. It is particularly useful to have key individuals in multiple ministries champion change, both initially and to sustain momentum. Pressure from the general public for better services and more effective spending is especially helpful. Voters demand high quality public services and governments must deliver these in order to justify the associated level of taxes. Support based on a broad consensus throughout policy and technical circles is desirable if it is to last through the inevitable changes of government. The reforms need to have broad support, based on an understanding they are an essential part of public sector modernization and efficiency, and thereby good for the country. When overly identified with one party or group, they risk being abandoned when the next group assumes office<sup>2</sup>.

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<sup>2</sup> In many Asian countries, such as Indonesia, great emphasis is placed on 'socializing' reforms, meaning widespread engagement inside and outside of government with key stakeholders, so all come to a similar understanding of the problems to be addressed, options for redressing the problem, and the way forward. This assures broad consensus on the reform, and getting all stakeholders involved in the solution and implementation.

### 3. Experience and enthusiasm

Within the public sector, it is important to create, maintain and encourage a core group of ‘modernizers’ supporting the endeavors of policy-makers. This includes offering them and their institutions relevant training opportunities. This group may comprise highly qualified younger civil servants open to modern methods in budgeting and who understand the changes needed to implement them. Having at least one lead organization with capacity and experience in managing the introduction of a particular aspect of these reforms – such as performance measurement – can be very beneficial for advising and consulting other agencies.

### 4. Relevant skills, capacities and employee attributes

Building the required skills and capacity in MOF and other agencies is another important element for achieving systemic, as opposed to cosmetic, change. Budget management skills necessarily comprise new technical knowledge (macroeconomic and policy analysis and sector modeling capacity) as well as managerial and interpersonal problem-solving abilities. The public management environment should motivate self-development and capacity building among employees, while emphasizing new levels of professional and personal integrity and commitment.

### 5. A well-staged, comprehensive and consistent approach

It may sound obvious but getting the basics right is essential for successful implementation of any advanced public expenditure reforms. This requires carefully identifying the shortcomings of the current public financial management process and developing a logically-sequenced program for introducing new and improved methods and systems. This program needs to incorporate both the technical changes associated with PFM reforms – revised budget classifications, new chart of accounts, program and sub-program structures etc – with organizational reforms in and across many public spending units, as well as engage policy-level officials to enable them to understand and use the information and tools available.

### 6. Recognizing complexity and complementarity in the reforms

Each reform may have a number of technical dimensions that are closely linked with other parts of the reform and with other new concepts and methods for improving budget management. Even the implementation of an effective MTEF may raise many challenges to existing capabilities and systems, including requirements for:<sup>3</sup>

- *Good macro-economic policies and reliable forecasting* – otherwise the credibility of the MTEF is diluted.
- *Adaptable fiscal policy and instruments* – projected spending must conform with available resources.
- *Reprioritization and reallocation* – the MTEF should be used to enhance alignment between budget policies and resources.
- *Budgetary discipline* – budget allocations must be based on a hard aggregate budget constraint, distributed among line ministries.
- *Institutional conformity* – the MTEF must be widely understood and adopted as the core framework within which all, or nearly all, government expenditure decisions are made.
- *Appropriate parameters* – these include definition of aggregate expenditure, the relationship between sectoral needs and the government’s organizational basis for appropriation, the content of expenditure envelopes, price level assumptions for estimating future expenditures and mechanism for incorporating these parameters into the annual budget process.
- *Transparency* – this includes both *fiscal transparency* concerning the structure and functions of government, fiscal policy limitations and constraints, public sector accounts, and fiscal projections, and *policy transparency* concerning the government’s budgetary objectives and intentions for social and economic development. It also refers to accounting and reporting for actual performance in ways that link expenditures made to the quality and quantity of outputs and results achieved.

### 7. Technical challenges

Implementing PBB and MTEF approaches involve a number of technical challenges. Two particular issues that confronted the six regional countries were:

<sup>3</sup> Seok-Kyun Hur, 2004, *Successful Installation of MTEF to the Korean Fiscal System*, Korea Development Institute.

- Achieving alignment between outputs with outcomes was problematic. This was due to limited initial understanding of the different concepts involved and, in some cases, due to reluctance and diffused responsibility for the monitoring and achievement of outcomes.
- Integrating the information systems of multiple ministries and agencies is necessary to provide more reliable and complete information necessary for these reforms. Reviewing the technical character and limitations of the existing IT system, as well as designing capabilities for the incorporation of new budget information and management needs, require not only specialist skills but an effective processes for identifying, discussing and specifying new needs. These additional demands must be applied in an environment in which the annual process of budget management is on-going and where other demands on PFM information systems – such as those associated with new EU funding or fiscal devolution – are growing and changing.

## 8. Building confidence and understanding

Building understanding of and confidence in the reforms among public servants is essential. This requires sustained learning opportunities and effective incentives for human development and to help overcome tendencies for bureaucratic resistance and inertia. Excellent communication is also required with politicians as public finance reform is often a technical and complex field. It can be a challenge to help politicians, for example, understand the link between these technical reform issues and the modernization and improvement of public services (which is what they are really interested in) such as in the revision of budget classifications or the introduction of accrual accounting. Specialist schools for public administration have an important role to play and can bring much-needed international experience and perspectives to local issues. Even so, variability in the quality and speed of reform implementation is unavoidable across different institutions. This diversity is often apparent at many stages of the implementation of performance-based budget framework.<sup>4</sup>

<sup>4</sup> Petrie M. and Webber D. (2001), reviewing the New Zealand's experience, suggests that uneven performance might result from over-extension of the supply of capable senior managers. They also noted considerable variations across departments in the quality of policy advice on budget issues.

## 9. Ensuring managers can apply the new methods

As noted by Chevauchez<sup>5</sup> (2001), the most difficult task is often not the technical design, but how ordinary members of the public sector may apply it. While some technical design aspects can be delegated to external consultants, this is usually not the case for application of these concepts and tools which are placed directly into the hands of budget managers. In France, regular contacts between the Ministry of Finance and budget managers enable views and proposals to be exchanged on technical topics and joint exploration of various ideas and solutions.

## V. The Challenges Ahead

Despite their difficulties, each of the countries covered in this study is pressing ahead with implementing these advances in public financial management. In each case, they are evolving toward improved levels of understanding and application for both MTEF and PBB. They are achieving this through a combination of persistence, trial and error and local innovation. At the 'end' of this evolutionary process, each system will undoubtedly be unique and should reflect and support each country's specific governance and institutional structures and management needs.

However, the road is a long one and the experience of other more advanced administrations suggests that as the reforms develop, so also do the professional competencies of budget managers and their expectations of even better performance. The roadmap for reform must be realistic but there is no end to the degree to which improvements are possible. Constant improvement is the aim, even for those few countries which have already made considerable progress. Successfully linking the human and technical dimensions of these budget reforms to a strong political agenda for improved public sector performance remains essential to their successful development.

<sup>5</sup> Chevauchez B., 2001, *Government Budgeting and Accounting Reforms in France*, Ministry of Finance France, Paper for Conference *Government Budgeting and Accounting Reform Symposium*, Beijing, China, April 11-12, 2001.

## **Chapter 1.**

### **PFM reforms – learning from Global lessons**

*Mario Sangines*

Democracy challenges governments to be transparent and accountable in their use of public funds. Minimum standards for ensuring legal expenditure of approved budgets are no longer sufficient. Authorities must implement management practices – some of which have long been applied by the private sector – that ensure maximum value for money and align budgets with national priorities.

This has proven a tall order for developing and developed countries alike. Well-meaning reform agendas are often hindered by changes in government, competing policy agendas (generally in more politically profitable areas) and limited understanding of key budgeting concepts. This chapter explores lessons learned from performance budgeting reform in other parts of the world and attempts to make them relevant to reform efforts in Emerging Europe.

We make a distinction between program-based performance budgeting and everything else. This distinction is useful because, first, program-based budgeting is a systemic reform that seeks to overhaul the entire budget cycle by introducing new classifications, indicators, and evaluation processes that feed back into budget preparation<sup>6</sup>. Other more specific initiatives, such as investment, staffing and procurement, can be applied to certain parts of the budget cycle. Second, many practitioners believe true performance budgeting can be obtained only through a systemic overhaul, starting with implementation of program budgeting. Making this distinction may help clarify the relative importance of program budgeting in the overall picture. We will look at program-based budgeting and then explore other tools for enhancing performance.

During the 1960s the United States (US) was a pioneer of budget reform when it designed programs around organizations' service delivery frameworks and assigned resources according to program structures. This was an important step in linking expenditure to outputs. It promoted a holistic view of public expenditure in relation to public policy objectives. Attempts at implementing similar methods of program budgeting in other parts of the world have had mixed success and some countries still struggle with the complexities of applying a program structure to their budgets.

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<sup>6</sup> There are cases where program structures have been applied selectively in certain parts of the budget but they are the exception rather than the rule.

One reason for this struggle, as we will discuss later, is that many countries try to implement budget reforms without dismantling or even disrupting existing budgeting practices. This results in a motley collection of classifications and other information that is difficult to analyze and integrate. There are other reasons that make implementing program budgeting difficult, such as unrealistic expectations and poor understanding of the information requirements and responsibilities, and we will look at these later in the chapter.

Applying a program-based budgeting framework is a systemic approach towards improving efficiency and effectiveness in public service delivery. It is systemic because it implies substantial reform to most aspects of public expenditure management (PEM), including the way the budget is classified, the type of information that needs to be gathered and analyzed, the accountability structures for results, and the accounting framework, as well as the type of external oversight by the legislature and the state, or supreme, audit institution.

Systemic approaches such as this are not, however, the only way to promote effectiveness and value for money in managing public expenditure. Chile, for example, has deployed program budgeting only recently and selectively; most of its efficiency gains have been achieved through efficiency-enhancing tools that include sound project and program evaluations and management improvement programs. Chile's program evaluations resulted in a zero-based budgeting exercise for each program, allowing both the implementing agency and the budgeting office to thoroughly review every aspect of the program and, where necessary, adjust objectives and resource requirements.

Determining the degree to which a reform strategy combines these elements depends on each particular setting. As noted by Levy (2007), there is a compelling case for combining systemic reforms "with more targeted efforts – within individual sectors and across sectors – to identify high-return investment opportunities, plus opportunities for freeing up resources locked into low-return activities". Whichever path is chosen, it must be done for the right reasons and with full understanding of the technical and political challenges to be overcome for its success.

External pressure by donors, or the need to reduce public expenditures, is generally an inadequate reason for embarking on a performance budgeting reform. As Shah and Shen (2007) have noted, advantages of PBB that constitute valid motivations are:

- *Enhanced communication between budget actors and with citizens.* Performance budgeting clarifies program goals and objectives and identifies performance targets, giving agencies and employees a better sense of expectations of their performance. It helps public managers communicate more effectively about their activities to the executive, the legislature, and the public.
- *Improved management in government agencies.* Performance budgeting reform can help program managers specify organizational goals, monitor program performance, maintain better knowledge of problems with program structure and operation, plan for the future, improve internal control, and communicate program results.
- *More informed budgetary decision making.* Performance budgeting may not rationalize and transform the political budgeting process but it adds value to deliberations. This is because performance information is taken into account when funding levels are decided.
- *Higher transparency and accountability.* Performance budgeting classifies resources by programs and presents performance indicators, making it much easier for the public to get a sense of major government activities and their achievements.

An integral part of many current reforms is the development of a framework to assign expenditures over the medium-term, usually three years. If expenditure allocations can be linked to outputs, and public sector entities have some idea of what outputs they wish to produce over a medium-term, it makes sense to assign expenditures over the medium-term as well. Government authorities should be able to visualize an overall budget envelope for a medium-term horizon based on sound macroeconomic forecasting and, depending on policy priorities, determine trade-offs between sector allocations. Implementation of Medium-Term Expenditure Frameworks (MTEF) has attempted to provide tools for this but has often fallen short of expectations. Although the underlying concept of an MTEF is sound and relatively simple, there is disagreement among practitioners about what it looks like in practice and what the necessary conditions are for it to be successful. We will address some basic elements of the MTEF in this chapter and discuss its challenges and shortcomings.

## 1. Fundamentals of PFM Reform and Sequencing

**PFM reform, as a general concept, is a driving force behind public sector modernization in advanced and developing nations alike.** In its most basic form, PFM reform can help countries emerging from a major crisis (such as a hyper-inflation) establish basic rules and systems for budgeting and expenditure control, with a focus on macroeconomic stability and monitoring of key fiscal aggregates. In this context, PFM reform may entail strengthening the operational capacity of the central fiscal authority and its links to revenue agencies. As fiscal aggregates come under control, measures can be put in place to promote greater efficiency in the allocations of expenditure – that is, to align the budget with public policy priorities, coupled with some degree of monitoring of the outputs produced. It is often at this stage that countries consider migrating from a line-item to a program-based budget, as well as establishing basic monitoring and evaluation capacities; in some cases, medium-term budgeting frameworks are also introduced.

**Many authors have emphasized the importance of getting the sequencing right.** The ‘platform’ approach that has been used in some World Bank projects identifies stages that ought to be followed sequentially in a long-term PFM reform process. The following is the example of Cambodia, as presented by Taliercio (2008):

- *Platform 1: More credible budget.* (i) Comprehensiveness and integration of the budget; (ii) Strengthen macro and revenue forecasting; (iii) Streamline spending processes.
- *Platform 2: Effective financial accountability.* (i) Re-design accounting and budgeting classification and coding system; (ii) Initial design of Financial Management Information System (FMIS) for core processes; (iii) Define leadership and standards for internal audit function.
- *Platform 3: Fully affordable policy agenda through policy-budget linkage.* (i) Re-design budget cycle and responsibilities (e.g. inclusion of MTEF); (ii) Program-based budgeting and budget analysis; (iii) Explore options for fiscal decentralization.
- *Platform 4: Effective program performance accountability.* (i) Initial design of full FMIS; (ii) Development of an IT management strategy; (iii) Initial design of asset register.

**Although there may be disagreement over specific elements of the strategy, or the fact that some key and controversial aspects of PFM reform are not addressed here (such as accrual accounting), there is**

**universal agreement, in principle, that the basics must be right before moving on to more advanced reforms.** For example, Schick (2008) emphasizes that a well-functioning annual budget must be in place before thinking about MTEFs. Others argue against accrual accounting before cash accounting is fully reliable, or against any type of budget reform before expenditure can be tracked under the key classifications (economic, functional and organizational).

**Unfortunately, this universal agreement is only in principle.** In practice, countries often move ahead with reforms that are in vogue without ensuring the basic building blocks are in place. It is often the international development community that encourages countries to move in this direction, without proper regard for the institutional underpinnings and the sustainability of the reforms. For example, countries that implement Poverty Reduction Strategy Papers (PRSPs) are often required by donors to undertake medium-term expenditure frameworks, often without reliable annual budgets or even stable macro-fiscal aggregates. This is a risky approach that in the long run has limited benefit.

## 2. Systemic Approach to Performance Budgeting

**According to Robinson (2007) there are four fundamental mechanisms operating under performance budgeting frameworks:**

- Program budgeting, which uses information about the costs and benefits of objective-based (program) expenditure categories for expenditure prioritization.
- Funding-linked performance targets which seek to link the level of funding to results targets – that is, to quantitative statements of the output and/or outcome the agency is expected to deliver.
- Agency-level budgetary performance incentives to motivate agencies to perform better by rewarding them financially for good performance (and possibly also financially sanctioning unsatisfactory performance).
- Formula funding in which funding provision is made an explicit function of measures of expected and/or actual results (usually outputs, but sometimes outcomes).

**Program budgeting, or some variation of it, has often been used as the vehicle to implement a systemic performance budgeting reform.** In traditional, line-item budgeting, budget organizations identify the inputs required for their operation during the fiscal year and present their budget estimates in a standard classification, without any reference to the outputs

expected to be produced. In some cases, such as Colombia, the budget is by organizations and line-items but information on performance is presented in parallel, without any clear impact on the actual budgetary allocations. This is usually referred to as Performance-Reported Budgeting (PRB).

**There are cases in which performance information informs the budget process but isn't used as a major factor in allocation decisions** (Shah, 2007). This type of budgeting, called Performance-Informed Budgeting (PIB), may signal either a major shortcoming in a budgeting process meant to have strong influence from performance information, or a characteristic of a more advanced system that, by design, may not want performance information to directly influence actual allocations. Chile is an example of the latter, where reliance on other tools for efficiency gains has more weight over performance budgeting per-se. This case will be discussed in greater detail in the following section. Chile hasn't implemented a complete program budgeting structure but is applying it selectively in a few organizations. Australia has PIB with an accrual-based outputs and outcomes budgeting and reporting framework (Shah, 2007).

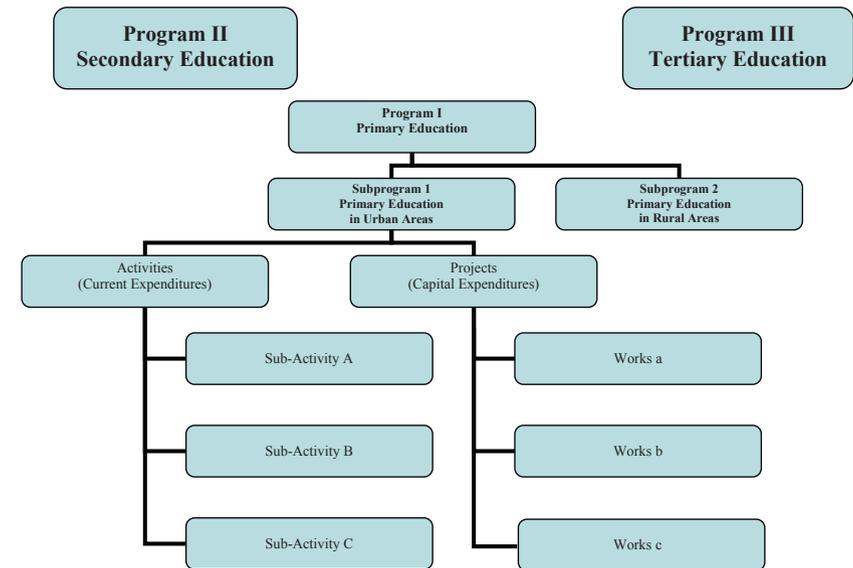
**Program budgeting is a more relevant tool when performance information is a more important (although not the only) element for deciding allocations.** Performance-based Budgeting (PBB), where performance information may play an important role in determining and reporting on resource allocation, can take advantage of a budget structure that groups expenditures in output-generating units, thereby enabling a close match between outputs and inputs. This approach sometimes views the organization rather like a 'production chain' with expenditure activities ideally matched to public service delivery targets set within a strategic planning process. However, the process by which performance information is used to inform and adjust budget allocations is not mechanical and may not even be fully explicit; other factors, such as policy shifts or budget rigidities, may have an equally important effect on expenditure.

**Cases where performance information actually determines allocations by an explicit, formula-like mechanism are rare and should be discouraged because they have a simplistic view of fiscal policy in which no other factors play an important role.** This type of budgeting is called Performance-Determined Budgeting (PDB). Few, if any, countries have been able to implement this approach successfully.

**Regardless of the particular point in their evolution, most advanced PFM reform efforts have at some point or another considered**

**implementing a program-based budget.** Remarkably, after nearly 50 years of accumulated experience in its implementation, there are few cases where program budgeting works exceptionally well. This raises the question of whether or not there is a fundamental flaw in the program budgeting philosophy or if we are all collectively very bad at learning from others' experiences. What is certain is that implementing program budgeting presents political, institutional, and technical issues that are not easy to overcome. Before exploring some of the typical pitfalls in its implementation, let's look at a stylized example of a program-based budget (Figure 1).

Figure 1. An Example of a Program Structure



Source: World Bank staff

**A simplified approach to transition from a line-item budget to a program budget would normally entail the following steps<sup>7</sup>:**

- Define exactly what is understood by a 'program'. Typically, a program is a coherent set of activities and projects that collectively produce units of output relevant to strategic planning. Further elaboration of the definition may be necessary in particular cases.

<sup>7</sup> For a more complete discussion, see *From Line-Item to Program Budgeting: Global Lessons and the Korean Case*. Kim, John, Editor. The World Bank and Korean Development Institute. 2006. (Available at: <http://www1.worldbank.org/publicsector/pe/bookprogrambudget.pdf>).

- Define the typical program structure to be used. One example is Program-Subprogram-Activity/Project-Sub-activity/Task.
- Determine the set of entities where the methodology will be applied. It is advisable to understand up front that a program structure may not be relevant for all organizations.
- Define virement authority<sup>8</sup> at each level of the program structure.
- Carry out individual functional reviews of each budget organization and identify the corresponding program structure. Although it is possible for programs to be implemented by more than one entity, it is advisable for the sake of simplicity and accountability that programs remain within a single budget organization.
- Identify the units and indicators to be used to monitor performance, and decide whether or not only outputs will be monitored, or if outcomes will also be measured.
- Define baseline indicators and establish lines of responsibility for collection, processing and auditing of performance information.
- Ensure proper institutional capacity in the Ministry of Finance and line ministries to carry out relevant budget evaluation.
- Establish or modify existing financial information systems so they can implement a program-based budget and collect performance-related information. Ideally, they could facilitate analysis as well by producing reports on, for example, unit costs.
- Train organizations, and other stakeholders such as external auditors and Parliament, on how to budget by programs and on the potential uses of available information.

**Countries may need to add additional steps to this roadmap or skip some altogether.** A detailed roadmap that considers all the above items should be prepared and, to avoid potential pitfalls, should tap into global program budgeting experience. Some pitfalls identified so far are:

- Poor understanding of basic concepts. It is essential that everyone involved shares the same understanding of programs, projects and activities etc, and of relevant institutions' relative roles, and how performance information will be used to affect allocations.

<sup>8</sup> That is, the bureaucratic or political level at which transfers between approved budget allocations may be authorized during budget implementation.

- Information overload. This can mean either a surplus of information that isn't used, or excessive requirements for information that cannot be fulfilled.
- Immeasurable indicators. Avoid indicators that are excessively qualitative, have no baselines, or can only be measured at great expense.
- Adding on a program classification as an informational annex to the budget without any real effect on budget implementation. This has been observed, particularly in countries where the Ministry of Finance hasn't lead budget reform, so the budget process continues as usual.
- Lack of political interest. A proper program budget may highlight a government's accomplishments but may also reflect its shortcomings. Also, budget reforms are not generally in the forefront of the political agenda.
- Making things too complicated. Start with a selected group of institutions and a manageable amount of indicators. Some countries have, unwisely, tried to launch a performance budgeting system using, simultaneously, as many as 1000 indicators.
- Excessive budgetary and administrative rigidities. Irrespective of the classification used, any reform aimed at improving allocative efficiency will have limited success if there are budget rigidities, either legal (protected programs, earmarked revenues) or de facto (high share of debt servicing, transfers and pension payments). These restrict the ability to redirect resources.
- Fuzzy responsibilities for program implementation. A tenet of program budgeting is that a program classification does not necessarily match the organizational classification of the entity. This can be problematic if there is no clear accountability of who manages the sub-programs, activities etc.
- Separated current and capital budgets. Proper integration of current and capital budgets is essential for both to be reflected in the program structure and provide a full picture of expenditures associated with service delivery<sup>9</sup>.

<sup>9</sup> The actual costs of service delivery in a program framework that integrates current and capital expenditures will be seen only if accrual budgeting is applied. Under traditional cash-based budgets, integration of current and capital expenditures in a single program structure will yield 'lumpy' service delivery cost estimates, as actual capital budget implementation is lumpy itself.

**Kim (Kim et al, 2008) identified the following three key principles for adopting program based budgeting in South Korea:**

- A program cannot span multiple ministries.
- All activities with the same policy objective must be grouped under a single program, regardless of revenue source.
- Programs must be clearly differentiated from one another both in policy objective and program name. This includes a strong preference for maintaining programs within a single ministry appropriation, based on experience where the lines of accountability and management became unclear within some cross-cutting programs.

**Chile successfully manages programs implemented in more than one ministry through a system of outsourcing** service delivery from one ministry (which is the head of the function and program and receives the full budgetary allocation for its implementation) to another which may be better suited to delivering the service. This works well as long as the subsidiary agreement is clear and overall leadership and accountability for program outcomes remain with the ministry responsible for the function.

**In summary, program budgeting can be a useful tool for organizing public expenditure by outputs, establishing cost benchmarks and eventually affecting appropriations based on actual service delivery targets.** For some, it is the backbone of a systemic performance budgeting system that truly affects the budget. Some countries apply the fundamental concepts but change the name or simplify or expand the standard classification structure. The common thread is establishment of a framework for clustering public expenditure along identifiable production units which are expected to produce a measurable quantity of a particular output. Ideally, these units should have clear lines of accountability.

**A question not yet fully answered is whether or not program-based budgeting is an essential condition for implementing performance-based budgeting.** For some, they are one and the same thing. Unless the budget is organized in a way that clearly reflects the production function of each entity or sector, with expenses properly correlated and measurable indicators established, there is no way to achieve accountability for results. Recent experience shows that a selective use of program budgeting coupled with targeted efficiency and effectiveness enhancing tools can be

a viable alternative<sup>10</sup>. In any case, it is essential to look beyond program budgeting and focus on a broader array of performance instruments that has evolved over the last few decades.

### **3. Developing a Toolkit for Improved Performance**

**Program budgeting can increase value-for-money in public expenditure but it is not the only instrument available.** In a sense, performance budgeting is about building a toolkit for efficiency gains across public service delivery, of which program budgeting can be one component. Ideally, implementing program budgeting is accompanied with as many of these other tools as possible. The tools used will depend on a country's particular context but there is abundant international experience to enable any country undertaking budget reform (or more broadly, public management reform) to start with a menu of options which support its strategy design. In Chile, this performance-enhancing toolkit has been in constant development for more than 30 years (Marcel, 2007) and we look at this in the next section, showing components of the toolkit of relevance to Emerging Europe.

#### **3.1. Enhancing capital expenditure efficiency**

**Good quality capital spending decisions are essential for improved public spending.** In the six countries included in this study, public investment ranges from 1.9 percent of GDP in Slovakia to 7.8 percent of GDP in Croatia (2007 data). Much of this investment flows through a public investment cycle inside each country, where guidelines for project identification, preparation, appraisal, and budgeting need to be followed before the project finds its way into the public budget. If the technical quality and comprehensive application of the process fails, a potentially large amount of public expenditure could go to waste. Unfortunately, not only are public investment institutions and processes often weak, political interference frequently finds its way into public investment decisions, further undermining what little rigor the institutional cycle may have<sup>11</sup>. This is most important in countries emerging from central planning, where a culture

<sup>10</sup> A strict across-the-board application of all program budgeting elements is generally undesirable. There will be certain institutions where measuring performance may not be relevant or interesting, and where pushing for full application of program budgeting may lead to situations that discredit the technique.

<sup>11</sup> Public expenditure, including investment, is, essentially, an instrument for implementing a public policy agenda and it is impossible to expect full isolation of the investment process from external political influence. Politically encouraged projects will always have a better chance of finding their way into the budget but certain safeguards can be put in place to prevent major investment mistakes.

of promoting investments for mostly political or strategic reasons has to evolve to one that incorporates technical, social and economic standards in a framework of sustainable development.

**Establishing a technically sound and reliable public investment process is an effective way to make public expenditure more efficient.** It is regrettable that countries with significant development challenges have, in their capital stock, public hospitals running at minimum capacity for lack of doctors (or excess hospital bed capacity), roads unusable for improper prevision of maintenance costs, or infrastructure built for a particular purpose (such as a sports event) that is not financially viable. Despite the emergence of public-private partnerships (PPPs) to relieve the public sector from some risks (though perhaps not as much as one would expect), improper project design remains a major issue to be addressed in efforts to improve the quality of expenditure.

**Ireland offers a good example of a sound project cycle.** In 1996, as part of its drive to improve the project cycle being promoted by the EU, Ireland established an Independent Evaluation Unit under its Ministry of Finance. In 2005, this unit issued new capital appraisal guidelines that form the backbone of a sound evaluation process. This process, which provides a valuable reference point for countries establishing or strengthening public investment departments, includes:

- Ex ante appraisal of all capital projects, with the methodology dependent upon the size of the project. These go from simple assessments for those under 0.5m Euro to full cost-benefit analysis for those of more than 30m Euros.
- The sponsoring agency is responsible for appraisal, but the sanctioning authority has to give its approval.
- Projects fall within a rolling five year envelope, in place for all investment areas, and the following steps are clearly identified:
  - definition of project needs and objectives
  - options analysis
  - identification of constraints
  - quantification of costs
  - analysis of options
  - appraisal techniques (cost benefit analysis, cost effectiveness and multi-criteria analysis)
  - analysis of uncertainty, risk and sensitivity.

**Since the early 1970s, Chile has established clear institutional arrangements and technical criteria for evaluating projects.** Its National Investment System (NIS) seeks to “provide public authorities with a plentiful portfolio of good investment projects so they can choose those suited as more convenient for society as a whole”. Projects need to “comply with quality standards in terms of elaboration, evaluation and analysis, and are controlled and monitored according to uniform and transparent rules and with adequate democratic participation of both the public institutions and the organized community or civil society” (Mimica, 2008). These uniform and transparent rules have four characteristics:

- a set of go/no-go criteria at the idea, profile, pre-feasibility, and feasibility stages
- key role by the Ministry of Planning to approve projects based on objective criteria, including a positive economic net present value (i.e. NPV>0)
- oversight, by the Ministry of Finance, of cost estimations for execution, construction and operation.

### 3.2. Undertake periodic, technical, and thorough reviews of programs

**Programs, in this context, can mean the concept described above as used in program budgeting or any other identifiable cluster of activities and associated expenditures that play a definable role in public policy.** In the United States, the Office of Management and Budget (OMB) has established good practice in this area through its Program-Assessment Rating Tool (PART). The purpose of PART is to:

- measure and diagnose program performance
- evaluate programs in a systematic, consistent and transparent manner
- inform agency and OMB decisions for management, legislative or regulatory improvements, and budget decisions
- focus program improvements and measure progress (making comparisons with prior year ratings).

This process enables evaluation results to feed back to four distinct stakeholders, allowing each to use the information for their own purpose. These stakeholders are the President, to inform budget decisions; Congress, to influence appropriations, authorizations, and oversight; the Ex-

ecutive Branch, to share best practices; and finally, the public, who are informed of such evaluations through the *expectmore.gov* website.

**In Chile, reviews are undertaken to ensure programs remain relevant, independent, timely and transparent.** Programs are selected jointly with Congress and evaluations are performed by independent evaluators selected by public tendering, and followed with formal agreements between the Directorate of the Budget and the executing unit. These agreements are extremely important and their implementation is closely monitored. Under this framework, three types of evaluation are conducted (Marcel, 2007):

- Program reviews which (i) review consistency in design, execution and reporting; (ii) are based on the logical framework methodology; (iii) are performed by panels of three independent experts; and (iv) issue final reports in six months.
- Impact evaluations which (i) assess program effectiveness on the basis of impact measures; (ii) use a methodology of extensive data collection, sophisticated evaluation techniques, control groups; (iii) are performed by consulting firms or universities; and (iv) issue final reports with 12 to 18 months.
- Comprehensive expenditure reviews which (i) assess the consistency of the ministry/agency portfolio of programs; and (ii) search for duplications, inconsistencies and opportunities to generate synergies and savings.

3.3. Establish an incentive system to encourage good performance  
**Designing a framework that provides tangible incentives for good performers in the public sector is a major challenge in public management.** Should incentives be institutional or individual? How can the performance evaluation system remain objective, impartial, and technical? Where do we find the resources to pay for the incentives? Are there only incentives for good performers, or are there also punishments for poor performers? Is the expectation of an additional monetary reward compatible with the philosophy of public service?

**These are questions that are answered differently in different settings, in part depending on the public management tradition and fiscal position of the country in question.** A country that runs a structural surplus policy can afford a monetary compensation scheme much more easily than one undergoing fiscal adjustment. A country with a tradition of measuring performance will have an advantage over another focused only on stewardship and legality. A country where administrative proce-

dures are sufficiently flexible to enable managers to manage will be more capable of redirecting efforts towards performance-enhancing measures than another where managerial leeway is more restricted.

**Chile is in the enviable position of running a structural surplus and having highly qualified civil servants as well as oversight institutions.** These institutions – such as the broad Civil Service and the Budget Directorate in particular – are empowered and well equipped to lead implementation of an incentives framework. Countries that do not (yet) enjoy these advantages can still benefit from lessons learned through this process and set future targets for its gradual deployment.

**In 1998, Chile implemented the Management Improvement Programs (MIP) through which annual bonuses are paid to staff on the basis of the agency's progress against goals in seven key management areas.** These areas are human resources, customer service, strategic planning and management control, internal audit, decentralization, financial management, and gender focus (Marcel, 2007). Each agency establishes benchmarks in agreement with the Budget Department and results are reported to Congress as part of Comprehensive Performance Reports (CPR). As of 2007, 75 percent of staff was receiving the maximum bonus of 10 percent of their salary. This example demonstrates the feasibility of combining institutional performance targets with individual monetary incentives, as well as good practice in benchmarking key areas of public service delivery and establishing clear lines of accountability to Congress.

**Mechanisms can also be developed to provide incentives to the institution itself.** These include access to additional budgetary funds or greater autonomy in its management in exchange for improved performance. In addition, an objective and public process of evaluating institutional performance can place institutions under pressure to perform, thereby creating reputational risks for managers if their organization falls into the lower tiers of performance. The specific instrument needed to deliver these incentives for the institution to perform better may vary. Chile, for example, has established a bidding fund that is allocated to innovative programs on the basis of quality and consistency of bids from ministries, which fosters a culture of quality management and accountability for results. As of 2007, 10 percent of government expenditure was allocated through this fund.

### 3.4. Design systems to foster political accountability for results

**Although not directly linked to budget decisions, some countries have established systems that allow citizens to monitor in detail fulfillment of government programs and the associated costs of achieving them.** To the degree that governments are willing to be publicly accountable for the promises made, such systems can be a powerful incentive for public sector managers to be aware of their performance and be creative about ways to enhance it, as well as for strengthening citizen oversight and democratic accountability.

**Colombia's National System for Evaluation and Management for Results (SINERGIA) is an interesting case.** Headed by the National Planning Department, SINERGIA was started many years ago as an internal system of agreeing performance targets with individual entities and monitoring the outcomes for feedback. The system was initially plagued by an overabundance of performance indicators, minimum visibility and no real consequences for performance gaps but it has evolved into an information platform that allows:

- the President to use the system to monitor the commitments and performance of his ministers
- an annual report of the President to Congress, outlining achievements in public policy and associated costs the public to access the information via the DNP website.

Although there is much to be done to build a formal feedback process into the budget cycle, SINERGIA is a good vehicle for introducing a performance-oriented culture in the public sector.

### 4. Medium-Term Expenditure Frameworks (MTEF)

**An element present in most advanced public expenditure reforms has been the establishment of medium-term expenditure frameworks (MTEF).** An MTEF is a tool for linking policy, planning and budgeting over a medium-term (usually three years). It consists of a top-down resource envelope and a bottom-up estimation of current and medium-term costs of existing policies, and involves rolling over this exercise each year to reflect shifts in policy. The framework matches these forecasts in the context of the annual budget process (Swaroop, 2000).

**Ideally, an MTEF should provide top decision makers with a control panel that identifies the cost of different policy options and trade-offs, all within the limits of what is fiscally affordable.** Once policy objectives and their associated aggregate costs are determined, each sector

ministry receives a resource envelope for the MTEF period as well as the agreed expected outputs and/or outcomes for their sector. The sector ministry then prepares its annual budgets under this envelope and monitors agreed performance indicators. An MTEF is a natural complement to a performance budgeting framework because it provides a limited, but realistic, timeframe within which most programs can be properly implemented and have some of their impacts measured.

**As a second-generation reform, implementation of an MTEF presupposes that certain basic building blocks are already in place.** The establishment of an MTEF can be seen as a final step in bringing together functional systems of macroeconomic planning, strategic planning, and sound annual budgeting. Unfortunately, many countries (with the encouragement of development partners) have used the label MTEF for reform programs that incorporate many other basic reforms in annual budgeting. MTEF has thus become a catch-all acronym for any type of budget reform that includes development of a medium-term budget outlook, even if it requires (or worse, ignores) first-generation reforms in areas such as budget classification, accounting, or institutional planning<sup>12</sup>. LeHuerou and Taliencio (2005) raised this problem when they stated that an MTEF had become a necessary condition for budget reform.

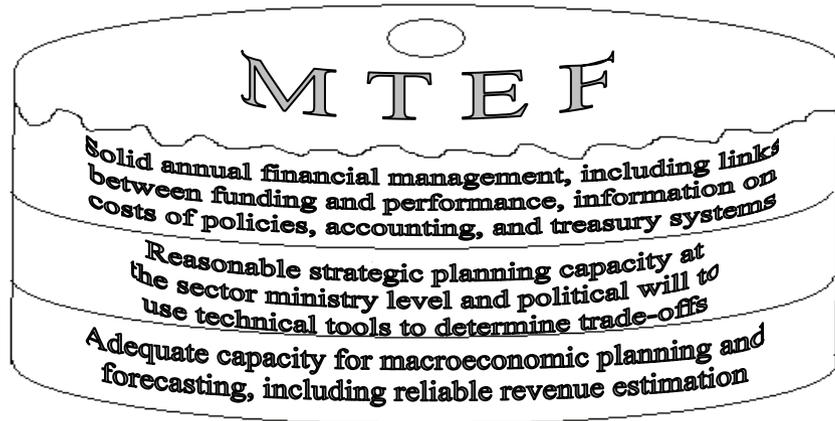
**A review of MTEFs by the International Monetary Fund (IMF) concludes that “developing comprehensive [MTEFs] can be effective when circumstances and capacities permit.** Otherwise, it can be a great consumer of time and resources and might distract attention from the immediate needs for improving the annual budget and budget execution processes” (Levy, 2008).

**So, what are the preconditions that ought to be in place before the implementation of MTEF is attempted?** According to the IMF (Levy, 2008), the preconditions are:

- reliable macroeconomic projections, linked to fiscal targets in a stable economic environment
- a satisfactory budget classification and accurate and timely accounting
- technical capacity and disciplined policy decision-making, including budgetary discipline
- political discipline for fiscal management.

<sup>12</sup> One symptom of this is the proliferation of MTEF in almost all PEM-related projects funded by the World Bank, even in countries with major deficiencies in basic budgeting. This was discussed during a PFM workshop on 21 March 2008.

Another way to view the preconditions for MTEF is to think of them as the icing on a cake:



An MTEF should build on existing capacity to carry out functions that are needed anyway for the annual budget process to be effective and efficient. Pressure to implement reforms that are simply ‘in vogue’, or which are based on an inadequate assessment of the situation, has led to many negative experiences in the implementation of MTEFs. As noted by Schick (2008), “Despite its popularity, MTEF has been effective in only a few countries. In most, it is a technical exercise that is institutionally and procedurally separate from the annual budget process. Resource decisions are still made on an annual basis. When the two processes are separated, the MTEF showcases government’s strategic or developmental ambitions, and makes extensive use of performance indicators, while the budget remains input-based and incremental”.

**The challenge is to start thinking about an MTEF at the right time, based on an objective assessment of conditions and a clear understanding of its benefits and limitations.** Failure to do this may devalue the concept of the MTEF which then becomes another empty term associated with unfulfilled expectations of public sector reform.

**In addition to the big picture issues associated with deciding whether or not to undertake an MTEF, there are practical considerations to be understood once the process is launched.** For example:

- *Integration with existing budgeting systems and classifications.* How will the MTEF implementation be monitored through treasury systems or FMIS? Is the budgetary classification the same as the one used for the MTEF?

- *Deployment of the MTEF process.* Some countries have opted for a pilot implementation of MTEF in certain sectors. Does that make sense, considering a key attribute of an MTEF is to provide a control panel for decision makers to allocate across all sectors?
- *Leadership of the process.* Normally, public finance is mostly under the purview of a Ministry of Finance while planning falls under Ministries of Planning or Economy. As well, central banks or statistical offices often play an important role in macroeconomic forecasting, and revenue estimation may fall under an independent revenue administration. An MTEF brings all these actors together – are their roles clear?
- *Linkages between MTEF and national planning.* Some countries have formal development plans that cover a specific timeframe, usually the tenure of a government. Given that an MTEF is a rolling plan, how is its consistency with the development plan ensured?

## 5. Conclusions

**Reforming public expenditure management is not easy.** Despite decades of international experience with budget reform, even advanced countries are struggling to align expenditure with policy and improve the efficiency of budget allocation. Why is this happening, especially considering international development institutions have been accompanying many of these processes since their inception and have accumulated a sizeable body of knowledge and lessons learned? Why is it that a certain country in the region addressed by this study, despite its remarkable progress in PEM, made the mistake of assigning responsibility for collecting performance data to budget officials in line ministries instead of staff directly involved with service delivery, when that issue had been discussed and resolved many times over elsewhere in the world? Why did another country attempt to implement performance-based budgeting without direct participation of the Ministry of Finance, when it is well known that it cannot succeed without its leadership?

**These are questions without answers, or rather, with many answers.** There are imperfections in the collection, processing and sharing of lessons learned and international development institutions need to play a much better role in creating a truly global community of knowledge. Political processes play an important role; short windows of opportunity to implement reforms force governments to leapfrog over the basics to at-

tempt more advanced options; and political negotiations to pass required legislation undermine ambitious reform initiatives. Governments often stubbornly defend a national way of doing things, disregarding valuable lessons from elsewhere in the world. Even external advisors that support reform processes bear some responsibility and, when advising their clients, need to keep in mind not only the best lessons from international experience, but also the lessons which are appropriate to each country situation.

**A growing number of countries are carefully designing a reform path and demonstrating discipline in its implementation.** Chile is exemplary in its implementation over many years of sequential and fully complementary initiatives. There are also remarkable success stories from Commonwealth nations where the philosophy behind public administration has evolved to a higher level. In Western Europe, nations like France and the Netherlands have much to share with their eastern neighbors. The United States has a long successful track record to share with tools for reviewing programs and reducing waste and duplication of effort. The following chapters explore similar issues and efforts in Emerging Europe.

## **Chapter 2.**

### **CORE FEATURES OF THE CURRENT BUDGET SYSTEM**

#### **in Emerging Europe**

*Leszek Kqsek*

**Substantial developments have taken place in PFM systems over the last 40 years.** Although not all innovations in budgeting have been successful or long-lasting, most have contributed in some way to a gradual advancement of public financial management, especially in developed countries (see, for example, Robinson, 2007). Many OECD and EU countries in particular have undertaken budget modernization steps in the last 30 years involving MTEF and PPB initiatives (e.g. Australia, New Zealand, USA, Canada, UK, Netherlands, France, Denmark, and others). More recently, many emerging economies have followed a similar path (e.g. Chile, Korea, South Africa, United Arab Emirates, Emerging Europe and Russia). Very few, if any, countries have halted, much less turned back from, these developments in budget management and public administration (Webber, 2007a).

**Emerging Europe as a whole still lags behind most advanced OECD countries in budget reforms and progress in recent years has been fragmented.** It takes several years to establish a government-wide performance management framework over a medium-term horizon so there is a need for a systemic approach and sustained reform. For this reason, PBB and MTEF initiatives have been analyzed in this study not only in the context of a broader public finance and administrative reform process but also with regard to the political circumstances and specific institutional arrangements in each country.

#### **1. General political and administrative structure governing budget preparation**

**Each of the six countries covered by this study is a unilateral state and parliamentary republic with its Ministry of Finance (MOF) taking a lead role in budget preparation and execution.** A partial exception is Turkey where the budget system has a more multi-institutional character with close coordination between MOF, the State Planning Office, and the Under-secretariat of the Treasury located in the Prime Ministry. Although Parliaments can amend the budget, these amendments, with the exception of Latvia, cannot lead to increased deficits in the general government

balance (Slovakia) or state budget balance<sup>13</sup> (Croatia, Poland, Bulgaria), but may lead to changes in the structure of expenditures. Budget accounts are audited at the end of the fiscal year by an independent audit institution which reports to parliaments on a regular (annual) basis. or acts on behalf of the Grand National Assembly (Turkey).

**The role of the Ministry of Finance in the budget process depends largely on the (informal) position of the Finance Minister in Cabinet.** Although MOF proposes preliminary spending limits for line ministries consistent with its target for fiscal balance, these can, in most cases, be easily changed by Cabinet. The Minister of Finance has no special powers in bilateral negotiations with spending agencies<sup>14</sup>. In *Slovakia*, MOF's informal power within the political hierarchy of the coalition parties is significant. In fact, the Minister is effective only as long as he or she is backed by the Prime Minister within Cabinet. In *Latvia*, recent institutional reforms were aimed at strengthening the role of MOF in the budget process, including in analyzing the existing base spending. In *Bulgaria*, the Minister of Finance ensures that the overall spending is within the limit of 40 percent of GDP and consistent with the planned fiscal balance.

**In the budget preparation phase, line ministries are largely autonomous in their decisions on resource allocation.** They are generally provided with total expenditure envelopes and in some countries (*Bulgaria*, *Slovakia*) with a few binding constraints from MOF (wages, capital expenditures, EU resources, co-financing). They set up their program structures in accordance with existing budget templates and allocate resources to various programs, present in the required classifications, and submit their budget proposal to MOF. In *Croatia*, line ministries and government agencies are encouraged to prioritize resource allocation in line with the greatest development impact and decisions on new employment, while large investments and social programs require additional supporting documentation (feasibility studies, impact assessments etc). Discussions are held with MOF before the final draft budget is approved by Cabinet. Later they must defend their budget proposals in the parliamentary committees or plenum.

**There are institutions whose budgets may not require an agreement with MOF<sup>15</sup>.** In this region, these may include the budgets of the Parliament, the President's Office, the National Audit Office, the Financial Supervision Commission and the Judiciary. These institutions submit their budget proposals to MOF for information purposes, on which MOF may provide feedback. Differences of opinion on budget proposals are clarified in the parliamentary forum. In *Bulgaria*, the budget proposal of the National Assembly is negotiated with the Prime Minister and the Speaker of the National Assembly, while the National Assembly has sole authority over the judiciary budget. Extra-budgetary funds (EBF), like social security or health funds, are attached to the state budget and submitted to the Parliament. The EBFs are presented together with the state budget in consolidated statements of the general government.

