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Budget Reform Seminar

Country Case Studies

Botswana
Kenya
Malawi
Mauritius
Mozambique
Namibia
South Africa
Tanzania
Uganda

CABRI
COLLABORATIVE AFRICA BUDGET REFORM INITIATIVE

This publication was compiled by the Expenditure Planning Unit within the Budget Office of the National Treasury of South Africa. It contains country case studies that were prepared for the Collaborative Africa Budget Reform Initiative's seminar in December 2004, and which have subsequently been edited.

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Acronyms

ABB	Activity-Based Budgeting
AP	Administrative Post
BFL	Budget Framework Law
BFP	Budget Framework Paper
BON	Bank of Namibia
BPS	Budget Preparation System
BRP	Budget Rationalisation Programme
CCS	Commitment Control System
CMU	Central MTEF Unit
DBA	Division of Budget Administration
DEA	Division of Economic Affairs
DOR	Division of Revenue
DORA	Division of Revenue Act
DPSM	Department of Public Service Management
ECC	Economic Committee of Cabinet
ERSP	Economic Recovery Strategy Paper
ESP	Economic and Social Plan
FDS	Fiscal Decentralisation Strategy
GABS	Government Accounting and Budgeting System
HIPC	Highly Indebted Poor Countries
IFMIS	Integrated Financial Management Information System
IFMS	Integrated Financial Management System
KPI	Key Poverty Indicator
LGA	Local Government Authority
LSFAS	Law on the State Financial Administration System
MBESC	Ministry of Basic Education, Sports and Culture
MCSA	Ministry of Civil Service Affairs
MDAs	Ministries, Departments and Agencies
MFDP	Ministry of Finance and Development Planning
MFPED	Ministry of Finance, Planning and Economic Development
MHETEC	Ministry of Higher Education, Training and Employment Creation
MOF	Ministry of Finance
MOFED	Ministry of Finance and Economic Development
MPED	Ministry of Planning and Economic Development

MPF	Ministry of Planning and Finance
MPRSP	Malawi Poverty Reduction Strategy Paper
MTBPS	Medium Term Budget Policy Statement
MTEC	Medium Term Technical Committee
MTEF	Medium Term Expenditure Framework
MTFF	Medium Term Fiscal Framework
MTP	Medium Term Plan
MTR	Mid-Term Review
MWG	Macroeconomic Working Group
NDP	National Development Plan
NDPB	National Directorate for Planning and Budget
NDS	National Debt Strategy
NEA	New Economic Agenda
NES	National Expenditure Survey
NPC	National Planning Commission
NPES	National Poverty Eradication Strategy
OOB	Output-Oriented Budgeting
OPM	Office of the Prime Minister
PAF	Poverty Action Fund (Uganda)
PAF	Performance Assessment Framework (Mozambique)
PARPA	Plan of Action for the Reduction of Absolute Poverty
PEAP	Poverty Eradication Action Plan
PEFAP	Public Expenditure and Financial Accountability Programme
PEM	Public Expenditure Management
PEMP	Performance and Effectiveness Management Programme
PER	Public Expenditure Review
PFM	Public Finance Management
PFMA	Public Financial Management Act
PFMRP	Public Financial Management Reform Programme
PIP	Public Investment Programme
PMS	Performance Management System
PPA	Participatory Poverty Assessment
PRC	Project Review Committee
PRFB	Programme Review and Forward Budget
PRS	Poverty Reduction Strategy
PRSP	Poverty Reduction Strategy Paper
PSR	Public Sector Reform
RBB	Results-Based Budgeting

ROM	Results-Oriented Management
RPFB	Rolling Plan and Forward Budget
SIP	Sector Investment Programme (Malawi)
SIP	Sector Investment Plan (Uganda)
SMU	Sectoral MTEF Unit
SSA	Sub-Saharan Africa
SWAP	Sector-Wide Approach
SWG	Sector Working Group
TEC	Total Estimated Cost
UPPAP	Uganda Participatory Poverty Assessment Project
URA	Uganda Revenue Authority

Background

With the aim of long-term, multilateral African support for budget reform and sound public finance management, the ministries of finance of South Africa, Mozambique and Uganda hosted a budget reform seminar from 1–3 December 2004 in Pretoria, South Africa. The seminar was the first activity of the *Collaborative Africa Budget Reform Initiative (CABRI)*. It was attended by senior budget officials from 16 African countries – Angola, Botswana, Kenya, Lesotho, Malawi, Mauritius, Mozambique, Namibia, Nigeria, Rwanda, Senegal, South Africa, Tanzania, Uganda, Zambia and Zimbabwe – public finance experts, representatives from regional organisations and members of the development partner community.

One of the primary challenges faced by governments across the world is to translate development goals into specific policies and programmes. Budgets, and how public funds are raised, allocated and managed, constitute the main avenue through which governments channel their resources in pursuance of welfare goals. Good public finance management requires a well-designed set of institutions and systems for budget formulation and execution. The budget reform initiatives across the African continent over the years have recognised the connection between sound budget management and development. Furthermore, to many stakeholders, more effective budget management systems are required not only to fulfil governance requirements, but also to ensure that increasing democratisation in Africa delivers real value to local electorates.

Finance ministry officials are at the heart of many of these reform efforts, as success depends to a large extent on their ability to analyse existing deficiencies, decide on changes and manage implementation. External assistance is usually available for this process; however, experience across Africa has shown that local knowledge and management is essential. When local knowledge is complemented by an understanding of alternative solutions that have been tried and tested elsewhere, the ability of officials to design and implement appropriate budget reforms is enhanced.

In addition, while there is considerable literature on budget reform efforts in Africa, it has mostly been developed by the multi- and bi-lateral providers of development assistance or by international research institutions. These documents are valuable but represent external evaluations of reforms efforts, based on external knowledge frameworks. More importantly, the interest of senior budget officials in learning from their peers in other African countries has become increasingly appar-

ent in recent years, with requests to the well-known reformers for information, exchange visits and presentations at in-country workshops.

CABRI began as a response to the interest in peer-to-peer lesson sharing. It is an African-led and managed initiative that aims to improve the efficacy of public financial management reforms by: (i) bolstering the capacity of senior budget officials to take an active role in planning and managing reforms; and (ii) expanding the existing knowledge of what works and what does not work, by making explicit the knowledge African officials hold on reform modalities. The spirit of the initiative's objectives is underpinned by the values of sound governance, accelerated development and African-grown solutions.

The programme of the CABRI budget reform seminar was a combination of a theme-based and case-study based approach, organised around four central themes related to the planning, budgeting and implementation aspects of the budget cycle. The themes were: (i) building budget credibility; (ii) introducing a strategic medium-term perspective; (iii) improving the quality of expenditure; and (iv) reform design and implementation.

The programme was aimed at affording as many participants as possible an opportunity to present an insight into budget reforms in their country. The seminar booklet, which accompanies this publication, provides a broad overview of the discussions, and includes a list of all participants. While 16 countries attended the seminar, the initiative is open to all countries – it is the explicit intention to give CABRI a pan-African character.

One of the aims of CABRI is to contribute to a common African resource base for African officials on public finance management in Africa – including materials and access to peers in other countries on the continent.

This book contains country case studies that were prepared for the seminar and that document experiences in a range of public finance and budgeting practices. They present an assessment by senior budget officials of the state of their country's budgeting system and a review of related reform programmes pursued – what successes were achieved and what obstacles were encountered. The case studies underline the many good practices and the progress made across countries that can be emulated by others. There are valuable lessons from reform efforts that can and should be shared amongst countries in Africa.

Introduction

State effectiveness is both an imperative and a challenge for many African countries. The challenges of deep poverty and few domestic resources to assist citizens are often coupled with low human resources capacity in the state and with inadequate systems to ensure that the available resources are used to their maximum effect. Therefore, it is not surprising that reforms to budget management systems have been a priority for African governments and their development partners.

It is significant that several countries in Africa have made marked progress in establishing effective systems of economic governance and public financial management, signalled by growing economies in a context of improved macro-fiscal stability, improved fiscal transparency and, in some, positive changes in public sector related social indicators such as access to education and educational attainment of the population, improved access to health care and reductions in infant and maternal mortality rates, and reduced income poverty. Even in countries where there were initial setbacks to reforms, further programmes have taken the lessons learnt on board and are bringing about improvements in macro-fiscal and public expenditure management.

African reformers also pioneered several successful innovations in developing country public sector planning and budgeting systems that are now being applied elsewhere. Poverty Reduction Strategy Papers (PRSPs) and participatory poverty assessments have their origin in Uganda's poverty eradication action plan and participatory poverty assessment. Sector working groups, as an integration and transparency mechanism between stakeholders in strategic budgeting, first made their appearance in different forms in several African countries, including Uganda, Tanzania and South Africa. Public expenditure tracking surveys are a product of the Ugandan understanding of why higher financial allocations to health and education did not materialise in commensurate improvements in outcomes. Botswana offers a long-standing example of disciplined medium-term planning and budgeting. Aid management and donor harmonisation modalities are also the result of learning how to co-ordinate massive country support programmes, such as in Mozambique. The

African experience in sector-wide approaches has informed similar efforts elsewhere.

These innovations are not the only lessons to be learnt from Africa. Insights can be gained from countries like Mauritius and Namibia, where the first efforts at reforms were successful, having been triggered less by economic or fiscal crises than by the desire to bring about improvements in functioning systems, into what the minimum conditions are for implementing specific budgeting instruments, such as Medium Term Expenditure Frameworks (MTEFs) and integrated financial management systems. This is true, particularly when contrasted with the reform paths of other African reformers, such as Malawi, which provide valuable experience on the advantages of a holistic approach when attempting reforms, and on how to manage longer reform programmes.

The nine countries represented in this volume of case studies are at the forefront of the African budget reform experience. In some cases, their experience goes back decades and offers insights into the successes and failures of earlier reform waves, while others are benefiting from the inclusion of these lessons in their reform practices.

This introductory chapter draws on these case studies to view the milestones achieved and some of the lessons learnt, both on the content of reforms and on how they could be sequenced and managed. It also draws on the proceedings of the 3-day seminar on budget reform in Africa held in December 2004 with senior budget officials from 16 countries. The seminar presentations and discussions not only offer a wider experience base, but also provide a summary of the more significant lessons learnt from the combined experience. It is these lessons that are at the core of this chapter. They are presented as ten key budget reform principles, which emerged from the seminar discussions, and are highlighted with examples from the case studies and further discussion of key seminar concepts.

The objectives of reform efforts across all of these countries are shared – the common language of the reform discourse is that of affordability, alignment with policy priorities and value for money. There is wide agreement on what characteristics a budgeting system should have to deliver on these objectives systematically, such as budget credibility, comprehensiveness, discipline, predictability, transparency, accountability and a focus on performance. The seminar countries' combined experience of how to achieve a system that displays the required characteristics and produces the desired results is of great consequence, particularly from starting positions that often included such complex budgeting problems as persistent mismatches between spending and stated priorities and between actual spending and budgeted spending, unpredictable revenue flows coupled with high expenditure rigidity, fragmented budgets, poor information on spending and achievements, and

long-standing patterns of non-compliance with existing budgeting rules.

Budget reform is about doing the right things right, in order to achieve the desired change. What the right things are is not independent from specific country circumstances. Nonetheless, generic principles can be formulated on the basis of African experience.

Effective budget reform requires a systemic approach

A working budgeting system requires that all its parts function properly, from effective and politically anchored mechanisms to decide on and fund priorities, through effective cash management and allocation, to accounting for funds used and reporting on the results achieved. As the Malawi case study illustrates, implementing a sophisticated activity-based budget planning system will not produce better results from spending in an environment of high resource uncertainty, if it is not accompanied by mechanisms to mitigate the uncertainty (such as sound revenue estimates, a cash management system that smoothes cash flow to expenditure agencies against revenue flow volatility and a transparent cash allocation system) and to account for spending timeously.

If a change in policy is to result in changes in the overall effect of government spending (for example, a focus on improving domestic transport systems resulting in more kilometres of tarred road and, say, slower spending on foreign missions) there are a few critical 'building blocks' that ought to be in place. To some degree, the experience of the countries represented at the seminar illustrates that while improvements to each building block of a budgeting system may be necessary, it is unlikely that any single reform will be sufficient to bring about systemic turn-around.

The first building block is technical budget credibility. Simply put, there is not much use in having sophisticated systems to ensure budgets reflect funding for new priority activities, if there is little chance that actual spending will shift to reflect the plans. A credible budget means that if an activity is funded in the budget as approved it will happen, and if it is not, it won't. Thus, a country has a credible budget if the budget out-turn regularly, and with little deviation, matches the budget as approved. This is the technical aspect of budget credibility, which requires what is often referred to as 'budgeting basics' to be in place – realistic revenue projections, a credible plan against likely increases in the cost of existing activities, and systems that ensure sound cash management and discipline in implementation, such as those providing reliable, timely information on resource use and routine sanctioning of unjustifiable deviation from authorised expenditure.

Seminar discussion: The central importance of budget credibility

Budget credibility is at the core of a good budgeting system. There are two dimensions. From a technical perspective, a credible budget is a budget that is implemented as planned and is comprehensive, affordable and sustainable. From a governance perspective, a credible budget is one that accurately reflects a nation's priorities. Together, these two dimensions encompass the objectives of budget reform.

There are several features that a budgeting system requires to deliver on these aspects of a credible budget. On the technical side are prudent macro-fiscal frameworks and realistic revenue projections; credible assessments of the existing cost of government and the cost of new initiatives; a transparent and disciplined budget planning process; robust systems of budget classification, execution, financial management and accountability; and the availability of good information on spending and service delivery.

On the governance side, access to quality information internally and externally throughout the budget process and clear mechanisms for political oversight, including that of Parliament, are key for managing the tension between competing priorities and to prevent narrowly focused interests from dominating the budget process.

Seminar participants emphasised the role of the budget as an agreed plan that balances different priorities and pressures; and the budget process as the means towards a plan, the implementation of which has the support of most stakeholders.

Participants also noted that credible budgets crucially depend on having predictable rules and processes in place for budget formulation and implementation, including how to deal with changing circumstances. Overall budget credibility entails more than ensuring that the numbers contained in the budget document are correct and based on a realistic macroeconomic foundation. It involves broad ownership of the priorities, predictable budget rules and processes and systems that ensure discipline in implementation.

Secondly, an effective link between policy and budgeting is necessary. Having a budget that is implemented as planned will not result in policy effectiveness if budget plans do not reflect priorities. This budgeting failure occurs when there are weak linkages between budgeting and policy-making, such as when they are conducted in separate institutions, or separate structures in the same institution, or are not linked in time. Different countries implement different systems to ensure this linkage. Some, like South Africa, largely make policy through the budget process. Others, like most of the PRSP countries, have separate framework policy processes, which are then funded through the MTEF and budget process, and are linked

through an range of mechanisms, including budget policy papers, the involvement of sector working groups in the budget process, and public expenditure reviews. An effective link between policy and budgeting improves budget credibility from a governance perspective.

The third crucial building block is an effective link between the budget as planned and approved and service delivery. While some of the technical requirements for improved links between the budget and service delivery rest with budget management (such as multi-dimensional budget classification systems that link programme-based allocations to administrative classification), other core public sector systems come into play, for example the underlying public service management rules and human resources management. However, within budgeting systems, experience across the represented countries has shown that improved budget planning on its own is not sufficient – it must be accompanied by systems that ensure disciplined use of resources and improved incentives for delivery.

The building blocks are interdependent. The question that faces budget reformers is not so much what technical reform will address a shortfall in any one of these building blocks, but how shortfalls within the blocks are linked across blocks, how these could be addressed holistically and which entry point would suit a country's particular circumstances best. The Mozambique case study provides an example: the basic budgeting systems, such as accounting and budget classification, were addressed first to allow clearer linkages between budgets and service delivery, before budget planning reforms like an MTEF were introduced. This is not the same sequence as in countries like Malawi, Uganda and South Africa, where budget-planning deficiencies were addressed in early reforms. The Mozambique route means that any further reforms aimed at better strategic prioritisation within and across sectors have an enhanced likelihood of succeeding, given a sound information base and a credible budget.

Be clear on objectives and principles, rather than instrumentalist

Different countries need different solutions to achieve such universal reform objectives as allocative and technical efficiency. What might be right on average across countries may be completely inappropriate for a particular country.

While the practical examples of budgeting instruments – such as how budget preparation can be more strategic if an activity-based classification is added (Zambia), or cash flow managed better through a quarterly commitment system (Uganda) – are useful, blindly transplanting mechanisms and instruments from one country to another can be ineffective or even leave the target country worse off than

before, if only on account of disillusionment with reform. For example, in Malawi, where macro-fiscal stability was not a given, implementing an MTEF approach to sector budgeting may have been premature; the efforts of spending ministries to develop costed, medium-term spending plans linked to priorities went without the expected reward of funding when revenue shortfalls forced in-year re-budgeting. In certain circumstances, specific instruments may be undesirable even if they work well elsewhere.

Ministries of finance should set their budget reform aim not on the implementation of specific instruments, such as MTEFs, financial management information systems or public expenditure reviews, but rather on what it is they seek to achieve through those instruments. That would offer a better chance of aligning reforms to country-specific circumstances, not only at the start of reforms but as they begin to take effect (or not) and need to be adapted. To illustrate: publishing a budget framework paper three-quarters of the way through the budget proposals preparation process may seem like a useful means to improve budget transparency; however, it may not result in any real improvement in budget transparency or in participation and accountability for policy decisions. A ministry of finance that is focused on the instrument, rather than the objective, would deem the reform successfully completed by the publication the budget framework paper. A ministry of finance that is focused on achieving budget transparency, in order to improve the results of spending, would be dissatisfied and would supplement the better budget documentation with other measures, such as extensive radio coverage.

No system has unlimited reform capital. For example, if an MTEF is unlikely to succeed because there is little domestic political will to move towards a disciplined budget process, its implementation should be deferred and efforts focused on placing better information on key trade-offs on the table, or improving the comprehensiveness of the budget framework outside of a full, technical MTEF. Forging ahead with new MTEF-type budgeting rules despite a lack of appetite for it and just because it is the instrument of the day will not substantially change how resource use is decided and will probably prejudice later attempts at improving budget planning.

Effective budget reforms change behaviour

An instrumentalist approach to budget reform can easily result in expensive reform programmes with few tangible results. This is particularly true of the introduction of technical reforms that have little or no effect on behaviour in the system. Good budget reforms change the behaviour of budgetary actors. Budgetary actors are individuals in the system, such as civil servants preparing policy options and making

spending decisions, political actors making political choices, development partners providing funding or parliamentarians and civil society members reviewing budget allocations and achievements. Often, reforms result in compliance but not in any substantive changes in behaviour. For example, where performance budgeting mechanisms are still limited to setting indicators and targets without making these targets count, it results in the creation of the required documentation by spending agencies without any meaningful processes and without any impact on budgetary outcomes.

In order to change behaviour, the combined impact of all institutional mechanisms – the rules, roles, structures and systems that govern budgeting and the information that is available in the process – matter. Behaviour in the budgeting system is a function of the incentives that individuals face; for example, an education manager is unlikely to ensure that qualified teachers are progressively distributed more equitably across regions, even when this is an explicit policy decision, if he or she is not required to report on that distribution regularly.

Incentives are about consequences, both good and bad, and good budget reforms ensure that the incentives for individuals across the system are compatible with the desired outcomes. As another example, piloting a sector-level MTEF (or a system-wide MTEF) will not produce better sector planning if the old budget system co-exists and is the real system for resource allocation. Completing the processes for the new MTEF system would then be mere compliance, with sector managers saving their efforts for where the real decisions are made. Equally, the weight of national MTEF strategic processes in the budget system is determined by how they are linked to allocations made in the annual budget process for parliamentary approval. If these allocations are made with scant reference to the MTEF process – in countries where these processes are separated – then the MTEF process becomes aimed at producing a document, rather than the document reflecting a meaningful process.

The budget process determines incentives. The countries where the reform path has been smoother (for example, South Africa, Uganda and Tanzania) have put considerable effort into developing a well-sequenced and transparent budget process with clear and enforced rules. In the case of Kenya, a recent MTEF review emphasised the importance of having the right incentives in the process, and this has led to better Cabinet involvement and improved documentation.

Paying attention to institutions and incentives means that budget reforms require interventions that enforce compliance with (new) formal budget rules governing both the budget preparation process and budget execution. This includes ensuring that the legal foundation is in line with the envisaged system. Countries differ in how they legislate. In some, like Mozambique, the legal framework was put in place as a first step on the reform path. In others, like South Africa and Namibia, modernising

the legislative framework governing budgeting and financial management came after many of the provisions were already in place in practice. The approach may be determined by the strength of the existing framework, and legislative practice in the country concerned.

A relevant legal foundation is necessary to ensure compliance, but is not sufficient. Strong budget transparency and accountability systems are also required to ensure that the informal institutions (the rules, roles and practices that govern budgeting practice) match the formal, stated rules and roles. The incentives people face in the public sector are largely determined by how much they have to disclose about their decisions and activities, and how much that information is used to hold them accountable in the monitoring, evaluation and oversight systems. Roles and responsibilities need to be clear for accountability to be operational. Even if good information is available, and even assuming good systems to monitor, evaluate and sanction, accountability will not ensue unless responsibility can be determined.

A strong direction in current budget reform is the allocation of responsibility between different institutions and actors. This can be done formally, as in the South African case, where the financial management legislation sets out the key responsibilities and assigns them, or more informally, like in Uganda and Tanzania, where sector-level reviews and the allocation of priorities are assigned to sector working groups in the budget process.

Overall, having the basics of budget execution in place can be seen as a necessary building block to getting incentives right. In a system where basic budgeting controls and record keeping are inadequate, it is unlikely that good information will be available or accountability operational. The Botswana case study is a good example of a functional basic budgeting system, producing perhaps better budgetary outcomes than many countries worldwide with sophisticated budget reform processes.

Budget reforms should support democratic public accountability

If budget reforms are to be successful, particularly in environments where there are institutional difficulties, the will to improve the system of central institutions like the ministry of finance, should be backed by better economic management and service delivery from outside the executive.

Discussions at the seminar emphasised the wider economic governance context of budget reforms. It was felt that, while managerial accountability within the public sector was an important element in getting the incentives right for better budget management, any formal performance management rules were likely to be ineffective unless supported by public accountability. The role of a credible budget as a

contract between citizens and government was also stressed, as was the significance of institutionalising mechanisms in the budget system that strengthen this role.

Several of the case studies illustrated such mechanisms. In Uganda and Tanzania, sector working groups that include representation by non-state actors play an instrumental role in the budget process. In Uganda, improvements in budget transparency (for example, through making budget allocations to local-level institutions public) are aimed at enabling the accountability of institutions on the ground to the publics they serve. In Tanzania, annual public expenditure reviews are conducted in a participatory manner, facilitating a more open debate on key expenditure issues.

Political involvement in budgeting is crucial

Mechanisms that allow for optimal political involvement enhance the budget process. Ultimately, if wider public accountability for decisions is to be enabled, decisions on what is affordable, and what to fund to what degree, are political matters, even if supported by rigorous technical advice. Also, the mechanisms of the budget process should ensure that the role of political decision-makers is constructive and contributes to more effective spending, rather than detracting from it through ad hoc spending decisions taken outside of the context of competing spending needs and scarce resources.

All of the case studies pay some attention to this aspect. In cases where budget process reforms have improved the strategic relevance of spending, earlier rather than later involvement by Cabinet in setting priorities and finally deciding on spending was institutionalised. A continuous role for Cabinet, stitched into the budget process, is a critical feature of the reformed process in South Africa and Uganda. This supports budget credibility, in terms of both economic governance and spending discipline. Peer pressure amongst Cabinet members not to introduce new policies outside of the budget process, which absorb funds at the cost of ongoing policies, contributes to policy predictability and budget credibility. In countries where this is not the case, such as Mozambique, lack of Cabinet involvement and continuing fragmentation of strategic decisions have been highlighted as future challenges. Another successful mechanism is specialisation at Cabinet level, where a sub-committee of Cabinet engages with the budget and fiscal and spending issues in more depth, and makes recommendations to the full Cabinet.

The macro-fiscal context is important

Experience with budget reforms in Africa has taught that getting the macro-fiscal

context right should be a priority. A shared feature of the more problematic reform efforts is the disruptive effect of macroeconomic and fiscal crises on budget reforms, whether they are on account of exogenous factors, such as falling commodity prices, or budget system factors, such as high overspending. Second waves of reform then include mechanisms to prevent and insulate the budgeting system from these crises.

Seminar participants agreed that transparent and technically sound macroeconomic forecasts, coupled with accurate revenue forecasts, were essential to smooth budget management. Revenue uncertainty discourages good budget preparation and disrupts implementation when budgets are remade during the year. One buffer against uncertainty is offered by caution in revenue estimation. In Uganda, where a significant percentage of revenue was from donor sources, a critical feature of improving budget certainty – and, consequently, fiscal discipline and allocative efficiency – was the implementation of decision rules that deliberately adjusted estimates of donor revenue downwards, and included only the donor revenue that Uganda could be relatively sure of receiving.

However, despite upfront mechanisms to improve certainty, the vulnerability of many of the represented economies still leaves budget management exposed to disruption. Of the countries in the case study sample, South Africa, Namibia, Mauritius and Botswana operate systems where cash flow to spending ministries happens automatically on the back of approved budgets, with short-term revenue shortfalls absorbed by the ministries of finance. In all the other countries, in order to maintain fiscal discipline in the face of revenue shortfalls, ministries of finance operate 'cash budgeting' systems, where only available cash is distributed on a monthly or weekly basis to spending ministries.

In its initial and crudest form, this caused repetitive budgeting and skewed distribution of available cash, with the most powerful ministries, rather than those with the highest priority, being funded first. Spending ministries were also unable to plan their activities beyond the current available cash horizon, because they had no certainty about future funds. In the absence of proper commitment controls, ministries continued to spend against approvals, rather than available cash, resulting in a serious build-up of arrears.

The country case studies provide clear examples of how to manage this better: Uganda operates a system of cash management where cash flow is smoothed over a year to provide a steady stream of funding, together with a quarterly cash allocation system that provides more certainty, and a proper commitment control system to prevent arrears. Malawi is moving towards managing in-year revenue uncertainty better, with transparent cash management (rather than the current cash rationing) one of the objectives of the second reform wave.

It could be argued that cash rationing points to an underlying budgeting failure, namely unreliable or overoptimistic forecasts of economic growth and revenue; cash rationing in response to unpredictability of revenue can amount to treating the symptom while deviating attention from the reform that is really necessary.

MTEF-type reforms are necessary to improve budgeting outcomes

MTEFs offer a reliable planning instrument to manage uncertainty. Seminar participants were in consensus that a forward planning horizon and a budgeting framework were both necessary elements of an effective budgeting system. Together they enable shifts in expenditure to new priorities in the face of short-term expenditure rigidities; make trade-offs explicit between expenditure and tax instruments, between different spending objectives and over time; provide greater predictability of policy and of funding; and are essential to ensure that budgets are affordable. There was agreement that the MTEF approach to budgeting is a powerful way to achieve these objectives.

However, this agreement on the desirability of MTEFs came with a few provisos. Firstly, while the MTEF approach may be useful and even necessary, it is not the answer to all budgeting ills. It is important for a country to be realistic about what it can achieve, and what other interventions are necessary. Secondly, a functional MTEF is dependent on critical preconditions, such as fiscal stability and the political will to implement budget planning and execution discipline. Thirdly, an effective MTEF is contingent on getting the design and implementation right. In too many countries, the MTEF is seen as being all about the outputs of the approach – a framework document and the resulting forward fiscal framework and expenditure estimates. In countries such as South Africa, Tanzania and Uganda, where there is greater emphasis on designing the approach, the process and the budget rules that go with it, the MTEF has had a real impact on the budgeting system. In order to get the design right, it is important to pay attention to the incentives that result. For example, what is the nature of the forward ceilings? If they are adjusted each year with little reference to previous years, proper forward planning is disincentivised. However, if spending agencies are forced to live within their own projections, there is a higher likelihood that the quality of information on the forward projections will be better.

MTEF implementation works better if it is not piloted in individual ministries. It also works better if the initial reforms are at the centre, and pay attention to the macro-fiscal framework, before detailed work is done at ministry level. In Namibia, for example, the MTEF was first implemented as a fiscal and aggregate expenditure framework, in order to give effect to fiscal policy choices. In South Africa, Uganda

and Mauritius, the expenditure framework was made applicable to all of government, at once. It is only now that the centre of the MTEF is institutionalised and successful that Namibia is moving towards developing sector-level expenditure strategies coupled to the MTEF. In Mozambique, the MTEF is still largely a fiscal framework, but as such it fulfils a vital role in managing revenue complexity, given the role of donors. In Uganda, one of the earliest implementers of an MTEF system, its initial role in making the macro-fiscal implications of spending clear to all stakeholders was critical.

MTEFs may be of particular importance in Africa, given the role of development partner resources. The integration of development budget spending (often funded mostly by donors and often unpredictable and vulnerable to revenue fluctuations) with recurrent budget spending is recognised as a critical precondition for better development outcomes from public expenditure. Several countries have struggled with the problem of how to integrate these two types of expenditure, while their funding and spending dynamics are so different. The Kenyan case study offers a good review of how different reforms tried to address the shortcomings of the system in this regard. Where MTEFs are more mature, such as in Tanzania and Uganda, the potential to co-ordinate development and recurrent budget revenue and spending into a coherent MTEF framework, through mechanisms such as sector working groups, public expenditure reviews and sector-wide approaches, is becoming clearer. Botswana offers an example of where solutions have been found on similar principles of fiscal framework and forward predictability.

Balancing predictability, rigidity and flexibility

The net impact of the institutional arrangements for budgeting should be to balance predictability of funding and policy with flexibility, in order to respond to the changing environment within the spending rigidities of an ongoing public service.

Predictability of policy and funding is necessary for a good planning environment and to enable stable service delivery. Budget reforms such as an MTEF and transparent cash management systems enable predictability of policy and funding. However, the system needs to allow for uncertainty and for policy change. If funding is entirely predictable, the incentives for effectiveness and efficiency at line ministry level are fewer.

The seminar included discussion on the types of mechanism that could balance these competing budget reform objectives. The nature of the forward ceilings, and the budgeting rules that govern them, the use of contingency reserves as a budgeting device in an MTEF, and forced savings to allow for flexibility on the margin to allo-

cate to new policies, were discussed. The common principle behind these mechanisms is that budgeting will always take place in an unpredictable environment – what is important is that there are predictable rules to deal with that unpredictability. In the absence of predictable rules, ad hoc decisions are taken that do not support good budget outcomes.

Introduce a performance orientation

A performance orientation in budgeting is indispensable in determining the appropriate incentives for service delivery. Different countries have completely different models and are experiencing different problems. In the case of Mauritius, line ministries are developing their performance frameworks within an emerging MTEF environment, but problems of co-ordination at the centre remain. In Namibia, a centrally determined performance framework exists, and is linked to the budgeting system, but line ministry buy-in is problematic. In Botswana, a sophisticated indicator-driven system is being implemented, but there is doubt as to whether the cost of developing the system will merit the potential benefits. In South Africa, performance indicators and targets form part of the budget documentation, but limited further progress has been made in changing behaviour and improving service delivery. In Malawi, the performance orientation is an integral part of the activity-based planning and budgeting model, but the centre does not have the capacity to make meaningful use of the overload of information that results. In Tanzania and Uganda (and recently in Kenya), contextualised review mechanisms, made operational through the sector working group system, allow for regular performance reviews through the budgeting system. In Tanzania, these reviews follow the public expenditure review model and are very effective in bringing better information to the budgeting table. In Uganda, public expenditure tracking surveys have similarly been very effective in reviewing the use of funds in specific sectors, and facilitating remedial measures.

Despite this variety of measures, core lessons are emerging. Progress towards better service delivery using a modern, performance-oriented budgeting system is necessarily slow. Most countries are learning by doing. Not only does it require a change of skills, approaches and behaviour on the ground, it requires a fundamental change in approach to managing the public service. The impact of changes in the budgeting system is also affected by the extent to which people perform. However, the budgeting system does play a significant role, and there are several important principles in this regard.

Firstly, a mechanistic collection of performance information is rarely effective. What is more important is how the information is used constructively to improve

budgeting and budget outcomes, and to enable accountability. Secondly, the performance management system should not be separate from core budgeting decisions, but should be integrated into the budget process as a basis for dialogue between the line and centre, and between the state and non-state stakeholders. Thirdly, there are technical requirements to be met before this can happen. Throughout the budget cycle, the classification system should tie allocations to policies and to performance (through a meaningful, programmatic and functional classification), enable accountability to be assigned clearly (an administrative classification) and enable clear information on the economic impact of spending (through an economic classification). Some of the represented countries have made progress with identifying poverty-related expenditures through coding these and using devices such as Uganda's poverty action fund (a virtual fund in the budget that combines poverty alleviation expenditures and provides an indication of the likely strategic impact of state spending on poverty). Others, like Zambia, have refined the programmatic classification to include an activity classification (tied to budget controls), making much more explicit what funds are likely to be used for, and changing the nature of the budget debate.

Get implementation right

The sequencing of budget reforms is important. The case studies show that countries with fiscal instability that did not first address revenue unpredictability and poor spending discipline found their earlier reform efforts to improve the strategic allocation of expenditure ineffective. Similarly, improving the link between plans and budgets requires better underlying budgetary controls to be in place; poor budget execution controls detract from the incentives for proper planning. A performance orientation in budgeting is contingent on fiscal stability and sound budget planning systems. African budget reform experience, therefore, points to the value of assessing the whole system for weaknesses before attempting reforms, and of paying serious attention to sequencing.

The phasing of reforms is critical. Ministries of finance, development partners and consultants have to be realistic about not trying to do too much with too little, particularly too little capacity in the system to manage and absorb reforms. Successful reforms are not created in a vacuum; equally, they are not created by budget officials or the consultants who assist them. Successful reforms are co-created by all the people in the system, who must be taken along on the reform path. This requires clear communication of goals to all stakeholders, why specific steps would lead to those goals, and what the roles of individuals and their institutions are in those steps. In addition, individual and institutional capacity must be built to fulfil these roles, as in

South Africa, where full implementation of public financial management and classification reform has taken several years as institutions and individuals pass through capacity-building programmes.

Incentives are important if reforms are to be effective. Good reformers deserve to be rewarded, while poor compliance with reforms should be sanctioned. For example, spending ministries that show efficiency gains on the back of a sector MTEF process may not only be allowed to retain their gains for implementing new spending activities, but could also be rewarded with additional funds. Namibia provides a good example of a disincentive to breaking a reform budgeting rule – the allocations to ministries that do not stick to their MTEF ceilings in their medium-term plan submissions are reduced.

However, if rules like these are made, it should be clear that they will be enforced. Reform implementation is a learning process for all actors in the system. It may be necessary for a ministry to enforce a new rule only once for it to be taken seriously thereafter. On the other hand, it may also take a rule not being enforced just once for spending agencies to doubt reformers' intent.

Similarly, care should be exercised in setting up institutions and assigning roles. Budget reform often goes hand in hand with a proliferation of institutions and mechanisms and the assignment of new roles to existing institutions. Only institutions that will be used meaningfully – and which do not duplicate the purpose of existing, but ineffective institutions – should be put in place. Only roles that will be made to count should be assigned. This generates the necessary demand for capacity building and, over time, it builds trust in budget reform programmes.

The African budget reform experience teaches that successful reforms are driven by the political will to make a change. This will is created in specific circumstances, which may be existing or looming macro-fiscal crises, democratic and constitutional transitions or growing dissatisfaction with public service delivery. While maximum use should be made of the window of opportunity that such a situation creates, the momentum can run out, often, paradoxically, on account of first reform successes dulling the edge of circumstance or just because of inertia in the system. The gains made in earlier successful reforms may begin to erode. Equally, not all reformers can rely on circumstances sufficiently compelling to overcome resistance to change from institutions and individuals in the system. Implementing budget improvement programmes in such cases, and sustaining improvements over long periods of time, takes strong leadership and vision. It also takes being mindful about what actions are likely to be the most effective at any particular time.

Reform programmes should not be understood as being carved in stone. Nor can

their introduction be seen as a task completed. Successfully improving budgeting requires frequent appraisal and evaluation of the budgeting system, and of efforts to improve it, against the core objectives of affordability, responsiveness to policy priorities and value for money. In this, and in developing remedies for shortcomings, senior budget officials should assume the leading role.

CHAPTER 1

Botswana

Getting the basics right

Mompati Nwako and Pauline Mpofu

1.1 Introduction

Botswana attained self-governance in 1965 after 80 years as a British Protectorate, and became independent on 30 September 1966. It is a non-racial country maintaining freedom of speech, freedom of the press and freedom of association – affording all citizens equal rights.

Botswana boasts a variety of wildlife and minerals, cultural diversity and natural wilderness (such as the Okavango Delta), all offering tourist opportunities yet to be exploited fully. Copper-nickel has been mined in the North-East for some time, but prices have been depressed for an equal length of time, necessitating continuing government assistance for the mine. Vast coal deposits are available in Central Botswana, although mining there is on a relatively small scale. Soda ash deposits at Sua are unlimited, but it is the country's diamond revenue that catapulted the country from a per capita GDP of P1 682 in 1966 to P9 793 in 2001, averaging approximately 9.2 per cent growth per annum in real terms over the entire post-independence period up to the beginning of National Development Plan (NDP) 8. The biggest

threat to all these gains is the HIV/AIDS pandemic, which challenges the survival of the 1.7 million inhabitants of this vast semi-arid country.

It is, however, fair to acknowledge that the large growth in the government budget, commensurate with economic growth, has put enormous pressure on its financial management resources. This does not relieve government of the need to control and manage its finances. The larger the quantum of funds handled and controlled by government, the greater the need for strong controls to be in place, to make sure that these funds are not misused or even fall into the wrong hands. The control of funds in Botswana is regulated by the Constitution and elaborated in the Finance and Audit Act.

For a country that initially had to have its budget balanced by the British government, the management and control of finances was always going to be an important factor in its development. One can say that the main aspect of public finance management is the principle of good governance and public accountability that came about as a result of a foundation based on the principles of democracy. It is in pursuance of this accountability that there exist such structures as an Auditor General and an Ombudsman answerable to Parliament and the Parliamentary Accounts Committee, which reviews the financial statements as laid before Parliament by the minister responsible for finance.

This chapter describes and reviews several mechanisms that are in place for the good management and control of finances, including the National Development Plan, consultations with citizens, the development of manpower, recurrent and development budgets, a new system of performance management and various financial management measures.

1.2 The National Development Plan (NDP) and expenditure management

The NDP is a blueprint of the country's development forecast six years at a time. Botswana is now in its ninth Plan. The NDP profiles the country and has chapters on socio-economic development prospects, economic performance and prospects, and planning strategy for development, before it looks at the different sectors. It is based on the Macroeconomic Outline and Policy Framework, and is the map for expenditure that is approved by the Economic Committee of Cabinet (ECC), setting priorities over the long term and proving the framework for budgetary planning year-on-year. This happens largely at the administrative level, in adherence to the Plan. It is only when there is a need to adjust the NDP for any fiscal year within the Plan period that the ECC would debate priorities at that level.

NDP 9 has been framed around the theme – 'Towards Realisation of Vision 2016:

Sustainable and Diversified Development through Competitiveness in Global Markets'. This takes into cognisance that development encompasses economic, human, social and environmental issues. It is important to note that government has made the commitment of aligning NDPs with the goals as enshrined in Vision 2016. Since the Vision was developed during NDP 8, the current Plan offers the first opportunity for various sectors to integrate Vision 2016 goals and objectives into the national development planning process.

The NDP derives its authority from the National Assembly. According to the Finance and Audit Act, no expenditure can be incurred on any project prior to its inclusion in the Plan. This means that any new capital spending projects, or new recurrent expenditure activities linked to new policies, cannot be undertaken unless included in the Plan. In this way, the Plan offers a vehicle for disciplined implementation within a medium-term planning framework. The Plan's credibility is rooted in the way it is perceived to be applicable in addressing the challenges faced by Botswana. The key to sustainable development in Botswana's case revolves around issues of global competitiveness and economic diversification. Within a global scenario, Botswana has to identify those areas in which it has a competitive advantage.

The Plan, once approved, is financed on an annual basis through budgets motivated by the ministries and the implementing agencies and departments within them. The integration of the recurrent and developments budgets (both funded out of the Consolidated Fund) is reflected in the Consolidated Cash Flow Presentation of the Budget, along with revenue derived and the financing of the overall budget. The NDP has projected these annualised numbers, but like any estimate, it is appreciated that many factors will impact on the Plan – hence, the Mid-Term Review (MTR) that comes up mid-way during the Plan. What the MTR does is to reconcile the current needs with those at the time the Plan was developed and to factor in the necessary changes in direction. An annual budget drafting process, linked to immediate priorities and resource availability, is also undertaken, and this finally determines spending.

Therefore, the NDP has to be as realistic as possible. It sets out the government's blueprint of the actual development activities, with estimates, to be carried over the 6-year period. As we know, however, expenditures in the end will depend largely on the level of revenues realised, especially if the policy is not to run budget deficits. In the period 1989/90–1998/99, Botswana never posted a budget deficit, which was supported by low capacity for expenditure, but which enabled predictable funding to implement a 6-year forward plan.

From 1998/99 onwards, the revenue streams were becoming increasingly inadequate, particularly on account of the pula/US$ exchange rate. This was managed by making development expenditure the residual of the recurrent budget within a set

expenditure ceiling. The result was postponement of various development projects mainly as a result of being squeezed out by priority projects such as HIV/AIDS, sanitation and education. Recurrent expenditure rose from P4.8 billion in 1997/98 to P12.9 in 2003/04, and development expenditure rose from P0.8 to P4.2 (an increase of 425 per cent), thereby putting more and more pressure on the development budget. Government then introduced several financing strategies. Although the initial idea of floating government bonds was to strengthen and develop the financial markets, the receipts have come in very handy as they have been earmarked to finance tertiary education, including the expansion of the existing university and the establishment of a second. More recently, government also sold the Public Debt Service Fund Loan Book, as well as its shares in Anglo American, to private investors.

1.3 The role of a bottom-up budget formulation process

Citizen input into priority-setting – and ultimately the allocation of resources – happens by way of the democratic link between government policy and citizen influence through the constituency-based electoral system, and the Kgotla mechanism, which pulls in traditional leaders.

1.3.1 Consultations with politicians

At the grassroots level, communities are able to access the NDP consultation process through their constituency Members of Parliament (MPs). The MPs will listen to the needs of their constituents so as to highlight these to the implementing ministry/agency. In their own right, MPs can be very influential in that they have the wherewithal to convince the electorate that the developments government is undertaking are what is required, although they may not necessarily be what the people want at that time. The biggest danger is that, at times, politicians may promote the interests of their constituency (or even their own agenda) at the expense of the country as a whole.

Likewise, members of district councils/local authorities also provide the people with a stake in the consultation process of the NDP. Members of the local authorities are even more at grassroots level than the MPs. As politicians at local level, they provide a more focused view than an MP may be able to see. Based within the communities and having more frequent interaction with them, local politicians can be very useful, especially to the MPs who cover a wider area of jurisdiction.