**In all six countries, the budget year matches the calendar year.** Key deadlines in the budget cycle and responsibilities of different agencies or units are specified in a legal act (budget law or public finance act and also, in some countries, in the Constitution). Although the first macroeconomic or tax forecasts are prepared by MOF in January-February (e.g. *Slovakia*) and directions of the medium-term budget in February (*Latvia*), the macroeconomic and fiscal assumptions are usually discussed in spring and approved by Cabinet in early summer (see Figure 2 for more details on the budget cycle). The decisive round of budget and political negotiations between the coalition partners is conducted in the summer. The draft budget is ready to be sent to Parliament and available for the public (via the internet) in the late summer or early fall. However, in *Bulgaria* and *Croatia* it happens a little later (end-October and mid-November, respectively). Operational guidelines for budgetary units are defined in a budget call circular. These include the forms to be used and expenditure templates (*Poland*), decisions or decrees of Cabinet (such as the budget agenda or proper budget draft) or decrees/guidelines of MOF (such as budget classifications or guidelines for spending units relating to the preparation of the budget).

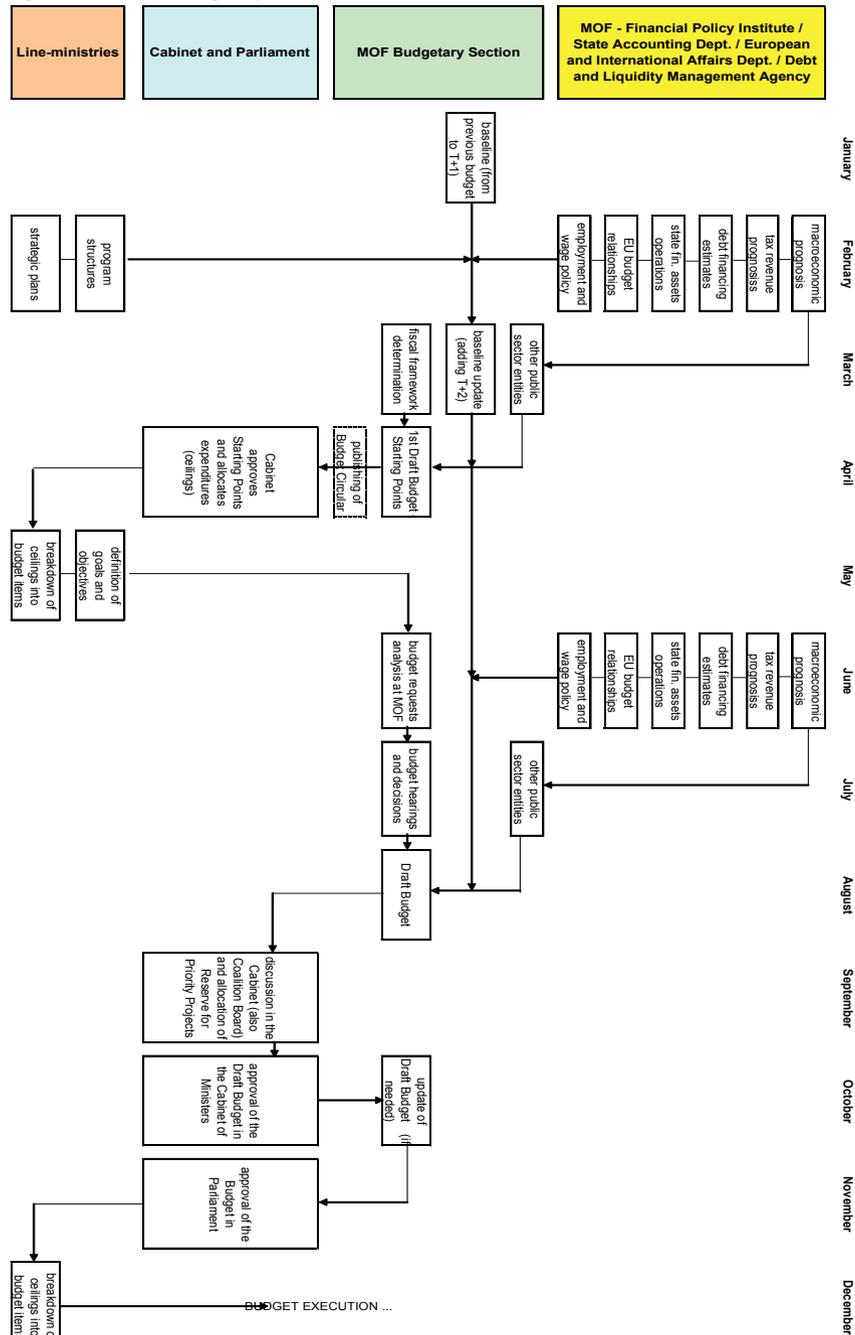
**In most countries in the region, Parliaments usually pass the budget without major amendments.** The draft budget submitted to Parliament normally envisages political agreements in the coalition and negotiations between MOF and line ministries. The draft is, however, thoroughly reviewed by parliamentary budget/public finance committees which elabo-

<sup>13</sup> This rule can be circumvented when Parliament finds additional revenues to finance extra spending. In Poland the Sejm does not need to identify sources of additional revenue inflows. It may just consider the Government's revenue projection as too cautious.

<sup>14</sup> MOF power is more pronounced in the budget execution phase, during which it can change individual allocations for line ministries to maintain overall deficit target.

<sup>15</sup> In some countries, these may be referred to more formally as 'appropriations under permanent legislative authority'.

Figure 2. Annual budget cycle in Slovakia



Source: World Bank staff, based on national documentation.

Table 1. Key legal act relating to the budget, as of mid-2008

Bulgaria	Croatia	Latvia	Poland	Slovakia	Turkey
Organic budget law, adopted in 1996	Budget Law, 2003 <sup>1</sup>	Law on Budget and Financial Management, 1994	Act on Public Finance, adopted on 30 June, 2005	Budgetary Rules Law, effective from 2005	Public Financial Management and Control Law, adopted in 2003

Source: World Bank staff.

rate their assessment for Parliament. This is often rather a formal assessment as the parliamentary committees lack professional budget analysts.

**Provisional arrangements apply if the budget is not adopted by end-December.** These may involve using the Government's budget proposal (*Poland*) or the previous year's budget (*Bulgaria*, and *Slovakia* with some restrictions), or provisional financing related to the one-fourth of last year's receipts (*Croatia*). These provisions take effect until the new budget is adopted. Non-enactment of the budget is a de facto sign of no-confidence in government, but a formal vote of no-confidence is done through a separate legislative process (*Bulgaria* and *Croatia*) or Parliament may be dissolved by the President (*Poland*).

## 2. Key pieces of legislation relating to the budget and country-specific circumstances influencing the budget system

The key legal act relating to the budget is a budget law or public finance act. New financial legislation of this type has recently been adopted or significantly amended across the region, often as a result of broader budget reform initiatives (*Bulgaria*, *Turkey*), or from EU membership and a need to formulate rules governing the flow of the EU funds. Table 1 indicates the key piece of legislation and the time when it became effective. In line with the delegation from the budget law, more specific guidelines related to MTEF or PBB implementation are set out in documents approved by Government or MOF. Examples are the Performance Management System Guidelines 2008-2013 in *Latvia* or Economic and Fiscal Policy Guidelines in *Croatia*.

**Budget legislation often also frames budget preparation and execution for sub-national governments.** In Emerging Europe, sub-national authorities are independent from central authorities, but financial management can be indirectly framed by the central government (e.g. through tax sharing rules).

**Budget legislation governs adherence to fiscal rules plus implementation of medium-term planning and performance budgeting within the budget cycle.** The influence of international best practice on

budgeting or requirements is visible in the region. This includes ESA95 standards (in case of new EU members) and standards or best practice promulgated by international financial organizations: (*Slovakia* was inspired by the OECD, *Turkey* by the World Bank and the IMF). In some countries, the budget law incorporates fiscal rules relating to debt (*Bulgaria*, *Croatia*, and *Poland*) or aggregate general government expenditures (threshold of 40 percent of GDP in *Bulgaria*). In *Poland*, a 60 percent of debt to GDP threshold ratio has been set in the Constitution since 1997. In addition, the budget law invariably specifies the main roles and responsibilities of budget actors and includes major deadlines in the budget preparation process.

**EU members must comply with the EU *acquis communautaire* and rules set by the Maastricht Treaty (and Protocol on the excessive deficit procedure, EDP) and the Stability and Growth Pact.** According to the EDP, the planned or actual general government deficit should not be higher than 3 percent of GDP, while the threshold for public debt is 60 percent of GDP. These limits constitute the fiscal requirement for euro adoption. The Stability and Growth Pact sets the structural deficit over the medium-term. In the case of the six EU members covered by this study, the medium-term fiscal objective (MTO) is set as a structural deficit of 1 percent of GDP.

**For several countries in the region, the reform process culminated in accession to the European Union in May 2004** (*Bulgaria* in January 2007) when flows of funds related to the EU contribution and EU policies had to be reflected in budget and financial management regulations. Within the fiscal policy supervision, EU members (and non-euro zone members) must submit an annual update of the Convergence Program, usually in late fall, while EU accession countries (*Turkey*, *Croatia*) submit Pre-Accession Economic Programs. These documents outline major economic and fiscal policy plans and targets in a three-year time frame. Although the programs are not legally binding, they envisage a clear political commitment and enhance transparency of public finance.

**Fixed exchange rate arrangements – peg within a narrow band in *Latvia* from early 1990s and currency board in *Bulgaria* from 1997 – introduced more discipline in fiscal policy.** Budget prudence is invariably a necessary condition for the smooth operation of these regimes. Fiscal deficits leading to money supply expansion will invariably threaten the credibility of the system.

**In *Latvia*, a characteristic feature of the budget system is the concept of base spending.** This captures the level of spending associated with a continuation of current government functions (similar to the concept of ‘no policy change’) although a key difference seems to be that base spending is the minimum or efficient level of spending needed to continue current functions). To determine the budget, spending for new priorities is added to base spending. Development of the base budget has traditionally been a largely quantitative exercise with most ministries perceiving the base as an entitlement, without a more robust assessment of existing programs being conducted. Strategic plans are being used primarily to justify new policy initiatives. The State Chancellery, in particular the Policy Coordination Department, has an important role in coordinating strategic planning.

**In *Poland*, the Council of Ministers (COM) plays a leading role in the budget process.** Only the COM has legislative initiative with respect to the budget act and only at its request can changes to the Act be introduced during the budget year. The lower chamber of Parliament (Sejm) has only 20 days for reviewing/amending the budget act (for other acts it is 30 days). As mentioned, it cannot introduce any changes to the draft which would increase the budget deficit. The President’s role is also limited. He or she has only seven days to sign the budget act (compared to 21 days for other acts) and has no veto right. The President may, however, ask the Constitutional Tribunal to check if the proposed draft is in line with the Constitution.

**In *Bulgaria*, the MTEF is regulated by the organic budget law although PBB measures do not feature in the law.** PBB is instead reflected in the COM decrees, MOF guidelines, and in the annual state budget laws.

**In *Turkey* the Under-secretariat of State Planning Organization (SPO), affiliated to the Prime Ministry, evaluates investment proposals.** The MTEF is based on two main documents: the Medium-Term Program prepared by SPO and the Medium-Term Fiscal Plan prepared by MOF.

### 3. Recent international assessments of quality and transparency of budget systems

Major strengths and weaknesses in budget systems in the region were also identified in various international assessments and country reports, such as the OECD Budget Survey, IMF Fiscal Transparency Report on Standards and Codes (ROSC), World Bank's Country Financial Accountability Assessment (CFAA) or Public Expenditure and Institutional Review (PEIR), and the multilateral Public Expenditure and Financial Accountability (PEFA) assessment.

Several external assessments have been conducted in Croatia recently. Under the 2006 World Bank IDF grant, an assessment of the public expenditure management system was undertaken drawing on the Pradhan and Campos (1995) methodology. The results show more problems associated with accountability and transparency than with rules. It highlighted the following priorities for strengthening the system:

- expenditure allocations based on economic analysis consultation mechanisms (especially with Parliament)
- dominance of central ministry (especially in relation to incentive compatible contract of the Minister of Finance)
- linking allocations to strategic outcomes (especially related to establishing correlations between forward allocations and budget bids based on evaluations of strategic outcomes)
- discussion of competing priorities (especially related to the cabinet review of competing priorities)
- identification of overspending and cutbacks of existing programs.

The World Bank Public Finance Review (PER) of Croatia in January 2008 identified significant progress during the last couple of years in strengthening public expenditure management. It noted additional effort required in performance and program based budgeting, analytical foundations of budget allocation decisions, budget transparency, and integration of strategic and budgetary planning. A review of Croatia's budget system was also carried out as part of the Budget Project of the Working Party of Senior Budget Officials of the OECD. This review noted:

- an overly detailed budget account structure
- a need to move towards a budget classification focused around program objectives

- a large number of public enterprises, many of which engage in quasi-fiscal activities, with no clear division of tasks concerning oversight of public enterprises between line ministries, MOF and the Privatization Fund
- lack of an explicit fiscal rule, instead relying on a medium-term expenditure and revenue strategy that aims to keep the deficit within acceptable boundaries
- lack of clear top-down steering of the budget process to ensure a multi-annual strategy.

Recent international assessments in Poland point to numerous shortcomings in the fiscal framework. These include budget fragmentation and insufficient transparency, inadequate linkages between the budget and policies, and an insufficient time perspective for budget planning<sup>16</sup>. Budget fragmentation, due mainly to multiple agencies and the existence of extra budgetary funds, is seen as contributing to inefficient allocation of budget resources. These reviews have also suggested that fiscal transparency could benefit from a harmonization of reporting standards and a revision of budget classification, the budget process is only very loosely connected with policy formulation, and that ministers act more like administrators of existing laws and programs rather than strategic managers of policy and programs.

International assessments of Poland have also called for the accountability framework within the public sector to be strengthened by creating incentives for improved public service delivery. In addition, the budget should be made more predictable over the medium-term by introducing an MTEF and strengthening the recently launched PBB initiative. Amendments to the Act on Public Finance<sup>17</sup>, currently on the agenda, go in the right direction and should make the budget more consolidated, transparent and predictable over the medium-term as well as more performance-oriented.

Reports on the Latvian fiscal sector have included a Fiscal Transparency ROSC (IMF, March 2001), Public Expenditure Review (WB, February 2002) and two research papers: 'Latvia's Macroeconomic Options in the Medium-Term: Fiscal and Monetary Challenges of EU Membership'

<sup>16</sup> International assessments include *Republic of Poland: Financial Stability Assessment* (2001 and update 2004), International Monetary Fund; *Poland: Toward a Fiscal Framework for Growth – Public Expenditure and Institutional Review* (2003), The World Bank; *Poland: Developing a multi-annual fiscal framework* (2008), International Monetary Fund; *Poland: Country Financial Accountability Assessment* (2006), The World Bank.

<sup>17</sup> Poland's MOF, *Draft New Act on Public Finance*, published on the website on 22 August, 2008, <http://www.mf.gov.pl/dokument.php?const=1&dzial=153&id=135646&typ=news>.

and the World Bank Policy Research Working Paper (May 2004). The reports acknowledged significant progress in public sector reform and governance but identified some challenges, suggesting a focus on rationalization of public expenditure and civil service reform. These analyses stressed the issue of building capacity to develop MTEF documentation in MOF, provide adequate MOF guidance and set hard budget constraints for line ministries. These reports also indicated a need to:

- improve policy formulation and planning (strategic plans developed by line ministries are biased toward new priorities)
- address artificial fragmentation and structural rigidities of the budget (about 45 percent of revenues are earmarked)
- reduce budget incrementalism (due to base budgeting).

**The research paper on the fiscal challenges of EU membership (WB, 2004) suggests that in addition to MTEF, Latvia would benefit from additional fiscal rules that would avoid making the fiscal policy pro-cyclical.** The paper suggests *Latvia* target the budget structural balance and set upper limits on expenditure increases, in addition to the medium-term zero budget balance target within the EU Stability and Growth Pact.

**In Slovakia the World Bank implemented a project called Public Finance Management Reform in early 2000s.** At the beginning of the reform agenda, major weaknesses included the fragmentation of public finance units and insufficient oversight performed by MOF. After addressing basic PFM problems, the Government's focus shifted towards more advanced reforms, including MTEF and PBB.

**Various external assessments show the Turkey budget system is well designed but with some shortcomings.** Many weaknesses identified in the World Bank PEIR from 2001<sup>18</sup>, such as insufficient accountability and transparency, were addressed in the following years. In 2006, the IMF Fiscal Transparency ROSC<sup>19</sup> report highlighted fragmentation in the PFM system while in 2007 the OECD<sup>20</sup> emphasized a need to reassess budget classification.

<sup>18</sup> World Bank, August 2001, *Turkey: Public Expenditure and Institutional Review – Reforming Budgetary Institutions for Effective Government*, Report No. 22530-TU, PREM, ECA, Washington D.C.

<sup>19</sup> IMF, March 2006, *Turkey: Report on the Observance of Standards and Codes—Fiscal Transparency Module*, IMF Country Report No. 06/126, Washington D.C.

<sup>20</sup> Kraan, D., Bergvall D., Hawksworth I., 2007, *Budgeting in Turkey*, ISSN 1608-7143, OECD Journal on Budgeting, Volume 7 - No. 2, OECD, 2007.

## Chapter 3. GENERAL PROGRESS ON BUDGET REFORM in Emerging Europe *Leszek Kqsek*

**As noted in this study, it is useful to view recent efforts to introduce MTEF and PBB initiatives as a part of broader public finance and administrative reform.** Introducing these methods is more than a technocratic budget reform. They are components of a wider reform process in which successful implementation leads to positive changes in the public management culture, including greater client (citizen) orientation in the provision of public services and programs.

**A well-functioning and efficient public sector may be one of the country's greatest strengths** contributing to improved competitiveness in the private sector and the national economy as a whole. A high quality public sector may be compared, for example, with favorable tax regulations whose role is to stimulate business activity and attract foreign investments. MTEF and PBB cannot be viewed as isolated interventions but rather as reforms contributing to better use of resources and increased economic competitiveness.

**Both the MTEF and PBB require smooth processing with additional information and appropriate capacity by civil servants** to ensure information-based decisions don't become information-overwhelmed battles between MOF and spending units. Because the road is long and sometimes bumpy, with benefits emerging only in the long-term, strong and motivated leadership is vital. International experience points to greater success when the key role in terms of leadership within the bureaucracy is played by the finance ministry and its budget department in particular.

### 1. Recent public finance reform initiatives and major institutional achievements

**MTEF and PBB are essential building blocks for fiscal and economic reform but they are complex and demand careful and phased implementation.** As discussed in Chapter 1, they are accompanied by supporting PFM reforms such as changes in budget classification, accounting, audit, accountability and control systems in the public sector. Creating changes in the administrative structure, empowering budget managers, and strengthening management and reward systems may be necessary for

Table 2. Date of initiation and coverage of major PFM reforms in Emerging Europe

Bulgaria	Croatia	Latvia	Poland	Slovakia	Turkey
1996 – organic budget law, 1997 – adoption of the currency board arrangement 1999 – 2002 Single Treasury Account 2002-Law on Government Debt 2003 – reorganization in MOF (Budget Directorate), 2002-first pilot PBB in one ministry 2006 – introduction of MTEF 2007 – creation of special subcommittee under the Budget and Finance committee in the National Assembly 2007 – expansion of PBB to all first level spending units	2003 – adoption of the organic BL: budget execution processes, including accounting and reporting, improved, GFS 2001 standards formally adopted, but rather weak adherence at local level, 2006-2007 – Treasury Single Account based on SAP covers all line ministries and EBFs 2008 (July) – new BL, effective from January 2009	1997 – introduction of budget programs; 2001-2003 – introduction of performance indicators (mainly for outputs) 2003 – introduction of strategic planning 2003 – human resources reform (remuneration system), 2007 – fully updated budget classification	Early 2000s – technical adjustments to EU requirements prior to EU accession; 2005 – pilot budget for science and higher education in a programmatic structure for 2006; August 2008 – draft Public Finance Law published by the MOF assuming organizational consolidation of budgetary units	1996-2001 – first efforts to implement Budget information System in MOF 2003-2005 – implementation of the comprehensive PFM reform project, financed by the WB, including: - introduction of program classification, 2004, establishment of State Treasury and Debt and Liquidity Management Agency, and creation of IT supported Budgetary Information and State Treasury Systems	2001 – abolishing of extra budgetary funds, 2003 – Law 5018 and its amendment in 2005 (accrual accounting – piloted in 2002 and put into practice in 2004) 2003 – Public Procurement; 2004 – new budget classification in line with GFS Manual 2001; 2005 – introduction of strategic planning system in local governments and gradually in central government units by 2009.

Source: World Bank staff. Countries in the region began implementing budget reforms both within an integrated package of economic and fiscal reforms (Bulgaria, Slovakia, Turkey) and as stand-alone reform initiatives in the case of the other four countries. In the integrated approach, coordination between reform components was focused largely in the hands of one institution but required ongoing guidance and supervision from the reform champion.

result-oriented thinking and longer-term foresight in the public planning process. This does not mean that all the PFM reforms should be conducted at once. Reform overload is a risk, but many synergies can be exploited on the back of an ambitious and broad reform agenda that includes parallel introduction of MTEF and PBB. Table 2 summarizes the main institutional achievements in relation to these reforms in Emerging Europe.

**This approach was largely successful in Slovakia where the Minister of Finance and Deputy Prime Minister were responsible for overall economic policy, including public finances.** In Turkey far-reaching institutional changes in PFM were begun as part of a broader rescue plan introduced after a severe economic and fiscal crisis in 2001 and supported by the IFIs (WB, IMF, EU, OECD). Lack of fiscal transparency was regarded as a major factor in the crisis and this led to many major changes in public finance management. Although the crisis heightened the urgency for a better budget system, valuable analytical work on budget reform had already been done during the preparation of the 8-Year Development Plan in 1999 and in the PEIR report prepared jointly by the World Bank and its Turkish counterparts<sup>21</sup>.

**In Bulgaria the economic and fiscal crisis in 1996-1997 also played a precipitating role in reform.** Following adoption of the currency board, budget reforms have been underway since 1997. In the initial phase, reforms aimed at improving overall fiscal discipline and sustainability. Roles and responsibilities of Parliament, Cabinet and spending units were clarified and limits on debt issuance and quasi-fiscal activities were imposed. Budget units and accounts were consolidated and together with better reporting and accounting systems, changes led to improved transparency of fiscal accounts. The results were astonishing. The headline fiscal balance moved from double digit-deficit in 1996 as a percentage of GDP to a balanced budget in 2003 and fiscal surpluses in the immediate following years. Strict debt issuance rules (including annual ceilings on total debt stock) and efficient debt management led to a decline in public debt from more than 100 percent of GDP in 1997 to 16 percent of GDP in 2008.

**Bulgaria took the first steps in implementing advanced PFM reforms in the mid 2000s**, more or less at the same time as Poland. Latvia and Croatia launched their reforms in the early 2000s. Bulgaria started by consolidating its fiscal accounts, improving transparency of the budget process and comprehensiveness of budget documentation, improving treasury and debt management functions. Fiscal decentralization was also

<sup>21</sup> World Bank, op.cit.

advanced and medium-term approach to budgeting and PBB were implemented. In *Poland*, PBB was put on the agenda in 2006 by the State Secretary in the Chancellery of the Prime Minister, Teresa Lubińska, who gained experience in this area from the local Government level. In 2007, the PBB approach was piloted in two small budget sectors (science and higher education) and amendments were made to the Act on Public Finance. These changes introduced reporting obligations in the PBB format in the justification to the budget act starting from the budget 2008 and in reporting on the execution of the budget.

**Although Latvia was a regional pioneer in PBB approaches and Croatia in the MTEF, progress made over recent years has been slow.** In *Croatia* PFM was modernized in many areas with the adoption of the budget law in 2003. This addressed budget execution, accounting, reporting (GFS 2001 standards), cash management through a more functional Treasury Single Account (TSA) and a wider use of the SAP system, including earmarked revenues. From 2007, emphasis was placed on integrating PFM systems and these measures should be implemented in 2009. Transparency of public finances was also enhanced by new regulations on internal audit and financial control.

**In Latvia, reforms were initiated early but it took several years to enforce significant change.** Budget programs were introduced in 1997 but in practice performance indicators focused too much on inputs. Development of more output-oriented indicators began in 2003 and these are now being revised and aligned with a new strategic planning framework for the budget. From 2003, reform of the remuneration system began across all budget institutions to link pay with performance. The concept of three-year budget planning was approved by the Government in the summer 2006 and became operational in 2008<sup>22</sup>.

**The region benefited from projects financed from external grants or loans** (mainly EU, but also World Bank, IMF, USAID, and US Treasury), oriented towards improvements in the budget process, both in the pre- and post-accession period. New EU members have made good use of EU structural funds available for spending on institutional improvements in the public sector. In *Poland*, the PBB initiative included strategic government documents like National Development Strategy 2007-2015, National Reform Program for Implementation of the Lisbon Strategy

2008 –2011, Convergence Program 2005, the National Strategic Reference Framework 2007-2013, and the Government Strategic Plan. The latter was announced in February 2008, while the previous agreements and strategies were approved by the former Cabinet.

**The EU integration agenda and EU membership itself has contributed to greater transparency and predictability of fiscal policy over the medium-term.** Although the Pre-Accession Economic Program (PEP) or the Convergence Programs (CP) cannot be treated as fully-fledged MTEFs, and fiscal targets were not legally binding even in the short term, they have assisted these countries to understand and achieve the requirements for an improved fiscal stance and structural changes in budget policies. Convergence Programs, prepared in line with the EU requirements, must include medium-term projections for expenditures and revenues as well as projections on deficit and debt levels for the coming years. The limitation of this approach is that those projections have indicative meaning only and there is no legal obligation for governments in the future to follow them.

**In most cases, adoption of a new budget law marked an important breakthrough in the development of budget systems.** This was the case in *Bulgaria, Croatia, Slovakia, and Turkey*. With new legislation, the PFM reform agenda was more comprehensive and better coordinated. This legislation does not guarantee success but a well-drafted budget law can be a solid base for reform. Although the region provides evidence that PBB in particular may be initially based on existing law (*Bulgaria, Latvia and Poland*), international experience suggests that changes to the law make new institutions more sustainable and weaken opposition and resistance to change. Possibly the best example of this are the reforms to the budget structure and policies in France which were begun through the new *Loi Organique 2000* (see, for example, Robinson, 2007).

## **2. Motivation, champions for reform, and involvement of budget departments**

**In countries which experienced serious fiscal imbalances (*Bulgaria and Turkey*), the necessity for budget reform was the mother of invention. In other countries external and internal pressures both played a role.** Complex restructuring in the public sector offered a good opportunity to introduce ambitious second generation PFM reforms. Other countries were following global or regional trends and the availability of external technical assistance (see above) and external funds was support-

<sup>22</sup> Thanks to the MTEF, an appropriation reserve was introduced (to transfer funds between years) and flexibility of expenditures increased (COM can, to some pre-set amounts, redistribute expenditure among programs, sub-programs, and economic classification codes. COM also considers introduction of performance evaluations which should be based on several criteria.

ive. In-house expertise has been growing too and has been readily shared between countries (Chapter 1). The attractiveness of the PBB concept may also partly lie in positive feelings associated with the word ‘performance’. Performance budgeting, and its more or less literal translation into local languages, sounds better (not only for the politicians) than traditional (incomprehensible) budgeting based on standard data-sets and constant checks and balances.

**In the globalization era, a well-functioning public sector provides a competitive advantage.** Also, some practices successfully tested in the private sector (sub-contracting, management for results, the concept of value for money) were applied subsequently in the public sector. Taxpayers are also voters and they demand more (i.e. better public services) for their taxes. *Slovakia’s* political leaders set an ambitious target for euro adoption and meeting the Maastricht criteria which required fiscal consolidation. Fiscal policy is one of the few policy levers under the currency board arrangement in Bulgaria. The aim to create fiscal space for new policy initiatives or comply with political promises (e.g. infrastructure upgrade, wage increases in the public sector) were reasonably common across the region, including especially *Croatia* and *Latvia*.

**The need to improve the quality of budget planning and fiscal policy predictability has motivated implementation of MTEFs.** When effectively implemented, an MTEF helps fulfill fiscal policy targets by:

- keeping expenditure within means (through spending reallocation between years)
- establishing links between policy, planning, and budgeting (broader space for spending prioritization)
- increasing operational efficiency
- exploring choices within the set of sustainable fiscal policies – the issue of ‘fiscal space’ (Bevan, 2006).

**Prioritization and allocation are the concern of policy-makers but improvements in operational efficiency must be owned by the public administration as a whole.** If, however, overall public finance sustainability is at risk, the remaining targets become less urgent. This has been shown in *Latvia* where the Government looks for considerable spending cuts as revenues have dropped sharply from a sudden economic slowdown and the subsequent serious recession.

**Advanced PFM reforms in Emerging Europe were initiated by policy-makers inspired by international lessons, or by external consultants, but they were quickly taken over by educated local technocrats.**

Some countries (*Latvia, Poland* and *Slovakia*<sup>23</sup>) created informal, cross-sector working groups of senior officials. Their purpose was to spread the new ideas more widely in government. In the beginning, the new approach was tested in selected ministries which were open to change and willing to run pilots projects, while various learning opportunities were offered more widely to spending units. Everywhere, MOF or other leading agencies had a key role to play as a center of expertise on concepts, methods and processes. It is also a major power for both the preparation of the budget and its execution. **Reform leadership had some different characteristics in each country:**

- In *Bulgaria*, a Deputy Minister of Finance with the support of a small unit with the Ministry of Finance provided much of the overall guidance for the reforms and assisted line ministries, especially those which introduced pilot budgets. This helped build capacity and buy-in for the reform.
- In *Croatia*, in the early 2000s, Treasury and analytical departments in MOF, supervised by the deputy Minister of Finance, cooperated with external experts and provided good international practices. Rulebooks and decrees on PBB were prepared. Currently, all budgetary users including local government units are preparing budgets in a program format.
- In *Latvia*, MOF drove reform as it strengthened its own position, but the reforms were also stimulated by the State Chancellery and the Prime Minister. MOF was the lead agency for the MTEF while strategic planning was developed by the State Chancellery. Both institutions worked jointly on the PBB agenda.
- In *Poland*, the State Secretary in the Chancellery of the Prime Minister and a Department of Performance-Based Budgeting launched the PBB initiative in early 2006. The Chancellery of the Prime Minister was created to spearhead this initiative. In early 2008, the new Government decided to dissolve this department and transfer some of its staff to MOF. The MTEF concept was elaborated in MOF and based partly on the work commissioned by the IMF in 2008.
- In *Slovakia*, the initial champion of PFM reforms was the Minister of Finance who was also the deputy chairman and economic leader of the strongest coalition party, and who pushed on many

<sup>23</sup> The group in Slovakia was abandoned soon after its creation, mainly because of resistance from line ministries.

changes. Reform was driven internally in the Government and technically prepared and executed by MOF staff, assisted by external consultants. There was a clear top-down approach in the reform implementation but the details of their execution were prepared in a bottom-up way. The Slovak Government showed strong ownership of the project, assisted by the World Bank which acted as project coordinator.

- In *Turkey*, reform-minded officials made good use of the momentum which emerged from the 2001 economic crisis. This momentum has been enhanced by negotiations with the EU.

### 3. Institutional changes, involvement of budget authorities and managing opposition

**Although new units responsible for MTEF and especially PBB implementation were created, the structure of public administration remained untouched in *Latvia* and broadly unchanged in the remaining countries.** Thorough restructuring of MOF was rare, though most countries undertook some kind of re-labeling initiative.

- *Slovakia* and *Bulgaria* were among the exceptions. In *Slovakia*, MOF was restructured and traditional budget departments (financing line ministries) were replaced by an analytical department, and a budget consolidation department – consolidating data sources and formulating the general government budget. The two departments became leaders of further reforms and their role has been formalized in the Ministry of Finance statute.
- In *Bulgaria* the Budget and State Treasury Directorate was restructured into two separate (1-planning, 2-execution and reporting) directorates. The Budget Directorate included three new departments – Budget Methodology, Public Finance School, and Microeconomic Analysis – and was instrumental in implementing both MTEF and PBB.
- In *Croatia* three new units were created in 2004 and covered Treasury System Development, Budget Analysis and Internal Audit Harmonization. The Institute of Public Finance, a public research institute, provided advice and reform impetus.
- In *Poland* no changes were made to the structure of public administration in 2006. The work started with the creation of a PBB department which was supervised by the Secretary of State in the Chancellery of the Prime Minister. After the general elections in

October 2007, MOF became primarily responsible for the new PBB approach and changed its name to the Public Finance Reform department.

- In *Turkey* organizational changes in MOF in the General Directorate of Budget and Fiscal Control resulted from the new budget law rather than requirements of advanced PFM reforms. The Strategy Development Units established in 2006 replaced budget units affiliated to MOF. Some duties of MOF in the budget process were delegated to line ministries.

**Lack of radical changes in the structure of public administration left budget managers with limited managerial flexibility and autonomy.** Accountability problems remained too. The link between responsibility and the discretion to perform flexibly and autonomously remains tenuous. There is also an inability to shift or shed civil servants in ministries unable to demonstrate sufficient performance.

**Chile's experience, where the performance budget toolkit was invented and led by a powerful and respected Budget Department in MOF, demonstrates useful lessons for Emerging Europe** (Chapter 1). It shows that government-wide systems can be built and applied at relatively low cost, but require discipline and persistence over long periods of time. Hierarchical budget institutions help (Marcel, 2007). Because of its technical complexity and generally apolitical character, leadership of PBB reforms has been necessarily taken over by committed technocrat champions in MOF (recently all countries in the region) or by State or PM Chancellery (as in the initial phase in *Latvia* and *Poland*).

**Having a reform champion with active participation of line ministries and their budget departments in the spending ministries creates a strong sense of ownership** within government and helps implement reforms. In Chile, the Budget Department attracted well-educated people as career technocrats who could operate with limited influence from political pressures. At the same time, they managed to present a broad and united front of political consensus and persevered with the necessary institutional changes.

**As with much radical change, some groups have opposed the MTEF and PBB reforms.** There have even been instances of resistance within MOF. Insufficient awareness and lack of commitment in a broader public administration still remain a challenge across the region.

- In *Bulgaria* the attitude of line ministries, Cabinet, and Parliament has varied. Some ministries appreciated the value of more

strategic allocation of resource, and improved transparency and accountability of public finances, but some treated the MTEF and PBB as a purely formal exercise leading to a bigger workload. Fragmentation of some line ministries is not conducive to PBB implementation and it has been difficult to involve senior officials in the preparation of their budgets in a programmatic structure and make them accountable for performance. The use of different reporting systems across ministries and agencies was also problematic. However, in tandem with the introduction of the Financial Management Information System (FMIS) some first-level spending units introduced additional analytical elements to comply with the PBB format.

- In *Slovakia* MOF middle-level management of budget departments opposed reforms but were overrun by restructuring of the budget section and by changes of people in crucial positions. The opposition of line ministries was two-fold. First, some of the budget departments within line ministries were not convinced, mainly because the reforms were implemented quickly. Pilot projects helped MOF gain allies in the budget departments of several line ministries. Second, policy sections within line ministries needed to be convinced to change their internal procedures to match the budget system changes, and to take over responsibility for the financial management of their programs. This change still needs to be accomplished in almost all line ministries. Some mild opposition has also come from the media which criticized imperfections in the program structure and questioned the necessity of medium-term planning. The latter objection was successfully handled after MTEF implementation brought visible results and was shown to have no relationship to the methods used during the former era of a highly centralized command economy.
- Resistance by middle-level officials in line ministries in *Croatia*, *Latvia*, and *Poland* was not unexpected because in the early stages these reforms increased their workload without bringing immediate benefits. However, the reforms did not provoke large controversies among experts. The questions were about ‘how’, not ‘why’ to implement them) and there was little coverage in mass-media and little debate among politicians.
- In *Turkey* central policy institutions lead the reforms. The other departments were required to comply with the new regulations

but noticed quickly that the strategic planning exercise enhanced their status/position during the budget process. Strategic development units of MOF, SPO, Prime Ministry and Treasury became role models for other strategy development units. Increased authority, coupled with relevant accountability for the head of the spending units, also encouraged implementation of these reforms.

## Chapter 4. Regional Overview of MTEF and PBB reforms *Leszek Kqsek*

### 4.1. Adopting Medium-Term Expenditure Frameworks (MTEFs)

An MTEF provides a multi-year framework for allocating expenditures according to policy priorities, subject to forecast revenue constraints (Taliercio, 2007). It rests on three pillars:

- top-down multi-year projections of the resource envelope (how much is available)
- bottom-up multi-year cost estimates of sector programs (what has to be financed, with a focus on priorities and objectives)
- institutional (political and administrative) decision-making to integrate the above two pillars (determining the necessary budget trade-offs).

**These MTEF pillars overlap with the PBB approach and help improve program performance** through predictability in resource flows to programs, planning beyond one-year horizons and by helping managers search for higher value expenditures. The necessary shift from a traditional administrative and input-item budgeting approach to a results-oriented managerial approach is proving a lengthy process in Emerging Europe but budget managers mostly welcome the opportunities for increased discretion in allocating funds to programs under their jurisdiction.

**With MTEF and PBB reforms, the devil is often in the details of implementation.** In the following chapter, we look at the PBB arrangements from a country-by-country perspective. In this chapter we investigate the following more general aspects of MTEFs in the region:

- coverage of MTEFs compared with the annual budget and its legal basis
- institutional set-up and supporting arrangements (rules, ceilings)
- methods and procedures used in compiling the MTEF
- modes of introduction of MTEF's (as a component of broader budget reforms or a discrete reformist step)
- preparation and updating of forward estimates across line ministries

- impact of the MTEF on the quality and efficiency of resource allocation and budget decision-making (both from the central budget planning and line ministry budget management perspectives)
- prospects for extending the use of MTEF concepts and methods.

### 1.1 Coverage of the MTEFs compared to the annual budget and its legal basis

Existing MTEFs in the region have a three-year planning horizon, i.e. current budget year plus two further years (Table 3). Poland expects to introduce a Multi (four)-year Financial Plan of the State in 2009. The three- or four-year time frame seems a reasonable compromise between the value of longer term planning and the shorter periods over which most government revenues and expenditures can be plausibly forecasted. For the region, the long run is especially more difficult to envisage because these countries continue to face the need for large structural changes in their economies, including the role of the public sector. Also, as a consequence of the recent global financial crisis, forecasting of most economic and financial variables has become much more complicated, even within a one-year horizon.

Although formal MTEFs are relatively new in the region, elements of the three pillars noted above have been in place for more than a decade. In Bulgaria, for example, the organic budget law from 1997 enabled MOF to prepare three-year macroeconomic and fiscal forecasts. Poland doesn't have an MTEF but its Public Debt Management Strategy operates on a three-year time frame. An explanatory note to the budget act updates fiscal data to the Convergence Program, which is in place in every new EU Member State, and includes three year economic projections and fiscal targets. Since 2007 budget units present their spending estimates for the following three years in a programmatic structure. EU and capital projects are also planned on a multi-year basis although most forward-looking figures are indicative only and medium-term expenditure planning is not systematically conducted at the sector level.

To have a significant impact on budget decision-making, fiscal plans should be integrated with the annual budgetary process. If they are not, the framework becomes a rather abstract exercise. Integration can be achieved by combining the bottom-up approach (where there is some risk of budget inertia) with expressing fiscal policy priorities at a high-level

Table 3. Date of initiation and coverage of recent MTEF reforms in the region

Bulgaria	Croatia	Latvia	Poland	Slovakia	Turkey
2006 – three -year macroeconomic and fiscal framework approved by COM, and sectoral ceilings, only first year is binding	2003 – three-year Economic and Fiscal Policy Guidelines 2005 budget – multi-year projections of fiscal items disaggregated to the fourth level of economic classification; 2007 - Medium-Term Strategy for Development and Modernization of the State Treasury 2007-2011	2000 -government's decision, 2006 – the concept of three-year budget planning approved by COM, not yet applied in budget preparation	Scheduled for 2010, four-year planning perspective, binding deficit level (but amendable in justified circumstances)	2005 – three-year budget presented in all existing classifications (four for revenues, seven for expenditures), budget targets binding only for the budget year, indicative forecasts as starting points for next year's budget negotiations	2005 – three-year rolling plans, Medium-term Fiscal Policy Statement (including fiscal plans and spending ceilings for broad categories) and Medium-Term Plan (with macroeconomic indicators and policy priorities)

Source: World Bank staff

el in the executive body (reconciliation part in the annual budget process). *Slovakia* is a good example in the region for achieving this integration.

**The success of the top-down and bottom-up reconciliation process depends on efficient communication within government and on debate about spending prioritization.** Without good communication, national policy objectives receive little consideration in the resource allocation process and transparency in decision-making is reduced. PBB strengthens the link between the budget and policies. In *Bulgaria*, selected ministries successfully used PBB for arguing for changes in budget allocations to policies and in programs.

**To be useful, an MTEF should also combine rational forward planning with an ability to accommodate unforeseen changes.** As an annual rolling process, an MTEF can be very useful for policy formulation. The framework reflects priorities within sectors and accounts for recurring cost implications of capital projects. Other key elements include projections of significant entitlement programs, interest payments, and forward costs of large investment projects.

- In *Bulgaria* the MTEF sets the aggregate budget ceilings (total expenditure, capital expenditure and overall fiscal balance) and defines key parameters like wage and pensions increase, staff levels, the size of social assistance benefits, service standards etc. Macroeconomic assumptions and forecasts are coordinated

within government and with the central bank. Sectoral ceilings then are agreed based on the approved macroeconomic and fiscal framework and budget plans are prepared by each FLSU in PBB format.

- In *Croatia* both the annual budget and two-year projections are prepared in the same format, all on the fourth level of economic classification (reduced to the third level since 2009). Although the three-year fiscal framework is presented to Parliament, only the annual budget is approved by voting. The quality of macroeconomic and fiscal projections has improved significantly in recent years.
- In *Latvia* the MTEF sets ceilings for broad categories of spending over a three-year period. As part of its public finance management reform, a system of strategic planning was introduced in 2003–2006. Strategic plans, however, tend to be biased toward new initiatives, while the review of existing programs, which were not formulated within the overall budget constraint, attracted less attention.
- The medium-term fiscal plan in *Turkey* includes fiscal deficit and borrowing positions, plus total revenue and expenditure projections for three years. Its State Planning Organization (SPO) prepares an investment circular with an appropriate guide.

## 1.2. Institutional set-up and supporting arrangements (rules, ceilings, guidelines)

**MTEFs began in Emerging Europe in a quite mechanical way and enhancements have been gradual.** Allocating discretionary resources between competing spending agencies in an informed way over a multi-year horizon is demanding. It is not surprising that some sectors grow at a higher percent than the average, some maintain their share, and others decline. Bevan (2006) argues that, with annual updating, the system should evolve away from its initial mechanical nature.

**In the beginning only aggregate forecasts are feasible but provide a good starting point for considering fiscal policy over the medium-term.** Best practice requires publishing a comprehensive, rolling medium-term budget framework as a baseline scenario for fiscal management. Enhancements to the framework in the region have proceeded slowly but consistently.

**Procedural rules in the IMF Manual of Fiscal Transparency (2007) apply broadly to the MTEF.** The manual states: “The annual budget should be realistic and should be prepared and presented within a comprehensive medium-term macroeconomic and fiscal policy framework. Fiscal targets and any fiscal rules should be clearly stated and explained”.

**Simple and transparent fiscal rules support the MTEF because they impose discipline for spending units and enhance communication within government.** Fiscal rules are forms of restrictions on fiscal policies at an aggregate level. They often take the form of a law or binding regulation. Examples of numerical or stand-alone fiscal rules include requirements to balance the budget, limit borrowing by the central or sub-national governments, or limit the pace at which expenditures are permitted to grow. In some cases, public borrowing is restricted to the level of public investment (a golden rule), or the fiscal deficit is constrained (e.g. the criteria for fiscal convergence under the EU Maastricht Treaty or the close-to-balance requirement of the EU Stability and Growth Pact).

**EU membership or an integration agenda has made fiscal policy in Emerging Europe more predictable and transparent over recent years.** All countries adhere to the EU reporting standards and every year submit updates of Convergence or Pre-Accession Economic Programs. EU members can be called to account under the Excessive Deficit Procedure (EDP) if the general Government deficit is higher than 3 percent of GDP.

**Transparency requires fiscal rules to be clearly defined with specified reporting requirements from the outset.** This transparency enables non-compliance to be easily detected and addressed. If an escape clause is included in a rule (e.g. when a departure from the rule is justified by economic conditions – such as with the MTEF in *Poland*), the circumstances in which it applies should be clearly defined. Stand-alone fiscal rules enhance the credibility of macroeconomic policies by limiting the scope for discretionary intervention.

**Numerical fiscal rules are intended to be a permanent constraint on fiscal policy, generally in terms of an indicator of overall fiscal performance.** The main types of numerical rules include:

- deficit rules (balanced budget)
- debt rules (ceiling ratios)
- borrowing rules (EU members are prohibited from central bank financing)
- expenditure rules (*Netherlands* sets ceilings on total expenditure and major sub-categories).

The credibility of numerical rules invariably depends on the realism of the budget, on the quality of the process for identifying fiscal risks and on political will. Exemptions (protected expenditures) should be clearly defined so as to accommodate unforeseen shocks which could breach the (expenditure or deficit) targets.

**Recent fiscal rules for many emerging market economies have tended to rely to a greater extent on numerical reference values.** *Chile* has implemented a ‘structural surplus rule’ to cyclically adjust the budget surplus for central government equal to one percent of GDP. The government must explain any deviations in the fiscal outcome from the surplus rule. The rule provides useful ex ante guidance for spending plans. Examples from the region covered in this study include:

- *Poland, Croatia, and Bulgaria* imposed a debt ceiling on gross general government debt as a share of GDP at the 60 percent of GDP (consistent with Maastricht fiscal criterion). Polish law foresees precautionary measures when the debt-to-GDP ratio crosses 50 percent and 55 percent of GDP and there are specific debt rules at local government level<sup>24</sup>. Although there is no formal mechanism to ensure adherence to a debt rule in *Bulgaria*, this is currently not a problem with a debt-to-GDP ratio below 20 percent of GDP. From 2006, in line with the informal expenditure rule, total public expenditures in *Bulgaria* cannot exceed 40 percent of GDP (excluding the contribution to the EU budget).
- Although *Croatia* doesn’t have an explicit fiscal rule, MTEFs in recent years have aimed at reducing the fiscal deficit to below the Maastricht threshold of 3 percent of GDP.
- In recent years *Latvia* kept its fiscal deficit below the Maastricht level to avoid the EDP procedure. This was readily achievable during the period of strong economic expansion, but may become much more problematic due to the sudden slowdown in 2008 and the ensuing recession. There is no formal fiscal rule as such but the MTEF sets sectoral expenditure ceilings.