1.3.2 The Kgotla and traditional leadership

In Setswana culture there is the traditional Kgotla, which is a meeting-place for the

community to talk about important issues affecting their everyday lives. Under the headship of the chief, it is the place to settle disputes, map out strategies for the tribe/clan and generally belong to one another with a common purpose. The Kgotla, unlike the two forums mentioned above, is not political; it wields its own respect and authority that transcend politics and religious denominations.

Bearing this in mind, we see that the chief or his representative (usually a close relative) still holds the people's respect, and they tend to follow his advice and what he believes is right. This influence and traditional set-up can be a very effective tool, especially in the rural and semi-urban areas. Therefore, Kgotlas are an important form of consultation for the NDP process, considering their traditional base. The importance of the chief's support for government projects cannot be overemphasised.

1.3.3 Creating ownership of projects in the NDP

The consultation as outlined above plays a vital role in promoting the ownership of projects by people at grassroots level. It is important for people to be consulted before projects in their areas can be included in the NDP. The projects stand a better chance of success, since the community owns them.

By going through these consultations, a spirit of partnership is established with the communities right from day one. The feeling that government is prescribing to them is reduced to a large degree, providing for smoother implementation of controversial projects (for example, those requiring the relocation of sections of the community). As these consultations move along, one will realise that the people's needs invariably exceed the resources available, resulting in some projects being deferred or not considered. The community would be more amenable to a project if they were part of the process all along.

1.4 Botswana fiscal policy

1.4.1 Fiscal policy discipline during budget implementation

It is government's fiscal strategy for NDP 9 to ensure budget sustainability and to restrain the growth of government expenditure. This will be a challenge against the backdrop of low implementation capacity in previous NDPs, which has created a backlog of projects and activities that are now under pressure to be carried out. As a result, there has been a steady increase in expenditures and net lending over the period. Table 1.1 provides data of development and recurrent expenditure against revenues and the resultant surplus/deficit.

By controlling government expenditure, the idea would be not to crowd out the private sector, which is expected to be the major engine of growth. Furthermore, with

minerals making up 50 per cent of the country's revenues, it is essential that appropriate investment be made in infrastructure and other assets of the country, such as human capital rather than consumption. During NDP 9, this aspect will be monitored by a sustainability ratio whereby non-investment recurrent expenditure to non-mineral revenue is less than one.

Fiscal control and discipline is made even more important by the pressures Botswana is experiencing as a result of the strengthening pula against the US dollar. The dollar-denominated mineral revenue streams result in challenges to balance the budget – an ideal the Ministry of Finance and Development Planning (MFDP) has committed itself to. Table 1.1 shows the revenue, expenditures and resultant surpluses or deficits for the last seven years to 2003/2004.

Table 1.1: Revenue, expenditures and surplus/deficit (P million), 1997/98–2003/04

	1997/98	1998/99	1999/00	2000/01	2001/02	2002/03	2003/04
Total revenue	8 281	7 678	11 963	14 115	12 709	14 311	16 197
Dev. expenditure	2 696	2 935	3 451	3 135	3 698	4 200	4256
Rec. expenditure	4 827	6 157	7 048	8 383	9 935	11 581	12 935
Other	(116)	(26)	(71)	19	38	(71)	(921)
Total expenditure	7 406	9 065	10 428	11 536	13 671	15 710	16 270
Surplus/(Deficit)	875	(1 388)	1 536	2 579	(962)	(1 399)	(73)

The Botswana government uses a spending authority system whereby funding appropriated by Parliament is provided to the ministerial heads (accounting officers) in the form of warrants. It is incumbent upon the accounting officers to ensure that expenditure in their respective ministries is within the warranted amounts. Where additional funding is required, supplementary requests are submitted to the MFDP for sanction prior to tabling in Cabinet and Parliament. The accounting officers are liable to explain to the Parliamentary Accounts Committee any administrative lapses under the Finance and Audit Act.

1.4.2 Forecasting

The MFDP is constitutionally required to submit estimates of government revenue and expenditure to the National Assembly before the start of each financial year. The Finance and Audit Act sets out procedures that all government departments are legally bound to follow in the management of public finances. Financial instructions

and procedures provide detailed rules for collection and expenditure of public funds.

The Division of Budget Administration (DBA) is responsible for the preparation of the government budget and the provision of support and advice on financial management issues to government ministries/departments. This is executed through secondment to line ministries of finance officers who are functionally responsible to the accounting officers of the respective ministries but remain professionally responsible to the Permanent Secretary of the MFDP through the Secretary for Budget Administration. DBA staff members are seconded to line ministries for the purposes of monitoring and advising the accounting officers on the use and control of funds, examination of budgetary requirements, consolidation of ministerial budget estimates and supplementary budget requirements, and the collection of revenues.

1.4.3 Components of the budget

The NDP is annualised through a budget preparation process that covers the five major categories, namely:

- Manpower budget;
- Recurrent budget;
- Development budget;
- Consolidated Fund revenue estimates; and
- Development Fund revenue estimates.

Manpower budget

The manpower budget covers the annual manpower resource allocations to various government departments. There is an established Manpower Sub-committee of the Estimates Committee, chaired by the Director of the Department of Public Service Management (DPSM). The sub-committee is made up of the Deputy Director, a representative of the MFDP and representatives of the DPSM's job evaluation and manpower budget sections.

One of the sub-committee's responsibilities is to allocate new posts of various categories to government departments as per their requests. The allocation of manpower, like financial resources, is guided by NDP priorities with an emphasis on controlling the size of the public service and the level of vacancies.

The end-product of the manpower budgetary process is the Establishment Register (see Section 1.5.2 below).

Recurrent budget

The Recurrent Budget Section co-ordinates the preparation of the recurrent budget.

The manpower allocations submitted by the DPSM to the MFDP are evaluated and added to the cost of existing establishment and other charges (running costs for ministries). Staff members of the MFDP liaise with finance officers in line ministries to reconcile the data required for the preparation of ministerial recurrent budgets, as well as compiling data on expected revenues from all sources for the Consolidated Fund.

The estimates stipulate the amounts that may be spent and their purposes. Minor changes may be made within the approved totals by transferring funds from one use to another (subject to MFDP approval on virements affecting personal emoluments, restricted items and add-back items), but increases in ministry totals require parliamentary approval through supplementary estimates. Once approved by the National Assembly, the recurrent estimates are the authority for government departments to spend. This authority becomes effective when the minister responsible for finance issues a general warrant at the start of the financial year.

Development budget

The Development Budget Section co-ordinates the formulation of the development budget. This section participates in the meetings of the Project Review Committee (PRC), which the Secretary for Economic Affairs chairs and which is also a sub-committee of the Estimates Committee. The PRC is responsible for the review of the implementation progress of projects and the assessment of financial requirements for each project on a yearly basis. Once the project review exercise is completed, the Development Budget Section collates the ministerial development budgets, which form part of the Project Review Report. During the project review exercise, sources of finance for the development budget are also identified. Donor funds in the form of loans and grants, and domestic development funds already approved, are specified so that the financing of shortfalls from either of these sources can be initiated during the course of the year.

Revenue estimates

Ministries submit revenue estimates to the DBA through finance officers seconded to them. The division then examines trends in revenue from each source and enquires about significant deviations. It later collates the estimates into the Consolidated Fund.

The DBA then consolidates all budget funds and prepares a prospective cash-flow report for briefing the Estimates Committee. Following the briefing, the committee meets all accounting officers individually to finally examine the recommended estimates and make proposals on manpower, recurrent and development budget estimates for each department.

1.5 The recurrent expenditure budget process

Heads of department submit their recurrent budgets, prioritising their needs within the given ceiling. Items that cannot be accommodated within the ceiling are negotiated by the ministries with a view to adjusting the ceiling on the strength of justifications made.

Non-recurring items (referred to as add-back items) are removed from the equation by the DBA when setting ceilings. These are items that do not follow the pattern of items such as utilities, which increase with inflation from year to year; they occur once-off and do not need to be accommodated annually.

1.5.1 Peculiarities including the lapsing of funds

The financial year runs from April to March and any unspent funds at the end of this period are taken back into the Consolidated/General Fund. Departments usually tie funds to votes, which they may not even need to use. There are several reasons why these funds may remain unused at the end of the year, but the most common is lack of good financial management skills. By the end of March, any funds that have not been used are automatically withdrawn and are no longer available for use by the department. If the department had omitted to buy something, say furniture, then it has to budget for it all over again. Sometimes a deficit budget may be presented and approved by Parliament, but then if the actual expenditure is less than the actual revenue collected there will be a saving rather than the deficit portrayed by the budget.

1.5.2 The manpower budget

There is a close link between manpower and recurrent ceilings and this is reflected and reinforced in the way the annual budget is prepared. At each stage, the DPSM is involved, as are officers from the Macro Unit and the Employment Policy Unit of the Division of Economic Affairs (DEA). The manpower review process culminates in the preparation each year of the Establishment Register, which shows the personnel at each level that each department is authorised to employ. The authorised establishment of each department is naturally a key determinant of its recurrent funding requirements.

The system for estimating manpower establishment ceilings relies on the recurrent budget ceilings, as well as manpower budget estimates provided by the DPSM. The manpower establishment ceilings are generally based on maintaining a constant ratio of emoluments to the total recurrent budget (so as to ensure adequate provision in the recurrent budget for other charges), as well as taking into account any known or

projected manpower needs. Efforts are made to ensure that growth in manpower establishment ceilings is consistent with the growth in recurrent budget provision.

The recurrent expenditure ceilings for each department are intended to be consistent with its manpower allocation. It is assumed that nominal wage and salary levels will increase at the rate of inflation over the Plan period. However, based on past experience, the real increase in wages and salaries is assumed to be about 3 per cent per annum to allow for increment creep (i.e. the real growth in aggregate salaries resulting from annual promotions and increments). If future salary awards or increases in average wages and salaries due to increment creep differ from the assumed growth rates, then manpower growth rates will be adjusted accordingly in order to make them consistent with the end-of-Plan recurrent expenditure targets.

1.6 The development budget

The DEA, through the Director of Development Programmes, drives the development programme in accordance with the Plan through the various planning units housed in the ministries. In achieving this, the DEA works closely with the Development Unit of the DBA. As already stated, a project first has to be included as part of the Plan to be subsequently funded and implemented. The DBA has the responsibility of seeing the administrative process through to approval by Parliament.

1.6.1 Total estimated cost

The total estimated cost of a project is commonly referred to as the TEC. This represents the overall estimated cost of all the components/activities included in the thumbnail sketch of a project over the NDP period. The sum total of all the TECs of approved development projects represents the total estimated cost of the Plan. The TEC of a project may be spent in one or more financial years, depending on its size and scope. While approving the annual development budget, Parliament also approves project TECs. Therefore, revisions to the TECs must be approved by Parliament through the annual budget and/or supplementary estimates. In urgent cases or emergencies, TEC revisions can also be sought through Cabinet memoranda. In such cases, the revised TECs must be submitted to Parliament for ratification at its next sitting. The need for TEC revisions arises as a result of inflation, implementation delays, expansion of the project's scope, and so on.

1.6.2 The thumbnail sketch

Each and every development project must have a thumbnail sketch, which briefly

describes the project's scope and components together with its estimated costs and the reasons for its inclusion in the NDP. Amongst other things, it also shows the project's TEC, in both constant and current prices, and annual phasing of expenditure over the Plan period. The thumbnail sketches are approved by Parliament as part of the approval process of the NDP; therefore, any subsequent amendment has to be approved by the National Assembly through the annual or supplementary estimates of expenditure. The initial thumbnail sketches of NDP 8 are included in the 'yellow section' of the Plan. Their updated versions, with amendments, and thumbnail sketches of new projects introduced into the Plan subsequent to its finalisation, can be found in the annual or supplementary estimates through which they were amended or introduced.

1.6.3 Project review meetings

The Project Review Meeting is where each ministry presents its annual bid for each project to the PRC. The Secretary of Economic Affairs, assisted by the Director of Budget Administration responsible for development, chairs the PRC. Other staff from the DEA and the DBA make up the rest of the committee. The PRC assesses the progress of each project and the anticipated activities during the year being budgeted for, and, in consultation with officials from each ministry, sets the expenditure levels of each project. The PRC then makes its recommendations to the Estimates Committee (EC). The EC, chaired by the Permanent Secretary of the MFDP, considers the report and any representations that may be made by individual accounting officers. The final EC report is the basis for the Budget Cabinet Memorandum.

1.6.4 Project ceiling/budget

The project ceiling/budget is the amount shown under a financial year in the estimates of expenditure. This amount is agreed in the annual project review meetings with line ministries and represents the level of estimated expenditure on a project during the financial year. However, ministries can spend more than the project ceiling so long as an equivalent amount of under-spending is anticipated for another project. The project ceiling is used in determining a ministry's overall annual development budget.

1.6.5 Ministerial ceiling/budget

The ministerial ceiling/budget is based on macroeconomic indicators and prospects of government revenues. The NDP also provides for annual phasing of development expenditure over the Plan period. Ministries are consulted in the process of determining ministerial ceilings. These ceilings are then communicated to ministries to

serve as a guide in the preparation of their annual budgets. Ministries are expected to keep their budget proposals within the ministerial ceilings. After approval of the budget by Parliament, the ceilings constitute the upper limit of what a ministry can spend during the financial year. The MFDP ensures that the total of all finance warrants issued to a ministry does not exceed its ministerial ceiling. In the event that a ministry needs to spend more than its ceiling, it must seek additional budgetary allocation through supplementary estimates.

1.6.6 Finance warrants

Finance warrants are issued by the Budget Section, authorising accounting officers to spend their budgets, as approved by Parliament through annual and supplementary estimates. In the case of the recurrent budget, only one finance warrant, covering a ministry's entire budget for the year, is issued upon approval of the budget by Parliament. For the development budget, however, several finance warrants can be issued (often more than one for each development project) during the course of a financial year. These are issued upon receipt of a finance warrant request from a ministry. The main reason why many warrants are issued for the development budget is that, unlike the recurrent budget, it is not fully funded when approved by Parliament. There are numerous projects with significant amounts still to be negotiated, and these are provided throughout the year, either by the Domestic Development Fund (DDF) or, in a few cases, by donors. There are three requirements to be met before finance warrants for the development budget are issued by the MFDP:

- the total of all warrants issued does not exceed the overall annual budget ceiling of a ministry;
- all warrants issued for a given project do not exceed its TEC; and
- back-up funds have been approved and are available to cover the requested amount of warrants.

1.6.7 Supplementary estimates

The circumstances under which a supplementary estimate is necessary are described in Sections 8 and 9 of the First Schedule of the Finance and Audit Act. These are that:

- the TEC of a project, as shown in the annual estimates and approved by the National Assembly, is insufficient to enable that project to proceed in the current financial year;
- the total amount appropriated for all projects in the current financial year is insufficient;

- a need has arisen to proceed with an approved project that has not been included in the annual estimates for the current financial year; or
- a need has arisen to proceed with a new project.

A supplementary estimate must be put before Parliament for approval by resolution. It should be noted that supplementary estimates are restricted to unforeseen and emergency requests only.

1.6.8 Special warrants

If in any financial year any of the circumstances described above (see Section 1.6.7) arise and, in the judgement of the President, expenditure up to the level of the new or revised total estimated cost of a project is so urgently required that it cannot, without serious detriment to the public interest, be postponed until a new or revised total estimated cost is approved by the National Assembly, the President may direct the Minister of Finance and Development Planning to issue a special warrant authorising that expenditure. At the next meeting of the National Assembly, after the issue of a special warrant, the minister must submit a new or revised total estimated cost of the project in question, as the circumstances require, to the National Assembly for its approval by resolution.

1.6.9 Withdrawal warrants

Surplus warranted funds can be withdrawn through a withdrawal warrant by submitting a withdrawal warrant request. However, since funds are approved for specific activities/components of a project, funds withdrawn from one project cannot be re-warranted to another project. The proper procedure is to de-commit the funds so as to enable their fresh commitment.

1.7 Revenue budgeting

Consolidated Fund revenues are budgeted for in basically the same way as expenditures. The main consideration is the increase in revenue that can be expected over and above the current year's base. This growth gives an indication of the extent to which expenditures in a particular ministry will be accommodated. It is the ministry's responsibility to ensure not only that credible revenue estimates are compiled but that all possible revenue sources have been covered.

It is important to note the way accounting for development revenue is carried out. At the time development expenditure is budgeted for, how it is going to be financed is determined – by the DDF, a particular donor or co-operating partner or, if the

source is as yet unidentified, with funds to be negotiated. This forms the budget for development revenue. At the time expenditure is incurred, it must be matched with a deposit that substantiates the source, or reimbursement that will match the expenditure in question must be obtainable. It is the matching of development expenditure with development revenue that ensures that sources of revenue, be they local, domestic sources or foreign donor funds, are accounted for.

1.7.1 Reforms

With revenue streams increasingly inadequate to cover government's total expenditure, consideration has been given to cost-recovery reforms, with a current emphasis on the charging of public services at cost or near cost. This, in turn, will lead to the achievement of sustainable fiscal and budgetary policies.

Government regards cost recovery as so important that a unit has been established in the DBA to oversee the exercise. The unit assists the ministries in identifying possible areas of cost recovery. Proposals are submitted to Cabinet, where a decision is made on the extent to which recoveries can be made. The idea is then to gradually introduce these charges without too much of a hike in any one year, so as to avoid shocking the system.

Implementation of the cost-recovery principle, however, is still very much at the consultative stage. Ministries and departments are identifying areas for cost recovery and will have to formulate proposals. The likelihood is that all services are heavily subsidised, with the exception of a few such as driver's licences and maybe passports. Take medical services – these have been virtually free at P2 a visit (and that is hardly ever collected). Government accepts that it is practically impossible to bring this up to full cost in the near future. Indications are that ways have to be found to identify those people who require subsidies, and to charge the full cost to those who can afford to pay (people on medical aids, for example, have been known to use government services when they have run down their medical aid allocations at private institutions).

Government will be introducing school fees with effect from January 2006. This is with the proviso that no child who cannot afford to pay will be denied education. As for the fees themselves, when presenting his budget, the Minister of Education said that government was looking at fees for locals of P300 for junior secondary, P450 for senior secondary and P750 for technical colleges per year. Expatriates have been paying P3 000 per year in secondary school fees for the last three or four years. It is clear that these fees, especially for locals, are still heavily subsidised.

Another reform that is being pursued in earnest is that of privatisation, a policy for which was approved in 2000. An autonomous organisation was set up to oversee this

process, mainly by identifying those organisations in government that were ready to be considered for privatisation and then guiding them through the process. Currently, the organisation is finalising the master plan for approval by Cabinet, a process that has proved slower than hoped for.

One area of government revenue that has not been closely monitored until recently is that of parastatals or quasi-government organisations. In the past, these government-owned organisations have tended to plough back profits generated instead of declaring dividends, because government did not really need the cash. However, with the increasingly tighter budgetary scenario, they have become an important source of income for government.

Botswana's financial management control revolves around the issuing of spending authorities after Parliament has passed the Appropriation Bill. It should be noted here that the system controlling these authorities was largely manual until recently. Government has implemented a real-time integrated financial system countrywide. The Government Accounting and Budgeting System (GABS), which went live in September 2004, will enable government to have the absolute controls necessary to avoid over-expenditures – this has not been an issue so far as controls have been closely monitored by the seconded finance officers at line ministries. Running alongside GABS is a new salaries system, and together these form a good platform for improving government processes.

At the time of implementing GABS, a thorough analysis of government business processes was undertaken in order to improve their efficiency. The long-term trend is to decentralise functions. Personnel management has been decentralised to line ministries for several years, and other functions, such as accounting, are to follow as GABS is rolled out.

1.8 Problems encountered

1.8.1 Expenditure budget exceeding revenues

It is envisaged that success in addressing this issue, mainly through the cost-recovery and privatisation policies, will not take long to be realised, as the reform is being implemented throughout government. Services that used to be offered free from government offices are now going to be charged for, with the ultimate goal of 100 per cent cost recovery. By the same token, privatisation is set to take off with the sale of quasi-government organisations.

1.8.2 Incremental budgeting and the scarcity of resources

The government of Botswana uses the incremental system of budgeting. The previous

year's approved estimate serves as the base, the ministry adds the growth and inflation factors as indicated by the MFDP, and submits this as its bid for the coming financial year. It is high time government moved from this system, as it has many weaknesses.

In the year 2003/04, funds were withdrawn from the recurrent budget (at 5 per cent) for the first time, and the budget for 2004/05 was slashed by 10 per cent, resulting in a net 5 per cent decrease from the 2003/04 base. This came about with the realisation that a deficit budget is submitted to Parliament every year, but departments do not spend all the funds approved. Now that departments are having their budgets cut instead of increased, they can appreciate the 'scarcity of resources' concept. In the past, the budget used to be increased irrespective of the justifications made. This encouraged poor management of funds, including sluggish spending, leading to the lapsing of funds at the end of the year and the same cycle repeating itself the following year.

1.8.3 Size of government and its containment

The total government establishment numbers about 70 000 employees. There is a concern that this is too large and not utilised to the maximum. The government service has been criticised for low productivity; hence, the establishment of the Botswana National Productivity Centre. This centre's duty, among others, is to teach the nation at large what productivity is and how it can be achieved.

The following measures have been put in place to contain the size of the public service:

- *Rationalisation of posts*. If a department has posts that it is unable to fill for one reason or another, it is encouraged to give them to other departments that can convert them and fill them. Instead of a department asking for completely new posts, it utilises posts from other departments.
- *Trading of posts*. If a department wants to create a post of higher responsibility, it can forgo a number of lower posts to the same cost of the higher post they require.

The target vacancy level for government is 2 per cent, and it is closely monitored by the DPSM. In the past, the vacancy levels were high and departments would still ask for new posts. The financial implication of a high vacancy rate is that funds in the form of salaries are provided for, although at the end of the year they will not have been paid out.

1.9 The performance management system (PMS)

1.9.1 The Ministry of Finance's vision and mission

The MFDP's vision is to 'be an effective, world-class provider and manager of economic and financial resources of the Republic of Botswana'.

The mission of the MFDP is to 'co-ordinate national development planning, monitor its implementation, mobilise resources, advise government on the allocation of financial and economic resources, develop and implement economic and financial policies'. These functions are to be undertaken within the framework of values developed and espoused by the ministry. These values are centred on honesty, timeliness, openness, transparency, accountability, tolerance, commitment, courtesy, motivation, productivity, interdependence and hard work.

1.9.2 The PMS

Of recent concern to government has been the increasing outcry from the public about poor service delivery by government and its agencies. The complaints have invariably been directed at the higher costs and the inherent inefficiencies that manifest themselves in the system, such as stock-outs at government depots, long queues at revenue offices for the payment of licences, and the like. To address this, government decided to implement the Performance Management System (PMS) during NDP 9. The PMS aims at sensitising workers to the vision and mission of their organisation, in this case the MFDP, so they may align their daily work with the ministry's strategic plan to achieve the goals intended by the ministry. It is important for people to know what they want to achieve by doing what they do. The PMS gives employees the opportunity to appreciate why their organisation exists and where they want to go.

In the implementation of the PMS, the MFDP has had to annualise its strategic plan into annual performance plans cascaded to each department. These plans have key result areas that have to be achieved, as they will indicate that the ministry is on track. In measuring how well this is proceeding, key performance indicators have been developed. At its most basic level, the PMS is the work improvement teams that identify work-related issues and how they are going to be resolved.

1.9.3 The NDP and Vision 2016

Botswana has a national vision, called Vision 2016, which reflects where Botswana wants to be as a nation by the year 2016. This vision is being conveyed to the ordinary citizen in different ways. The pillars of Vision 2016 are:

- an educated, informed nation;
- a prosperous, productive and innovative nation;
- a compassionate, just and caring nation;
- a safe and secure nation;
- an open, democratic and accountable nation;
- a moral and tolerant nation; and
- a united and proud nation.

For the nation to achieve this vision, the projects and activities undertaken should contribute towards its goals (for example, to improve health outcomes for all by the year 2016, clinics and hospitals have to be built and appropriately staffed within the communities they serve).

Therefore, the strategic plan for the MFDP is developed in response to NDP 9, which is designed to focus the ministry towards the realisation of Vision 2016. The development of the key result areas, goals and strategic objectives of the Plan has to be carried out with the Vision as the major goal. This alignment is important to ensure that, as the ministry implements its strategic plan, the construction of the pillars of Vision 2016 is made as practical as possible.

1.9.4 Productivity and government spending

The MFDP has finance and economic-planning personnel seconded to line ministries to represent the interests of the ministry and provide advice on the allocation of financial and economic resources. Other departments in the ministry (such as the supplies department) also have officers in line ministries to assist in achieving prudent financial management throughout government. The finance officers, who are the financial advisers to the Permanent Secretary, are there to ensure that government spending is in order. This reflects a direct link, in government spending, between the mission of the ministry and productivity.

The ministry cannot achieve its vision without being productive. The effective provision and managing of financial and economic resources needs a productive, cost-conscious, hardworking, dedicated and disciplined team. The vision on its own drives one to excellence, and this has produced another reform, an extension of the PMS, that aims at providing motivation to employees to work towards achieving world-standard productivity levels.

1.10 Conclusion

For a long time, Botswana's budgetary performance gave little reason for the consideration of reforms. The large surpluses and resultant build-up of reserves created the impression of comfort. However, there has been a change, and this has been recognised by government. It is clear that, along with the deteriorating budget situation, the delivery of government services is a concern. It has become incumbent upon government to resolve issues such as cost recovery, on the one hand, and privatisation, on the other.

Botswana has also had to realise that it needs to be a global player in a global market. It has to be competitive within the world economy, more especially because it relies on one major source of revenue. The diversification of Botswana's economy probably remains the biggest challenge, but along with it has to be the assurance that budgetary and fiscal disciplines are inculcated in the system to support strong financial management. Quality management information is one such area; with the investment in a state-of-the-art financial and management information system, there is every reason to believe that timely and quality decisions will prevail. Pressures on the Treasury will increase as the areas in which government participates increase (such as the recent issue of government bonds).

Note should be taken of the fact that these are still very early days in the reform initiatives as far as Botswana is concerned. Certain ministries have still to roll out the PMS fully, which means that the evaluation of levels of success is still a year or two down the road. As for the financial system, it went live in September this year and will only be rolled out to all ministries by next year, meaning that the full fruits of its implementation will be felt only from March 2005.

It is important to realise that no system will result in better use of management information if it is not applied appropriately. Realistic estimates still need to be carried out so that these can be fed into the system. This will continue to be a challenge, which will be made that much easier, however, by the quality of information that will be available on the system.

Special mention must be made of the PMS. This reform initiative strikes at people's attitudes and the way they work, and it is clear that its success is determined largely by how much and how quickly it is accepted across the civil service. It is already apparent that some areas find it easier to integrate the PMS into their work environment than others. As the PMS becomes fully embraced, it will lead to a civil servant with a productivity level accountable to various stakeholders, which is an incentive in itself.

Finally, the reforms that have been initiated can only benefit Botswana's public sector planning and management. There is no doubt that the country would have been worse off if these reforms had not been undertaken. There is agreement that the budget cycle, which started in April/May and continued to February when the Budget Speech is read in Parliament, can now start in August/September, enabling the use of better comparative information on current-year spending.

CHAPTER 2

Kenya

Integrating expenditure towards policy priorities

Kubai Khasiani and Phyllis Makau

2.1 Background

According to the Constitution of Kenya, the Minister for Finance must table the budget before Parliament by 21 June every year. The executive ensures that the budget is prepared and is ready for presentation to Parliament. The government recognises that a robust public expenditure management system is critical to the delivery of its economic reform agenda. The budgeting process has gone through many reforms since independence. These reforms have been carried out in an effort to improve public expenditure management for better delivery of services and goods to the Kenyan citizenry.

Prior to the budget reforms, the government of Kenya used to prepare two budgets annually – a recurrent and a development budget. As the economy evolved and became more complex, the need arose to change the manner in which resources were mobilised and allocated. Other pressures for reform in the budgeting process have been external, mainly from development partners who have been giving Kenya budgetary support.

The reforms introduced have included a Programme Review and Forward Budget (PRFB), a Budget Rationalisation Programme (BRP), the Public Investment Programme (PIP) and, more recently, the medium-term budgeting process commonly referred to as the Medium Term Expenditure Framework (MTEF).

This chapter reviews the various budgeting process reforms (particularly in the planning phase), with a detailed analysis of the introduction of the MTEF, its successes, weaknesses, challenges and its linkages to the Poverty Reduction Strategy Paper (PRSP) and the Economic Recovery Strategy Paper (ERSP). With the aid of the reform programmes, many obstacles that were plaguing the country's budget system, such as lack of co-ordination between planning and budgeting, overestimation of revenues resulting in frequent re-budgeting, and inadequate costing and prioritisation have been addressed and to an extent overcome. This has resulted in increased transparency, improved budget credibility and political endorsement, which was a key component of the last set of reforms.

2.2 Reforms in public sector financial management prior to the introduction of the MTEF

2.2.1 Programme Review and Forward Budget

Before the first reforms, the recurrent budget provided for the costs of personnel, operations and maintenance, whereas the development budget was essentially the capital budget.

The annual process was co-ordinated by the Ministry of Finance, which issued budget ceilings for the recurrent budget every year. Thereafter, each ministry would prepare its itemised budget and submit it to the Treasury for review and approval. However, this process had several shortcomings, including non-adherence to the ceilings given, no prioritisation of programmes and activities, and lack of consideration of future recurrent costs generated by capital outlays. Another issue was that, as the budget put more emphasis on item level, there was no linkage to the development plan. This problem was worsened by the fact that the Ministry of Planning was charged with the responsibility of developing the plan, while the Ministry of Finance co-ordinated the budget. In addition, the development plan was general and included objectives and broad strategies, whereas the budget was highly itemised, without much emphasis on expected outcomes or the overall objectives of the development plan.

Adopted in the 1970s, the PRFB was the first major reform in the budgeting process. The rationale behind the introduction of the forward budget was to provide

a mechanism that linked the annual budgets to the development plans (i.e. it was the initial attempt to link planning to budget). At the outset, it was conceived of as an annual exercise that involved preparing a recurrent and a development budget for three years, rolled over every year with the first year forming the basis of the annual budget.

The main objectives of the PRFB were to:

- provide for a hard budget constraint by giving ministries and other spending agencies a 3-year ceiling on expenditures;
- establish the cost of programmes, particularly the future cost implications of current investment in facilities;
- establish a process of reviewing priorities and linkage to available resources;
- provide for identification of future requirements generated by present policies;
- provide a criterion for reviewing the performance of ongoing as well as future programmes (the forward budget was assumed to be the only mechanism for the introduction of new programmes); and
- provide/establish a linkage between planning and budgeting.

Elaborate institutions were set up to oversee the implementation of the new process. Indeed, the government sought technical assistance from development partners to support the new process and to build capacity on budgeting throughout government.

The PRFB continued until the introduction of the MTEF. However, several other processes were adopted with the aim of improving the process and this included the introduction of the BRP and the PIP.

2.2.2 Budget Rationalisation Programme

Despite having introduced a PRFB, there was still low productivity in government's own investments; the reasons for this were inadequate provision for the maintenance of existing assets and a bias towards new programmes. Available resources were being spread thinly across a large number of projects due to a lack of clear prioritisation and too little attention to available resources in an adverse economic environment. Too many projects not being completed on schedule (or remaining uncompleted) led to cost escalation and the postponement of likely benefits to the economy. In addition, the investment portfolio contained several externally funded projects in different sectors that did not reflect national priorities for investment.

At the time of the introduction of the BRP, there was a squeeze on the availability of operating funds in many sectors, as a result of a tight budgetary constraint.

Projects that had been completed did not receive sufficient recurrent resources to operate at full capacity. Indeed, considerable difficulties were experienced in providing adequate funds for the operation and maintenance of existing capacity, especially physical infrastructure in the rural areas. Hence, the rationale for introducing the BRP was to ensure that there was improvement in the allocation of available budgetary resources and that there was closer linkage between what the economy could afford and the priorities that would lead to faster growth of the economy. The objectives of the BRP were to:

- improve the productivity of scarce budgetary resources;
- improve the planning and budgetary process;
- increase the contribution to budgetary resources of user fees and other non-tax revenues; and
- increase aid on better terms and to restructure external assistance.

The expectation was that, within a short time, the BRP would revamp the budgeting process, prioritisation of programmes would occur and ministries and spending agencies would adhere to ceilings for faster implementation of programmes. Four years down the line, the problems had worsened despite the strengthening of the forward budget by introducing various guidelines. The hard budget constraint did not clear as the ordinary resources did not grow as expected and the envisaged increase in flow of funds from development partners did not materialise. Thus, there was insufficient provision for operating expenses, personnel were poorly paid (which led to low morale) and the completion rate of programmes and projects was very low. The sight of many uncompleted projects across the country was an indication that the budgetary process was not supporting the development agenda.

Still in an effort to strengthen the PRFB process, the government introduced the PIP to enhance the capital budget.

2.2.3 Public Investment Programme

Recognising that the BRP could not by itself achieve the higher level of strategic forward investment planning that had to be the basis of the forward and annual budget capital spending planning exercises, the government introduced the PIP. The main rationale for the PIP was to strengthen the forward budget by providing a more comprehensive instrument for the planning and prioritisation of public expenditures. The PIP had six major objectives, which were to:

- strengthen the project cycle, namely the identification, design, appraisal,

implementation, monitoring and evaluation of projects;

- be an instrument of economic management used to monitor public sector capital formation targets, and to ensure that sectoral strategies were translated into projects and programmes;
- be a tool for better aid co-ordination to assist in the matching of government investment needs with donor financing opportunities;
- strengthen overall public expenditure management by sharpening departmental priorities, improving the phasing of projects and relating their total implementation costs and subsequent operating costs to recurrent and development ceilings;
- be used to monitor the investment plans of state corporations that may directly or indirectly impinge on government finances; and
- allow for accurate forecasting of future recurrent expenditure demands on financial resources.

Development partners played a key role in the introduction of the PIP as they also provided technical assistance for the implementation and institutionalisation of the exercise into the budgeting process. By 1994 some progress had been made as the PIP was now being co-ordinated by the Ministry of Planning and National Development. The annual timetable had incorporated the PIP as a key input to the annual budget and in this way it was able to influence the budget exercise. However, despite all these improvements the major weaknesses in budgeting for capital investments continued – the completion rate of programmes was as low as 3 per cent. Many projects had stalled, some as complete as 90 per cent. This was not for government-funded projects alone but also donor-funded programmes. These projects had also generated pending bills and the deficit on a commitment basis had gone up, as the hard budget constraint translated into informal funding.

2.3 Public expenditure management prior to the MTEF's introduction

Before the introduction of the MTEF in 2000, policy-making, planning and budgeting in Kenya took place independently of each other, even though several earlier reform programmes had tried to remedy this. Planning was confined to the Ministry of Planning, whereas budgeting was confined to the Ministry of Finance. Despite various reforms having been undertaken, particularly in the budgeting process, the budget was not delivering. The resources available were distributed too thinly over too many projects and were not linked at all to the policy priorities. This often resulted

in stalled projects, increases in pending bills (budgetary arrears), low funding to priority areas and consequent non-delivery of intended services.

At the start of the forward budget, or the annual budget, a forecast of aggregate resources was a requirement. Over the years, there was a tendency to overestimate revenues, which resulted in adjustments to the budget in the course of the year. The overestimation was mainly driven by the fact that as the performance of the budget was judged in terms of the size of the deficit, greater efforts were made towards achieving that variable than towards processes that could lead to the restructuring of the expenditure patterns and composition.

During the period when the budgetary reforms were being instituted, the country recorded high fiscal deficits, some of which were due to lack of discipline, whereas others were due to external factors, such as the flow of funds from development partners. The budget was adjusted as soon as it was presented to Parliament, resulting in a lack of credibility in the budget as a vehicle for government action. This was occasioned by the fact that in an effort to balance the budget, expenditure adjustments were effected on areas where commitments had already been made. There were instances of over-expenditure due to commitments that were higher than the approved budget, and also due to programmes that had been started despite having no budgetary provision.

Another weakness of the budget was lack of a process of costing and prioritisation. Despite having introduced the PIP, the process of project appraisal was not developed. The viability of projects was assessed solely on the arguments of the implementing agency. Consequently, the budget turned out to be incremental.

2.4 Recent budget reforms: The introduction of the MTEF

Through internal reviews of the performance of the budget process, the government realised that its public expenditure management was inconsistent with the objective of achieving the high and sustained growth of the economy necessary for reducing the levels of poverty. The performance of the public sector in itself had become a constraint to the growth prospects of the private sector and thus to overall economic growth. The composition of public expenditure was inappropriate and inefficient. It was these reviews that emphasised the need for a comprehensive reform of public expenditure management, spanning from budget formulation to budget implementation.

Arising from the reviews and their recommendations, the government adopted the MTEF, which would guide the efficient and effective use of government resources, and result in a reduction in the share of public expenditure to GDP. The MTEF was and is expected to achieve three tasks, namely to:

- maintain aggregate fiscal discipline by ensuring that policy changes are consistent with fiscal norms and programme objectives;
- increase efficiency in resource allocation; and
- promote efficient delivery of services.

2.4.1 Design and rationale for the adoption of the MTEF

The MTEF was designed to impose discipline on planning and management of national resources by establishing an explicit link between the annual budget process and agreed national policies and long-term national development objectives. The main objectives in introducing the MTEF were to:

- link the annual budget to the long-term development policies, objectives and plans;
- improve macroeconomic growth targets by developing consistent and realistic resource envelopes;
- improve the allocation of resources to agreed strategic priorities both between and within sectors;
- generate the commitment of ministries/departments to increased predictability in resource allocations so that these spending agencies could plan ahead; and
- increase incentives for more effective (better targeted) and more efficient utilisation of resources by ministries/departments, by providing these agencies with predictable funding levels and increased autonomy.

2.4.2 Institutional arrangements for the implementation of the MTEF

As in all other countries that have adopted MTEFs, an elaborate system of institutions was put in place to co-ordinate and manage the MTEF in Kenya, the most important of which are considered below.

The MTEF Secretariat

The introduction of the MTEF required a concerted effort across all ministries and government departments. As a start, a core MTEF Secretariat was set up in the Ministry of Finance and Planning. The Secretariat co-ordinated and directed the implementation of the MTEF on a full-time basis. It was also expected to make arrangements for internal capacity-building and for the training of key stakeholders and participants in this process. After a review of the MTEF process 2003/04, the MTEF Secretariat was merged with the Budgetary Supply Department.

The Macroeconomic Working Group (MWG)

The MWG is responsible for preparing consistent forecasts for economic development and growth. The group also prepares the expected revenues, the financing strategy of public expenditures and, together with the Sector Working Groups, proposes sectoral resource ceilings. The group is chaired by the Director of Planning and has members drawn from the relevant departments in the Ministries of Finance, and Planning and National Development, the Kenya Institute for Public Policy and Research Analysis, the Kenya Revenue Authority and the Central Bank. It may also co-opt other specialised institutions as and when the need arises.

Sector Working Groups (SWGs)

Initially, seven SWGs were set up. This was later increased to eight, in the following sectors: Agriculture and Rural Development; Physical Infrastructure; Human Resource Development; Tourism, Trade and Industry; Public Administration; Public Safety, Law and Order; Information, Communication and Technology; and National Security.

The SWGs work closely with line ministries, and are responsible for developing sectoral policies and objectives, evaluating ministry/department estimates and submissions and ensuring that the inputs, activities, outputs and outcomes are in line with national objectives. Each sector has a core secretariat based at the Ministry of Planning and National Development (following the recent review of the MTEF, SWGs are now co-ordinated by the Ministry of Finance), which incorporates other ministries and stakeholders when required.

The Planning and Budgeting Steering Committee (PBSC)

The PBSC is made up of permanent secretaries and authorised officers, who evaluate the macroeconomic and financing strategies recommended by the MWG and how they link to national objectives. They validate the allocation of the national resource envelope to the eight broad sectors, as recommended by the SWGs, and submit the same to Cabinet for approval. The PBSC is chaired by the Head of the Public Service and Secretary to the Cabinet.

2.4.3 The MTEF process and the annual budget

In implementing the MTEF, ministries/departments are required to focus on the expected outcomes of their expenditures and programmes, instead of just concentrating on inputs. The annual budget and the 3-year rolling MTEF provide a way to evaluate the realisation of the outputs and outcomes and their contribution to the overall economic growth of the economy. The first step is the establishment of

national priorities, which become the basis for the claim of resources and a consistent macro-forecast of key parameters, such as desired growth targets, inflation rate, exchange rate, interest rate and other macroeconomic parameters.

The MWG analyses the macroeconomic situation, forecasts a realistic level of available resources and determines the overall expenditure envelope as well as other macro and sectoral parameters. This is reflected in a Fiscal Strategy Paper that is discussed with ministries and is taken to Cabinet for approval. After the MTEF review, changes have been made; for the MTEF cycle of 2004/05, the paper prepared is known as the Budget Outlook Paper (BOPA), which gives the indicative resource envelopes to the line ministries. This paper is also taken to Cabinet for approval. This is a very important strategy to generate political endorsement and understanding of the foundation on which the budget is based.

The ministries participate through the SWGs, where, through the ministerial public expenditure reviews, they are able to analyse their past performance and expenditures and to prioritise their programmes. The ministerial reports are consolidated into a sector report that is subjected to public consultation through a process known as sector hearings. Thereafter, the sector reports are finalised and criteria are developed for sharing out the resources among the various ministries

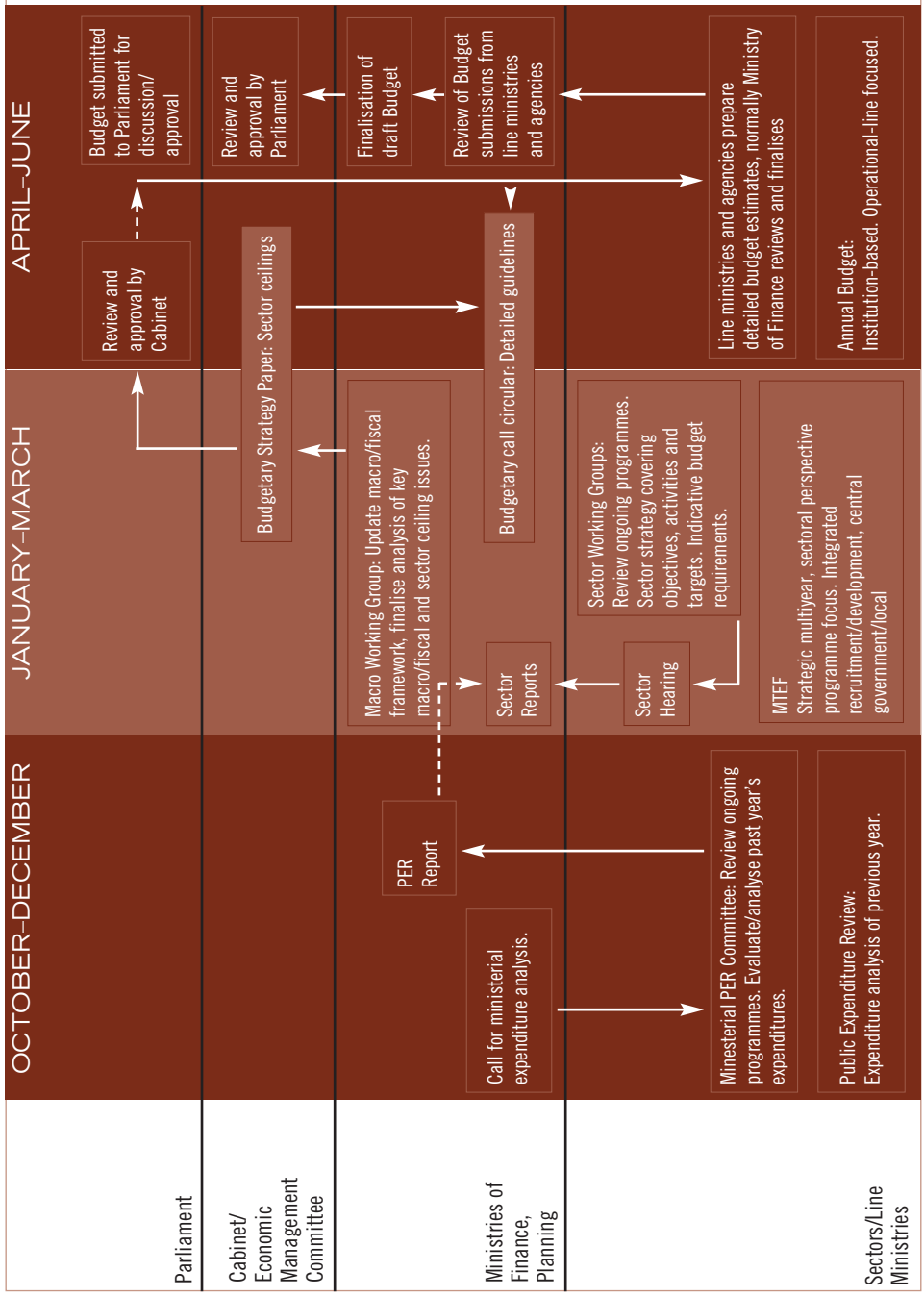
The ministries engage in a negotiation process known as sector bidding, where the ministries are allocated funds according to priorities and available resources. In line with changes introduced since the MTEF review, after the ministries have shared their resources, they finalise the sector reports, which they submit to the Treasury. The Treasury then develops a budget strategy paper that outlines the medium-term framework and gives firm ceilings on a ministerial basis. This paper is also taken to Cabinet for approval. Thereafter, the ministries consolidate their recurrent and capital resources to form the ministerial ceiling, which is used to prepare their itemised budget for a 3-year period, the first year of which becomes the annual budget. The ministries submit their itemised budget, which Treasury reviews and finalises for submission to Parliament.

One major departure of the MTEF from the previous process is the issue of political buy-in. At almost every stage, the budget is submitted to the Cabinet, either for briefing or for approval. There has also been substantial engagement with Parliament through the departmental committees. Figure 2.1 provides a pictorial representation of the MTEF process and the annual budget.

2.5 The MTEF process and linkage to the PRSP and the ERSP

With the introduction of the PRSP tool, the government consulted with internal

Figure 2.1: The MTEF and the budget preparation cycle in Kenya



stakeholders on what its priorities were and what the best strategies to eliminate poverty would be. The government launched an interim PRSP, which had been developed through a limited consultation at national level with a promise that there would be wider consultation for the full PRSP.

The PRSP consultative framework that was established with its organs at national and district level ensured that the process was participatory and inclusive. The national forum brought together different people and sectors, including government agencies, organised groups in civil society and the private sector. Similarly, the district forum brought together district government officers, Members of Parliament, local community-based organisations, local NGOs, local government and other interest groups.

One other key objective of the PRSP process was to facilitate the participation of communities, especially poor communities. The PRSP process included participatory poverty assessment studies in selected districts. The methodology followed ensured that the poor and disadvantaged were engaged in the dialogue on strategies for poverty reduction.

Agreeing on the goals that a country wants to achieve is a way to focus efforts and resources, and helps to prioritise objectives, setting clear goals. It can add transparency to the process of allocating resources. It also provides a benchmark against which to monitor the success of policies. The consultation process had an objective of identifying priorities and building consensus on the strategies that need to be adopted for the reduction of poverty. The district priorities that emerged through the process clearly showed the importance of consulting the poor on what their needs are.

Since its publication in 2002, the PRSP has formed the basis of the allocation of resources. The PRSP feeds directly into the sector reports, as there is a section for each sector in the PRSP and these sectors are similar to the MTEF sectors. Indeed, at the national level, the PRSP consultations were at sector levels. In the first year of implementing the PRSP, the criteria used to allocate resources among sectors were based on the outcomes of the PRSP consultations. This resulted in substantial resources for agriculture, health and education. In addition, criteria were developed for identifying core poverty programmes, which get first priority in the allocation of resources. The ministries are guided by the priorities in the PRSP when making their budget proposals. Soon after the change in government, an ERSP was developed, which itself validated the PRSP and now forms the guide to the budget.

One major contribution of the PRSP to the budget process has been the enhancement of transparency and governance. However, the people's expectations had grown as they expected an immediate shift of resources to the areas they had identified. They also expected greater predictability of resources flowing to the small villages, an

achievement that could not be reached immediately as the hard budget constraint continued.

2.6 Lessons learnt, successes and failures

Three years after having adopted the MTEF, the following are some of the lessons that have been learnt.

The MTEF gives more strength to medium-term planning. Ideal MTEF implementation moves emphasis from the short term to the medium term. It improves the link between planning and budgeting, placing greater emphasis on the medium term by giving indicative ceilings for the outer years. Better forecasting of resources is one major advantage of the MTEF.

Securing political endorsement strengthens the allocation of resources and restores credibility to the budget. The MTEF in Kenya enhances dialogue between the executive and the politicians; at every other stage, proposals were submitted to Cabinet for approval. However, political endorsement can also be elusive. Accusations may arise that politicians are grouping in accordance with party lines, rather than under the national agenda. As every politician represents a constituency, it is also easy for the budget to be locked in tightly, which allows for very little manoeuvrability by the administration.

There is also concern about the type of institutions put in place to implement the process. When the MTEF was introduced, a key point of departure was that the Ministry of Finance and the Ministry of Planning and National Development were to be merged. This meant that planning and budgeting decisions would have been under one authority, enhancing the linkage between the budget and the planning process. Two years later, the two ministries are still split. A critical concern in the introduction of the MTEF has been creating an enabling environment for the implementation of the process. Experience shows that institutional arrangements are critical for the success of the MTEF.

The MTEF is not a stand-alone reform, and other complementary reforms have to take place simultaneously. The introduction of the MTEF in Kenya has been accompanied by several other reforms, such as civil service reforms, local government reforms and governance reforms. The phasing and sequencing of these reforms have an impact on the MTEF. The MTEF facilitates a shift of resources from low priority areas to high priority areas. Thus, for example, it helps support a leaner and more efficient civil service, which is also an objective of civil service reform. Therefore, the time taken to make the civil service leaner determines the process of shifting the resources from the areas that are axed. Another impact has been the cost of these

reforms. The retrenchment packages arising from civil service reform in Kenya have had an impact on the available resources.

The MTEF process has turned out to be costly. It imposes a substantial strain on the administrative service, as more analytical work has to be done and many budgeting processes have to be completed. In Kenya, a major challenge has been the fact that many of the old institutions and previous budgeting regulations have remained, making the full budgeting process more complex and costly

The MTEF and the PRSP processes have opened up the budget as indicated. Previously, only a small group of officers in the Ministry of Finance knew about the reasons behind the spending ceilings given to the ministries, and the ministries only got to know the outcome of the budget process after the budget's presentation to Parliament. Transparency in budget preparation has ensured that there is, at least, public engagement with the budget process, although limited and unstructured at this point in time. It has allowed for more meaningful interaction between civil society organisations and the legislature.

It has also become very clear that the MTEF alone is not a panacea to all public expenditure management weaknesses. Indeed, it has to be supplemented with reforms in procurement, cash planning, commitment control and the review of several regulations.

2.7 Conclusion

A recent review of the performance of the MTEF process in Kenya identified several weaknesses, including the fact that the process usually started very late and this did not allow for proper analysis and review of programmes. The government has already revised the timetable to ensure an earlier start.

Another issue identified as a major weakness was that an indicative resource envelope was not issued at the start of the process, and this meant that ministries and other spending agencies were planning without any indication of available resources until very late in the process. To sort out this problem, in its new calendar for the MTEF, the government is committed to ensuring that the MTEF guidelines circular will include the sectoral ceilings.

There is also the issue of political buy-in and the need to promote awareness of the process throughout the government. Policy-making needs to be synchronised with resource availability. Therefore, efforts are to be made in ensuring that information is available at all levels so as to facilitate analysis and decision-making.

The structure of the budget has remained the same, with all the regulations that existed before the introduction of reforms. Already, the government is working on

the budget classification and hopes to use it in the new MTEF year. However, the issue of the existing regulations will remain a challenge, as not much has been done in this area.

Additionality of resources is not guaranteed when a country implements an MTEF. What a country implementing an MTEF needs is to come up with criteria for reprioritising both existing and future programmes, so as to ensure that priority activities are fully funded. In an effort to ensure that there is a shift of resources from low to high priority areas, the problem of terminating several activities arises. If these activities do not cease, they create a contingent liability. The challenge faced here is how to develop and implement criteria owned by all for prioritisation of public activities.

The existence of huge budgetary arrears has continued in the case of Kenya. The government recognises this as a major challenge if resources have to be released to priority areas. Administrative measures have already been put in place to ensure that there is a commitment control system. This must ensure that no commitments are entered into when there are no funds, or when the total committed amount will be over and above available resources. Coupled with the procurement reforms, this is expected to result in the reduction and elimination of budgetary arrears.

Finally, the reforms have tended to address budget preparation, leaving behind the issues of a legal framework and budget execution. This needs to be remedied.

CHAPTER 3

Malawi

Lessons learnt from first reforms lead to new approach

Chauncy Simwaka

3.1 Introduction

This chapter presents a synopsis of a programme for public expenditure management (PEM) reform in Malawi, focusing on the consolidation and revitalisation of the Medium Term Expenditure Framework (MTEF) and the introduction of Public Expenditure Reviews (PERs).

The aim of the second MTEF phase is to provide a co-ordinated framework for donor assistance to PEM and a framework for co-ordination within government, by linking together all the previously ad hoc and marginal reform processes into a coherent whole. The reform programme is also an essential complement to the Malawi Poverty Reduction Strategy Paper (MPRSP). Together, the MPRSP and the MTEF/budget form the core of the Malawi government's planning, budgeting and monitoring framework.[1]

Improved public expenditure management is crucial to Malawi's poverty reduction efforts for at least three reasons. Firstly, improved PEM is a prerequisite for

stronger fiscal discipline and therefore macroeconomic stability. Without macroeconomic stability, poverty reduction will be impossible, as high interest rates impede investment and growth, and inflation erodes the real incomes of the poor. Secondly, improved PEM is essential if the objectives of the MPRSP are to be met, since it is clearly stated in the MPRSP that the budget is a principal vehicle for its implementation. Thus, improved PEM will ensure that public resources are allocated to priority areas and will produce value for money.[2] Thirdly, the MPRSP is expected to bring a shift by donors away from donor-driven project-based support towards programme or general budgetary support with reduced conditionalities, more regular inflows and improved government ownership. However, this shift will not occur unless significant improvements are made to the budget process using an MTEF approach, so that the donors are assured their financial support will be utilised on priority activities as stated in the MPRSP.

In Malawi the MTEF is being implemented at a time when government is adopting other reforms across the public sector. In addition to the overall programme for the reform of the public sector, there are specific initiatives, such as sector investment programmes (SIPs) and sector-wide approaches (SWAPs), which are directly related to the MTEF. In the past, such initiatives have been seen as separate donor-driven 'add-on' activities requiring only temporary and minimal changes to 'business as usual'. This programme is intended, in part, to address these problems by defining a Malawi-owned coherent reform package that will transform the PEM system.

3.2 Background

3.2.1 Evolution of the MTEF in Malawi

The central tool for PEM is the budget process, which since 1995 has been based on the principles of the Medium Term Expenditure Framework (MTEF). The MTEF was introduced in order to correct some of the problems of the existing budget process in Malawi. These problems were highlighted in the 1990 Public Expenditure Review and the 1995 Budget Management Review conducted by the World Bank. The first central problem was the failure to link policy-making and planning to the recurrent budget. Although the development budget (through the public sector investment programme) was generally well prepared by planners and based on overall government policy and planning,[3] the recurrent budget was not planned and was generally prepared on an incremental basis. The second central problem was that the budget system was focused on the short term rather than the medium to long term. Not only were budgets prepared for one year, the recurrent and development budgets were subject to separate analysis. This led to a strong upward bias in development

expenditure (reinforced by donor pressure) and a shortfall in recurrent expenditure needed to maintain the development projects.

To address these problems, the MTEF was intended to introduce strategic, medium-term budgeting, bringing together the policy-making, planning and budgeting roles of government into a rolling 3-year horizon. The focus was on the reallocation of expenditure to priority activities. As such, the role of the budget under the MTEF was to change from a centralised inventory of inputs adjusted on an incremental basis to an output-focused approach based on costings of priority activities and projections of available resources. In order to ensure consistency and comprehensiveness, the MTEF reforms were also intended to lead to the integration of the recurrent and development budgets.

The MTEF was introduced on a phased basis, starting in 1995/6 with five key ministries (Agriculture and Irrigation; Education, Sports and Culture; Health and Population; Works and Supplies; and Police – together accounting for 40 per cent of the recurrent budget), expanding to 12 ministries in 1996/7 and covering all ministries and departments by 1997/8. The initial phases of the MTEF emphasised prioritisation through the production of logical frameworks. Although the emphasis was on the budgetary processes of the line ministries, the Ministry of Finance (MOF) managed the MTEF from the start.

3.2.2 Situation analysis

Progress has been made, including some shift of resources to priority sectors and the preparation of detailed activity-based budgets in selected sectors. By 1999, however, it became clear that the MTEF had not transformed the budget into an effective allocative and management tool. Sector policies remained unaffordable and resources were spread too thinly across many activities, substantial off-budget expenditures were taking place and there were significant divergences between priority expenditures, as expressed in approved budgets, and actual expenditures. As a result, the MTEF failed to achieve aggregate fiscal discipline,[4] adequate direction of resources to strategic priorities, or value for money in service delivery.

In order to properly assess the status of the MTEF, government conducted a comprehensive review of the MTEF in 1999/2000, which has informed the design of the MTEF Phase II reform programme. The review concluded that the budget was not operating as an authoritative and credible fiscal management tool. The review went on to evaluate the strengths and weaknesses of the MTEF process to date, considered the causes of these, and proposed the reforms required.

At the outset of the MTEF Review it was determined that it would not be sufficient to focus only on the planning and MTEF/budget formulation processes. The early

indications were that critical weaknesses elsewhere were undermining the implementation of the MTEF. Therefore, the scope of the MTEF Review was the full PEM cycle. As a first step, the MTEF Review took a view on the current functioning of each stage in the cycle, based on the findings of the Institutional Analysis of the 2000 Public Expenditure Review. At the time of the MTEF Review (March 2000), the assessment was expressed as follows:

- *Planning* is undermined by technical and institutional deficiencies in resource forecasting, which have made it impossible to generate a reliable medium-term framework. This has been compounded by weaknesses in policy formulation.
- *Budget preparation* has, as a result, been hampered by an absence of timely and authoritative expenditure ceilings and by the continued attempt to pursue sectoral policies, which are in aggregate unaffordable. The end result has been a persistent mismatch between expenditure plans and actual budgets, with many activities being under-funded as a consequence.
- *Budget execution* has been based on the cash budget system, with inevitable divergences between actual monthly releases and approved budgets. These divergences have been aggravated by pressures to finance new, unbudgeted activities and by lax controls over expenditure commitments.
- *Accounts reconciliation* within line ministries and *accounts consolidation* within the Accountant General's office have been several months late,[5] seriously compromising *within-year budget monitoring*. This has been partly compensated for by the monthly monitoring of expenditure returns, although without the possibility of verifying returns against payment vouchers and accounting records, there is clearly a question mark over accuracy.
- *Reporting and audit* processes are supported by adequate legislation and regulations but are undermined by capacity and resource constraints. In addition, the absence of disciplinary actions, follow-up investigations and prosecutions dramatically weakens the effectiveness of audit in enforcing accountability.
- *Policy review*, in the sense of a formal annual evaluation of policy outcomes with results fed into the definition of expenditure plans and output targets, simply does not happen.[6] There are many individual policy reviews – indeed, too many – but most of these are donor-driven and are rarely linked back to the budget process.

This listing of the key weaknesses at each stage of the budget process illustrates why MTEF Phase I was unable to have any significant impact on the quality of budgetary outcomes. It was a partial intervention, supported only by modest resources and not concerted efforts. As such, it was unable to have a real impact on the complex, inter-linked problems that existed throughout the budget process.

There were enormous divergences between the approved budget and out-turns, due to the issues discussed below:

- Weak revenue projections and unpredictable revenue flows, both from domestic and from donor sources were common. There were inadequate risk management strategies to ameliorate these factors. In principle, since the cash budget system aimed at countering the risk of aggregate fiscal over-runs, it did not comprehensively recognise mechanisms to counter the negative effects of revenue uncertainty on the distribution of resources and MTEF implementation. This undermined the MTEF by shifting focus from strategic budgeting to ad-hoc and short-term decision-making.
- Weak budget execution institutions in the spending ministries further limit the ability of government to implement the MTEF. There is insufficient technical capacity to control and report on expenditures, both internally and to the MOF. Controls over expenditure (i.e. robust systems of commitment approval, verification of delivery and payment approvals) are weak.
- Financial reporting is not done on a timely basis throughout the system, thereby impairing the ability of controlling officers, whether in the spending ministries or the MOF, to react timeously and use financial reporting as a means to control expenditure.
- The practice of undertaking new, unbudgeted (off-budget) expenditures during the spending year continues. In an environment of less than budgeted resources, unplanned activities routinely divert scarce resources from planned priorities, leaving them even more severely under-funded.
- Due to weaknesses in both the budget planning and execution systems, actual expenditure deviates severely from planned expenditure. This means that the MTEF/budget has very little credibility, and therefore is unsuccessful as a planning and control tool.
- The technical linkages between budget planning and budget execution are weak, allowing the link between strategic budgeting and funded activities to break down.
- The institutional arrangements of the budget planning process (i.e. the roles and responsibilities, rules, processes and sequencing of processes, and the

information that is requested and used) do not support stronger linkages between policies, budgets and actual expenditure.

- It is unclear where, when and by whom bottom-up demands for spending are reconciled with the top-down resource constraints, during both budget planning and budget execution. Hard budget ceiling rules are neither clear, nor consistently rolled out and enforced. This leaves funding decisions uncontested and undermines accountability for the decisions.
- In an attempt to address issues impinging on smooth implementation of the cash budget system, several mechanisms have been developed that have assisted government to more effectively control the aggregate level of spending and, to a limited degree, keep better track of the uses of available funds.
- Most recently, the MOF has put in place an improved system for tracking priority poverty expenditures. The system speeds up the monthly process of collating expenditure reports and enables the MOF to respond sooner when required.
- While there have been delays, the Integrated Financial Management Information System (IFMIS) is being developed and will lead to further improvements.

Creating an improved environment for strategic, medium-term results-oriented budgeting in the current context will involve a number of elements. This should begin with marshalling political will to implement both the MTEF and an improved PEM. The result must be the adoption of hard budget ceilings, with adequate controls and penalties to enforce compliance. In order to simultaneously maintain a strategic focus, there must be improved human and systems capacity in the MOF and in line departments to develop realistic forecasts, with respect to both revenue projections and programme costing, with greater involvement of ministries and external stakeholders, and established links to other planning initiatives. Full transparency throughout the budget process, with respect to plans and outcomes, will increase accountability at the technical and political levels. Predictability of the policy framework and consistency in policy decisions, and predictability of cash flows, part of which remains the responsibility of donors, will be essential for government to maintain compliance with the hard budget constraints.

3.2.3 Desirable characteristics of the MTEF

The main thrust of the MTEF Review was to consider what the PEM cycle was actually delivering, compared to the characteristics that a well-functioning PEM system would normally exhibit. In arriving at the characteristics, the MTEF Review drew on

Malawi's own experience as well as experience from elsewhere. The desirable characteristics are as follows:

- political leadership and commitment to the MTEF/budget;
- effective management, co-ordination and development of the MTEF/budget cycle, principally by the MOF;
- predictability in the funding of services;
- ensuring that policies and budgets are focused on the delivery of affordable and prioritised outcomes and outputs;
- comprehensiveness in the coverage of the MTEF/budget; and
- accountability for the use of public resources, incorporating effective management, control and accounting for expenditures.

While it is convenient to consider each of these characteristics in turn, it is evident that some weaknesses in different characteristics have common causes, or that problems regarding one characteristic have cross-cutting impacts on others.

Political leadership and commitment to the MTEF/budget

Ministers and parliamentarians have not taken advantage of the budget as a management tool to achieve Malawi's development goals, despite the fact that the budget is essentially a political process. This arises for several reasons. The extent to which Parliament is able to fulfil its role of 'watchdog' over government is limited, partly due to lack of knowledge and poor presentation of information. At present, the National Assembly has little substantive engagement in the process of determining the budget, and little results from the deliberations of the Public Accounts Committee on the Auditor General's Report.

In addition, Cabinet committees with responsibility for issues regarding the budget have not been systematically engaged in budget formulation and budget monitoring.

Finally, the line ministry managers often do not consider the budget to be a binding constraint on the total level of expenditure and the allocation of expenditures, largely because recourses are occasionally made available outside the formal budget process, and because of the lack of proper accountability for the use of funds.

Effective management, co-ordination and development of the MTEF/budget cycle

The first phase of the MTEF suffered from inadequate management and co-ordination. The institutional rules and procedures for planning and managing the MTEF/budget across government were not effectively applied, the MOF did not

operate as a cohesive team to provide leadership and guidance, and the management and co-ordination arrangements within line ministries were poorly defined.

The effective functioning of the MOF is the central issue, both in terms of its internal operation and its relationships with other central agencies and line ministries. In part, the problem relates to a lack of teamwork across the ministry.

The MOF encompasses the Budget Division, Economic Affairs Division, Debt and Aid Management Division, and the Accountant General's Department, which operates separately from the rest.

Predictability in the funding of services

The flow of funds to service providers has not consistently met the monthly cash release requirements agreed with the line ministries. This is a result of three main factors: firstly, fluctuations in revenue receipts, which determine aggregate expenditure through the cash budget system that Malawi operates; secondly, releases within the year for expenditures that are not included in the budget; and, thirdly, intermittent inflow or/and withholding of budgeted resources by donors. As a consequence, the approved annual budget allocations and the projections for the subsequent two years are not considered to provide reliable indications of the level of resources that will be made available to a ministry or spending unit.

Lack of predictability in funding is a critical factor in undermining the efficiency and effectiveness of service delivery. It does not allow managers to plan. Spending agencies do not know what they will receive until the bi-weekly release is made by the Budget Division. From the beginning of the 2001/02 financial year, the Budget Division has provided spending agencies with an estimate of the allocation they are to receive for the coming quarter; however, communication between the Budget Division and line ministries remains a problem.

Focusing policies and budgets on the delivery of affordable and prioritised outcomes and outputs

The MTEF Review concluded that policy development was weak and not clearly focused on affordable outputs and outcomes. As a consequence, inconsistency between budgets and policies persist, and expenditure is not focused on the outcomes desired by government.

The main causes were identified as a lack of clear resource limits to guide sector policy development, a policy process that is not systematically linked to the budget process, lack of clarity in policy-making responsibilities, lack of standard costs for budget preparation, and lack of transparency and accessibility in the presentation of the MTEF/budget documents.

Comprehensiveness of budget coverage

Two main issues exist regarding the comprehensiveness of budget coverage. The first is the existence of off-budget expenditures, often funded by donors. In some cases, no information is available to the MOF regarding donor activities. The second is the lack of co-ordination regarding the planning and financing of the recurrent and development budgets. There is still a tendency within government (often reinforced by donor practices) to treat development projects as separate from recurrent expenditure, and to focus more on the planning and monitoring of development projects than on the recurrent budget.[7] As a consequence, government expenditures are not derived from a single set of policies, accountability does not embrace all activities and programmes equally, and the financial implications of some programmes are not properly captured in the selection and budget processes.

This situation is further complicated by a breakdown in the clear distinction between the recurrent and development budgets. Rather than capturing all recurrent costs and all investment costs, respectively, the two budgets tend to capture programme costs and project costs, respectively. As many donor projects now contain a significant (often majority) proportion of expenditure that is recurrent in nature, and many government programmes contain expenditures that are investment in nature, the distinction breaks down.

Accountability for the use of public funds

The MTEF Review found accountability to be critically important for the proper functioning of the MTEF. The core problem identified by the review was that financial discipline is weak and good performance is not encouraged. This has led to significant weaknesses in financial management, including: (i) accumulation of unpaid bills and extra-budgetary expenditures, which undermines fiscal discipline; (ii) retention of funds for service delivery by ministry headquarters, which diverts funds from priorities expressed in the budget; and (iii) unauthorised virement and unsound financial management and procurement practices, which reduces value for money.

The root causes are:

- lack of transparency about expenditures made, outputs achieved, compliance with rules, and procurement, due to inadequacies in the availability and dissemination of information;
- inadequate monitoring of outputs and service delivery;
- non-enforcement of rules and procedures;
- low morale in the public service; and
- lack of incentives for controlling officers who perform well.

Without improvements in accountability, improvements in the formulation of the MTEF and annual budgets will have little impact, as they will continue to lack the authority required to make them effective.

Progress since the MTEF Review

Since the MTEF Review, steps have been taken that suggest some improvement in specific areas. Many of the recommendations arising from the review have guided the budget preparation process, and the 2000/01 budget marked the start of the new direction. In addition, the planning and monitoring sections of the Budget Division have been reorganised, and important improvements have been made to the funding system and the banking and commitment control functions. These advances provide a gathering of momentum that will be continued through the comprehensive MTEF Phase II programme, which demonstrates government's commitment to the improvement of PEM using an MTEF approach.

3.3 The reform programme

3.3.1 Programme design

The reform programme is based on solutions to the problems already outlined. It is built around the following six outputs, which reflect the six desirable characteristics identified above:

- strengthening management and co-ordination of the MTEF/budget process, especially through the MOF;
- improving the information base for political leadership of the MTEF/budget;
- improving the predictability of funding of services, especially though macroeconomic management processes;
- strengthening the policy and budget scrutiny process to emphasise outputs, effective poverty reduction, affordability and value for money;
- improving the comprehensiveness of budget coverage; and
- strengthening accountability for the use of public funds, including strengthened expenditure control and monitoring.

Although several activities that are included in this reform programme are ongoing, the majority of the activities will be implemented during the main implementation period of the programme (and of the MPRSP), which runs for three years with an allowance that further reforms will continue beyond this time frame.

A summary of the anticipated activities is provided below. It should be noted,

however, that the activities and their timing may change significantly as the project develops and as progress towards the stated output and purpose targets is assessed.

Strengthened management and co-ordination of the MTEF/budget process

The role of the MOF is key to the success of Phase II. Improved management and co-ordination within the MOF and interaction with implementing agencies is crucial. In order to ensure effective management and co-ordination, a strengthening programme for the MOF will be designed and implemented as an immediate objective. This strengthening programme will apply to the whole ministry, including all departments and divisions for extensive consultations and capacity reviews. At a minimum, the implementation phase will involve seminars for senior management and training for all departments and divisions.

Efforts will also be made to develop and operationalise a revised budget calendar, so that the budget process is fully predictable and institutionalised. This issue has been identified as one of the critical success factors for MTEF Phase II, and a considerable emphasis has been placed on establishing a revised MTEF/budget calendar within which responsibilities and rules are clearly spelt out, and which becomes the backbone of the budget process. This will be supported by stakeholder sensitisation workshops on the budget calendar and the role of MTEF Phase II.

Political leadership of the budget process

MTEF Phase II aims to improve the presentation of the MTEF/budget, to make it more intelligible to parliamentarians and ministers. This will be facilitated by the introduction a new Budget Preparation System (BPS) to replace the current input-based system. The new BPS will be based on a user-friendly software package to be customised to ensure output focus and consistency with IFMIS. It will be introduced across government through extensive training and support services, together with the appropriate computer hardware, where necessary. This new system will have advantages in accuracy, activity focus and speed of budget preparation, clearer budget presentation, and budget monitoring.

These activities will be complemented by efforts to improve understanding of public finance issues by MPs, Cabinet and the media. In particular, this will focus on the role and importance of the MTEF/budget and its links to macroeconomic stability and poverty reduction. Basic information on the MTEF/budget will also be disseminated directly to the general public through leaflets and radio programmes.

Finally, fiscal transparency will be improved by ensuring that quarterly expenditure reports are submitted to Parliament, Cabinet and the media.

Predictability of funding

MTEF Phase II will aim to create an MTEF/budget process that guarantees quarterly allocations, and delivers them on time. In addition, it will aim to set credible and reliable 3-year ceilings for the joint budgeting of recurrent and development activities. This will be achieved through a phased improvement of the macroeconomic forecasting model, especially as regards fiscal projections.

Formal risk management processes will also be developed to ensure exogenous shocks, including non-availability of donor funds, do not undermine predictability. Further, the forecasting and accounting of non-tax revenues will be improved. Finally, the administration and communication of funding between the MOF and the line ministries will be improved after consultation with the line ministries.

The negative impact of non-predictable funding on the quality of service delivery makes this a high priority in MTEF Phase II.

Strengthening policy and budget scrutiny processes

These issues are central to the effective working of the MTEF/budget, and will be a major part of MTEF Phase II. The MPRSP forms the key link between policy processes and the MTEF/budget, by translating consensus-driven policy into an affordable action plan. The MPRSP will be reviewed annually to monitor progress and make necessary alterations. Further, the links between the MPRSP and the MTEF/budget will be strengthened. In particular, the Ministry of Economic Planning and Development will develop poverty-related budget contestation criteria linked to the Key Poverty Indicators (KPI), which it will use to appraise investment plans submitted by ministries.

The MOF will also conduct annual Public Expenditure Reviews (PERs, see Section 3.4) in conjunction with line ministries. Each PER will cover a number of cross-cutting issues (e.g. decentralisation and non-tax revenues) and a number of sectors.

This output will involve strengthening budget scrutiny capacity within the MOF, and budget preparation capacity within line ministries. The MOF will provide timely expenditure ceilings and budget preparation briefings for line ministries. Training will be provided in activity-based budgeting and outputs, and budget submissions will be critically reviewed in line with the MPRSP, MTEF and cross-cutting principles. A process for agreeing on and monitoring performance indicators for line ministries linked to MTEF/budget preparation will also be introduced, with the appropriate training.

Finally, an MTEF/budget manual will be developed, taking into account the activities of the reform programme and the views of stakeholders. This manual will be

supported by extensive training designed to ensure institutional rather than merely personal capacities.

More comprehensive budget coverage

As an early priority, MTEF Phase II will aim to improve the flow of information from donors, and within the MOF, in order to achieve some immediate improvements in aid management. As a starting point, a development activity database will be established to record all existing and planned development activities of government and its development partners, both domestic and international. These activities will be assessed to check for duplications and consistency with the MPRSP. This database will then inform the preparation of the development budget as part of the MTEF/budget process.

Further, an improved tracking system for donor projects will be introduced in a phased manner across all ministries. Finally, the MOF will review and redefine an aid and debt policy, to ensure that donor inflows are directed towards government's priorities, that the financial implications of donor inflows are taken into account, and that the flow of donor budgetary support is smoothened.

Strengthening financial accountability systems

Achievement of early gains in accountability is one of the critical success factors identified for MTEF Phase II and is amongst the highest priorities for the first phase of the programme. The early gains include strengthening the legal framework for financial accountability through revised and separate Finance, Audit and Procurement Acts. These Acts provide for the passing by Parliament of supplementary budgets before spending by ministries; and for the early introduction of Performance Accountability Compacts with linkages between annual performance and salary/renewal of contracts made clear. Controlling officers currently have authority to discipline their staff by means of interdiction under the Public Service Regulations. Both of these initiatives include stronger sanctions against poor financial performance.

Budget monitoring systems, focused on finalising the introduction of IFMIS, will be strengthened. Once implemented, IFMIS has inherent controls to match expenditure to budget and flag where budgets/commitments have been exceeded. In the context of the MPRSP, an effective budget monitoring system focusing on pro-poor activities and outputs will be introduced to complement IFMIS. Additional efforts will be made to improve the quality of expenditure returns, by improving reconciliation of accounts and designing and implementing a systematic and rigorous process of monitoring budget execution.

Recent improvements in treasury and cash management and commitment control will be consolidated, and processes of bank reconciliation and financial record keeping in line ministries will be revised, in conjunction with the strengthening of internal audit systems based on the establishment of an internal audit unit in the Office of the President and Cabinet (OPC).

Other reform elements

Many of the reform initiatives contained in this programme are dependent on complementary reforms, particularly to the public service and accountability framework. Further, the programme will be implemented in the context of decentralisation.

Government adopted the Decentralisation Policy in order to consolidate democracy and allow people to take an active role in issues of governance and development. The policy aims at mobilising the local community to participate in socio-economic development and the promotion of accountability and good governance. Accordingly, the decentralisation process has been designed to be implemented in two phases. The first phase was scheduled for 2002/03 to 2004/05, with the second phase from then until 2010. During the process, central government will devolve the planning and implementation of agreed activities to local authorities. The activities will be devolved together with the required material, financial and human resources.

The MTEF recognises the decentralisation policy and process. The first phase of the MTEF emphasised prioritisation at sectoral level through the production of logical frameworks. Capacity-building at central and line ministry levels, especially in the area of training around the concept of an MTEF and its implementation, was widely covered during the first phase. The second phase, which aims at revitalisation and consolidation, will build on the existing capacity at central level. MTEF Phase II will consolidate and interface with various financial management and public sector reforms that are under implementation. Introduction of the MTEF to the local authorities will be a milestone of MTEF Phase II. The current planning and budgeting system of district assemblies will need to be reoriented during MTEF Phase II to easily interface with the national (central government) system.

3.4 The use of public expenditure reviews (PERs)

Government carried out a PER for the 2000 fiscal year together with the World Bank. On a macro level, the PER analysed overall trends in expenditure, institutional framework for expenditure management (particularly the budget process) and the development budget. On a sectoral level, the PER was carried out for the four key sectors of education, health, agriculture and roads. For each sector, past trends in intra-

sectoral expenditure were analysed, and recommendations were made for future allocations on the basis of past trends, benefit incidence analysis and prioritisation through reassessment of the role and resources of government. Thus, the PER was designed to complement existing and ongoing work on improving the quality of public expenditure, and to provide input into the Poverty Reduction Strategy and strengthen the MTEF process.

3.4.1 Objectives of the PER

The primary objective of the PER is to guide government in making more efficient use of its scarce resources, in order to foster more rapid and equitable growth and wealth creation, and improve the effectiveness of public policies, notably, on service delivery. Therefore, the role of the PER is to assess and improve the quality and content of public expenditure.

Specifically, the PER is aimed at supporting government in addressing the challenges encountered in public expenditure, by exploring options to tackle them in order to root out causes of inefficiency. Some of the areas of concern are civil service rationalisation and a review of government's operations and its use of public resources, in order to identify policy reforms that can support faster growth and more efficient delivery of services to the public, thereby contributing to the reduction of poverty. From the macroeconomic perspective, proper expenditure management and prioritisation, by helping to maintain fiscal stability, are critical for economic growth and poverty reduction. High fiscal deficits can hurt growth and employment by raising the interest rate and inflation, creating exchange rate instability, and crowding out critical public and private investment.

3.4.2 Methodology and content

As mentioned above, the PER was a joint exercise of the Malawi government and the World Bank. The macroeconomic chapters were drafted by teams drawn from the MOF and the National Economic Council (now the Ministry of Economic Planning and Development) and then revised to accommodate the World Bank comments. Teams from the relevant ministries drafted sectoral chapters (education, health, agriculture and roads) with assistance from the World Bank.

The PER was conducted through detailed consultations with various stakeholders, down to the lowest-level cost centre to appreciate the problems encountered in the course of service delivery.

3.4.3 PER findings

The PER format assists government to make immediate decisions in view of longer-

term trends, and helps bring more rationality into budget management processes. The findings point out long-term trends in budget policy and pertinent issues in budget planning and implementation that require attention. In this way, the PER helped shift the focus from the immediate problems of ongoing budget allocation on an annual basis to an analysis of longer-term issues.

Typical macroeconomic findings

The macroeconomic and budget management findings set out the fiscal policy and budget reform challenges. The PER found that over the years of structural adjustment programme implementation, the country's economic performance was dismal. The unstable macroeconomic environment and low (or even negative) growth were attributed to multiple factors, including external shocks, inconsistent implementation of reforms, poor fiscal discipline and a severe drought. Economic instability also resulted from poor expenditure management, which led to high fiscal deficits, forcing government to borrow large amounts on the domestic market, thereby crowding out the private sector and putting pressure on inflation and the interest and exchange rates.

However, changes in distribution of spending were positive from a pro-poor perspective, with spending in the social sectors growing from 6.16 per cent of GDP in 1993/94 to 9.24 per cent in 1998/99. General administration expenditure fell in the same period, but spending on the economic sector (in such vital areas as agriculture and tourism) also declined, raising the challenge of generating even further savings on the civil service in order to invest more in the economic sector.

Typical budget management findings

The PER pointed out that many of the problems in the budget process were caused by lack of co-ordination at all levels. For example, the roles of key players were not clearly defined and information about new budget system initiatives and sectoral expenditure ceilings was not clearly communicated to line ministries. It was recommended that co-ordination problems within ministries be resolved through the use of Budget Co-ordination Committees, and those between government and donors through the use of Sector-Wide Approaches (SWAPs). The PER also made useful findings on the first MTEF reform programme, most significantly that there was a lack of ownership, on account of poor understanding and the perception that it was a donor-driven process. Thus, while ministry budgets were supposed to be prepared through activity-based budgeting (ABB), the budgets in most ministries were not consolidated (i.e. were meaningless) as the line-item budget was still perceived to be the important resource-negotiation tool.

Findings on the development budget

The development budget accounts for an increasing share of total government expenditure, reaching 25.3 per cent in 1998/99. The majority of the development budget (66 per cent in 1999/2000) is spent on the key sectors of education, health, agriculture, water and roads. Wages and salaries (13 per cent) and operations and maintenance (23 per cent) together account for 36 per cent of development expenditure, while building accounts for 27 per cent (averages 1995/96–1998/99).

Donor resources make up over 80 per cent of development expenditures. Of this, grants account for around 28 per cent (1997/98–1998/99 average) and loans 72 per cent. This means that around 58 per cent of development expenditure is financed through loans, which raises concerns about the sustainability of development projects and future budgetary pressures through interest payments.

Other findings were:

- In general, actual development expenditure was far less than budgeted expenditure, on account of capacity problems associated with government (delays in counterpart funding, and inaccurate work plans, for example) and donors (linked to the multiple and varied conditions for the release of funds). Remedies for these problems were improving expenditure prioritisation and implementation and building the capacity of the Debt and Aid Management Division of he MOF to track aid inflows and ensure that conditionalities are met.
- The development budget does not cover all projects implemented by government. In order to gain control over public expenditure, it was seen as critical that all government-managed projects be included in the development budget.
- Better estimates of the recurrent implications of project spending need to be made.

Typical sectoral findings

The sectoral analysis provided a detailed review of trends in intra-sectoral funding and expenditure for the four key sectors of education, health, agriculture and roads. The first step in this analysis was the identification of priority activities that are core to the performance of the sector and that are largely public goods or services. This was complemented by a benefit incidence analysis that provided an examination of the effectiveness of expenditure. The cost of priority activities was calculated in order to assess the extent to which they are affordable given a particular resource envelope. Consequently, strategies to close the resulting funding gap were identified, such as

cost-recovery and efficiency-enhancing measures. We briefly discuss the main findings and recommendations for education, as an illustration of the scope and usefulness of PERs.

Education sector review

Outcomes in the education sector

The PER found that primary school enrolment had risen by more than 50 per cent over the period, largely due to the abolition of school fees in 1994. However, there were very high rates of dropout and repetition, especially in low standards and for girls. The survival rate to Standard 8 was about 30 per cent. The majority of students who sat the primary school leaving certificate passed, but the transition rate to secondary education was only about 65 per cent.

Secondary school enrolment had trebled over the period, with the largest absolute increase in community day secondary school (CDSS) students, who made up about 55 per cent of enrolment. Nevertheless, access to secondary education is still limited: the gross enrolment ratio is less than 30 per cent. There were several inequalities present in the system. Firstly, access was heavily skewed in favour of children from high-income families. Secondly, girls were under-represented and accounted for about 40 per cent of enrolment. Thirdly, there was a huge disparity in the Malawi School Certificate Examination (MSCE) pass rate between conventional and community schools, and the trend had worsened considerably over the period. In 1999, the CDSS pass rate was 4 per cent.

Enrolment at university level had increased very little over the period and was below 4 000 students. Female students occupied less than 30 per cent of places and were particularly under-represented in science disciplines. Enrolment was almost completely skewed in favour of high-income families.

Financing of education

By the time of the PER, the government had made education a high priority, increasing its share of the national recurrent budget from 22 per cent in 1993/94 to 28 per cent by 1999/2000. Within this allocation, there had been a clear shift in favour of primary education. In terms of development expenditure, up to 1998/99, government loans mainly financed primary school construction; however, in the following two years there was a move into the construction of day secondary schools. Bilateral donor grants were substantial in the education sector, more than matching the loan funds, and were focused on primary school construction.

Primary school students were receiving a vastly lower public resource allocation,

on a per student basis, than their counterparts at higher levels. Over the period, the matter had worsened, with a university student receiving over 200 times the amount of a primary student. These ratios were considerably higher than regional norms.

Between 1990 and 1998, the distribution of both public and primary secondary education expenditures had become more pro-poor. Nevertheless, at secondary level the distribution was still extremely inequitable – over half of secondary public education expenditure accrued to the richest 40 per cent of households, and boys benefited more than girls.

The definition of 'Free Primary Education' varied among different communities. Although no fees were charged, some parents contributed directly to general-purpose funds, provided labour in kind for construction projects, and supplemented government provision of learning materials. At secondary and university level, fees were extremely low in real terms and collection rates were less than 50 per cent. Approximately 5 per cent of public secondary costs were recovered from fees, and at the University of Malawi the rate was 1 per cent.

At primary level, salary expenditure was severely crowding out other quality inputs, which accounted for less than 20 per cent of total expenditure. The amount spent on teaching and learning materials was less than 50 per cent of the recommended US$5 per pupil. However, there appeared to be little scope for reducing the salary bill: pupil-teacher ratios were high and salary levels were low in real terms. In short, more resources were needed.