<sup>24</sup> According to the new draft Law on Public Finance, the first precautionary public debt threshold is set at 47 percent of GDP.

### 1.3. Methods and procedures used in compiling an MTEF

**MTEFs in the region are still in their infancy and governed to some extent by budget incrementalism.** This is true irrespective of the mode in which the framework was implemented. Neither *Slovakia*<sup>25</sup> nor *Turkey*, which introduced an MTEF as a component of broader budget reforms, nor the remaining countries which introduced it as a discrete reform, can easily escape budget inertia. New programs are easily added but it is difficult to evaluate existing ones or change or remove them. PBB initiatives offer a good opportunity for systematic monitoring and evaluation of spending programs but are still insufficiently effective.

**An MTEF works well when its requirements are properly understood and observed, including smooth cooperation between line ministries and local administration.** In *Turkey*, strategic plans prepared locally as ‘wish lists’ exceeded allocations set centrally. In *Bulgaria* and *Croatia*, some budget units ignore spending ceilings and, to work within overall budget constraints, overly generous proposals have to be revised in consultation with MOF.

**Different models can be considered by countries at different stages of development but building capacity across line ministries and agencies to forecast expenditures accurately is time consuming.** Implementing more advanced methods should go hand in hand with improved administrative capacity. Capacity, and reliability of data, may vary across line ministries. This was the case in *Slovakia* where the MOF and six major line ministries gained support during the PFM reform project implementation, and in *Latvia* where some ministries like agriculture, culture, environment or education and science were more active in reform implementation. In *Turkey* the capacity was more uniform across government. In most countries in the region, solid analytical capacity was built into MOF (especially in macroeconomic modeling and forecasting) but line ministries rely, to a large extent, on using a simple inflation (or wage-growth) adjustment factor when forecasting future spending.

**While impact assessment is obligatory in most countries, it is rather a pro forma exercise.** For example, in *Croatia* changes in policies are sometimes reflected in budget estimates with a time lag so budgets sometimes fail to take all circumstances into account. Neither Cabinet nor MOF explain deviations in the previous year’s framework and sometimes new government policies/initiatives lead to more than 10 percent deviations between planned and actual spending. An incrementalist approach

<sup>25</sup> In *Slovakia* an MTEF was introduced earlier and independently from PBB.

to budgeting is somewhat more entrenched in *Latvia* due to a formal separation between base budget and development spending.

**MTEFs in the region include some country-specific practices.** *Bulgaria* has instituted a contingency reserve<sup>26</sup> for structural reforms, natural disasters, and significant macroeconomic changes. For 2009-2011 it accounts for 1.1 percent of GDP and is allocated for ministries responsible for health care, judiciary, and pension reforms and, in part, for the National Assembly. In *Slovakia*, a planning reserve<sup>27</sup> of up to 3 percent of total budget spending, is set aside for political priorities and disbursed before the budget is submitted to Parliament although it can be held over within the MTEF for expenditure proposals in the later years.

#### 1.4. Preparation of forward estimates and their updating mode across line ministries

**High quality forward estimates of expenditure are essential for a sound MTEF; without them the medium-term framework can have little impact on planning or policy decisions.** Best international practice from countries like UK or Australia includes the use of forecasting and presentation techniques that distinguish between a baseline path for existing (on-going) expenditure activities and estimates of the costs of new policies.

**Compiling line ministry estimates based on different methodologies, as practiced in the region, cannot guarantee overall consistency.** It is important to identify the cost drivers of different programs. This is difficult without a well-established programmatic structure of expenditures (generally missing in every country in the region) and the ability to estimate unit costs of different activities across the public sector.

**In all countries in the region only the expenditure ceilings for the next year's budget are legally binding; those for the following two years are indicative** and updated annually on a rolling basis.

<sup>26</sup> A 'Contingency Reserve' is a line in the budget that may be used for unexpected and unforeseen expenditures, often associated with natural disasters. The Contingency amount is usually 2-3 percent of the total budget and there are normally rules governing how and for what it can be used.

<sup>27</sup> A 'Planning Reserve' is an amount of money, or percentage of the total expenditure available, that is not committed to specific allocations or purposes during the budget preparation process. It may be around 5 percent of total expenditures but is sometimes more. Once the budgets of all ministries have been prepared, money available within the Planning Reserve may be allocated to specific new policies or initiatives that government wishes to pursue. The Planning Reserve therefore protects an amount of funds from the budget negotiation process and provides some scope for policy flexibility and innovation. By the time the final budget is approved all Planning Reserve funds are usually committed to specific expenditure proposals. It may be desirable to identify a planning reserve in each of the budget years of the MTEF.

- In *Bulgaria* the first level spending units propose ceilings and, after negotiations with MOF, the ceilings are approved by the COM. The previous year's ceilings serve as a basis for the next round of the exercise, adjusted to changes in key macroeconomic indicators. Other changes proposed must be justified and agreed with MOF.
- In *Croatia* the MTEF has become embedded in budget managers' practices and the reconciliation process between MOF and line ministries operates smoothly and in line with deadlines set in legislation.
- In *Slovakia* the MTEF is an integral part of the budget and prepared in line with the Budgetary Rules Law. A three-year budget is presented to Parliament with the same level of detail for every year, although only the annual budget law for budget year is adopted by voting. Allocation limits for out years are not legally binding but are considered the starting point for next year's budget discussions.
- In *Turkey* expenditure ceilings for each line ministry and agency are determined by the High Planning Council and published in the Official Gazette by mid-June. They can be revised annually, taking into account changes in macroeconomic indicators, especially inflation.

**Medium-term revenue projections are prepared by the MOF while on the expenditure side the process is more complex and interactive.** In all countries except *Slovakia*, the first steps are taken by spending units. However, MOF has a later, and decisive, input before the budget estimates are referred to COM for the final word.

- In *Slovakia*, on the basis of the Starting Points approved by COM, MOF sets detailed expenditure ceilings for line ministries. Exceptions are special purpose funds and self-governing bodies outside the direct control of central government; MOF uses their budget proposals to compile the consolidated budget.
- In *Turkey*, expenditure proposals (based on institutional, functional and economic classification) are prepared by line ministries or agencies based on requests from units they control or supervise. These are then negotiated with MOF. Investment proposals are submitted to the State Planning Organization for evaluation.

**An effective MTEF requires agreement on a comprehensive set of fiscal policy objectives, within which inconsistencies should be easily identifiable.** A strong interface between government's national strategic planning (required by the EU) and the medium-term budget is needed. Medium-term aggregate spending ceilings are useful (but optional) elements of the framework. A well-structured picture of plans and possibilities enables government to decide, in an informed way, what spending can be increased, cut, or shifted across years. This benefits line ministries because it reduces uncertainty about future budgets.

In line with the IMF manual<sup>28</sup>, an MTEF should incorporate projections of expenditures and revenues by individual spending agencies that allocate resources in line with strategic priorities. It also extends analysis of expenditures to more detailed sectoral costing and performance measures (possibly including activity-based or output-based budgeting). These include production of medium-term disaggregated expenditure profiles and, in more advanced versions, detailed costing of performance measures that may be monitored at aggregate and sectoral levels [IMF, 2007]

#### **1.5. Impact of MTEFs on the quality and efficiency of resource allocation, external reactions and prospects for extending the use of MTEF concepts and methods**

**Benefits from an MTEF have appeared mostly in those countries where the framework has achieved some maturity.** For example, in *Slovakia* overall fiscal predictability and credibility have improved considerably. Together with other measures, the MTEF allows for effective targeting for the general government budget, an improved fiscal discipline, and better fiscal performance. This improved performance may be reflected in reduced costs for short-term government borrowing. The effects from reformed PFM in line ministries are less evident although previous budget overruns have disappeared and accumulation of debt in several public agencies not included in the central government budget was stopped. Re-allocations between line ministries, however, are still occurring during budget execution. Improvements have been recorded in *Croatia*, particularly in the quality of official macroeconomic forecasting and sensitivity analysis.

**In the remaining countries in the region, reform is still in the early stage of development** and their impact on decision making has so far been limited.

**Budget issues are only seasonally debated in Parliaments and are not topics favored by media.** External reaction in *Turkey* was positive. In *Slovakia* some commentators compared the budget reforms with planning exercises during the Communist era. Reactions in the remaining countries were mostly neutral.

#### **Budget and MTEF reform is still far from a steady state in the region.**

- Planned changes to the organic budget law in *Bulgaria* are designed to strengthen credibility of the MTEF through its further institutionalization. Hard budget constraints will be enforced across ministries and agencies; budget allocations will be better linked to results with clarified accountabilities at different administration levels. Greater capacity in line ministries and more authority of MOF are needed to improve the quality of the bottom-up planning process. Planned introduction of comprehensive sector reviews as well as enhancement of the PBB process will be beneficial.
- *Croatia* could benefit from making multi-annual expenditure ceilings of first level budget managers binding while leaving more discretion at the line item level. This would combine better fiscal discipline with budget flexibility. Budget documentation would provide feedback on budget execution and deviations from the MTEF in the past. Making this information available should enhance debate on fiscal developments, especially in Parliament. Further enhancements are expected from the new budget law effective from July 2008 – making two outer years in the MTEF binding at the aggregate level – and linking MTEF to strategic priorities as stipulated in the newly introduced three-year strategy of government programs. To make this happen, budget manager need greater capacity and MOF needs to provide guidance on the proposed programs and evaluate them more thoroughly. The planned introduction of overall government and sector strategies together with PBB enhancement will improve the credibility of the MTEF.
- The role and capacity of MOF in *Latvia* should be strengthened, particularly in setting key parameters within the MTEF, evaluating line ministries' strategic plans and budget proposals, and developing PBB methodology. Reform progress on the institutional

<sup>28</sup> IMF, 2007, *Manual on Fiscal Transparency*, Washington D.C.

front has been complicated by more severe fiscal constraints due to the financial and economic crisis.

- Budgetary reform momentum in *Slovakia* slowed somewhat before the general elections in 2006. The new Government focused primarily on different policy areas (euro adoption, for example). After the elections, the Minister of Finance was not appointed as the deputy Prime Minister, which had an effect on policy coordination. Despite this, the accounting system and tax administration improved with a monitoring and evaluation system scheduled to start in 2009 when program budgeting will be introduced by regional administrations. This was piloted, with MOF support, in 30 local units during 2008. Furthermore, according to recent amendments, from 2009 the carry-over of unspent capital expenditures is restricted to two subsequent years. For the future, strategic planning needs to be better linked with the budget. Among other challenges, the non-disbursed reserve (of less than 3 percent of the total budget), allocated annually according to political decision, distorts the medium-term planning by line ministries who treat this reserve as ultimately expendable.
- In *Turkey*, the Government is considering a fiscal rule to enhance the credibility of the Medium-Term Fiscal Plan. Technical studies have been initiated recently with the support from the IMF.

**Poland is expected to introduce an MTEF in 2009.** Existing elements of the medium-term fiscal framework, like the Convergence Program, are a good starting point. The focus should be on capacity building to produce reliable bottom-up forward estimates, including their presentation in program format and harmonizing parameters and methods applied by sectors in the estimation process. Successful implementation of PBB greatly increases the effectiveness of the reconciliation process within the MTEF. Well-structured programs group together services which have common objectives and parameters, facilitating preparation of forward estimates.

**Regional experience in MTEF implementation highlights the following lessons:**

- Fiscal policy objectives and quantitative fiscal targets need to be well defined at the highest level of government and rigorously pursued under leadership of a strong MOF responsible for reforms.
- Robust forecasts on the revenue side and realistic expenditure targets are critical. To achieve this, the analytical capacity of

MOF and budget units in line ministries must be strengthened. This is a lengthy process. Advanced MTEFs require a country's readiness to make medium-term expenditure commitments by sectors.

- The framework should be based on clearly defined and fully-costed policy proposals and should be accompanied by measures to review individual expenditures. From this angle, the MTEF benefits from parallel implementation of PBB.

**MTEFs across the region have potential to provide better, more transparent tools for formulating, assessing, and implementing fiscal policy.** These reforms take time and, in order to work efficiently, must be based on fundamental institutional improvements along with sustained political commitment. Independent oversight helps ensure robust forecasting capacities, accurate costing of programs, and overall budget discipline.

#### 4.2. Performance Budgeting

**There is no one-size-fits-all model of performance budgeting.** Each country needs to adjust its approach to relevant political and institutional circumstances. Recent efforts in advanced economies<sup>29</sup> have emphasized the need to increase authority and incentives for line managers to achieve agreed results. Some countries are developing relatively sophisticated systems for performance-based (i.e. results-oriented) budgeting and accounting. These increase the transparency of strategic and operational choices made through government budgets. Emerging Europe can learn from global and regional best practices.

**There is no single description or understanding of performance budgeting** but it is widely agreed that defining objectives, developing intervention strategies and reporting against specific achievement measures or targets are the cornerstones of a performance budgeting approach. These concepts and methods, including comprehension of the appropriate situations in which they can be applied and the degree to which resource allocation decisions might be based on past (or expected) results, are still evolving. A common element of performance budgeting is that it gives budget managers greater autonomy, flexibility and certainty over resources. In many cases, a principal trade-off against this increased managerial freedom is increased responsibility and accountability for results (Weber, 2007b).

<sup>29</sup> See, for example, Curristine T. (ed.), 2007, or Robinson M. (ed.), 2007.

**Options are available in institutional arrangements and accountability arrangements** ranging from a highly decentralized approach (Holland) to a more centralized model (Chile). Understanding the options available helps governments avoid the mistakes of being too liberal in their deployment of PBB. Given Emerging Europe's tradition of an organizational culture, a centralized model may be a more attractive option.

**There is still some debate on whether or not PBB and MTEF work best in tandem.** If applied rigidly, an MTEF can be used to establish hard or semi-hard budget constraints for institutions over a medium-term horizon without much change in the way annual budgets are prepared, or in the accountability mechanisms under which they operate. Performance-based Budgeting (PBB) in its most austere form (such as Performance-Determined Budgeting, PDB) can report ex-post on results without the need of substantive medium-term planning.

**For many reasons, Emerging Europe needs improved public financial management.** These reasons include large macroeconomic imbalances, compliance with Maastricht criteria (see Annex 3), or the poor quality of basic public services like infrastructure, health care or education. The current global financial crisis has placed even greater demands on government budgets and on getting better performance from public expenditures. Efficiency gains and increased effectiveness in government expenditure policies and programs are therefore a necessary and attractive means for improving the impacts of fiscal policies in the region. Increasing revenues or borrowing may have a negative impact on economic growth, especially in countries with relatively high tax-to-GDP ratios and public debt levels (*Turkey, Poland, Croatia*), and there are risks connected with Public-Private Partnerships (PPPs).

**Although greater efficiency in public expenditures is increasingly sought, PBB initiatives cannot bring immediate results.** International experience suggests successful PBB implementation requires persistent efforts over several years, combined with an ongoing political consensus on the need for this reform.

## 2.1. Motivating factors behind adoption and current status of PBB reforms

**Across the region, PBB reforms have been seen primarily as a means to improve allocative efficiency of public finances.** On the back of international trends or inspiration, policy makers have viewed PBB as a tool to change the institutional culture of public administration, introduce more predictability in fiscal policy, and demonstrate links between funding and results. Reformists believe in strengthening aggregate fiscal discipline (*Bulgaria, Latvia, Poland*)<sup>30</sup>. *Turkey's* motivation to introduce PBB was a legally binding commitment to restructure PFM and the control system. Generally, growing peer pressure, international debate on the issue and the fact that PFM reforms are now 'trendy' made the PBB concept fashionable. In practice, all countries reviewed in this study opted for Performance Informed Budgeting (PIB) or Performance Reported Budgeting (PRB) rather than PBB or the variant of PDB as outlined above.

**Countries in the region have recently taken the first steps in PBB implementation (see Table 4) and are now refining the performance framework.** There is still considerable room for improvement. These improvements include better specification of outcomes, more relevance in performance indicators and institutional changes leading to increased accountability for achieving results. **The introduction of PBB methods in some parts of the region has been made in the context of broader PFM reform programs and accompanied by changes in organic budget laws (*Slovakia, Latvia and Turkey*).** In the other three countries, there was no broader reform context and these methods were based on the existing legislation that was modified later on. All countries used COM decrees or MOF instructions/manuals/guides or the budget circular. Some PBB-related adjustments in the budget law were made (e.g. *Poland* – amendments in 2006 and new Law on Public Finance 2008) or are expected (*Bulgaria*) to reflect the first lessons from the learn-by-doing process and strengthened political support. In all countries, PBB was initiated together with an extensive training program and consultations with public administration and some have been making use of significant financing from EU structural funds (*Poland*).

**Counties are currently in different stages of PBB implementation.** *Slovakia* is a front-runner while the two non-EU members are least advanced. *Croatia*, four years from reform initiation in the 2005 budget, is

<sup>30</sup> PB enables selective spending cuts instead of blind flat cuts all across the budget, which is often a reality in case of fiscal crisis. It can help relax budget rigidities but requires a complex public expenditure and institutional review.

Table 4. Date of initiation and coverage of recent PBB reforms in the region

Bulgaria	Croatia	Latvia	Poland	Slovakia	Turkey
2002 – pilots (Ministry of Environment and Waters), 2003-2005 – pilots in other ministries, 2007 – all first level units required to prepare budgets (multi-annual plans and implementation reports) in programmatic format for the 2008 budget.	2003 – initiation of program budgeting, while implementation started in the 2005 budget, 2004-2006 – pilots in selected line ministries and state agencies, with assistance of US Treasury and the World Bank; draft methodology for key aggregate performance indicators, 2008 – Medium-Term Strategy for Development and Modernization of the State Treasury, 2007-2011 and new budget law introduced the PBB framework as mandatory to be applied gradually.	1997 – budget programs, 2003 - introduction of performance management system and mainly output indicators, 2008 – revision of PBB approach (more specific objectives, better quality of indicators and reduction of their number, improving M&E process).	2006 – first steps in PBB led by the Chancellery of the Prime Minister (creation of PBB department, supported by experts, preparation of methodological guidelines), 2006 – pilot programs (science, higher education, education, labor, social affairs), 2007 – the first (partial) supplemental PBB budget 2008, 2008 – new guidelines for the preparation of PBB documentation under MOF leadership; PBB-related amendments in public finance law of summer/fall 2008, the 2009 budget prepared according to the revised methodology.	2000 – hiring of US Treasury adviser, 2001 - four pilot projects of the program budget (Ministry of Education, Academy of Science, Supreme Court, and Constitutional Court), 2002- additional six pilot projects, 2003 – MOF reorganization, budget division as driving force of PBB reforms, World Bank project, refinement of budget information system and State Treasury IT system, 2003 – budget for 2004 prepared across the board in 3-level program structure, 2008-2009 – introduction of program monitoring and evaluation system.	2006 – PBB approach to be completed by 2010 in central Government units.

Source: World Bank staff

Table 5. PBB approach - coverage in public spending and by administrative units

Bulgaria	Croatia	Latvia	Poland	Slovakia	Turkey
As percent of total general government expenditure					
Around 40 percent	Around 80 percent*	Around 80 percent	Around 50 percent	In 2008 – 46 percent, In 2009 – 63 percent	Not applicable
As percent of total central government expenditure					
All units	All units*	All units	All units (2009)	All units except targeted funds	Not applicable
By administrative units					
State budget	State budget, facultative for local governments	Central government, facultative for local governments	State budget, sub-national governments are independent	State budget units and state funds, from 2009 obligatory also for sub-national governments	State budget, facultative for local governments

Notes: \*) In Croatia, PBB approach refers to the programmatic structure, while performance information is not in place

Source: World Bank staff

still without a cost allocation mechanism or a set of performance indicators; an organizational rather than a program approach to budget allocations dominates and PBB remains very much at the pilot phase. *Bulgaria*, *Latvia*, and *Poland* are somewhere in between, but closer to the non-EU members, compared with *Slovakia*. *Bulgaria* has, however, advanced the implementation of the PBB with all line ministries and state agencies developing now program budgets with comprehensive performance information. *Latvia*, which pioneered the reforms in the region in late 1990s, has revisited the approach thoroughly in 2008 and developed new guidelines on performance indicators.

**Only Slovakia is introducing monitoring and evaluation (M&E), an advanced element in the PBB toolkit.** The benefits of M&E become more evident in the effective absorption of pre-accession and structural EU funds. In-depth program evaluations require special resources and considerable time, effort and funding. This is why governments in the region undertake only a few such evaluations each year. It is not possible at this stage to assess these M&E efforts more thoroughly when only a small proportion of programs have so far been evaluated in depth.

**Given the current stage of PBB development in the region, governments are more likely to focus on systematic performance information rather than on program evaluation.** Such regularly-collected performance data can be useful for later in-depth program evaluations.

Most evaluations are done ex post and are influenced by how much earlier performance data is available.

**On the implementation side, in early years PBB builds on rather than replaces existing basic budgetary procedures or institutions.** It introduces a new budget classification by objectives and programs which exist alongside existing economic or administrative classifications. The PBB framework is usually multi-annual. The PBB system requires considerable additional information and some efforts have been made to integrate these needs into the financial management information system (*Slovakia*). Internal audit and monitoring and evaluation arrangements gain importance when budget managers have more discretion selecting inputs.

**All countries in the region have been struggling with performance information overload.** In budget documentation, the emphasis is primarily on transparency at an aggregate level. Going downwards in the PBB architecture, more detailed information is provided because it impacts directly on budget decisions. The comprehensiveness of performance indicators is not always satisfactory in Emerging Europe but all countries in the region have the capacity to specify clear objectives for their governments.

## 2.2. Budget classifications at present and prospects for the future

**To help address the management challenges of PBB, Schick<sup>31</sup> recommends breaking it down into its two main elements.** First, PBB is a system for compiling and presenting information on actual or expected results. Second, it may be used as a means for ‘purchasing’ results through expenditure of public funds. These two elements are interdependent. To change the way a budget is made, its content and structure must be changed. And to implement PBB, budgets must include information on results and link that new information to decisions on future expenditures. PBB always increases the cost of generating and processing budget information and the more comprehensive the PBB system, the more demanding it is to implement. This is because performance-based budgets depend on information gathered through special effort, while traditional budgets oriented to line items and organization units usually operate with little regard to actual results.

**PBB is usually launched by adding performance data to the stockpile of information already processed through the budget.** In the region

<sup>31</sup> Schick A., *Getting Performance Budgeting to Perform*, May 2008, Performance Budgeting Conference in Mexico.

Table 6. Expenditure classifications and accounting standards as of mid-2008

	Bulgaria	Croatia	Latvia	Poland	Slovakia	Turkey
Economic	V	V	V	V, national	V, national	V
Functional	V	V	V	V	V (CO-FOG)	V
Administrative	V	V	V	V	V	V
Program	V (partial)	V (too fragmented)	V (partial)	V (partial)	V	
Funding	V	V	V	V	V	V
Accounting Standard	Cash	Cash, reports also in GFS 2001, from 2008 in ESA'95	Cash, transferable to ESA'95 or GFS 2001 standard	Cash, transferable to ESA'95 or GFS 2001 standard	Cash, transferable to ESA'95 or GFS 2001 standard	GFS 2001 from 2004, accruals from 2004

Source: World Bank staff

(Table 6) this information includes itemized inputs, economic, functional, and administrative (institutional) classifications, and data on outputs or outcomes. This creates new information demands which must be processed under tight deadlines. In the past, while focusing on outputs or outcomes instead of inputs, countries like New Zealand eliminated much line item data from the budget. Schick argues that overload also occurs when governments add new expenditure classifications to the old ones. He emphasizes that while there are many ways to tell a budget's story and explain how public money is spent, there can be only one classification for budget decisions.

**Program classification is usually the first step in introducing PBB but was circumvented in most countries in the region.** Instead, they focused on other PBB elements such as performance indicators. Only *Slovakia* developed a holistic program classification. *Bulgaria*, *Croatia*, *Latvia*, and *Poland* did so partially (covering only state-budget units), while *Turkey* is still debating whether or not transition to the program classification is necessary. According to Van Eden<sup>32</sup>, program classification is a useful planning tool even without links to performance management. To ensure ownership and comparability, PBB needs to be developed jointly by line ministries and MOF.

**Program classification has not replaced traditional line-item budget classifications in the region** and nor has any country scheduled this move for the future. Even where budget allocations and expenditure decisions are made on the basis of a full program classification, it is es-

<sup>32</sup> Van Eden H., *Key issues in program classification*, High-Level Seminar: Performance Budgeting and Information, IMF-FAD, Paris, March 2007.

essential to retain the main elements of an item classification for budget analysis and management purposes<sup>33</sup>. Once a full program classification is in place, it will be desirable to review and revise the item classification to ensure it can continue to provide essential, but not excessively detailed, expenditure information. Even in the comparatively more advanced budgeting system in *Slovakia*, program classifications are regarded as a new way of presenting budget data and serves as additional information for policy makers. Traditional line-item budgeting and PBB are used simultaneously. The budget information system connects both forms of budget presentation and, since 2006, the State Treasury provides data on budget execution in the program structure. In *Poland* it has not been decided yet whether or not a PBB approach will replace the traditional one. This decision will be made in 2014 and will be based on an evaluation of parallel functioning of the two forms of budget management scheduled for 2013. These examples show the challenge in making program structure the basis for budget management, including appropriation, execution and control.

**Across the region, administrative and economic classifications provide the principal basis on which budget expenditures are allocated and managed.** For each agency and line ministry a limit is determined (based on existing costing methods, in many cases incrementalism) and broken down into major economic budget lines: wages, separation of current and capital expenditures etc. It is difficult to explain why it takes so long to replace input budgeting and line-item classification with a transparent program classification. It focuses budget policy on goals and performance and offers managerial flexibility to line ministries as well as an opportunity to evaluate public agencies against their stated objectives. All countries in the region are combining the organizational breakdown beside the program structure, as shown in the left panels in Figure 3.

Figure 3. Modes of combining organizational and program budget classification

Organization	Program	Organization/Program
Ministry		Ministry
Agency	Program	Agency/Program
Department	Sub-program	Department/Sub-program
Division	Activity	Division/Activity

Source: Van Eden, op. cit.

<sup>33</sup> Ministries and governments need to know how much is being spent on travel, vehicles, and utilities, across all programs, to identify areas for improved control measures and for improving cost-efficiencies in purchasing and procurement.

**Retaining some input controls after PBB introduction is common practice.** Such controls can include actual expenditures on salaries and wages, staffing numbers and capital spending at the ministry level or below at the program or sub-program level.

**With regard to accounting standards in the region (Table 6), it is sufficient at this stage to note that PBB approaches work perfectly well on the types of predominantly cash-based systems which are prevalent in the region.** In all countries, the budget is enacted on a cash basis but some supporting documents for a consolidated general government are presented on an accrual basis. (Accounting issues are not covered in this study but, as noted in Chapter 1, most Anglo-Saxon countries have adopted the PBB framework under accrual budgeting<sup>34</sup>). Accounting issues become extremely important when designing an IT system to support budget operations. Before designing the system, it is worth reviewing government accounting standards to check for inconsistencies. Even if the accounting system is cash-based, fiscal transparency requires the system to record commitments as well as payments. Regardless of the accounting basis, the system should be capable of tracking assets and liabilities and their changes. Because of the complexity of both issues, simultaneous implementation of PBB and introduction of accrual budgeting is not recommended (see also Robinson, 2007b).

### 2.3. Basic architecture of the PBB approach

**Initial efforts in introducing PBB usually focus on classification of expenditures into programs, sub-programs and activities** and, sometimes, sub-activities. At the more detailed levels, specificity is increasing and relates clearly to policy objectives. Conceptually, program classification differs from the GFS 2001 functional classification because government program objectives may be met by activities in several functional areas. Government activities are performed by a number of organizational entities. All these activities are transparently consolidated in the program classification, usually organized by the line ministry.

**The fundamental principles of program classification are common but the overall approach is not standardized.** This is revealed in the comparison shown in Table 7. Most frequently, program classification covers from two to four layers and the nomenclature depends on the national practice. Although the first layer is a full program, it is not always

<sup>34</sup> Technically, accrual accounting methods can provide greater transparency in measuring the cost of public policies and may sometimes support improved management of assets and liabilities.

called a program. As indicated by Van Eden<sup>35</sup>, policy objectives define programs and program structure is driven by the government's strategic objectives. The program structure arranges budget information in a useful way to respond to the what, how, and at what price the program manager within each spending agency wants to achieve its goals.

Table 7. Architecture of PBB framework, as of mid-2008

	Bulgaria	Croatia	Latvia	Poland	Slovakia	Turkey
<b>Level 1</b> No. of items	Policy 72	Main program 47	Program 424	Function 22	Program 95	Not in place
<b>Level 2</b> No. of items	Program/ Other Program More than 215 altogether	Program	Sub-program	Task Max. two targets	Sub-program 411	
<b>Level 3</b> No. of items	Product/ Service	Sub-program 448	Items from economic classification	Sub-task Max. five per task	Element or project 804	
<b>Level 4</b> No. of items		Activity (current or capital project)		Activity		

Source: Bank staff.

**Programs have been developed by line ministries in cooperation with MOF (bottom-up approach) and include goals, objectives and measurable indicators.** Line ministries are responsible for further breakdown of given limits into classifications available to the lowest level of detail. In *Poland*, after the pilot phase in 2006-2007 in which line ministers had a lot of freedom in proposing the structure in their area of responsibility, MOF decided to oversee more closely the general framework (a delicate shift towards a top-down approach). In spring 2008, it formulated the general architecture at Levels 1 and 2, while giving line ministers more freedom to formulate the lower levels. In *Slovakia*, ministries in many cases use the program structure actively in their policy planning. Sometimes it is treated as a rigid framework and strategic planning or costing exercises are separated from budget programs. Pressure from MOF has so far been unable to change these practices.

**Pilot projects in selected sectors were very useful but additional efforts are needed to make the PBB approach operational.** Line ministries in *Slovakia* could develop program structures and performance measures

<sup>35</sup> Van Eden, op.cit.

on their own. The Justice Ministry provided a strong example. Subsequent negotiations with MOF were conducted in the context of budget submissions. Pilot projects enable technical adjustments to be made to the reform project. They are also conducive to greater acceptance by the staff concerned. In *Bulgaria* PBB methodology exists but its uniform implementation is complicated by the limited oversight and feedback that MOF provides to line ministries on the quality of the program budgets and performance information. Bulky reporting requirements and capacity constraints prevent MOF from making systematic quality assurance of PBB. To get the PBB approach operating, the region would benefit from standardizing methodologies and procedures relating to the design of the PBB architecture and monitoring of PBB indicators.

#### 2.4. Approach in sectors with overlapping responsibility of some institutions, including extra-budgetary funds

##### **The pace of PBB implementation depends on MOF involvement.**

Even in countries where reforms were initiated by another institution (*Poland, Latvia*) or jointly by several institutions (*Turkey*), the main efforts after the initial phase were taken by MOF. This positively affected ownership of the PBB reforms in MOF.

**The vast majority of programs are embedded under a single agency (ministry) across the region.** In the case of overlapping tasks of some institutions, MOF or the Chancellery of State (or Chancellery of the Prime Minister) took responsibility for coordination. Defining all programs under line ministry structure is the most practical approach because it aligns with overall ministerial accountability. With a long-lasting tradition of sectoral breakdown, cross-agency responsibility would be too demanding for any country in the region. Level 1 programs have not, anywhere in the region, become the budget management unit and ministers or authorized budget administrators have not become budget managers<sup>36</sup>. In the case of multi-sector (inter-ministerial) budget programs, inter-governmental working groups have usually been created to solve policy and operational conflicts.

**If the program overlaps the activities of more than one institution, a program leader is appointed.** In *Latvia*, the Ministry of Finance, supported by the State Chancellery organized working groups with representatives from other institutions to solve specific issues of the division of inter-sectoral responsibility. In *Slovakia*, five of its 70 programs are multi-

<sup>36</sup> Conversely, in France, a dedicated program manager is in charge of implementation with fundable credit lines within the program allowing for more flexible management.

sectoral and a lead ministry is appointed with responsibility for program coordination. Other participating ministries create their sub-programs with goals consistent with program goals.

**Nowhere in the region have extra-budgetary funds (EBF) been brought fully within the PBB process.** Usually only selected EBFs or agencies have been included. For example, in *Croatia* all social security EBFs follow program budgeting requirements but agencies such as Croatian Roads and Croatian Highways do not. Because not all sources of funding and planned outlays were considered, the overall picture is not fully consistent with broad policy statements and commitments<sup>37</sup>. EBF can undermine transparency of public spending and distort resource allocation from the announced policies. This makes it essential to include EBFs into the PBB framework and ensure they carry out government policies transparently and subject to the same accountability requirements as other budgeted expenditures. They should also follow the same basis as budget reporting with expenditure presented on existing classifications, including the program classification.

## 2.5. Main problems impeding effective adoption of the PBB structure

**Chapter 1 summarized most problems impeding effective adoption of PBB, based on international experience.** In Emerging Europe, the following issues are particularly relevant:

- *Insufficient commitment of government or selected line ministers.* Public finance reform has been on the agenda for many years but progress has been limited. Many governments in the region still treat PBB as a trial initiative. Changing behavior in public administration is difficult; strong leadership and commitment are vital. *Slovakia* lacks political commitment in several line ministries and this was reflected in the quality of their programs and indicators.
- *Lack of clear vision and conceptual clarity.* In many countries the required PBB system (whether PIB, PRB, PBB, or PDB) has been unspecified and the associated methodology therefore unclear. Too much attention has been paid to performance indicators and not enough to linking program structures to broader strategic goals. Programs still tend to be aligned to organizational struc-

ture rather than to government strategy. M&E systems are on the agenda only in *Slovakia*. It is still unclear whether, when and to what degree the PBB approach will replace traditional budgets.

- *Insufficient capacity and the lack of clarity about ownership.* Training in public administration is an extensive rather than intensive process and difficult to conduct without a clear vision. Different knowledge is needed by policy makers and those responsible for planning and budgeting.
- *Resistance to change in public administration.* Inevitably individuals are threatened by the disruption of well-established operating procedures and resist change. Reforms have to be 'sold' to agencies which must accept the need for the new system and understand that it will provide managers with useful information. In *Latvia*, PBB was perceived as a tool for punishment which, in conjunction with insufficient training, led to resistance. In *Slovakia*, PBB implementation in the early stages was not to punish or reward performance but to gain support for the changes. This lessened the risk of opposition from the public administration.
- *Lack of aligned, holistic and robust program classification.* In *Latvia*, programs are broad and allow for flexibility but the links between them and strategic priorities are blurred and there is unjustified focus on performance indicators. *Croatia* has a proliferation of programs with weak links to strategic priorities and limited to an individual ministry's policy agenda. Overly fragmented programs prohibit design of an adequate M&E system.
- *Ineffective budget negotiation processes* should be changed to focus on results and achievements. Although the budget manual defines program classification as a basis for budget preparation, it is often carried out on the basis of organizational classification – i.e. in terms of expenditures per organization units. There is no institutionalized process for using high quality indicators (results of research, performance and efficiency benchmarks etc.) during the budget negotiation process.
- *Inadequate IT systems for budget operations (planning, execution and reporting) and collection of indicators.* Even if a fully computerized budget system exists, additional solutions are needed to create user-friendly tools. Establishing an IT system should not be seen as merely computerizing existing procedures but rather as an organizational reform which includes redesigning

<sup>37</sup> This is especially true for sectors like health. For example, in Poland the National Health Fund controls for around 90 percent of public expenditure on health while the Minister of Health controls the remaining 10 percent and is responsible for supervising the fund.

information flows and which supports all budget classifications. Building such a system takes time and effort. The steps are well known: preparatory requirements analysis, system design, development and testing; procurement and installation; testing of the full system in the user environment, training and conversion. It is important to get these steps right because fixing mistakes later is never easy. As well, it is difficult to specify functionality in the original design phase because the methods of the new PBB approach may be subject to further change.

- *Insufficient use of performance information in the decision-making process.* Across the region, budgetary decisions haven't been and probably won't for several years be made on the basis of performance. However, performance information may be used with other types of information for policy decisions. Even in advanced countries, integration of performance and budgeting remains difficult. According to Breul<sup>38</sup> this is because performance planning, budgeting and cost accounting systems often operate in parallel silos. Breul believes a mechanistic link in the budget process between resources and results is neither possible nor desirable. Performance data can inform but should not drive budgetary decision-making.
- *Timing issues and unrealistically short project timetables.* In hindsight, these changes may have been made too quickly in *Latvia*, especially for building sufficient capacity in MOF and for strengthening expertise in sectoral expenditure policy and management. In *Slovakia*, rapid change led to reluctant cooperation among some middle-management staff in line ministries, especially in the policy sections.
- *Insufficient involvement of budget people from MOF.* Aside from the additional work burden, budget staff may have felt threatened by the level of transparency an FMIS imposes on them.

## 2.6. Performance indicators: their selection mode, number and accountability processes attached to their achievement

**Application of PBB methods in the region is still evolving** in parallel with other developments and improvements in public administration and management.

<sup>38</sup> Breul, Jonathan D., *Performance-Based Budgeting in the United States*, Presentation at the International Conference on Performance-Based Budgeting, Warsaw, November 2007.

**In the UK approach, design of performance measures has been closely related to the selection of targets at each level of the system** (Webber<sup>39</sup>). The UK has established eight criteria for performance measures:

- relevant to what the organization is aiming to achieve
- able to avoid perverse incentives
- attributable – the activity must be influenced by actions of the institution,
- well-defined,
- timely – produces data regularly and quickly enough
- reliable
- comparable with either past periods or similar programs elsewhere
- verifiable with clear documentation behind it.

**A discussion about the nature of indicators (outcome/output/result) which work best for users of the PBB framework was held in the region.** As is the case internationally, it is far from being settled (see Box 1).

**Countries in the region spent much time debating between MOF and line ministries whether or not particular measures are outputs or outcomes and the quality of indicators remains an issue.** As Schick<sup>40</sup> points out, spending units often deal with the cost problem by producing vast amounts of data on the activities and work of spending units. Having a surfeit of data is often a substitute for having the right kind of data. In the PBB framework, agencies are tempted to itemize all the things they do; this is why PBB systems, especially in this region, may be inundated with far too many low quality indicators. There is no independent audit of indicators, for example by a national audit office.

**Performance targets and indicators are generally defined in a bottom up process, which suffers from some weaknesses.** Performance measures were based on criteria outlined in the budget circular and explanatory note to the budget act (the latter case in *Poland*) or in methodological guidelines issued by MOF (remaining countries). In *Poland*, before the revision of the PBB approach in spring 2008, budget units had to define performance targets for tasks and subtasks (Levels 1 and 2) in

<sup>39</sup> Webber D., 2007, *Good Budgeting, Better Justice: Modern Budget Practices for the Judicial Sector*, Law & Development Working Papers series, No. 3, World Bank.

<sup>40</sup> Schick A., op.cit.

consultation with MOF and external experts. Because methodological guidelines were quite general, line ministries relied on their best knowledge in selecting indicators. This approach was criticized by Misiąg<sup>41</sup> because the entities responsible for achieving targets have little motivation to set ambitious ones. It failed to force managers to use budgetary resources in a manner expected by the public. This happened in *Slovakia* where achievement of planned results varies across different line ministries in tandem with the quality of their objectives. Weak or outstanding performance can be attributed mainly to poor definition of targets (exaggerated or underestimated) rather than excellent program management. In *Latvia* and *Bulgaria* the number of indicators is excessive, lacks a clear hierarchy, and is mostly output oriented. In *Turkey*, due to the absence of a relevant standard, agencies determined their performance indicators individually and this led to differences in the number and quality of indicators.

**Box 1. Some insights from debate on the nature of performance indicators**

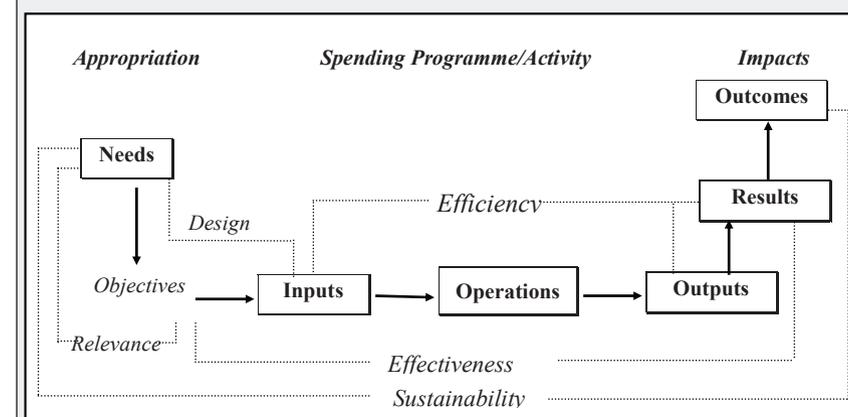
**The argument for downplaying the role of outputs, while giving increased attention to outcomes**, is well summarized by Brumby and Robinson (2004)<sup>42</sup>. *A strong argument can be made for outcome-focused performance budgeting. Outcomes are the intended effects of government programs, whereas outputs — the goods or services delivered by government — are the means of achieving those outcomes. It can be argued that outcomes are what really matter and that to focus too much on outputs in a performance budgeting system is to run the risk of focusing too little upon the effectiveness and quality of services. Nevertheless, it can be argued that outputs must have a central role in a workable form of performance budgeting.*

The issue was also discussed by Webber<sup>43</sup> based on New Zealand's experience. A gradual re-orientation from outputs to outcomes is also visible in subsequent PSA (Public Sector Agreements) rounds in the UK. Outputs still exist at a more operational level and are much more likely to be available than those pertaining to outcomes or impacts so they are often given prominence in PBB systems.

However, the linkage of resources and results is much stronger in budgeting for outputs, even though outcomes generally are regarded as the more appropriate measure of performance. The resources-to-results link is weak because outcomes often derive from multiple causes, some of which are beyond government control.

Key relationships in the budgeting and expenditure management process are demonstrated in Figure 4. This process shows that operational activities sit at the centre of program management and resource allocation decisions and the impacts of these decisions may be measured and assessed in varying ways, and at varying distances, from the programme delivery function.

Figure 4. The Public Expenditure Management Process



Source: Webber 2004<sup>44</sup>

**Outcomes are at the end of the PEM process.** For this reason they may often be the most difficult to identify and intervention is required. Performance measures flow upwards from outputs to results and finally outcomes. The latter indicate the sustainability of the range of government expenditure policies in realization of the society-wide goals. *Outputs* help ministries formulate decisions and program design in a practical way. Their direct consequences or the impacts of the expenditure are *results*. These results from the policy or program and their impact is detectable within a policy-relevant period; at this level the effectiveness of interventions can be measured.

Figure 4 indicates the links between the components of the PEM process in a way that meets relevance, efficiency, effectiveness, and sustainability criteria.

**Schick (2008) emphasizes the issue of asymmetric information.** When their budgets are at risk and performance measures are used, budget managers have incentives to provide misleading information or even deceive. One sensible tactic would be to identify a small number of powerful measures that represent the main objectives of an organization or program and verify the results independently.

**Although indicators are not the most important element of the PBB approach, especially in the early phase of its implementation, their uneven quality has exposed PBB to some criticism.** Initial difficulties in identifying and selecting suitable performance indicators can undermine the overall PBB reform efforts. However, this needs to be bal-

<sup>41</sup> Misiąg W., 2007, *Performance-based Budget for 2008 and what is next?* (Budżet zadaniowy na rok 2008 – i co dalej?), Public Finance Bulletin, IBnGR.

<sup>42</sup> Brumby, J. and M. Robinson (2004), *Performance Budgeting, an Overview*, paper prepared for IMF and Brazilian Ministry of Planning, Budget and Management seminar: *International Seminar on Performance Budgeting*, Brasilia, March 2004.

<sup>43</sup> Webber D., *Wrestling with Outcomes: The New Zealand Experience*, Agenda, Volume 11, Number 4, 2004.

<sup>44</sup> Adapted from an idea in a European Community (2000) Working Paper on designing evaluations.

anced against the risks of allowing line ministries to choose simple and readily available indicators that may not reveal the true focus or impact of their expenditure activities.

**These different attitudes and technical capacities are reflected in the quality of performance indicators across budget units.** In *Poland* some indicators used in the 2008 budget were imprecisely defined, immeasurable and, in a few cases, without a baseline value. In one case, the target value was below the baseline. Indicators published in the 2008 budget were not subject to internal or external control and some indicators in the 2009 budget share these weaknesses.

**It is difficult to judge the appropriate number and relevance of performance measures in the region but it is clear that many are not ideal.** As shown in Table 8, there are differences across the region regarding the number and coverage of indicators. Too many indicators pose a risk for credibility and for remaining unused. A collection of (numerous) indicators fails to provide information about the efficiency of expenditures. International experience suggests each country should seek to improve the quality of its indicator sets and its capacity for good monitoring over time. A small number of key measures is preferable. The United States' PART model offering simple summary measures has merit, but it may be too early to adopt this tool in Emerging Europe.

Table 8. Performance indicators in 2008 budgets

	Bulgaria	Croatia	Latvia	Poland	Slovakia	Turkey
<b>No. of indicators</b>						
<i>Outcomes</i>		N/A	496	approx. 950 indicators	631	
<i>Outputs</i>		N/A	1597		675	
<b>Coverage of indicators</b>	Baseline year and three years beyond	Baseline year and two years beyond	Budget year	Baseline, budget year, and two years beyond	Three previous years, budget year, and two years beyond	Two previous years, budget year, and two years beyond
<b>Specific guidelines for indicators</b>				Max. three indicators per tasks and one indicator per sub-task	Previous limits on the number of indicators were cancelled	

Source: World Bank staff

## 2.7. Accountability processes

**Although good cost accounting capabilities are rare in many governments, these skills are especially useful in the context of PBB.** A key requirement of PBB involves allocating costs among the units of outputs or outcomes produced by the public sector. Unit cost data enables governments to focus on efficiency and performance management, including assisting with making trade-offs among competing claims for budget funds. This requires a capacity to apportion costs among the results produced by public agencies, including an ability to distinguish between fixed and variable costs. A challenging element is attributing indirect costs, like legal services<sup>45</sup>. Computerized financial management information systems can greatly facilitate cost accounting in a modern government expenditure system.

**The traditional one-year budget horizon does not suit PBB systems and focusing only on outcomes is insufficient.** When government wants to generate significant changes in outcomes, it needs to budget over at least a medium-term horizon. The MTEF becomes a very useful tool, provided it is not merely a technical exercise. A monitoring system based only on outcomes rarely provides a useful signal of either the efficiency or effectiveness of individual agencies or expenditure programs. Outcomes may suit policy makers as a means for better explaining policy goals and expectations, but budget managers need also to monitor and analyze output measures.