The distribution of primary teachers across divisions, between urban and rural areas, and between standards, was extremely inefficient. Female teachers were concentrated in urban areas, which was a particular worry for the educational attainment of rural girls. In terms of effectiveness, roughly half of the primary system's resources were being spent on dropouts and repeaters. The average duration of study for a dropout was much less than the four years thought to be necessary to achieve functional literacy.

In conventional secondary schools, boarding costs and 'other' non-salary expenditures were crowding out quality inputs. As in the primary system, teachers were not deployed efficiently across divisions, and pupil-teacher ratios were much lower in conventional secondary schools than in CDSSs. Over the period, cost-effectiveness in the conventional secondary system had fallen dramatically. While enrolment had nearly doubled, the number of graduates remained almost static. In tertiary education, there were vast differences in student-lecturer ratios, and in public expenditure per student in the six primary teacher training colleges. There appeared to be scope for redistributing resources between colleges to improve efficiency.

Education policy recommendations

The policy recommendations that came out of the education sector review were as follows:

- Realistic cost-sharing schemes should be introduced at secondary and university level, to free up resources for quality improvements at primary level.
- Improving access at secondary and tertiary level should be an important objective. The introduction of local area recruitment would allow a phased process of de-boarding to begin at secondary level and an expansion of day schooling. Promoting a more judicious use of physical facilities, through double-shifting at secondary level, and through weekend and holiday time use at the university, would enable greater access at a lower unit cost. Private sector provision should be encouraged through a partnership arrangement, which would enable the government to ensure quality standards. Finally, to ensure that the poor are not disadvantaged, a targeted bursary scheme should be implemented at secondary level, and the student loan scheme revamped at university level.
- More trained teachers are needed. A high-volume programme of initial teacher training needs to continue in the medium term. At secondary level, a fast-track method of training untrained teachers, who currently staff the CDSSs, is urgently needed.
- Adequate provision needs to be made in the recurrent budget for teaching and learning materials for primary schools and for school inspection and advisory visits. This should include support for the zonal in-service teacher education programme.

Cost-saving and cost-effectiveness measures include:

- Raising pupil-teacher ratios in conventional secondary schools. Both double-shifting physical facilities (but using the same teachers in both shifts) and ensuring that newly trained secondary teachers are able to teach at least two subjects could achieve this.
- At the university, the student to administrator/lecturer ratios need to be dramatically reduced. The exam system should be rationalised by reducing the number of subjects and papers offered.
- Putting in place measures to improve the quality of education, and continuing to sensitise the community on the need for regular attendance, form the

core of the recommendations to reduce dropout and repetition rates. Other means of improving the efficiency of expenditures are to reduce the resource inequities across standards, regions and between different types of school.

- Improvements in the government budget system are needed to ensure that the recommended resource shifts actually take place. This includes the development of a sector-wide expenditure and output monitoring process. Furthermore, secondary school fees should be retained at school level, and not remitted to the central treasury, in order to improve collection rates, accountability and effectiveness.

3.5 Conclusion

Malawi has been undertaking major reforms to its public expenditure management systems for a number of years. Since the early 1990s, two main reform waves can be distinguished. In the MTEF Phase I project, reforms were focused on the planning phase of the budget process, and were implemented largely in a bottom-up manner, with more concerted efforts to improve forward policy prioritisation and financial planning at the sector level than to improve the centrally driven, comprehensive framework within which the planning was taking place.

While there were some benefits from these reforms – for example, a more transparent linkage between sector policy and budgets, and improved capacity at line ministry level to link policies and budgets – their full impact was somewhat undermined by unpredictable funding during budget execution (on account of revenue shortfalls and in-year allocation to new activities), resulting in non-funding of the detailed sector requirements. Weak institutions and capacity at the centre, for the provision of suitable resource frameworks and assessing the more detailed sector plans, also undermined the first-phase reform mechanisms. Sector detailed development of activity-based budgets and efforts to prioritise happened in a vacuum, and largely amounted to empty annual compliance with procedural requirements – with only limited effect on spending outcomes – rather than robust engagement with problems.

The second phase of reforms has paid far greater attention to strengthening complementary systems, to sector policy prioritisation and budget planning systems, such as improved macroeconomic and revenue forecasting capacity, improved cash management and in-year transparency systems, improved capacity at the centre for budget management (including the development of a considered budget process that provides timely hard budget constraints) and improved institutions for economic governance, including mechanisms for political involvement, transparency and accountability.

The Malawi case study highlights the need to consider individual technical reforms in a specific phase of the budget, within the larger context of budget management, and the degree to which reforms are likely to succeed only if they are useful to participants in the budget process (if they count in determining what happens eventually), and if attention is paid to the overall incentive framework within which budget management and the reforms take place.

One of the shortcomings of MTEF Phase I can be said to relate to the MTEF reforms being implemented on a sector-by-sector basis and as parallel systems to the ongoing pre-reform system of budget allocations from the centre. This prevented proper consolidation of the bottom-up activity costings, even at ministry level (and therefore fell short of inducing prioritisation within sectors), as senior management perceived the annual budget process to be more important. While the development of detailed expenditure strategies can happen on a sector-by-sector basis, the Malawi case study illustrates that such sector-specific development needs to happen within a co-ordinated framework for budget management that is resource constrained, provides medium-term predictability and awards prioritisation.

The case study stresses the need for strong capacity at the centre (in the Ministry of Finance) to forecast revenues, to involve the political level, to assess budget formulation against cross-cutting issues and to co-ordinate the process.

Endnotes

1 This framework covers both the recurrent and development budgets, with the intention of moving from improved co-ordination and integration to eventual merging of the two.
2 This reform programme is itself based on the PEM sections of the MPRSP.
3 However, the strengths of the PSIP were fading by 1995, as the development budget increasingly became a collection of projects with both investment and recurrent elements, rather than purely investment in nature.
4 In terms of adhering to aggregate fiscal policy targets.
5 The revision of the Chart of Accounts to introduce Programme and Sub-programme classifications has apparently increased the time required for accounts consolidation and reconciliation. These delays may therefore not have been so significant in 1995 and 1996.
6 The completion of the 2000 Public Expenditure Review and the introduction of the MPRSP represented an important step to correct this deficiency. Malawi is intending to make PERs an annual process linked to the PRSP review process.
7 At a national level, the selection and monitoring of the development budget has declined in recent years as a result of the PSIP being transferred from the National Economic Council to the MOF. However, the PSIP has now been given to the Ministry of Economic Planning and Development, where screening, monitoring and evaluation projects will be conducted using poverty budget contestation criteria linked to MPRSP KPIs.

CHAPTER 4

Mauritius

Forward results-based budgeting for better economic management

Anil Kokil, Sunildutt Ramdeen and Rattan Khushiram

4.1 Introduction

Mauritius' remarkable pattern of long-term economic growth has been based on traditional lines of production and services – sugar, tourism and textiles – and on a broad and effective social pact that has brought together a very diverse society. However, presently the economy is being challenged on both the domestic and the international front as a result of:

- the phasing out of preferential trade access, which is likely to affect the traditional sources of growth;
- constraints in the tourism sector due to environmental fragility and the small capacity of the island;
- the unsustainable level of the budget deficit, which has been worsening since FY 1999/2000, and the excessively high and gradually rising public debt burden;

- the lack of due consideration to training and skills development;
- unemployment (currently at around 10 per cent), which has reached levels not witnessed since the mid-1980s;
- a welfare system that is increasingly coming under strain, with an ageing population and huge commitments to free education, free health care, non-contributory universal pensions and a multitude of social assistance schemes, including housing; and
- the growing dichotomy between social progress and economic development, which has resulted in pockets of poverty affecting some 10 per cent of the population.

4.2 The New Economic Agenda (NEA)

In 2001 the government of Mauritius set an ambitious medium-term development objective in a serious attempt to kick-start the economic reform process, confront the policy choices in restructuring the economy and build the strong macroeconomic, institutional and social underpinnings to power the country's drive to a high-tech, high-income, service and knowledge economy. The key components of the New Economic Agenda (NEA) are: (i) improvement in the competitiveness of the economy; (ii) investment in people and society; (iii) preservation of Mauritius' fragile environment; and (iv) improvement in economic management.

The NEA is a 5-year reform programme aimed at achieving the following specific medium-term outcomes:

Competitiveness and productivity

- Introduce information technology as a new sector.
- Strengthen the supervisory arrangements of the non-bank financial sector.
- Improve the quality of infrastructure.
- Modernise and streamline the public-private sector interfaces.
- Improve the functioning of the labour market.
- Intensify diversification efforts to move up the export value chain.

Investing in people and society

- Produce a better-educated workforce that fully meets the requirements of the public and private sector.
- Improve social cohesion and seek a fairer distribution of the benefits of growth and greater inclusion for all population groups in the country.

Environment and transport

- Ensure that the liquid waste, solid waste and transport sectors are financially, institutionally and legally sustainable and operate in full compliance with the environmental standards.

Economic management

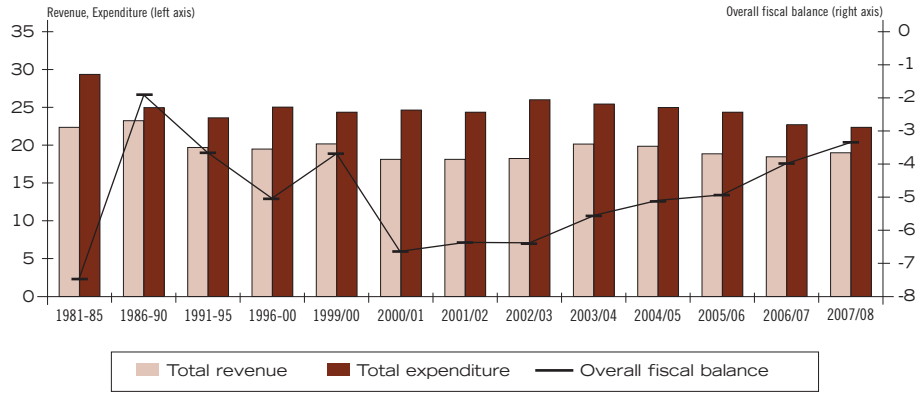
- Ensure medium- and long-term fiscal sustainability.
- Better align expenditures with the country's strategic priorities.
- Rethink the welfare state in a bid to streamline public expenditures on social programmes like education, health, housing and social security. Some targeting is required as those who can afford to pay should bear the cost.

4.2.1 Improving economic management

One starting point for the NEA is fiscal management. Sound budget management has been critical for Mauritius' success in the past, and will continue to be a cornerstone of success in the future. However, Mauritius experienced some slippages in the late 1990s. The gains in fiscal management that were made in the late 1980s and early 1990s were gradually allowed to be eroded through large revenue shortfalls as a consequence of tariff liberalisation in line with regional free trade agreements and WTO commitments.

Tax revenue had reached 20 per cent of GDP in 1996/97, and was down to 16 per cent of GDP in 2001/02. Concurrently, expenditure reduction (and prioritisation) was not undertaken in those years, and expenditure pressures have been rising; the higher expenditures on wages and salaries and basic pensions were at the cost of an increase in expenditures on education and health. In 2000/01 Mauritius' central government budget deficit stood at 6.6 per cent of GDP, compared to an average of 5 per cent in the preceding five years, and about 3 per cent in the period 1986–1995. The consolidated budget deficit, which includes the deficit of parastatals, amounted to around 8 per cent of GDP. The total public debt stood at 64.3 per cent of GDP (50 per cent from central government, the remaining 14 per cent owed by parastatals). The rollover risks from the government's short-term portfolio of domestic debt, contingent liabilities (unfunded pension schemes, accumulation of important losses from parastatals) and the risk of further erosion of tax revenues also pose significant risks. The NEA is trying to restore the fiscal balance (as illustrated in Figure 4.1, years 2001/02 through 2005/06). It is aiming to bring the overall fiscal deficit down to about 3 per cent of GDP by 2007/08.

Figure 4.1: Fiscal aggregates (% GDP)



4.2.2 Budget reform

Fiscal discipline is a major component of overall medium-term macroeconomic management. To secure fiscal discipline, government initiated a growth-friendly fiscal consolidation programme with emphasis on high-quality reduction in the deficit. The key components of the medium-term fiscal adjustment programme are revenue consolidation, expenditure restructuring and management, and the adoption of a medium-term framework and results-based budgeting as necessary preliminary phases for budget reform.

On the revenue side, government launched a major reform programme to modernise the entire revenue administration system. This includes:

- the creation of a large taxpayers' department;
- the modernisation of tax and customs administration systems and procedures, including increased co-ordination and co-operation between tax and customs departments;
- a review of corporate taxes to address the equity and tax buoyancy issues;
- scaling down the large dispersions and inefficiencies of the tariff system;
- strengthening the value added tax (VAT) administration – the registration, audit, database and enforcement functions;
- joint tax audits of the various revenue departments; and
- improving the efficiency and effectiveness of tax revenue administration by bringing the VAT administration, Customs and Excise Department, the

Income Tax Department, and the Large Taxpayer Department under the single central administration of the newly created Mauritius Revenue Authority.

Government is also working to restructure public spending, and improve expenditure controls and budgetary processes by:

- restraining current expenditure;
- improving the efficiency of civil service and welfare expenditures, and meeting the needs of the genuinely disadvantaged;
- readjusting the social maintenance programmes, which will impact on the financing, structure and delivery of social services;
- restructuring public enterprises to restore them as viable units;
- looking into the efficiency, equity and sustainability of the pension system;
- consolidating various off-budget government funds with the central government budget to make it more transparent;
- adopting a fiscal reporting system that compiles clear, comprehensive and timely data on budget execution;
- introducing public-private partnerships whereby a number of projects could be carried out jointly; and
- setting up a fully fledged debt monitoring unit.

While the ultimate aim is to move towards performance budgeting, our reform programme has adopted a phased approach. The first phase relates to the implementation of a Medium Term Expenditure Framework (MTEF). The fundamental objective of the MTEF is to enable government to prepare annual budgets within a sustainable fiscal strategy, which extends over several years, and to facilitate a progressive reshaping of budget allocations across and within sector portfolios, consistent with the strategic goals of the NEA. The second phase involves the introduction of a transitory or rudimentary form of programme-oriented results-based budgeting (RBB) – a form of RBB that retains the system of incremental budgeting, within an aggregate expenditure ceiling with a 3-year horizon, but introduces programmes and programme indicators to relate resources to results proposed and achieved. It also attempts to ensure a better allocation of resources, and involves introducing a results focus in the planning and management of resources. An increased focus on results is also part of wider reforms in public sector management. A whole range of civil service reforms are being initiated in the areas of performance appraisal, organisational structure, quality improvement and financial management.

Box 1

Results-Based Budgeting & Performance Budgeting

Results-based budgeting emphasises what has to be done, and helps link missions, goals, objectives and resources. A results or programme approach provides more flexibility to move resources around within programmes if there is a shift in priorities. The focus is on outputs and deliverables, together with greater delegation of authority to line ministries to improve performance in exchange for increased accountability. The aim is not to put an excessive emphasis on costs, but rather to focus on the results defined and achieved.

The existing budget system

The government of Mauritius operates a dual budget system in which the recurrent and development budgets are prepared and presented separately. Both the recurrent and the development budgets are presented on a line-item basis showing types of expenditure. It is conventional incremental budgeting where current budgets are increased by some margin for the following year. The estimates for the capital budget are based on current implementation of capital projects and projected requirements for the forthcoming year. The budget documents do not present sufficient information to allow for detailed analysis of projects. Although the Budget Statement sets out government plans and priorities, these are not clearly linked to the expenditure allocations. The focus of expenditure planning is very much on individual projects, rather than on a wider programme of activities and/or projects aimed at achieving government objectives. The release of capital funds is on a project-by-project basis, rather than on an implementation plan for the whole ministry or department, thus lower priority projects may be implemented prior to higher priority projects

Strengths of the existing system

Mauritius has an effective budget implementation system; there is a close match between estimated and actual expenditures, and there is a high level of compliance with fiscal regulations. Mauritius has developed expertise in running a tight budget-preparing process with proper expenditure monitoring, and much of the foundation for the MTEF and RBB already exists in Mauritius. A state-of-the-art accounting system has been introduced and has been made fully operational in a relatively short period of time. Reports on actual expenditures are produced in a timely fashion and there is a high level of compliance with laid down procedures. The Ministry of Finance and Cabinet discuss government priorities and the translation of these into ministry allocations. Some sector ministries have developed sub-sector master plans

and/or reform programmes, and most have developed mission statements and objectives. Policy analysis and reforms have been started in a number of ministries, and financial monitoring systems and compliance to existing rules are strong. Overall fiscal discipline is maintained by tight cash controls. A broad range of output statistics are collected and used to some extent in taking management decisions.

Rationale for reform

The main shortcomings of the budgetary system are that well-structured interactions and thorough discussions on the prioritisation of the competing proposals of line ministries are not carried out; resource allocation decisions do not clearly reflect the trade-offs between and within sectors; and, given the focus on inputs rather than a programme of activities or outcomes aimed at achieving government objectives, funding proposals are not made subject to expected performance.

These have contributed to a lack of effectiveness in public expenditure projects. The budgetary system falls short on development policy and sectoral programme design as well as monitoring and evaluation of outcomes. It is particularly ill-equipped to engage in good strategic planning. It does not allow government to effectively evaluate its earlier measures, rethink its key policy objectives and prioritise expenditures in the best possible way. The lack of cohesion in expenditure programmes, formulated on an ad hoc basis and on insufficient analytical foundations, makes trade-offs between different priorities difficult. It only encourages line ministries, as a convenient short cut, to put forward a shopping list of projects, not necessarily in line with their genuine needs.

Box 2

The budgetary process in Mauritius

The budgetary process in Mauritius is driven by the Ministry of Finance and Economic Development (MOFED), which is solely responsible for the preparation of the budget. Other agencies participating in the preparation are the line ministries and the Ministry of Civil Service Affairs (MCSA). The budget cycle begins around February, about five months prior to the commencement of the fiscal year on 1 July. The MOFED requests line ministries to submit their expenditure proposals for the forthcoming budget year, given the expenditure envelopes. On the basis of the macroeconomic fiscal framework, ceilings are issued to all ministries in a Budget Circular that sets out overall government objectives as well as detailed instructions for the recurrent and capital budgets. Line ministry submissions are then reviewed by MOFED staff. Since expenditures are generally well above the notional expenditure envelopes indicated by MOFED, formal meetings are held between line ministries, MOFED and MCSA to iron out the differences.

Most of the time, ministries tend to regard the ceilings set by the MOFED not as firm envelopes but simply as departure points for a bilateral budget negotiating exercise. These overestimated budget submissions by line ministries often result in arbitrary cuts by the MOFED. The present budgetary procedures for the allocation of resources do not allow for greater contestability and transparency. Moreover, the dual budgeting process is seen as a means of fragmenting the decision-making process. The national budget does attain aggregate fiscal discipline, but fails to some extent on the other two core budgetary outcomes, namely allocative efficiency and effective service delivery.

4.3 The introduction of the MTEF

The NEA is an extensive reform programme. Government's initial assessment of the total investment costs of the 5-year programme amounted to some Rs50 billion or about 6 per cent of GDP per annum. Thus, the NEA entails ambitious plans and large public investments compared to pre-NEA levels. The low levels of tax revenue combined with increased levels of public spending have meant increasing pressure on the budget, and highlight the need to manage fiscal policies carefully by prioritising and phasing expenditures.

Government recognised the need to move to multi-year budgeting and to introduce clearer links between development objectives and the budgetary process, and embarked on reforms aimed at introducing an MTEF as a first step. In public expenditure management terminology, improvements had to be made in terms of fiscal discipline, inter-sectoral allocations and intra-sectoral efficiency. The definition of realistic and sustainable fiscal targets and political commitment to those targets can go a long way in addressing these concerns; however, better capacity in aligning government spending with development priorities is also important, as are strong a priori analyses of spending programmes and the fiscal risks on the expenditure and revenue sides.

Building on the systems already in place, an MTEF was introduced for the 2003/04 budget, mainly as a central tool for prioritising and allocating resources between sectors. The chief elements of this top-down approach were the development of a macroeconomic framework, medium-term fiscal targets, an aggregate expenditure limit, and sectoral allocations.

To fill a critical gap in the machinery for co-ordinating macroeconomic policy, a Macroeconomic Technical Committee, comprising the Ministry of Finance and Economic Development, the Central Bank, and the Central Statistics Office, was set up to develop a Medium Term (3–4 year) Fiscal Framework (MTFF). The MTFF

discusses critical macroeconomic and fiscal issues facing the economy, and incorporates likely and consistent medium-term macroeconomic and fiscal frameworks for the budget. It also sets out the fiscal policy trade-offs faced by the government and associated implementation issues. The MTFF details targets for total revenue, spending and the deficit for the forthcoming budget and successive framework years, based upon the government's current assessment of the development path of the economy and its strategic intentions for fiscal policy.

The MTFF is presented to Cabinet in February, four months before the presentation of the budget, for discussion and endorsement ahead of the issue of a Budget Circular. The current process of setting budgetary ceilings involves assessment of the macroeconomic forecasts, agreement on overall recurrent and capital expenditures, and allocation of resources between ministries according to priorities. The capital budget ceilings are based on mid-year implementation assessments of capital projects. As part of this process, lower priority projects are dropped from the budget. The ceilings are consolidated in a Cabinet report, which outlines the overall macroeconomic situation, targets, and broad issues for reallocation of resources between sectors. The ceilings are then issued to all ministries in the Budget Circular, which sets out overall government objectives and macroeconomic targets as well as detailed instructions for the recurrent and capital budgets.

The Budget Circular process entails the conveying of ceilings to line ministries for the following three fiscal years. With the MTFF as a point of departure and debate, government agrees on medium-term fiscal targets and inter-sectoral allocations (i.e. a set of medium-term sector or ministry ceilings presented in the Circular).

The Budget Circular then incorporates these medium-term (3-year) ceilings for each ministry, consistent with the priorities emerging from Cabinet discussions. These ceilings are consistent with the aggregate fiscal framework. The purpose of the medium-term ceilings is to give ministries an indication of the level of funding they may reasonably expect to receive for existing programmes and policies in the outer years. The expectation, however, would be that ministries frame their spending proposals, both recurrent and capital, within these medium-term resource envelopes. Compliance with these rules is strong at the time of the budget submissions. However, Cabinet decisions on new policy initiatives are still made on an ad hoc basis during the spending year, as line ministries prepare new policies, programmes and projects for presentation. This can serve to undermine the budget process.

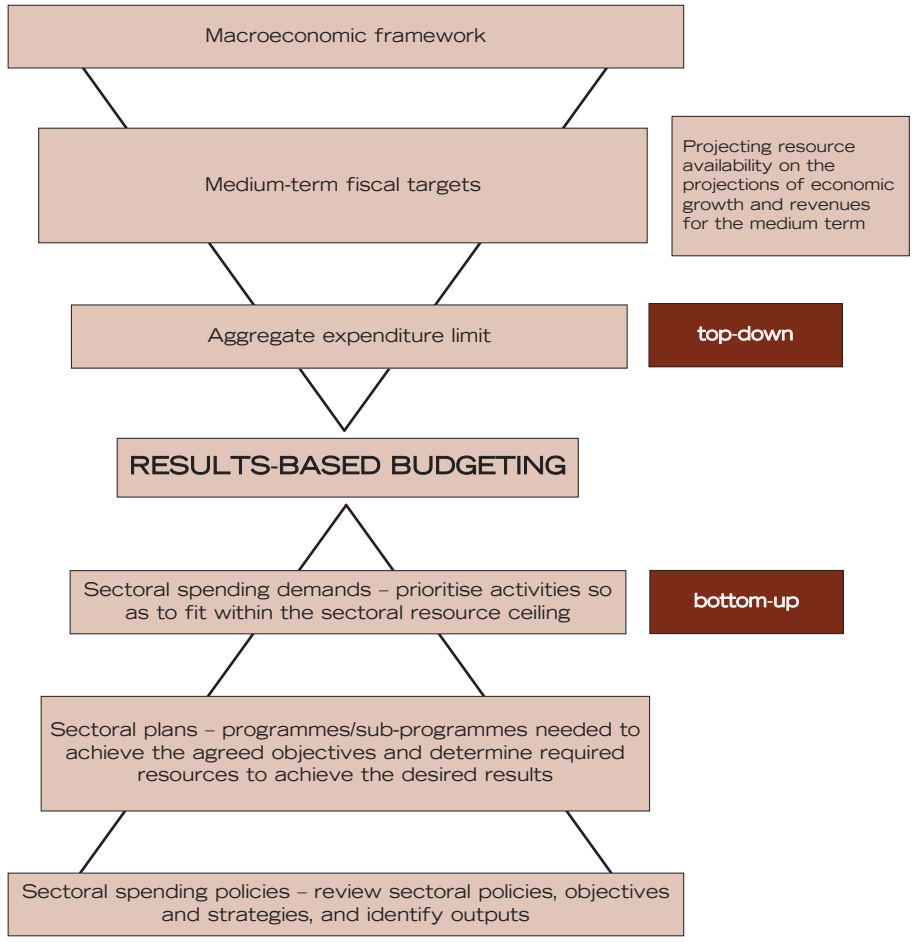
Some two months before the budget, consultations are carried out with line ministries. The budget estimates are reviewed by the MOFED, which has all the information on the status of each project and is thus in a position to decide on the amounts that should be allocated to each project. During the bilateral discussions of

the spending proposals, ministries are required to present supporting information, as available, on policy objectives, outputs and outcomes.

4.4 The introduction of results-based budgeting (RBB)

Once the top-down approach had been implemented, it was decided to introduce programme-based or results-based budgeting (RBB), the first component of the bottom-up process of our budget reform – an important stage on the road map to fully fledged performance budgeting, as depicted in Figure 4.2.

Figure 4.2: Performance budgeting



The key elements of the bottom-up approach are policy design and implementation, programme monitoring and costing. This requires that line ministries are staffed both by administrators and accountants, and by a multi-disciplinary team comprising policy specialists and economists, who not only formulate polices (including government and private sector roles) according to medium-term budget availability but also monitor outputs and outcomes (where possible) that feed into the annual budget exercise. This would help line ministry managers to ensure that resources are used to achieve their intended results. The bottom-up budgetary process would also enable government to better gauge progress in implementation and allow activities to be linked to performance indicators. Such a performance focus, or increased emphasis on service delivery, would increase the transparency of government and strengthen democratic accountability. Pilot ministries could be required to prepare annual reports. Finally, ministries would estimate the costs of implementing policy and achieving agreed outputs through the preparation of 3-year, integrated, performance-based budgets, and provide this information to the MOFED and Cabinet, so that adjustments in the allocations between sectors and ministries are based on the costs of implementing priority policies and programmes.

Government decided that, parallel with the existing traditional line budgeting, RBB would be introduced in stages over a longer time frame, initially covering the following sectors on a pilot basis – Education, Training, Health, Social Security, Environment (including Waste Water) and Public Infrastructure (including Transport). The remaining sectors are expected to follow suit as implementation progresses.

Despite being both top-down and bottom-up in design, the RBB approach has been a largely top-down exercise to date. It is only in the current RBB cycle that the MTEF cells in ministries are being built up to improve the bottom-up aspects of policy formulation, prioritisation and costing of programmes in the context of RBB.

However, a very elementary form of RBB in Education and Training has been completed with a recasting of the present line budgeting to a 3-year rolling budget of the total recurrent and development budgets within the incremental budget framework. It emphasises the allocation of resources on a sector and programme basis. Introducing a focus on results means that government can begin to move from reporting on inputs (i.e. how much money was spent on a particular project) to reporting on results (i.e. the efficiency of what was produced as a result of the project and its effectiveness, and whether this had a positive benefit to specific groups). Focusing on results also enables managers in ministries to take decisions based on performance information to improve the impact of their programmes, rather than simply ensuring that funds are spent. Such information was presented in a separate

document along with the 2004/05 budget on 11 June 2004. In the case of the Education sector pilot, the document set out the financial allocations for the fiscal year (by programme and economic line-item classification), with projections for the two forward years, together with indicators for the three years. For example, in the school education programme, the results-based objectives were targets for the final examination pass rate and for reducing the drop-out rate and rate of absenteeism.

The rolling out of the new budgeting process necessitated a reorganisation of the existing institutional structure (see Figure 4.3). In this regard, government decided in December 2003 to merge the Ministry of Economic Development (MED) with the Ministry of Finance (MOF) and set up a Central MTEF Unit. In addition to the complementary nature of the functions of the two ministries, an important rationale for the merger was the need to bring together their respective accumulated experience and ensure enhanced economic management with special emphasis on efficient expenditure management.

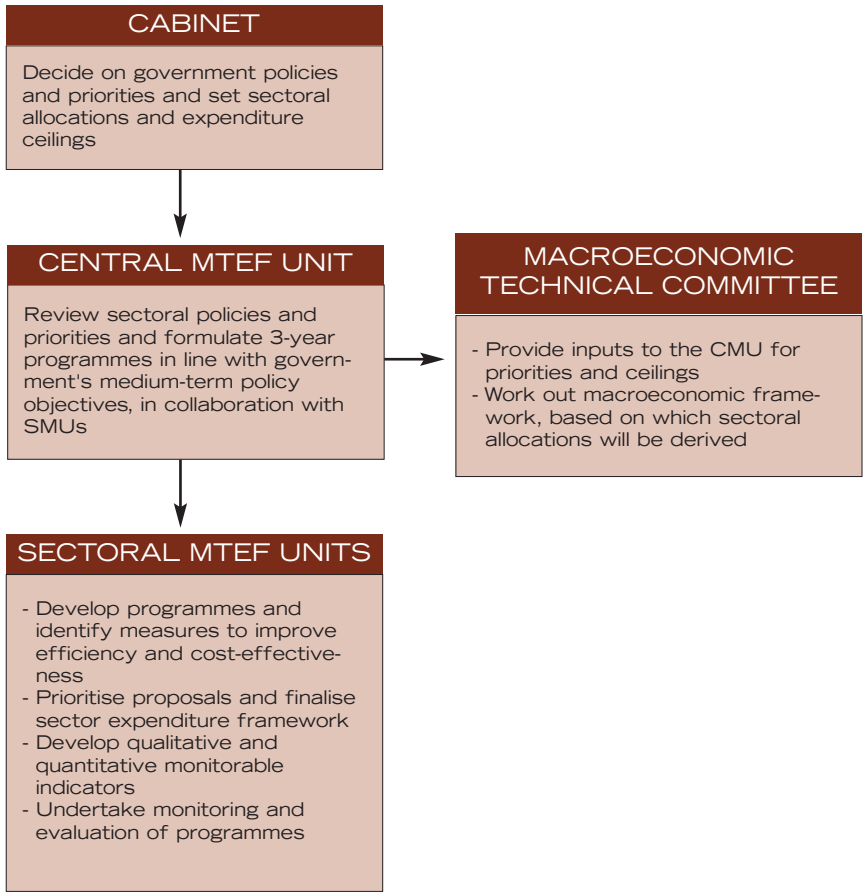
The Central MTEF Unit (CMU) spearheads the implementation of the MTEF/RBB in the MOFED and line ministries. Multi-disciplinary Sectoral MTEF Units (SMUs) are being set up in line ministries to implement the MTEF/RBB. Some economists from Economic Development sectoral units have been posted to the SMUs. They will be assisting in undertaking policy analysis, working out sectoral MTEFs, identifying measurable outcome indicators and preparing reports on programme management, as well as acting as co-ordinators between the SMUs and the CMU.

The CMU is presently working on the second stage of the RBB implementation plan, which involves the conversion of the budget allocations of Environment (including Waste Water), Social Security, and Health. A list of programmes for these sectors is being finalised in consultation with the line ministries and spending/executing bodies. The whole MTEF/RBB process for these sectors is expected to be completed by April 2005 and the document presented along with the traditional budget for 2005/06. The programmes and expenditures of Education and Training are being fine-tuned and broken down into specific activities, as shown in Figure 4.4. The CMU is also developing a monitoring and evaluation mechanism, which is a key component of the budget reform. A format has been devised and is currently being tested with the budgets of the pilot RBB ministries. It is represented in Figure 4.4 below.

4.5 The Treasury accounting system

The Treasury is responsible, inter alia, for ensuring the adequacy of departmental accounting systems and procedures as laid down in the Financial Management

Figure 4.3: Institutional structure



Manual and other financial regulations and legislation; advising ministries/departments on accounting and financial matters; exercising general supervision over the receipts of public revenue and over the expenditure and other disbursements of government; and reporting on the financial position of the Republic of Mauritius periodically.

Prior to 1999, ministries and departments used stand-alone account system software to manage their expenditures and revenues. Each ministry/department would submit soft copies of their consolidated accounts to the Treasury, which in turn would integrate the different inputs into its system. The major drawback of the

Figure 4.4: Monitoring and evaluation instrument

Programme, by Activity					
			Medium Term Estimates		
	2003/4 Estimates	2004/5 Budget	2005/6	2006/7	2007/8
Expenditures, by Activity					
Construction and Improvement of pre-primary schools					
Training of teachers					
Curriculum development					
Total Expenditure, by Activity					
Objectives	**Activities**				
Greater access to pre-primary education	Construction of pre-schools				
Improving the quality standards of the learning environment	Develop a New Regulatory Framework in line with the Convention of the Rights of the Child				
	Develop standard programme guidelines				
	Training of teachers				
Posts and Programme Indicators					
Posts	**2003/4**	**2004/5**	**2005/6**	**2006/7**	**2007/8**
Managerial and Administrative					
Technical					
Support					
Other					
Posts, Total					
Programme Indicators	**Benchmarks**				
	2003/4	**2004/5**	**2005/6**	**2006/7**	**2007/8**
Gross enrolment rate					
Number of pre-schools					
Percentage of trained teachers					
Student-teacher ratio					

system was the time lag involved in the consolidation of government accounts. Furthermore, a similar exercise was being carried out at the Ministry of Finance for the monitoring of revenue and expenditure. Ministries and departments were required to submit monthly returns of revenue and expenditure within five days after month end. These were consolidated at the Ministry of Finance. It was observed that, due to administrative reasons, many ministries and departments were unable to meet the deadline for submission of returns, which resulted in delays in analysing budget performance on a monthly basis.

In 1999 the Treasury reviewed its accounting software in addressing the 'Y2K' problem. It adopted an integrated system, the Oracle Public Sector Financials, whereby all ministries/departments were connected to the system. With four

modules (Accounts Receivable, Accounts Payable, General Ledger and Cash Management), the system provides for a central database with an intranet interface.

Therefore, a new Chart of Accounts was adopted that, besides giving financial information, was customised to provide other information on aspects of management accounting. The system was developed with a 15-year horizon and incorporates important features for the effective implementation of the MTEF. The system also provides an up-to-date statement of accounts, as the database is updated on a daily basis. As soon as data is entered, it is instantly available online via the intranet system for analysis at the MOFED. There is no need to spend time re-keying data. Presently, the Treasury closes the government's financial accounts for the month after only two days. The annual report is prepared within two months. Through its connection to the system, the MOFED can obtain specialised reports for monitoring purposes. The Central Statistics Office is also connected to the system to extract relevant data for the preparation of the quarterly government finance statistics and national accounts estimates.

The new system has been very helpful in the forecasting exercise. Information on any major discrepancy between estimates and actual figures is known instantly, and forecasts are revised accordingly. Two major levels of control are incorporated in the system: first, absolute control that strictly prevents ministries/departments from spending beyond their allocated budgets; second, optional (or advisory) control, whereby on the approval of the MOFED, the Treasury may increase the budget limit for certain projects and proceed with a reallocation of funds. Ministries/departments are also required to submit weekly forecasts of expenditures and revenues. In cases where expenditures exceed the forecasts, the Treasury queries the ministry/department and, if the expenditures are justified, asks the ministry/department to submit an update of its weekly forecasts. The system has established a strict control over public expenditures and has resulted in around 98 per cent accuracy in expenditure forecasts.

The whole system was designed and developed by Mauritian professionals in close collaboration with the Treasury, and was operationalised within five months. Mauritius is one of the first African countries to have adopted the Oracle Financials.

The Treasury will soon be incorporating two new modules into the system, namely the Oracle Payroll and the Oracle Assets modules. The Payroll module is a high-performance, graphical, rules-based payroll management system that is designed to keep pace with the changing needs of government and its workforce. The Assets module will allow for a complete inventory of government assets and greater control of acquisitions, disposals and maintenance.

The Treasury is also envisaging adopting the Oracle Public Sector Budgeting

module, which is a new application that delivers scalable planning and analysis, offering sophisticated data modelling and multidimensional analysis in a web environment. This will allow for an effective use of the Oracle Financial Analyser (the leading integrated analytical application) for financial reporting, analysis, budgeting and planning. The objective is to transform budgeting into a dynamic, transparent and collaborative process, and enable ministries/departments to link their budgets to their strategies. The budget preparation process may undergo important changes as discussions on budget proposals, prioritisation of projects and other issues can be done online. The Budgeting module, which supports rolling budgets and forecasts, is indeed in line with the budget reforms, particularly the implementation of the MTEF.

4.6 Lessons learnt

The introduction of the MTEF is an attempt to move away from conventional incremental budgeting, where current budgets are increased by some margin for the following year, to a budgeting system based on the actual cost of service delivery. This is a long-term process that can only be implemented in stages. The whole process will have to go through the necessary learning curve. In the present phases, greater emphasis has been placed on aligning the objectives of programmes with outputs, and increasing results-accountability, than on improving cost-effectiveness. We believe that we have more chance of success if we adopt a phased approach that will first put in place the building blocks at the levels of macroeconomic stability and strategic allocation of resources, and then add the other layers of the different stages of results-based budgeting that will ultimately allow us to improve the effectiveness of expenditures through the introduction of performance-based budgeting.

For a genuine bottom-up approach, the causal links between activities and outputs and between outputs and policy outcomes have to be well established. Moreover, objectives and targets have to be properly disaggregated and cascaded down to operating units. Implementation decisions should be devolved to the lowest feasible level in the hierarchy.

The determination of priorities becomes precise and realistic during the preparation of the budget. Thus, it is important that there should be mechanisms within the budget process that encourage the re-evaluation of policies and priorities and that facilitate the generation of policy alternatives.

A coherent framework for MTEF/RBB preparation, training needs and implementation from the MOFED, which would serve as a foundation, is lacking; and the current level of training for line ministries is so low that it risks not generating sufficient commitment and ownership.

The bottom-up approach will require capacity to be increased in the line ministries for policy development and programme management – these are new specialties for ministries, which have thus far relied primarily on external advisors for their analytical work. Reinforcement of the line ministries, especially the pilots, will be critical at this stage.

For an MTEF to perform its strategic allocation function, the top echelons of government need to have ownership of the medium-term inter-sectoral allocations. Ultimately, the allocation function remains the privilege and responsibility of the political leadership

4.7 Conclusion

As Mauritius faces the challenge of financing the NEA's investment programme in the presence of budget constraints, the process of inter-sectoral choice is among the most strategic decisions that the country can make. Today, budget constraints require greater efficiency in using public resources. To assist in making better inter-sectoral decisions and improving the efficiency and effectiveness of expenditures, Mauritius is reforming its budget management and budgetary processes by:

- more closely aligning development objectives, programme objectives and budget allocations;
- broadening the realm of public/private solutions for the attainment of development objectives;
- improving the economic analysis of programmes and projects; and
- attempting to develop the right institutional structure that will help in guiding the ultimate choices of resource allocation across and within sectors.

A crucial element in this bold reform programme is the institutional mechanism that should be put in place to support the implementation of MTEF/RBB. This will necessitate that:

- line ministries are restructured to meet the demands of programme or results-based budgeting;
- strategic planning and analytical capabilities for assessing and appraising public spending are reinforced in line ministries;
- the MOFED is redesigned to effectively co-ordinate MTEF/RBB, review sectoral policies and formulate 3-year programmes;

- the top-down (government, through the MOFED) and the bottom-up (sector) processes for deciding on sectoral priorities and allocation are strengthened;
- the political will to carry forward the budget reform programme is reinforced.

Often the search for the appropriate mechanism to address the above issues is a learning-by-doing process. More importantly, the whole budget reform programme must be owned by the implementing agencies and be allowed to generate its own local specificities, adaptations and pace of implementation – preferably without the usual retinue of advisers.

CHAPTER 5

Mozambique

Better budget machinery – First focus of reforms

José Sulemane

5.1 Introduction

Mozambique is currently undertaking major reforms within the public sector in general, including modernising the public finance management (PFM) system. The public sector reform (PSR) is intended to be a comprehensive overhaul of the public sector. It covers issues such as deconcentration and decentralisation of public administration; civil service restructuring, including pay and compensation reforms; legal and judicial reforms, with an anti-corruption component; and procurement reform, which is considered critical to curb corrupt practices within public procurement. PFM reform is a component of the PSR, but contains specific aspects that make it a separate process. The key dimensions of the PFM reforms are:

- the introduction of a new PFM system;
- revenue reform; and
- internal audit reform.

The sections that follow summarise the reform process within PFM in Mozambique since the 1990s, when the reforms took off.

Before proceeding, the structure of the state should be considered briefly. The structure consists of two levels, Central and Territorial. At the Central level there are ministries and related or subordinated institutions. At the Territorial level there are two sub-levels, each following specific legislation. The first, according to the Constitution, is divided into 11 provinces. The provinces are divided into districts (a total of 128), which are divided into administrative posts (APs), and these into localities. On average, there are three APs per district, and four localities per AP. These parts of the Territorial units follow the Law of Local Government Organs of 2003. In the second sub-level, there are 33 municipalities, which follow separate legislation approved in 1996/97.

5.1.1 The scenario prior to budget reforms (and some current issues)

Significant progress has been made in tackling some of the main budget outcome problems, especially since the end of the war in 1992:

- Overall fiscal stability had improved markedly by the mid/late 1990s.
- There was also a substantial expansion in expenditure, in real terms, on the priority sectors for poverty reduction, partly due to high levels of donor assistance, but also on account of the peace dividend. This has been buoyed by the gradual increase in internal revenue (rising from 11.3 per cent of GDP in 1997 to 14.3 per cent in 2003).
- Still, serious deficiencies in the effectiveness, efficiency and (territorial) equity of spending exist. These issues were revealed in the public expenditure review exercises (and related sector expenditure reviews) conducted in the 1990s and more recently during 2001–2003.

Prior to budget reform, the main concerns were about weaknesses in the budget process. These are outlined below.

Budget planning and preparation

- Lack of linkage/consistency between long-term plans – the Government Programme, PARPA/the Poverty Reduction Strategy Paper (PRSP) and sector strategic plans – and annual Economic and Social Plans (ESPs) and the annual budget (AB).
- The fragmentation inherent in the incremental nature of input-based budgeting, in the absence of frameworks/criteria/procedures for objectives-driven

resource allocation.

- The overly detailed nature of the budget, with thousands of input-based allocations to government bodies and thousands of micro-projects.
- Large off-budget resource/expenditure flows, which make coherent, prioritised planning and budget formulation extremely difficult.
- Direct donor funding of line ministries, in a context where donors account for more than 50 per cent of total resources and only about one-third of donor funds are for general budget support; in other words, direct budget support represents approximately 18 per cent of total expenditure (recurrent and capital).
- Internal revenues from user charges, and so on, being retained by government bodies and not fully reported to the Ministry of Planning and Finance (MPF).
- Confusion over vertical and horizontal channels for planning and budget formulation (through vertical ministry hierarchies and/or through district or provincial governments), due to the 'matrix' system of public administration inherent in double subordination, in which there is no clear attribution of competencies to different levels of government (reflecting, in turn, a failure to develop coherent policy for decentralisation and deconcentration).

Implementation

- Lack of a double-entry accounting system.
- Lack of planning mechanisms for budget execution, under a simple 'duodecimal' system, resulting in liquidity problems, especially in the early part of the year.
- Liquidity problems exacerbated by the existence of thousands of government accounts (and the lack of a single Treasury account).
- Serious delays in releasing funds to budget units, and in reporting, replenishing and closing accounts, prejudicing service delivery.

Governance framework

- Weak auditing, both internal (by the General Finance Inspectorate, GFI) and external (by the Administrative Court, AC), due to capacity constraints, resulting in long delays in the delivery of audited State Accounts, which take up to two years before reaching Parliament. Prior to budget reform there were no State Accounts; only in 2000, for the first time after Mozambique's independence, were State Accounts for the 1998 fiscal year produced and submitted to the AC and Parliament.

- Weak involvement of the Council of Ministers in making trade-offs in resource use, due to the input-based nature of the AB and fact that a Medium Term Fiscal Framework (MTFF) is not used as a strategic resource allocation instrument.
- Weak oversight by Parliament, which includes
  - not receiving, debating or approving key long-term plans, such as the PRSP, sector strategic plans or an MTFF;
  - deputies having difficulty in analysing a very detailed, input-based budget and relating it to policy objectives and the ESP;
  - off-budget problems, which remove large chunks of government resources/expenditure from parliamentary oversight;
  - poor parliamentary capacity (political polarisation, low level of education of most deputies, no research assistants);
  - a high degree of flexibility for the MPF to make budget adjustments (hundreds annually) without the need for parliamentary approval;
  - the setting of tax rates by executive decree, outside the AB; and
  - long delays in submitting audited State Accounts to Parliament.

This brief analysis of the situation prior to budget reforms, and some current concerns on this matter, points to the following objectives in attacking the weaknesses of the system:

- improve the coverage and transparency of the management process of public finances (revenues and expenditures);
- gradually assure effectiveness and efficiency of public spending according to policy objectives; and
- enhance and assure long-term sustainability of the fiscal policy and processes.

This chapter sets out the various steps that have been taken to address these concerns and achieve the objectives. It does so in three main sections. Firstly, the major technical reforms are discussed, from changes to the legal framework through to particular interventions, such as the development of a budget planning and control tool. Secondly, budget governance is considered, particularly whether sufficient reform has taken place to facilitate improved transparency and public accountability. Thirdly, an assessment is offered of reform effectiveness, and the remaining challenges to the reform process are identified.

5.2 Main stages of the reform

Given the major objectives of the PFM reforms, and also considering the human resources and financial constraints, certain steps were deemed critical to pursue these reforms. There was the need to improve the legal framework and procedures to facilitate resource allocation (internal and external) in accordance with priorities defined in policy documents and statements, and to contribute to greater transparency of the decisions undertaken. Actions and mechanisms had to be established to allow decision-making instances to deliberate in accordance with defined policies and priorities.

5.2.1 The BFL and the LSFAS

In order to advance with these activities, two milestones in recent years were the Budget Framework Law (BFL) of 1997 and the Law on the State Financial Administration System (LSFAS).

The objectives of the BFL were to increase coverage and transparency of the budget, achieve effectiveness and efficiency in the use of government resources and ensure fiscal sustainability. This legal framework established the budget structure using modern and universal classifiers adjusted to Mozambican conditions, and imposed specific requirements in terms of organic structure, norms and procedures for programming, management and budget execution.

The objectives of the LSFAS were very broad – to establish and harmonise rules and procedures for programming (revenues and expenditures), managing, executing, controlling and evaluating the use of public resources. The main intended reforms include:

- the establishment of an Integrated Financial Management Information System (IFMIS);
- a new double-entry accounting framework;
- the establishment of a single Treasury account;
- the introduction of cash-flow planning for budget execution, through quarterly and monthly plans; and
- the introduction of programme classifiers as a means of linking policies/plans and expenditures.

The focus of the reforms has mainly been on improvements in process (rather than product), chiefly the technical as opposed to institutional aspects of process.

BFL measures

The main measures undertaken in terms of the BFL are outlined below.

Introduction of the Medium Term Fiscal Framework (MTFF) in 1998/99

In practice, the MTFF is focused more on forecasting the resource envelope and much less on making priority-based resource allocations. The first phase of the development of the MTFF emphasised the analysis of the expenditure side of the budget and forecasts, aiming at bringing together a more comprehensive approach to public expenditure, taking into account domestic and external resources. In the second phase, during 1999 and 2000, the focus was on establishing the links between policies and the process of resource allocation, in particular analysing the coherence of public spending and imposing its rationalisation. The third phase, from 2001, has focused on the objective of promoting the equilibrium and stability of the public finances, in particular the control of spending as a means for more effective use of resources. In this regard, the MTFF has become an exercise for projecting public spending (based on the resource envelope from a macroeconomic framework) on a predetermined indebtedness situation, in particular related to the Highly Indebted Poor Countries (HIPC) initiative. This has become a mere financial exercise, and there is a need to reinforce the analytical content of the different programmes and their links to policies and strategies, as it is being used as a framework for decision-making at the Cabinet level.

Introduction of a new budget classification system

The new classification system (functional, organic, economic and territorial) has improved budget planning and execution. However, the functional classification is not fully applied and, in essence, remains an aggregation of administrative classification.

Integration of investment and recurrent budgets

The investment and recurrent budgets have been integrated in the framework as a financial exercise, but could still be made more effective in supporting better allocative decisions. Currently, the two budgets are still predominantly planned separately, a large amount of recurrent expenditure is wrongly classified as investment expenditure (partly to circumvent IMF targets for the primary deficit) and there is no real attempt to analyse the implications of investments for future recurrent outlays.

Improvement in budget preparation and reporting

Based on the two previous activities, and in order to improve budget preparation and

management, an IT application (SISORÇ) was developed in 1998 within the National Directorate for Planning and Budget (NDPB). SISORÇ is basically software for budget preparation, using detailed classifiers and items on expenditure; it is also a budget management tool for budget alterations during the year, taking into account the budget ceilings approved by Parliament. The software provides a permanent and exact record of the situation of the state budget at a central level. This system was extended to provincial level in 1999, which has contributed to the reduction of time required for budget preparation at the moment of globalisation of the AB. Regulations for budget execution and alterations have been implemented, as has a handout of procedures and routines for budget management and elaboration.

Improvements in budget coverage (the off-budget problem)

Interventions in this regard improved the recording of resource and expenditure flows on the approved budget, but brought far less progress in making execution procedures and the reporting of state accounts more comprehensive. The first study of off-budgets was conducted in 1999 and covered the health, education, agriculture, public works and social actions sectors.

Improvements in accounts

Accounts recording is performed by the National Directorate for Public Accounts. Since 1901 a manual system for recording expenditures was used. In 1997/98 this system was computerised. The computerised system facilitated the elaboration of the consolidated State Accounts produced annually. Since the State Accounts for the 1998 fiscal year were released in 2000, these accounts have been sent annually to the AC and Parliament. Based on this system, quarterly budget execution reports have been produced, and have been released 45 days after the end of each quarter, since the first quarter of 2000.

Improvements in debt management

The restructuring of public debt has been quite successful, with most public debt reduced according to the HIPC initiative and guidelines. Mozambique still needs to establish a post-HIPC debt-management strategy, which is required to analyse the country's vulnerability to future debt problems. There is an ongoing exercise with Debt Relief International in designing this strategy. An immediate concern is internal debt and its related management. In the past few years, there has been large and costly internal debt, coupled with high interest rate spreads; this can reduce government flexibility to manage the economy through short-term treasury bills, in particular in a situation where external resource disbursements are not predictable.

LSFAS activities

Under the LSFAS, the main activities in practice are related to implementation of the reforms, focusing overwhelmingly on computerisation, for example on the establishment of the IFMIS and the related single Treasury account. Other components, such as the introduction of programme classifiers and cash-flow planning (to replace the duodecimal system), have been delayed. Very little, if any, attention has been paid to other aspects of planning and budget formulation, for example strengthening of the MTFF (in particular, to overcome the limitations signalled above).

5.3 Efforts to improve budget governance

Budget governance, in the sense of institutional arrangements and political involvement in budget and financial management, has been much less of a focus in practice, compared with reforms related to the technical aspects of the accounting/payments systems and computerisation. This section provides an overview of problems and interventions in various systems that support transparency and public accountability.

PFM reforms have been concentrated at the MPF level, moving towards the line ministries and provinces and districts due to the ongoing decentralisation process, but other stakeholders must increase their role in budget governance. One of these stakeholders is Parliament. The main measures that would improve parliamentary oversight can be grouped as follows:

- improved budget comprehensiveness (reducing off-budget problems), but this activity is proving slow and difficult in practice, because it affects both internal and external partners, each one with specific interests;
- the speeding up of production and auditing of consolidated State Accounts (to be reduced to nine months after end of fiscal year), to permit more timely parliamentary oversight; and
- a medium-term vision of fiscal accounts provided by the MTFF/budget.

Efforts to improve budget governance have to start with revenue reforms: very little revenue is raised locally, producing poor incentives for local accountability. Revenue reforms cover both revenue collection and institutional aspects. Reforms in this area started in 1987 with the first programme with the IMF. In the period 1987–1996, most of the reforms concentrated on indirect taxation (excise tax and customs). From 1997 onwards, a period of consolidation of reforms followed, in terms of collection and institutional arrangements. In 1997, customs reforms took place, with regard to both institutional capacity building and simplification of the tariff system. In 1999, these

were followed by more reforms in indirect taxation, in particular the introduction of the Value Added Tax. In 2002/03, most of the reforms concentrated on direct taxation. From 2004 onwards most reforms will be related to the creation of the Central Revenue Authority and the effects of regional integration or trade blocks. These reforms have contributed to the increase in the domestic revenues as a percentage of GDP since 1997.

Another area for budget governance is related to auditing practices. Recently, there have been some related investments in strengthening procedures and capacity for auditing (internally and externally). The AC is the entity that deals with the external auditing of the State Accounts. This institution has received technical assistance for some time, which has permitted it to audit the State Accounts from the 1998 fiscal year onwards. Besides this oversight activity of the State Accounts, the AC is a Civil Service Commission (providing clearance on major personnel decisions like hiring and promotions) and a National Contracts Committee/Tender Board (providing clearance of public contracts), and it provides for clearance of financial agreements (for example, grants and loans) with foreign institutions. This imposes an insurmountable burden on the AC and, consequently, limits its capacity to perform; it also includes conflicting functional roles as the AC passes *ex ante* judgments on contract/tender procedures and hiring decisions, which later it has to audit. Although the AC has an independent status under the Constitution, it follows normal civil service hiring conditions (depending on the state budget for normal functioning), so it faces normal recruitment problems for qualified staff. In the last two years, budget allocations have improved to allow for the strengthening of the institution, but it has continued to face structural problems given its conflicting responsibilities.

The GFI, within the MPF, is the entity responsible for internal auditing, the internal inspectorate for public finances. It has undergone some improvements over the last few years, even being treated as a semi-autonomous institution for budgetary purposes, in order to exercise more control over resources and their internal allocation. It has been recruiting skilled staff and has designed a long-term development plan, which is being implemented systematically. The GFI has received some technical assistance, and has been able to perform more in-depth audits, including performance audits (value-for-money audits). It is now in the process of strengthening the regional offices in the central and northern parts of the country.

Attempts are ongoing to involve external partners linked to the budget support schemes and civil society, in general, in the planning/budget process. Two lines of action can be presented here.

External partners. A highly structured process has been developed for dialogue between the government and the G-15 partners (13 bilateral donors and the European

Commission and the World Bank) providing general budget support to Mozambique. This involves a Memorandum of Understanding that establishes two joint reviews annually, focused on a performance assessment framework (PAF) indicating key outputs and actions over a 3-year period. Donors constitute both a strength and a challenge for Mozambican authorities. Donor staff are proactive and engage in very detailed monitoring activities, providing proposals, undertaking studies and engaging in policy and technical discussions. This can overwhelm local staff and result in them feeling more accountable to donors, through this and other (sectoral) processes, than to Parliament. Discussion with donors focuses on strategic policy issues, the quality of work and data, thus raising the appropriate issues for debate and decision-making. One important aspect of this harmonisation exercise, however, is the use of existing planning and budgeting instruments/documents to incorporate the discussed indicators/issues within the ESP and the AB, and also the use of the existing monitoring and evaluation mechanisms (ESP Reports, Quarterly Budget Reports and State Accounts).

Civil society. The framework for dialogue with other (internal) stakeholders is much weaker, although an annual 'Poverty Observatory' provides a consultative forum for dialogue with civil society organisations on progress in the struggle against poverty. Various documents produced either by the government or by civil society are analysed at this forum. However, the budgetary dimensions of this have not been prominent in the dialogue.

Finally, continuing weaknesses of the MTFF are a subject of concern. The MTFF has not yet developed into an instrument for strategic, medium-term resource allocation; it remains essentially a technical forecasting tool, used internally within the NDPB for projecting resource envelopes and setting limits for budget formulation using an incremental approach. Given its limited technical role, the MTFF still does not go to the Council of Ministers for discussion and approval, and therefore is also not submitted to Parliament.

The NDPB has drawn on these lessons, and has developed a methodology for submissions to MPF senior management, which addresses these institutional weaknesses. Since the beginning of 2004, a major overhaul of the methodology has been proposed, in the sense of looking at the MTFF, the ESP and the AB as part of a single process. The first stage is at a strategic and policy level, while the second stage deals with the detailed elaboration of the documents, which are submitted to Parliament. With this single process, policy documents become more integrated. The new process may be implemented in the 2006 budget cycle.

5.4 Assessment of the budget process reforms

Assessing the effects of reforms is a very complex matter, particularly in a changing environment. Reforms are moving in a relatively structured and comprehensive manner. The trend in PFM has been positive, but further improvements are needed in medium-term planning and budgeting to increase transparency and coverage, while budget execution is still weak, as are external auditing and accountability in general. Budget formulation has improved slightly in terms of coverage, classification, identification of resource envelopes and discipline regarding fiscal aggregates.

A look at the budget out-turn in the last several years shows that the overall balance after grants, which had been very high in early 1990s, was reduced to 1.5 per cent of GDP by 1999, though it widened in the early 2000s, peaking at 8.2 per cent in 2002, falling in 2003 to 4.6 per cent and in 2004 falling again to around 4.1 per cent.

In what is a concern regarding coverage and transparency, significant off-budget flows remain, making budget management inherently difficult. Due to the size of these resources in some sectors, the government and external partners have decided to start a health sector study to analyse these off-budget resources and to propose measures for their incorporation in the state budget and its mechanisms.

Budget formulation has changed very little, if at all, in terms of effectiveness, equity and efficiency, because there are no mechanisms in place (through the MTFF or the budget itself) for linking resource allocation to policy priorities, addressing territorial equity issues, and so on. The only allocative targets explicitly being followed are on fiscal aggregates (agreed with the IMF) and the share of PRSP priority sectors (65 per cent of overall recurrent and capital expenditures), but some slippage has occurred (63 per cent in 2003 according to the audited State Accounts). There are no explicit targets for intra-sectoral or territorial allocation. For Budget 2005 some basic criteria based on population size and the poverty index level have been used to start to determine resource allocation for provinces, in particular.

Some large line ministries are beginning to plan and budget better, but they are doing so with their own systems, parallel to the macro-level AB system. These line ministry systems are related to the sector strategic plans and common-funds schemes developed as a result of sector-wide approaches, and include off-budget flows.

An overall assessment of the reforms can be classified as a positive change, but it is still at an early stage. The trends are clearly positive; however, limited resources – in particular, senior technical skills – to attend to the vast demands of the reform agenda, impose some risks on the actual implementation of the reforms.

5.4.1 Successful aspects and challenges

It is fair to say that the following have aided the successful aspects of the reforms:

- Political commitment exists, for the PSR, in general, and for PFM reforms within the MPF, in particular. The MPF is in the driving seat of the PFM reforms, so senior management provides appropriate support for the reform process.
- There is strong donor pressure (to reduce fiduciary risk), given the high level of dependence on donor resources. The move towards budget support and the implementation of the Memorandum of Understanding puts quite a lot of pressure on government and its institutions to show positive outcomes through the PAF indicators and the policy discussions during the joint reviews.
- Technical assistance, as indicated above, has had a positive effect in helping to implement reform tasks in different areas, due to the shortage of skilled staff.

Mozambique's reform route differs to some degree from that of other countries. Whereas many other countries introduce more sophisticated strategic budgeting systems, such as Medium Term Expenditure Frameworks, while the annual budget process and budgeting machinery are still in disarray, Mozambique's first efforts were aimed at addressing underlying systemic problems, such as an inadequate classification system and poor financial management information systems, and to improve the coverage of the budget. The MTFF was only introduced later and is being used with some success as a technical financial forecasting tool. Mozambique's budget management system now faces issues regarding the alignment of policy and budgeting, and co-ordination of spending plans towards improved overall budget policy performance. There are major challenges for further development of budgeting systems in this regard. This may require a shift in approach to budget reforms, from emphasising the technical to including consideration of institutional factors. Specific challenges in this regard are:

- There is a strong incentive for line ministries and donors to maintain direct donor assistance to line ministries, bypassing fully or partially the state budget system. This hinders budget coverage and transparency by maintaining off-budget flows. It also makes policy co-ordination at the central level more difficult.
- There are weak incentives for the political leadership (Council of Ministers)

to assume control of the resource allocation process, to avoid having to make hard decisions about trade-offs between competing priorities, while individual ministries (or even directorates within them) have direct access to donor funds to meet their own priorities. The MTFF is still largely a technical exercise, with little involvement by the Council of Ministers.

- There are huge capacity constraints, both within the MPF and within line ministries, provinces and districts. This aspect will determine the pace of the reforms, because reforms require changes in the mindset of public servants.
- Internal demand (from Parliament and civil society) for improved budget management is still very weak – all the pressure is coming from donors and international financial institutions.

CHAPTER 6

Namibia

Public finance reforms – Successful fiscal policy through medium-term planning

Erica Shafudah, Chris Claassen and Fabian Bornhorst

6.1 Introduction

Only 14 years into independence, Namibia looks back at a track record of stable economic development and sound macroeconomic policies. The government has recently embarked on a set of public finance management reforms to further improve its fiscal performance. These reforms are a manifestation of a pre-emptive and forward-looking policy aimed at strengthening the economic and social development of the country rather than a reaction to crises and instability.

Over the last decade, Namibia has experienced a period of economic stability and moderate but steady economic growth. With its population growing at an average rate of 2.5 per cent, the macroeconomic conditions were favourable and real GDP grew on average by 3.3 per cent over the last seven years. The Namibia Dollar (N$) is tied at par with the South African Rand; as a consequence, inflation rates in Namibia closely follow the rates measured in South Africa. Table 6.1 summarises the main macroeconomic trends.

Table 6.1: Recent macroeconomic trends

	1998	1999	2000	2001	2002	2003	2004[F]
GDP (N$ million)	18,789	20,684	23,690	27,333	30,012	33,074	36,541
Real GDP growth	3.3%	3.4%	3.5%	2.4%	3.3%	3.1%	3.8%
Inflation rate	6.2%	8.6%	9.3%	9.3%	11.3%	7.3%	6.5%

Source: National Planning Commission (2003); Bank of Namibia (2003)
Note: F = forecast

In comparison to other middle-income countries, the public sector in Namibia is rather large, and public spending has averaged 36 per cent of GDP over the last three years. The budget deficit averaged 4 per cent over the previous four years and, as a result, the debt stock has increased (see Table 6.2), currently standing at slightly above 30 per cent of GDP, of which 15 per cent is foreign debt. Given the macroeconomic and fiscal environment, the public finance reforms came at a time when the government had resources for their implementation.

Table 6.2: Recent budgetary trends

	2001/02	2002/03	2003/04	2004/05[F]
Deficit, % of GDP	4.3%	2.7%	7.5%	1.6%
Debt stock, % of GDP	26.6%	25.2%	30.3%	32%

Source: MTEF, various issues
Note: F = forecast

While current debt levels are still sustainable, the outlook may worsen if debt continues to accumulate at the current pace. Government's fiscal targets prescribe that, on average over three years, the budget deficit shall not exceed 3 per cent of GDP, the debt stock shall not exceed 25 per cent of GDP and public expenditure shall not exceed 30 per cent of GDP. The government has recognised the need for action in order to achieve these targets.

In terms of outcomes of fiscal policy, Namibia has made progress, but important challenges remain. The fight against HIV/AIDS, poverty and extreme income inequality are the key issues that are being, and will continue to be, addressed in the next decade. In order to achieve progress on these pressing issues and to lay the foundations for a growth-enhancing and sustainable macroeconomic policy, the government

has started a set of public finance reforms that will ensure fiscal discipline over a longer term and improve the outcomes of fiscal policy. His Excellency the President announced in the 2001 State of the Nation Address that the aim of the reforms is to shift the budget process:

> away from a focus on input needs and towards allocations based on what we get for our money. To change the budgetary debate from how many millions of dollars each vote should get, and more towards the benefits that will accrue to our citizens as a result of the outcome-focused resource allocation decisions.

This chapter reviews the recent public finance reforms in Namibia, taking the reader through the different stages of reform up to the challenges faced today. A conclusive analysis of the reforms would not only be premature but is also well beyond the scope of this chapter. Instead, the aim is to provide readers with a critical snapshot of successes and obstacles encountered during the reform process in the hope that the Namibian experience will contribute to the discussion of public finance reforms in Africa.

Starting with a brief description of the situation of public finances before the introduction of reforms (Section 6.2), the paper describes the steps that the Namibian government has undertaken to reform public finances, and where this process is leading (Section 6.3). Section 6.4 presents the Medium Term Expenditure Framework (MTEF) and the Performance and Effectiveness Management Programme (PEMP), which form the core of the public finance reforms. Section 6.5 looks ahead and discusses the remaining steps that are necessary to complete the reforms and ensure their success.

Throughout the chapter, the reform process will be exemplified by reporting on the experiences of the Ministry of Basic Education, Sports and Culture (MBESC) in implementing the reforms.

6.2 Public finance in the late 1990s

In 1990 the government decided on the legislative and regulatory basis for public finance management. This regulation centres on the State Finance Act of 1991 with accompanying Acts. The State Finance Act also covers the powers and duties of the Auditor General in the budget process.

Prior to the recent public finance reforms, the budget used to be prepared on an annual basis with a one-year horizon (see Biwa & Zaaruka 2001). Based on a Macroeconomic Framework drafted by the Ministry of Finance (MOF), the Bank of

Namibia (BON) and the National Planning Commission (NPC), the MOF asked line ministries to submit requests for funds (to be precise, the Namibian budget is allocated to votes, and not every vote constitutes a line ministry, but the terms will be used interchangeably in this chapter). Since the funds requested usually exceeded the total budget, a negotiation phase was necessary to finalise the budget and agree on allotments.

The line ministries' requests for funds were based on a line-item budget system, where line items corresponded to expenditure items such as salaries, expenses for vehicles, and so on. Spending was not justified on the grounds of policies, and expenditure increases were derived using an incremental budgeting procedure. The increases in expenditure did not rely on any long-term financial or strategic planning, nor were analytical models used to derive projections. Instead, expenditure was simply estimated from an accounting perspective.

Line-item budgeting implied that ministries were not allowed to switch from one expenditure item to another without approval from the Treasury. This restriction removed any savings incentives once the budget was allocated to a certain item. As a consequence, inefficient expenditure within line ministries could not be ruled out. Furthermore, additional expenditure requirements had to be addressed directly by the Treasury (through the 'Additional Budget'). This was the primary cause for the discrepancy between the main budget and the actual budget (see Table 6.3).

The table reveals that over the five years prior to the reforms, the budgeted and actual figures for expenditure differed on average by 5 per cent. The discrepancy in budgeted and actual revenue stood even higher at 5.3 per cent. As a whole, the table shows that budget credibility offered potential for improvement.

Table 6.3: Discrepencies in expenditure before the reforms

N$ million	1995/96	1996/97	1997/98	1998/99	1999/00
Budgeted revenues	3,828	4,489	5,135	6,062	6,870
Actual revenues	4,081	4,676	5,690	6,186	7,203
Percentage difference	*6.2%*	*4.0%*	*9.8%*	*2.0%*	*4.6%*
Budgeted expenditure	4,341	5,073	5,754	6,724	7,751
Actual expenditure	4,557	5,567	6,129	6,936	7,953
Percentage difference	*4.7%*	*8.9%*	*6.1%*	*3.0%*	*2.5%*

Source: MOF

Note: The table compares the allocation in the main budget with the actual fiscal outcome for each year. Up to 1998/99, revenues are total revenues; for 1999/00, revenue from own sources.

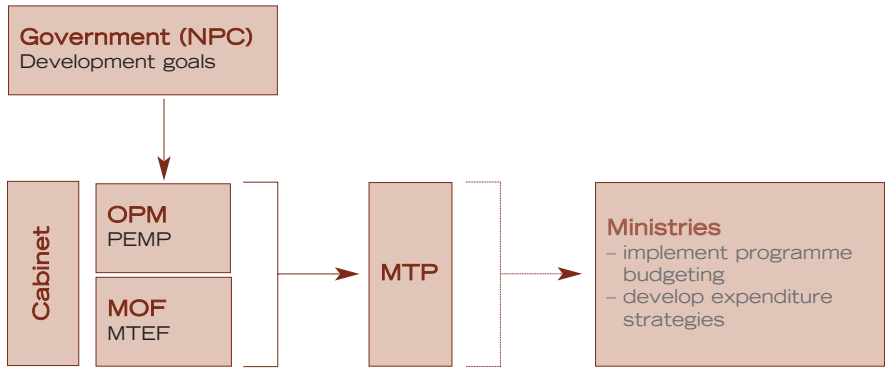
6.3 Stages of public finance management reform

The underlying idea of the budgetary reforms is to use government expenditure as a strategic tool to achieve the development goals set out in the National Development Plan (NDP). This implies a shift from line-item budgeting to programme budgeting, which is the financial reflection of specific policies and programmes designed to achieve clearly defined objectives. Under programme budgeting, expenses are justified according to the impact they have on outcomes.

6.3.1 Offices involved in the reform process

In 1996 Cabinet decided upon the reform path of the budget process. Following the approval from Cabinet, the Office of the Prime Minister (OPM) and the MOF spearheaded the public finance reforms by designing them and overseeing their introduction. The introduction required a wide range of interlinked reforms at various levels of budget preparation, both at the ministerial level (through the MTEF) and within ministries. The reforms were implemented through a centralised top-down approach. Figure 6.1 is a schematic representation of this process.

Figure 6.1: Reform implementation, offices involved in top-down approach



The reforms consist of three main building blocks:

- *The Medium Term Expenditure Framework (MTEF),* to ensure a rolling 3-year planning horizon for all offices, agencies and ministries (see discussion in Section 6.4.1). The introduction of the MTEF was prepared by the MOF. It was presented to Cabinet and later approved by both houses of Parliament.

- *The Performance and Effectiveness Management Programme (PEMP)*, to link development goals with operational measures for each line ministry (see discussion in Section 6.4.2). The idea of the PEMP originated from the OPM and is now the responsibility of the MOF.
- *The Integrated Financial Management System (IFMS)*, which is a modern data-processing tool, to integrate and analyse all relevant financial information (see Section 6.4.3). The IFMS is based at the MOF.

For the line ministries, the PEMP and MTEF have now been fully integrated into the so-called Medium Term Plans (MTPs). These plans form the basis for the annual budget and have become the interface between the MOF and the line ministries. The MOF currently oversees the whole process and guides line ministries in the preparation of their MTPs; line ministries, in turn, have to work on the diffusion of the reforms and ensure that the strategy set out in their MTPs informs the actual expenditure of their monies.

6.3.2 Time frame and implementation

Figure 6.1 reveals three different levels at which reforms take place: the planning level, the budget formulation level and the actual spending level. Table 6.4 relates these three levels to a time frame of reform implementation.

Table 6.4: Time frame of main budgetary reforms

Planning level	MTEF/PEMP	MTEF/PEMP	MTP	MTP		
Budget reality	line item	MTEF	MTEF	MTP	MTP	MTP
Spending reality	line item	line item	line item	line item	line item	programme budgeting
Year	late 1990s	2001/02	2002/03	2003/04	2004/05	future

After the reforms had been discussed at the planning level in the late 1990s, they were introduced to the budget formulation process with the first MTEF in 2001/02. Since then, budget preparation has gone through various stages of improving the MTEF and the MTP. It is crucial for the effectiveness of the reforms that the spending reality reflects the priorities set out in the MTPs and that it does not remain in the tradition of line-item budgeting. This process is currently under way in many ministries; in general, however, the spending reality has yet to be adjusted.

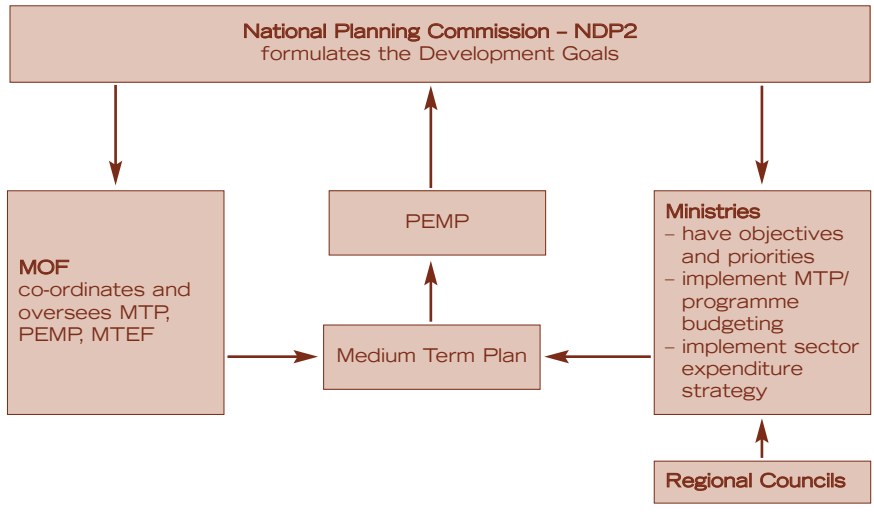
As mentioned above, reforms were introduced through a centralised top-down approach. This approach is recommendable due to the centralised nature of budget

preparation, with the MOF being the co-ordinator and the ministry responsible for financing the deficit. Consequently, any reform of the budget process needs to be nested around the MOF. The involvement of the OPM in this process clearly showed the political will to reform public finances. Among the possible drawbacks of this approach is that line ministries may not be sufficiently involved in the process. However, the introduction of the MTEF was welcomed by the ministries because the benefits of medium-term financial planning were clearly visible. It is important for the success of the reforms that line ministries adopt the measures imposed by the MOF and that the MOF, in turn, ensures that feedback channels are open and keeps a close eye on implementation progress.

6.3.3 The optimal working structure after the reforms

Upon successful implementation of the reforms, the expenditure reality will be guided by the principles of programme budgeting. The programmes within each ministry are reflections of the development goals at the operational level. A combined set of the programmes will make up the MTP for each vote. The MOF merges all MTPs into the MTEF, and will continue to oversee the implementation of MTPs and the preparation of the PEMP data. The PEMP framework, which has become an integral part of the MTPs, will serve as a control and monitoring device that links the operational level with policy design. Figure 6.2 shows the key offices and tools, following the successful implementation of the reforms.

Figure 6.2: The ideal working structure after the reforms



As time passes, the focus of attention is shifting from the planning offices to the implementation of programme budgeting at the level of line ministries. While the MOF will continue to improve its co-ordinating work in the MTEF, the remaining effort will have to concentrate on the line ministries adopting the principles of policy-oriented planning, budgeting and expenditure.

6.3.4 The wider context of reform

The aspects of public finance reform discussed here are linked to other reform projects that are currently underway. Several important reforms aim at improving the macroeconomic framework in which the budget operates. Related to long-term fiscal planning, efforts are underway to improve debt management and to implement a Sovereign Debt Management Strategy. In this context, government has also reformed its loan guarantees scheme to strengthen control over new debt. A generous approach to loan guarantees not only increases the potential debt burden of government in the case of a default, it also takes away responsibility and incentives from the managing unit of the project. Government has successfully adopted a rigorous review process and has substantially reduced the issuance of new guarantees. In addition, a moratorium on guarantees to the private sector is in place. Another reform project focuses on improving revenue-forecasting capabilities. These measures will aid the MTEF and the MTPs in becoming fully operational; and by improving overall fiscal performance, the MTEF gains credibility and planning uncertainty is reduced.

The reforms are backed by measures to increase transparency and accountability. The budget documents (MTEF, MTP/PEMP) are submitted to Cabinet and then approved by Parliament. All of the documentation, including the budget statement, is made public, and electronic copies are available on the ministry's website.

Namibia's budget reforms have attracted the attention of the international development community. The Public Expenditure and Financial Accountability Programme (PEFAP), a joint initiative of the World Bank, the European Commission and other donors, has selected Namibia as a pilot country for testing the Public Financial Management (PFM) performance-monitoring system. This initiative has come up with a diagnostic tool for public finances, and an assessment of Namibia's performance is currently under way.

6.4 The main building blocks of public finance reform

The budget cycle for each fiscal year starts in August of the preceding calendar year. Ministries prepare their MTP in consultation with the MOF. This document forms the

basis for the Budget Hearings that take place in October and November. Following the hearings, the MOF prepares the MTEF, which is presented to both houses of Parliament from March onwards. Halfway into the next fiscal year, the expenditure and revenue situation is reassessed and the revised budget is tabled. This contains revised estimates of the macroeconomic framework and necessary corrections to the revenue and expenditure plans. Government is gradually abandoning the revised budget and thereby enhancing budget credibility. In the fiscal year 2004/5, government has, for the first time, not tabled an additional budget, meaning that ministries will have to stay within the expenditure ceilings from the main budget. The budget is divided into an operational budget and a development budget. The development budget covers important investment projects (mainly capital expenditure) and is prepared by the National Planning Commission (NPC). In the current MTEF period, the operational budget makes up 89 per cent of the total budget.

6.4.1 The Medium Term Expenditure Framework (MTEF)

Namibia's first Medium Term Expenditure Framework (MTEF) was introduced with the 2001/02 budget. An MTEF covers a period of the current and the two subsequent fiscal years, and is a rolling budget that sets expenditure ceilings for the operational and development budgets for each vote. The document also includes a 3-year forecast for revenue and expenditure as well as a strategy for financing the deficit. Hence, it provides a macro-fiscal framework for the budget.

The rationale for the MTEF is to enhance planning certainty both for the MOF and for line ministries. The MOF commits to certain expenditure levels for each ministry for three years, and the ministries, in turn, expect to receive the funds set out in the framework. This forces both parties to plan ahead and optimise their operations accordingly. With this tool in place, government can use expenditure more efficiently and can set strategic priorities for achieving the development goals with the limited funds available.

Since their introduction, the quality of the MTEF documents has constantly improved. This does not apply only to the general fiscal policy aspects discussed therein but also to the contributions made by the line ministries. The introduction of the MTEF is a further step in the transition from incremental budgeting to programme budgeting. Because the budgetary reforms aim for a change from pure input-needs-based budgeting (staff, cars and equipment, etc.) to output measures (the socio-economic impact), all activities within the ministries need to be reframed into specific policies and programmes.

With the introduction of MTPs in the 2003/04 budget, the logic of the MTEF was extended to the line ministries. The objective of the MTPs is to rationalise spending

within each vote according to sector objectives. To that end, MTPs explicitly relate the objectives of each ministry to a set of measurable performance indicators. The MTPs also form the basis for the move towards programme budgeting within the line ministries, as ministries are required to report their activities in the form of programmes. Each programme is described in detail and, ideally, the description includes the costing of sub-activities and the likely effect that the programme is going to have on the performance indicators. MTPs further contain a compilation of the operational budget, the development budget and the assistance from external donors outside the State Revenue Fund for each vote, which gives an overview of all non-donor and donor activities within the vote.

The MOF sends out an MTP template, and guides each ministry through the completion of it. In summary, this template contains: (i) objectives; (ii) allocations from the State Revenue Fund; (iii) priorities over the MTEF period; (iv) programmes (and their costs); (v) a description of the programmes; (vi) new resources; (vii) development partner and other funds; and (viii) their involvement in the programmes mentioned under point (iv).

The system of MTPs has been in place for two consecutive years, and the requirements are increasing from year to year. For the 2005/06 MTEF, the MOF is asking ministries to be even more specific in their programme descriptions, and to provide a costing of all sub-activities. Close attention is also being paid to the impact of programmes on the stated objectives of each ministry.

Once the system of MTPs is in place and fully functional, it will be the basis for the allocation of funds by the MOF. In particular, the MOF will use the data provided by the ministries on their programmes and their effectiveness, and the PEMP data (see below), as one argument when making allocations. This means that ministries will get more funds if they have relevant and effective programmes in place – programmes that contribute to the development goals and are effective in improving socio-economic conditions.

Strengthening and centralising the budget process under the supervision of the MOF not only increases transparency but may also encourage donors to use budget support as a channel to deliver aid. This form of support both strengthens the expenditure system and allows for better co-ordination of development assistance. The co-ordinated manner in which the budget is prepared opens the floor for government and donors to discuss and agree on funding priorities. Furthermore, due to its medium-term perspective, the MTEF is a useful instrument for donors to disburse loans and grants over a 3-year period, because the MTEF provides a compilation of all non-donor and donor activities in each sector.

Effects of the MTEF/MTP

A full assessment of the impact of the MTEF/MTP is beyond the scope of this chapter, and with reforms still underway it would be premature to suggest any conclusions with respect to their effectiveness. Still, some preliminary statements about the effects can be made, for example with respect to budget credibility. As shown in Table 6.5, there continue to be some discrepancies between the main budget and the actual outcome for both revenue and expenditure figures. However, since the introduction of the MTEF, actual expenditure differed from the budgeted amount on average by only 3.4 per cent, and the trend points towards a further narrowing. This is an improvement compared with the situation before the reforms were introduced (see Table 6.3).

In years where the actual revenues exceeded the budgeted amount, the increase in expenditure was only moderate. In 2003/04, when revenue collections were 3.6 per cent below projections, actual expenditure was within 0.1 per cent of the main budget. This development shows that with the introduction of the MTEF, budget credibility has improved and reflects the MOF's efforts to completely do without the revised budget.

Table 6.5: Comparison of the main budget and the fiscal outcome

N$ million	2000/01	2001/02	2002/03	2003/04
Budgeted revenues	7,606	8,595	9,290	11,164
Actual revenues	8,286	8,923	10,451	10,780
Percentage difference	*8.2%*	*3.7%*	*11.1%*	*-3.6%*
Budgeted expenditure	8,447	9,781	10,786	12,257
Actual expenditure	8,708	10,302	11,399	12,243
Percentage difference	*3.0%*	*5.1%*	*5.4%*	*-0.1%*

Source: MOF

Note: The table compares the allocation in the main budget with the actual fiscal outcome for each year.

On average, revenue was 6.6 percentage points off projections. Up to 2003/04, revenue was usually underestimated. This trend reversed suddenly, when revenue collections fell 3.6 per cent behind projections in that year. This was caused mainly by the sharp appreciation of the Namibia dollar against major international currencies, which negatively affected profits and, consequently, tax revenue from the exporting

industry. Surely, the fact that for years the revenue forecasts were below actual collections has put pressure on the MOF for an additional round of mid-year spending. The under-collection in 2003/04, however, has changed this situation. Expenditure in 2003/04 was below projections, and in 2004/05, for the first time, there was no additional round of mid-year spending.

In general, this shows that accurate revenue forecasts are crucial for the logic of the MTEF.

As mentioned above, part of the working mechanism of the MTEF is that line ministries rely on the ceilings they were promised in the MTEF. However, if revenue projections do not materialise, the government is in a position where it has to choose between two evils: it either has to increase borrowing or is forced to revise the expenditure ceilings for the line ministries downwards, thereby undermining the working mechanism of the MTEF.

While discrepancies in actual outcomes and the need for a revised budget are a dimension in terms of which the impact of budgetary reforms can be assessed, this is only a part of the story. In any case, one would not expect the reforms to have an immediate impact, as the financial implications of programme budgeting have yet to materialise. There is, however, another aspect of the reforms that should be taken into account. The introduction of MTPs, the backing that this initiative received from senior people in government and the fact that these documents now form the basis for the annual budget hearing are changing the way senior executives from line ministries think about the budget. The need to produce sound MTPs has created an environment that favours policy debates and conceptualising in terms of programmes and outcomes. This is a welcome development, which adds momentum to the reform process.

The experience of the MBESC and other ministries shows that the MTPs are changing the way ministries approach the annual budget. The need for medium-term planning is beginning to move the debate towards prioritising the policy impact of programmes and their effectiveness. The experience also shows the difficulties and obstacles that need to be addressed. The re-thinking from line-item to programme budgeting is a process that does not happen overnight; adjusting the working of an entire ministry to these changes requires time and continuous effort.

6.4.2 The Performance and Effectiveness Management Programme (PEMP)

In 1998 the government decided to use performance-based measures in public policy implementation. Co-ordinated by the OPM, the Performance and Effectiveness Management Programme (PEMP) was developed. It began as an OPM initiative, but has now become a joint initiative of the OPM, MOF and NPC in order to broaden its

Box 1

Introducing an MTP for basic education

The budget for the Ministry of Basic Education, Sports and Culture (MBESC) amounts to roughly N$2.3 bn, which represents slightly over 20 per cent of the total government expenditure. After experiencing substantial increases in the past, the scope for further increases in this allocation in the near future is limited.

Bringing a ministry of this size and with such widespread operations from incremental budgeting to programme budgeting is a mammoth task that cannot be accomplished in a year. It requires effort at all planning levels.

The MTP for MBESC is prepared by the planning office in the ministry, following the guidelines from the MOF and the PEMP framework as designed by the OPM. It specifies nine objectives, three relating to education, four to cultural activities and two to sport. However, there is a consensus that the first two objectives – that 'All children receive quality education' and 'All Namibians are functionally literate' – are the most important, which is also reflected in the allocation of funds.

The priorities set by MBESC for the MTEF period are: (i) to meet staff and service costs; (ii) to improve access to secondary education; (iii) to improve the quality of basic education; and (iv) to improve efficiency in resource allocation.

This prioritisation results from the particular financial problems faced by MBESC. Personnel salaries currently make up nearly 93 per cent of the primary and 81 per cent of the secondary education budget. This leaves little room for financing quality improvement measures, such as the purchase of textbooks or the construction of laboratories, which have been found to have much more cost-effective impact on improving learner outcomes. With priority (iv), improving the efficiency of resource allocation, MBESC hopes to control key cost drivers, and to transfer freed resources across programmes and regions.