**Slovakia illustrates the benefits of an integral database for collecting and analyzing performance indicators.** Program performance is monitored through the budget IT system twice a year, in addition to routine monitoring by policy makers. Line ministers in Slovakia as well as in Bulgaria are obliged to submit monitoring results to MOF, Cabinet, and Parliament. In *Poland*, in the 2007-2008 budgets, performance indicators were presented only in the justification of the budget act. Without a proper mechanism for data collection, analyzing, and verification, the exercise at the very early stage of the PBB implementation was of limited use. In *Latvia* MOF prepares a report on implementation of the performance management system within the previous year. From 2009, ministries are expected to report on results and performance indicators.

**Accountability processes relating to the achievement of performance indicators in the region are weak or non-existent.** In *Turkey* there are annual accountability reports and internal control assurance state-

<sup>45</sup> See Robinson, 2007, op.cit. for more discussion.

ments, and performance outcomes are evaluated within the framework of managerial responsibility. In *Latvia* information resulting mainly from international commitments has been regularly monitored and updated. Collecting performance indicators is treated as a formal exercise with no impact on budget allocations. In *Bulgaria*, where there is no formal accountability related to achievement of performance targets, line ministries have no incentives to improve the quality of program budgets. Lack of program evaluations in *Slovakia* is acknowledged as a weakness in the system but there are proposals for change in 2009. Given that projects aimed at implementing M&E systems were started in 2006, this is long overdue.

## 2.8. Examples of the best practice or poor performers in PBB preparation

**Progress in PBB implementation is understandably uneven across sectors.** Certain sectors (e.g. health, education<sup>46</sup>) usually find it easier to adopt PBB methods while other sectors where the impacts of policy may be harder to quantify (e.g. justice) have greater difficulty. Sectors where independent agencies execute government policy (such as transport) can also adapt readily to PBB methods and structures when strategic objectives are well defined and flows of funds are adequately managed. For the first few years since the reform initiation, many departments (ministries and agencies) struggled to develop a set of clear, meaningful and achievable outcomes. Other challenges have since emerged such as developing effective links between outputs and intended outcomes and underpinning outcomes with useful and consistent performance measures.

**Differences may also result from participation in pilot programs or involvement of (inter)national experts.** In *Poland*, variable quality across spending agencies was attributable to inconsistencies in the organizing principle underlying the selection of 'tasks'. Some ministries defined their tasks partly on broad policy objectives and partly on existing programs of expenditure. In *Slovakia*, the logical basis of the program structure is coherent, but some line ministries still fail to follow best practice.

**The value of some pilot projects in demonstrating the advantages of the PBB approach were constrained because the agencies involved were required to continue with parallel systems and rules for traditional budgets.** It may be worthwhile to select one ministry and provide the minister with full discretion over personnel, organizational structure, management etc. At the same time, the ministry would be given a clear

<sup>46</sup> Examples from Slovakia show that while education may serve as a good example, there were difficulties defining strategic goals for health care.

mandate to achieve its mission (objectives). Performance would be a key driver for the minister and staff because they would be judged on their achievements. If successful, such a pilot project could have a powerful impact on other public sector units.

**Some countries in the region (*Bulgaria, Poland and Slovakia*) started with government-wide implementation and a few agencies working more intensively on budget reform.** This had beneficial results. It quickly yielded results showing other agencies the promise of the system and highlighted problems to be addressed. Pilots, however, risk sending the message that government is not fully committed to PBB reform. A clear shift from pilots to government-wide implementation is essential. The pilot should not delay agencies from taking the effort seriously and using the time to master the basic concepts.

## 2.9. Impact of PBB on budget allocations and the quality of budget preparation and oversight, and future plans for PBB implementation

**Most countries in the region have adopted performance-informed budgets but their impact on resource allocation has so far been marginal.** Performance programs in *Turkey* have been used to provide information in the course of budget preparation, rather than for resource allocation purposes. Ideally, PBB should inform government budget preparation through better prioritization and increased pressure to perform.

**Performance information is not used when decisions are made.** Unless this issue is resolved, PBB initiatives in this region may be discredited and spending units will further base their decisions on incremental norms to ascertain the amounts needed for specific expenditures. This may reduce the quality of information provided.

**With the exception of *Slovakia*, countries in the region are still in an early stage of PBB application but some are showing positive results.** The key challenge in the remaining EU members is to improve existing program structure by aligning it better to government's strategic policies. Nonetheless, PBB cannot yet be considered a fully developed tool for helping to identify potential spending cuts across the region.

**An OECD study<sup>47</sup> shows that only a few OECD member countries have so far used PBB as a tool for reducing public expenditures, though most countries use it in achieving significant improvements in pub-**

<sup>47</sup> Curristine T. (ed.), 2007, Performance Budgeting in OECD countries, OECD, Paris.

**lic expenditure management systems.**<sup>48</sup> Positive effects usually emerge within a few years from introduction of the reform – expenditure cuts are generally less painful when applied to less effective programs. At the very least, performance information may provoke agencies to undertake a more detailed review of these expenditures.

**M&E has an essential role to play in streamlining performance information and making it useful to decision makers,** enabling them to take this information into account when allocating budget resources. In all countries there is more awareness and support for the concept of managing for results, where budget accounts are more transparent and budget managers held accountable. *Latvia*, for example, plans to strengthen its M&E system to close the gap between performance information and budget allocations.

**All countries in the region will inevitably struggle with the quality, relevance, and credibility of their performance measures.** PBB implementation needs to be well-managed at various levels, from encouraging politicians to use it in decision making to changing the behavior of civil servants. In some countries, e.g. *Bulgaria*, creation of a fiscal accountability institution would help systematize more comprehensive use of performance information.

**Political commitment and a positive attitude by public administration are key factors keeping PBB reforms on track.** Even in *Slovakia*, there is a risk of these reforms being reversed. In every country, top-down action is needed and should be accompanied by capacity building in public administration to convince public servants that reforms will increase efficiency. This is the best citizens can expect from the public administration, not least in an era of global financial crisis. As Schick (2008) pointed out, “without exception, performance-oriented approaches are effective only in well-managed governments which have low corruption, elevated levels of public trust, reasonably efficient and fair public services, and media and interest groups that pay attention to results. When these conditions are lacking, no PBB system is capable of fulfilling its ambitions”. It is a paradox of improved management of public finances that developing highly professional public administration people and systems will be assisted, in part, by improved budget processes.

<sup>48</sup> Korea is an exception. After PBB implementation, it announced a 10 percent budget cut for ineffective programs. Korea is one of few countries worldwide opting for a big bang in PBB implementation.

#### 4.3. Budget Presentation and Classification

**Making fiscal information available to the public is a core requirement of fiscal transparency.** According to the IMF manual on fiscal transparency<sup>49</sup> “principles and practices in this regard concern provision of comprehensive information on fiscal activity and government objectives and the presentation of such information in a way that facilitates policy analysis and promotes accountability. A cornerstone for ensuring timely and uniform availability of fiscal information is that it can be readily accessed free of charge on the internet. (...) Also, any changes to the classification or presentation of items from year to year should be disclosed”.

##### 3.1. Components of core budget documentation capturing MTEF and PBB methods

**Changes in budgeting practices in the region have been reflected in expanded budget documentation and increased complexity.** As well as the traditional budget documentation, there is an MTEF showing a medium-term macroeconomic and fiscal scenario and either a separate document, describing the budget in PBB framework, or a chapter in the budget explanatory note<sup>50</sup> (the latter in the case of *Poland*). A lot of practical information related to MTEF or PBB has been included in budget circulars or special handbooks or manuals (the latter in *Slovakia*). The system and documentation has become so complex that in countries like *Slovakia* some simplification and refinement would help to sustain these achievements.

**Countries use their own document sets and nomenclatures** (see case studies in Chapter 5). In *Slovakia* and *Croatia*, budget documentation relies on data provided by the budget IT system and follows various classifications. Based on this, a book is published (in *Slovakia only*) containing all programs, fund allocations, policy goals, and indicators. The quality of these documents and analysis has been improving. In *Poland*, during 2007, the Chancellery of the Prime Minister spearheaded production of a sizeable document describing key tasks and sub-tasks together with the Zloty amount in 2008 budget proposals from each ministry. It included performance indicators (in terms of both baselines and target values) associated with each of these tasks. However, this document did not set a sufficient basis for sustainable implementation of PBB reforms in the future and, following stronger involvement from MOF, was replaced

<sup>49</sup> IMF, 2007, *Manual on Fiscal Transparency*, Washington D.C.

<sup>50</sup> This is an appendix to the state budget.

with new documentation. The new chapter in the explanatory note to the budget act, however, adjusts to the existing *status quo* rather than reshapes government's prioritization process.

**A more or less comprehensive PBB component is presented with the traditional budget** but there is little ownership of this documentation by many ministries and programs. Generally, policies were not based on clear overall strategies and procedures for monitoring and reporting remained weak. Ministries that later started developing their program budgets face difficulties identifying programs and performance indicators, not to mention developing other aspects like program evaluation.

**In accordance with best practices, emphasis should be on explaining the government's expenditure policies and objectives and their reflection in the program structure.** More attention could also be given to identifying new policies and projects. And sector ministries and agencies need guidelines on new performance-related documentation they must be able to demonstrate how their expenditures (including new policies) contribute to government's broader strategic aims.

**Performance information demonstrates future plans and expected achievements but is yet to show clearly what has been achieved.** PBB documentation resembles a statement of intent or a planning framework, informing how each department will contribute to government's overall policy objectives. Integrating these statements into a coherent government program and demonstrating that it is being achieved is another matter.

### 3.2. Current state of development and plans in budget classifications and coding

**Introducing better budget classification and an improved accounting systems has emerged as a most time-consuming and difficult element in effective PBB implementation.** This is because it is unique for every country and every ministry and requires complex interactions between inputs, outputs and outcomes. For the region, most programs have been developed initially on the basis of current activities within the existing public administration organizational structure.

**While the top-down approach program structure can optimize organizational structure it can disrupt current activities.** Van Eden<sup>51</sup> advises against making too many changes to organizational structure and give a program structure time to mature. This may take several years. In the longer term, an organizational structure could align more with the

program structure through improvements in design processes, including subjective elements, but at the end of the day should be based on government's strategic objectives.

**All countries in the region opted for separate rather than combined classifications.** While this duplicates information and requires specific 'keys' to move from one classification to the other, it allows flexibility to introduce further changes. These changes are gradual but necessary if a full rather than ad-hoc use of program classification is to materialize, at all budget stages, in the future. Budget decisions can be strongly influenced by the way information is presented.

**IT supported budget systems operate across the region but with varying integration (fragmentation) and functionality.**

- A budget IT system in *Bulgaria* has been deployed to major but not all budget units and does not support the program structure of the budget.
- Since 2007, *Latvia* has had a unified and comprehensive IT system, based on integrated SAP platform, with all ministries connected online.
- A centralized IT system, called TREZOR, is being implemented in *Poland* to support budget planning, execution and reporting and, ultimately, link all budget holders. For management and accounting purposes, however, different institutions installed their own systems which are not centrally integrated. This means information from individual budget institutions' accounting systems must be entered separately into TREZOR.
- *Turkey* has had an integrated and centrally monitored on-line accounting and reporting system since 2004, covering all general government units.
- *Croatia* has a SAP based system which is particularly helpful in budget preparation.
- *Slovakia's* budget IT system has made a major contribution to implementing budget management reform. It offers different modules, from budget preparation, through budget execution, to budget monitoring, and transitions among different classifications.

**In no country in the region does the accounting system provide a program classification** which is the appropriate classification not only for PBB but for an MTEF's sectoral allocation. Classifying expenditures is im-

<sup>51</sup> Van Eden, op.cit.

important for policy and budget formulation and measuring resource allocation among sectors. The system should allow categorizing expenditure by sector and avoid double accounting. The sum of all the sectoral spending should equal total spending. *Poland* plans to create an integrated IT system supporting budget documentation in PBB framework around 2013.

#### Box 2. Financial Management Information System (FMIS)

FMIS usually refers to computerization of public expenditure management processes including budget formulation, budget execution, and accounting with the help of a fully integrated system for financial management by line ministries and other spending agencies. The full system should secure integration and communication with other relevant information systems.

According to Diamond, Khemani<sup>52</sup> a well-designed FMIS features nine attributes:

- modular and capable of progressive upgrading to cater to future needs
- offers a common platform and user interface to the stakeholders
- maintains a historical database of budget and expenditure plans, transaction data, cash flows, and bank account operations
- has dedicated modules to handle monthly, rolling, short-term and longer-term forward estimates of revenues, and expenditures prepared by agencies
- has built-in analytical tools to offer trend analysis of various elements of fiscal operations to permit a forward look on the fiscal stance
- compiles formal government accounts from the database of authorizations and cash allocations,
- enables real-time reconciliation of parallel but related streams of transaction data - at the agency level
- mechanizes all routine tasks at the central and spending agencies, generating various forms/authorizations, checks, outputting hard copies of key registers and statements etc
- is flexible enough to provide user-defined management information from the database, aggregated at the desired level of detail.

No country in the region regularly publishes a citizens' guide to the budget, apart from information available on official websites and sporadic messages released by media. Simplified PBB documentation would explain the main features of the budget in PBB format, and in plain language, making it easier for the general public to understand. Some countries (*Croatia, Poland and Slovakia*) have issued a budget guide for citizens. Lack of public interest ended this practice in Slovakia.

Greater transparency is a prerequisite for successful PBB and MTEFs – good budget classification, accounting and reporting – are es-

essential for changing incentives in the budget process and enabling performance and accountability. Spending ministries under an MTEF have a greater role in developing sectoral policy within resource constraints. Access to accurate public finance information is important for the general public and for markets, and makes agencies more receptive to cut-backs in spending when they are needed.

#### 4.4. Public Management Performance Culture

PBB requires a radical change in public sector management because it shifts the focus from public spending inputs and amounts to outputs and results. PBB improves the transparency of public spending and puts greater emphasis on long-term financial planning. This requires changes in both human resource policies and public servants' attitudes.

The civil service in Emerging Europe does not have a performance-oriented culture. Rather, it is characterized by life-long job security, seniority-based systems for promotion and non-merit based salary, short-term tenure of high level policy makers. These leave little incentive for bureaucrats to change, a critical factor for the success of the reform initiative. As Schick<sup>53</sup> says, "when employees arrive to work late and leave early, when using public money for private gain is accepted practice, when pay and promotions are determined by favoritism or bribes, when official pay rates are so low that civil servants are on multiple payrolls, sounding the call for performance will not make much of a difference, nor will efforts such as awarding bonuses to high-performing employees".

#### 4.1. Links between budget reforms (especially PBB) and other measures or monitoring and evaluation systems to improve performance in the public sector

As of 2008, M&E systems were missing across the region although some countries produced official reports on PBB with regular audits. M&E is usually left to the later stages of PBB implementation. *Slovakia*, for example, is initiating it in 2009. Program performance in Slovakia is monitored twice a year and official reports based on the program structure of expenditures have been prepared since 2003. In *Bulgaria*, budget managers are required to report in PBB format with semi-annual and annual frequency. Annual implementation reports are available to the public but these documents tend to meet formal compliance requirements, rather than provide easily readable policy and impact information. *Poland*

<sup>52</sup> Diamond J., Khemani P., 2005, *Introducing Financial Management Information Systems in Developing Countries*, IMF Working Paper, WP/05/196, IMF, Washington D.C.

<sup>53</sup> Schick, Mexico

will produce its first budget execution reports in 2009, in accordance with budget law, and these will refer to the 2008 budget.

**Budget reform, and particularly performance re-orientation, is more about improving people's managerial and decision-making capacities than about budget figures or indicators.** Human resources management in the public sector is designed to support sound fiscal policies, improve service to the public and rationalize the distribution of tasks between private and public sectors. Evaluations have a crucial role to play, as demonstrated by the success in countries like Chile, Australia, USA and Canada.

**It takes many years to establish an effective evaluation system and countries in the region could select areas for evaluation according to strategic priorities.** At present, their purpose would be both funding and reorganization of programs. This can be achieved if the evaluator is fully independent, has access to reliable data, and minimal scope room for subjectivity. Evaluations, in particular their organizational set-up, should be coordinated with national supreme audit institutions which are mostly independent institutions experienced in reviewing fiscal activities.

**Few incentives are available to motivate public servants to improve efficiency and performance though Latvia is an exception.** Predominantly, existing arrangements in the civil service are not based on an accountability framework. In most of these six countries, financial rewards and sanctions are not systematically used. Current management culture offers little scope for increasing financial or managerial flexibility in exchange for more accountability. There are also sporadic opportunities for public recognition. In *Latvia*, however, a public sector wage reform introduced gradually since 2003 links wages with responsibilities and performance. In *Croatia* civil service reform started in 2005 but has proceeded slowly and salary reform stalled in negotiations with trade unions. Although *Slovakia* introduced a new public service remuneration system in 2004, it remains rigid with remuneration based on an employee's position and age rather than his or her performance. The civil/public service attracts people who prefer stability over performance pay.

**Non-monetary and monetary rewards have a role to play.** Hatry<sup>54</sup> list the potential benefits as:

*Non-monetary rewards:*

- offer more flexibility to ministries, agencies and their programs in exchange for achieving results (in procurements, personnel changes, flexibility in use of their funds etc)
- provide added opportunities for outside training
- distribute performance reports to personnel so they know the progress their programs are making
- call for agencies and programs to report outcomes to the public
- hold regular program review meetings with staff in which performance is a major topic, demonstrating management's commitment to a results-oriented approach
- include performance criteria as part of annual individual performance appraisals
- recognize good performance in one part of the program by asking staff to provide technical assistance to another part of the program.

*Monetary rewards:*

- provide monetary awards to programs or agencies
- link individual salary to performance
- provide one-off bonuses to individuals or to teams.

**Program classification is not the leading classification so the structure of public administration doesn't lean in this direction.** Current administrative structures are not best suited to the concept of managing for results because flexibility is limited and accountability blurred. Consistent administrative and program structures would be more effective.

<sup>54</sup> Hatry H.P., Nayyar-Stone R., 2004, *Establishing a Performance Management Strategy: Governing for Results*, The Urban Institute, 2004 Korea conference.

#### 4.2. The idea of a performance management culture in the public sector

**The civil service in Emerging Europe lacks a performance-oriented culture but this is only gradually being established.** Outcome management requires a shift in thinking for government employees traditionally focused on inputs. When they think of their products, government managers typically think of physical outputs. Switching their focus to outcomes requires institutions to think more about what good they can do for citizens. MOFs and budget departments in line ministries have grasped the idea of PBB; progress is a little slower in policy departments.

**A performance management culture requires staff to adopt the values, beliefs and behaviors that better enable governments to achieve policy goals.** This requires better human resources management and re-orientation through training programs, workshops, seminars. Governments need to use performance information and tools like regular program reviews to motivate employees. At the same time, they must demonstrate its commitment to reform and convince employees that adjustment is inevitable. State audit offices also have a major role to play in promoting performance culture, for example through performance audits. This is already a practice in *Croatia* where the national SAO has conducted six pilot performance audits.

**A major barrier to altering public manager culture is managers' concern that performance information will be used against them.** Governments can alleviate this concern by emphasizing the use of performance information for making service improvements (including turning organizations into learning organizations). Performance information can be used to reward the staff for high performance or identify knowledge gaps among staff. Knowing this will help managers become less wary of collecting performance information. Where performance targets aren't met, for example due to external factors beyond their control (see Hatry 2004<sup>55</sup>), staff should be given the opportunity to explain why.

**MOF and line ministries may resist reforms.** With a smaller role in allocating resources, MOF may be concerned with the potential loss of influence and power or prestige. Line ministries may perceive the changes as additional work without any real pay-off. Other concerns may arise from limited knowledge of the new budgeting methods, uncertainty about individual incentives, and potential shifts in the work burden from people executing micro-level activities to staff responsible for macroeconomic

analyses and national policy priorities. Line ministries may gradually acquire greater discretion and flexibility in decision making in planning and prioritization within sectors and implementing policy and executing budget. Greater discretion over budgetary decisions should go hand-in-hand with greater accountability for results.

#### 4.3. Readiness of the civil service and the public administration system to implement the principle of increased managerial flexibility in return for increased accountability

**PBB reforms give greater autonomy to budget managers but there is a trade-off against in the form of increased responsibility and accountability for results.** Increased responsibility should go hand-in-hand with increased flexibility in resource management, strong internal audit and monitoring mechanisms, and financial and non-financial reporting systems. In a mature PBB system, budget appropriations may be more broadly based, giving managers increased flexibility. In many cases, rules pertaining to personnel expenditures may be more tightly controlled, though internationally adjustments in salary levels are increasingly based on performance.

**PBB works well in countries with common law tradition while middle-income countries rely on a principle of limited trust in public sector management.** In the first group of countries, flexibility is given to medium-level managers in spending public funds to achieve objectives (e.g. New Zealand, UK and USA). In middle-income countries, PBB systems assign less trust to middle-level managers (e.g. Chile). Mutually-enforcing objectives of performance budgeting cover improvements in both allocative and managerial efficiency of public expenditure, with the former predominant in transition and developing countries, and the latter in developed countries. Both approaches permit greater managerial freedom as long as they can produce the desired outputs and outcomes.

**In regional countries with a more socialist or communist history (excluding *Turkey*), and no tradition of common law, it may be too early to give public managers substantial autonomy.** Decentralization of authority from central ministers may be unsuitable if the MOF favors a Chilean model in which significant control and oversight are maintained in a MOF. Increased delegation requires robust systems for accountability. To ensure budgets are effectively spent and accountability based on program result, the nature of expenditure controls must be changed, with formal mechanisms put in place and financial authority and accountability strengthened at the spending agency level

<sup>55</sup> Harry P. Hatry, Ritu Nayyar-Stone, 2004, *Establishing a Performance Management Strategy: Governing for Results*, The Urban Institute, 2004 Korea conference.

**Changing the culture of control is difficult in Emerging Europe.** Financial control systems are centralized in MOFs unwilling to delegate funds and responsibility to implementing agents. Agency managers must have the capacity, incentives and willingness to adopt change and accept accountability. Delegation of managerial accountability often becomes a topic of political intervention.

**Countries with the best and most advanced PBB systems are among the best managed in the world (Schick<sup>56</sup>).** These advanced systems generally have low levels of corruption, an efficient public administration service, effective accountability arrangements, political and administrative channels for citizens to express preferences and grievances, and procedures for monitoring the quality of public services. Of course, PBB will work best where there is trust and confidence in government leaders and public institutions, where civil servants are recruited and promoted on the basis of merit and where there is relatively low turnover in civil service jobs when the governing party loses an election. However, it is precisely these attributes that PBB systems help to achieve.

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<sup>56</sup> Schick, op.cit.

## Chapter 5 – country case studies

### Bulgaria

*Stella Ilieva*<sup>57</sup>

#### General Assessment (Summary)

Bulgaria has made good progress implementing medium-term expenditure framework and introducing performance-based budgeting. Reforms to the budget system have been designed well and in line with international good practices. They have been implemented consistently over the last several years to improve the aggregate fiscal discipline and support greater allocative efficiency in public spending. The reforms have effectively instilled a prudent fiscal management culture with practices supported by constraints imposed by the currency board. The budget preparation process as well as budget documents and procedures have become more transparent and consistent with improved international practices.

Since it was introduced in 2006 the MTEF has increasingly become an important instrument for enhancing strategic allocation of resources, improving the predictability of the aggregate expenditure envelope and supporting the sustainability of public finances. The Ministry of Finance (MOF) has a good capacity to lead preparation of the MTEF and support line ministries develop three-year budget plans. Sustainability of the MTEF has been strengthened with implementation of program budgets. Now, first level spending units develop their medium-term budgets in programmatic format. Further refinement of the processes and methods already used, including changes to the organic budget law, would improve the credibility of the MTEF. Better capacity and more authority of MOF are needed to evaluate first level spending units' (FLSU) budget proposals and provide meaningful feedback to them to improve public finance efficiency and effectiveness. Ministries' capacity for medium-term planning linked to strategic priorities should be strengthened. Bulgaria's planned introduction of comprehensive sector reviews as well as enhancement of its performance budgeting process should contribute to greater effectiveness of its MTEF.

Program budgeting reform was initiated in 2002 on a pilot basis and is now being applied to all FLSUs which are preparing their budget plans and implementation reports in program format with performance indicators identified for each program. However, the current institutional

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<sup>57</sup> Based on responses kindly provided by the Bulgaria's Ministry of Finance staff.

setting needs to be adjusted to respond to a performance management culture. This requires legislative amendments to the organic budget law to reinforce the program budgeting approach and link it better to performance. Incentives to all players in the budget process need to be established to make better use of performance information and support enforcement procedures. The capacity of ministries and agencies to develop good program budgets should be improved, especially for those ministries that started the process later. MOF capacity and authority to review and evaluate the quality of program budgets and performance indicators need to be strengthened.

Sustaining these reforms and improving their payoff requires increased political commitment and use of these budget tools to enhance effectiveness and efficiency of resource allocation and improve public sector accountability. Putting in place an evaluation and monitoring system would help Cabinet and Parliament improve resource allocation and increase accountability.

## 1. Core Features of Current Budget System

**Bulgaria's budget system has undergone substantial transformation over the last decade.** Improvements have been made in all stages of the budget process; the roles and responsibilities of all institutions have been clarified; and core functions of budgeting, control and management of public resources have been strengthened. The result is greater predictability of the budget, improved aggregate fiscal discipline, and transparency of the budget process.

**MOF plays a key role in the budget process,** responsible for:

- issuing guidelines and instructions for the different stages of the budgetary procedure
- developing the medium-term budget framework
- reviewing budget proposals of line ministries and agencies that are FLSUs<sup>58</sup>, including in PBB format
- providing feedback to FLSUs on whether or not proposed spending programs are realistic and feasible
- preparing draft state budget law and submitting it to Cabinet with all budget documents.

MOF also reviews the proposed budgets of agencies and institutions with autonomous budgets that are approved only by Parliament (National Assembly). During budget execution, the Minister of Finance could, on FLSUs' request, reallocate budgets between spending units or give consent for reallocation of expenditure within the budget of the spending unit. The Minister of Finance could stop transfer of state subsidies or other transfers to budget entities in the case of a breach of law or breach of financial discipline.

**The Council of Ministers (Cabinet) participates actively in budget preparation and consultations.** It approves the medium-term budget framework and main macroeconomic assumptions for the three-year period and submits them for information to the Budget and Finance Committee and other related committees in the National Assembly. Based on the approved fiscal framework, MOF develops the MTEF including expenditure ceilings by FLSU and updates the State Government Debt Strategy. These are also approved by Cabinet, usually in end-July. Draft budget law and all budget documents, including FLSUs' program budgets, are also approved by Cabinet and submitted to the National Assembly at least two months before the start of the fiscal year, usually end-October. While Cabinet does not approve budgets of autonomous entities or intuitions, it provides its opinion on their draft budgets. Once the budget law is adopted, Cabinet adopts a decree on the budget implementation which details the budgets and various indicators and standards for FLSUs and municipalities, including the standards for delegated functions to municipalities.

**Line ministries now have more flexibility in allocating and using resources within the agreed expenditure ceilings.** Line ministries and government agencies are autonomous in their decisions on resource allocation within a few protected items like wages, social contributions and debt. Line ministries develop and submit to MOF their medium-term budget plans (including in program format) and draft annual budget once the expenditure ceilings are agreed with MOF and approved by Cabinet.

**Budgets of pension and health insurance funds are approved by the National Assembly separately and do not constitute part of the state budget law.** The National Social Security Institute (NSSI) budget is presented to Cabinet for approval by the Minister of Labor and Social Policy. The National Health Insurance Fund (NHIF) budget is presented by the Minister of Health. Usually these draft budget laws are considered together with the draft state budget law by the National Assembly.

<sup>58</sup> These are all ministries (16), the COM, four government agencies—State Agency for ITC, State Forestry Agency (est. 2007), State Agency for Youth and Sports, and State Agency for National Security (est. 2007).

**The National Assembly approves the annual budget law taking into account budget documents submitted together with the draft budget law.** The annual budget law is based on the economic classification of the budget while program budgets of the FLSUs are attached to the budget documents submitted to the National Assembly together with the draft budget law. The draft budget is discussed by various parliamentary committees while the Budget and Finance Committee summarizes the proposals of all committees within the overall budget proposed by Cabinet. Therefore all changes proposed and approved by the National Assembly need to be accompanied by a proposal for offsetting the respective increase or decrease of a budget item. Line ministries are required to reflect respective changes in their program budgets. In 2007 a special subcommittee was set up under the Budget and Finance Committee in the National Assembly to improve accountability in the public sector. It is yet to be seen how this committee will function.

**There are a number of institutions with special status, whose budgets are approved only by the National Assembly although they are included in the state budget law.** These include the budgets of the:

- Judiciary
- National Assembly
- National Audit Office
- Financial Supervision Commission.

All these institutions submit their budget proposals to MOF for information. MOF comments on the appropriateness of the budget requests and provides feedback to these institutions. Differences of opinion on the budget proposal of the National Assembly are resolved in consultation with the Prime Minister and the Speaker of the National Assembly. The National Assembly has sole authority over the judiciary budget.

**Municipal budgets are adopted by municipal councils.** MOF signs an agreement with the National Association of Municipalities in the Republic of Bulgaria (NAMRB) on the total amount of subsidies to municipalities. Line ministries, MOF and NAMRB agree on expenditure standards for activities delegated by the state. Municipalities have flexibility to reallocate resources within delegated state activities (except expenditure on compensation of employees and scholarships) and even more flexibility on municipal activities.

**Key pieces of legislation related to the budget system are the constitution, the organic budget law, social security code, the municipal budget law, and the annual budget laws of the state budget, the NSSI,**

**and the NHIF.** The organic budget law was approved in 1996 and governs the budget process—planning, approval, execution and reporting of the state budget as well as fiscal relations between central and local governments and the scope of extra-budgetary accounts. Amendments in 2007 incorporate issues related to EU membership or the independence of the budget of the National Assembly. While there are provisions in the organic budget law related to the MTEF, the performance-based budgeting does not feature in the law. Instead it is reflected in Cabinet decrees and in the annual state budget laws.

## **2. General Progress on Budget Reform**

**Budget reforms have been implemented since 1997 following introduction of the Currency Board in Bulgaria.** Initially budget reforms aimed to improve aggregate fiscal discipline to ensure sustainability of public finances. These reforms involved clarifying roles and responsibilities of spending units, Parliament and Cabinet, introducing strict limits on debt issuance, reducing the quasi-fiscal activities of non-financial public corporations, improving the comprehensiveness of the budget by reducing the number of extra-budgetary accounts, and improving the reporting, accounting, and transparency of fiscal accounts etc.

**These reform initiatives have instilled a prudent fiscal management culture and practices.** Supported by constraints imposed by the currency board, overall fiscal deficits declined from double digits in 1996 to a balanced budget in 2003 and fiscal surpluses thereafter. Restrictions on the issuance of new debt were introduced with a list of new investment projects financed by external sources approved each year and included in the annual budget law. In addition, ratification by the National Assembly of all external obligations of Government is required. The annual budget law specifies ceilings on total debt stock and on the issuance of new government debt, including state guarantees. Stricter rules on debt issuance brought public and publicly guaranteed debt down from more than 100 percent of GDP in 1997 to below 20 percent in 2007. This was helped by a series of active debt management operations.

**Running fiscal surpluses revealed the need to make further adjustments to the public finance management system. This was because some of the tools and practices used to maintain fiscal discipline did not correspond to a more developed budget system.** For example, to ensure the overall balance supports the macroeconomic framework, revenues were systematically underestimated. The rationale for this was that

it was difficult to justify a fiscal surplus when a lot of budget funded functions suffered from under-investment for more than a decade. As a result, the fiscal surplus voted in Parliament was two or three percentage points lower than the actual surplus. In addition, a 90 percent rule was introduced to limit line ministries' spending to only 90 percent of planned allocations and ensure fiscal accounts were responsive to the worsened external environment. This rule was imbedded in the annual draft legislation. It meant all FLSUs' spending was restrained legally till the fourth quarter of the year. FLSUs either didn't get the remaining 10 percent as the external current account deficit was widening or ended up spending a huge amount of public resources in the last couple of months of the year. Use of this rule ended in 2007.

**Cabinet's discretion to approve large amounts of the fiscal over-performance was limited with amendments to the organic budget law in 2005.** Cabinet can now approve, during the year, spending of additional resources or new sources of revenues only up to 1.5 percent of estimated revenues from the consolidated government budget. All other additional spending is subject to Parliamentary approval. However, with substantial over-performance of revenues in recent years, government discretionary spending still represents a substantial amount of the budget. For example in 2007 additional end-of year spending accounted for about 2 percent of the GDP.

**A contingency reserve was incorporated in the annual budget law to protect against unexpected worsening of the macroeconomic framework, natural disasters or higher costs of structural reforms.** In 2008 this reserve was increased to almost 5 percent of the republican budget as the 90 percent rule was abolished. The judiciary's budget also has a contingency which in 2008 accounted for 0.2 percent of total appropriations.

**Recent reforms have been geared to improving allocative and technical efficiency of public spending.** The MTEF was established and strengthened with the introduction of program budgeting. MOF, which has had a leading role in moving forward budget reforms, has been restructured and a Public Finance School established. Substantial improvements in transparency and accountability of the budget process have taken place and the quality and comprehensiveness of budget documentation has been enhanced. Requirements for making publicly available budget-related documents were formalized and well met. Fiscal decentralization advanced with improvements made in the formula for allocating resources to municipalities and standards for delegating central government functions developed and enforced. Restructuring and optimization in some

sectors as well as in the government administration advanced further which allowed shifting resources to quality improvements.

**MOF has developed good capacity to design, implement and enhance all these reform initiatives.** In 2003 the Budget and State Treasury Directorate was restructured into two distinct directorates to separate budget planning from budget execution and reporting. The Budget Directorate included three new departments: Budget Methodology, Public Finance School and Microeconomic Analysis. The Budget Methodology Department is responsible for developing and implementing the methodology, standards, and guidelines related to the introduction of the programmatic and performance-based budgeting as well as on monitoring the implementation of the process. The Public Finance School provides theoretical and practical training to staff in the ministry and all line ministries and other players in the budget process on public finance management issues. The Microeconomic Analysis Department analyzes and evaluates the micro-economic impacts of horizontal and sectoral policies.

**MOF's Budget Directorate was instrumental in implementing two large-scale budget reforms: the MTEF and program budgets.** A core unit led by the Deputy Minister of Finance reviewed good international practices and developed the methodological underpinnings of the MTEF and program budgets. Detailed guidelines and manuals were prepared and made available to all line ministries' staff with the Public Finance School providing extensive training. MOF's Budget Directorate worked closely with all line ministries and provided extensive technical support in preparation of the program budgets. The phased approach to the introduction of the program budgeting and MOF's support to pilot ministries ensured buy-in of the reform and built capacity in FLSUs. All FLSUs (except municipalities and autonomous budgets) are currently preparing budgets in program format and with the 2009 budget three more institutions are included: the National Assembly, the administration of Cabinet, and a newly created agency.

**Program budgeting started on a pilot basis with one ministry and a plan for step by step inclusion of other ministries and agencies to 2007.** On a policy level this process was supported by the World Bank's Programmatic Adjustment Loan which included a public sector governance component. Under this component, Government agreed to expand the scope and scale of program budgets by including more ministries in the pilot. Some ministries started preparing program budgets ahead of the plan. On a technical level this process was supported by EU funded projects and IMF technical assistance. The pilot ministry applied the pro-

gram budgeting approach to all stages of the budget cycle, including external audit of the budget execution report. These, and all program budget plans and reports developed by other pilot ministries, have been submitted to the National Assembly for information. Workshops and seminars were organized to acquaint MPs with the new budget tools.

**Support for these reforms by line ministries, Cabinet and Parliament has varied.** The benefits of more strategic allocation of resources, and improved transparency and accountability of public finances, have been understood and valued by some line ministries while others formally complied but viewed the MTEF and PBB as a formal exercise that only increases their reporting requirements. Ministries' capacity to develop budgets closely linked to sector policies and priorities needs further development while performance information included in the budget documents needs to be improved and used for budget decisions and accountability purposes. MOF capacity to evaluate program budget proposals and performance indicators could be strengthened as well as its authority to provide meaningful feedback to FLSUs on specific programs, policies or performance indicators. The organizational structure of some line ministries is fragmented and not conducive to performance-based budgeting. The existing organizational structure in some line ministries obstructs coordination of a program for which several entities have responsibility, including second and third level spending units. In addition, responsibility for achieving results is unclear. Senior level involvement in the preparation of program budgets needs to be ensured as well as accountability for performance. The challenge now is to show more broadly the benefits of PBB and provide incentives to improve its quality and usefulness.

### 3. Adopting Medium-Term Expenditure Frameworks

**The MTEF was introduced in 2006 although some of its elements have been in place for more than a decade.** The medium-term approach to budgeting was introduced in 1997 with the organic budget law giving MOF responsibility for preparing a three-year macroeconomic and budget forecast and presenting it to Cabinet for approval. The medium-term fiscal plan is presented to the National Assembly as part of the budget documents (usually only at aggregate level – total revenues, expenditure, and overall fiscal balance). The MTEF was introduced with an amendment to the Organic Budget providing for the setting of spending ceilings for all FLSUs that are approved by Cabinet. The MTEF is updated annually and is binding only in the first year while the outer two years are indicative. FLSUs update their three-year budget plans and agree with

MOF on the three-year budget ceilings. These ceilings usually do not undergo substantial revisions (relative to GDP as the aggregate spending is constrained to 40 percent of GDP) at the time when the MTEF for next fiscal year is developed. The previous year's indicative ceilings are used as a basis of developing the three-year budget plans adjusted for changes in key macroeconomic indicators. Any other changes to the ceilings have to be justified by FLSUs when agreeing three year sector ceilings with MOF. Only changes to policy are reasonable grounds for justification although these are not explicitly shown in the MTEF approved by Cabinet. Some FLSUs don't consider these ceilings binding and present to MOF three-year budget requests that exceed the ceilings agreed during the previous year's budget process, and without any reasonable grounds. These differences are usually resolved in consultation with MOF which ensures all budget requests fall within the aggregate budget constraint.

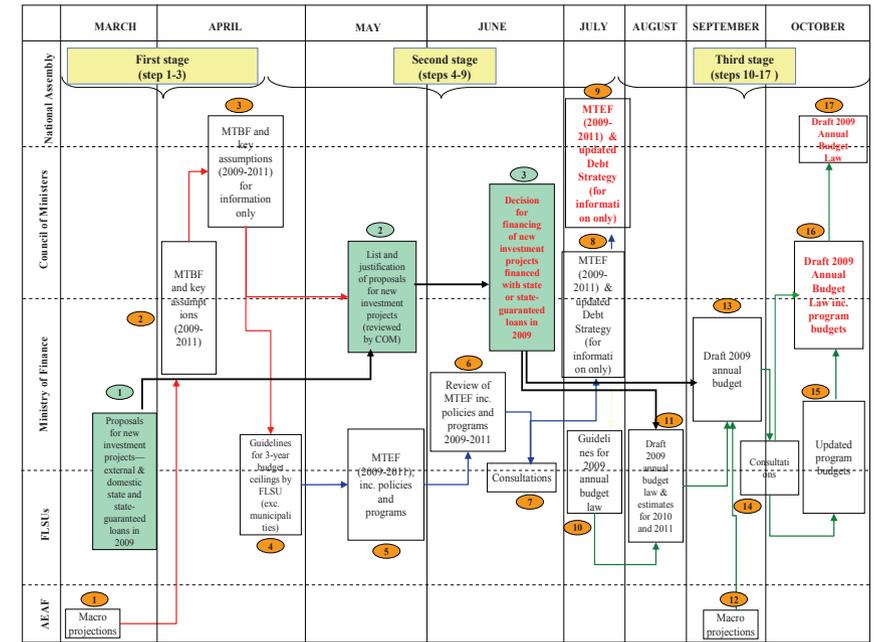
**The link between budget and policies was strengthened with the introduction of program budgeting but a meaningful integration between the MTEF and program budgeting will take a while.** Since 2007 all FLSUs have been required to present their three-year budget plans in a programmatic format. Some ministries and agencies have recognized the value of medium-term planning by programs and have used it to negotiate their overall spending ceiling proposals with changes in policies and programs. Others saw this as an additional reporting requirement with only presentational purposes. This inconsistent application of program budgeting was apparent in the 2008-2010 MTEF budget document approved by Cabinet; policies and programs were presented with their main objectives but there was little if any information on planned changes or improvements to programs. Given the short period of implementation of program budgeting and the MTEF, their integration needs to be stronger and institutionalized.

**MTEF preparation starts early in the year with development of the three-year macroeconomic and fiscal framework.** A schematic presentation of the budget procedure for 2009 is shown in Figure 1. The first stage of the procedure covers development of the medium-term budget framework (MTBF) and key assumptions which would be used for preparing the three-year spending ceilings during the second stage. The MTBF sets the aggregate budget ceilings (total expenditure, capital expenditure and overall fiscal balance) and defines key parameters of budget policy (wage and pensions increase, staff levels, size of social assistance benefits, service standards etc). The MTBF is approved by Cabinet and submitted for

information to the National Assembly while MOF prepares guidelines for FLSUs to prepare an MTEF.

The second stage of the budget procedure covers preparation and approval of the MTEF. It starts with FLSUs developing their three-year budget plans within overall budget constraints and on the basis of both key parameters approved during the first stage and budget ceilings approved during the previous year. MOF reviews these three-year plans, including in program format, and consults with FLSUs. Three-year budget ceilings are agreed with MOF and memoranda of understanding signed with all FLSUs. MOF consolidates the MTEF and submits it to Cabinet for approval together with detailed analysis of the macroeconomic outlook and underlying assumptions, goals of the economic and fiscal policy and assumptions about strategic directions of tax policy, expenditure programs by sectors, as well as assessment of the sustainability of public finances and assessment of structural balances. An update of the Government Debt Strategy is also approved by Cabinet as well as a list of new investment projects financed by state or state-guaranteed loans. The approved package is submitted to the National Assembly for information. MOF then issues guidelines for the preparation of FLSUs' annual budget plans.

Figure 5. Bulgaria: 2009 Budget Procedure



Source: Bulgaria's Ministry of Finance

**MOF leads preparation of the medium-term fiscal framework.** The medium-term macroeconomic forecast is prepared by the Agency for Economic Analysis and Forecasting (AEAF), a second level spending unit under MOF. This agency coordinates its forecasts and assumptions with the Bulgarian National Bank and other agencies. The model used for the macroeconomic forecasts has been developed with EU technical assistance and has been widely consulted with government and non-government organizations. Annual consultations on the macroeconomic prospects with the public, however, are not being held. The scope and quality of presentation of the macroeconomic framework has improved substantially in recent years with detailed presentation of the risks to the outlook and fiscal risks. The medium-term fiscal framework is prepared by MOF's budget department in consultations with other MOF departments (responsible for updating the debt strategy) and expenditure execution. Projections for revenues and expenditures are shown in detail by economic classification in nominal terms and as a percentage of GDP. MOF is involved in extensive consultations with FLSUs during the setting of three-year spending ceilings and evaluates the feasibility and quality of budget proposals in the medium-term and by program. MOF also prepares draft proposals

for budgets of autonomous and independent institutions. Consultations are held between line ministries and the National Association of Municipalities on the standards and proposed allocations for delegated central government functions to municipalities.

**The existing MTEF is intended to strengthen sustainability of the fiscal rules laid down in the program of the Government, in the Convergence Program, in the Law on the Annual State Budget and in other documents.** One of the fiscal rules that has been applied and strictly adhered to since 2006 is the expenditure rule. Under this rule, aggregate expenditure level can not exceed 40 percent of GDP (the contribution to the EU budget is excluded). This rule has not been regulated in any legislation but constitutes part of Government's strategic documents, including the MTEF. Similarly, the overall fiscal balance rule is presented as a percentage of GDP but could be changed every year. The only aggregate fiscal rule defined in permanent legislation is the debt rule which limits issuance of new government and government guaranteed debt so that debt stock at the end of the year does not exceed 60 percent of GDP. There are also limitations on the issuance of new debt and the total debt stock in absolute terms in the annual budget law despite the fact that the level of public debt is much lower than 60 percent of GDP. There are no formal mechanisms for enforcing these rules but they are generally adhered to.

**The MTEF includes a contingency reserve for structural reforms, natural disasters, and significant changes to the macroeconomic environment.** The contingency reserve planned in the 2009-2011 fiscal framework accounts for 1.1 percent of GDP. Part of the contingency is allocated for structural reforms carried out by specific ministries or entities – for health reform, reform of the judiciary as well as for the National Assembly, and the pension fund. The size of the contingency varies each year depending on the specific needs. Cabinet defines the rules for spending the contingency fund for structural reforms and natural disasters while the portion of the contingency related to changes in the macroeconomic environment are spent only if the consolidated budget balance has not worsened<sup>59</sup>.

**Next steps in strengthening the MTEF's credibility include further refining processes and methods already used to better integrate resource allocation, strategic goals of the Government and value for money.** This requires further institutionalization of the MTEF including enforcing budget constraints on all ministries and agencies. Planned

<sup>59</sup> The 2008 Budget Law specifies disbursement is allowed only if the expected consolidated budget surplus exceeds 3 percent of GDP.

changes to the organic budget law need to tackle these issues as well as issues related to the need to better link budget allocations to the desired results of government policies and programs with respective mechanisms for accountabilities at the different levels. While the MTEF has been more or less well developed using a top-down approach, bottom-up strategic planning needs further enhancement and top management engagement in the process ensured. This requires better capacity of line ministries to develop medium-term plans with a supporting organizational structure. MOF needs more capacity and authority to evaluate FLSUs' budget proposals and provide meaningful feedback to improve the efficiency and effectiveness of public finance. MOF's organizational structure also needs to be reviewed to maximize the benefits of the MTEF. Planned introduction of comprehensive sector reviews as well as enhancement of the PBB process would help increase the MTEF's effectiveness in Bulgaria.