The MTP mentions 14 programmes, with 'Primary Education' (51 per cent of ministry expenditure) and 'Secondary Education' (22 per cent) being the largest. Currently, the programmes mentioned in the MTP are more a reflection of the organisational structure of the ministry than a set of efforts supporting a certain policy. In the future and as the MTPs improve, programmes will be redefined and changed in order to reflect groupings of actions that aim to achieve a certain goal but cut across directorates. For example, 'Monitoring and Evaluation' may be a programme that evaluates certain effects on learner outcomes. This activity is currently housed within more than two directorates and is only vaguely described in the current programme 'Quality Control'.

In the case of MBESC, the introduction of the MTEF and the ceilings contained therein have shown in a dramatic way the need for a medium-term plan to keep operations running despite the tight budget and the cost drivers mentioned above. Given these constraints, MBESC has

Box 1 continued

taken up a series of measures to increase efficiency. Among them are strict application of staffing norms, effective monitoring of the payroll and some measures for cost recovery (of hostel fees, for example).

In general, the budgeting and spending reality within MBESC still needs to complete the transition from incremental budgeting to programme budgeting. The early stage at which reforms currently stand is reflected by the fact that the preparation of the MTP documents takes place in the planning office, in collaboration with only the financial advisor.

This highlights one of the main challenges of budget reform. The transition from line to programme budgeting can be slow, implying that during the transition years parallel budgeting systems can exist within line ministries. Thus, although the ministry produces MTPs, its budget is still implemented according to line items. It is hoped that the MBESC Medium Term Expenditure Strategy (see Box 3), will contribute to a more effective link between planning and budgeting, enabling the move towards budgeting for outputs.

support base (see Randall 2003). PEMP serves the following main purposes:

- to underpin the targets set in the National Development Plan;
- to measure outcome and impact for strategic decision-making;
- to serve as a basis for targets to ministries;
- to set accountability targets for senior public servants and chief executives of parastatals; and
- to provide day-to-day operational management guidelines.

For each vote, the PEMP framework links the objectives set out in the National Development Plan (NDP) to the operational level of measurable indicators.

Government wants to increase the role of the PEMP framework in future budget allocations. Expenditure for certain programmes within a ministry will be assessed based on the impact they have on outcomes. Given the priorities set out in the NDP, funds will be allocated according to the importance of the goal and the expected (measurable) impact on PEMP.

The PEMP framework has also been introduced in a top-down approach, but the acceptance of this framework by the line ministries was less enthusiastic than for the MTEF reform. One reason for this might be that an awareness of the importance of this process, and the necessary information, was not disseminated in time to the key people in the line ministries. As the indicators touch on the very foundations of each

Box 2

Introducing performance measures for MBESC

MBESC publishes its PEMP data together with the MTP in the annual MTEF documents. The framework links the objectives set out in the MTP to measurable performance indicators. Several indicators correspond to each of the objectives for the ministry.

The indicators cover a broad range of aspects. In the case of education, they cover enrolment ratios, gender equality in enrolment, pass rates (by gender, level and region), teacher-leaner ratios, and so on. Many of these indicators are internationally accepted performance measures in education. However, at the current stage, some indicators are not yet operational. There are, for example, conceptual problems with the measurement of quality of education and with the implementation of this measure.

One of the more generic problems faced by MBESC with regard to PEMP data is that PEMP is not the only monitoring and evaluating tool in place, although it may be the most important. There are several groups of indicators used to evaluate progress in the basic education sector, which makes data collection and reporting more confusing. MBESC is working to harmonise and rationalise these indicators, which will also impact on its choice of PEMP indicators. One of the first draft reports produced in this process, 'A Review of Indicators used to Monitor and Evaluate Education Sector Progress in Namibia', identifies indicators that are ambiguous or irrelevant.

Data availability to produce reliable PEMP data is a general problem. The framework requires an update on a yearly basis, but many of the indicators are not available because the necessary surveys do not exist at all or are carried out infrequently. Furthermore, the capacity is not in place to produce accurate estimates of the indicators in the absence of annual survey data. For instance, the calculation of net and gross enrolment rates requires population estimates by age; although the national census for 2001 is available, there are significant omissions that make it difficult to calculate enrolment rates.

All these factors negatively affect the accuracy of PEMP data. Hence, decision-making in the sector cannot yet be based on the framework alone.

ministry's activities, more involvement by the line ministries in the choice of indicators and their use is needed. The PEMP framework will become the basis for policy evaluation, and line ministries will realise its usefulness and benefits not only in medium-term planning but also for day-to-day operations.

As the experience of MBESC and other ministries shows, some improvements are necessary in order to make the PEMP framework fully functional and to ensure that it fulfils its presumed role within the budget process. A monitoring group for the

PEMP framework is needed to address the following issues:

- Feedback from the ministries is required to make the indicators more operational and to adjust them to the reality within the ministries.
- Indicators that cut across ministries (such as the unemployment rate) need to be made more specific, or the responsibility for addressing them needs to be clarified.
- The ministries currently produce their own PEMP data, and no device is in place to monitor and evaluate the accuracy of the figures provided.
- General data problems need to be addressed. Due to the lack of survey data, some figures are provided following subjective estimates.

The PEMP framework has yet to receive the necessary attention from the ministries. Making the system fully operational will require strengthening the capacity to produce accurate outcome measures in the ministries, as well as the establishment of an effective monitoring unit.

6.4.3 The Integrated Financial Management System (IFMS)

The MOF is currently introducing an Integrated Financial Management System (IFMS). This system establishes procedures and processes for an efficient system capable of producing timely and reliable financial information.

The system will integrate all data requirements of the ministry in one system. The IFMS has different modules that will allow the various authorised groups within the MOF to access and process the required information. Among these modules are a Treasury General Ledger Module, a Cash and Debt Management Module, a Budget Management Module, a Payroll Module and a Revenue Management Module.

Through these modules and interfaces, the IFMS will:

- permit close and timely monitoring of the government's cash position;
- provide adequate management reporting at various levels of budget execution;
- assist in the preparation and execution of the budget; and
- assist in the preparation of financial statements, reports for budgeting analysis, financial control and compliance audits, and so on.

Ideally, the IFMS will also provide an interface with the line ministries. Needless to say, the IFMS requires major investments in IT infrastructure, as well as extensive training measures for the system operators and users.

Box 3

A sector expenditure strategy for education

The development of a medium-term expenditure strategy for the education sector by MBESC and MHETEC follows the insight that cost alignment in the sector is needed to cope with the problems of rising costs and limited resources. The expenditure strategy aims at creating a framework that allows the freeing of resources to address the priorities in the sector rather than the enforced undertaking of discretionary expenditure cuts.

The sector expenditure strategy cuts across ministries and is the first such initiative to look at the education sector as a whole. It is intended to be more than just a financial planning tool – it will be a policy and service-delivery plan, designed to be a 'living desk document' that will link directly to budget preparation within the ministry.

The expenditure strategy can be regarded as the action plan for the sector on how to spend in order to achieve its goals. It will inform the MTP about the programmes in place and the needs for funding. This bottom-up approach will be an essential complement to the current reforms.

The education ministries have already undertaken concrete steps towards the development of the sector expenditure strategy. The Medium Term Technical Team (MTTT) has agreed on a strategy that will culminate in a sector expenditure strategy to be implemented starting with the 2006/07 budget. Features of the strategy are:

1. *Expenditure Issues Paper.* This draft expenditure strategy is a good base of information for the best mix of policies.
2. *Dissemination of the Expenditure Issues Paper* to sector managers and to other stakeholders for feedback.
3. *Sector Expenditure Strategy.* Strategy to be prepared with sector managers to determine the best mix of activities and most needed changes given the best available information and sector priorities.
4. *Dissemination of Sector Expenditure Strategy* throughout the sector and external stakeholders to reach agreement on key decisions.
5. *Prepare Implementation Strategy.* This step reviews the sector financial management information procedures and identifies critical implementation weaknesses.
6. *Training* of sector managers and others for implementation.
7. *Implementation.*
8. *Monitoring and evaluation.* Outcomes will be evaluated, and the experiences will feed back into the next Expenditure Issues Paper.

6.5 The next step

The three building blocks of public finance reform described in Section 6.4 focused on the offices that are at the centre of budget formulation. However, the reforms have implications that reach further than that. The process of disseminating the reforms into the ministries from the top to the bottom requires not only time but also a set of additional measures to back up the process.

The development of sector expenditure strategies is one way forward to complete the reforms. In a sense, these expenditure strategies are a logical extension of the MTEF and MTP into the ministries. While most of the current measures have been implemented top-down, this initiative comes from within the ministry and is a vehicle to ensure that budget reforms reach the spending reality. In the future, MTPs should be documents that emerge entirely from a planning process within the ministries that encompasses all levels down to the spending reality.

The sector expenditure strategy currently being developed for the education sector (see Box 3) is a good example of how the budget reforms can be complemented by sector initiatives. It is important that these emerge from the sector itself and feed into the MTP-formulation process from the bottom of the spending reality. This not only improves the practicability of expenditure reforms but also increases their acceptance within the sector. More such initiatives are needed in the key ministries to bring the reforms to a successful conclusion.

6.6 Conclusion

In recent years, Namibia has embarked on a set of interlinked and wide-ranging public finance reforms. The reforms were carefully thought through and phased in gradually. They are still at an early stage and will require further elaboration and operationalisation, backed up by capacity-building initiatives. These are necessary both within the central institutions responsible for overseeing and guiding through the reform process as well as within the line ministries.

Having been implemented through a centralised top-down approach, the reforms will now be complemented by bottom-up sector initiatives to ensure that the reforms impact on the spending level.

The reforms show government's commitment to fiscal discipline and to using expenditure strategically and responsibly to achieve its objectives. Despite the short time since their introduction, the reforms are already showing results in terms of improved budget credibility and have created a platform for policy discussion useful for the implementation of future measures.

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MTEFs (including MTPs and PEMP data) as well as the Annual Budget Statements are published by the Ministry of Finance. Electronic copies can be obtained from the Ministry's web site (www.mof.gov.na). The Institute for Public Policy Research (www.ippr.com.na) holds a public database with further Namibian government budget documents and Namibian macroeconomic data. The web site of the Bank of Namibia (www.bon.com.na) also offers a range of macroeconomic data and periodical publications.

CHAPTER 7

South Africa

Transition to democracy offers opportunity for whole system reform

Alta Fölscher and Neil Cole

7.1 Introduction

The 1994 transition to a democratic state brought many challenges for managing the public finances in South Africa. Not only did the new constitutional dispensation lay down a changed structure and distribution of power in the state, with implications for the way in which public funds were allocated and used, but the new government had a critical political commitment to improve the coverage and quality of public service delivery to the majority of the population, in order to redress the racially based distortions of the past.[1]

The new government did not start with a clean fiscal slate. In the 1992/93 fiscal year, the main budget net borrowing requirement had reached 8.7 per cent of GDP, and in the 1994/95 fiscal year, public debt rose to almost 47 per cent of GDP (from a level of approximately 30 per cent, ten years earlier), leaving very little fiscal room for the state to improve the equity of public services. The annual budgeting system the new government inherited provided inadequate tools with which to stabilise fiscal

balances and manage the required policy shifts. It was highly fragmented, not only in terms of a de-linking of policy, budgeting and implementation, but also institutionally, increasing budgeting uncertainty, lack of clarity and the scope for budget games. It planned and controlled for inputs and cash, with limited opportunity for systematic assessment of the effectiveness and efficiency of spending, or for relating allocations directly to policy. It was not transparent, with poor underlying information systems, hidden spending and inadequate mechanisms to extract good information for use in the budget process and for accountability purposes. The budget process itself was largely incremental, offering insufficient opportunity for the new government to identify ongoing non-priority activities and create fiscal room for higher priorities. Accountability was procedural, and the system was plagued by deeply entrenched inefficiencies.

In short, what was required was an overhaul of the system of budget management, not only to fulfil the demands of the new constitutional framework, but also as a tool to bring about the improved substantial outcomes sought in terms of fiscal sustainability, improved alignment of spending with the new national priorities and the maximisation of existing resources towards these priorities.

The South African public expenditure management system has undergone substantial reform since the mid-1990s. While the early reforms shaped macroeconomic stability and strengthened public spending, the more recent emphasis of the reform programme has been on efficient resource allocation and effective service delivery. The highlights of the reform programme have been: the roll-out of a new intergovernmental system that requires all three levels of government to formulate and approve their own budgets; the introduction of 3-year rolling spending plans for all national and provincial departments under the Medium Term Expenditure Framework (MTEF); new formats for budget documentation that include a strong focus on service delivery information; and the enactment of new financial legislation. In addition, changes to the budget process have allowed role-players to deliberate on key policy choices and on the matching of available resources to plans, rather than item-by-item cost estimates.

Underlying the reforms were the following principles:

- *Comprehensiveness and integration*. The main national budget framework co-ordinates, integrates and disciplines policy and budget processes for the country at national, provincial and, increasingly, at local level.
- *Political oversight and a focus on policy priorities*. Choices between priorities are political in the final instance. The South African system recognises this and structures the integration of political and administrative practices to ensure

that funding choices align with the priorities of government, and that political oversight is reinforced.

- *Using information strategically*. The reform process systematically set out to improve the timeliness, quality and usefulness of information on the allocation and use of funds, both internally and externally, to improve public policy and funding choices and to enable accountability.
- *Changing behaviour by changing incentives*. Responsibility was devolved to spending departments for spending choices and use of funds within approved ceilings and against policy commitments.
- *Ensuring budget stability and predictability while facilitating change at the margin*. The budget process includes various mechanisms to manage uncertainty and maximise funding and policy predictability over the medium term, while promoting alignment with policies at the margin, through the use of rolling baselines, a contingency reserve and a disciplined budget process, amongst other measures.

These principles, applied throughout the institutional arrangements of the budget process from preparation to audit, put in place a changed set of incentives for budgetary actors, reducing the potential for budgeting games and improving planning practices to align policy with budgets and actual spending. A key aspect of these arrangements is the recognition that, while the quality of budgetary estimates is important for the eventual policy outcomes, the process by which they are derived should carry equal weight in reform design. Similarly, while the technical information systems are important to support financial management practices, good budget implementation is about getting the institutions right. In fact, it can be argued that the South African reforms placed emphasis in the early years on getting a functional budgetary process in place (involving all relevant, and not just financial, decision-makers, and changing incentives to change behaviour) rather than on attempting to formulate budget estimates that were technically the best expression of policies and/or expenditure realities.

The budget reform process is still underway. In some ways it will never be complete, since the budgeting system would always need to be responsive to changing circumstances and demands. However, there are remaining budget reform challenges that have not been addressed adequately yet, and also some persistent weaknesses in the system, which the current institutional arrangements have not overcome. Despite these issues, the system in place today is significantly different from that of ten years ago, and the changes introduced have succeeded (or have yielded substantial budget outcome benefits) in several critical respects.

Firstly, the reforms facilitated the disciplined implementation of fiscal policy aimed at setting the economy on a renewed growth path. The first few years after transition were still marked by relatively high deficits and a steady increase in public debt (to almost 50 per cent of GDP in 1996/97). The period 1997–2000 saw fiscal consolidation (in tandem with other macroeconomic reforms), stabilising the level of debt and reducing the budget deficit to contribute to lower interest rates, improving fiscal sustainability and freeing up resources for social, developmental and infrastructure expenditure. Simultaneously, the overall burden of tax was reduced, so as to lower the costs of investment and job creation while releasing household spending power. Since 2001 a more expansionary fiscal stance has been adopted, reaping the benefits of the consolidation period. These gains would not have been possible without the establishment of a functional intergovernmental system, the introduction of medium-term expenditure planning and improvements in public financial management.

Secondly, not only did government succeed in maintaining a sound fiscal policy stance while simultaneously reducing the tax burden for the consolidation period, it also shifted the distribution of expenditure in a number of important dimensions. It shifted the functional distribution of expenditure, with social and developmental expenditure increasing at the cost of defence and business subsidies. In the latter years, it has also shifted the economic distribution of expenditure, turning around negative real growth in gross fixed capital formation of general government. Also, it has shifted the distribution of expenditure between households, spending relatively more on poorer and marginalised communities than in the past. Government has made significant inroads into meeting the basic needs of the poor, including building approximately 1.6 million houses, improving access to schooling for the poor, constructing and upgrading primary health clinics, extending and improving potable water supplies to about 9 million people, putting in place a sanitation roll-out programme, providing nutritional daily meals to over 4 million children and fiscal transfers to over 7 million poor South Africans (up from just under 3 million in 1997).

Thirdly, overall budget credibility improved markedly after the implementation of a medium-term budget framework and improvements in public financial management. In both 1995/96 and 1996/97, fiscal out-turns for consolidated national and provincial spending showed marked under-expenditure. In 1997/98, the first year of a block unconditional transfer to provinces, this swung to marked over-expenditure. However, this shift was reversed and stabilised at less than 2 per cent over-expenditure in 1998/99, the first year of the MTEF.

This chapter discusses the budget reform process in South Africa. It reviews the different aspects of the reforms, showing how the principles were consistently

applied to integrate what could have been merely a series of technical reforms addressing specific shortfalls in budget management into an overall system of democratic budget governance. It does so, firstly, by discussing the different aspects of the main budget and financial management reforms in the national and provincial executives; then by taking stock of where the country is now, identifying remaining (and new) challenges and the likely future path of reforms; and, finally, by considering the reform process itself.

7.2 Aspects of budget reform

The Constitution provides the institutional framework for budget reforms in South Africa. In addition to detailing the structure of the state, expenditure and revenue assignment and setting out key institutions, roles and responsibilities, it also includes a Bill of Rights – with implications for the allocation of available resources between the spheres and functions of government – and establishes the principle of co-operative governance, which set the tone for a consensus-seeking budget process. However, the Constitution leaves it largely up to further national legislation and practice to sort out how these principles are given effect. The evolution of budgetary practice in South Africa since 1996 – the year in which the new Constitution was enacted – has been a key component in realising its democratic and developmental ideals.

7.2.1 Stabilising the intergovernmental system

South Africa is a unitary state with three interdependent but distinctive spheres of government: national, provincial (nine provinces, created in 1994 out of four provinces and ten so-called homelands and three ethnic administrations) and local (284 municipalities, demarcated in 2000).

The Constitution assigns to each of the three spheres of government certain functions, which may be concurrent (shared responsibility between spheres) or exclusive (sole responsibility of the unit of government). The national government's main role is policy-making, regulation and oversight. It also administers exclusive functions (e.g. justice, defence and foreign affairs). Provinces are mainly responsible for social delivery, either concurrently with national government (e.g. primary and secondary education, health, social services and housing) or exclusively (e.g. provincial culture matters, provincial sport, recreation and amenities), while municipalities have localised functions (e.g. stormwater management and fire-fighting) and deliver basic services (e.g. water, sanitation, electricity and refuse removal).

The expenditure mandates of provinces and municipalities are not matched by

their assigned revenue-raising abilities, although this is less so for local government, which has access to property taxes and user charges for basic services. The lion's share of revenue is collected nationally. Provinces (and to a lesser extent municipalities) therefore depend on transfers from national government to fulfil their expenditure responsibilities. The Constitution states that provinces and municipalities are entitled to an equitable share of nationally collected revenue, and that they may borrow under certain conditions. A key additional intergovernmental-relations feature of the constitutional framework is co-operative governance.[2]

These provisions of the Constitution regarding intergovernmental relations and the intergovernmental fiscal system are supported by various pieces of legislation enacted in the first years after transition, providing the legal framework for ongoing intergovernmental relations supported by the evolution of practice.[3] This section briefly sketches the main institutions of the intergovernmental system.

Legislated frameworks, not specifics

Unlike in other federal and/or decentralised countries, neither the Constitution nor supporting legislation spells out quantitative parameters for revenue sharing, nor does it explore the minutiae of co-operative governance. The Constitution sets out the principles and requires subsequent acts of Parliament to determine how these principles are to be applied and their requirements met. In keeping with this spirit, the supportive legislation enacted in the first years after the 1994 transition also does not primarily legislate specifics, but puts in place sets of institutional arrangements to facilitate the best possible substantive outcome to be found in any given year or circumstance.

Integrating the intergovernmental system and annual budget process

The annual budget process provides the vehicle for the practical fulfilment of the constitutional and legislative requirements. The share of available revenue for provinces and municipalities is determined finally by Cabinet, but only after a process of intergovernmental consultation. In addition to their equitable share, which is a block grant, provinces and municipalities also receive specific-purpose grants and other transfers that are intended to fulfil national policy imperatives in subnational spheres.

A predictable and transparent allocative process

The allocation of the equitable shares is determined in the same sequence annually. The first call on available revenue in the main budget framework is a provision for debt service cost, and the contingency reserve, on the logic that both support the

financing of government functions in all three spheres. The remaining available revenue is then first divided between the three spheres of government before being divided between the provinces and municipalities by a transparent formula in the division of revenue process (and between national government departments in the national budget process).

The division of revenue process lasts from early May, when national Cabinet and provincial executive councils consider policy priorities, through to October, when government signals the likely division of revenue in the pre-budget policy statement known as the Medium Term Budget Policy Statement (MTBPS). The division of revenue process should not be seen as a separate process from the national and provincial processes; instead, it is an integrated process both informed by and providing the respective expenditure envelopes to these processes.

The division of revenue between spheres of government (vertical division) follows the principle that funds should follow function, and is informed by the responsibilities of each sphere and its capacity to generate revenue to meet its obligations, amongst other considerations.[4] It is managed primarily as a political decision, however, as it derives from the relative priority given to different functions of government and how these functions are shared between the spheres of government. As such, it is discussed in the administrative and political spheres through the work of intergovernmental forums, and is underpinned by technical work undertaken jointly by national and provincial Treasury task teams. However, it is finally determined by a meeting of the extended national Cabinet (the national Cabinet plus the premiers of the nine provinces).

Intergovernmental forums to improve allocations

Prime amongst the intergovernmental forums are the Budget Council and the Budget Forum, both of which are constituted in terms of the Intergovernmental Fiscal Relations Act of 1997. The Budget Council is a consultative body, comprising the Minister of Finance and the nine provincial Members of the Executive Council (MECs) for Finance, assisted by the Heads of Treasury and Treasury advisors. In the Council, consensus amongst 'Team Finance' is reached on fiscal and financial matters affecting provincial government, and recommendations are made to Cabinet. The Budget Forum comprises the Budget Council plus local government representatives and discusses local government matters.

It is primarily through these forums that discussions take place (from June to September each year) between the three spheres of government on the overall budget framework and the division of revenue between the spheres of government. These political/technical forums are supported by committees of officials preparing

and discussing technical background work for use in the budget process. They include national and provincial Treasury and national and provincial sector department officials.

Use of formulae to maximise transparency and predictability

Only after the share of each sphere has been determined is the horizontal division of revenue between the provinces determined by transparent formulae that take into account national priorities, relative demand for services between provinces and particular provincial circumstances. The practice is to phase in any drastic shifts in allocations on account of changes in formula structure or key determinant data so as not to upset the stability of provincial budgets. Similarly, the redistribution of resources from previously advantaged to disadvantaged provinces, which resulted from the formula structure and weighting, were phased in over the first few years of the formula. The formula is currently under review, partly to take account of changes in the financing of social security grants.

In South Africa, therefore, the sequencing of annual decision-making on the allocation of available revenue to competing policies is inextricably bound up with the intergovernmental system. The institutions created within the system are key structures in the annual budget process. Aligning the intergovernmental and budgeting system through the budget process strikes a fine and responsive balance between the need to reduce the fiscal risk associated with decentralised systems and to co-ordinate national policy objectives, on the one hand, and the constitutional requirements of provincial autonomy, on the other.

7.2.2 Adopting a multi-year budget framework and a top-down budget process

The MTEF operates at the centre of the South African budget reforms and frames, in the final instance, all policy discussions in the country. In the case of South Africa, the benefits of the MTEF have been realised, in part, through the application of clear objectives. The first of these objectives has been to ensure affordable programme budgets through the preparation of spending plans within the context of existing macroeconomic and fiscal policies. The annual revision of these policies determines the extent of additional money that gets allocated for new priorities. The second objective of the MTEF is to strengthen the link between policy priorities and public expenditure, by ensuring early policy prioritisation, rigorous evaluation of competing policies and programmes, and the matching of current and medium-term plans with available resources. Through this process, and over time, a higher proportion of public funds is spent on core programmes that have the highest returns in terms of poverty alleviation, job creation or whatever the government has put at the top of its

agenda. In this way, the focus of public expenditure can gradually shift with the changing needs of government and its main stakeholders. In recent years, for example, having a medium-term planning and budgeting perspective has assisted in facilitating a balance between spending on poverty alleviation and spending on economic services programmes.

Understanding how the MTEF operates to realise these objectives has two important dimensions. The first is that the MTEF system revolves around integrated sets of rolling national and provincial 3-year forecasts, targets and plans – from macroeconomic forecasts and fiscal targets, through revenue forecasts, to the forward projection of what public goods and services will be delivered by spending departments at what cost. These plans are the end-product of the annual process by which the expenditure needs are matched to the available resources. The second dimension is that the MTEF system is as much about the structures, institutions and rules of the budget process as it is about the sets of 3-year plans that result.

The discussion of the MTEF below identifies the key institutions (or budgeting norms) that make it functional (not in order of importance) and considers the MTEF process and role-players.

Fiscal policy drives expenditure envelopes

As is common practice in most MTEFs, the top-down process starts with updating the forecasts for key macroeconomic variables over the medium term, including GDP and inflation. Fiscal policy targets are subsequently revised. Since the inception of the MTEF, these targets have included reducing the tax burden, reducing general government dissaving (use of domestic savings to fund recurrent rather than capital spending), reducing public debt as a percentage of GDP and increasing public fixed investment spending. The important budgeting-systems point is that fiscal policy targets are generally determined in the absence of any detailed expenditure bids. The overall available expenditure in the main budget framework is a function of what is fiscally affordable, which constrains and disciplines the subsequent spending choices. What is fiscally affordable is driven first by the targeted tax to GDP ratio, and then by what level of borrowing is affordable.

Central role of the budget framework

The fiscal policy objectives translate into the budget framework, which in its various forms (depending on which component parts are included or excluded) presents a comprehensive and transparent aggregate picture of all revenue and all expenditure in general government at national and provincial level. All allocations at national level are made from the available expenditure envelope in the budget framework,

including funding the national departments and the unconditional and conditional grants to the provincial and local spheres of government. The nine provincial budget frameworks, therefore, reflect the national framework, with any differences being a function of provincial own revenue.

Preparing credible macro-assumptions and revenue targets

In South Africa, the implementation of the MTEF has not been hindered by overestimation of revenue, as is often the case. Three factors contribute to this: the credibility of the macroeconomic assumptions, which are published in the pre-budget statement and debated in public forums; the tax administration reforms, which buoyed revenue collection in the first few years, enabling the fiscus to provide predictability of funding to spending departments; and the use of the contingency reserve to absorb macroeconomic uncertainty.

The MTEF process is the annual budget process

Different from many other countries that have introduced multi-year budget frameworks, the South African system makes no differentiation between an MTEF and the annual budget process. This means that the budget proposals that are voted by Parliament are prepared and considered in the MTEF process, coherently with the forward estimates, and are not revised separately from the forward estimates in a subsequent process. All budget estimates, down to sub-programme level, are compiled for the full 3-year period. This strengthens the link between policy and planning. Instead of having two separated phases impacting on budget allocations (with the first being of a more strategic/policy nature and the second dealing with annual budgeting), the process in South Africa facilitates strategic policy decisions being taken in the context of budgeting decisions and vice versa. The sequencing, instead, is from larger aggregations of funding (and policy) to vote, programme and sub-programme level, but keeping a medium-term perspective throughout.

A disciplined top-down process

All bids competing for the same envelope of available funds are considered together within an overall hard budget constraint, forcing hard choices. This may result in certain programmes receiving additional funding, while others will be required to accelerate delivery within baseline budgets. In certain cases, the budget allocation process may result in programmes having to release funding that can be used for new priorities. This holds in theory from the vertical division of revenue, where the hard budget constraint is available revenue and the competing claims on it from the different spheres are considered systematically in the division of revenue process to

be allocations within a vote or programme. There is evidence, though, that this system grows less robust lower down the allocation chain. However, in principle, unless it is unforeseen and unavoidable or emergency spending (in which case it is covered by a separate vote or the adjustment estimates) all spending is decided within the formal budget process and voted by Parliament (or the provincial legislatures) in one parliamentary budget process. Strict virement rules apply in-year (see Section 7.2.3). In addition, the budget process runs to a firm timetable, with transparent rules and allocation norms. All of these factors contribute to making the MTEF process the 'only game in town'.

A similarly disciplined process is followed for the adjustment estimates, which can be tabled legally at any time during the year. In practice, however, all claims on the additional available resources (from the draw down of the contingency reserve, additional borrowing or additional revenue collected) are brought together in one process, thereby improving contestability of policy.

Forward projections count

At the same time as the top-down processes are completed to determine the available expenditure envelope, individual spending departments revise their forward plans, based on their baseline funding envelopes of the previous year, and prepare spending bids motivating for additional funding. No adjustments are made to departmental ceilings at the beginning of the process. This means that departments can only fund new policies if they are able to convince Cabinet (or the provincial executive councils, in the case of provinces) to allocate a share of nationally (or provincially) available additional funds resulting from adjustments to the macroeconomic forecasts and fiscal targets, or if they can find savings within their existing spending baselines. This practice of spending departments starting their budget preparation from their existing funding baseline has the merits of imposing planning discipline and providing a stable medium-term funding and policy horizon. While zero-based budgeting may be the ideal scenario to align budgets with policy priorities, in practice it is not feasible on an annual basis, if at all. Forcing spending departments to live within their baselines, while holding them accountable for delivering on policy priorities, creates incentives to improve the quality of the forward projections.

Use of the contingency reserve

The contingency reserve is top-sliced before available revenue is divided between and within the spheres of government. It is not a separate bank account accumulating funds over years, but a budgeting device that entails reserving a percentage of the available funds in the budget as a cover against uncertainty and a pool from which

to allocate funding to new spending priorities. This percentage is small for the budget year (the first year of the 3-year medium-term period), but increases in the outer years where policy and macroeconomic uncertainty is larger. In the budget year, the contingency reserve is allocated in the adjustment budget, tabled six months after the start of the fiscal year, and is used to cover the balance of revenue shortfalls or expenditure overruns on the fiscal framework. During budget planning, the contingency reserve plays a key role in making available additional resources for new expenditure, which come from the draw down of the contingency reserve and changes to the macroeconomic forecast. Thus, the contingency reserve plays an important function in providing flexibility and protecting stability in the MTEF (and thereby its credibility) against uncertainty.

Focus on the margin and on the outer years

In the system, flexibility around available additional funds and policy changes is least in the budget year, given existing policy and spending commitments, but increases towards the outer years, because of a larger contingency reserve that can be allocated and because spending that is non-discretionary in the short term, such as personnel costs, can be shifted over the medium term, for example through programme restructuring or phasing in new priorities. In this way, South Africa has been able to reduce personnel spending as a percentage of revenue, since the introduction of the MTEF, creating critical fiscal space for complementary inputs and investment spending.

For each budget round, baseline funding decisions have already been discussed for the bulk of spending in the first two years of any medium-term framework (those having rolled over from the previous year) and, particularly for the first year, the rule is to allow only minor changes. These factors shift the focus of discussions in the budget process to the use of funds in the outer year. Parliament is also increasingly centring its discussions on the outer years, where it can influence funding decisions more than in the year on which it is actually voting.

The budget submission format encourages departments to focus on maximising the alignment of policy and budgets over time by making changes at the margin. Reprioritisation is pushed as an important budgeting principle that identifies savings that can be reallocated to priority programmes. Departments are requested to provide information on their baseline spending (previous allocations rolled over for the first two years, and the new outer year being equal to year-two plus inflation) as well as changes to the baseline. Changes to the baseline need to be justified as either 'structural changes' or 'policy options'. Structural changes to the baseline are typically moderate adjustments for service delivery trends (such as higher than expected

increases in demand for a service), higher salary increases or the acquisition of specific scarce skills. These are considered by the Medium Term Expenditure Committees (MTECs). Policy options involve much bigger amounts and/or new services/activities that require careful examination to determine long-term affordability and alignment with government's priorities. These are deliberated and decided finally by Cabinet.

When evaluating policy options in order to advise Cabinet, the Treasury-led MTECs assess whether there is a clear link between the department's budget proposals and government's broad policy priorities and key sector challenges; whether new funding is required and whether the proposal can be accommodated in the baseline through reprioritisation; whether the department is able to implement the plan over the MTEF period; and whether the expected outputs are clearly defined.

Departments are also required to illustrate how they will generate savings within their baseline to fund new policy options. In the latest budget year, this requirement has been formalised, requiring departments to make a 2 per cent saving on their administrative costs, and to illustrate how this saving will be generated.

Political oversight of the budget process

Deciding and agreeing on the best allocation of scarce resources to fund government's many social, economic and political goals is the main purpose of the budget process. The setting of these goals is clearly a political matter. However, trade-offs between these goals within the resource ceiling are equally political, although technical work can identify policy options and make clear what the consequences of trade-offs are likely to be. The South African budget process applies this principle through several mechanisms ensuring appropriate political oversight of the budget process, and ensuring that policies are made within the context of budget constraints.

The budget policy process begins with the identification of national policy priorities by the national Cabinet. These priorities are expressed in a spending priorities memorandum, which provides a basis for departmental planning and budgeting. Ministerial letters are also exchanged between the Minister of Finance and spending ministers on major policy thrusts, signalling the direction of sectoral policy early in the budget process (spending departments are required to get information to their ministers in time for this letter). This creates the opportunity for the Treasury to engage in bilateral discussions with departments at an early stage, where critical spending pressures and major policy considerations exist, in order to undertake a more rigorous examination of the economic and fiscal implications over the medium to long-term period.

The Ministers' Committee on the Budget is another critical vehicle through which

overall political oversight of the MTEF process is realised. It is a formal sub-committee of Cabinet that considers policy changes with budgetary implications, and all main budgetary decisions, before making recommendations to Cabinet. After Cabinet has approved the new MTEF allocations, allocation letters are sent to all departments, informing them of their ceilings and triggering the final part of the budget process, where departments prepare their budget documentation for submission to Treasury, and Treasury prepares the Budget Review, Estimates of National Expenditure and other components for tabling on budget day.

Other structures through which political involvement in the budget process is secured, are the Budget Council, the Budget Forum and the Cabinet cluster system. Where it is known that the programme will impact on provincial and/or local expenditure (or that expenditure pressures arise at these levels), the fiscal implications will also be discussed in the Budget Council and the Budget Forum, and consensus on key trade-offs sought. At a sectoral level, committees of national sector ministers and their provincial counterparts discuss sector achievements, policy priorities and funding decisions that have provincial implications. At the national level, broad sector policies and budgets are integrated through the Cabinet cluster system, which mirrors the main functional spending categories in the budget.

National Cabinet makes all the final decisions on medium-term policy priorities and spending; this includes the macro and fiscal framework, the division of revenue, approving the MTBPS and changes to the medium-term allocations to national votes and provincial governments. An important event in supporting this decision-making process is Cabinet's periodic strategic planning 'lekgotla' at which budget policy and planning uses are discussed. At the provincial level, discussion on provincial policy priorities and the finalisation of allocations to provincial departments takes place in the Provincial Executive Councils.

An important principle in structuring political oversight of the budget process in South Africa is the use of inter- and intra-governmental political/technical forums where competing interests are represented on an equal footing, thereby maximising the possibility of political peer pressure, discipline and sanction if commitments made are not kept. Together with appropriately timed public statements to signal closed-off budget decisions, a transparent budget process, the system of hard budget constraints and the provision of good technical support to these forums on the financial implications of policies, this reduces the potential of accessing funding 'through the political back door' or through in-year budgeting games.

Aligning strategic policy development and budgeting at sector level

A closer alignment of policy priorities and spending allocations is facilitated by a

number of mechanisms already discussed, for example the use of forward estimates as planning baselines in the new cycle and the use of hard top-down budget constraints. However, it is through the creation of a strategic policy planning process and making its outputs count in the budgeting cycle that this alignment is given substance.

Spending departments conduct an annual rolling strategic planning process in tandem with preparing medium-term budgets. A recent innovation is to provide longer planning horizons for capital spending plans. The strategic planning cycle is concluded with an annual report. In preparing annual reports, departments need to review the performance or service delivery results of the previous period, undertake an assessment of service delivery or performance targets and re-examine departmental strategic objectives against broader government priorities.

Using budget documentation strategically

The MTEF system in South Africa utilises key sets of budget documentation to extract strategic information for decision-making, to ensure commitment to decisions taken and to enable accountability. Changing the format of budget documentation to achieve these objectives has been an important aspect of the budget reform process.

The first public document in the budget process is the MTBPS, which is tabled in Parliament at the end of October, approximately four months before budget day. The MTBPS was also the first 'new' document to emerge (in 1997) from the budget reform process. This public document serves to conclude the broad prioritisation phase of the budget process and consolidate the main budgeting ceilings. Thus, it signals government's fiscal and budget policy intentions, providing information on the macroeconomic assumptions and policy priorities driving the budget, the fiscal policy framework, the vertical and horizontal division of revenue and the expected functional and economic spending allocations.

The main budget documentation includes the Budget Review, the Estimates of National Expenditure, the Estimates of Revenue and the Division of Revenue Bill, and imparts a comprehensive and transparent review of government's current and planned future fiscal and budget directions, and the consequences of past decisions.

The Budget Review provides information on national policy priorities and how they are to be realised through the budget. The budget framework, in its various forms, represents a comprehensive picture of all revenue, including off-budget revenue, and expenditure of general government and the main fiscal balances, framed within information on the macroeconomic outlook and the key macroeconomic assumptions. Information on the broader public finances (including, for example, the borrowing requirement and investment performance of state-owned

enterprises) is provided with a discussion on its implications for fiscal policy. The Budget Review also discusses revenue issues in detail and the management of public assets and liabilities, including an assessment of contingent liabilities.

In the South African budget structure, expenditure information is first broken down by government unit (national or provincial), then by vote (usually coinciding with a main spending department at national and provincial level) and then by programmes and sub-programmes within a vote. The programmes relate to the objectives of spending departments. A view of the economic distribution of expenditure is also provided at each level. Updated financial information is provided for the current fiscal year (i.e. the year in which the budget preparation is taking place), backed by actual spending information on the three previous years and with forward estimates for the budget year and two outer years. Most recently, the forward estimates for expected once-off, large expenditure outlays for a further two years have been added, extending the forward horizon to a 5-year period.

On the expenditure side, the Budget Review provides aggregate information on the distribution of expenditure in the MTEF framework, between spheres and functions of government and between the economic purposes of expenditure. It does so, however, in the context of a discussion on past policy and expenditure performance, current national expenditure policy priorities and future policy and service delivery objectives.

Detailed financial and non-financial revenue and expenditure information is provided by vote in the Estimates of National Expenditure, which was developed and added to the stable of budget documents in 2001. The Estimates provide seven years of financial and performance information together, by national vote, and is aimed at providing parliamentary committees and other stakeholders with comprehensive information on departmental performance and plans. An important reform in 2002 was the introduction of measurable objectives for each programme, published in the Estimates. Therefore, it effectively serves as a co-ordinating document for coherent planning (and information) from departments, since they are called to account in Parliament for their chapters. Departments are required to set out what their main objectives are and what strategies they will be deploying to achieve them, and how they intend financing these strategies within their budget allocations. They also review their past performance, both financially and in terms of achieving objectives.

The Division of Revenue Bill details the respective shares of the three spheres of government in nationally raised revenue and, together with the Intergovernmental Fiscal Review, is the key public document in the intergovernmental system. It sets out how the provincial and municipal shares are to be divided horizontally, details

conditional grants to the two sub-national spheres and provides for various procedural matters regarding the management of intergovernmental finances, the responsibilities of Treasuries, accounting officers (individuals responsible for financial management in government departments and public entities) and the Auditor General. It also legislates a number of rules of co-operative governance, including what must happen if actual revenue falls short of anticipated revenue, under which circumstances allocations to sub-national governments may be withheld or delayed or a payment schedule changed and under which circumstances, and how, funds may be reallocated from one horizontal unit of government to another. Finally, it determines sanctions and consequences for individuals if the provisions of the bill are not met. The annexures to the bill include a framework analysis of each conditional grant, detailing its conditions, rationale, criteria for allocation, monitoring mechanisms, past performance, allocations, projected life and payment schedule. This framework is published to provide clarity and certainty on the complex system of conditional grants to stakeholders, and for budget implementation and monitoring purposes.

Departments are expected to report against the Division of Revenue Bill and its schedules, covering both financial and non-financial performance. The Auditor General audits compliance with the bill, in both the transferring national departments and the receiving provincial departments and municipalities.

In the intergovernmental system, the Division of Revenue Bill is supported by the annual Intergovernmental Fiscal Review, first published in 1999, which is a compilation of expenditure and service delivery trends and financial issues in the nine provincial governments and local government. The Review provides invaluable holistic information on provincial service delivery achievements and obstacles. Similar to other public documents in the budget cycle, the Review has become an annual feature in the cycle, thereby contributing to a high and continuing level of transparency in a very complex system.

Finally, in addition to spending information in documents detailed above, actual spending information is published in-year on a monthly basis for all national departments by the National Treasury, and on a quarterly basis across national and provincial government, providing vital information to Parliament and other stakeholders to monitor budget implementation. The information is submitted to the Treasury under the statutory reporting requirements of spending departments, and forms part of the 'early warning system' whereby deviation from spending plans can be detected early and addressed by the Treasuries. Currently, the National Treasury is in the process of reviewing the in-year reporting system, both for national departments and provincial governments, in order to make it more effective.

A considered budget process

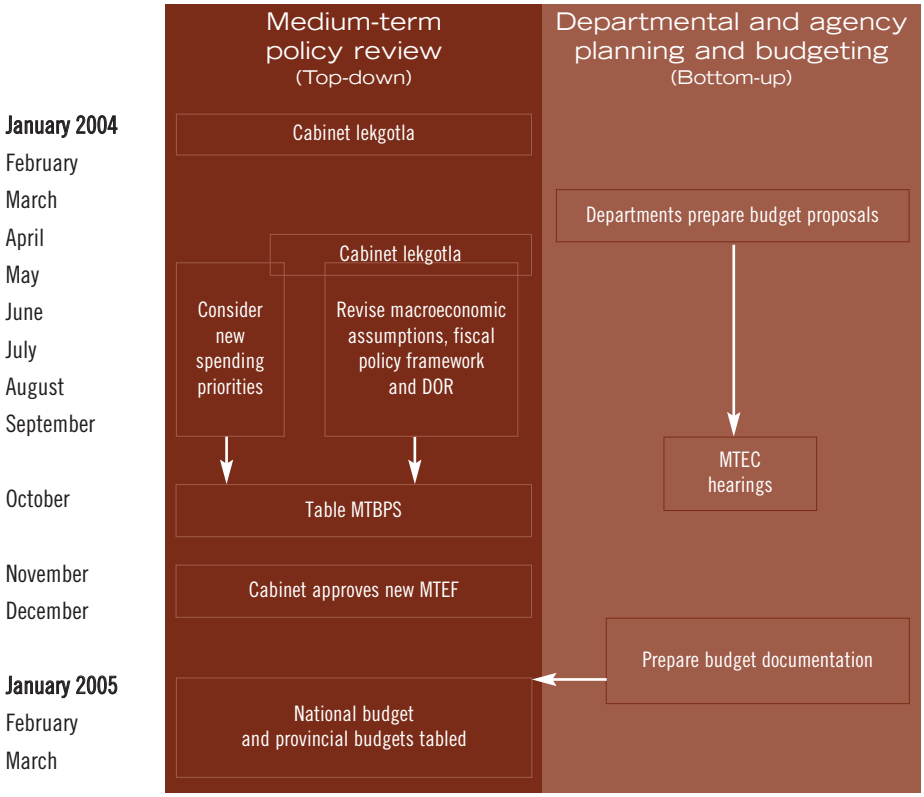
One view of the MTEF is that it is the end-result of explicit and implicit policy decisions and policy trade-offs made by bureaucrats following the broad policy commitment of the executive, and finally decided on by the political principals. So, while the MTEF is usually presented as a broad conceptual framework with certain desirable features, it is important to recognise that it is effectively the outcome of many layers of micro decisions taken by programme and project managers in different spheres and at different levels of government. A signal achievement of the MTEF process in South Africa is the degree to which it has attained co-ordination of these decisions towards policy priorities. The key to that lies in the institutions discussed above and how they are sequenced in the budget process. This section provides a brief overview of this sequencing.

The budget process allows government to involve various role-players that provide political and technical advice when faced with trade-offs between competing spending priorities. It starts with national Cabinet determining the policy priorities, and high-level consultation between the Minister of Finance and other members of Cabinet, including provincial finance ministers. In the months that follow, from April to September, the two parallel dimensions of budget preparation take place – the determination of available resources and the preparation of good information on the competing claims on those resources.

The consultation process includes spending departments at national and provincial level preparing their budget proposals, national and provincial Treasuries engaging some departments in discussions on pertinent policy issues, and joint research teams working on specific expenditure issues. In addition to determining national spending priorities, the macroeconomic forecasts and fiscal policy targets are updated to prepare the national budget framework, followed by the vertical and horizontal divisions of revenue. The division of revenue process interacts with both these dimensions, culminating in the MTBPS, tabled in Parliament in late October. National departments and provincial governments are subsequently informed of their allocations. At the national level, spending departments then prepare their budget documentation. At provincial level, clarity on final allocations allows the provincial budget process to enter its final rounds. The national and provincial budgets are tabled in February and March, respectively, for the year beginning 1 April.

The multi-year, decentralised budgeting system in the context of co-operative relations between the spheres of government is a critical foundation of government's approach to public sector management. Its emphasis on getting managers at appropriate levels (i.e. those with the best information on which to base decisions) to plan and budget, aligns budgeting with other evolving practices, such as human resources

Figure 7.1: The budget process



management. The provision of a multi-year funding horizon, coupled with incentives to make use of it, facilitates policy-makers and managers making key policy decisions in light of their long-term cost and benefit estimates. The availability of much-improved information on the financial consequences of policies over a longer horizon enables public debate, which in turn supports improved policy-making. A key success factor in the development and implementation of the MTEF was not to see it in isolation or as a technical response to a short-term need, but rather to develop it as a component of the overall vision of public finance management, together with other aspects.

7.2.3 A new framework for public financial management and reporting

The introduction of an MTEF for the 1998/99 fiscal year was followed by a

programme of financial management improvement. A cornerstone of this programme is the Public Financial Management Act (PFMA), which came into effect in April 2000. The PFMA repealed the ten exchequer acts that previously governed public financial management. It was developed to transform an environment where financial administration was rule-bound and management exclusively input-focused, policy and financial responsibilities in departments were separated, where capital resources and liabilities were not properly managed and where there was a great lack of reliable and timely information. Treasuries' resources were devoted excessively to exercising micro-control, with even mundane matters referred to it for approval, and too little in the strategic management of public finances in line with policy and efficiency objectives. In short, there was insufficient practice of functional financial management of public resources in government as a whole.

The PFMA put in place a legal framework for modern public financial management, shifting the onus of managing the use of resources from central control to the managers of spending departments and agencies. This mirrors the shift in budget preparation practices from central decision-making to discretion resting with spending departments for programme choices within spending ceilings.

In order to engineer this shift, the PFMA does not prescribe specifics, for example what payment approval procedures should be. Instead, the Act specifies who is responsible for putting in place such procedures, what the procedures should achieve, what the information and reporting requirements are and how these are to be overseen, monitored and compliance assured. This section discusses the main public finance management institutions established under the PFMA.

Responsibility of individuals and ensuring checks and balances

Throughout the Act and the accompanying Treasury Regulations (as gazetted in terms of the Act), individuals are made responsible for flow of funds and/or establishing systems. In tandem, checks and balances have been instituted to ensure that individuals undertake their responsibilities. For example, the payroll is divided into pay points, where the legitimacy of payments needs to be certified monthly by an individual who is not the same person making the payments.

The Act designates heads of departments and constitutional institutions and boards of public entities as accounting officers or accounting authorities and gives them responsibility for the effective, efficient, economical and transparent use of resources in accordance with the Appropriation Act. In doing so, the PFMA requires them to produce monthly and annual financial reports and ensure effective, efficient and transparent systems of financial and risk management, internal control and procurement. If accounting officers do not comply with these requirements, they are

guilty of financial misconduct and can have disciplinary or criminal proceedings instituted against them, depending on the nature of the offence. The Act, therefore, provides the legal framework for devolving responsibility for the use of public funds to spending departments, and for ensuring transparency and accountability.

Financial responsibility of executive authority

The PFMA compels ministers to fulfil their statutory responsibilities within the limits of their vote amount in the Appropriation Act, and requires them to consider the monthly reports submitted to them by their accounting officers. It also sets out a framework to clarify accountability when a political directive could result in unauthorised expenditure.

Legal underpinning for the role of Treasuries in the budget process

In addition to regulating accounting officers and executive authorities, the PFMA provides a legal framework for the role of the national and provincial Treasuries in the budget process, including co-ordinating the national and provincial budget processes, managing budget implementation and enforcing revenue, asset and liability management. In addition, it provides the legal framework for the National Treasury to develop the macroeconomic and fiscal framework, co-ordinate intergovernmental relations and determine the banking and cash management framework. It also puts the Treasuries in charge of the revenue funds.

The PFMA makes its implementation the responsibility of the National Treasury. To this end, the National Treasury is required to gazette Treasury Regulations, giving practical effect to the framework provisions of the Act.

Systematic in-year monitoring, management and reporting

Giving managers financial management discretion must be commensurate with holding them accountable for resources used, which in turn requires good information on budget implementation to be available. The aim of the reporting system is to enable appropriate oversight throughout the system as an incentive on performance, and to locate the accountability at the correct level. This means that the reporting framework needs to strike the right balance between continuously filtering sufficient information upwards (without overloading the capacity of either those compiling reports or those who are supposed to use the information) and, at the same time, providing managers with good information at the level of implementation. The provisions for in-year monitoring, reporting and management of the PFMA, the Division of Revenue Act (DORA) and the Treasury Regulations, and other best practice frameworks prepared by the National Treasury, are aimed at achieving this

balance and answering three questions for each level of budget implementation: What has happened so far? What do we think will happen to our plan for the rest of the year? What (if any) action do we need to take to achieve our agreed plan?

The PFMA specifies a variety of financial budget progress reports – monthly, quarterly and at year-end – with different responsibilities for executive authorities and accounting officers. These are supplemented in the intergovernmental system by the reporting requirements of the DORA. The National Treasury is currently developing a unitary, streamlined reporting system to meet the information needs of managers, provide an early warning system on budget implementation for Treasuries and to satisfy the reporting requirements of the PFMA and the DORA.

The current in-year and *ex post* reporting requirements are summarised in Figure 7.2. Accounting officers are required to compile monthly financial reports (including information on conditional grants) for their executive officers and relevant Treasuries, which publish monthly reports on the status of national budget implementation, in accordance with the PFMA. Accounting officers are also required to prepare quarterly financial reports. These are consolidated for national and provincial government by the National Treasury and are published.

Shortening the budget cycle

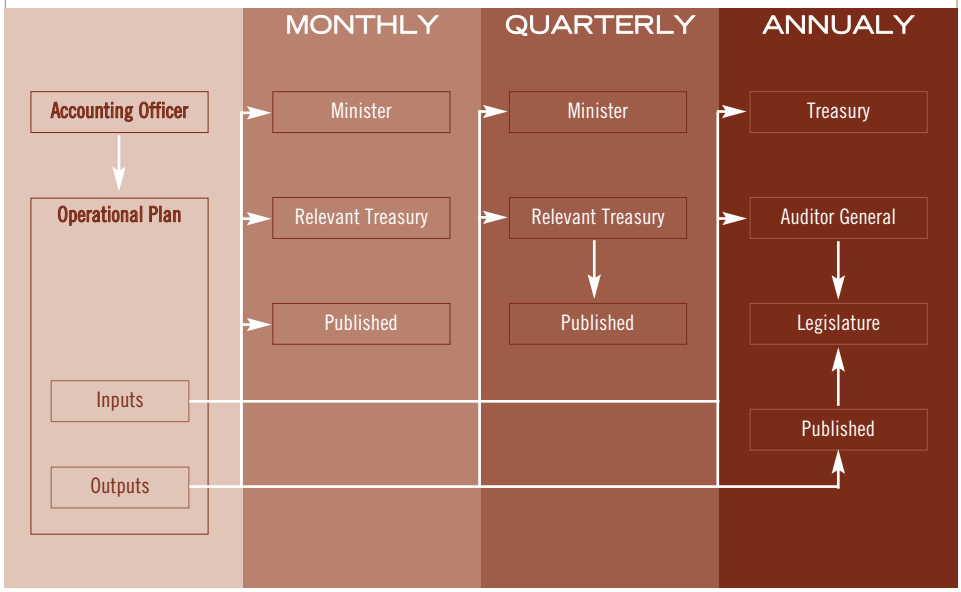
The PFMA shortens the budget cycle to bring audited actual spending information to Parliament seven months after the end of the financial year. This means that public accounts committees deal with much more recent matters, enabling improved oversight and allowing audited information to be used more effectively in the assessment of departmental spending plans.[5]

The shortening of in-year time horizons for capturing transactions also reflects the principle of introducing early, accurate financial information as a management tool, and serves well to illustrate how adjustments to the financial management framework are aimed at improving the incentives in the system. Whereas previous regulations and accounting systems used to allow transactions to be written to a specific financial month up to three months after month-end, this has been shortened to ten days. Given that departments are required to provide cash flow projections, that their cash use is made transparent through the monthly reporting system and that the limits on virement and rollovers (see below) are by and large enforced, this has sharpened the incentives for effective and efficient accounting practices considerably.

Providing for, but limiting, in-year flexibility

Budgeting can never predict the use of resources down to the last detail – projects may be delayed or events in the outside world may necessitate new expenditure. The

Figure 7.2: PFMA reporting requirements



PFMA allows for flexibility, within a framework, to make adjustments. The Act, supported by the Treasury Regulations, provides several rules to manage this flexibility, so as to support incentives on sound planning and to control for behaviour that, in aggregate, could compromise fiscal policy.

Managers are allowed to vire (shift) funds between subdivisions of a vote (up to 8 per cent of any subdivision total). However, further limits hold; for example, funds may not be vired from capital to recurrent spending and, under current Treasury Regulations, personnel compensation may not be increased without prior Treasury approval. Accounting officers are required to report to Treasury and their minister within a week on any virement within the 8 per cent limit.

Certain funds may be rolled over from one year to the next. Unspent funds on payments for capital assets may be rolled over only to finalise projects still in progress. Savings on transfers may not be rolled over for purposes other than those originally voted for, and savings on employee compensation may not be rolled over. While there is no restriction on what types of other recurrent expenditure may be rolled over, there is a limit of 5 per cent of a department's non-personnel recurrent expenditure.

Emergency expenditure must be authorised by the Minister of Finance, but may

not exceed 2 per cent of the total national budget, must be reported to Parliament and the Auditor General within 14 days, must be made public and must be attributed to a vote.

The PFMA allows for a Treasury committee to approve additional expenditure and deviations from expenditure, but only if the expenditure is recommended as 'unforeseeable and unavoidable' by Cabinet. The Treasury Regulations further define 'unforeseeable and unavoidable' as excluding expenditures that were submitted and not approved in the budget preparation process, increases in tariffs and prices and the extension of existing, or initiation of new, services. The Adjustment Estimates approve roll-overs, virements, allocations for unforeseeable and unavoidable expenditures and savings.

Setting clear sanctions

Accounting officers can be subjected to disciplinary proceedings if they permit unauthorised, irregular, fruitless or wasteful expenditure, or fail to comply with any of the requirements regarding budget implementation, setting up of financial management systems and reporting. If they are found to be grossly negligent, criminal proceedings can be instituted. In addition, any loss accruing to the state on account of negligent or wilful action by an official must be recouped from the individual.

Internal control framework and regulating support for accounting officers

The Treasury Regulations require all departments to appoint chief financial officers, to whom the accounting officer can delegate some of his/her functions under the Act. As part of risk management, all departments must also set up internal audit committees and formulate 3-year rolling internal audit plans that assess and address key areas of risk, as well as fraud-prevention plans.

Providing for effective cash management

The South African budget is implemented in an environment of relative revenue certainty. This means that in practice departments can expect to receive their full budget allocation in a fiscal year. Any shortfalls in revenue are absorbed at Treasury level. One of the key challenges in the system is to extract relatively accurate predictions of cash flow requirements from spending departments, in order to match these with expected fluctuations in revenue collection and to avoid borrowing unnecessarily or locking in cash in departmental accounts unnecessarily and inefficiently. The regulations require departments and provincial Treasuries to submit predictions of monthly cash flow requirements at the start of the financial year. These are updated

monthly, throughout the year, but any changes to the approved cash flow need to be motivated to the National Treasury.

Mindful implementation

The paragraphs above set out, in principle, the framework for financial management in South Africa. While theoretically it is a comprehensive and coherent system, any system is only as good as its implementation. It can be argued that in the environment of its design, the PFMA represented a highly idealistic vision of a modern public finance management system for South Africa. However, six years later the basics of this system have been realised and the benefits in terms of accountability and improved budget implementation are evident. While the final section of this chapter pays attention to what made the reform process successful, it is useful to consider the implementation path of the PFMA here, in context with its driving principles.

The PFMA made provision for its phased implementation over five years. Similar to the development of the MTEF, the approach was to put in place the scaffolding of a holistic system and then allow quality improvements to develop over time, driven by the changed incentives in the system itself. Thus, the PFMA was made immediately applicable to all government departments and entities and constitutional institutions. Specific areas of it were delayed, however, particularly if the necessary systems were not yet in place to enforce or support it. For example, the legal requirement of measurable objectives for all programmes was delayed, as were some of the provisions relating to financial statements and public entities.

In keeping with the spirit of the PFMA and its changed role, the National Treasury required all departments to submit implementation plans within six months after the Act came into effect, and provided best practice guides, training and capacity development support. The plans were structured to assess the financial management and accounting capacity in departments, the financial skills of line managers and the quality of internal control systems. They were required to propose an implementation plan for each department, particularly the strategy for risk and performance management. In the first year of PFMA implementation, the appointment of chief financial officers was prioritised, as were the establishment of internal audit committees and the implementation of monthly reporting requirements.

Today, in a context where public service delivery is managed in terms of the PFMA, programme managers are faced with only a limited set of choices when monthly reports point towards a year-end deviation between budget and actual expenditure in a programme, and the cause is substantial (rather than accounting errors or delays in capturing information). In the case of over-expenditure, funds can

be vired within the vote, the department can apply to the Treasury for additional funding, or spending for the remainder of the year in the vote can be curbed. In the case of under-expenditure, spending can be accelerated or funds can be rolled over. Given the threat of sanction, and the certainty of 'exposure', increasingly the most unattractive choice these days is the one that would have been the default position six years ago – continuing with business as usual.

7.2.4 Improving the classification system

Before recent reforms, the South African budget was classified on functional, economic, line-item, administrative and programmatic lines. However, the quality of information was dubious, with many inconsistencies in the application of the standards. The line-item classification was also archaic and a hangover from an earlier incremental, input-based budgeting system. The relations between budgeting, accounting for funds spent, and reporting by the Auditor General and in the national statistics were not clean-cut, disabling the link between policy and actual spending, and ultimately affecting the quality of oversight and undermining accountability. Since 1997 the underlying classification structure has been modernised and the chart of accounts reviewed. This section briefly reviews the main features of the reforms.

The new economic reporting format

The old economic and line-item classification of inputs has been replaced by the new economic reporting format, which is aimed at providing better-quality information to legislatures on the economic nature of financial outlays towards policy objectives. The new format is in line with the 2001 Government Financial Statistics standard, also enabling improved international reporting. However, in order to take into account the specific nature of the South African environment, certain modifications to the structure of the account and the labelling of receipt and payment items have been made. Most significantly, the South African system still operates a cash-based accounting system, although it is a modified cash base with entries for national budget data made in the time period in which transactions are captured on the financial systems, rather than when the actual cash flow occurs. The intention is to eventually move towards accrual-based accounting.

The new format, which is used consistently for the budget estimates and for recording and classifying the economic nature of transactions in the revised chart of accounts, organises the multitude of government transactions into three broad categories: receipts, payments and financing. The budget deficit or surplus is calculated as receipts less payments; by definition, it is equal to net financing, but with the

opposite sign. Payments are also divided into three broad categories – current payments (e.g. employee compensation, goods and services, interest and rent), transfers and subsidies (funds that are transferred to other institutions, businesses and individuals and are not final expenditure by the spending unit) and payments for capital assets (buildings and fixed structures, machinery, cultivated assets, intangible assets and land and sub-soil assets).

Improved quality of functional classification

The functional classification is complementary to the economic classification. It serves to distinguish transactions by policy purpose, or expense by output. Its main purpose is to clarify how spending by government contributes to social, economic and other objectives. In the budget structure, four broad categories of functional classification are used – general government services, protection services, social services and economic services.

Improved programmatic classification

In co-operation with spending departments, the Treasury has been systematically improving the programmatic classification of the budget, in order to strengthen the link between policy objectives and financial information. One intervention has been to standardise vote structures across provinces, in order to enable co-ordination of policy implementation and monitoring.

Mindful implementation

While the careful redesign of the budget structure and chart of accounts framework is a necessary input into improving the quality of budget and financial information, it does not guarantee that spending departments, which are responsible for recording transactions in the South African system, will apply the frameworks well. A key feature of the South African reforms has been implementation support for spending departments, including working with departments to re-code their transaction base correctly, and providing training programmes to financial management personnel.

The new South African classification system is aimed at improving financial information for budget management and accountability purposes. The structure and presentation is fully compatible with, and can be converted easily to, the Government Finance Statistics format (since the same classification base is used at a high level of detail). However, the South African system avoids the use of unclear terms such as 'other' and 'miscellaneous', includes more detail on various transfer categories and labels items more clearly.

7.2.5 Improving budget management for service delivery

The earlier phases of the South African reforms placed emphasis on planning better for the financing of new policies and priorities and, ultimately, improved service delivery. However, the reform vision recognised from the start that planning and budgeting need to be integrated with monitoring service delivery performance to strengthen the link between the services that departments provide and the benefits and costs of these services. Performance measures were to give effect to the emphasis on improved transparency and accountability for the management and use of public resources. As in many other countries, the development of effective and appropriate performance measures has been a difficult process, and is still ongoing as lessons are learnt and capacities built. This section reviews developments and discusses the main characteristics of the current system.

The meagre information on departmental policy and budget performance in 1997 has since systematically been improved, slowly moving South Africa from an input-focused system towards a system of managing for performance. The National Expenditure Survey (NES) took the brief discussion of sector policies out of the Budget Review and expanded it at vote level in 1999. The PFMA requires 'measurable objectives' to be formulated for each main division (i.e. programme) within a vote. In 2001 the Estimates of National Expenditure replaced the NES, bringing financial and narrative performance information together and making a first effort at formulating measurable objectives and indicators. The Intergovernmental Fiscal Review also provides more information on the context of budget implementation.

However, the introduction of service delivery and performance information into the budget documentation has meant that public service managers have had to grapple with new concepts and tools for monitoring and measuring performance. Experiences since 2001 have highlighted difficulties in developing appropriate output performance measures and service delivery indicators. Many of the 'indicators' specified were not related to clearly measurable objectives of programmes and did not actually relate to the outputs. They have failed to show whether services contribute towards meeting government's outcomes. These indicators are, therefore, of little value to the public, Parliament, the executive and even the department itself. Today, attention is focused on improving the quality of the measurable objectives and the indicators. This section discusses the framework that is provided to departments to develop these measures.

Measurable objectives and output performance measures

The Treasury guidelines define 'measurable objectives' as clear statements of the specific outcomes or results that can be achieved over the medium term in a given

programme. They should provide a clear link between the programme's outputs and the department's goals, and define the actual impact on the public rather than focusing on the level of effort that is expended. Measurable objectives are tools to assess the effectiveness of an agency's performance and the consequent public benefit that is derived.

In the current performance management framework, departments are required to make a distinction between outcomes and outputs, with the former referring to the end social and economic results of public policies or programmes. Outcomes refer to, for example, changes in the general state of well-being in the community, examples of which include a safe and secure environment, healthy citizens, reduction in the number of repeat offenders, reduced poverty levels and stable and self-sufficient families. Outcomes should clearly relate to the government's strategic priorities. At the same time, departments need to ensure that their measurable objectives link to the outcomes to which their programmes contribute. Outcomes are usually not within the control of a single department, or of government as a whole.

Outputs are the goods and services produced or delivered by departments to customers or clients who are external to the department. The framework defines outputs as the 'what' that departments deliver or provide, contributing towards meeting the outcomes that government wants to achieve. Outputs are usually measurable, and include services such as issuing passports, providing policy advice, assessing applications for benefits and policing the streets, and must be within the control of the department.

Departments are required to develop output performance measures and service delivery indicators that measure how well an expenditure programme is delivering its output and contributing towards meeting the desired outcomes. Output measures represent the level of service provided, and may measure the quantity, quality and/or timeliness of services.

The Treasury Guidelines advise departments to undertake an internal process to develop their performance indicators, including steps to agree on the results intended, to specify the outputs that are to be measured, to select the most relevant measures and indicators and to set realistic targets. The framework emphasises the need for departments to be explicit about performance reporting institutional arrangements, including a process and formats, and to establish mechanisms that will facilitate corrective action when required.

However, the South African experience shows that better financial management and improved service delivery do not occur simply through the passing of legislation and regulations and the provision of guidelines. Implementation of performance-oriented reforms requires appropriate training of managers and recruitment of addi-

tional management skills into the public service. It can require an overhaul of information systems and information processing. It necessitates the building of capacities and an understanding of new concepts and systems, and it calls for a different style of management across the public service. Successful implementation will take time, effort and a change of mindset within the public service.

7.3 The way forward

The reforms set out above have brought huge benefits. The introductory section of this chapter set out some of the policy outcomes gains that have resulted. These came on the back of an improved environment for budget planning and financial management, in several respects, particularly the following:

- *More stable public finance environment*. The reforms have contributed to providing a stable environment for public policy delivery. They have enhanced macroeconomic stability, which has supported predictability of funding for policy priorities. They have improved policy predictability, requiring all policies to be developed within the medium-term framework, which in turn has supported the predictability of expenditures, stable public finances and macroeconomic stability.
- *Improved political involvement and oversight*. The budget process reforms have enabled greater political involvement in the budget process, turning it into the most important policy process. This facilitates the effectiveness of the medium-term budget framework as a mechanism to link policy-making and budgeting.
- *Improved policy environment and improved performance*. While there is still much room for improvement, few would deny that policy contestability has improved (leading to pressure to formulate better policies), that there is better linking of policy, spending and delivery and that policy co-ordination between the three spheres of government, while still imperfect, could have been in much worse shape without the reforms.
- *Greater transparency*. Parliament and other non-executive stakeholders in the budget have access to much better information than before 1997. The available information covers more of government and the public sector, it is more timely, its accuracy is improving and, to a large degree, its provision has been imbedded either in legal requirements or in well-established practices.

7.3.1 Remaining challenges

The reform process is far from complete. Some areas that were targeted for reform in the initial vision of a results-oriented, accountable budgeting environment have just not yet been reached, such as a fully fledged accrual accounting system. Other issues, such as performance management and the planning, budgeting and reporting links, have been tackled, but progress has been slow.

All in all, the South African system has reformed fast, up to a point, but has been struggling to deepen the reforms in order to further enhance service delivery. It can be argued that whereas fiscal discipline has been achieved, by and large, and the allocation of scarce resources to spending priorities improved, addressing efficiency issues is the greatest challenge remaining. Perhaps in these areas it is not only the public financial management systems that are at fault, but further reforms need to be co-ordinated with improvements in parallel systems, such as human resources management. Also, the improvements in the quality of information that were envisaged have taken time to materialise, because they are a function of capacity developments, particularly in management. The remaining challenges are outlined below.

- *Strengthening the planning, budgeting and reporting links*. While the improvement in information availability is one of the achievements of the budget reform process, the information that is provided is not always used sufficiently. There is still a lot of work remaining to be done on developing and providing appropriate performance information in effective formats. Information sharing could improve; many departments are still not able to provide adequate information on their policy priorities, budget allocations and links between them. Moving further towards an output orientation and improving the outputs of the reporting system are current reform focuses. However, this needs to be supported by a reassessment of how well the information is being used. This holds not only for programme managers and their seniors, but also for ministers and for Parliament. Within the current framework, there is considerably more leeway for action in cases of poor performance than is being used. It can be argued that the way in which practice is evolving is diluting the original conception of the system as set out in the PFMA. Some of this is perhaps inevitable. Nevertheless, long-term expected non-enforcement may have the consequence of limiting the usefulness of the MTEF in forging a policy-budgeting link and could allow wastage of scarce resources through inefficiency and corruption.
- *Improving capacity throughout the system*. Effective medium-term planning at the departmental level cannot be taken for granted. A lot of work needs to be

done to realise the benefits of a medium-term planning horizon. For example, while possible in principle, providing medium-term budgets for learner support materials to schools is not a standard feature of education management. The medium-term allocations stop at programme level, with financial planning lower down still being done largely on an annual basis. Deepening the reforms in this way would require working with individual departments at national and provincial level to develop managerial capacities.

- *Improving parallel systems*. Supply chain management and human resources (performance management) frameworks are two areas that need further development to realise improved service delivery.
- *Reforming the financing of specific services*. With improved basic budget and financial management, a better base is in place from which to investigate improved ways of financing certain public services, such as social security payments. Frameworks for public-private partnerships for the financing of large infrastructure projects have already been developed and are being implemented.
- *Increasing the planning and budgeting horizon*. It is becoming increasingly clear that a 3-year planning horizon is inadequate for budgeting in some areas, such as the promotion of a sustainable social security system and for large, once-off expenditure outlays. Budgeting for social grants needs to arise from a 10–20 year projection of demographic changes and other social dynamics such as the evolution of the population's health status. Investment projects often span more than three years. Extending the budgeting horizon is an area that is being investigated.
- *Integrating donor financing into the budget*. Donor financing is approximately 2 per cent of the budget. However, in many cases it provides important marginal flexibility to implement policies. Ensuring that these resources are used well towards policy priorities and are reflected accurately in budget documentation remains a challenge.
- *Improving intergovernmental co-ordination further*. While the intergovernmental fiscal relations system is stable and supports affordable and effective spending, there is still room for improving co-ordination of spending towards policy priorities and for improving the functioning of the intergovernmental forums and other co-ordination structures.
- *Improving municipal financing and budgeting*. A key focus of current reforms is local government. Municipal financial management legislation was enacted recently, setting improved frameworks for budgeting and financial management practices at this level.

By and large, the reforms that occurred between 1997 and 2004 have put in place the foundations for modern public finance management in South Africa. Major system changes were undertaken and implemented with relative success. With the exception of one or two major structural reforms that still need to be undertaken, what remains is the patience and hard work needed to make the changes fully effective.

7.4 Conclusion

South Africa has succeeded in radically altering the way in which it budgets for public services and how it accounts for public expenditure and commitments. It did so in a relatively short time and has already started reaping the benefits, with more realistic policy debates and increased funds available for much-needed investment and poverty-alleviating expenditure. Many other countries that have embarked on similar processes struggle to anchor changes and make them count. South Africa has several advantages over other African countries – it has a modern economy that generates predictable resources for public spending, it has a functioning tax administration, donor financing is a minor proportion of its budget and it started off from a base where cash was relatively well accounted for and with comparatively good capacity in the public sector. Several lessons can be taken from its reform experience. We discuss these in conclusion.

Political commitment to budgeting and financial management reforms
The starting point for the reforms was not to put in place a sophisticated MTEF system. The reforms were driven by a political commitment to realistic macroeconomic projections, sensible budgeting norms, good accounting practices and regular reporting through transparent budget documents, objectives for which medium-term budgeting and the public financial management reforms were tools.

A simple framework and transparent norms
It is important that all actors in the budget process grasp the framework approach behind the reforms. This is the only way in which they will be able to fulfil their adjusted responsibilities in such a manner that the reforms achieve their objectives. In the case of South Africa, reforms centred on putting in place credible 3-year plans, focusing in the budget process on changes to baselines and devolving accountability to spending departments. This was done through simple frameworks that were easy to communicate and easier to implement than systems with high levels of complexity. However, the complexity of the system has been growing as capacity and understanding develop, both in the centre and in service departments. At the same time,

the budget process was changed from being a 'black box' to one with a high level of transparency, where the criteria for decisions are communicated early and policy objectives publicly articulated. The rules that governed this process were made explicit and enforced.

Comprehensive implementation

Major reforms in South Africa, such as the MTEF and the PFMA, were implemented throughout government, and replaced the existing frameworks. This made sense. Because the MTEF is a framework approach and because ceilings are determined in a top-down manner within the framework, it would have been very difficult to establish credible forward funding projections at any level if they were not connected to the fiscal framework and other projections. Similarly, because it is about competing priorities at any level, having only a few priorities competing within the MTEF, while others are still outside, would have undermined the principle of working within a framework.

Make sure it matters

Because both the MTEF and the PFMA were implemented across government, they became the frameworks driving any policy and budgeting decisions and financial management. Departments did not have recourse to any other way of getting activities funded. Anchoring reforms by linking them with other processes has also contributed to their implementation, and was necessary for their effectiveness. For example, linking the MTEF to financial management through the PFMA (which makes it a legal requirement) and other reforms, such as those at the Office of the Auditor General, helped to consolidate it as the only system for budget planning. It can be argued that if the MTEF had been implemented in isolation, without linkages to improved fiscal and financial management, it would have been far less successful.

Convince stakeholders that you are serious

Another aspect of making sure that it matters is disciplined and mindful implementation in the first year. It often takes only one instance of a rule being enforced for budgetary actors to change their behaviour. For example, in the first year of the intergovernmental fiscal system, there was pressure on the National Treasury to bail out some provinces that were unable to redeem overdrafts at commercial banks. The national government refused, enforcing the constitutional requirement that provincial governments are accountable for their finances, and signalling clearly that it was no longer business as usual. Similarly, spending agencies have had to absorb the unauthorised expenditure of one fiscal year within their budgets of the next year. The

successful implementation of the budget reforms has been facilitated by the Treasury making the rules explicit and enforcing them. Enforcing hard budget ceilings, during planning and preparation, from the first year of the MTEF, has been a key determinant of success.

Strong central agency responsible for reforms

The implementation of the MTEF and the PFMA was strengthened greatly by the amalgamation of the former Department of Finance (responsible for macroeconomic, fiscal and budget policy planning) and the Department of State Expenditure (responsible for departmental budgeting and implementation) into the National Treasury. Institutionally, this has brought expenditure planning and monitoring together, and has located the full budget process, from macroeconomic forecasting and fiscal planning through to managing expenditure in-year and compiling reports on the state of the budget, under one executive authority and one accounting officer. Better integration in the budget process between budgeting and implementation has resulted. For example, one desk is now responsible for monitoring a spending department/sector, assessing budget plans and monitoring in-year performance. The unit responsible for determining budget planning modalities takes responsibility for managing the whole process, including reporting modalities. All in all, mainstreaming the reforms from the start, through making it the only process and system through which funds are allocated and used, and having the central agency responsible for budget management and implementation responsible for the main reforms, has ensured that they have taken root.

Build capacity by demanding it, and support its development

Reforms were implemented in a comprehensive and disciplined manner, changing the incentives for budget actors, and they were supported through linkages with public service management frameworks, for example the Public Service Regulations. This immediately placed increased demands on spending departments, which often did not have the capacity to comply in any meaningful way and were forced to develop it fast. The Treasury, however, developed specific strategies (for example, in the implementation of the PFMA) to support the development of the capacity in line agencies.

Demonstrate wins early

Any reform process is likely to meet with resistance from vested interests, and to experience setbacks. Therefore, it is important to build support for the reform process at all levels of government. In the case of South Africa, the benefit of working within

a multi-year budgeting framework was demonstrated early, when the fiscal framework for the 1999 budget had to contend with fewer resources than expected. Instead of having to institute budget cuts, as would have been required under a one-year framework in order to meet deficit targets, the government used the medium-term framework to keep spending stable in the short term, absorbing the shortfall by drawing down the contingency reserve and shifting the impact to the outer years. So, whereas an annual budget cycle would have forced immediate expenditure disruption (and could have reinforced the negative economic environment), the medium-term framework allowed the shock to public finances to be smoothed over the economic cycle. This demonstrated the usefulness of medium-term planning, helped to overcome resistance at political and institutional level and contributed to making the MTEF a functional strategic budgeting tool.

The South African case illustrates the importance of being clear about objectives, getting the principles right when designing reforms to fulfil those objectives, and letting realism guide the reform process and the speed with which it is implemented. The South African experience also shows that, while it makes sense to approach budget reforms in terms of frameworks, it requires time for the reforms to take effect. Quality improvements in terms of expenditure estimates, actual spending information, performance information and service delivery materialise slowly. Reforming the budgeting system is never the full answer to economic governance challenges; however, when backed by robust political support and decision systems and sound human resources management, it plays a significant part in improving public sector management.

Endnotes

1 This chapter borrows from Chaponda T, Cole N & Schoch M (2004) Budget Reform as a Means to Strengthen the Link Between Micro and Macro Policies, unpublished draft paper.

2 This requires that the spheres of government co-ordinate their actions and legislation, and exercise their powers in a manner that does not encroach on the geographic, functional or institutional integrity of government in another sphere.

3 This legislation includes the Intergovernmental Fiscal Relations Act, the Financial and Fiscal Commission Act, the Public Financial Management Act, the Provincial Borrowing Powers and Tax Regulation Process Act, and legislation pertaining to the municipal level of government, such as the Municipal Finance Management Act.

4 The Constitution lists ten factors that need to be taken into account in the division of revenue. Other factors include the national interest and debt, addressing economic disparities, the interest of national government and provincial and local spending obligations in terms of national legislation. How these factors play out in any given year is made public in Annexure E of the Budget Review, as is required by legislation.

5 Accounting officers are required to submit financial statements to the Auditor General and their relevant Treasuries within two months after year-end. The Treasuries, in turn, are required to submit consolidated financial statements to the AG within three months after year-end. The AG's audit must be completed within three months, and the audited financial statements returned to the Minister to submit to Parliament within seven months after year-end.

CHAPTER 8

Tanzania

Aiming reforms at better economic management

Nashon Magambo and Ramadhan Hamisi

8.1 Background

The overarching objective of our reforms is to have better economic management. In an increasingly integrated world, poverty reduction and economic growth would remain unattainable without the mediating influence of sound macroeconomic policies and public financial management.

It is important to put the ongoing public sector reforms in Tanzania into historical perspective. By early 1980s our country's economic decline and macroeconomic imbalances had reached severe proportions. In a resolute effort to address the economic problems, the government has endorsed various economic reform initiatives since 1986. These initiatives have included the following:

- *fiscal policy reforms* – through reforms in revenue and expenditure;
- *monetary policy reforms* – discouraging excessive commercial borrowing from the Central Bank;
- *financial sector reforms* – improving banking decisions and breaking the

pre-reform monopoly;

- *exchange rate management reforms* – moving towards the principles of a market-based system for exchange rate determination;
- *liberalisation of international trade* – reforms in trade policies;
- *liberalisation of prices and domestic trade* – addressing price controls and marketing channels;
- *labour and wage policy reforms* – to improve the performance and morale of civil servants;
- *public enterprise reforms* – to hive-off activities not considered to be core government functions; and
- *social sector policy reforms* – to improve the delivery of social services.

Better economic management remains the fundamental objective of the ongoing reforms. The Public Financial Management Reform Programme (PFMRP) seeks to contribute to this end by improving the capacity for achieving macroeconomic stability and best practices in public accounting, budgeting and financial management, as cornerstones of sustainable economic growth.

8.1.1 Milestones achieved under PFMRP Phase I

The first phase of the PFMRP initiative started in 1996/97. During this phase, the government focused mainly on reforms in accounting, budgeting and revenue mobilisation. Improvement in these areas is inextricably intertwined with macroeconomic stability – there is a transmission mechanism between the three. For instance, controlling public expenditure, which is in the domain of accounting and financial management, should have a positive impact on certain macroeconomic variables, such as lowering inflation and interest rates. Inflation and interest rates are important variables that economic agents take into account when contemplating investment in any country. The decision to focus on accounting, budgeting and revenue mobilisation in PFMRP Phase I was made with these interrelationships in mind. The reforms have led to positive results. Significant milestones have been achieved, as summarised below.

Broad-based participation in budgeting

Broad-based participation in budgeting is enshrined in the Public Expenditure Reviews (PERs) that have been carried out since 1997/98. Through the PER process, government budgeting has been taken to the public domain by promoting the wide participation of all key stakeholders in the policy debate and budgetary allocation of public resources. The PER process is led by the Ministry of Finance (MOF) and oper-

ates through a working group comprised of representatives from government, the private sector, Members of Parliament, development partners, research and academic institutions, faith organisations, NGOs and the media. The working group sets the agenda for the PER process. Involving this independent, professional and diverse group of stakeholders enhances the chances for strategic prioritisation of public expenditures across programmes and projects, taking into account both allocative efficiency and poverty-reduction issues. The PER has also provided an independent (external evaluation) forum for reviewing fiscal developments in the country.

The PER processes are an aspect of government accountability and transparency. Further accountability and transparency have been achieved through client surveys, contestability in government service delivery, and disclosure of government financial reports, budget allocations and expenditure to the media and on the MOF web site.

Improvements in external resource management

In November 2001, Tanzania reached the completion point under the Highly Indebted Poor Countries (HIPC) initiative. As a consequence, Tanzania benefited from the cancellation of debt to the tune of US$3 billion. The impact of this cancellation was that debt service payments were cut substantially (by an average of 47 per cent over time).

The Tanzania Assistance Strategy is in operation. It was launched in June 2002 as a coherent national development framework for managing external resources to achieve the development strategies as stated in Vision 2025, the National Poverty Eradication Strategy (NPES), and the Poverty Reduction Strategy Paper (PRSP).

A rising proportion of external resources are untied. In conformity with the spirit of the Rome Declaration on Harmonisation, programming of external resources into the budget has improved. For example, in 2003/04, ten bilateral partners and two multilateral partners pledged resources under the Poverty Reduction Budget Support (PRBS) framework to the tune of US$370 million.

Improvements in Treasury management and accounting

One of the first steps the government took to ameliorate weaknesses in public expenditure management was to close the accounts of a multitude of ministries, departments and agencies (MDAs), and to centralise the government's payments system through the introduction of a Treasury Single Accounts System (SAS). Shortly thereafter, in 1998/99, the government introduced the Integrated Financial Management System (IFMS) to support SAS operations.

This involved significant capacity-building efforts and the documentation of new processes. The initiative also required enabling legislation to be enacted. To this end,

the Public Finance Act (PFA) of 2001 was passed, and associated regulations were formulated.

The milestones achieved include operationalisation of the IFMS in 47 ministries/departments, in 20 regional sub-treasuries, in 20 regional administrative secretariats and in 32 local government authorities (LGAs).

Over 800 personnel have been trained. Three years of accounts are online, as are four years of budgets based on the Medium Term Expenditure Framework (MTEF), and final government accounts can now be produced within three months of year-end. The accounting is automated, and reports based on international financial standards are in place. Altogether, this has resulted in a major reduction in domestic arrears and better control over funds. Revenue accounting is in place, too, with a direct link to the Tanzanian Revenue Authority. All procurement occurs through the computerised system, and local purchase-order production is automated. There is a framework in place for automating document generation (vouchers). The national budget, based on the MTEF, is automated. Although not yet in operation, the system includes a framework to cover other areas, for example government assets and inventory control.

Improvement in debt management

In 2002 the Cabinet endorsed the National Debt Strategy (NDS), which is geared towards eliminating the debt burden, slowing the build-up of Tanzania's debt and alleviating poverty. The NDS articulates the magnitude and types of debt. It also assesses the long-term sustainability of debt and the current status of financial markets, as well as measures for their development.

Greater fiscal stability and better economic performance

Before the first PFMRP initiative, government was operating huge budget deficits and overdrafts. The budgeting and integrated financial management reforms under the PFMRP have shown very positive results. The IFMS has helped to ensure that there is no commitment before budgetary approval and actual allocation of funds to MDAs. These measurers have contributed to macroeconomic and fiscal stability, resulting in higher economic growth and controlled inflation. The IFMS provides a useful infrastructure for planning, execution and reporting poverty-reducing public spending.

Economic reforms have contributed to sustained growth of the economy by reducing inflation and improving government's fiscal position. During 2002 the GDP growth rate rose to 6.2 per cent from an average of 3.7 per cent in the mid-to-late 1990s. In addition, there has been a significant drop in inflation from levels in excess of 30 per cent in 1995 to 4.2 per cent in March 2003.

The focus of PFMRP Phase II

In an endeavour to consolidate and deepen reforms, government (in collaboration with development partners) commissioned several studies to assess the robustness of public financial management systems in the country. The studies include:

- the Country Procurement Assessment Report (2003);
- the Ministry of Finance Service Delivery Survey and Self Assessment Exercise (2003);
- the Results-Oriented Expenditure Management Country Study – Tanzania (2003);
- the Country Financial Accountability Assessment Report (2002);
- the Report on the Observance of Standards and Codes – Fiscal Transparency (2002); and
- the Public Financial Management Reform Programme: A Strategic Framework for Capacity Building in Central Government Financial Management (1999).

The improvements suggested in these reports were reviewed by stakeholders and used to revamp PFMRP Phase I. Furthermore, government enacted the Public Finance Act of 2001 and the Public Procurement Act of 2001 to provide an enabling legal framework for the PFMRP.

On the basis of the reports, the procurement regulatory framework and government's resolve to achieve macroeconomic stability and to promote best practices in public financial management policies and practices, PFMRP Phase II will continue to consolidate gains achieved under PFMRP Phase I and to deepen the reforms.

In terms of new consolidation and deepening measures, all achievements at MDA level must now be extended to LGAs. PFMRP Phase II will extend reforms to cover:

- procurement;
- information and communication technology services;
- investment management; and
- external audit services.