#### 4. Performance-based Budgeting

**Introducing performance-based budgeting reform was seen as a means of strengthening aggregate fiscal discipline but more importantly improving allocative efficiency of public finances.** It was felt that this new tool would change institutional culture towards greater predictability and accountability of resource allocation and greater attention to results of public finance policy. The objectives of the program and results-oriented budgeting as stated in government budget documents are to help policy makers:

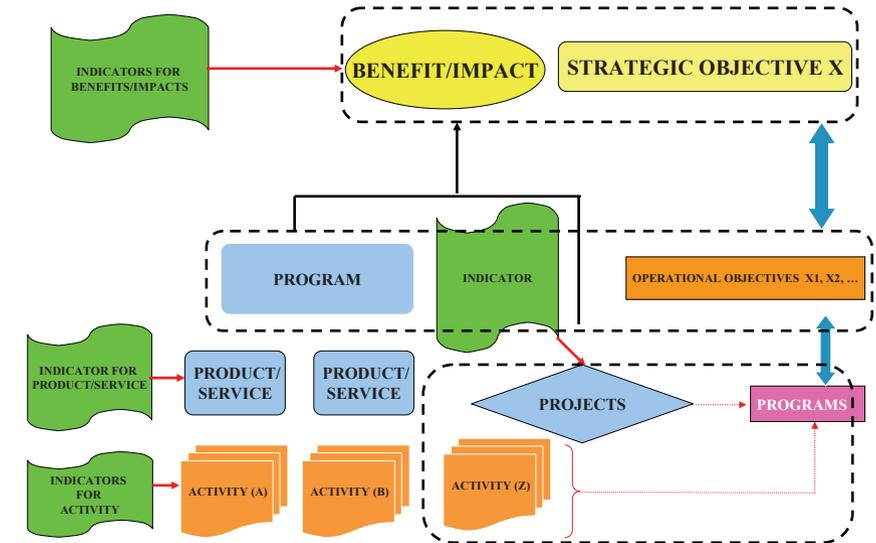
- define priorities and select the benefits to be pursued by the ministry
- identify the set of products/services forming the program's structure
- justify changes in the structure of policies and programs to achieve targeted standards for the products/services
- identify risks to achieving the benefits planned including using performance information as an indication of progress achieved
- make adjustments to strategic plans and planned products/services based on findings from the evaluation of program budget implementation.

**Program budget reform was initiated in 2002 and is now more or less integrated into the budget process.** A pilot program budget was developed for the Ministry of Environment and Waters (MOEW) for the 2003 budget. A year later two more line ministries were included in the

pilot and another seven in 2004. At that time the Ministry of Environment presented its first budget execution report in programmatic format. This was audited by the National Audit Office. In 2005 ministries participating in the pilot increased to 11 while MOEW's program budget for 2006 was presented to the National Assembly together with the annual budget law. By 2007 the pilot was completed and all line ministries and two agencies prepared their budgets in programmatic format for the 2008 budget. Ministries included early in the process prepared reports on the implementation of their program budgets. All FLSUs must submit their program budgets to the National Assembly and publish them on their websites. For the first time, the annual budget law included provisions for adjusting the program budgets of ministries and agencies following approval of the annual budget law.

**Preparation of program budget plans and implementation reports was formalized in a COM Decree and MOF instructions rather than in the organic budget law.** It was felt that amendments to the organic budget law would be difficult to introduce given the heavy legislative program of the National Assembly before EU accession. Despite the lack of permanent legislation related to program budgeting, it was introduced and is being further enhanced on the basis of experience accumulated during the five years of pilot implementation. Regulating performance-based budgeting in a permanent legislation, however, would strengthen political support for linking budget to performance. Detailed guidelines and a manual were developed by MOF and refined each year with the budget circular. The manual is based on good PBB practices around the world and effectively explains all the elements of PBB with practical examples from the program budgets of Bulgaria's Ministries of Environment and Transport. Extensive training and consultations have helped line ministries better understand the benefits of PBB and apply its techniques. Workshops have been organized for the Budget and Finance Committee of the National Assembly as well as staff of the National Audit office.

Figure 2. Structure of the Performance-based Budget



Source: *Manual for Ministries Implementing PBB, 2005, Ministry of Finance*

**Program budget documents prepared by FLSUs follow MOF guidelines although their quality varies.** Program budget documents include a general section stating the mission and medium-term priorities of the ministry/agency, explanation of key assumptions underlying the MTEF (these are usually macroeconomic indicators, changes in tax and wage policy, which have been developed by MOF), allocation of expenditures by the program and overall revenues of the ministry by sources of financing. This is followed by a detailed presentation of the ministry's policies, strategic and operational objectives, and an analysis on the benefits to society. Performance indicators and targets for the medium-term are shown at the policy level. A short section comments on the availability and quality of data used for performance indicators as well as the institutional relationships with other agencies contributing to respective policy implementation (usually second level spending units). Under one policy there are usually a number of programs. Presentation of programs starts with a statement of program objectives and description of the institutional arrangements for implementing the program (the agencies or directorates of the ministry, municipalities etc) with the name of the manager leading the program implementation (usually minister or deputy minister). Performance indicators are presented for the baseline year and targets for the next three years with information about the data availability and quality and external factors affecting the achieving of the targets. Programs are

also broken down by products and services. Following MOF's instructions all administrative functions (e.g. accounting, IT services etc) that can't be allocated to a specific program are aggregated in an administrative program.

**The four elements of the programmatic classification are policies, programs, other programs which don't fall within the framework of particular policies, and products/services.** These are presented in Figure 2. If a program falls outside the strategic objectives/policies of the ministry or agency, it is shown as 'other program' and considered later if its activities should be transferred to another FLSU, outsourced or discontinued. Programmatic classification applies to expenditures only which in turn are classified as either institutional or administered expenditures. Institutional expenditures are those for which the FLSU has direct control while administered expenditures are expenditures for services externally provided to a final beneficiary and over which the FLSU does not have direct impact (e.g. subsidies to universities, pensions, social assistance benefits). Programs are also broken down by aggregated economic classification (salaries, operating and capital expenditure).

**The program budget structure has been consistently adopted by all ministries and agencies that are FLSUs and currently covers some 60 percent of the consolidated fiscal program.** While ministries and agencies generally follow the program budget guidelines developed by MOF, there is wide variation in the quality of the performance indicators used. Ministries that joined the program budgeting process late find it difficult to identify programs and links between budget and performance. The 2009 budget includes program budgets for the National Assembly, Cabinet and a recently established agency. Extra-budgetary funds, municipalities and autonomous entities whose budgets are not subject to Cabinet's endorsement are not required to follow the PBB approach.

**While important elements of the performance budgeting reform are already in place, the most difficult part of maximizing the benefits of this reform is still ahead.** Bulgaria implements performance-informed budgeting and indicators have been developed by policy and program, but their use is limited in the budget decision process. The budget is approved on the basis of economic budget classification while program budgets are presented to the National Assembly only for information. Further effort is needed to create incentives to improve the presentation of performance budgets including the quality of performance information. Incentives are also needed to extend the use of performance information for strategic budgeting, reporting, and accountability purposes, including legislative

amendments to the organic budget law. Organizational structures in some ministries don't adequately support effective use of performance budgets. Replacing traditional line-item budgeting with program budgets will take time but establishing a Public Finance Accountability Subcommittee in the National Assembly would help improve demand for performance information.

**A challenge facing ministries and agencies in results planning and reporting is to define indicators by policies and programs, and identify their target values.** Output indicators are usually represented more than outcome indicators. Usually, there are too many performance indicators, some of which cover inputs or are inconsistent with program objectives and outcomes. This makes monitoring and evaluation difficult. Ministries develop their own set of performance indicators because they have a better knowledge of the performance of the sector. But more effective evaluation and feedback, when reviewing program budgets, would improve selection and use of performance indicators. With all FLSUs included in the program budgeting, however, this represents quite a challenge for MOF staff who must review around 25 program budget plans and implementation reports. Given that no formal accountability for good performance is attached to the program budgets and implementation of performance targets, line ministries don't have incentives to improve the quality of the program budgets and this reduces their impact on the quality of spending allocations.

**Program budgeting contributed to improved accountability and transparency of programs funded by the budget.** Despite the weaknesses in program budget implementation, it has helped introduce a strategic management approach to budgeting and a focus on efficiency and effectiveness. Growing attention by senior management to the program budgeting process and understanding of its benefits, and greater capacity in ministries and agencies to develop performance indicators and targets, will help demonstrate the benefits of program budgeting. Greater demand for performance information by Cabinet, Parliament and the general public would provide incentives for improving the quality and impact of program budgeting on public expenditure management.

## 5. Budget Presentation and Classification

**Programmatic budgeting has made budget documents more comprehensive, meaningful and transparent.** The following documents relating to the MTEF and PBB are being used to prepare the budget:

- *Budget circular* includes information about the stages, roles and responsibilities of the main players, establishing rules and time schedules.
- *Medium-term budget framework and key assumptions* include information about the medium-term objectives of the fiscal framework, macroeconomic projections, economic and fiscal policies and the parameters of the fiscal framework, analysis of the long-term sustainability of public finances, as well as underlying assumptions necessary for development of the three-year budget framework with ceilings by FLSUs.
- *The three-year budget framework and expenditure ceilings by FLSUs* represents the preliminary assessments of proposed parameters of the consolidated fiscal program, the central state budget and of the budgets of the first-level spending units within the three-year period.
- *The Budget Policy Statement* presented to the National Assembly together with the draft annual budget law. The budget policy statement presents Government priorities for the next year by sector, along with an analysis of implementation in the current year budget, and medium-term priorities and macroeconomic outlook, fiscal risks and allocation of budget resources by sector. Program budgets of all FLSUs are attached to this report, presented to Parliament and used during budget deliberations.
- *Decree of the Council of Ministers on the implementation of the State Budget* which specifies the essential elements of the budgets of the state bodies, including program budgets of ministries and the state agencies which are FLSUs for budget appropriations.

**Economic classification plays a leading role in the budget process.**

This classification is based on the national Uniform Budget Classification developed by MOF. The unified budget classification is supported by the Government Finance Management Information System (GFMIS) which has not been deployed to all budget units. Program classification is not used in the annual budget law approved by the National Assembly and is not supported by a unified information system. Some ministries have adjusted their accounting systems to allow for allocation of expenditures by programs. A thorough review of existing programs is needed before the program classification is codified across government. There are close to 80 programs, making their monitoring and evaluation difficult.

## 6. Public Management Performance Culture

**A regular reporting of performance budgets has been in place for a couple of years.** FLSUs are required to report on an annual and semi-annual basis, on both execution by programs and performance indicators. Reports are presented to MOF and the National Assembly and taken into account during discussions in Parliament or when the annual budget report is audited by the National Audit Office. Annual implementation reports include performance information and are open to the public. Implementation reports are reviewed by the Public Accountability Subcommittee in The National Assembly whose main function is to review and assess FLSUs' implementation reports. There is no functioning system for monitoring and evaluation that would support improvement of implementation reports.

## Croatia

*Sanja Madzarevic-Sujster and Matija Laco*

### **General Assessment (Summary)**

During the last couple of years Croatia has made good progress in strengthening public expenditure management. The budget execution processes, including accounting and reporting structures, have improved. GFS 2001 standards have been formally adopted in accounting and reporting although adherence to these standards by some local governments remains questionable. The Treasury Single Account has been expanded to cover bank accounts of all line ministries and the remaining extra-budgetary funds (the health insurance, pension and employment funds). The Ministry of Finance (MOF) has carried out preparatory work to integrate existing financial management information systems used by some line ministries in 2008. The budget preparation process as well as budget documents and procedures became more transparent and consistent with good international practices, although keeping up with the legally binding timetable could further be improved. Functionally independent units of internal audit have been established in all ministries, budgetary users and the City of Zagreb. Stronger financial management processes and control has helped strengthen fiscal discipline, evident in declining deficits, and increase transparency of public finances.

Croatia has made consistent efforts over the last four years to improve the rules and relevance of multi-year fiscal planning. These efforts were supported by the need to introduce a three-year perspective in the Pre-Accession Economic Programs (PEP) as well as by the need for a general improvement in quality of macroeconomic forecasting and fiscal planning. While implementation of a medium-term fiscal framework (MTFF) has been well integrated into public expenditure management systems and is now embedded in all budget managers' practices, additional efforts are needed to make them more mandatory and credible. Deviations between next year's budgets and planned expenditures in the MTFF exceed 10 percent, sometimes led by unplanned liabilities created by new legislation. The new budget law from July 2008 aims to improve the relevance of the MTFF by making fiscal projections more binding and linked to strategic priorities as stipulated in three-year strategy of Government programs. A clear top-down steering of the budget process to enforce the multi-annual strategy is needed to yield the desired results.

Moves to more performance-oriented budgeting have been slow. While program budgeting has been in place for more than four years, performance indicators have not moved beyond the pilot phase. With international donors' assistance, two pilot projects have been undertaken in selected line ministries and state agencies, and a methodology for key performance financial and personnel indicators developed and tested, but there's been no political commitment to roll it out. Strategic and budgetary planning need to be integrated and proper monitoring and evaluation systems introduced. This became evident in the EU pre-accession process. Government's adoption of the Strategic Development Framework 2006-2013 in July 2006 provided an opportunity to link broader strategic considerations with operational budgetary decisions but, without systems to integrate strategic priorities and strategic goals with budget allocations, policy effectiveness and efficiency is constrained. The Strategy for the Development and Modernization of the State Treasury 2007–2011, a core forward-looking document for public finance management improvements, was adopted in October 2007 to introduce performance information to measure programs' effectiveness and reward effective functioning. The champion of these reform efforts is the Ministry of Finance.

Sustaining these reforms and improving resource allocation efficiency requires greater political commitment and more performance-oriented budgeting. The relevance of these budget tools for Cabinet to efficiently fulfill its strategic priorities and for Parliament to monitor and hold Cabinet accountable has been proven in a number of countries. Croatia needs to continue with its plans in a more decisive manner.

## 1. Core Features of Current Budget System

**The budget system and rules are set under Constitutional Law, the organic budget law, several social security and assistance laws, the financing of local and regional self-Government law, and the annual budget execution laws.** The new organic budget law, approved in 2008, governs the budget process (planning, approval, execution and reporting of the state budget, extra-budgetary funds and local and regional self-government units). It also reconfirms the medium-term fiscal framework which became mandatory in 2003 as well as program classification of the budget

**The budget preparation cycle starts with preparation of Economic and Fiscal Policy Guidelines for a three-year period by MOF.** This is a key document for setting the medium-term fiscal and economic frame-

Table 9. Budget Preparation and Execution Timetable

Due dates	Activities
By end-April	Guidelines for economic and fiscal policies (medium-term economic and fiscal outlook) prepared by MOF and presented to Government.
By mid- May	Government enacts budget guidelines.
By end-May	On the basis of the guidelines, MOF issues instructions for the preparation of the budget proposal to budget managers and extra-budget managers of the State budget, and to local and regional self-government units, for the development of the State budget proposal.
By mid-June	Budget managers deliver their financial plan proposals to the responsible ministry.
By end-July	Responsible ministers deliver harmonized financial plan proposals to MOF.
August- October	MOF reviews proposals and reconciles them with estimated revenues and receipts. Detailed negotiations between MOF and the responsible ministries.
October 15	MOF prepares the draft State budget and draft consolidated budget and delivers to Government.
Late October	Government deliberation and decision over final budget proposal, on the basis of competing proposals from MO and line ministries.
By November 15	Government delivers the budget proposal and consolidated budget to Parliament.
By end-December	Parliament passes the budget. The approved budget is published in the Official Gazette.
By May 1	MOF draws up the annual accounts of the state budget and consolidated budget for the proceeding year and reports to Government.
By July 1	Government delivers the budget execution for the previous year and the State Audit Office reports to the Parliament about audits being done.
By September 5	MOF prepares half-year execution of the Budget and sends it to Government.
By August 5	Government forwards the half-year execution of the budget and sends it to Parliament for enactment. On enactment, it is published in the Official Gazette.

work and provides an analytical and strategic basis for budget preparation. It is adopted by Government by mid- to end-May of the current year. Immediately afterwards, MOF issues Instructions for the Preparation of the State Budget Proposal (budget circular) to all budget and extra-budget managers. This contains key variables and aggregate envelopes by line ministries and other budget managers that they need to take into account when preparing their financial plan proposals. Budget managers deliver their financial plan proposals to their responsible ministry which, after certain adjustments, submit them to MOF, preferably by the end of June. Sometimes all of the above steps fall behind by two months.

**MOF leads preparation of the draft state budget and draft consolidated state budget (which includes extra-budgetary funds and agencies) for the coming budget year with projections for two consecutive years, in consultation with line ministries and other budget and extra-budget managers.** MOF presents it to Government by October 15 for adoption. Government is obliged to submit the final draft state budget bill

and consolidated budget to Parliament for enactment by November 15. The law on state budget execution (which defines borrowing and guarantees' issuance limits, reporting and execution rules, a budgetary basis that serves as a threshold for social benefits and various other elements) is submitted for enactment along with the annual budget. This law defines standards for delegated functions to municipalities. The budget year in Croatia matches the calendar year.

**Although MOF guidelines provide a framework for a multi-year budgeting approach, and a detailed budget is prepared for three years (based on economic, organizational and program classifications), budget projections serve informational purposes only. They are not mandatory and the budget is passed for only one budget year.** Parliament enacts the budget and the consolidated central Government budget<sup>60</sup> (that includes extra-budgetary funds and agencies) for the coming budget year and receives, for information only, projections for the subsequent two years. During parliamentary debate on the State Budget proposal and financial plans of extra-budget managers, Members of Parliament (MPs) present their proposals for amendments, which Government may adopt or reject. An amendment proposing an increase in expenditure above the amount established in the Budget Proposal may be accepted only if it is financed by a commensurate cut in another item of expenditure, not from budgetary reserves or additional borrowing. This means that adopted amendments may not exceed proposed and projected deficits of the consolidated budget of the Republic of Croatia. Equally important, any legislative proposal or strategic document adopted within a fiscal year cannot become effective in the current budget year unless funds have been secured in the budget proposal (or revised budget) based on the fiscal impact assessment (FIA). FIA must be submitted with the legislative or strategic document and ex ante approved by MOF.

**MOF plays a central role in the budget process** and is responsible, among other things, for:

- issuing Medium-Term Guidelines and Instructions for the budget preparation procedure
- reviewing and providing feedback on medium-term budget proposals of all line ministries, budget managers and extra-budgetary funds and agencies (EBFs)

- ensuring medium-term budget proposals remain within the expenditure, deficit and debt targets as defined in the Medium-Term Guidelines
- developing the medium-term budget proposal and submitting it to Cabinet with explanatory notes
- preparing medium-term debt strategy
- giving consent for reallocation of expenditure within the budget of the spending unit during budget execution
- reporting on the budget's execution, monthly to Cabinet and twice yearly to Parliament
- monitoring compliance with budget law and informing Cabinet of any revisions that may be needed in the fiscal year.

A Department for Budget Preparation in MOF is divided into three units: the Budget Analysis Unit (four staff); the Budget Preparation Unit (eight staff); and the Unit for Local Government (four staff). The Director of this department is a professional, employed through a competitive selection process. Compared with the approved number of established positions, all three units are understaffed (42 established versus 23 filled positions). In 2008, a functional review of MOF, including its Budget Preparation Department, suggested the need for restructuring of the ministry to strengthen two groups of functions: analysis of public policy and coordination and supervision of administrative functions, moving the latter away from administrative support services. This would help increase efficiency and promote continuous improvement in the State Treasury's planning activities.

**Cabinet participates actively in budget preparation and consultations.** It approves the medium-term fiscal framework and main macroeconomic assumptions for a three-year period. Although these are available to the general public after Government adoption, the Medium-Term Economic and Fiscal Guidelines are not officially submitted to Parliament. The most important expenditure allocation decisions, and arbitrations between MOF and line ministries, are carried out in a closed Cabinet session which usually takes place before a final draft budget submission to Parliament. The draft budget and consolidated budget, that includes all extra-budgetary funds and agencies following organizational, economic and program classifications together with all budget documents and budget execution law, are then approved by Cabinet and submitted to Parliament by mid-October. If during the budget year the expenses and/or expenditures increase, or if budget revenues and/or receipts become reduced due

<sup>60</sup> Additionally, the consolidated central government budget combined with local and regional governments' budgets forms the Consolidated General Government (CGG).

to the occurrence of new budgetary obligations or changes in economic developments, Government may, at MOF's proposal, suspend for up to 45 days execution of specific expenses and/or expenditures. If the budget balance can't be reached, Government proposes a budget revision according to the same rules applied to the original budget preparation.

**With ex ante agreed medium-term expenditure framework and consolidation of all line ministries' accounts into a Single Treasury Account, line ministries have an increasingly important role in efficient expenditure allocation.** Following agreed expenditure ceilings, line ministries and government agencies are encouraged to propose resource allocations which provide the greatest development impact. Decisions on new employment, large investments and social programs require additional supporting documentation (feasibility studies, laws or job systematization decree) to be approved by Cabinet upon the fiscal impact assessment approved by MOF. Line ministries are developing and submitting to MOF their medium-term budgets, in program format once MOF agrees and Cabinet approves expenditure ceilings. MOF is authorized to clear all line ministries' requests for opening new programs in the SAP system. Once enacted by Parliament, budget managers have limited flexibility to reallocate funds among various line items. This is due partly to a high level of state budget detail. Budgetary funds may not be reallocated, except under the terms and in the manner stipulated by budget law and law on budget execution. An exception to this is that reallocation of budget items within budget managers' lines or between different budget managers may make up to five percent of expenses and expenditures at most, if the Minister of Finance approves it. The new budget act envisages a lower level of state budget detail (a third level of economic classification rather than the fourth level prescribed in the 2003 Budget Act) which should allow for more flexibility in reallocating funds.

**On receipt of the draft state budget and consolidated budget, together with the draft budget execution law and budget explanation, Parliament has six weeks to debate and enact the budget.** The budget is presented according to economic and program classifications with a budget explanatory note and corresponding laws. Budget documentation is discussed by various parliamentary committees including the Finance and Budget Committee which is obliged to give Parliament its opinion on the budget. This Committee doesn't employ professional budget analysts but engages three independent non-parliamentary members from scientific and professional institutions. Usually, the Committee recommends Parliament approve the budget but there may be times when the proposed

budget and the associated budget execution law have not been satisfactorily drawn up. In these cases Parliament's Speaker sends them back, at the Committee's recommendation, for MOF and Government to reconsider. This is one of the reasons why the Committee should have well-informed, professional personnel able to detect shortcomings in budget proposals.

**Parliamentary debate has a limited impact on budget policy.** During parliamentary debate on the state budget proposal and financial plans of extra-budgetary managers, Members of Parliament present their proposals for numerous amendments, which Government may adopt or reject. Amendments are rarely accepted. All proposed amendments need to be accompanied by a proposal for offsetting the respective increase or decrease of the budget item. During the course of the financial year, Parliament receives information on the execution of central Government's budget. The budget act requires Government to prepare a semi-annual statement on budget execution and submit it to Parliament no later than the beginning of August of the current budget year. Parliament debates the semi-annual execution in mid-July at the earliest; this suggests monitoring of budget implementation by Parliament is not strongly developed.

**While non-enactment of the budget is a sign of no confidence in the Government, and requires approval of temporary financing, legally, voting no-confidence is done through a separate legislative process.** If Parliament fails to pass the budget before the beginning of the budget year, financing central, local and regional government units, and other budget managers, continues on the basis of temporary financing (provisional financing) and on the rights of budget fund recipients established by laws and other regulations. Temporary financing is carried out proportionally to revenue collected in the same period of the previous year and up to 25 percent of the total income realized, excluding the financing receipts. Temporary financing is allowed only for the first 12 weeks of the budget year.

**Local and regional self-government units (LGUs) prepare and execute their budgets independently although there are several channels through which central government frames local government budgets.** MOF issues Instructions for the Preparation of the Local and Regional Self-Government Units Budgets for a three-year period. These provide basic macro and fiscal assumptions for LGUs developing their budgets as per the earlier adopted Medium-Term Economic and Fiscal Guidelines. The medium-term fiscal framework also underlines the general government deficit target with a separate deficit limit proposed for LGUs. Budget execution law sets the overall borrowing limit for all LGUs while individual

LGU's annual amortization repayment cannot exceed 20 percent of their own revenues. There are firm rules for delegated functions and these are funded by shared tax revenues and equalization of fund resources. MOF discusses with line ministries additional capital transfers planned for upgrading LGUs' physical and social infrastructure. Municipalities may reallocate their own resources, including for their own expenditure on compensation of employees, current spending, other transfers and capital spending.

The budget is enacted on a cash basis although in the explanatory budget documents, Government presents a consolidated central and general government budget balance on accrual basis. Budget documents would benefit from an explanation on how conversion from cash to an accrual basis is done, as well as from a full inclusion of all 576 local government units (as opposed to a sample of the largest 53), all extra-budgetary agencies, quasi-fiscal activities of public enterprises and cumulative changes in the stock of arrears. An attempt was made in 2001-2002 to calculate tax expenditures but this was never repeated. Without this information it is difficult for Parliament to assess the general budgetary strategy in the context of the medium-term fiscal framework. While following a full accrual basis accounting would be difficult at this stage – there are other pressing PFM priorities – this information is essential for assessing the real fiscal policy impact on the economy and understanding what drives the differences between cash and accrual numbers.

## 2. General Progress on Budget Reform

**Since it adopted the budget law in 2003, Croatia has made good progress modernizing its public expenditure management system (PEMS).** Budget execution processes, including accounting and reporting structures, have improved. GFS 2001 standards have been formally adopted in accounting and reporting, although adherence to these standards by some local governments warrants further improvement. The Treasury Single Account (TSA) is now functioning, with the wider use of the SAP system, and in 2006 was expanded to cover bank accounts of all line ministries and, in 2007, the remaining extra-budgetary funds (health insurance, pension and employment funds). All budgetary revenues and receipts are channeled into the TSA from which all payrolls, current and capital expenditure payments are made. This facilitates daily liquidity management and provides a solid basis for effective financial planning.

**Despite some budget managers' skepticism, implementation of a TSA allowed more rational management of public funds, without infringing on the managerial independence of budget managers.** From 2006, all revenues of budget managers, revenues under special regulations (administrative fees and other earmarked revenues) and EU grants have been incorporated into the budget and channeled through the TSA. This has facilitated greater control over the collection and use of earmarked revenues. Preparatory steps to integrate existing financial management information systems were undertaken in 2007 and, with the use of EU funds, will be implemented in 2009, facilitating swifter and more transparent exchange of information and funds. Government has passed the Strategy of Development of the Public Internal Financial Control System. Functionally independent units of internal audit have been established in all ministries, budget managers and the City of Zagreb. The adopted Rulebook on Internal Audit of budgetary beneficiaries provides, among other things, work methodology and requirements for appointments of certified internal auditors. The Internal Audit Manual has been prepared and training of internal auditors and FMC staff is underway. In December 2006, Parliament passed the Law on the System of Internal Financial Controls in the Public Sector. Stronger financial management processes and control has helped strengthen fiscal discipline, evident in declining deficits and greater transparency of public finances.

**Budget preparation processes as well as budget documents and procedures are more transparent and consistent with good international practices.** Government submits to Parliament (public) the semi-annual statement on the state budget execution for the first half of the current budget year by the end of July. MOF prepares the consolidated statement of the Republic of Croatia's annual budget accounts and submits it to Government by May 1 of the current year. This is detailed information. Aggregate data following GFS 2001 methodology, or ESA 1995 from 2008, for consolidated central government accounts are published every month and for consolidated general government accounts every quarter (with a lag of around two months). The state budget proposal is accompanied by an explanatory note that only recently contains some sensitivity analysis of public debt, and some selective analysis of long-term sustainability of public finances (health and pension expenditures specifically) over a horizon of 45 years. In 2005, Government prescribed that central bodies of state administration, when submitting their legislative and regulatory proposals for approval, enclose a statement on the projected impact of proposed legislation on the state budget, local and regional self-govern-

ment budgets and public sector employment (the same applies to any laws that Government submits to Parliament for adoption). This is available to the general public in an abbreviated form. The fiscal impact assessment is provided on a Fiscal Impact Assessment Form and requires ex ante MOF approval.

**Several formal and informal fiscal rules have been introduced but need to be better enforced to ensure fiscal discipline in the budget process.** The organic budget act from 2003 introduced a fiscal rule that limits central government debt to GDP ratio. The new organic budget act from 2008 envisages that the ratio of unsettled amounts of Government debt at the end of the year and gross domestic product (GDP) projections may be greater than the last year's ratio, provided the mentioned ratio does not exceed 60 percent of GDP. Government and Parliament are monitoring compliance with the fiscal rule. Furthermore, the Budget Execution Act for the fiscal year establishes the total amount of new Government debt and states guarantees that may be assumed or issued during the fiscal year. Enforcement procedures are not defined ex ante. As well, there is an expenditure (nominal expenditure ceiling) and a budget balance (as percentage of GDP) rule introduced through the Medium-Term Economic and Fiscal Guidelines, which are being revised annually and receive only political commitment of Government. These guidelines define expenditure envelopes per budgetary institutions, economic classification, and deficit targets for the medium-term. MOF is responsible for monitoring compliance with those targets but without any enforcement procedures deviations are common, even in the budget proposal for an immediate fiscal year. Once expenditure ceilings are established in the guidelines, controls for budget preparation are set in the SAP system and budget managers cannot independently change them. However, if MOF and budget managers, during their negotiations, identify a need for redefining some expenditure ceilings, Cabinet, at MOF's proposal, considers and establishes new ceilings. While deficit targets have generally been respected, deviations from these guidelines are still common, even in budget proposals for an immediate fiscal year.

**Budget reforms have been implemented in response to large deviations of budget out-turn compared with plans and this has made fiscal policy unpredictable.** Each year since 2003 there has been a budget revision enacted in the second half of the year with aggregate expenditure increased following revenue over-performance. Initially, budget reforms were designed to improve the aggregate fiscal discipline to ensure sustainability of public finances. These reforms set out to:

- clarify the roles and responsibilities of spending units, Parliament and cabinet
- introduce strict limits on debt issuance and penalties for over-spending
- reduce quasi-fiscal activities and control arrears and line ministries over-commitments
- improve macroeconomic forecasting and comprehensiveness of the budget by reducing the number of extra-budgetary accounts
- improve reporting, accounting, and transparency of fiscal accounts.

Later on, reforms were directed at improving allocative and technical efficiency of public spending. The MTEF was established and strengthened with the introduction of program budgeting. Reforms in selected sectors have advanced and enabled shifting of resources to other priorities. MOF has taken the lead in moving budget reforms forward.

**External aid to MOF in early 2000 was used to inform Croatia's reform directions.** USAID, the US Treasury, IMF and the World Bank (WB) helped make Treasury functional; strengthened accounting, forecasting, monitoring and budget reporting rules; restructured debt and the cash management system; established an MTEF; helped draft the 2003 organic budget law (which was also supported by the WB Structural Adjustment Loan in 2002 and 2003); and set up the advanced reform agenda for budget planning and monitoring (through an IDF grant). Reform support from the WB Programmatic Adjustment Loan 1 and 2 and EU grant funds helped further strengthen the Treasury system, auditing standards and capacity, and the move towards more performance-oriented budgeting. They have helped initiate these recent reforms along with adoption of the Medium-Term Strategy for Development and Modernization of the State Treasury for 2007-2011. The Strategy is a core forward-looking document of the Government for public finance management, setting goals and an action plan for modernization of the State Treasury system.

**Additional efforts and priorities outlined in the Government's strategy are, among others:**

- shifting towards performance-informed budgeting
- strengthening analytical foundations of budget allocation decisions
- strengthening consultation mechanisms (especially with Parliament) and budget transparency

- increasing flexibility of budget execution
- integrating strategic and budgetary planning by linking allocations to strategic outcomes.

Until 2008 the state budget was adopted on the fourth level of economic classification which reduced flexibility in execution and increased the number of necessary reallocations of funds. Because it lacks detailed enough information, Parliament opposes raising the level of economic classification (e.g. from fourth to third) on which the budget is enacted. A new organic budget law, enacted in July 2008 and effective from January 2009, envisages adoption of the state budget on the third level of economic classification, while reporting on budget execution will be submitted on the fourth level. This law confirmed intentions to strengthen, and make more relevant and binding, an MTEF. The MTEF will be enacted by Parliament as a whole, which was not the case so far. Introduction of strategic medium-term plans as a mandatory first step in the budget preparation process is expected to strengthen program budgeting. Future financial plans of budget managers should include programs established by a long-term development strategy, special laws and other regulations passed on the basis of law, accompanied by the expected performance indicators. Financial plans will include, among other things, a report on the achieved goals and results of the previous year's programs as well as expected future results. Although allocation of funds will remain, to some extent, subject to political decisions, performance-informed budgeting should help MOF improve allocation of funds and get better value for money, as well as facilitate adherence to Government-set fiscal rules. But without well-developed programs for appropriation and reporting, the performance side of PBB is unlikely to contribute reliable information on progress towards policy objectives.

**The approach to reform has combined top-down and bottom-up decision-making.** In early 2000, external assistance received significant attention from top management and many changes occurred quickly during that period, including changes in debt and cash management, TSA, the MTEF, accounting rules, and program budgeting. Starting in 2004, reforms were driven mostly at technical levels and many initiatives have been tested through pilot projects. Examples include fiscal impact assessment, consolidation of bank accounts, internal audit units, and performance-based budgeting. All line ministries' budget units were consulted during the initial process and training efforts were comprehensive. Since 2004, three new units, instrumental in recent reform efforts, have been established: a Treasury System Development, Budget Analysis Unit and

a Unit for Internal Audit Harmonization. The Institute of Public Finance, a public research institute, has provided advice and reform impetus for strengthening public expenditure management.

**Key drivers of the MTEF implementation and program budgeting have been Treasury and MOF's Budget Preparation and Macro Analysis and Forecasting Departments.** A core unit led by the Deputy Minister of Finance in the early 2000s used external assistance to provide MOF with good international practices and recommendations for program budgeting. The 2003 budget law introduced program budgeting but implementation began only in 2005. Rulebooks and decrees were prepared and training undertaken to educate budget managers on program budgeting. Treasury worked closely with all line ministries and provided extensive technical support for a swift introduction of program budgets. All budget managers including local government units are currently preparing budgets in program format. These, however, are not used for budget decision making and don't control policies effectively across all budget managers. Organizational and economic classifications still dominate budget allocation policies and negotiations.

### 3. Adopting Medium-Term Expenditure Frameworks

**Consistent efforts have been made over the last four years to improve the rules and the relevance of multi-year fiscal planning.** These were supported by the need for a three-year perspective in the Pre-Accession Economic Programs (PEP) and for better quality macroeconomic forecasting and fiscal planning.

**The MTEF was introduced in 2003 with the organic budget law giving MOF responsibility for its preparation and Cabinet for its approval.** The MTEF covers the annual budget plus projections for two following years, all prepared on the fourth level of economic classification. Projections are prepared on the same structure and level of detail as the annual budget. Although the MTEF is presented to Parliament, it is mostly used for budget planning purposes, because Parliament approves only appropriations for the first year. The MTEF is updated annually and only the first year is binding; the other two years are indicative.

**Until 2003 the MTEF was not formally adopted by Government. It was a mere analytical exercise, focused mainly on the macroeconomic framework, aggregate revenue and expenditure items.** Initial efforts, supported by the IMF and US Treasury, aimed to improve the quality and realism of the macroeconomic framework, and budget procedure

and documentation, and introduce sectoral ceilings. Ownership of the Treasury Department was crucial for advancing the MTFF to its current form. The 2005 budget, for the first time, contained multi-year line item estimates as prescribed by budget law. It has been disaggregated down to the fourth level of economic classification for all budget managers and has become a core part of budget documentation submitted to Parliament after Cabinet's formal approval.

**MOF plays a leading role in the MTFF preparation.** The medium-term macroeconomic forecasts are prepared by the Bureau for Macroeconomic Analysis and Planning, a department in MOF. The Bureau coordinates its forecasts and assumptions with the Croatian National Bank; more recently MOF has begun consulting with independent research institutions or the private sector. The model used for macroeconomic forecasts has been developed with IMF support. The scope and quality of presentation of the macroeconomic framework has improved substantially with presentation of fiscal and macro risks, as well as sensitivity analysis. The medium-term fiscal framework is prepared by MOF's Budget Preparation Department in consultation with the Treasury and the Debt and Cash Management Department. Projections for revenues and expenditures are shown in detail by economic classification in nominal terms and as a percent of GDP. Once this medium-term fiscal framework, presented in the Medium-Term Economic and Fiscal Guidelines, are approved by Cabinet, a Budget Circular with sector ceilings and key fiscal and macro assumptions is shared with all budget managers. Budget managers present their medium-term budgets to the MOF by end-June after which bilateral negotiations with MOF start.

**Line ministries' estimates of their institution's medium-term expenditure are as detailed as the budget but it is questionable how realistic they are.** Budget projections aren't mandatory and they are often only simple inflation or wage-growth adjusted forecasts of current programs or projections of payments for civil work as per signed contracts. Budget managers don't make sufficient effort to provide realistic estimates and their submissions make no impact on the budget negotiations process. For all new policies and laws, the forward-looking fiscal impact assessment is prepared in an obligatory form but, in practice, these estimates can deviate from the final budgeted amount. Since policy changes and saving measures often require long lead times before they are reflected in budget estimates, it is important that all policy discussion in government (and not only budget policy issues) is accurately informed on multi-annual fiscal consequences and the required changes in multi-annual estimates.

**The MTFF implementation has been well integrated into public expenditure management systems and embedded in budget managers' practices but more effort is needed to make it credible.** Croatia lacks an explicit fiscal rule for the total or current deficit so MTFF serves as a multi-annual expenditure and revenue strategy for keeping the deficit within acceptable boundaries. Over the last four years, the MTFF has aimed to reduce the consolidated general government deficit below the 3 percent margin, a Maastricht criteria for entering the Economic and Monetary Union. But deviations from expenditure and deficit targets are typical. While deficit deviations are within acceptable boundaries and sometimes even reflect over-performance, deviations between next year's budgets and planned expenditures, as contained in the previous year's MTFF, sometimes exceed 10 percent. These are led by unplanned liabilities created by new legislation or new government programs. The budget is made from year to year without much attention paid to the MTFF adopted in the previous year. So far, neither MOF nor Cabinet has provided an explanation for expenditure deviations from the previous year's MTFF. And neither Parliament nor external reviewers have raised this issue and the relevance of the MTFF exercise hasn't been adequately respected (e.g. at the level of aggregate expenditure ceilings).

**Croatia would benefit from making multi-annual expenditure totals of first level budget managers mandatory, while allowing flexibility at the line item multi-annual estimates.** Expenditure totals could be rigorously enforced from year to year during budget formulation as well as during budget execution. Unexpected developments, including overspending on entitlement programs, or new spending priorities could be accommodated by reallocation within the totals or saving measures. Although line item budgetary and multi-annual estimates can be flexible, totals of first level budgets should not be. Enforcing aggregate expenditure ceilings is a priority task for top decision-makers. It is also important to explain in budget documents how budgetary and multi-annual line item estimates relate to the previous year's multi-annual estimates and the reasons for change. Making this information available to Parliament would help MPs make more informed proposals and external reviewers provide more informed judgments on fiscal developments.

**New budget law from July 2008 aims to improve the MTEF's relevance.** This law provided for the two outer years in the MTFF to be binding at the aggregate level and linked to strategic priorities, as stipulated in the newly introduced three-year strategy of government programs. But without a clear top-down steering of the budget process to enforce

the multi-annual strategy this may not yield the desired results. Building budget managers' capacity to develop medium-term plans with more accuracy, while being realistic, and strengthening MOF's authority to evaluate and provide agreement/disagreement with their proposals, would significantly improve public finance effectiveness. Planned introduction of a three-year sector and an overall government strategy, along with better general performance of the budgeting process, would increase the MTFE effectiveness in Croatia.

#### 4. Performance-Based Budgeting

**Progress towards more performance-oriented budgeting has not advanced as much as the MTFE.** Croatia's budget preparation process had a transition from line-item budgeting to program budgeting, starting with the 2005 budget. Four years later most budget managers seem to think that program budgeting is only about consolidating spending into activities, projects and programs. They don't recognise it as a major shift of methodological focus, from type and size of expenditure to expected outcomes and results.

**Program budgeting was formally introduced four years ago but has limited relevance.** It's not used as a budget allocation and control mechanism and there is no set of measurable program performance indicators. Organizational views on the budget still dominate over program perspective and this limits transparency in budgetary presentations and consultations. Consequently, the impact on budget allocation decisions of various economic and social analyses of present and future public expenditures remains limited.

**A need to integrate strategic and budgetary planning and introduce proper monitoring and evaluation became more evident in the EU pre-accession process.** Adoption of the Strategic Development Framework (SDF) 2006-2013, the first consistent longer-term government strategy, in July 2006, provided an opportunity to link broader strategic considerations with operational budgetary decisions. But policy effectiveness and efficiency were constrained by the absence of systems to integrate strategic priorities and strategic goals with budget allocations. A comparison of priority rankings implied by the SDF 2006-2013 and the budget for 2007 illustrates the gap between strategic goals and annual budgetary allocations. The framework for comparisons is weak because definitions of strategic areas and goals in the SDF cannot easily be matched to budgetary allocations. The top priority in budget 2007 is attached to regionally bal-

Table 10. Transport Sector Program-Budgeting, 2008 Budget

Programs	Ministry of sea, transport and infrastructure (065)	HRK 8,259,997,126
1200	Administration and governance	186,709,092
1202	International cooperation of inland water navigation	4,460,000
1204	Restructuring and modernization of railways	510,050,000
1205	Modernization and development of ports of state interest	217,037,000
1208	Modernization and construction of railway tracks and junctions	4,000,000
1209	Support for Croatian shipping industry	85,500,000
1210	Support to port traffic	4,110,000
1213	Subsidization of railway traffic	414,000,000
1215	Monitoring and development of the postal services	2,900,000
1217	Accession to NATO - map program	300,000
1218	Transport connection of mainland and islands, and between islands	100,000,000
1219	Development of road transport and safety on roads	1,620,000
1221	Development of air transport	95,575,000
1222	Security and safety in air transport	41,472,000
1224	Safety of sea water transport	70,690,000
1229	Environment protection in transport	12,818,000
1497	Transport infrastructure construction	3,418,006,441
1510	Development of inland waterways navigation	1,830,000
1511	Monitoring and development of telecommunications and postal markets	4,200,000
1544	Safety and oversight of navigation on inland waterways	10,500,000
1545	Support for river transport	2,500,000
1546	Developments of inland waterways ports of state interest	50,300,000
1547	Construction and technical maintenance of inland waterways	450,000
1688	Implementation of national railway infrastructure program	2,248,172,000
1218	Transport connection of mainland and islands, and between themselves	378,647,500
1547	Construction and technical maintenance of inland waterways	78,704,000
1215	Monitoring and development of postal system and traffic	2,569,251

Source: Official Gazette

anced growth and fiscal decentralization. Budget allocation for regional development programs almost doubled relative to 2006, and tripled relative to 2003. Looking at the SDF, balanced regional development is reflected in the definition of only two goals among seven in section VI on Space, Nature, Environment and Regional Development. This does not indicate a high priority ranking. On the other hand, SDF's top priority is reflected in the section on People and Knowledge and is comparable with the section on Education and Science in the Budget. This budgetary allo-

cation has been increased by 5.5 percent which, again, seems mismatched with SDF's priorities.

**Several attempts have been made to launch PBB but introduction of performance elements remains at the pilot phase.** With help from the US Treasury and the World Bank, two rounds of pilot projects have been undertaken in 2004-2006 for selected line ministries (Justice; Sea, Tourism, Transport and Development – program Tourism; Finance – customs Directorate; Health and Social Welfare – program Health; Agriculture, Forestry and Water Management – program Agriculture) and a state agency (State Geodetic Institute). They aimed to collect information on the ministry's mission, policies, strategic and operational objectives. Programs were accompanied by a statement of objectives and a description of institutional arrangements for implementing the program. Names of the responsible manager for the program implementation were included. Performance indicators are presented for the baseline year and targets for the next three years with the source of information identified. A draft methodology for key aggregate financial and personnel performance indicators has been developed and tested on pilot programs but no decisions have been made on rolling it out further. Persistent focus on input budgeting has led many line ministries to inflate and fragment the number of existing programs, hindering meaningful performance measurement. For example, the transport sector in the 2008 state budget has 27 programs, many of which are activities contributing to a meaningful performance area. Further advancement towards performance budgeting requires consolidation of programs. In the transport sector, this means consolidating from 27 to 10 programs.

**Budget architecture involves the programmatic structure but needs to be complemented by strategic and operational objectives, performance indicators and medium-term policy targets for the medium-term.** Expenditures are classified and reported on four-levels. Program classification, as described in the Rulebook on Budget Classifications, has three levels:

- P1 – main program has one or more programs: sector-wide or cross-cutting program; can be executed in one or more different ministry levels.
- P2 – program: belongs to one main program; belongs to one ministry level; has one or more sub-programs; can be executed in one or more agency levels.

- P3 – sub-program belongs to one program; belongs to one agency level; has one function. There are three types of sub-programs: activity (coded A), current project (coded T) and capital project (coded K).

In MOF budget terminology an 'activity' is a part of a program for which expenses and expenditures are planned to achieve program objectives. A 'project' is a component of a program, planned on an ad hoc basis, in which expenses and expenditures are planned to achieve objectives established for a program. A 'program' is a set of independent, closely related activities and projects oriented towards achieving a common goal. A 'main program' is a set of programs that contribute to realizing the executive body's objectives established by its decision. However, in the Instruction for 2009-2011 Budget Preparation, budget managers are asked to provide program objectives and performance indicators when explaining their financial plans.

Table 11. Croatia's Budget Structure: Organizational and Program Classifications

Budget Classification	Classification Categories
Organizational	Ministry (Razdjel)
	Agency (Glava)
	Budget end user
Program	Main program
	Program
	Sub-program
	Activity (A)
	Current project (T)
	Capital project (K)

Source: MOF

Figure 6. Example of Organizational, Program and Economic classification

	üüü	2008
065 Ministry of sea, transport and infrastructure	8,259,997,126	
06505 Ministry of sea transport and infrastructure	7,797,027,941	
1213 Subsidization of railway traffic	414,000,000	
A761010 Subsidies to railway passenger traffic	400,000,000	
35121 Subsidies to public corporations	400,000,000	

**The following six pre-conditions are necessary for successful introduction of PBB:**

- Further *alignment of program classification* to measure and monitor program performance in terms of their economy, efficiency and effectiveness, and enable them to be followed up in a better way (alignment of programs with the Key Performance Areas (KPA)s).
- *Systematic collection of the lists of indicators* currently available and/or in use in the state administrations (for example CRO-STAT, Financial Agency) and recognition of the need for additional measures and indicators and to identify sets of Key Performance Indicators (KPIs) for programs and sub-programs.
- Stronger *capacity of line ministries* in terms of understanding the log frame (inputs, outputs and strategic objectives). In the past two years, together with the budget proposal, Parliament received the explanation of select programs which included some performance information. But the implementing agencies providing these performance reports focused mostly on output measures which are easier to collect but provide little understanding of sector performance.
- *Changes to the budget negotiation process* to achieve results. Although the budget manual defines program classification as a

basis for budget preparation, it is effectively done on the basis of organizational classification. Budget is conducted in terms of expenditures per organization units and there is no institutionalized process for using quality indicators (results of research, performance and efficiency benchmarks etc).

- *ICT system support* to create user-friendly tools. The SAP-based IT system supports all budget classifications. An application for managing budget classifications has been developed which helps to improve budget preparation process.
- *Political support from decision-makers* that not only lifts the budget process above excessively narrow or partial interests, but ensures greater focus on strategic management and on ensuring external control and accountability for the delivery of programs.

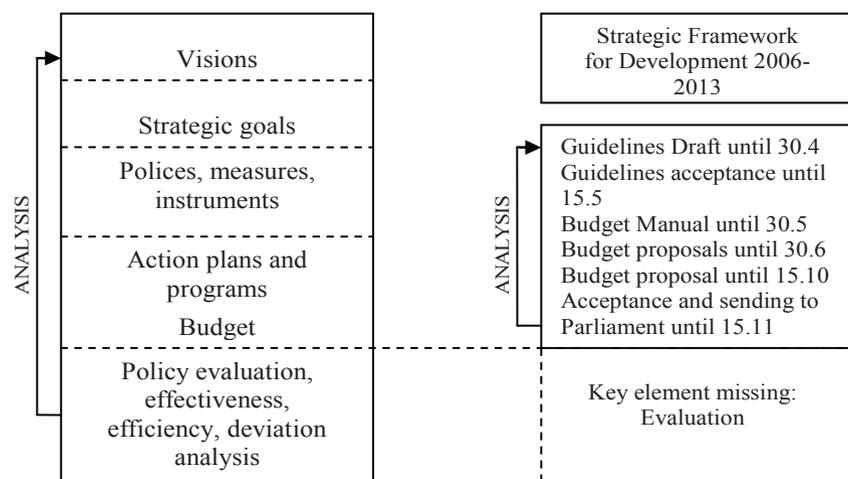
**The Strategy for the Development and Modernization of the State Treasury 2007-2011, a core forward-looking document for public finance management improvements, was adopted in October 2007. The aim is performance information to measure programs' effectiveness and reward effective functioning by:**<sup>61</sup>

- At the *state level*, strengthening overall fiscal discipline to ensure and maintain macroeconomic stability. This task, inter alia, requires detailed and comprehensive macroeconomic analyses and some form of a multi-year budget framework to maintain the sustainability of current programs and public debt policy.
- At the inter-sectoral (*inter-ministerial*) level, ensuring effective inter-sectoral allocation of resources, i.e. allocation of resources consistent with the strategic priorities of the State. Institutional solutions and tools for enhancing strategic allocation of resources include the top-down development approach to budgetary planning and the development of a multi-year budget framework.
- At the *programmatic/managerial* level, coordinating budgetary authorizations and operative effectiveness. Getting the right balance between flexibility during the execution phase of the budget and budgetary restraint is essential. Measures will be directed towards strengthening fiscal controls, improving inter-sectoral allocation of resources and providing greater flexibility for effective management and the development of accountability mechanisms.

<sup>61</sup> The Strategy for the Development and Modernization of the State Treasury 2007-2011, August 2007, page 20

**Integrating established strategic priorities and budgetary processes would significantly increase Government's ability to meet its obligations in a timely fashion.** An element of the MTEF, introduced through the 2008 Budget Act, is preparation of strategic plans. Plans will be prepared by line ministries for their scope of work and, based on these, the Strategy of Government Programs for a three-year period (Financial Strategy) will be prepared and submitted for adoption by Government, as stipulated by the budget act. Preparation of the Financial Strategy and other activities for the integration of strategic and budgetary planning will be done in close cooperation with the Central Office for Development Strategy and Coordination of EU funds. This Office is already engaged in formulating the development strategy of the Republic of Croatia and monitoring its implementation. The Financial Strategy will clearly define Government priorities, goals and policies and will be reflected in three-year budgets ensuring adequate resources are allocated to meet them. It will have to be supplemented with performance indicators, but initially for selected programs and ministries only.

Figure 7: Comparison of Desired and Current Processes of Strategic and Budgetary Planning



Source: Arhivanalitika ltd, Strategic Planning and Budgeting Process for the Government of Croatia, World Bank, IDF Grant: Croatia – Strengthening Budget Management, September 2006

**MOF stands firmly behind this reform.** Its goal is to implement proper program budgeting over the next few years. It sees performance information as valuable for the budget planning process but also for the

accountability of the executive. MOF plans to use performance information to monitor programs' effectiveness, and in budget negotiations and provide a foundation for rewarding effective functioning. MOF recognizes performance won't be the only element directly affecting allocation of funds according to programs; it calls this a transition towards performance-informed budgeting, as opposed to performance-based budgeting.

**The institutional framework of budget process and its classifications needs no changes.** Programs will be redefined to reduce their number, align them with the strategic framework and determine their measurability. This work will be supported by the EU Phare 2006-funded project. Because this modernization effort is complex, establishing performance indicators will initially be restricted to pilot ministries. Organizational structures in some ministries and across government don't support effective use of performance budgets. For example, there are 17 institutions dealing with environmental programs, many of which overlap across several ministries and agencies. Recent functional reviews of state institutions to prepare for government organizational reform should complement and support effective PBB implementation.

## 5. Budget Presentation and Classification

**Budget documentation is better and more comprehensive.** The following budget documents are used in preparing the budget:

- *The Economic and Fiscal Policy Guidelines* for a three-year period prepared by MOF and adopted by Government at the beginning of the budget preparation process. These Guidelines include a description of the current macroeconomic and fiscal setting; analysis of the long-term sustainability of public finances; macroeconomic and fiscal assumptions for the budget year and the following two years; estimates of revenues and expenditures, and receipts and expenses at all government levels; a proposal of aggregate budget managers' expenditure ceilings for a medium-term by FLSUs; projected changes in assets of central, regional and local governments, and debt of regional and local governments; and an overview of central government obligations to be met in the coming years and the policy plan for the development/investment programs.
- *Instructions for the Preparation of the State Budget Proposal ('budget circular')* and *Instructions for the Preparation of the Lo-*

cal and Regional Self-Government Units. These are prepared by MOF and based on the Guidelines. They include key information about the budget managers' responsibilities, time schedules, key documents to be delivered, FLSUs' expenditure ceilings and macro and fiscal assumptions to be used in preparing medium-term financial proposals.

- *State Budget and the Consolidated Budget MTFE* which represents the draft state budget and consolidated budget medium-term fiscal program for a three-year period. It is presented at economic and program classification.
- *The Budget Explanatory Note* is presented to Parliament with the draft annual budget and MTFE. It explains, in a general way, Government priorities for the next year, macro and fiscal assumptions as well as allocation of budget resources by sector.
- *Budget Execution Law* details the rules behind implementation of the state budget as well as other levels of general government. It is submitted to Parliament with the above two documents.
- *Reports on the semi-annual and annual execution of the consolidated and the state budget* present the semi-annual and annual budget execution to Parliament by end-June and end-September, at the same level of detail as the budget law and MTFE. MOF also issues a promotional publication on the execution of the previous year's budget, outlining main performance indicators of the budget, some output indicators and financial outcomes of the fiscal policy. This is widely disseminated.
- *Annual Report of the Ministry of Finance* is issued for the previous year's budget execution with some ten months lag. It has a wide distribution including through the MOF website. It provides an overview of macroeconomic and fiscal setting, revenue and expenditure developments of state budget, consolidated central and general government by economic, functional and organizational classification, debt developments of central and local governments, and any institutional change that may have happened.
- *A promotional publication on budget* for the following year.<sup>62</sup>
- *A Budget Guide for Citizens* was prepared jointly with the Institute of Public Finance five years ago. Its main purpose was to

familiarize the public with the state budget, budget procedures and the way it affects the economy and society.

**The 2003 Budget Act identified the following types of budget classification: organizational, economic, functional, location and program.** Economic and organization classifications dominate the budget process. Budget classifications and coding are further regulated by the Rulebook on Budget Classifications from 2007. This Rulebook prescribes types, content and application of budget classifications and determines the sources of financing.

- *Organizational* classification is a presentation of expenditures and expenses according to organizational structure of central government and local and regional self-governments, broken down by first and second level budget managers.
- *Economic* classification comprises revenues and receipts classified by economic type, and expenditures and expenses classified by the economic purpose they serve.
- *Functional* classification is a set of operations, functions and programs of central, local and regional governments.
- *Location* classification presents expenditures and expenses according to the territorial organization of the Republic of Croatia. Although MOF has tried to establish it, this is yet to be published.
- *Program* classification is a presentation of budget programs, and their integral parts – activities and projects.
- *Sources of financing*, introduced by the new Budget Act, although operational 2007, and based on the Book of Rules on Budget Classifications.

All expenditures, expenses, revenues and receipts must be reported in accordance with budget classifications. Revenues and receipts are also monitored by sources of financing.

## 6. Public Management Performance Culture

**Program budgeting has been in place for a couple of years but further advancement is constrained by lack of certain performance elements.** The execution of programs with some results and/or achievements information is reported to Parliament on an annual and semi-annual basis. The State Audit Office (SAO), according to INTOSAI Auditing Standards and State Audit Act, is obliged to implement the performance

<sup>62</sup> <http://www.mfin.hr/adminmax/docs/Proracun2008.pdf>

audit, in addition to financial and special audits. The financial audit is the most frequent type of audit carried out by SAO. It is an audit of public income and expenditure; financial statements audit and an audit of financial transactions in public bodies, local and regional self-government units, legal entities financed partly or entirely from the budget, public companies, companies and other legal entities in which the Republic of Croatia (i.e. local and regional self-government) is a major shareholder. It covers the use of funds from the EU and other international organizations or institutions to finance public needs.

**SAO's role in promoting a performance culture is significant but would benefit from more capacity.** SAO's powers to conduct performance audits is defined by the State Audit Act which stipulates that auditing include an assessment of the efficiency and effectiveness of business operations, and an assessment of performance in the realization of particular program outputs. So far, six pilot performance audits have been conducted. SAO has developed an audit manual which dates back to the mid-1990s. Up-to-date and more detailed manuals are needed. Drafts of a Financial Audit Manual and a Performance Audit Manual have been prepared in line with INTOSAI – Auditing Standards, INTOSAI – Practical Guidelines for Performance Audit, European Implementing Guidelines for the INTOSAI Auditing Standards, as well as examples of good practice and Manuals of Supreme Audit Institutions from other countries.

**The ongoing civil service reform program of the Government of Croatia should complement and mutually reinforce PBB initiatives.** Better understanding of the benefits of a more performance-oriented culture is important but achieving it requires an effective program and performance budget framework. For example, development of job descriptions for position holders and of staff appraisal systems needs to be informed by program performance measurement and objectives. The civil service reform, which started in 2005 with enactment of a new Civil Service Law, set the basis for a merit-based promotion and pay system and has professionalized top civil servants' ranks. These were previously political appointees. Reform proceeded slowly with de-politicization taking place only in early 2008, while salary reform is still being discussed with stakeholders, particularly unions. The major disagreement between unions and Government is about the replacement of tenure (years of service in administration) and bonuses (currently creating a large part of the salary) with performance-related bonuses. Despite efforts to professionalize top managerial posts, the public administration system is not ready to increase flexibility in return for increased accountability. The new salary

system proposed to social partners allows for the above principle to be implemented but resistance, generated by the fear of decreased job security, and a non-objective staff appraisal system need to be addressed first.

**Latvia**  
*Paulina Hořda*

**General Assessment (Summary)<sup>63</sup>**

Latvia has undertaken a number of important institutional reforms to strengthen fiscal policy making. These include extending budget analysis beyond a single year by introducing the medium-term expenditure framework (MTEF) and implementing program budgeting. This includes establishing and monitoring targets for outputs and Government spending objectives. A performance-oriented culture has been strengthened by ongoing public wage reform which envisages a closer link between pay levels and the professional content of different positions, plus actual performance.

Support from the State Chancellery, and within the Ministry of Finance (MOF), at the outset of these reforms helped set the pace and quality of reforms. Despite this, their implementation suffered from some problems and, while significant progress has been made, challenges remain. These include improving policy formulation and planning, addressing artificial fragmentation of the budget, building capacity to develop a meaningful medium-term budget framework and improving the structure and policy applicability of the performance information system.

Reforms aimed to improve control over the budget process, with MOF playing a more strategic role. To be successful, these public finance management reforms need first to get the basics right to support three functions of the budget: control of public resources, planning for future allocation and efficient and effective management of resources<sup>64</sup>. Control of public resources comes first, so reformers need to control inputs before seeking to control outputs. The Latvian experience illustrates the need to focus on the architecture and rationale of the system and not on its particular technical parameters.

Recently, Latvia's political and economic environment for public finance reforms has changed. The economy is undergoing major adjustment and more short-term pressures are emerging on the fiscal side. In this changed environment it may be difficult to enforce the MTEF developed in 2007, or to encourage hard choices between expenditure options.

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<sup>63</sup> We are grateful for excellent and timely assistance provided by the Latvian Ministry of Finance, and in particular Ms. Ilonda Stepanova, Director of Budget Department.

<sup>64</sup> World Bank, 1998, *Public Expenditure Management Handbook*, Washington D.C.

On the other hand, tightening constraints may stimulate further reform to better prioritize and improve efficiency of public spending. The necessity for this may have not been obvious to all stakeholders during times of successful economic performance.

## 1. Core Features of the Current Budget System

**Latvia has achieved many of the basic requirements of fiscal transparency.** As noted in the IMF assessment<sup>65</sup>, Latvia has been a leader among economies in transition. It adopted improved accounting and fiscal management practices and provided financial markets with relevant information on fiscal activities. In particular, the state treasury established an accounting and reporting system that is widely recognized as effective and reliable. The budget process is open and soundly based on a macroeconomic framework with reliable estimates of expenditure and revenue.

**The budget process is transparent with an emphasis on financial compliance. It also provides for development of performance budgeting and medium-term planning.** The annual budget process is well defined and clear about timelines and the roles and responsibilities of key agencies. Important steps for further improvement have been identified and authorities are undertaking institutional reforms to strengthen fiscal policy making. This includes extending budget analysis beyond a single year by introducing the MTEF with the 2008 budget. Government is already implementing a program budgeting framework which includes establishing and monitoring targets for outputs and government spending objectives. Further work is required to put these elements into effective practice.

**MOF needs to play a more strategic role if fiscal policy making is to improve.** An important feature of Latvia's budget system is the concept of base spending. This captures the level of spending associated with continuing current government functions, similar to the concept of unchanged policy. To determine the budget, spending for new priorities is added to base spending. Developing the base budget has traditionally been a quantitative driven exercise with most ministries perceiving the base as an entitlement to be carried forward, with little concern for scrutiny and rationalization. Institutional reform aimed to strengthen MOF's role in the budget process, including analyzing existing base spending, evaluating strategic plans and budget requests and developing methodology for program and performance budgeting.

**Despite significant progress in public sector reform and governance, challenges remain.** As identified in the World Bank Public Expenditure Review (2002) a primary task facing Latvia in the fiscal area was rationalizing public expenditure and reforming the civil service. Reforms in these areas are being implemented but work is yet to be done to improve policy formulation and planning, address artificial fragmentation of the budget, build capacity to develop a meaningful MTEF and improve the structure and policy applicability of the performance information system.

## 2. General Progress on Budget Reform

**Reform efforts have been made in public finance management, including introduction of an MTEF and program and performance-based budgeting.** To limit discretion in fiscal policy, Government decided in 2000 to move towards an MTEF and making this framework operational from 2008 was the key achievement in strengthening policy planning. Strategic planning to link policies with budget allocation has been developed since 2003. Budget programs were introduced in 1997, performance management developed since 2003, with the second cycle of reform starting from 2008 to revise and improve results and performance indicators. Public wage reform across all budget institutions began in 2003 to introduce clear job descriptions and base wages on revised job classifications linked to professional content and actual performance. This is a major positive shift from the traditional seniority rules.

**Institutional reforms aimed at strengthening fiscal policy, giving MOF a more strategic role.** MOF has traditionally played a weak role in the budget process which, to a large extent, has been based on non-scrutinized base spending. There was a strong internal drive for reform at MOF, as well as external stimulus from the State Chancellery and the Prime Minister, to improve control over the budget process. MOF has been the lead agency in introducing the MTEF, with the State Chancellor developing a system of strategic planning.

**Under strong fiscal performance, political support for reducing base spending has been limited. This has meant limited fiscal space for new policy initiatives.** Under impressive economic growth following EU accession and the resulting revenue over-performance, political support for cutting base spending has been limited and attempts to revise existing budget programs haven't been successful. Existing expenditure programs have limited fiscal space for new policy initiatives, as well as for wage increases committed at the political level.

<sup>65</sup> Report on Observance of Standards and Codes, Latvia – Fiscal Transparency, March 2001.

**Against this background, implementation of reforms has suffered.**

Introducing the MTEF is intended to better align budgeting with policy priorities but strategic plans developed by line ministries have been biased toward new initiatives with little attention paid to reviewing and rationalizing existing programs. Furthermore, strategic plans haven't been constrained by resource availability. On performance systems, the reforms tended to focus on particular techniques, i.e. on results and performance indicators, without revising more fundamental issues of program structure and failing to use performance information in budget decision making. As a result, identifying and measuring results and performance indicators is viewed as a formal exercise which bears no relation to the real performance of public administration institutions.

**The economic and political environments have changed recently. The severe economic downturn has focused efforts on short-term concerns.** Following a period of above-potential economic growth, the Latvian economy entered a phase of substantial adjustment with significant short-term challenges emerging on the fiscal side. Faltering revenues on the back of sharp economic slowdown resulted in increased pressure on budget expenditure, including on the 2009 draft budget, and renewed interest in tools and techniques for finding cross-cutting savings. Given the changed political environment, it may be difficult to enforce the MTEF or encourage hard choices between expenditure options. In July 2008, faced by deteriorating macroeconomic fundamentals, Government revised the state budget from a planned surplus of 1 percent of GDP by adjusting both the revenue and the expenditure side.

### **3. Adopting Medium-Term Expenditure Frameworks**

**The MTEF has been adopted as part of broader reform of public finance management.** Reform towards an MTEF was initiated in 2000 with MOF playing the leading role. The reform program includes several elements of the MTEF, such as a medium-term fiscal policy statement, a budget priorities statement, and development of guidelines for line ministries to design their own strategic plans. The legal basis of the budget process, the Law on Budget and Financial Management, has been amended to

reflect the MTEF. The medium-term macroeconomic development and fiscal policy framework has been operating since 2008.

**The MTEF provides for a three-year rolling expenditure framework for broad categories of spending.** Medium-term macroeconomic development and fiscal policy framework, to be approved by Cabinet by May 1, includes forecasts of fiscal aggregates for the next budget year and two following years. By May 5, the Minister of Finance will inform the Saeima on the framework approved by Cabinet. The framework includes:

- a forecast of the medium-term State macroeconomic situation
- the fiscal policy aims of the Government in the medium-term
- a forecast of revenues in the medium-term
- the maximum permitted total amount of State budget expenditures in the medium-term
- the planned State budget appropriation reserve in the medium-term
- the maximum permitted total amount of State budget expenditures for each ministry and other central government institutions in the medium-term.

By September 1 of the current year, the Minister of Finance submits an updated medium-term macroeconomic development and fiscal policy framework to Cabinet, along with the draft budget law (package of draft budget laws) and explanations.

**As a part of public finance management reform, a system of strategic planning has been introduced.** Strategic planning allows for formulation and prioritization of policies and links them with budget decisions. Led by the State Chancellery, which is responsible for establishing a policy formulation system, this was introduced in Latvia in 2003-2006 alongside training and introduction of structural funds. From 2007 all ministries are required to prepare strategic plans. This marks significant progress in policy formulation although in practice results have been only partially successful.

**Despite reform efforts, the budget process is still based largely on incremental budgeting.** Budget practice in a number of developing countries shows it is easier to add new policies than remove old ones. For this reason, linking policy, planning and budgeting should start with a review of policies and programs of the previous planning and implementation period. In Latvia, the budget still remains artificially fragmented into base

budget and development spending. This creates a perception in line ministries that base budget expenditures can be carried forward with little concern for scrutiny and rationalization.

**Strategic planning has so far failed to address weaknesses in policy formulation and the budget system.** Weak policy formulation has been identified as an area for improvement.<sup>66</sup> Strategic planning should improve policy formulation but instead has revealed a key weakness of the budget process, i.e. artificial fragmentation of the budget. Strategic plans developed by line ministries are biased toward new priorities and initiatives without fully reviewing and rationalizing existing programs. New programs are only vaguely prioritized and inadequately integrated with the MTEF.

**Strategic plans have not been formulated within an overall budget constraint.** A successful MTEF assists and requires relevant decision makers to balance what is affordable in aggregate against policy priorities. The MTEF comprises a top-down resource envelope, a bottom-up estimation of the current and medium-term costs of exiting policy and, ultimately, these costs with available resources.<sup>67</sup> In Latvia, sequencing these stages has been different with strategic plans developed without guidance from indicative medium-term resource envelopes at the ministry level. Thus, strategic plans haven't been realistically fitted in to the overall fiscal and macroeconomic framework.

**MOF should be strengthened and technical capacity further developed.** MOF still needs to improve its capacity to build a meaningful MTEF and, in particular, provide projections of base spending. Its role needs to be significantly enhanced, particularly in determining key parameters of the MTEF, evaluating line ministries' strategic plans and budget requests, and developing methodology for program and performance budgeting.

<sup>66</sup> As noted in Public Expenditure Review for Latvia (2002), policy formulation in some sectors remains poor and the lack of clearly defined policy priorities has often led to an increase in unfunded mandates and ineffectiveness of the budget formulation process. Another weakness is ad hoc commitment to unfunded policy proposals during budget preparation or execution (World Bank, 2002, *Republic of Latvia - Public Expenditure Review*, Washington D.C.).

<sup>67</sup> World Bank, 1998, *Public Expenditure Management Handbook*, Washington D.C.

#### 4. Performance-based Budgeting

**Program based budgeting has been introduced within broader public finance management reforms.** Program based budgeting reform was initiated in the second half of the 1990s, starting with budget programs. At that time, the focus was on controlling inputs in terms of the number of subordinated institutions and staff, rather than on controlling outputs. As a result, the introduction of performance indicators failed. Later in 2003, within a broader scope of introduction of unified policy making system in 2001-2003, performance indicators were defined mainly for outputs. Starting from 2008 there has been a second cycle of reforms in performance management and the system is now being revised. Work focused on new guidelines on performance indicators<sup>68</sup> approved by Cabinet in June 2008.

**The system architecture includes programs and subprograms with defined objectives, outcomes and outputs.** The basic architecture of the system comprises two levels – programs and subprograms – for which expenditure is classified by economic codes. Each program and subprogram has a defined objective for which policy results (outcomes) and activity results (outputs) are specified (see Table 12 for an example) and, where possible, measured by performance indicators. The programmatic structure has been consistently adopted across central government, with local governments choosing whether or not to adopt the system.

Table 12. Budget program: objective, policy results and activity results, example from the Ministry of Education.

<p><b>Objective</b></p> <p>Provide each citizen with opportunity to receive qualitative lifelong professional education in accordance with individual interests and abilities, as well as in compliance with state economic development needs.</p> <p><b>Policy results</b></p> <ul style="list-style-type: none"> <li>• number of learners financed from state budget (thousands of learners)</li> <li>• number of graduate, whose education has been financed from state budget</li> <li>• percentage of 25-64 year olds' participation in further education and non-formal education</li> <li>• number of regional education centers for adults.</li> </ul> <p>Activity results</p> <ul style="list-style-type: none"> <li>• professions for which content of centralized exams for qualifications has been elaborated</li> <li>• percentage of learners who have received qualification in relation to the total number of learners financed from the state budget</li> <li>• percentage of teachers improving professional skills in relation to the total number of teachers</li> <li>• number of modernized rooms for professional courses and workshops.</li> </ul>
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Source: Ministry of Finance

<sup>68</sup> *Performance Management System Guidelines 2008-2013*.

**MOF leads the way with cross-sectoral working groups created to solve the issue of overlapping tasks.** Budget and performance management system is being developed primarily by MOF. To solve issues of division of inter-sectoral responsibility for overlapping tasks between institutions, MOF is organizing working groups with representatives from other institutions. The State Chancellery, which is responsible for coordinating policy planning and implementation, is making a significant contribution to the process.

**Program and subprogram design remains input-oriented with little performance orientation.** The programmatic structure of the system has its drawbacks with budget programs in many cases input-oriented and similar to traditional spending lines (see Table 13) for which it is impossible to set outcome indicators. Programs tend to be broad to allow ministries budget flexibility. Links between priorities and budget programs are unclear. In practice, the system seems unhelpful for policy planning, especially as performance information isn't used in budget decision making.

**Adopting a performance-based system has met challenges and constraints, mainly on the capacity side.** A major challenge has been resistance to change with program based budgeting perceived as a tool for punishment rather than improving efficiency. The rapid pace of reforms has not been accompanied by adequate capacity building, both in MOF and line ministries. Training for better understanding of the rationale behind program based budgeting has been inadequate, focusing only on technical parameters and indicators. More fundamental issues of program structure require revisiting.

**There is room for considerable improvement in the current system of output and outcome indicators.** Ministries responsible for developing indicators tend to focus on inputs and processes and their capacity to prepare outcome-based indicators is underdeveloped. Reporting requirements are comprehensive with too many indicators (496 for outcomes and 1597 for outputs) and no clear hierarchy. There is duplication in planning and reporting systems concerning performance indicators (identified in Cabinet), activity strategies of direct public administration institutions, budget explanations, financial and annual public reports<sup>69</sup>.

**There is no systematic analysis and monitoring of results and performance indicators and nor is information aggregated to make it avail-**

<sup>69</sup> There are no clear links between results and indicators featured in the policy planning documents and the results and indicators used in the activity strategies of public administration institutions. Therefore, the same policy may have different results and performance indicators across various documents.

Table 13. Budget program structure in the Ministry of Transport.

Budget program	Budget allocation in 2008 (in percent of total)
TOTAL	100.0
03.00.00 Branch Management	4.7
08.00.00 Ensuring Operation of the State Agency „Riga Motor Museum”	0.1
09.00.00 Installments in International Organizations	0.0
11.00.00 Ensuring Operation of the State Railway Technical Inspectorate	0.1
12.00.00 Ensuring Operation the State Railway Administration	0.1
14.00.00 Coordination and Technical Support of European Union and International Funding	0.0
23.00.00 State Road Fund	50.9
26.00.00 Port Development Fund	0.0
29.00.00 Implementation of Projects Financed from the Cohesion Fund the Road Branch	10.1
31.00.00 Public Transport	16.1
33.00.00 Implementation of Railway Infrastructure Development Projects Financed from the Cohesion Fund	6.2
34.00.00 Port Development Projects Financed from the Cohesion Fund	2.9
35.00.00 Airport Development Projects Financed from the Cohesion Fund	1.1
37.00.00 Technical Support Projects Financed from the Cohesion Fund	0.1
38.00.00 Trans – European Network Projects of Common Interest	0.1
39.00.00 Ensuring Operation of the Transport Accident and Incident Investigation Bureau	0.0
40.00.00 Ensuring Operation of the Road Transport Inspectorate	0.2
41.00.00 Ensuring Operation of the Civil Aviation Agency	0.3
42.00.00 Wide-Band Communication Infrastructure Development in Rural Area Financed from the European Regional Development Fund (ERDF)	0.5
43.00.00 Road Development Projects financed from the Cohesion Fund in the Programming Period 2007-2013	0.0
44.00.00 Ensuring aviation safety, emergency operations and medical services in the International Airport Riga	1.2
45.00.00 Preparation of documentation and construction of East - West transport corridor projects	5.1

Source: Ministry of Finance

**able and useful to decision makers.** Results and performance indicators are not systematically analyzed and monitored and nor has responsibility for information analysis, collection and collation has been identified. As a result, comparative aggregate information is often unavailable when needed for optimizing budget programs and analyzing the cost-efficiency of inputs. So far, the information that has been kept up-to-date is that needed to meet international commitments. Identifying and measuring results and performance indicators is viewed as a formal exercise bearing

no relation to performance. As a consequence, program budgeting has made little impact on budget allocations.

**Weaknesses of the performance management system will be addressed in the second cycle of reform which began in 2008.** Current performance systems will be improved with new basic principles for preparation and use of results and performance indicators. These are set in the Performance Management System Guidelines 2008-2013, approved by Cabinet in June 2008. New guidelines are expected to minimize the number and increase the quality of indicators allowing for gradual transition from monitoring inputs to monitoring results (outputs). Monitoring and evaluation will be improved to ensure policies are based on verifiable information (ex ante evaluation) and accumulation of data on results and performance indicators will be available for ex post evaluation of policies. Performance information will be linked more closely with budget program allocations which will be based on identified spending purpose, planning and approval of deliverable results.

**While the new phase of the reform will improve the system, some basic challenges remain.** The new system guidelines, although technically sound, are limited in scope and focus largely on preparation and use of results and performance indicators. Indicators form only a small subset of an effective performance management system. Even more important is the analysis behind the indicator results and the program structure they are built on. A phased implementation may be advisable because indicators for some functions are easier to develop, and more useful, as for example in the areas that deliver services to the public. To develop an efficient and useful system, MOF needs to build its capacity to assess the policy-relevance of indicators and strengthen sectoral policy expertise to interpret the indicators and understand the factors affecting them.

## **5. Budget Presentation and Classification and Public Management Performance Culture**

**Budget documentation provides information on the annual budget and the MTEF, operational from 2008.** Core budget planning documents include a scenario of macroeconomic development and fiscal policy, the medium-term macroeconomic development and fiscal policy framework (MTEF), package of the draft State budget law and explanations, and convergence program. The complete budget documents are submitted by MOF to Cabinet by September 1, and by October 1 to the Saeima for approval.

**Budget classification has a programmatic structure with expenditure recorded in economic classification.** Budget classification of expenditures includes division by programs, sub-programs and economic classification codes. Sections of programs and sub-programs are further divided, including information on resources for covering expenditure, remuneration, maintenance expenditure and capital expenditure. Budget classifications of revenues, expenditures, financing and debt are compatible with ESA'95 and, in part, consistent with GFSM 2001.

**Latvia has developed a unified IT system based on an integrated SAP platform.** Since 2007 all participants in the budget process have been using a unified IT system, based on an integrated SAP platform (except for some annexes to the budget law). Ministries and other central government institutions have internet access to the system which is used to produce and submit budget documents. The system consists of two modules – budget planning (under the Budget Department of MOF) and budget execution (under the Treasury) – the latter still under construction.

**Public wage reform has been a major step in improving public management performance culture.** Since 2003, wage reform in the public sector has been developed under the leadership of the State Chancellery. Its aim is to include all budget institutions and gradually all civil servants (teachers will be included in 2010). This reform has introduced clear job descriptions, with positions divided in clusters and levels, and depending on functions. Ultimately, wage setting has been linked to a new job classification structure based on professional content and actual performance rather than seniority or length of service. The system has been in place since June 2006, with all 300 central government institutions included by April 2007. Each institution still has its own system of salaries which are to be aligned for corresponding job classifications by 2011.

**Greater capacity is needed to improve application of public finance management reforms.** MOF needs more capacity in evaluating line ministries' strategies and budget requests, developing methodology for program and performance budgeting, and using effectively the performance information in the budget process. Line ministries' capacity to prepare outcome-based performance indicators is under-developed and there is a need for performance information to be more closely linked to decision making and budget allocations.

## Poland

*Ewa Korczyk*

### **General Assessment (Summary)<sup>70</sup>**

Poland is committed to making its budget more predictable over the medium-term and more transparent. A Medium-term expenditure framework (MTEF) and performance-based budgeting (PBB) are recognized as necessary and important developments for improving management of public finances and economic competitiveness. PBB is a major step in modernizing and improving its management and administration of public finances. It is also a key component in the strategy to improve the organization and efficiency of the public sector<sup>71</sup>.

Poland is still in the early phase of reform. Strong political leadership and support is crucial for its successful implementation. Political commitment can help embed modern public finance management into the public sector. A critical factor for Poland is to ensure PBB reform is a part of a broad reform agenda. Improved capacity is needed to pursue reforms related to civil service, the introduction of an MTEF, and establishment of an integrated financial management information system. Work is needed to design the budget in a performance framework, particularly methodological guidelines for creating program structures and setting performance targets and indicators. This is central to PBB reform. Other areas of work include aligning programs to strategic documents of the Government and establishing an effective monitoring and evaluation system.

Poland's greatest challenge is to make PBB reform work. The crucial factor is not only to prepare legislative amendments, design program structure and select performance indicators but how to combine these techniques and integrate them into the budget strategies and the civil service's day-to-day financial management procedures.

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<sup>70</sup> We are grateful for excellent and timely assistance provided by the Polish Ministry of Finance, and in particular Ms. Marta Postuła, Director of Public Finance Reform Department.

<sup>71</sup> Webber D. 2007, *The Introduction of Performance-based Budgeting in Poland: An Assessment of Progress, Achievements and Next Steps*, World Bank, Warsaw.

## 1. Core features of the current budget system

**Poland's budget process is similar to most OECD parliamentary democracies.** Budget initiative is exclusively in the hands of Cabinet. In cooperation with analytical departments in the Ministries of Economy and of Labour and Social Affairs, MOF prepares general macroeconomic assumptions for the draft budget. These are then supplemented with preliminary estimates of aggregate revenues and expenditures and submitted to Cabinet for discussion and approval. At the same time, the Minister of Finance prepares a budget circular. This contains a set of rules for budget preparation and the main forms to be used when submitting estimates. The budget circular, along with macroeconomic assumptions and spending ceilings, is then sent to line ministries. Since 2008, the budget circular has obliged line ministries to justify their spending requests. The budget circular is usually sent in April and line ministries have 21 days to provide MOF with their spending requests. Bilateral budget negotiations between MOF and line ministries take place throughout the summer. The aggregated budget draft (modified by Cabinet) must be submitted to parliament by September 30.

**The legislature plays a limited role in the budget process.** The Sejm, the lower chamber of the Polish Parliament, cannot introduce any changes to the budget act that would increase the budget deficit. Amendments must be neutral with regard to the budget balance which in practice means the Sejm can raise expenditures beyond Government's proposal but has to include corresponding revenue increases. The Sejm may, however, propose changes in the composition of expenditure. After three readings, amendments are voted and a vote on the full budget takes place. The approved budget act has to be reviewed by the Senat, Parliament's upper chamber. The Senat also makes amendments to the budget act but these have to be voted again by the Sejm which can overrule Senat proposals.

**The President has no formal role in the budget process.** While the President can veto normal legislation, he or she cannot veto the budget. Constitutionally, the President is required to sign the budget bill within seven days after receiving it from the Sejm. The President may ask the Constitutional Tribunal to check if the proposed draft is in line with the

Constitution. If Parliament fails to pass the annual budget within four months after Government has submitted it, the President may call new elections although he or she is not obliged to do so. If the budget is not approved by the start of the new fiscal year (January 1) the executive's budget proposal takes effect.

**MOF's role in the budget process depends on the position of the Finance Minister in the Cabinet.** Although MOF proposes preliminary spending limits for line ministries consistent with its target for the fiscal balance, these can be changed by Cabinet. The Minister of Finance has no special powers in bilateral negotiations with spending agencies and cannot cut a specific ministry's request<sup>72</sup>. The Minister can act only with full support of the Prime Minister.

**Poland's budget process is to some extent strengthened by fiscal rules.** The debt rule is set out in the Constitution of the Republic of Poland and the Public Finance Act. The overall objective is to ensure the debt level does not go beyond 60 percent of GDP (compatible with the EU's Stability and Growth Pact). The Public Finance Act spells out actions to be taken if there is a risk of breaching this limit, with different triggers taking effect when debt levels reach thresholds set at 50, 55 and 60 percent. There are doubts about the effectiveness of the debt rule. First, it puts no effective constraint on the budget deficit, as long as public debt is below 50 percent of GDP. Second, if thresholds are reached with high deficits and low economic growth, the constitutional level may be breached before corrective actions take effect. And third, given a low share of discretionary expenditures, corrective actions may not be politically feasible<sup>73</sup>.

**It is worth stressing that the budget balance rule was introduced in 2006.** This rule, more a kind of budget policy than a traditional budget rule, sets the maximum state budget deficit at PLN 30 billion. It is based only on political commitment and doesn't involve any constitutional or legal obligation. This rule, introduced by Marcinkiewicz's Government, was supposed to put Poland on track to meet the Maastricht fiscal criteria. Following its introduction, the budget deficit hasn't exceeded the 30bln PLN level but it remains questionable whether or not it is the rule that stopped expansion of the deficit or political commitment and a favourable business cycle.

**The Constitution and the Public Finance Act set some general rules for the budget process. Specific issues are regulated by the de-**

<sup>72</sup> Hallerberg M., Von Hagen J., 2006, *Budget Processes in Poland: Promoting Fiscal and Economic Stability*, Ernst and Young

<sup>73</sup> Allen R., 2008, *Poland: Developing a multi-annual fiscal framework*, International Monetary Fund

**crees of Cabinet and the Finance Minister.** Since 1997 the Constitution has specified roles and responsibilities of budget managers in preparing, executing and controlling the budget along with major deadlines in the budget preparation process. Apart from introducing a legally binding debt rule, the Constitution prohibits financing of budget deficit from credits from the National Bank of Poland. The Public Finance Act describes in detail the most important definitions and rules governing the budget.

Table 14. Limitations set by organic budget laws

Limitations set by Constitution	Limitations set by Public Finance Act
Possibility of changing the draft of the State budget in Parliament	Expenditures set in the State budget constitute limit for public expenditures
Ban on covering a budget deficit by way of contracting credit obligations to the State's central bank	State budget cannot embrace regulations changing other acts
Exclusive right to introduce legislation concerning a budget	State budget can determine expenditure limits for multi-annual programs
Restrictions concerning a national public debt	Multi-annual programs are set by Cabinet

Source: *Organic Budget Law, Ministry of Finance (Presentation from SBO meeting, OECD, 2006)*

**Recent international assessments point to numerous shortcomings in the fiscal framework**<sup>74</sup>. These shortcomings are:

- Budget fragmentation, due mainly to multiple extra budgetary funds leading to inefficient allocation of budget resources. Although some progress in this area has been made, there are still agencies and funds that don't appear in the budget. Their number has declined in recent years but the amount of money they receive has increased.
- The budget process is only loosely connected to Government policy. Spending ministers act more like administrators of existing laws and programs rather than managers of policy and programs.
- International assessments call for strengthening the accountability framework in the public sector with incentives for improved public service delivery.

<sup>74</sup> International assessments include: *Republic of Poland: Financial Stability Assessment (2001 and update 2004)*, International Monetary Fund, *Poland: Toward a Fiscal Framework for Growth – Public Expenditure and Institutional Review (2003)*, The World Bank, *Poland: Developing a multi-annual fiscal framework (2008)*, International Monetary Fund, *Poland: Country Financial Accountability Assessment (2006)*, The World Bank.

- The budget needs to be made more predictable over the medium period by introducing an MTEF and PBB.

**The amended Public Finance Act<sup>75</sup> has been widely debated by the Sejm's Public Finance Commission.** The draft act incorporates institutional measures aimed at making the budget more consolidated, transparent and predictable over the medium-term as well as more performance-oriented.

- Budgetary units (funds and agencies) will be consolidated, also at local level. The law proposes dis-establishing numerous extra-budgetary funds or agencies although new executive agencies will be created to perform the duties of some dis-established units. The purpose funds at the central level will become budget units without separate legal status will be funded directly from the budget.
- An MTEF will be implemented with introduction of the Multi-year Financial Plan of the State (MFPS) covering a four-year period and updated every year on a rolling basis (including the current fiscal year and three years ahead).
- As well as recurrent activities, the programmatic structure will cover public investment and long-term programs. The new Multi-year Financial Plan of the State will be presented in a programmatic structure.

## 2. General progress on budget reform

**Introduction of PBB and an MTEF has not been part of a broad reform aimed at improving the organization of public finance.** However, some elements of these reforms are in place. With amendments to the Public Finance Act, the number of extra budgetary units has been systematically reduced. Efforts have also been made to make the existing budget more predictable over the medium-term with introduction of a medium-term fiscal framework. Steps have also been taken to ensure efficiency and effectiveness of public expenditure through improved transparency and accountability arrangements connected with performance-based budgeting.

**Progress has been made in eliminating budget fragmentation.** Several state agencies and special funds have been dis-established and their responsibilities taken over by other agencies or line ministries. Ex-

<sup>75</sup> Draft of Public Finance Act, October 2008 (nr druku 1181). The new Law on Public Finance was passed through Parliament in August 2009, and signed by the President in September 2009.

amples are the National Labor Office which was merged with the Ministry of Labor, and customs administration which was incorporated into MOF. The number and the variety of extra budgetary funds and agencies call for further consolidation. A recent draft of the Public Finance Act envisages removing more extra budgetary funds, agencies and special funds.

**To address shortcomings of the budget system, Poland has taken steps to introduce a medium-term fiscal framework.** Multi-annual targets appear in three forms, with the first two included in the national documents. The *Debt Management Strategy* considers projections of the public debt to GDP for the medium-term perspective (three years). The *Justification to the budget act* includes deficit targets for the next three years. Convergence Programs, prepared in line with EU requirements must include figures for expenditures and revenues in addition to projections on deficit and debt levels for the next three years. The problem is that those figures have indicative meaning only and there is no legal obligation for governments in the future to follow them.

**Following the global trend, Polish authorities decided to introduce program structure to the budget in 2006 and eventually move to performance-based budgeting (PBB).** Clearly, the increasing popularity of modern public finance management systems and the need for further expenditure rationalization were important triggers for this reform. According to Polish authorities, PBB reform is a milestone in the public finance reform and a major step for Poland in modernizing and improving the management and administration of its public finances to improve public sector organization and efficiency.

**Since 2006, performance budgeting reform has been high on the agenda.** The reform was initiated by Marcinkiewicz's Government and led by Teresa Lubińska, State Secretary in the Chancellery of the Prime Minister (KPRM). Ms. Lubińska, whose experience in introducing performance budgeting at the local government level, championed this reform. She created a special department in the KPRM responsible for preparing a methodological framework for PBB. This department was supported by an inter-ministerial working group and independent experts. Under Lubińska's leadership methodological guidelines were prepared (*Performance Budget: Rationality- Transparency-Effectiveness*<sup>76</sup>) and PBB was piloted in the budget chapters Science and Higher Education.

**Reform entailed amendments to the Public Finance Act.** These obligated budget managers to specify tasks, with planned expenditures

<sup>76</sup> *Performance-based Budget: Rationality, Transparency, Effectiveness. Methodology*, Chancellery of the Prime Minister, Warsaw, 2006

and description of objectives, indicators and multi-year expenditure for these tasks in the justification to the budget act for 2008. The report on the execution of budget law must contain information on realization of tasks, expenditure, with description of objectives, indicators, and multi-year expenditure, and also on funds spent on executing tasks. Introducing program structure and certain performance elements in the form of performance indicators and targets clearly changed the way line ministries think about their budgets.

**After the elections in 2007 and the change of government, MOF took over reform efforts.** The existing group, responsible for the reform, was partially moved to MOF's Department for Public Finance Reform. The new arrangement slightly stalled the reform momentum because the new owners wanted to revisit existing rules and guidelines.

### 3. Adopting Medium-Term Expenditure Frameworks

**Poland does not have an operating MTEF.** Some elements of the medium-term perspective in public finances exist but they don't fit into a fully developed MTEF. Introducing multi-year budgetary planning will be an essential element of a broad initiative to reform Poland's budgetary system. The initiative was included in the Convergence Program prepared in 2005 in collaboration with the EU.

**The draft of the Public Finance Act provides for introduction of an MTEF.** Expenditure ceilings in Medium-Term Fiscal Plans will not be legally binding. An MTEF will be implemented with the introduction of the Multiyear Financial Plan of the State (MFPS) covering a four-year time perspective and updated every year on a rolling basis (including the current fiscal year and three years ahead). The plan will include macroeconomic projection (growth and inflation), forecasts of state budget revenues and expenditures (the latter also in programmatic mode), financing needs and sources of financing, and a forecast of general government balance.

**For now, the multi-annual macroeconomic estimates appear in several forms:**

- A Debt Management Strategy considers projections of public debt to GDP for the medium-term perspective.
- The Justification to the budget act includes deficit targets for the next three years.
- Convergence Programs, prepared in line with EU requirements must include figures for expenditures and revenues in addition to projections on deficit and debt levels for the next three years.

Since 2007 budget managers have been required to prepare estimates for their expenditures for the next three years in program structure. EU projects and some other capital projects are already planned on a multi-year basis and there are annexes in the budget documentation which provide three year projections of such expenditures. Good quality medium and longer-term projections of pension expenditures are also prepared. All those figures have indicative meaning only so there is no legal obligation for governments in the future to follow them.

**Macroeconomic forecasts are supported by several fiscal rules.** The source of the rules is both national and EU regulations. The debt rule set out in the Constitution of the Republic of Poland bans contracting loans and granting guarantees which would result in the public debt exceeding 60 percent of GDP. This is in line with protocol on the excessive deficit procedure annexed to the Maastricht Treaty. There are also specific rules that apply to debt issuance by local governments. These provide that the level of debt cannot exceed 60 percent of projected revenues and the level of debt servicing costs plus principal repayment cannot exceed 15 percent of such revenues. Although there is no formal fiscal limit, the EU Strategy and Growth Pact established that fiscal deficit target for the deficit cannot be higher than 3 percent of GDP.

**Poland needs to strengthen its efforts implementing an MTEF.** Work is needed on the three core pillars of the MTEF:

- top-down multi-year projections of resource envelope targets (what is affordable)
- bottom-up multi-year cost estimates of sector programs (what has to be financed, with a focus on performance)
- institutional (political-administrative) decision-making process to integrate the above two pillars (making the necessary trade-offs).

**Medium-term fiscal framework exists but fiscal targets are not legally binding.** Macroeconomic forecasts prepared in line with the Public Finance Act recommendations for the budget process (deficit and debt estimates for the budget year and subsequent two years,) along with revenues and expenditures forecast for the Convergence Program, provide a good basis for developing top-down resource envelope targets for budget chapters/line ministries. These estimates, prepared by analytical departments in MOF and National Bank of Poland, and reviewed by an independent panel of experts, are good quality and provide a sound departure point for further development of an MTEF.

**The deficit ceiling from the new Public Finance Act will not be fully binding.** There is a safety valve and in justified cases Government may adopt a higher deficit and explain it in detail in the justification to budget law. Such a deficit ceiling may prove ineffective, particularly in pre-election or election years when Government may want to inflate spending or both Parliament and Cabinet change and a new government may not treat the deficit ceiling as binding.

**Greater capacity is needed to produce reliable bottom-up forward estimates.** So far, line ministries prepare expenditure estimates for one year only which aren't subject to any kind of analysis or quality control by MOF. As long as expenditures were below the ceiling given to line ministries, MOF could not question or cut proposed programs. The obligation to prepare three-year expenditure estimates, together with a program framework for the budget document, is a good starting point for introducing forward estimates in the Polish budget system. However, as these estimates are not legally binding, not much attention is being paid to their quality. And there is no process for agreeing what is to be considered as existing policy for the purpose of their preparation, or for agreeing on parameters to be applied in the estimation process.

**A good process is needed for reconciling top-down and bottom-up elements of the MTEF.** This requires a strong link between policy formulation and the budget, as well as a good mechanism for prioritizing expenditure. It is the phase in which performance budgeting can greatly increase the effectiveness of the MTEF. When the reconciliation process reveals the need to cut expenditures, program budget closely linked to government priorities will help avoid cuts across the board and enable an intelligent reduction in spending. Poland started working on introducing program/ performance budgeting in 2006 and this element will surely be used once Government decides to fully introduce an MTEF.

#### **4. Performance-based Budgeting**

**Performance-based budgeting has been on the agenda in Poland since early 2006.** The initiative to introduce program framework to the budget is included in the most relevant strategic documents: *2007-2015 National Development Strategy*, *2008-2011 National Reform Program for Implementation of the Lisbon Strategy* and *2007-2013 National Strategic Reference Framework*. The Government elected in 2007 confirmed its commitment to continue with PBB reform and the program for its imple-

mentation was included in the Government Strategic Plan announced by the Prime Minister in February 2008.

**This reform was motivated by the EU which, in its assessment of the Polish Convergence Program, mentioned results-oriented budgeting as a priority for public finance reform.** Introducing PBB is a key support area of the Operational Program 2007-13 Human Capital. PBB is also regarded by authorities as a tool for better fiscal discipline. A new way of budgeting is recognized as necessary for the transition to a more economically stable and competitive economy. It's about creating good and efficient governance within the public sector.

**Reform started in 2006 and was coordinated by the Chancellery of the Prime Minister (KPRM).** A Special Department for State Performance Budget was established to develop the methodological framework and guidelines for performance budgeting. This department was supported by the inter-ministerial group of experts, mainly from MOF and the Ministry of Regional Development. After the 2007 elections this department was moved to MOF where work on PBB has since been coordinated.

**Methodological guidelines developed in 2006 are based on best international practice.** The Department for State Performance Budget was involved in international cooperation with countries already using a program/performance framework (France, the Netherlands, Slovakia) or on a similar level of development (Latvia, Bulgaria). Best practice examples were reviewed during the International Conference of Performance-based Budgeting: Lessons for Poland. This conference was organized by the KPRM in cooperation with the World Bank. A similar conference was held in Krakow in 2008.

**MOF is fine tuning methodological guidelines and concentrating its effort on making PBB work.** The schedule for PBB implementation (Table 15) says very little about the final shape of the framework but it sets major reform milestones for the next few years.

**PBB has been introduced in three phases: pilot programs, first operational budget 2008, and second operational budget 2009.** In 2006 KPRM prepared pilot projects of budget for 2007 using the program framework. New techniques were tested in budgetary sections devoted to the Ministry of Science and Higher Education, and budgetary parts Science and Higher Education were published in the justification to the budget law for 2007 in PBB framework. Initial versions of pilot projects were created in the Ministry of National Education and Ministry of Labor and Social Affairs.

Table 15. Schedule for PBB implementation in Poland (extract)

	Main Steps
2008	- Reviewing legislative changes necessary for PBB implementation - Initiating work on methodological guidelines for PBB
2009	- Final methodology for PBB implementation - Establishing guidelines for reporting in performance framework. - Preparing main IT system requirements
2010	- Preparing concept of monitoring in performance framework - Completing the first stage of work on reporting system.
2011	- Establishing performance indicators database - Completing second stage of work on reporting system - First trial of reporting and monitoring in performance framework
2012	- First performance-based budget for Poland for 2013 (in parallel with traditional budget) - Implementing guidelines for effective management of public funds via multi-year budgeting and comprehensive performance indicators database
2013	- Preparing methodological guidelines for program evaluations - Implementing IT system for PBB
2014	- First report on budget execution (based on budget in performance framework from 2013) - Evaluating 2013 performance budget
2015	- Reporting on the impact of performance budgeting on the public finance system

Source: Ministry of Finance, <http://www.MOFnet.gov.pl/index.php?const=5&dzial=1822&wy-sw=4&sub=sub2>

**The first operational budget was prepared for the fiscal year 2008.** It included many, but not all, of government's expenditure, activities and agencies<sup>77</sup>. At the time there was a two-level programmatic design of the budget structure: tasks and subtasks. The quality and specification of tasks and sub-tasks varied across spending agencies. It appeared the organizing principle underlying the selection of tasks was not entirely consistent because some ministries defined tasks partly on the basis of broad policy objectives and partly on the basis of existing programs of expenditure. This approach made it difficult for them to separate actual expenditures between these tasks for both budget appropriation and execution and reporting purposes.

**After responsibility for the reform was transferred to MOF, changes were made to the methodological framework of PBB.** MOF adopted a functional approach as a new methodology. Tasks were no longer placed

<sup>77</sup> The budget covered all ministries and central government offices, 19 special purpose funds and seven government agencies. It excluded 15 managers whose financial plans are included in the justification to budget act project (sacred cows). A simplified performance budget was prepared for the Ministry of National Defense, Central Anti-corruption Bureau, Foreign Intelligence Agency, and Internal Security Agency

in various budgetary parts. Instead they became building blocks in newly defined state functions<sup>78</sup>.

**Poland operates a four-level program classification framework.** It includes division into functions, tasks, subtasks and activities:

- Function is the highest level in the new PBB architecture and groups expenditures with certain areas of government activity. There are 22 government functions. The classification is not entirely in line with COFOG methodology. The functions were derived from the structure of government administration as specified in the Polish law.<sup>79</sup>
- Tasks group expenditures with common objectives.
- Subtasks are operational.
- Activities comprise key steps in achieving the objectives of tasks and subtasks. This level was created to avoid very detailed specification of subtasks and ensure budget transparency.

**Program classification is independent and functions in parallel to the existing section-chapter-paragraph budget classification.** The four-level design of the program budget is just enough to ensure adequate accountability and control. More work is needed to clearly define functions and tasks. This will help stabilize the programmatic framework and ensure analysis of budget expenditures and their impacts are comparable over time. Some matters are yet to be addressed, e.g. the approach to intersectoral responsibilities for overlapping tasks, and performance accountability in entities where responsibility is delegated to special agencies.

**Budget for 2009 was prepared according to the new methodology.** Budget managers submitted expenditures in program framework along with performance measures and targets, and presented MOF with three-year spending estimates. Coverage of the budget increased in relation to 2008 and covered central government. Only sensitive institutions (defense, intelligence etc.) prepare performance budgets in a simplified framework.

**Following the change of government in 2008 MOF took the lead in the reform process.** Until then, the Chancellery of the Prime Minister was responsible for managing and funding the design and development phase of PBB. The move to MOF was a step in the right direction but

organizational changes in MOF since then appear to have stalled reform efforts.

**As well as inclusion in broad strategic documents, PBB is incorporated into the Public Finance Act.** Amendments to the Public Finance Act were introduced in December 2006 establishing a legal requirement for budget managers to present their spending in program framework. Justification to the budget act has to specify tasks with planned expenditure and defined objectives, indicators and multi-year expenditures for tasks (Article 124, Public Finance Act). The report on the execution of budget law must contain information on the realization of tasks, expenditure with description of objectives, indicators and multi-year expenditures.

**Amendments enable development of the performance budget but don't show the importance of these changes.** The light nature of current regulations gives authorities managing the reform process a great deal of flexibility. It also reflects a 'try before you buy' attitude<sup>80</sup>. The Public Finance Act doesn't specify how and where the new budgetary structure will replace existing categories and procedures and nor does it specify a date by when PBB is to be adopted.

**Further regulations are needed to firmly establish PBB.** New legislation is needed to specify performance budget coverage in relation to various types of government organizations; make changes to budget documentation; allow for a new financial control framework and changes to the budget classification and accounting systems. Additional regulations are needed to standardize methodology and procedures around the design of tasks and sub-tasks, and the role and monitoring of performance indicators, multi-year expenditure planning etc<sup>81</sup>.

**Performance targets and indicators are, generally, defined bottom-up.** The budget circular obliges budget managers to define performance targets for tasks and subtasks. Sometimes there are methodological consultations with MOF or (inter)national experts. However, there are no methodological guidelines for preparing performance indicators. Line ministries rely on internal knowledge and experience from other countries. Moves to make the entities responsible for achieving targets define those targets and their performance indicators have been criticized<sup>82</sup>, but this approach has support. Internal setting of performance indicators cre-

<sup>78</sup> Allam M. *The Development of Performance Budgeting in Poland*, (2008), draft version

<sup>79</sup> Webber D, op.cit.

<sup>80</sup> Misiąg W., 2007, *Performance-based Budget for 2008 and what is next? (Budżet zadaniowy na rok 2008 – i co dalej?)*, Public Finance Bulletin, IBnGR.

<sup>78</sup> Current budget structure is explained in the chapter: Budget Presentation and Classification

<sup>79</sup> Law on Central Government Sectors of September 4, 1997 (Art. 5 ustawy z dnia 4 września 1997 r. o działach administracji rządowej (Dz. U. z 2007 r. Nr 65, poz. 437 oraz z 2008 r. Nr 12, poz. 20)).

ates better accountability within the relevant ministry which has the best sector knowledge.

**Quality of performance indicators varies across budget managers.** More effort is needed to develop proper performance indicators. Some indicators used so far are difficult to define, some are not measurable, and in a few cases, there is no baseline value for indicators. In other cases target value was below the baseline. Much public discussion is around performance indicators when more attention should be given to putting in place the best possible program structure.

**There is no integrated database for collecting and analyzing performance indicators. Nor is there an efficient information system to make them fully usable.** Performance indicators are presented only in documents in the justification to the Budget Act. There is no proper mechanism for collecting, analyzing and verifying performance information. This makes the whole exercise artificial and useless. Government expects to cooperate with statistical units in line ministries, and the Central Statistical Office, to establish an integrated framework for performance information.

**Poland is in the early stage of developing PBB.** The country acknowledges the need to manage for results and has increased transparency and accountability of its budget system. Although it is still undecided what it will look like, performance budgeting will soon be in place.

**The key challenge now is to improve the program structure** by aligning it better to Government's strategic policies. Only then will it serve its purpose<sup>83</sup>.

**A proper monitoring and evaluation system is needed.** Performance-based budgeting can't function without a firm monitoring and evaluation (M&E) system. Performance information doesn't always answer questions about a program and good quality evaluation is essential for efficiently allocating resources.

## 5. Budget Presentation and Classification

**Good budget documentation increases budget transparency.** PBB increases transparency of the budget system, showing clearly what public money is spent on, but of budget documentation. This has a lot to do with the existing budget classification and the level of IT development.

<sup>83</sup> Current practice to submit the budget in performance framework two weeks after traditional budget indicates shows PBB is still treated as secondary and, perhaps, as a purely mechanical exercise.

**The performance budget is generally well presented.** Budget justification, added to the budget act for 2008 and the draft of the budget for 2009 in a performance framework, is more transparent and easier to understand. Breaking expenditures down into tasks and subtasks, with key performance targets and indicators, provides much more information than the traditional line-item budget. However, information submitted by particular budget managers still show a need for quality control, particularly in defining performance indicators and targets. Various experts and economists welcomed the Government's initiative to introduce performance elements to the budget but at the same time they expressed the urgent need for further improvements<sup>84</sup>.

**PBB is not yet included in core budget documents.** Making PBB an integral part of budget law is an important first step but its current inclusion in the justification to the budget act is not its final place in budget documentation. The budget justification for 2008 has 12 chapters. One of these chapters is devoted entirely to PBB. It includes a short description of PBB as a budgeting method and key features of the Polish system as well as program breakdown of expenditures along with desired outcomes, measures and target values.

**Guidelines on presenting PBB are needed.** While it undecided what to include in standard budget documentation, international best practice suggests emphasis should be put on explaining Government's expenditure policies and objectives and how the task structure supports these. More attention could also be given to identifying new policies in the budget, including their specific objectives and costs. Performance budgets should establish clear links to strategic plans and explain how the expenditure tasks and subtasks contribute to achieving broad strategic goals.

**Program classification plays only an auxiliary role in traditional budget classification.** PBB has not brought changes to the existing budget classification and MOF does not intend to change the classification in the near future. The Department of Performance Budget in the Central Statistical Office, which helped prepare the program structure, will ensure the existing framework is compatible with traditional line-item budget and international statistical standards.

**Current budget documentation shows expenditures in line-item classification.** Poland operates on a four-level budget classification: parts, sections, chapters and paragraphs.

<sup>84</sup> Misiąg W., op.cit.

- Part (część) corresponds to an administrative classification (organizational)
- section (dział) is similar to a functional classification
- chapter (rozdział), in some cases, corresponds to an organization or program
- paragraph (paragraf) is a line item in the economic classification.

**Current program classification is not supported by the IT system.**

Government plans to create an integrated IT system to support budget documentation but work is yet to start. According to the revised schedule, the system should be in place by the end of 2013. When it's complete, the IT system should support programmatic structure and standardize and modernize other aspects of the financial reporting process. At present central state administration units (line ministries and their underlying budgetary units) are decentralized. Most of them have their own IT and accounting systems, later entering information from these into the centralized TREZOR system. This is an inter-system interface connecting the NBP system with the central budget, making possible an online correlation between pending payment orders and State Budget cash availability. TREZOR works at first and second levels but is expected to later include all sub-national entities. Because the system is being implemented in stages, information flows are currently both paper-based and electronic. TREZOR is not an integrated accounting system so budgetary reporting, in line with current budget classification, is based on aggregated information as entered periodically by budget managers, usually monthly. Information available from TREZOR relates to actual transfers broken down by main budget paragraphs according to cash requirements. A fully operating program classification structure would improve budget analysis and create performance indicators to strengthen monitoring and make public expenditures more efficient. High priority should be given to ensuring public budget units use accounting software that meets current standards, e.g. for security and access, and facilitates on-line reporting to MOF in a format that consolidates data and documents audit trails. MOF needs to set medium and long-term objectives to develop an integrated financial accounting system, allowing the central treasury system to draw directly on electronic accounting data from all public budget units' accounting systems.

## 6. Public Management Performance Culture

**There is no regular monitoring and evaluation of programs.** Poland is still in the very early stage of reform and little attention has been paid to establishing a formal mechanism for linking M&E systems with the budget process. Line ministries rely on their internal monitoring systems. Government has concentrated efforts on designing program structure and setting performance targets and indicators rather than strengthening the M&E framework. Successful implementation of PBB must go beyond performance indicators. As Robinson put it, "indicators rarely tell the whole story. They need to be put in context. And if a program is not delivering value for money, they do not answer the really vital question – can the program be salvaged by, say, redesign? Or should it simply be cut out? It is for this reason that evaluation linked to the budget process is now enjoying resurgence".

**Civil servants are administrators rather than managers of spending programs.** The public/civil service is not based on an accountability framework. Much more effort goes into design and preparation of legislative initiatives than operation of the program. Performance budgeting reform requires a lot of support from the public administration and a capacity to change. This is a critical success factor.

**The structure of the public administration is not well suited to the concept of managing for results.** The whole public sector is dispersed over numerous and largely autonomous entities with no managerial supervision. There is limited cooperation between central and local government, and across and within line ministries.

**Civil servants are unused to performance evaluation and need to change the way they think about working in the public sector.** Performance-based budgeting puts public servants into the role of service providers to the public. And performance targets and indicators serve as a basis for their evaluation. Getting ministry staff to be more client-focused is a challenge. Meeting it will require design and implementation of systems that provide reliable and timely feedback from clients, as well as an organizational culture that values feedback and employs it to continuously improve services to those clients. It demands an organizational culture that rewards achievements of agreed objectives and encourages all staff and units to learn from their mistakes and engage in continuous improvement.

**The quality of the civil service must be upgraded.** Its performance management culture is underdeveloped and future civil servants are unaware of modern management systems. Greater capacity in this area is needed. MOF is aware of the problem and has initiated a massive training effort. Training for public administration (both managerial and operational) is co-financed from EU structural funds<sup>85</sup>. The main purpose is to introduce higher standards of public service and improve policy design and implementation. Training is organized by the Warsaw branch of EIPA and focuses on PBB best practice with practical guidelines for preparing budget documents in a performance framework for the 2009 budget.

**When capacity is enhanced, retaining and motivating high quality staff becomes a challenge.** This issue is related to the management of human resources in the public sector. A worrying feature of recruitment is that most new entrants don't see the public sector as a long-term career but rather as a stepping stone to better prospects in the private sector. Retaining staff demands attractive incentives. The current salary system is complex and opaque. Major distortions exist in the salaries paid by different ministries. The promotion system is non-merit based, discretionary and non-transparent. The overall human resource system lacks strong central control and, while some ministries are better than others in this respect, leadership is weak, modern techniques of management are lacking, and not enough resource or management time is devoted to personnel issues. All of this tends to reduce staff motivation. Chronic politicization of the system affects staff quality, particularly at senior levels.<sup>86</sup>

**Strong top-down leadership will engage civil servants.** Only when staff understand the reform process and accept it as one of Government's top priorities will their opposition weaken. Civil servants have to see benefits in the reform. If they don't, the reforms will not succeed.

<sup>85</sup> European Social Fund, Human Capital, Priority 5: Good governance

<sup>86</sup> *Public Administration Reform and Capacity in the EU-8. Poland – Background Paper*, 2006, The World Bank

## SLOVAKIA

Ján Marušinec

### General Assessment (Summary)

Slovakia made good progress in budget system reforms within a short time (2003-2005). Changes were driven by the need to decrease the fiscal burden on the economy (deficit, revenues, and expenditures) and the MTEF and PBB served as tools for accomplishing this goal.

The MTEF has been an integral part of the budget process since 2005, covering the budget year and two following years. Only budget year allocations are adopted by Parliament as a binding constraint within the budgetary process. Technically, a mix of line-item budgeting and PBB is used to prepare expenditure projections. Line ministries are given clear expenditure ceilings at the beginning of the budget process and are responsible for explaining their budget proposals within those limits. A separate reserve is used for financing Government priorities and this is disbursed during budget negotiations in Cabinet in September. This reserve, though relatively small, distorts the medium-term focus of line ministries. The MTEF, particularly the binding nature of out-years, needs to be stronger.

Slovakia chose a decentralized approach to PBB. Line ministries are responsible for designing their program structures, including goals, objectives, and measurable indicators. MOF gives them methodological and practical support. PBB currently covers all central government activities and from 2009 will cover regional and municipal self-governments.

PBB has dramatically increased budget transparency although implementation results vary from one line ministry to another. Program structures are yet to be fully used to design and cost Government policies which causes inconsistencies in Government's agenda. A performance management culture is still missing. Communication between budget and policy departments within line ministries is poor and there is no comprehensive education system for public employees. Performance pay is possible, although limited to some extent by the Civil Service Act. Flexible procurement methods are still under-used.

The Public Finance Management Reform (PFMR) project, financed by the World Bank (WB), made fiscal policy more predictable and credible and can be considered a success, mainly on the central budget planning level. But it brought limited progress at the micro management level although it has made budget documentation more transparent and im-

proved accountability of program managers (line ministries and agencies). Monitoring and evaluation (M&E) need to be stronger.

A separate PFMR project was prepared and launched in cooperation with the WB to systematically address all major shortcomings in the budget system. Political commitment to change, leadership and support of the Minister of Finance were critical success factors, as were a robust IT system, good methodology, and committed MOF officials.

The speed of reform had a negative impact. The rapidity of change, insufficient training and lack of preparation among policy sections in line ministries highlighted cracks in the PFMR project implementation. The budget system became quite complex and it needs to be simplified (especially the system of classifications) if progress is to be sustained.

Better results might have been achieved with more careful phasing in and a lot of pilot projects. PBB needs to be further refined and the budget system simplified. A training program for line ministry staff would help spread the performance management culture throughout the bureaucracy.

The key to success is offering stakeholders a trade-off. If changes bring new tasks and challenges, old tasks should be redesigned or removed to avoid overload. Focusing on technical preparation and especially the classification system, IT support, and presentation format of the budget are important and staff will see the benefits. If there is a clear vision, finding allies will be much easier.

## 1. Core Features of Current Budget System

**Slovakia is a parliamentary republic. Its Cabinet is formed from several coalition parties gaining the majority of votes in Parliament.** Usually three to four parties form the coalition so a Coalition Board (an informal political body) is created to resolve important or sensitive political disputes before they are discussed in Cabinet or Parliament.

**Traditionally, MOF coordinates the budget process.** It starts by preparing a macroeconomic and revenue forecast, and submits the first draft budget – called Starting Points – for discussion in Cabinet. After discussion and/or approval by Cabinet, MOF sends an expenditure ceiling to line ministries and asks them to prepare detailed budget proposals. MOF collects these and runs a series of budget discussions with line ministries. MOF then compiles a draft budget and submits it to Cabinet. Following Cabinet approval, MOF send the final budget draft to Parliament for discussion and final approval.

**Line ministries are autonomous in their resource allocations.** MOF gives them total expenditure ceilings and some binding constraints (wages, capital expenditures, EU resources, co-financing). They set up their program structures, allocate expenditures to various programs, break them down into different required classifications and send their budget proposal to MOF. Discussions are held with MOF before the final draft budget is approved by Cabinet. They later defend their budget proposals in parliamentary committees.

**Cabinet discusses the Starting Points in April and usually adopts a decree governing further details of the budget process,** setting the deficit and debt targets for the general government budget, and indicating expenditure ceilings for individual line ministries. In September Cabinet discusses the draft budget in several rounds. Usually, the Coalition Board is involved in these discussions because the budget is always politically sensitive. After all disputes are settled, Cabinet adopts the draft budget by a decree and sends it to Parliament for final approval.

**Parliament discusses the draft budget in committees and in plenum.** The committees also discuss the budget proposals of individual line ministries and may recommend the plenum adopt changes to them. After discussion in plenum, Parliament adopts the budget (annual budget law covering only central government) by simple majority voting. Because the budget is discussed and political agreements are already reached in the Coalition Board, Parliament usually passes the budget without any major amendments.

**The key piece of legislation regarding the budget system is the Act No. 523/2004 Coll. on Budget Rules of the Public Service (Budgetary Rules Law).** This came into force on January 1, 2005 and governs deadlines in the budget process. The budget year is the same as the calendar year. Starting Points have to be submitted to Cabinet for discussion by April 15 and the draft budget before August 15. After discussion and approval by Cabinet, the final draft budget has to be submitted to Parliament before October 15. All other practical issues of budget preparation process are governed by Cabinet decrees (early decree on Starting Points) or MOF guidelines (budget call circular).

**Budgetary Rules Law also reflects Government decisions to implement medium-term and program budgeting.** It defines the budget as a mid-term economic policy instrument, set up for a three year period. It also includes the requirement to set expenditure ceilings for government programs, as well as goals and objectives. Evaluation of these should be a

part of the closing account of the line ministry. Slovak Budgetary Rules Law was influenced by OECD best practice on budgeting. Requirements of ESA95 methodology were also given a priority in the revision of the Act. Currently only minor amendments, related to EU structural funds, subsidies, and use of capital expenditures are considered.

**Traditionally MOF played an influential role in the budget process and still does.** This is visible in the budget execution phase during which MOF can change individual allocations for line ministries without Parliament approval, as long as they don't exceed the overall deficit. The President, Prime Minister and the Minister of Finance have no special budget powers. The Minister of Finance has only one vote in Cabinet and cannot effectively veto proposals with unsustainable fiscal impact. His or her informal power within the political hierarchy is crucial, as is the role of MOF and its position in the budget system.

## 2. General Progress on Budget Reform

**Major changes in the budget system occurred between 2003 and 2005,** supported by the World Bank financed Public Finance Management Reform (PFMR) project. These changes focused on creating compatible and modern public finance management processes based on EU and OECD best practice. The PFMR project included the following key elements:

- strengthening MOF's macro-analytical and fiscal forecasting capacities
- enhancing capacity for coordinating Slovak fiscal policy with the EU and matching fiscal reporting requirements
- implementing and improving multi-annual budgeting
- implementing and improving program budgeting
- strengthening institutional capacity for budgeting (in the above mentioned areas)
- qualification support for the State Treasury staff and its full integration into the public finance management system
- improving debt and liquidity management through a new institutional set-up.

**Within PFMR, MOF's position as guardian of fiscal stability has been strengthened** although the focus of its activity was narrowed by the reforms. A lot of decision making power was delegated to line ministries (binding indicators in the appropriation were reduced), increasing their

accountability for sound financial management. MOF now focuses on overall fiscal developments rather than on micro managing the budget.

**Budget coverage has improved dramatically since 2003.** With the 2004 budget, across-the-board implementation of program budgeting made information provided to Parliament and the public much more comprehensive. With the 2005 budget, Slovakia shifted to a two year budget in its full complexity (all classification used for all three years). Despite the fact that figures for the outer years aren't legally binding, everybody considers the limits as a starting point for the next year's budget negotiations. Only minor amendments based on changes in the macroeconomic framework and high level political decisions are done to out-year projections.

**A new classification was introduced with program budgeting making it a more demanding task.** Traditional classifications remain but have been reshaped to reflect ESA95 methodology. Slovakia now uses four types of revenue and seven types of expenditure classifications. The complexity of the coding required a change in IT support for budgeting. Two major systems provide data for budgeting purposes: Budgetary Information System and State Treasury System. A separate system manages EU funds.

**State Treasury and a Debt and Liquidity Management Agency were established to centralize the financial flows of public institutions.** This brought a new quality to monitoring budget execution and substantial savings related to debt financing. Hand in hand with these changes, budgeting transparency and accountability have improved. Reform also brought a new approach to financial control and sanctioning mechanisms. Subjective approaches – such as capacity for granting exceptions and excusing violations of financial discipline – were avoided in the new legislation. Also, emphasis is no longer solely on disciplinary sanctions but on increased education of officials.

**The National Control Office (local SAO) gives Parliament its opinion on the budget and the closing account,** focusing on performance data provided by MOF and line ministries. An internal audit function has been introduced and is being continuously strengthened under MOF oversight. Monitoring and evaluation of program performance is being prepared and will start operating during 2008-2009.

**In the early stages of PFMR, MOF's budget departments were observers only of the changes.** Since the moment of the MTEF and PBB implementation, these departments opposed the changes and this prompted a reorganization of MOF. Its budget section was restructured and tradi-

tional budget departments (aimed at financing line ministries) were replaced by two – one analytical department to work with line ministries and independent public agencies, and another to compile data and formulate the general government budget. These two departments became leaders of the reform process. Their role has been formalized in the MOF Statute and MOF's budget section became the methodological centre for budgeting.

**To successfully implement the changes, MOF established a cross sector working group of senior officials** responsible for financial management in line ministries and agencies (covering all government activity). This group was led by MOF's general director of the budget section. Institutional and methodological issues were discussed by this section before they were fully implemented. The group didn't have a formal status although members were appointed by particular ministers or heads of agencies. The group was soon abandoned because of resistance from several line ministries but a piloting approach was introduced before changes were legalized. Pilots were selected not by sector but by the willingness of particular line ministries to cooperate.

**Line ministries' opposition was two-fold.** First, some budget departments in line ministries thought the changes were being implemented too quickly and, second, officials weren't ready for them. This was partially true because everything was done in a hurry. A new approach, piloting the changes before their full implementation, gained MOF allies in several line ministries.

**A necessary step was to convince line ministries' policy sections to change internal procedures to match the budget system changes** and take over responsibility for the financial management of their programs. This reform is yet to happen in many line ministries. Only some pilot ministries have complied with the new PBB financial management requirements.

**Slovakia took ownership of PFMR project while the World Bank acted as project coordinator.** There was a clear top-down approach to changes within the PFMR, although the details of their execution were prepared in a bottom-up way. Politicians motivated civil servants with their willingness to change and gave them sufficient freedom to come up with specific solutions. Political commitment to reform the budget system was important and gave the necessary institutional changes credibility. MOF demonstrated how the changes could happen, an example followed by several line ministries.

**Changes were implemented largely because of a commitment to reduce the excessive fiscal burden** on the economy (e.g. decrease the deficit and debt) and the level of overall taxation and public expenditure. The MTEF and PBB were good tools for accomplishing these high level political goals. This fiscal consolidation was driven by pressure from outside and by Slovakia's ambition to enter the Euro zone and meet Maastricht criteria.

**PFM reforms were championed by the Minister of Finance who was also the deputy chairman and the economic leader of the strongest coalition party.** His willingness to move forward on the reform path, combined with his informal influence within his party and Cabinet, brought about many changes. Until then discussion of these changes had been restricted to a small group of experts. Reform was driven internally, technically prepared and executed by MOF staff, with help from external consultants.

**For political reasons, reform activity slowed down a year before the elections in 2006 and has remained slow.** The new Government has focused on different priorities, failing to give PFM due regard as a key element of successful public management. The Minister for Finance is no longer the Deputy Prime Minister and informal power in Cabinet has shifted to other line ministries, mainly from the social sector. MOF's commitment remains strong but the changes had an effect on policy coordination. MOF's reform agenda is now focused on technical changes in accounting and tax administration.

### **3. Adopting Medium-Term Expenditure Frameworks**

**Slovakia started implementing an MTEF relatively early in the reform process.** The MTEF began as a separate document discussed by Cabinet each April and gave a brief overview of the macroeconomic and fiscal forecasts (revenues, expenditure, and deficit). It had no binding nature, nor did it discuss alignment of priorities and budget allocations. The MTEF covered three years (the budget year and two following years). Its implementation was independent of PBB although it was helpful to have the MTEF present when government programs were formed and allocations determined.

**Since 2005 the MTEF has been an integral part of the budget with a detailed budget prepared for three years instead of one.** It is revised annually on a rolling basis and adjustments are made according to changes in macroeconomic predictions and political decisions. A full three year

budget is presented to Parliament although only the annual budget law is adopted by voting. Allocation limits for out years are not legally binding although their adoption by Cabinet establishes them as the starting point for the next year's budget discussions. Regulations concerning the MTEF preparation are covered by the Budgetary Rules Law.

**The MTEF is used a fiscal policy management tool.** MOF sets detailed revenue and expenditure ceilings for lined ministries, prepared within the MTEF. These ministries are obliged to prepare their budget proposals within these limits. Exceptions are special purpose funds (Social Insurance Fund, Healthcare Insurance Companies, National Property Fund) and self-governing bodies outside the direct control of central government (regional and local self-governments, public media). MOF uses projections of their budget proposals for the consolidated budget but cannot directly influence their budget decisions.

**With the MTEF an integral part of the budget, all government agencies are involved in its preparation.** MOF's macro and fiscal forecast unit – the Financial Policy Institute (FPI) – is responsible for preparing the underlying macroeconomic and tax revenue prognosis and setting total deficit and expenditure ceilings in line with actual economic development. Forecasts are updated three times a year and, before they are published, are subject to discussion by macroeconomic and tax committees. Representatives of the central bank, academy, commercial banks and financial market take part in these discussions.

**Afterwards, the budget section, in close cooperation with the EU relations section, prepares the budget Starting Points and sends it to Cabinet for discussion,** usually at the end of March. Starting Points is a document containing macroeconomic and revenue (tax and non-tax) forecasts, deficit targets, and expenditure framework, for the budget year and three following years. It covers all government activity

**After the Starting Points are approved by Cabinet, MOF informs line ministries of their expenditure ceilings** and, by end May, line ministries provide MOF with their budgets. MOF analyses the draft budgets and in June/July negotiates them line ministries. The final budget is adopted by Parliament at the end of the (calendar) year.

**Institutional capacity for performing the MTEF tasks is concentrated mostly in MOF** where staff have undergone a series of education programs. Six major line ministries gained support, and strengthened capacity, within the PFMR project. While other line ministries are getting

support from MOF staff, they need more methodological and institutional support.

**MOF's Financial Policy Institute uses standard forecast models for macroeconomic and tax revenue projections.** An in-house model for non-tax revenue forecasting was developed by its budget section. Predictions of the expenditure side of the budget depend either on macroeconomic variables (social or unemployment benefits) or discretionary decisions of Cabinet (certain subsidies, wage rises). Generally, inflation adjustment is used for other expenditure items (goods and services, investment expenditures).

**A non-allocated reserve, not higher than 3 percent of total budget spending, is set aside for political priorities which are determined later in the budget process** (during discussion of the draft budget by Cabinet and Coalition Board in September). This reserve is disbursed before the budget is submitted to Parliament but it can be kept in the medium-term budget for the out-years. Sensitivity or risk analysis is not currently used in Slovakia.

**Theoretically, medium-term expenditure projections prepared by line ministries in their budget proposals provide the same level of detail as the current year's budget.** The same classifications are applied and the same level of detail is provided, as in the case of the budget year. The reliability of the data, however, varies between line ministries. Some line ministries with sound internal financial management procedures provide detailed and reliable data on all programs (Ministry of Labor and Social Affairs, Ministry of Interior); some provide only inflation-adjusted expenditure forecasts (mostly agencies with administrative character – Presidential Office, Parliament Office etc). The reason for such variation is the uneven distribution of human capacity across line ministries and, sometimes, limited access to training and education. Another factor is line ministries' reluctance to disclose future policy decisions to MOF and/or the public. Despite this, the MTEF is relatively stable and this is due to MOF's strict oversight of expenditure planning in line ministries.

**Expenditure forecasts are revised annually and the limits for out-years within the MTEF aren't legally binding.** These revisions are managed by MOF and all adjustments have to be justified either by a change in macroeconomic variables or by a political decision taken by Cabinet or Parliament. Estimates are fine tuned twice a year, following revision of macroeconomic and revenue forecast prepared by FPI. Expenditure limits are politically binding and respected by line ministries. Cabinet discusses,

although does not formally adopt, expenditure ceilings for out-years together with the budget.

**The biggest benefits of the MTEF are visible at the central budget planning level.** Overall fiscal predictability and credibility have improved dramatically. Before PFM reform, and the MTEF in particular, were implemented, the general government budget deficit wasn't targeted and the fiscal outcome was known only after the fiscal year was over. The MTEF, together with other measures, now allows for effective fiscal targeting for the general government budget. This has substantially improved fiscal discipline and resulted in better fiscal performance with lower borrowing costs for the Government.

**The MTEF has led to better financial management in line ministries although the results are not as clear as they are in central government.** It was not unusual for budget expenditures to be over run by some line ministries with poor fiscal planning in several public agencies led to accumulated debt. Now, line ministries comply with expenditure ceilings although adjustments to the budget (reallocations between line ministries) are still frequent during budget execution. Formal rules, however, limit the extent of adjustments that can be made to the budget after its adoption.

**Linking strategic policy preparation with the budget is a challenge for the future.** It requires better fiscal impact assessment when preparing key strategic policies. The World Bank recommends that Slovakia strengthen the binding nature of the MTEF and make out-years binding. According to recent amendments from 2009 the carry over of unspent capital expenditures was restricted to two subsequent years.

**The non-disbursed reserve allocated each year according to political decision remains a big challenge.** Compared with the total budget it is not a big amount (less than 3 percent) but it distorts line ministries' medium-term focus because when they prepare their budget proposals, they take into account the possibility of extra money from this reserve. When the budget is submitted to Cabinet, some important policy areas are under-financed because of line ministers' tendency to rely on their political influence to get additional resources from the reserve fund. Sometimes they ask for non-discretionary expenditures from this reserve while in their budget proposals they plan for discretionary expenditures.

#### 4. Performance-based Budgeting

**PBB has been introduced gradually since 2000** driven by the Finance Minister's reform minded approach and the necessity to institutionalize a tool for improving public spending efficiency. An aim was to maintain or increase the quality of public services at lower cost.

**At the Minister's request, a US Treasury adviser was assigned to work on this** and (two) staff from the budget section was dedicated to help him. They were isolated from real execution of budget policy but during a short period of time were able to prepare a basic methodology and build awareness among the key players. In 2001 the first four pilot chapters (Ministry of Education, Slovak Academy of Sciences, Supreme Court, and Constitutional Court) prepared their budgets for 2002 based on expenditure programs. In 2002 another six line ministries joined the exercise for the 2003 budget. Understanding of the programs was limited, however, to time-limited government activities, mainly related to EU structural funds management.

**When the Government changed in 2002, the new Finance Minister continued to support the idea and stepped up preparatory work for full PBB implementation.** In 2003, MOF was restructured and its budget section departments took the lead in driving PBB related changes. With political support and resources within the PFMR project (human and financial), the necessary institutional and legal adjustments were soon implemented.

**Since the 2004 budget, all 34 budget chapters (line ministries and other government agencies) apply a full program structure.** Major revision of Budgetary Rules Law was passed in 2004, including institutionalization of PBB. New methodology on PBB was published and implemented in 2004, establishing a logical framework for the program structure. A major revision of existing programs, goals and objectives reduced duplication. The budgetary information (BIS) and State Treasury IT systems were reshaped to support new program classification. A manual on M&E was prepared in 2007 and today MOF is working on implementing it.

**Since PBB was introduced, the quality of budget preparation and oversight has improved significantly.** New ways of classifying expenditures brought more clarity and transparency to the budget. MOF, and Cabinet and Parliament, and the general public, can now concentrate on fostering greater efficiency of public spending. This is indeed happening during budget negotiations with line ministries, where program structures are actively used to support the arguments of both sides. There were no

major objections during implementation, apart from opposition by several line ministries. Current discussion (Parliament and public) is aimed at Government goals and objectives presented in the program budget. This means any objections are about content and not method.

**PBB neither replaced nor supplemented the traditional budget.** It is simply a new way of presenting budget data in budget documentation, providing policy makers with additional information. Traditional line-item budgeting methodology and program budgeting methodology are used at the same time. The BIS effectively connects both kinds of budgets. Since 2006, the State Treasury has provided data on budget execution in the program structure. All other classifications have been preserved and the budget is still, on request, presented in different classifications. The program book is a separate document from the text explanation of revenue and expenditure development in the budget document.

**With regard to fund allocation, the leading classification is organizational.** For each entity and line ministry a limit is developed (based on costing methods and expenditure indexation) and broken down into major economic categories – wages, capital expenditures and the rest. EU resources and their co-financing are earmarked by MOF. Programs are developed by line ministries and include goals, objectives and measurable indicators. The line ministry is responsible for further break-down of given limits into all the classifications available, to the lowest level of detail. This work is supported by the BIS provided by MOF.

**There are three levels in the program budgeting system – programs, sub-programs and elements/projects.** Currently, there are 95 programs in Slovakia, a few of them multi-ministerial. Line ministries can, but are not required to, form sub-programs and elements/projects under the programs. Element is a time-unlimited part of a program, while project is time-limited. Specific objectives are required at the lowest level of detail but, usually, higher levels have strategic objectives or goals. Objectives and goals differ. An objective has a specific value (short- or long-term, output or outcome), and a goal describes a desired change or result. Each objective must have a measurable indicator (at least one) assigned to it. More than one indicator is allowed to measure the progress of accomplishing objectives.

**The logical framework of a program structure is coherent and can be used across various government agencies.** It allows for demonstrating how a ministry wants to intervene and achieve certain socio-economic objectives. It also enables resources used for this intervention to be linked

with intended results. Some line ministries still don't follow best practice and lack clear motivation to do so.

**Generally, the architecture allows line ministries to form strategic policy within the logical framework of programs.** They can set goals, strategic objectives and specific objectives and assign measurable indicators to them. Line ministries also allocate resources for accomplishing those goals and objectives. In many cases line ministries use the program structure to actively plan their policies although this is not the case across the board. Some line ministries still use the program structure in a rigid and formal way, forming strategic policy separately from budget programs.

**Traditionally, policies were adopted by Cabinet in the form of decrees, where policy objectives were stated, but there was no direct link between those objectives and the budget.** The MTEF and PBB have changed this and policy should now, ideally, be prepared in line with the program structure and budget allocations. There is a methodology for preparing materials for Cabinet discussion. This includes a part on policy costing although the quality of materials with budgetary impact prepared by line ministries and discussed by Cabinet varies.

**Some line ministries use PBB to develop policies and cost the prepared programs with their objectives accordingly.** Others use it only as a formality and still rely on the willingness of Cabinet to adopt policies that are neither costed nor properly reflected in their programs. MOF, as an important hub in the inter-ministerial commenting procedure, is putting a lot of emphasis on using the program structure to design and cost policies, and to keep them only within the scope of the budget envelope. Like any other minister, however, the Minister of Finance has only one vote in Cabinet.

**Indicators were defined from bottom-up but several rounds of discussions took place between the policy owners (line ministries) and MOF.** After these discussions MOF prepared a comprehensive guideline on setting objectives and measurable indicators. This guide is now publicly available and gives helpful examples of good and bad practices. There are 675 output indicators in the budget for 2008 and 631 outcome indicators respectively. The mix of output and outcome indicators is not spread evenly across line ministries. Some of them tend to use output indicators while some prefer outcome indicators. Only a few ministries use a comprehensive mix of both types. The quality of objectives and indicators is probably currently the weakest point of program formulation.

**OECD and other internationally used indicators were used to set up a monitoring framework of major Government policies.** Domestic data was also used for policies where international comparisons were unavailable and, on a lower level of the program structure, to support high level objectives. These indicators have different data sources, the main one being the Statistical Office. The final list of indicators was reviewed by MOF to ensure quality. Further improvements are made annually during budget discussions. An independent audit of indicators – preferably by the National Control Office (local SAO) – is yet to be done.

**The quality of objectives and performance (achievement of planned results) varies across different line ministries.** The quality of performance can be attributed mainly to how well targets were defined (exaggerated or underestimated) rather than program management.

**In the early stages of PBB implementation a decision was made not to reward or punish good or bad performance.** This decision was aimed at gaining line ministry support for the changes. If they thought they would be punished for poor performance, their opposition would have been greater. Program performance is monitored through the BIS twice a year, although monitoring is performed by the policy managers themselves. Monitoring of program performance is required as a part of the closing account and line ministries are obliged to submit monitoring results to MOF, Cabinet, and the respective parliamentary committee. Further development of M&E is underway and, in the near future, should enable Government to apply incentives for good performance.

**Central government was the first public sector entity to introduce PBB.** From 2009 regional and municipal self-governments will be obliged to prepare their budgets using the PBB approach. This may be a problem for smaller municipalities (there are almost 2900 municipalities in Slovakia). Some targeted funds (Social Insurance Fund, health care insurance companies) are using PBB because they are legally required to do so. Line ministries responsible for complex sectors (like education and health) set strategic objectives in their program structures for policies they can influence only indirectly, through their regulatory activity.

**Various implementation results can be tracked in complex sectors.** Because of their decentralized nature and private service provision, education and health care are complex sectors. Education is a good example. It has clear goals and objectives, developed centrally, and financial flows are designed to motivate different areas to achieve desired results. Health care, on the other hand, is a poor example because the Ministry of Health

was unable to define high level goals and objectives and financial resources are disbursed without any link to performance.

**Sectors with a lot of independent agencies executing Government policy (transport for instance) can be managed well** by the program structure if the goals and objectives formed at the top level are well defined and the flow of money gives them the right incentives to achieve them. The Ministry of Transport in Slovakia still focuses on output indicators rather than outcomes which doesn't make best use of PBB's potential.

**If a government policy has a multi-sectoral character, multi-ministerial programs are created to cover the tasks of different line ministries or agencies.** A lead ministry is always appointed to oversee a program. This ministry is responsible for achieving goals and objectives and for monitoring and evaluation. Other line ministries or agencies act like program participants, creating sub-programs with goals and objectives referring to the overarching program goals. The performance of multi-ministerial programs varies significantly from one program to another. In some cases, where the lead ministry puts pressure on participants, the management of multi-ministerial programs seems free of problems. But there are cases where the program exists only to cover expenditure in a certain area (economic mobilization for instance); it is poorly managed and failing to bring about measurable results.

**Two major sources of problems in PBB implementation can be identified:**

- Lack of political commitment, mainly from line ministers, has reduced the quality of program structures in several line ministries. Ministries, where top management supported PBB reform, prepared well structured and technically sound programs, objectives and indicators.
- The extent of the change and the speed of implementation created reluctance on the part of some line ministries' middle-management, largely because they lacked capacity. Policy sections' involvement also proved sensitive and difficult. Better prepared and more sensitively phased-in changes in budgeting procedures, supported by formal training program for budget officials, would probably have brought better results.

**Legislation and methodological guidelines covering PBB include:**

- the Budgetary Rules Law
- MOF's methodological handbook on program budgeting

- manual on formulating goals, objectives, and measurable indicators
- manual on monitoring and evaluation of programs.

**Slovakia now operates an almost fully fledged PBB system.** There are some weaknesses in its operations although all the essential building blocks of its application are in place. Program costing lags behind the countries with best PBB application practices but is at a sufficient standard. The program's weaknesses are, first, in program performance evaluation and feedback for policy making, which are being addressed, and second, encouraging greater responsibility and accountability among program managers.

**In the first years after implementation, Slovakia operated a PRB system. It is now somewhere between PIB and PBB (since 2005-2006).** PBB is still perceived as a tool for strengthening institutional management rather than fiscal discipline and there has been no major progress on its implementation since 2005. Many M&E projects started in 2006 are still running. Overall, the current situation can be described as stagnation. The causes are reform overload from the previous period (2003-2005) and a lack of political commitment. If the situation doesn't improve there is a slight risk of reform reversal. The focus needs to shift to simplifying the current system and building capacity in the public administration – particularly in policy sections – to cope more easily with the changes.

## 5. Budget Presentation and Classification

**Budget documentation relies on data provided by the Budgetary Information System (BIS)** which is the core of budget management. Based on data from this system, analytical comments are provided in budget documentation. These follow separate classifications, mainly organizational and economic (traditionally). An annex is prepared to show the full extent of the program budget and published as a separate book with all programs, their parts, financial allocations, goals, objectives and measurable indicators.

**Since 2003, the quality of documents and analysis has improved significantly.** 2005 was the first year in which the budget was published in this new structure. Since then only minor revisions have been made to the template which provides all the necessary information. Unfortunately it is written in a style, and with a lot of tables and charts, that makes it difficult for a non-informed reader to understand. Attempts have been made to

publish a citizens' guide to the budget (in 2004) but lack of public interest quashed this.

### **Slovakia operates seven classifications in its budget system.**

- **Economic** classification of revenues and expenditures is standard with GFS guidelines although it doesn't yet fully reflect GFSM 2001. Adjustments have been made to incorporate ESA95 standards.
- **Functional** classification of expenditures is based on COFOG and has two additional levels for detailed tracking of expenditures. This level of detail became obsolete when program classification was introduced but is still used for statistical purposes.
- **Organizational** classification of revenues and expenditures aligns with Government structure – line ministries and agencies – and includes their budgetary and subsidiary organizations.
- **Type of budget** classification determines the type of public entity in the consolidated general government budget (one level above the state budget).
- **Program** classification of expenditures has three levels: programs, subprograms and elements/projects. It covers the state budget and three of the remaining state funds and, from 2009, will be used by regional and local self-governments although they will develop their own program structure.
- **Source of funds** classification tracks the financial means coming from the EU through the Government budget. It also distinguishes national co-financing of EU resources.
- A **Register of Investments** which separately codes all capital expenditures into several categories of projects. This classification is suitable for merging with the program classification but a detailed analysis hasn't been prepared and no decision has been made to do so.

**IT support for budgeting was crucial to the program's success.** The Budgetary Information System (BIS) proved a tremendous help in the budgeting reform. It has been developed gradually as the complexity of the budget system increased. All methodological changes were reflected immediately in the architecture of the system and the user interfaces. It is a powerful tool for focusing line ministries' attention on complying with MOF methodology and expenditure ceilings. The IT system supports all classifications and can sort data according to user needs. Pre-defined and

random views can be exported to various formats (PDF, MS Excel etc). Being a multi-modular program it allows not only for budget preparation but also execution (automatic data transfer with the State Treasury System is ensured on an on-line basis) and monitoring of the budget and administration of classifications (ledgers, automatic bridge tables etc).

**The budget system at present is too complicated and without further work there is a risk of reform reversal.** Simplifying the budget system and especially the currently used classifications would help budget managers. Unofficial discussions are underway about integrating some classifications but ideas haven't been presented to MOF management. Reducing workloads and avoiding data entry errors might be the first results of the budget system simplification and would lead to wider acceptance of the PBB culture. Focus could be shifted from formal compliance to strategic thinking. And simplification could be supplemented with targeted training to help line ministries with their program structures and expenditure planning procedures.

## 6. Public Management Performance Culture

**Slovakia doesn't yet have regular evaluation of program performance.** Generally, the M&E function is weak. A separate project aimed at addressing this shortcoming was conducted during 2006-2007 with 19 pilot evaluations produced, a training system designed, and more than 100 civil servants trained. Several line ministries were involved in this project. The organizational set-up of M&E is determined by Government and three options were considered:

- evaluation cells in line ministries coordinated by MOF
- coordination by the National Control Office
- integration of M&E tasks with line ministries' internal audits.

When PBB was introduced, a decentralized approach was taken for managing M&E but the methodology is coordinated centrally.

**The role of the National Control Office (local SAO) in the PBB framework implementation is important.** In the beginning NCO was passive and reluctant to change its methodology for external audits. Since PBB reforms were implemented, NCO's position has changed and it started to catch up with MOF activities. The PBB methodology was discussed with NCO and MOF provided several training courses for NCO auditors.

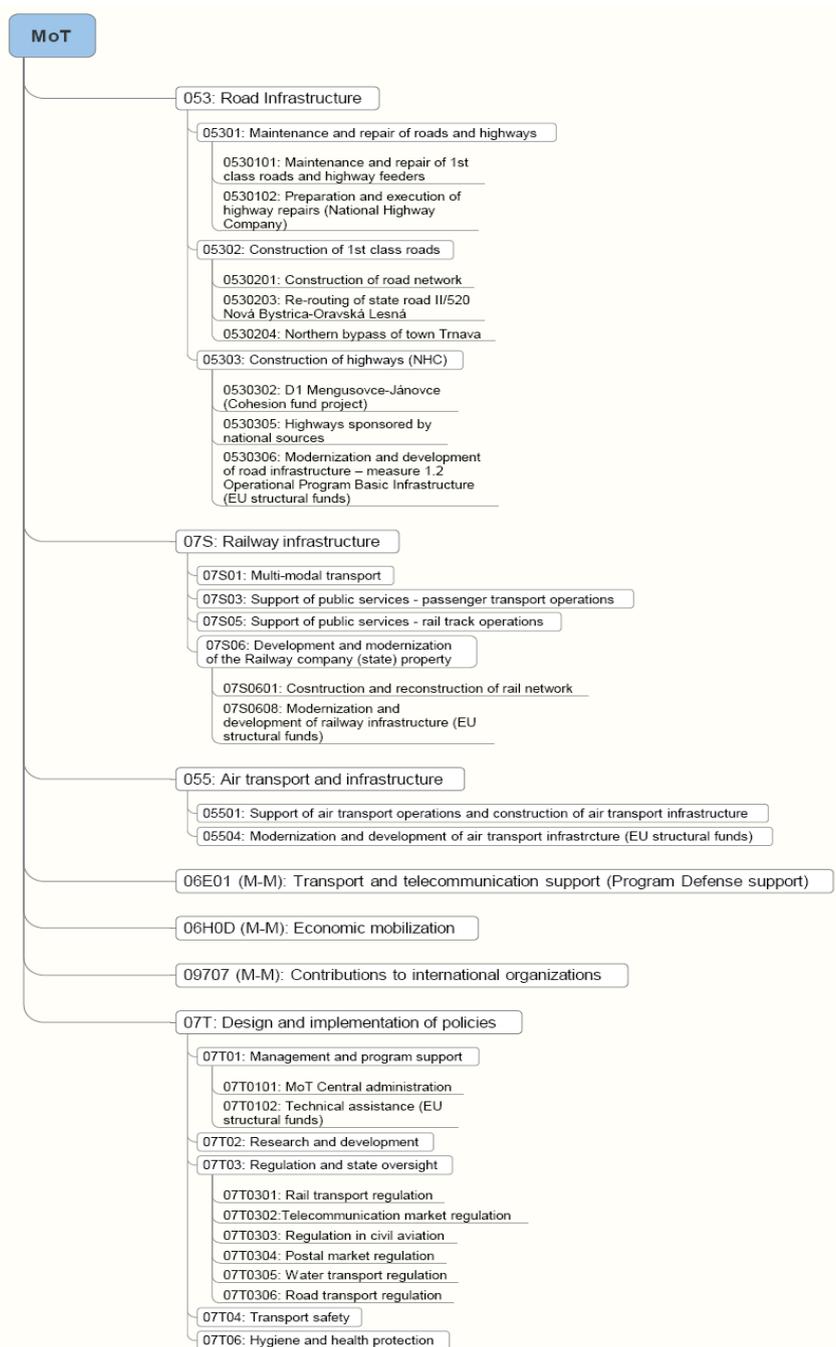
**NCO is an independent body responsible for external audit and control of public entities. It provides Parliament with its opinion on**

**their budget proposals and final accounts.** It also publishes reports on its findings which can be sector specific or topic based. Several audit reports on the quality of program structures and performance data of particular line ministries have recently been produced. Methodology for performance audits, however, still needs to be developed and implemented.

**Although PBB has caught on among key players (staff in MOF and line ministries' budget departments), a performance management culture hasn't.** Policy departments only partially understand the PBB concept. Traditionally they have focused on designing policy design and ignored its budgetary implications. This is an internal problem in line ministries but MOF can help address it with targeted education for program managers.

**Public sector employment and remuneration systems were reformed in 2004** to better reflect individual performance but the new system is quite rigid. Remuneration is based on position and age rather than performance. Further reform of the civil service (remuneration system and flexibility in employment contracts) is needed to fully benefit from the PBB culture.

**Public procurement procedures have been modified to meet EU standards and allow for a certain level of discretion among public servants.** Modern methods of procurement (electronic, joint procurement, auctions etc.) are still rare but efforts are being made to use them more frequently.



Source: Bank staff based on national documentation.

## TURKEY

Mediha Agar

### General Assessment (Summary)

In the 1990s, leading up to the 2001 economic crisis, a fragmented budget and ineffective fiscal accountability mechanisms in Turkey's public sector contributed to large fiscal imbalances. Fiscal policy was outside policy makers' control and a fragmented budget made both maintenance of fiscal discipline and management of fiscal risks difficult. Multiple layers of inspections and internal controls were ineffective but provided incentives for agencies to establish off-budget flows to evade controls. This further fragmented the budget. Extensive off-budget activities made it difficult to estimate and therefore manage the full extent of government finance and expenditure.<sup>87</sup>

Past pre-crisis periods (1994, 1999 and 2001) were characterized by large public sector borrowing requirements, due to a sharp increase in public wages, widening of social security deficits and transfer of expenditures, including to state banks.<sup>88</sup> State banks kept accumulating so-called 'duty losses' incurred as they funded government programs and provided subsidized lending to certain borrowers. With limited public information about the extent of these duty losses, and the widespread perception that they constituted a contingent government liability, the sustainability of public debt came into question. Large off-budget expenditures or so-called extra-budgetary funds (EBF) added to concerns about fiscal sustainability.

Until 2001, PFM in Turkey was dominated by an outdated legal framework (Public Accounting Law dated 1927). A multitude of extra-budgetary funds and revolving funds seriously jeopardized budget discipline. A plethora of control and inspection agencies focused on compliance rather than ensuring effectiveness of management and control systems. The Turkish Court of Account (TCA), Turkey's supreme audit institution, was limited by its restricted mandate; it didn't cover the entire public sector and its scope was confined to conformity audits only. General government institutions lacked uniform accounting and reporting and a chart of accounts that could be readily consolidated. Accounting was cash-based; PFM systems were unable to capture expenditure arrears and government assets and liabilities, including contingent liabilities.

<sup>87</sup> Underlying public sector structural and management issues were analyzed in the 2000 and 2003 CEMs and the 2001 PEIR

<sup>88</sup> Transfer to state banks was in the form of either capital injection or duty losses

The 2001 economic crisis provided the impetus for policy-makers to comprehensively address economic, social and structural issues, including PFM. In response to the 2001 crisis, Turkey adopted a new medium-term macro-economic program and launched a renewed structural reform program in December 2001.<sup>89</sup> The renewed program incorporated a three-pronged strategy to achieve macroeconomic stability supported by improved social cohesion:

- macroeconomic policies to restore fiscal stability and growth, and aggressively support the disinflation process
- structural policies and institutional reforms to address the financial sector and weaknesses in the PFM system
- enhanced social dialogue with increased emphasis on protecting the most vulnerable groups.

Accordingly, public sector reform since 2001 has focused on achieving the significant fiscal adjustment required to underpin macroeconomic stabilization, while simultaneously addressing underlying structural/institutional weaknesses. There has been significant progress on both fronts.

A major effort at modernizing Turkey's fiscal institutions was undertaken after 2001 and supported by the World Bank (WB) and the IMF. Two background documents laid the grounds for legislative, institutional and systemic reform initiatives – the Special Ad-hoc Committee report on *Restructuring the Public Financial Management and Fiscal Transparency-1999* prepared by the Government in the context of the Development Plan and *Public Expenditure and Institutional Review-2001* prepared jointly by Government and the WB.

Following these documents, the two main pillars of renewal were the Public Finance and Debt Management Law (PFDML) adopted in 2002 and the Public Financial Management and Control Law (PFMCL) adopted in 2003. Both have been framed along best practice. The PFMCL aimed to thoroughly restructure public expenditure management by consolidating all government fiscal operations in an integrated approach, from preparation to execution and ex-post monitoring of the budget. The law provided the legal framework for reforming the budgeting process, including:

- broadening the scope of financial management and fiscal control
- extending coverage of the budget and financial accounts to all sectors of government in accordance with international standards of national accounting (SNA93, ESA95)

<sup>89</sup> Supported by an IMF Stand-by Arrangement (SBA) and the Bank's Programmatic Financial and Public Sector Adjustment Loans (PPSALs)

- introducing Medium-Term Program and Medium-Term Fiscal Plans covering three years
- a new, more comprehensive budget classification (including functional and institutional classification) system for the budget
- starting a shift from input- to performance-based budgeting which embraces strategic planning
- transferring responsibility for internal financial controls and auditing from MOF to line agencies
- a formal legal schedule and calendar for budget preparation, implementation and monitoring processes.

There is more to be done. What's needed is greater commitment to fiscal transparency, better links between programs and budgets, alignment of fiscal reforms with other public administration reforms (in areas like civil service reform) and a better equipped external auditing system.

## 1. Core Features of the Current Budget System

**The multi-institutional nature of Turkish economic policy making is a key aspect of the budget system.** MOF (budget preparation, revenue policies and fiscal control), the State Planning Office (macro plans and investment policies) and the Under-secretariat of Treasury (cash and debt management) are the central control agencies with varying degrees of responsibility, during the budget process. The High Planning Council and Cabinet act as ultimate political decision makers for the final shape of the budget. Public Procurement Agency and State Personnel Office determine procurement policies and policies for civil service recruitment. The Turkish Court of Accounts is the external audit institution acting on behalf of the Grand National Assembly.

**Division of labor between the three economic management institutions demands close coordination. This is important for policy making which requires strong political leadership for improved coordination among central control units.** The role of the State Planning Office (SPO) on investment planning and the investment budget and the Under-secretariat of Treasury (UT) on debt and cash management, forces MOF to cooperate closely with them. Although the division of responsibilities is regarded as a weakness in the structure of budget organizations, it provides useful checks and balances against undue expenditure demands.

**Two key pieces of legislation – Public Financial Management and Control Law (PFMCL) and Public Finance and Debt Management Law**

(PFDML) – regulate the budget process and financing of government entities. PFMCL governs the main provisions of the Turkish budget system. It regulates the structure and functioning of public financial management, preparation and implementation of public budgets, accounting and reporting of all financial transactions and financial control. This ensures accountability, transparency and the effective, economic and efficient collection and use of public resources. The Minister of Finance has discretionary powers to govern budget implementation. PFDML lays the principles of debt and asset management which are acquired during the budget process. It also sets borrowing limits for financing the budget deficit. It regulates debt and asset management and contingent liabilities between central government and local authorities and other public entities.

**Civil Society plays a minor role in budgetary decisions although there is growing interest in budgetary issues and monitoring.** Because of the budget's complexity, and limited budget literacy, the general public cannot easily participate in budgetary decisions at national and local levels. This attitude is changing and NGOs and think-tanks are keeping a closer eye on budgetary matters and, gradually, taking a more active role.

**Various international assessments (IMF, WB and OECD) show the Turkish Budget System is on the right track but more needs to be done.** These assessments show that, with implementation of PFMC law, the budget system has been well-designed and strengthened but work is needed to re-assess budget classifications to improve PBB efficiency and the quality of parliamentary debate on the budget.

## 2. General Progress on Budget Reform

**Turkey has initiated a number of programs to reform its financial management system.** In 1995, in the context of World Bank-financed Public Financial Management Project (PFMP), some steps were taken to streamline and improve the budget process particularly in the areas of budget classification and cash management. A lack of political and bureaucratic interest limited its success but two documents pushed for reforms:

- During preparations for the 8th Year Development Plan in 1999, a special ad hoc committee was established with participants from Government (most of who also participated in PFMP), academia and NGOs. This committee issued a report called *Restructuring of Public Financial Management and Fiscal Transparency* which

identified major weaknesses of the system and proposed a number of steps to correct them.

- In 2001, a Public Expenditure and Institutional Review (PEIR) was prepared jointly by WB staff and Turkish counterparts, most of who also participated in PFMP and ad hoc committee work.

**The relative success of budget reforms after 2001 can largely be attributed to the 2001 crisis and EU processes. The two policy documents mentioned above created an impetus for policy makers to address economic, social and structural issues, including budget reform, in a comprehensive manner.** The PFMC Law and Public Finance and Debt Management Law benefited from the recommendations of these documents. The 2001 financial crisis, which had links with the weak public financial management system, helped raise awareness of the need for a better budget system. Accession to EU helped to speed up the process and reform-minded officials championed the work. External dynamics also played an important role.

**Enactment of the PFMC Law in 2003 provided a new legal framework for modern public expenditure management and accountability.** Objectives of the new PFMC Law are to improve the quality of public service delivery, enhance government functions and increase public sector accountability and transparency. The law introduced strategic management by:

- linking plans and policies with the budgets
- initiating institutional strategic plans and performance budgets
- introducing medium-term fiscal framework into the budgeting process.

The law strengthens the link between the responsibilities of officials and politicians and their accountability to the public. It also improves public expenditure and financial management processes in line with international practices. A number of systemic reforms have been implemented to support these new management concepts. These include a Government Financial Statistics (GFS) compliant budget classification, an online budget management information system, an online networked accounting system for the central government, and an IT based tax management system.

**Reforms in this area sought sustainable fiscal adjustment as well as greater budgetary transparency. Lack of these is regarded as the ultimate source of the crisis.** The reform program expanded coverage of the budget to all central government institutions and adopted international standards – IMF's GFS classification – of budget classification to enable

economic, functional, and institutional breakdown for the entire government. It:

- abolished all budgetary funds, with the exception of the Support Price Stabilization Fund (DFIF), and all but five EBFs (i.e. the Social Solidarity Fund, the Defense Fund, the Promotion Fund, Savings Deposit Insurance Fund (SDIF) and the Privatization Fund)
- increased credibility of the budget formulation by introducing medium-term program and fiscal plan
- enhanced transparency by disclosing information on detailed fiscal balances of EBF, local administrations, social security institutions, and revolving funds as an attachment of the budget submitted to Parliament
- eliminated the ex ante control function of MOF and TCA, transferring this authority to line agencies
- developed automated Online Public Accounting System (Say2000i) for the entire central government
- moved gradually from cash-based to accrual-based accounting.

**These legal and institutional reforms aimed to strengthen fiscal policy creating a more strategic role for MOF** which now plays a more critical role in the overall design of fiscal policy. However, this necessitates better coordination between MOF, SPO and UT. MOF was restructured to ensure it carried out its duties, assigned by PFMC law, effectively and efficiently. Four departments responsible for central harmonization have been established under the General Directorate of Budget and Fiscal Control. An Internal Audit Coordination Board, which has an inter-ministerial structure, has been established. To increase efficiency and ensure standardization of implementation among public administrations, budget units affiliated to MOF were closed and Strategy Development Units established in administrations.

**Lack of awareness and limited commitment in public administration hindered reform management. But thanks to the facilitating role of training, seminars and informative meetings organized during the reform process, the new methods and structures gradually introduced by the reform have been adopted.** Budget reforms were mostly prepared within MOF, SPO and the Treasury. Spending units were usually taken on board after legislation had been passed which created a feeling of isolation and made internalization of the reforms by others difficult. But it has been observed that other departments have felt obliged to adopt the new envi-

ronment and mostly for two reasons. First, many reform areas (strategic planning, multi-year budgeting, internal control and audit) were made legally binding, and second, departments found strategic planning exercises a useful way to improve and/or advance their institutional identity. Training sessions and seminars facilitated the process.

### **3. Adopting Medium-Term Expenditure Frameworks**

**An MTEF has been operating since 2005 and is being adopted as part of broader reform of public finance management.** Reform toward the MTEF has been a key component of the reform initiative, with MOF and SPO taking the lead. The MTEF in Turkey involves two documents. These include several important elements of an MTEF, such as a medium-term fiscal policy statement (including expenditure ceilings and three year fiscal plans) prepared by MOF, and a medium-term plan including priority areas and macroeconomic indicators to be used by spending departments) prepared by SPO. SPO also developed guidelines for line ministries to design their own strategic plans. The legal basis of the MTEF is PFMC Law, marking a key initiative in strengthening fiscal planning and public finance management.

**The MTEF provides for a three-year rolling expenditure framework for broad categories of spending.** The medium-term economic plan, to be approved by Cabinet by May 30, includes forecasts of macroeconomic variables for the next budget year and two following years. By June 15, the Minister of Finance issues the three year medium-term fiscal plan to be approved by High Planning Council and based on the medium-term plan. These documents comprise:

- a forecast of the medium-term macroeconomic situation and macroeconomic targets such as inflation, growth, balance of payments etc (Medium-Term Economic Plan)
- sectoral policies and priority areas (Medium-Term Economic Plan)
- medium-term fiscal policy objectives of Government (Medium-Term Fiscal Plan)
- forecast of revenues in the medium-term (Medium-Term Fiscal Plan)
- expenditure ceilings for the spending departments (Medium-Term Fiscal Plan).

In July, the Minister of Finance issues to the public an updated current year fiscal policy outlook (Mid-year Fiscal Update).

**A system of strategic planning was introduced in 2005.** Strategic planning is expected to allow for formulation and prioritization of policies and link them with budget decisions. The system has been introduced gradually, first for local authorities and then for central government units. Introduction should be completed in 2009. While it is too early to comment on results, the initial experience of local authorities suggests that linking strategic goals with the budgets has been problematic (see below).

**The MTEF is still largely based on incremental budgeting.** PBB, strategic planning and an MTEF have been introduced as interrelated components of financial management reform. The MTEF was expected to provide macro fiscal discipline by providing top-down expenditure ceilings while strategic planning and PBB provided efficiency and effectiveness in resource management under those ceilings. Ensuring links between plans, programs and budgets will take time. As is the case in a number of developing countries, it is easier to add new policies than to remove old ones. For the time being, spending ministries regard the MTEF as kind of rough guideline for preparing budgets. They are yet to link their strategic plans to their budgets. PBB may be a useful tool to help them do this.

**Practice at the local level indicates that strategic plans have not been formulated within an overall budget constraint. This may impede reform.** A successful MTEF helps and requires decision makers to balance what is affordable in aggregate against national policy priorities. The MTEF comprises a top-down resource envelope, a bottom-up estimation of current and medium-term costs of existing policy and ultimately the matching of these costs with available resources. In Turkey, strategic planning is fully operational at local administrations and experience suggests that strategic plans are being developed without guidance from indicative medium-term resource envelopes at the mayoral level. As a result, strategic plans have not been realistically fitted in the overall fiscal framework of local authorities. It is necessary to bear this in mind and more closely monitor the links between strategic plans and budgets at central levels. Another risk factor might be that budget expenditures can be carried forward with little concern for scrutiny and rationalization of existing policies even through the use of strategic planning.

**The MTEF is not geared towards providing fiscal rules.** Expenditure ceilings in medium-term fiscal plans aren't legally binding and are

subject to change with rolling years added every year. MOF recently announced in the Medium-Term Fiscal Plan covering 2009-2011 that it would implement fiscal rules but failed to announce any detailed statement to that effect.

#### 4. Performance-based Budgeting

**Program based budgeting has been introduced in broader public finance management reforms.** Transition to performance-based budgeting (PBB) studies have been made widely available in central government and social security institutions in accordance with the 'transition to strategic planning calendar' and in local administrations in line with their own legislation. Provisions regarding PBB have been included in primary and secondary legislation and a *Guide for Performance-based Budgeting* has been prepared by MOF. Rather than a big bang approach, public administrations phased in PBB. The transition period began in 2006 and will be complete by the end of 2010.

**The architecture of the budget and accounting system includes economic, functional and institutional expenditure classifications without any program structure.** The GFS consistent budget classification is new and Government is considering how best to integrate the program structure within the current budget classification in the short term. Whether or not a transition from current budget classification to program based budget classification is necessary for effective implementation of PBB in Turkey is still being discussed.

**The motivation behind the PBB approach is the legal requirement for restructuring public financial management and control system.** The basic approach which leads to the adoption of PBB has the following familiar logic prevailing in all modern budget reforms:

- macro fiscal discipline (i.e. top-down budgeting MTEF expenditure ceilings)
- strategic priorities (strategic planning)
- efficiency and effectiveness (performance-based budgeting) when implementing the budget.

The first item has been discussed and supported by bureaucrats. The second has been a fashionable concept (visions, missions, institutional identity, targets etc) which seemed attractive to spending departments. PBB has been the subject of rhetoric rather than actual implementation but once all these basic principles have been made legally binding both institutional capacity and fiscal discipline will be stronger.

Since the PBB is in a transition period and not fully operational it is too early to assess the system in detail. The PBB model in Turkey has been built on a structure comprising strategic planning, performance budgeting and accountability reports. Consistency is sought between the performance objectives listed in performance programs and the goals and objectives listed in strategic plans. Performance programs prepared every year in the budget process include strategic goals and objectives, performance objectives, performance indicators, activities and projects of the administration concerned. MOF has issued a *Performance Program Preparation Guideline* to help administrations determine their indicators, in compliance with the standards, principles and examples included in the guide. Since each public administration determines its performance indicators individually, no relevant standard is in place and practices among administrations vary. For all these reasons it is too early to comment on the overall success of PBB in Turkey.

## 5. Budget Presentation and Classification and Public Management Performance Culture

**Budget documentation enriches and provides information on the various aspects of budget and the MTEF.** Core budget documents include medium-term program, medium-term fiscal plan (MTEF), package of draft central government budget law and explanations, and debt management report by UT and investment program prepared by SPO. The complete budget documents are submitted by MOF following approval by Cabinet, to the Grand National Assembly in mid October. In the year following implementation, administrations publish and publicize their accountability reports where their performances and activities realized in the previous year are evaluated. A General Accountability Report records the performances and activities of all administrations within the scope of central government. This is publicized and submitted to the Turkish Grand National Assembly by MOF, making the Turkish budget system more transparent and accountable.

**Turkey has a well established IT system to monitor budget accounts and statistics.** A new budget classification system, in compliance with GFS 2001, has been operating since 2004. In line with the mentioned classification, budget proposals are received over an e-budget system managed by MOF and budget appropriations are monitored by this system. Budget implementation results are accounted for and reported by means of an IT system called SAY2000i. These two systems are compatible and provide consistent information. They provide an integrated and cen-

Annex 2. Program structure in Transport – Turkey 2008

Example: 2008 Performance Program of General Directorate of State Highways

STRATEGIC GOAL	Road and Traffic Safety				
STRATEGIC OBJECTIVE	Accidents with deaths and injuries caused by highways will be lessened at the ratio of 40 percent in five years.				
PERFORMANCE OBJECTIVE	40 percent of the works as placement of horizontal and vertical signs as well as fog lightening on the dangerous points of roads completed in 2008.				
ACTIVITIES AND PROJECTS	(t-2) 2006	(t-1) 2007	(t) 2008	(t+1) 2009	(t+2) 2010
Road maintenance and repair services	8.080.000	9.400.000	9.450.000	9.363.500	9.881.675
Administrative services	104.052	44.835	58.990	60.644	63.344
Traffic Safety Project	250.000	500.000	600.000	400.000	600.000
Total Resource Requirement (YTL)	8.434.052	9.944.835	10.108.990	9.824.144	10.545.019
PERFORMANCE INDICATORS					
Traffic accidents with deaths due to dangerous points where drivers are alerted with horizontal and vertical signs	8	4	10	12	10
Number of foggy places where fog lightening is provided	1	1	1	3	3
Decrease rate of accidents with deaths	ND (no data)	ND			
Decrease rate of complaints received from citizens	ND	ND			

Source: World Bank staff, based on national documentation.

trally monitored on-line accounting system covering all general government institutions.

**Improving public management culture requires time and effort.** This cultural change is in the development stage in Turkey. To spread the reforms to all public administrations, and ensure their sound implementation, progress is needed in areas such as human resources through training, workshops and seminars. Increasing administrative capacity and support from senior management is also critical for successful implementation.

**Civil service reform is necessary to improve public management performance culture.** Civil service reform should go hand in hand with PBB, particularly in regard to measuring and awarding personal performance. Turkey needs to consider shifting from life-long employment

to contracted personnel status. Trade unions, staff representatives and NGOs need to be engaged in the process if the whole reform process is not to be undermined.

**Effective application of public finance management reforms demands greater capacity.** Experience suggests that MOF needs to invest more in building staff capacity for evaluating line ministries' strategies and budget requests, developing methodology for program and performance budgeting, and effectively using performance information in the budget process. Closer links between performance information and decision making and budget allocations are also needed.

Annex 3. Main macroeconomic and fiscal indicators in Emerging Europe

		Bulgaria	Latvia	Poland	Slovakia	Croatia	Turkey
<b>Real GDP growth, %</b>	<b>2005</b>	6.2	10.6	3.6	6.5	4.2	8.4
	<b>2006</b>	6.3	12.2	6.2	8.5	4.7	6.9
	<b>2007</b>	6.2	10.0	6.8	10.4	5.5	4.5
	<b>2008</b>	6.0	-4.6	5.0	6.4	2.4	1.1
	<b>2009F</b>	-6.5	-18.0	1.0	-4.7	-5.2	-6.5
<b>CPI, %</b>	<b>2005</b>	6.0	6.9	2.1	2.7	3.3	8.2
	<b>2006</b>	7.4	6.6	1.0	4.5	3.2	9.6
	<b>2007</b>	7.6	10.1	2.5	2.7	2.9	8.8
	<b>2008</b>	12.0	15.3	4.2	4.6	6.1	10.4
	<b>2009F</b>	2.7	3.1	3.4	1.5	2.8	6.2
<b>Current account balance (% of GDP)</b>	<b>2005</b>	-12.4	-12.4	-1.2	-8.5	-5.7	-4.6
	<b>2006</b>	-18.5	-22.7	-2.7	-7.0	-6.7	-6.0
	<b>2007</b>	-25.2	-21.6	-4.7	-5.3	-7.6	-5.8
	<b>2008</b>	-25.5	-12.6	-5.5	-6.5	-9.4	-5.7
	<b>2009F</b>	-11.4	4.5	-2.2	-8.0	-6.1	-1.9
<b>Gross External Debt (% of GDP)</b>	<b>2005</b>	70.9	99.4	44.1	58.2	71.8	35.2
	<b>2006</b>	81.9	114.0	46.6	50.9	75.1	39.2
	<b>2007</b>	100.2	127.6	48.2	54.7	76.8	38.4
	<b>2008</b>	107.7	128.2	56.7	55.2	84.1	38.1
<b>General Government Balance (% of GDP)</b>	<b>2005</b>	1.9	-0.4	-4.3	-2.8	-3.5	-0.6
	<b>2006</b>	3.0	-0.5	-3.9	-3.5	-3.0	0.8
	<b>2007</b>	0.1	-0.4	-1.9	-1.9	-2.5	-1.0
	<b>2008</b>	1.5	-4.0	-3.9	-2.2	-1.4	-2.2
<b>Public Debt (% of GDP)</b>	<b>2005</b>	29.2	12.4	47.1	34.2	38.3	52.3
	<b>2006</b>	22.7	10.7	47.7	30.4	35.7	46.1
	<b>2007</b>	18.2	9.0	44.9	29.4	33.1	39.4
	<b>2008</b>	14.1	19.5	47.1	27.6	33.5	39.5

Source: Eurostat. For 2009, International Monetary Fund, World Economic Outlook (WEO), October 2009.

## Annex 4. Questionnaire for World Bank Country Economists

David Webber

### Introduction

The purpose of this questionnaire is to help World Bank country economists in the countries selected for this study<sup>90</sup> to undertake a comprehensive stock-take of the implementation of some major budget reforms in their respective countries. The particular focus of this study is on the progress made by these countries in introducing Performance-based Budgeting (PBB) and Medium-Term Expenditure Frameworks (MTEF) as discussed in the Concept Note.<sup>91</sup>

The questionnaire has been developed, in part, to ensure consistency and coverage in the research undertaken in each of these countries. Nonetheless, in making their assessments, it will be important for WB economists to use both the questionnaire and their own judgment in seeking out what has been achieved, or not achieved, in these countries, and why. In other words, the questionnaire should be used as a guide to gathering the kind of information on which to base well-informed comparative assessments which will be interesting and potentially useful for others working in these areas of budget reform. The principal focus of the questionnaire on the above two major areas of budget reform should not lead economists to exclude analysis and discussion of other potentially important and related steps in budget modernization in their countries.

The questionnaire should be used in conjunction with the general 'template' that the task team leader has designed for presentation of information and analysis that will underpin the budget reform assessments in each country. Both the questionnaire and the results presentation template, however, have been developed to cover all six countries; it is fully expected that some sections of both documents will have varying relevance for each country, based on what they have achieved and the type and quantity of information available.

Remember that the study does not set out to present a detailed account of what each country has achieved in these areas of budget reform for references purposes. That would be become dated very quickly. Nor is it a PEFA-type assessment. Rather, we are concerned to understand what has been achieved in the context of how successfully, or unsuccessfully,

each country has managed these budget modernization aspects of the transition process. The picture this provides should be directly helpful in determining where and how to assist further, not only with these countries but with others who may be contemplating developing their public financial management systems along similar lines.

<sup>90</sup> Bulgaria, Croatia, Latvia, Poland, Slovakia, and Turkey.

<sup>91</sup> "Current Issues in Fiscal Reform in Central Europe and the Baltic States 2008: Performance-based budgeting (PBB) and medium-term expenditure frameworks (MTEF) in Emerging Europe – *From Diagnosis to Remedy*", Concept Note, December, 2007,

## Questionnaire

[Questions *in italics* were sent to national counterparts]

### Section 1: Core Features of Current Budget System

(1 page)

- 1.1. *What is the general political and administrative structure governing budget preparation? Provide a brief description of the key agencies and their roles and responsibilities in the annual budget process. Include briefly at what stage, and with what responsibilities, the parliament is involved.*
- 1.2. *What are the key pieces of legislation relating to the Budget? In addition to citing the relevant legislation, include description of key sources or influences on this legislation, when it was passed, and any notable provisions with regard to any PBB or MTEF requirements (including any relevant proposed amendments under consideration.)*
- 1.3. **Are there any unique political or cultural factors which influence the structure and implementation of the budget system?** This may include the roles of particular institutions, the part played by civil society, any special budget powers of the president or prime minister etc.
- 1.4. **Have there been any international assessments made since 2000 of the quality and transparency of the budget system; such as OECD Budget Survey, IMF Fiscal Transparency, CFAA, PEFA, or PEIR,?** Describe briefly any major strengths or weaknesses that were identified and whether any changes have been made as a result.

### Section 2: General Progress on Budget Reform

(1-2 pages)

- 2.1. *Have there been any major programs or initiatives undertaken in budget reform in recent years? Consider also whether these initiatives have been sustained, variable, and/or influenced by elections or other political factors over time.*
- 2.2. *What progress has been made so far in terms of the adoption of specific new methods for improving the budget processes? List/describe what are clearly the main achievements of budget reform to 2008. This may include institutional reforms, changes to budget coverage, struc-*

ture and presentation, classification, reporting, accounting issues, incl. IT system(s), transparency improvements, better fiscal control, enhanced internal and external audit, etc.

- 2.3. **What has been the motivation for this reform process?** Consider also whether there has been a champion for the reforms, the role and impact of political parties, public opinion, reform-minded officials, NGOs, external / international pressures and obligations etc.
- 2.4. **Has there been and is there still a ‘lead agency(s)’ responsible for driving further budget reforms within the bureaucracy?** Try to give a sense of their effectiveness and their current level of commitment to this task.
- 2.5. **To what extent were budget departments involved in the reform process?** Explain if budget departments in MOF were directly involved in the reforms. Consider whether they can be regarded as reform drivers or observers? Clarify whether the cooperation with budget department was conducted on ongoing (and informal) basis or rather formalized and limited to the extent necessary.
- 2.6. **Has this agency(s) changed its institutional structure or ways of working that have been clearly effective in promoting and/or supporting budget reforms reform?** Has their approach been inclusive, consultative and comprehensive? Explain whether the approach has been top-down or rather bottom-up one or it combined elements of the two. Identify whether the use of pilot projects has figured prominently and what sectors were addressed first.
- 2.7. **Are there any particular sectors or groups – either within or outside the public sector - that have consistently opposed and impeded (or supported) these budget reforms?** Describe any apparent reasons for this opposition or support – e.g. capacity for change, influence over budget resources, fears of retrenchment etc – and how important they continue to be to further progress. (Clearly, analysis and reporting of these issues may have to be managed sensitively, with an emphasis on the general nature of such influences, rather than specific groups or individuals.)

### Section 3: Adopting Medium-Term Expenditure Frameworks (MTEFs)<sup>92</sup> (3 Pages)

- 3.1. **What is the coverage of the MTEFs compared to the annual budget approved by the Parliament? What is the period of coverage (e.g. 2+1?). What is the legal basis of the MTEF?** Is the budget presented to parliament on a multi-year basis, with annual appropriation, or are medium-term revenue and expenditure forecasts for budget planning purposes only. Indicate how many forward years are used and the depth of detail in budget documents on revenue and expenditure for these forward years.
- 3.2. **Which institution/unit assumes responsibility for the MTEF?** Try to capture the institutional capacity in this area, including any special resourcing, skill development, modeling capacity or other unique features. Is there a particular organizational unit (within the Ministry of Finance or elsewhere) with specific responsibility for the development of the medium-term budget framework?
- 3.3. **Does the MTEF, if it exists, operate in support of any formal fiscal rules; does it assist in setting budget expenditure ceilings for the ministries, or medium-term fiscal guidelines or strategies with regard to movements in the fiscal balance?** This question should capture the degree to which the MTEF provides framework for managing aggregate fiscal policy and guidance to line ministries in formulating their budgets.
- 3.4. **What are the main methods or procedures used in compiling the MTEF?** These might include the use of particular types of revenue forecast models, standardized or non-standardized cost inflation factors, retention of a ‘Planning Reserve’ in allocating future indicative budget ceilings to line ministries, sensitivity analyses etc.
- 3.5. **Was the MTEF approach introduced as a component within wider budget reforms, such as PBB, or simply as a discrete step in budget development?**
- 3.6. **How detailed are the line ministries’ estimates of their institution’s medium-term expenditure? Do they provide the same degree of detail as the budget?** In many cases, these may be simple inflation-adjusted forecasts of current policies and programs, but they may also be the result of much more elaborate exercises aimed at generating a comprehensive costing of future policies. Note whether

<sup>92</sup> Pre-accession economic programs or convergence programs should not be considered as MTEFs.

donor funding has played an important role in setting up the MTEF process and capability.

- 3.7. Are the expenditure forecasts for forward years indicative, and therefore updated/revised on the rolling basis, or not? Does the MTEF process have credibility with spending ministries?

Describe also how frequently they are revised, to what degree, and the main reasons for the revisions.

- 3.8. **Has the application of the MTEF varied significantly in quality and usefulness across line ministries and, if so, what the reasons for this?** International experience suggests considerable variation in this regard. Consider also the question of MTEF sustainability
- 3.9. **Has the introduction of an MTEF improved the quality and efficiency of resource allocation and budget decision-making - from both the central budget planning and line ministry budget management perspectives?** Try to capture the nature and extent of any worthwhile changes in terms of budget (re)allocation decisions and/or budget management, or in better enabling inclusion of budget provision from, or for co-funding, EU or other external funding sources? In other words, has the MTEF led to more strategic fiscal policy?
- 3.10. **Has there been any reaction of Parliament, media or the public to the publication or availability of a medium-term budget framework?**
- 3.11. **What are the authorities' intentions and priorities, if any, for extending the use of MTEF concepts and methods?** (Explain)

#### SECTION 4: PERFORMANCE-BASED BUDGETING

(5 PAGES)

- 4.1. **What achievements have been accomplished so far with regard to PBB (as at mid-2008?)** This may range from almost complete unfamiliarity, to discussions/workshops etc for assessing potential relevance and application, to pilot applications, to comprehensive and legislated application. Try to be precise about accomplishments, including any legislated changes, achieved to date.
- 4.2. **What is the budget classification structure? (program, economic, functional, etc)**
- 4.3. **Are there plans for PBB to replace fully the traditional line-item budget in the specific time perspective or should PBB rather supplement the traditional budget?**

If the answer is yes, indicate the stages in which the PBB should replace the traditional budget.

- 4.4. **What have been the motivating factors behind the adoption of (or interest in) a PBB approach?** What has been the main motivation behind the PB initiative? This may involve a specific donor project, an initiating conference, steps taken by neighboring countries, individual ministerial initiative, etc. Try to give a sense of how broadly based the support for this development has been within and outside the bureaucracy. Indicate whether it is supposed to strengthen institutional management (PIB, PRB) or introduce more fiscal discipline (PDB)?
- 4.5. **What is the basic 'architecture' of the PBB approach as taken so far by the authorities in your country?** The architecture involves the 'programmatic' (or outputs) structure on which objectives and performance indicators are based. Describe, as far as you can, the different (how many?) levels at which expenditure is classified and reported (e.g. programs, sub-programs and activities/projects, etc.) At what levels are specific objectives and indicators required? Describe how PBB may be linked to improved strategic planning processes.
- 4.6. **How would you assess the 'quality' of the programmatic structure adopted so far? What are the strengths and weaknesses?** This assessment will require consideration particularly of the basic logic (or organizing principle) underlying the design of programs and sub-programs. What is this logic and how readily and consistently can it be applied given the administrative structure of Government? Does it, for example, provide a sound framework for developing performance concepts and methods by demonstrating where and how the ministry or agency proposes to intervene in the pursuit of economic or social welfare objectives?
- 4.7. **Has the PBB structure been consistently adopted across the public sector (general government/central government)?** Indicate whether some or all ministries have adopted and are using the structure, either fully or partially. To what extent have similar principles been applied to public entities outside the budget, in particular extra-budgetary funds and local governments? Indicate, if possible, the percentage of central government expenditures covered by the PBB approach.
- 4.8. **What was the approach in sectors where ministries are responsible for overall sector performance, but have a small influence on fund-**

ing (e.g. health, education) or the execution of tasks is delegated to specialized agency (e.g. in transport)? Try to examine the issue of how intra-sectoral division or delegation of tasks and allocated funds works within the PBB framework.

- 4.9. **How was the division of inter-sectoral responsibility for overlapping tasks between two or more institutions organized?** Issue of tasks /outcomes for which several institutions are responsible.
- 4.10. **What are the main problems impeding effective adoption of the PBB structure?** This may just be a timing issue, or it may be that the uptake of the new architecture has stalled for political or technical reasons, lack of capacity, or insufficient involvement of budget people from MOF.
- 4.11. **How well defined and effective are the links between policy objectives and budget program allocations (in terms of assisting institutions to meet their key objectives)?** Indicate the nature of these objectives and whether they are defined in the budget documentation or produced/available elsewhere. Describe any formal or informal processes that applied to drafting and agreeing the objectives?
- 4.12. **How were the indicators defined and determined (e.g. imposed from the top or negotiated with MOF or 'leading agency' with a high degree of freedom of line ministries)?** Explain the process of indicator selection, its definition together with baseline and target values and indicate which institution prepared the first proposal of indicators. Also, describe briefly the source of input and output/outcome indicators (external or provided by budget departments, measurement process) and indicate whether the final list was reviewed or audited by any institution to ensure quality.
- 4.13. **How many outcome and output indicators have been used in total/ per program/ per ministry?** Indicate the balance in use of outcome and output indicators. Try also to assess the quality and rigor of the indicators. Are they likely to provide a good framework for performance evaluation or so they still require a lot of work?
- 4.14. **What accountability processes are attached to the achievement of these indicators and what incentives exist for good performance?** This may range from none, to formal annual performance review processes, possibly including allocation of bonuses etc. Are there concrete plans to develop specific processes in the future?
- 4.15. **Are there any best practices or poor performers across the different line ministry budgets and what might explain that result?**

4.16. **Present in a table/diagram, as an example of the methodology and structure, a PBB budget framework for one line ministry (e.g. transport), including major performance indicators.** Refer to the basic structure in Annex 2, but highlight differences in transport sector.

4.17. **Has there been any impact of PBB on budget allocations, the quality of budget preparation and oversight?** Describe any strong complaints, objections or disputes around this methodology. Have these been resolved? Separate by institutions: line ministries, MOF, PM, Parliament, external audit etc.

4.18. **What is the plan, if any, for PBB implementation in your country in the next two years?** Assess whether this is moving ahead, muddling along, or stalled and possibly under threat of being abandoned?

## **SECTION 5: BUDGET PRESENTATION AND CLASSIFICATION (1-2 PAGES)**

- 5.1. **What constitutes the core budget documentation that now captures MTEF and PBB methods and to what degree does it measure up to international best practice?** Try to provide an overview of the quality and extent of the budget documentation, including any documents that may be issued or published during the budget preparation cycle. Is the budget documentation significantly more comprehensive, meaningful and transparent than it in previous years? Where are the gaps?
- 5.2. **What reaction has there been, if any, from the parliament and public to the new budget documentation?**
- 5.3. **What is the current state of development in budget classifications and coding (especially in relation to improved IT systems)?** Assess current practices in terms of the degree to which they support any new program and output structures, are compliant or consistent with international (IMF/GFS or ESA'95) standards, and provide a sound and transparent basis for expenditure reporting.
- 5.4. **What are the needs and plans of the authorities with regard to improving budget classifications, including giving better support for PBB etc?** What are the key constraints on these developments? This may include unresolved budget architecture issues, financial information system technology limitations, financial management and accounting capacity and skill shortages, determination of policy-makers etc.

## Section 6: Public Management Performance Culture (1 Page)

- 6.1. *To what extent have these budget reforms (especially PBB) been linked to other measures or monitoring and evaluation systems to improve performance in the public sector? Describe what these other measures are how much progress has been made with them.*
- 6.2. **Is it a problem that the idea of a ‘performance management culture’ in the public sector has not yet caught on and this has diminished the understanding and effectiveness of these reforms?** Describe some of the changes that need to occur for a performance culture to develop, either in budgeting and financial management, or more widely across the public sector.
- 6.3. **Is there much more that needs to be done in terms of civil service reform before these performance concepts can really be applied effectively?** Try to be specific about the key weaknesses (including specific institutions) that must be tackled.
- 6.4. **Is the public administration system ready to implement the principle of increased managerial flexibility in return for increased accountability? Has this been achieved already through recent reforms, to some degree? What is needed before this concept can be (more) effectively applied?**

## Section 7: General Assessment (Summary) (1 page)

This section requires you to make an assessment of these budget reforms in your country, taking into account the state of development and successes, issues and problems that you have described above. Remember the broad aim of this study is generate comparative assessments of the six countries that may help to illuminate useful ideas or approaches to applying these budgeting methods, and/or which may suggest successful, transformational, processes in managing these reforms.

The core goals in undertaking these budget reforms are to improve **efficiency, effectiveness, transparency and accountability** in the management of fiscal resources. Your summary comments should consider the progress and developments against these specific goals, but the following questions may also help you to frame your judgments.

- 7.1. *What have been the critical factors overall in determining the pace and quality of these budget reforms?*

- 7.2. *How might they have been managed differently so as achieve better or more rapid results? Are there any thoughts of turning back, or taking a different track?*
- 7.3. *Are there any unexpected ideas or developments, especially of a positive nature, emerging as a result of these budget reforms which – although they were not foreseen at the beginning – may prove interesting and applicable to other countries?*

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