8.2 Specific reform mechanisms

Within these larger programmes, Tanzania undertook several interrelated reform initiatives and introduced several instruments into budget planning and manage-

ment, from the rolling plan and forward budget (RPFB) in 1992/93, through a performance budgeting initiative, and an MTEF in 1999/2000, to using the PRSP as a central co-ordinating framework for budget planning. We briefly discuss each of these.

8.2.1 The rolling plan and forward budget (RPFB)

In 1992/93 the government of Tanzania introduced the RPFB, with the principle of multi-year budgeting linked to a macro-fiscal framework. The exercise was led by the National Planning Commission. The RPFB can be seen as a predecessor of the MTEF, but was perceived at the time to be focused on the development budget. Its main objectives were:

- to provide an overview of developments in the economy and in each sector – such an overview should enable the government to see the linkages and trade-offs between different policies and the allocation of funds between activities (and the summary of government policy and activities contained in the RPFB would facilitate the monitoring of policy and expenditures);
- to enable the government to decide on its objectives for the economy as a whole and for each sector, and to make sure that these objectives are consistent; and
- to provide a means of allocating limited funds to those activities that would be the most effective in terms of achieving government objectives.

The RPFB was introduced in recognition of the shortcomings of the planning and budgeting system in being able to fulfil the above functions. The RPFB process was seen to improve the links between planning and budgeting, in that it required the Ministry of Finance and the Planning Commission to work jointly on the RPFB document. The RPFB was also an attempt to align resource scarcity with the funding demands of programmes outlined in the 5-year plan; in the absence of such a framework, the allocation of funds would be based solely on the annual budgeting exercise. Therefore, the RPFB included an effort to improve the forecasting of macroeconomic variables, likely revenue and, consequently, available expenditure. It required, in principle, that all funds pass through the government budget. A simple budget projection and macroeconomic model were developed and used for the projections contained in the RPFB. The reform included the preparation of sector policies, which were contained in the document, and which were required to illustrate consistency with macro policies. There was also an effort to reduce the number of development projects, so that more effective use of resources could be made. The

RPFB models enabled government to forecast the recurrent cost requirements of government services, and the recurrent cost implications of development projects. Similar to an MTEF, the RPFB was rolled over annually, with adaptations in accordance with economic circumstances. This made it a more flexible instrument than the 5-year plan.

However, while the RPFB contained many of the elements of an MTEF approach, it did not produce the desired effects. Annual budget preparation still determined the resource envelope and resource allocations, with the result that the RFBP recommendations in this regard were frequently overridden. Despite efforts to integrate the Planning Commission and the Ministry of Finance through the RPFB process, the institutional separation of responsibilities constrained its success. In addition, poor costing of activities, leading to meaningless projections and inadequate involvement of stakeholders and inadequate integration of the development and recurrent budget, impeded the effective implementation of the RPFB.

By the time the MTEF was introduced, however, the reforms had already assisted Tanzania to move towards fiscal stability and the use of a realistic macroeconomic framework for budget development. The operation of a cash budgeting system, under which total funding to expenditure activities was determined by available cash in any given period (rather than budget allocations only) aided the achievement of fiscal stability.

8.2.2 The Medium Term Expenditure Framework (MTEF)

In the 1999/2000 budget, the government of Tanzania introduced an MTEF as the key budget planning tool, linked to the Public Expenditure Review (PER) process (see below). The MTEF was a response to difficulties the government was facing in implementing the recommendations of the PER process, which was first undertaken in 1987/88.

The MTEF is a 3-year, integrated, prioritised and performance-based budget process that takes into account all resources, both government and donor funds, although there are difficulties in accurately projecting these funds. The strategic plans formulated by MDAs provide the broader framework for developing annual and medium-term budgets at sectoral/institutional level. The MTEF is not a completely new process; it builds upon earlier reforms like the introduction of institutional strategic plans, performance budgeting (see below) and the RPFB.

The MTEF, however, is more strategic and forward-looking in resource planning, and regards resources as a package. It is aimed at improving government budgeting at the level of fiscal discipline (by formulating plans within a fiscal framework linked to macroeconomic realities) and at the level of the distribution of expenditure, in

terms of facilitating better alignment between funding and government priorities (by requiring prioritisation at inter- and intra-vote level), and ensuring better value for money (by linking budget planning through the MTEF to performance budgeting).

The following are the most important operational features of the MTEF:

- The MDAs operate within known resource ceilings, including government and donor resources, in a 3-year time frame. At the beginning of each budget planning cycle, the previous year's allocations form the basis of planning, improving planning discipline and funding predictability for budget preparation.
- A performance basis is introduced into budget preparation, implementation, monitoring and evaluation, which flows from a review of MDAs' strategic planning.
- MDAs have to prioritise between competing demands within their provided ceilings; however, the wage bills for MDAs are still determined centrally, limiting the trade-offs that can be made between wage and non-wage expenditure (although this constraint has been relaxed for priority sectors). Ceilings are largely adhered to, making the MTEF a successful move away from a shopping-list approach to budget requests.
- Managers are more involved in the budget process.
- Through linking the MTEF to the PRSP and the annual PER process, there is greater emphasis on service delivery and meeting the needs of priority stakeholders.
- Implementation of budgets should follow priorities set in budget preparation.
- The budget process is used to assess whether activities are the most cost-effective and efficient means of achieving objectives.
- Planning ahead for the achievement of objectives is required, rather than attempting to implement all activities in one year.
- The service activities arising from new investments must be planned for.

The preparation of the MTEF and annual budget is co-ordinated by the Budget Guidelines Committee, whose role is to establish the macroeconomic and fiscal framework for the budget. The key activities involved in this are outlined below.

Macroeconomic policy review and resource projections

This review of macroeconomic performance starts with an assessment of performance of the previous budget's assumptions and targets to determine the level of achievement. Other variables that are reviewed include economic growth rate, infla-

tion and government finance. It is imperative to review the past and current performance before looking to the future. During this stage of macroeconomic review and resource projections, the PER provides important support to the budget process. The PER delivers such inputs as updated sector MTEFs, sectoral resource requirements, macroeconomic issues, donor financial commitments and other important concerns for improving resource allocation and management of the budget in general.

Currently, the sector MTEF inputs come mainly from the Poverty Reduction Strategy (PRS) sectors. The current PRS sectors and activities include social services, works, agriculture, HIV/AIDS and governance. Thus, performance and resource requirements indicated in the MTEFs of PRS sector ministries reflect PRS targets and actual performance.

Based on the macroeconomic and other developments indicated in the economic performance review, the overall framework for the future is formulated.

Resource allocation and prioritisation

Once the macroeconomic policy and sectoral performance review and the resource projections are completed, the government defines objectives and budget priorities to be achieved in the current and following two years of the MTEF, in the context of PRS targets. Resource ceilings are then determined for each sector and spending agency. Pro-poor programmes and activities are treated as priorities in resource allocation.

When completed, the Budget Guidelines are submitted to the Cabinet Secretariat and Inter-Ministerial Technical Committee (IMTEC) for discussion, and then to the Cabinet for approval before they are distributed to spending agencies. However, in practice, Draft Budget Guidelines are issued to MDAs to start preparing their budgets while waiting for the approved document, which contains firmed-up ceilings.

Besides the macroeconomic assumptions, budget framework, and sectoral and institutional ceiling forecasts, the Budget Guidelines present the procedures to be followed in preparing the MTEF-based budgets, institutional responsibilities, policy priorities to be pursued in the three years, and the budget limits for the sectors. The timetable for submission of estimates and specific instructions to be adhered to by MDAs are also outlined in the Guidelines.

The MTEF planning process at institutional level

At an institutional level, the MTEF planning process integrates a strategic planning exercise, starting with an examination of the national and sectoral goals and an environmental scan to identify key issues facing each MDA. On the basis of these activities, the MDA's vision, mission and objectives statements are formulated (or reviewed in subsequent years). This puts an MDA in a position to review policies and

strategies in the sector to ensure that they are consistent with the national policies and are the most effective way of achieving the agreed MDA objectives. The MDA then needs to set targets for achieving the objectives and to identify the commensurate activities that will produce the targets. The activities are costed, which results in the preparation of 3-year integrated estimates. Given available resources, MDAs then prioritise the objectives, targets and activities to determine which ones will be funded first and to what level.

The introduction of the MTEF in Tanzania has benefited from strong leadership by the Ministry of Finance. At the same time, the sound linkages between the process and other budget planning, implementation and review instruments, such as the PRSP, Integrated Financial Management Information System (IFMIS) and the PERs, have enhanced its impact at all three levels of its objectives. The MTEF also benefited from not being the first attempt at multi-year planning and on account of its having been introduced when fiscal and macroeconomic stability had already improved.

8.2.3 Performance budgeting

The introduction of the MTEF was linked to a sector-level performance budgeting system adopted prior to the MTEF's introduction. The medium-term targets and activities under the MTEF were to be identified as quantifiable or qualitative performance targets for service delivery, similar to those used in the existing system. However, it has been difficult to develop appropriate performance indicators within and across sectors for measuring efficiency and effectiveness in the use of resources. The main features of performance budgeting remain descriptive of monitorable service delivery, costed targets and activities in the context of an institutional strategic framework. Often these targets are quite high and it is not clear that they are entirely within the control of the government of Tanzania.

Performance budgeting was introduced in the government system on a pilot basis in 1998/99, and on full-scale application by all ministries, independent departments and regions from 2000/01. Performance budgeting seeks to reorient incremental input-based budgeting to output-based budgeting. This technique of budgeting was initiated as a logical extension of the work done by the Organisational and Efficiency (O & E) component of the former Civil Service Reform Programme. Having finished defining organisational structures, the O & E started to address the issue of improved efficiency and accountability in service delivery. It was recommended that improved organisational efficiency, effectiveness and accountability would be achieved through the process of annual performance reporting and service improvement planning. Thus, performance budgeting was recommended as a tool that could operationalise the whole process.

This new approach was expected to improve budget performance as measured by output indicators, unit costs and measurable deliverable quantity of service for a given allocation of budget resources. After the introduction of an institutional performance management system and strategic plans, which were results-oriented, performance budgeting techniques provided the necessary supportive framework. Performance improvement targets at institutional level had to be reflected in the budget process for effective implementation. This is achieved to some degree within the MTEF process, but improvements can still be made in rendering the targets more meaningful and effective as accountability tools.

8.2.4 Public Expenditure Reviews (PERs)

Since 1998, PERs in Tanzania have been conducted on an annual basis and are closely aligned with government's budget cycle. They are carried out under the direction of the PER Working Group, chaired by the Ministry of Finance and including in its membership a wide range of stakeholders from government, the Bank of Tanzania, research and academic institutes, development partners and civil society. This approach has been consistent with the series of initiatives in Tanzania aimed at developing an open process in the formulation of policy and budget strategy.

What is a PER?

A PER is an evaluative analysis tool that assists the Tanzanian government to improve the quality of expenditure. It analyses the level and composition of public expenditure, and its effectiveness in terms of expenditure objectives. Analysis is undertaken along the following lines:

- *Aggregate fiscal discipline*. The aim is to evaluate effectiveness in control of public resources and adherence to rules and institutional roles.
- *Prioritisation of competing claims on scarce resources (strategic resource allocation)*. The aim is to assess allocative decisions against competing claims on public resources in the budget process, across or within sectors/sub-sectors, between levels of government (e.g. between central and local government level of education services) and between the economic composition of inputs (e.g. between personnel expenditure, other current expenditure and capital investment).
- *Efficiency and effectiveness of programmes and service delivery*. The aim is to evaluate the cost per unit of output and whether the outcome for which the outputs are intended has been achieved.

PERs are key instruments to inform decision-making, particularly to achieve resource contestability in budget allocations (and budget cuts during the spending year), to target spending towards the poor and to assess the equity of spending patterns (for example, between regions or between income classes). PERs also inform key monitoring and evaluation tools such as service delivery surveys and public expenditure tracking surveys. Further, PERs fulfil a needed role in public accountability systems; the reviews are used as accountability tools and form the basis on which domestic stakeholders can hold government accountable, on the one hand, and donors can be provided with reassurance that external support is being used for the intended purpose, on the other.

The PER process in Tanzania

Before 1998, despite the presence of World Bank-driven PERs, the public finance environment was characterised by weak budget management (high extra-budgetary expenditure, diversion of resources from priorities and unpredictability of resources). Participatory PERs were born in Tanzania out of government-donor consultations to review the PER for the 1998 fiscal year. The first participatory review was done in 2001, and enabled a greater focus on supporting the implementation of the PRS as the overriding objective for a review of the fiscal years 1998–2000. Key features of the new approach were that it was government-led, open to a wide range of stakeholders and fitted and fed into the budget process.

The modern PER process has as its principal objective the strengthening of budget management at central and local government level, in order to improve:

- *budget predictability* – adoption of the MTEF and integration of external finance in the budget;
- *fiscal sustainability* – affordability of sector targets versus budget frame; and
- *budget efficiency and flexibility* – via prioritisation and move to budget support.

It also focuses on strengthening strategic expenditure allocations by evaluating performance against the approved budget (whether funds were spent on the intended purposes), by enforcing budget discipline and adherence to priority sector allocations and by enabling public scrutiny of spending.

The PER Working Group provides overall leadership to the process. It meets bi-weekly to monitor and oversee implementation and is also responsible for dissemination of findings to the stakeholders and receiving feedback.

The main working group is supported by sector working groups (SWGs) and

working groups on cross-cutting issues. They have responsibility for drafting terms of reference, selecting consultants (a mix of local and international) to work with sector officials and oversee the PER analytical work, including peer review and the timely delivery of outputs. These groups are also involved in the development of sector MTEFs and the dissemination of the results to wider stakeholders.

There are five PRS sectors and a number of cross-cutting working groups (on HIV/AIDS, environment, gender, children and the young, the justice system/governance, the public sector and land). There is also a macro group that oversees macroeconomic issues with fiscal implications, looking at the fiscal aggregates, revenue dynamics and fiscal risks.

The PER work is financed by individual donor support and domestic funds. The financing operates through a PER basket fund. Table 8.1 sets out the emerging PER cycle.

Table 8.1: The PER cycle

Month	Activity
June	Prepare work programme
July	Sector work identification
August	Finalise Terms of Reference; Contracting
September	Execute analytic work
October	Execute analytic work
November	Provide inputs into Budget Guidelines
December	Provide inputs into Budget Guidelines
anuary	Finalise sector PER/sector MTEF
February	Sector-specific consultations; External evaluation
March	Input into draft fiscal frame
April	Main consultative meeting

The Tanzania PER blueprint requires there to be sector ownership and leadership, stakeholder participation and networking in order to build wider capacity. As regards content, it should include a thorough review of previous PERs, PRS progress reports and Sector Development Plans. There should be a review of the policy and institutional context; the level and composition of spending; progress on key recommendations and targets; constraints and the way forward; new fiscal

issues; prioritisation of activities, sequencing and financing options; and HIV/AIDS, environmental and gender issues. Key findings and recommendations need to be highlighted. The timing of the PERs and their delivery is very important so that the findings can inform the preparation of the Budget Guidelines, the MTEF and the budget.

There have been notable improvements in public expenditure management on account of the PER process. The PER has become a key instrument to inform decision-making on priority setting for poverty reduction. The process has instilled the discipline of strategic public expenditure and improved governance (accountability, transparency, predictability and participation).

However, there are several challenges remaining, amongst others: mainstreaming cross-cutting issues in practice, improving budget and financial management in the LGAs, strengthening the PER process at sector level, monitoring the impact of public expenditure on the poor and harmonisation with other processes.

8.2.5 The Poverty Reduction Strategy Paper (PRSP)

The origin of the PRSP (the HIPC initiative)

In 1996 the International Monetary Fund and the World Bank announced a Debt Relief Scheme for Highly Indebted Poor Countries (the HIPC initiative). However, the relief scheme did not benefit the poor countries, because they were precisely the ones that could not fulfil the conditions set (for example, that they should be performing well economically). In June 1999, the seven rich countries referred to as the G7 introduced another scheme called the Enhanced Highly Indebted Poor Countries initiative. This was a modification of the earlier relief scheme of the IMF and the World Bank. The Enhanced HIPC was adopted by the boards of the IMF and World Bank in September 1999. On 14 April 2000, the Paris Club granted relief to Tanzania based on the Enhanced HIPC initiative.

The PRSP process

The PRSP for Tanzania was prepared through a process of consultation. In October 1999, a Cabinet committee was formed to steer the process of preparing the PRSP. The Technical Committee, made up of officials from key ministries, was specifically asked to prepare the interim and final PRSP and to organise the participation of stakeholders.

The interim PRSP was prepared by the Technical Committee in early January 2000. It was then discussed at a consultative technical meeting, which included government representatives and stakeholders from the donor community and civil society. Thereafter, it was reviewed and approved by the Cabinet in early February 2000.

Zonal Workshops, which included a large number of representatives of the poor at village level, were key in this process, and yielded results paralleling those of earlier participatory poverty assessments (PPAs) conducted by the World Bank ('Voices of the Poor' in 1995) and by the UNDP in Shinyanga (1997).

The workshops were aimed at soliciting views from the grassroots stakeholders, and were conducted concurrently during 11 and 12 May 2000 in seven zones covering all regions in mainland Tanzania. A total of 804 participants attended the workshops, comprising 426 villagers, 215 councillors, 110 District Executive Directors (DEDs) and 53 persons from NGOs. Of the participants, 180 (or 22 per cent) were women. The workshops were conducted through working groups, followed by plenary presentations. To ensure active participation, villagers were grouped according to region and gender, councillors by region, DEDs by region and NGOs by zone.

Among the issues discussed by each group were the perceptions of people about the definition of poverty, causes of poverty, characteristics of poverty, indicators for poverty, identification of priority areas for poverty reduction and actions required. In summary, participants in all zones identified education as the top priority area for poverty reduction, followed by agriculture, health, roads and water. The following were identified as constraints in the effort to reduce poverty: poor governance, cultural factors, illiteracy, the poor condition of rural roads and the marketing system for agricultural produce, unavailability of inputs and implements, lack of credit and inadequate (and poor) extension services, as well as gender imbalances.

The government intends to continue to seek fuller representation of the poor and other stakeholders in the implementation, monitoring and evaluation of the poverty strategy, and in subsequent updates of the PRSP.

At the Consultative Group meeting, which took place in Dar es Salaam on 22 May 2000, progress towards preparation of the PRSP, including the outcome of the Zonal Workshops, was discussed. Civil society organisations were also invited.

The initial draft of the PRSP was prepared by the Technical Committee, using the results of consultations with stakeholders and background documents such as Tanzania Development Vision 2025 (1998), Tanzania Assistance Strategy (TAS), National Poverty Eradication Strategy (1997), National External Debt Strategy (1998) and Public Expenditure Review (PER). The Technical Committee secured expert assistance mainly from local research institutions to prepare the draft PRSP.

The government convened a consultative meeting with the donor community on 30 June 2000 to seek comments on the PRSP process and the draft document.

On 1 July 2000 in Dodoma, Members of Parliament were briefed on the concerns and priorities identified at the Zonal Workshops. This background information gave the parliamentarians an opportunity to indicate their concerns and priorities regarding

poverty reduction efforts. They endorsed the priorities emerging from the consultations and the proposed actions.

A national workshop was held on 3 and 4 August 2000 in Dar es Salaam to seek further reactions to the targets, priorities and actions as outlined in the draft PRSP. Among the participants were permanent secretaries, regional commissioners, representatives of the donor community, the multilateral institutions, private sector organisations, non-governmental organisations, the public media, informal sector representatives and other members from civil society. At the same time, the draft PRSP was also presented to regional administrative secretaries.

A revised draft PRSP was presented to the Cabinet for review and approval on 31 August 2000.

The strategy

First, the strategy is viewed as an instrument for channelling and concentrating national efforts toward the broadly agreed long-term objective of halving absolute poverty by 2010 and eradicating it by 2025. The PRSP process is viewed as ongoing, with continuous updates and reviews responding to feedback and broad-based evaluation. The management of the overall strategy of poverty reduction, therefore, will require flexibility to accommodate concrete action plans, results from evaluation and activities emanating from the continuing and future work.

Second, the poverty-reduction strategy, to a large extent, is an integral part of ongoing macroeconomic and structural reforms that are being supported by Tanzania's multilateral and bilateral partners. Some of these reforms are expected to have a significant impact on the welfare of the poor, primarily through enhanced growth. Accordingly, the government has chosen to accelerate selected reforms that are likely to have a major impact on poverty reduction through this channel.

Third, in keeping with the concerns of stakeholders, and guided by the overarching orientation of Vision 2025 and the NPES, the focus of the PRS has been targeted at:

- reducing income poverty;
- improving human capabilities, survival and social well-being; and
- containing extreme vulnerability among the poor.

The government expenditure policy now, guided by the findings from stakeholder consultations, is to confine its financial interventions mostly to:

- education (notably at primary school level);
- health (primary health care);

- agriculture;
- roads (in the rural areas);
- water;
- the legal and judicial system; and
- HIV/AIDS.

Additionally, poverty reduction in Tanzania will require decisive action in other areas, such as gender, environment, and off-farm employment-creating initiatives in rural and urban areas, the financing of which should be provided by communities, donors and other stakeholders.

Finally, the PRS has it own cycle of policy objectives or desired outputs to be attained, and the timing normally extends beyond the annual budget cycle. However, the PRS targets for each PRS sector are the basis of resource allocation. As PRS progress reports are completed and targets updated, the results feed into PRS sector annual budgets and MTEFs. Allocation of government resources is focused on poverty reduction. The PER process ensures efficient and effective allocation and utilisation of priority activities under the PRS.

8.3 Conclusion

The government has been going through a period or reforms in the public sector. Some of the reforms have started to yield positive results in the context of the envisaged objectives. However, most of the reforms depend largely an external support in terms of resources, technical know-how and hardware. The apparent challenges, therefore, include sustainability of the gains, enhancing local capacity and involving stakeholders at grassroots level, and technical improvements to the existing processes.

Despite good progress in introducing different instruments in an integrated manner, problems still arise in their linkages; for example, earlier involvement by Cabinet, which currently approves sector ceilings without earlier input into the policy work on which these ceilings are based, could be beneficial to link the MTEF process to the annual budget allocation and budget implementation.

Also, the comprehensiveness of budget planning could still be improved at sector level. At the aggregate level, the MTEF includes most public sector resources, including donor funds. However, at the sector level, wage bill expenditures are excluded from the planning process, being determined outside of MDAs. This limits the ability of MDAs to align their policies with available funding. Regarding analysis in the MTEF, not all sectors are included in the PER/SWG process, which means that not all activities and costs of government are subjected to the same level of scrutiny.

Bringing in the outlying sectors would not only enhance analysis of cross-cutting issues within the MTEF, but also improve overall expenditure outcomes.

The budgeting system in Tanzania has become increasingly complex, with more and more detailed review and planning work being undertaken, particularly at the sector level. It is not always clear that the strategic level receives the same attention, or that the detailed costing of PRSP proposals (where targets may remain unattainable given available resources) and sector strategic plans and activities yield commensurate benefits. Capacity constraints remain, which limit the ability of decision-makers to engage with the volume of information that comes from the detailed bottom-up work. Also, the detailed work that goes into budget preparation may restrict the discretion of managers during implementation in a way that is counterproductive to the overall effectiveness of expenditure. Sector and central managers are also buried under in-year reports that contain considerable levels of detail, perhaps obscuring the major strategic issues. There may be an argument to be made to simplify budget approval to a higher level of disaggregation, and to streamline reporting requirements to ensure that they are meaningful.

Despite these ongoing challenges, the Tanzania budget management system has evolved in ways that are uniquely appropriate to the country's needs.

CHAPTER 9

Uganda

A decade of budget reform and poverty reduction

Florence Kuteesa, Ishmael Magona, Maris Wanyera and James Wokadala

9.1 Background

Uganda's economic history has gone through four distinct episodes since independence. Between 1960 and 1970, Uganda had one of the most vibrant economies in sub-Saharan Africa (SSA). Real GDP grew at an average rate of 4.8 per cent and GDP per capita grew at 3 per cent per annum. The national savings rate averaged 13.4 per cent of GDP, which was sufficient to finance a moderate level of capital accumulation amounting to 13 per cent of GDP. The growth of manufacturing played a key role in maintaining economic growth, and by 1971, industrial output accounted for 14 per cent of GDP.

From 1971, the situation changed drastically. The economy experienced domestic and external shocks, which were worsened by the absence of sound macroeconomic policies to address them. Productive sectors were ignored in pursuit of informal trade, as most skilled personnel fled the country to escape the economic mismanagement and civil unrest, in which they were often caught as soft targets. The breakdown of the East African Community, rising prices of petroleum products, and the

'economic war of 1972', which led to the expulsion of Asians and expropriation of their assets, further worsened the situation.

For most of the 1970s and 1980s the country suffered severe macroeconomic imbalances, including high rates of inflation and balance of payments deficits, because the growth of nominal aggregate demand consistently outstripped the growth of real supply in the economy. The main reason for this was the printing of money to finance public sector deficits, leading to large increases in money supply, which fuelled high rates of inflation.

By 1980, the need to rehabilitate the economy was obvious. Structural adjustment measures, focusing on demand management, were introduced in 1981 to encourage economic growth through: realignment of the value of the shilling; providing price incentives; removing price controls; increasing interest rates; and improving economic management through fiscal and monetary measures. The economy immediately responded to these adjustments. National output recovered from a –2.7 per cent growth rate between 1971 and 1980 to 1.7 per cent between 1980 and 1983. However, industrial production, which had initially reacted positively then declined due to problems of foreign exchange allocations and the poor state of infrastructure. Industrial production fell by 3.9 per cent per annum between 1983/84 and 1985/86. Agricultural production also failed to respond as anticipated because government price incentives failed to trickle down to the producers/farmers, resulting in the abandonment of the production of major export crops, especially cotton, tea and tobacco. Overall, GDP growth averaged –0.4 per cent between 1983/84 and 1985/86.

In May 1987, Uganda embarked on an Economic Recovery Programme with support from the IMF, the World Bank and other multilateral and bilateral donors. The principle objectives were to rehabilitate the economy and enhance economic growth, to reduce inflation and to minimise the potential for a balance of payments crisis. Because of the consistency with which these measures were and are being implemented, real GDP growth rates have been positive since then, averaging 6.4 per cent per annum from 1986/87 to 2003/04, and inflation has been contained at an average of 4.8 per cent per annum from 1993/94 to 2003/04.

Following the successful implementation of the Economic Recovery Programme, focusing on stabilisation, Uganda also pursued more rigorous reforms of public expenditure management. The public expenditure reforms that have been implemented over the years can be broadly broken down into:

- enhancing fiscal discipline;
- focusing public expenditure on poverty eradication;
- enhancing efficiency and effectiveness of public expenditures;

- improving financial management and accountability; and
- improving transparency and openness of the national budget processes.

The aim of public expenditure reforms is to ensure efficient and effective utilisation of limited government resources in order to deliver on the overall long-term objective of eradicating absolute poverty by 2017. This chapter analyses the key government measures and actions undertaken within each reform category and concludes with the lessons learnt and the way forward in dealing with existing and emerging issues.

9.2 Enhancing fiscal discipline

9.2.1 Macroeconomic objectives and performance

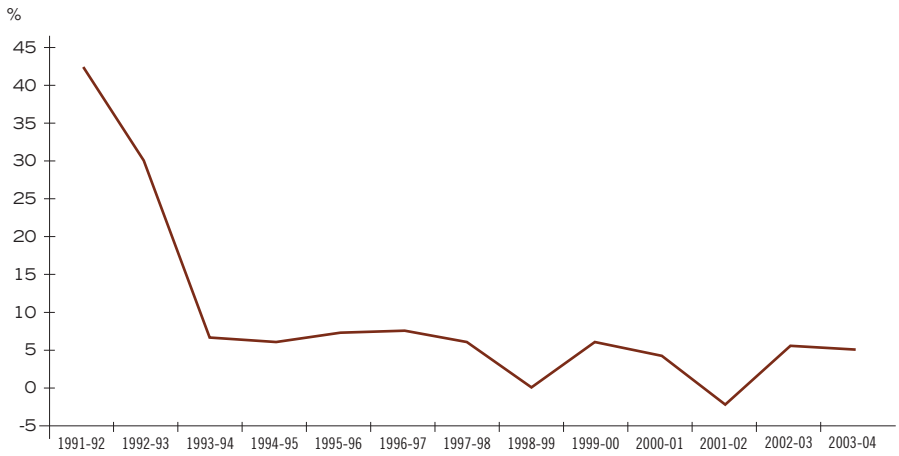
A sound economic framework conducive to private sector investment is the cornerstone of Uganda's growth strategy. The fundamentals required of this economic framework are low and stable inflation, a competitive exchange rate and low interest rates.

After the experiences of the 1970s and 1980s, characterised by double and sometimes triple-digit inflation, control of inflation became one of the foundations of Uganda's macroeconomic management from the early 1990s. Experience has demonstrated that high inflation is detrimental to growth. It generates uncertainty in the economy by reducing the efficiency of the price system and also erodes the real value of financial assets, such as savings, as real interest rates become negative. This reduces investment, output and employment and therefore reduces real incomes, leading to an increase in the incidence of poverty.

Since 1992/93 Uganda's fiscal policy has entailed very strict budgetary discipline. Government has kept firm control over its own expenditures to ensure that it does not have to borrow from the domestic banking system to finance budget deficits. Consequently, Uganda has been able to keep annual headline inflation at single-digit levels, and often below 5 per cent, since 1993. Figure 9.1 shows changes in Uganda's annual headline inflation rate for the last 13 financial years.

The macroeconomic stability that was ushered in by the low level of inflation immediately translated into a rebound in Uganda's real GDP growth rates (see Figure 9.2). This was boosted by other reform programmes such as liberalisation of cash and produce marketing channels, as well as by exchange and interest rates. Average growth since 1986/87 is 6.4 per cent, with a peak growth of 10.9 per cent registered in 1994/95, during the coffee price boom. Growth in total factor productivity also made a significant contribution to GDP growth during the 1990s, reflecting the scale of rehabilitation of production processes after the restoration of peace to

Figure 9.1: Changes in annual headline inflation, 1991/92–2003/04



most of the country. However, government recognises the challenge of relatively slower GDP growth in the last five years, which has averaged 5.7 per cent.

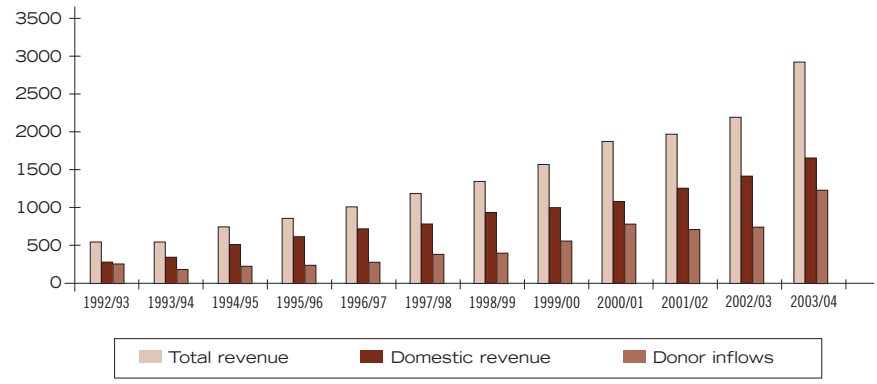
9.2.2 Resource mobilisation and allocation

Funding of Uganda's budget, as shown in Figure 9.3, is split almost equally between external and domestic revenues. Inflows of external resources have been attracted

Figure 9.2: Real GDP growth rates, 1986/87–2003/04

largely by Uganda's record of consistent macroeconomic reforms and performance. Beginning in the second half of the 1990s, Uganda enjoyed an increase in inflows of budget support, including debt relief. Gross aid inflows increased by over 4 percentage points of GDP; from around 5 per cent in 1998/99 to 9 per cent last financial year. By end of June 2004, total external assistance contributed 49 per cent of Uganda's total resource envelope. With the strategy of fiscal consolidation, in order to scale back the size of the deficit, this ratio is expected to reduce over the medium to long term.

Figure 9.3: Composition of Uganda's total revenue, 1992/93–2003/4

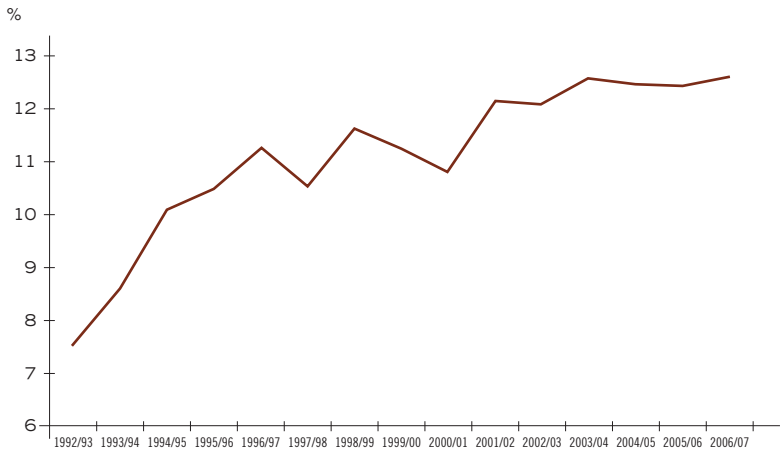


On the domestic front, the Uganda Revenue Authority (URA) was established in 1991 by an act of parliament as a semi-autonomous body to assess and collect specified taxes, administer and enforce laws relating to those taxes, and to account for all revenue to which those laws apply. The creation of such a semi-autonomous revenue collection agency was deemed necessary for an improvement in revenue collection, which by 1991 was only about 7 per cent of GDP but rose by almost 5 percentage points to 11.5 per cent in 1998 and is currently estimated to be 12.4 per cent as of end June 2004.

Immediately following the creation of the URA, Uganda registered significant improvement in revenue collection; however, in recent years the proportion of tax revenue to GDP has been increasing only very modestly, as shown in Figure 9.4, largely due to problems with tax administration. This is exacerbated by limited opportunity for new tax measures and the recent ratification of the East African Customs Union, which has further diminished the opportunities for increasing the

revenue to GDP ratio in the short term. However, government fully recognises these challenges and has included them in its wider deficit reduction strategy by aiming to increase domestic revenues by half a percentage point of GDP per annum.

Figure 9.4: Trends in domestic revenue to GDP ratio



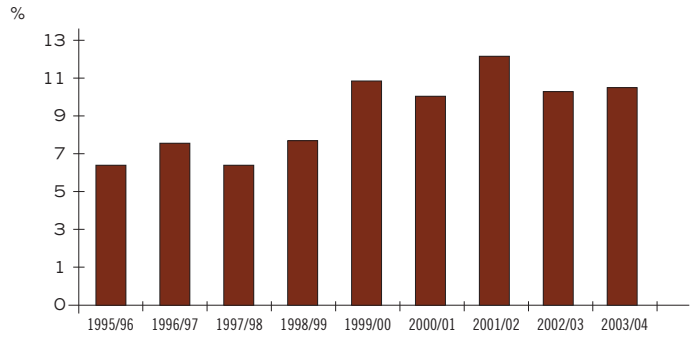
9.2.3 Fiscal deficit

Thus, over the years, Uganda's domestic revenues have been insufficient to fund its public services; as a result, it has relied on concessional external borrowing and donor grants to supplement its domestic revenue earnings. Because of good macroeconomic management, Uganda has received substantial donor inflows since the late 1990s. Recently, Uganda's fiscal deficit has increased as a percentage of GDP because of the increase in government expenditure, financed by donor aid inflows. Consequently, Uganda's fiscal deficit excluding grants more than doubled as a percentage of GDP over a 4-year period, rising from 6 per cent of GDP in 1997/98 to almost 13 per cent of GDP in 2001/02.

Government believes that this level of fiscal deficit is unsustainable because of its threefold macroeconomic impact. First, is the impact on relative prices in the domestic economy; in particular, the real exchange rate and the cost of investment goods. Second, is the impact on domestic financial markets; absorption of donor funds in the domestic economy is causing instability in the financial markets, particularly in terms of high and volatile interest rates, with negative consequences for the private sector. Third, is the vulnerability of a government budget that relies on donors for half of its

funding to any significant cutback in donor aid, and the knock-on effect this would have on the macro economy.

Figure 9.5: Uganda's fiscal deficit excluding grants as a percentage of GDP



In an attempt to address these undesirable effects of large increases in donor-funded government expenditures, in 2002/03 the government adopted a strategy of fiscal consolidation with the objective of reducing the deficit gradually to 6.5 per cent of GDP by 2009/10. This is to be achieved through increasing domestic revenues by half a percentage point of GDP per annum, and improving the efficiency of government's donor-funded expenditures by encouraging development partners to switch from project support (which is often duplicative and tends to drive up prices in key non-tradable areas of the economy, such as construction) to budget support. The deficit reduction strategy will not entail a reduction in the overall level of government expenditure or in absolute flows of donor aid, but it will require the annual growth in expenditure to be less than the annual growth of GDP. As a result of the fiscal deficit reduction strategy, the deficit has already fallen to just less than 11 per cent of GDP.

This fiscal stance remains unpopular in many quarters. It is certainly unpopular among the spending agencies, which think that government can and should spend more. Yet fiscal deficit reduction does not mean that government will be spending less. Government spending will continue to grow as domestic revenues grow, but the stance it is adopting provides government with a much greater incentive to strengthen revenue efforts by broadening the tax base where possible and improving tax administration.

This strategy also does not necessarily mean that government's outputs will diminish, nor does it mean that government will be rejecting productive donor aid. Rather, there is a need to address the issue of efficiency and effectiveness in public expenditure and to move towards rationalisation of development assistance, redirecting it towards productive sectors. Going forward, government's preferred aid modality is budget support and, in particular, budget support grants.

9.2.4 The Medium Term Expenditure Framework

To enhance the fiscal discipline necessary for smooth operation of the budget, in 1992/93 government began formulating its annual budget within a 3-year rolling budgetary plan known as the Medium Term Expenditure Framework (MTEF). Initially, the MTEF was a fiscal policy tool, but in 1998 the MTEF was formally anchored as a tool integrating budgeting and planning. The objectives of the MTEF are to:

- match expenditures with available resources;
- guide sectoral allocation of expenditure;
- facilitate strategic sector planning; and
- improve efficiency and effectiveness in resource use.

The MTEF sets the sector and district spending ceilings, taking into consideration the macroeconomic environment and prospects for revenue mobilisation. These expenditure ceilings are intended to provide each of the different sectors with a predictable and stable projection of the budgetary resources that will be available over the medium term, and within which the sectors can plan their expenditures. The sector spending ceilings are determined within the Sector Investment Plans (SIPs), led by the Sector Working Groups (SWGs). The MTEF integrates policy-making, planning and budgeting with expenditure based on strategic priorities identified in the Poverty Eradication Action Plan (PEAP).

9.2.5 Cash budgeting

Among the stabilisation reforms implemented by government was the adoption of a system of cash budgeting in the 1992/93 financial year, with the objective of ensuring that expenditures are not inflationary. The instability arising from inflationary financing of public deficits by borrowing from the central bank, which characterised the 1970s and 1980s, was only contained when government imposed strict control over its expenditures. The low rate of inflation achieved since then, averaging only 5 per cent per year, compared to 110 per cent in the 1980s, is evidence of the direct link

between fiscal discipline and macroeconomic stability.

Under a cash budgeting system, shortfalls in expected resources within a fiscal year are matched by cuts in expenditure, when this is necessary for macroeconomic stability. For example, government responds to a shortfall in expected tax revenue by cutting expenditure, rather than covering the shortfall by printing money, which could generate inflation, depending on the size of the shortfall. In the case of a temporary shortfall in committed donor inflows, government responds by running down its stock of foreign reserves at the central bank to smooth the expenditure path. The starting point for a cash managed system of budgeting is ensuring that aggregate expenditures in the annual budgets do not exceed the projected budgetary resource envelope – that is, by containing government expenditure at a level that is consistent with the money available to it through tax revenue and donor aid, so avoiding the potential for excessive borrowing from the banking system.

However, while successful in improving fiscal discipline, the cash budgeting system had severe costs in terms of the effectiveness and efficiency of expenditure. It also undermined the reforms focused on improving budget planning. With the budget being adjusted several times a year, it was less important for spending ministries to focus on their budget preparation, because of the weakened role of the up-front budget allocations in determining funding during the spending year. Also, ministries resorted to a huge build-up of arrears in the absence of cash funding; spending continued in line with the budget despite the funds not being available. These problems prompted Uganda to undertake complementary reforms to its cash management and commitment control systems, which are discussed below. These operate in tandem with the overall fiscal management system.

9.3 The poverty focus of public expenditures

9.3.1 The Poverty Eradication Action Plan (PEAP)

By 1995, it had become clear that Uganda's impressive macroeconomic performance was not reducing poverty as fast as policy-makers desired. As a result, government resolved in 1996 to prioritise poverty eradication as the major focus of its overall sustained growth and development strategy. To this effect, the PEAP was formulated after a long consultative process with a wide range of stakeholders, including government officials, Members of Parliament, district administration officials, employers' and workers' organisations, donors, the NGO community, social researchers, academics and other representatives of civil society. The process was spearheaded by the then Ministry of Planning and Economic Development (MPED) and facilitated by technical working groups and research in selected key areas.

The PEAP is Uganda's comprehensive policy framework for the eradication of poverty, as well as its national planning framework. The purpose of the PEAP is to guide public action to eradicate poverty. It does so by providing a framework within which sectors develop detailed plans. The PEAP was launched in 1997, and underwent its first revision in 2000. The second revision was concluded with Cabinet approval in October 2004. PEAP revisions are intended to keep the PEAP current in the light of changing circumstances and emerging priorities.

The first version of the PEAP and the revised version of 2000 had four pillars:

- creating a framework for economic growth and structural transformation;
- good governance and security;
- increasing the ability of the poor to raise their incomes; and
- improving the quality of life of the poor.

Government recognises that it is still faced with the following core challenges: restoring security, dealing with the consequences of conflict and improving regional equity; restoring sustainable growth in the incomes of the poor; human development; and using public resources transparently and efficiently to eradicate poverty. Therefore, the latest version of the PEAP comprises five main components in recognition of these challenges:

- economic management;
- enhancing production, competitiveness and incomes;
- security, conflict resolution and disaster management;
- governance; and
- human development.

Priority areas for poverty eradication are identified in the PEAP, and these guide SWGs in the preparation of their SIPs based on clear output targets, interventions and resource requirements, which can be accommodated within the MTEF. In addition, in the case of resource shortages, the Poverty Action Fund (PAF) protects priority poverty areas from budget cuts during budget execution.

9.3.2 Prioritisation of poverty reduction

In recent years, sector-wide investment plans have been developed in key areas, including Education, Health, Roads, and Agricultural Modernisation. The plans have matched and sequenced the allocation of recurrent and development resources within the identified priorities for a specified period. Programmes spell out the goals

and objectives that have a direct impact on poverty eradication, and identify cost-effective strategies and interventions by the respective stakeholders. Critical requirements and costs that can be accommodated over the medium term are also identified.

Table 9.1 shows how MTEF allocations over the years are increasingly focused on poverty priority areas identified in the PEAP.

Table 9.1: National budget allocations by sector as a percentage of total expenditure

	1998 /99	1999/00	2000/01	2001/02	2002/03	2003/04	2004/05[F]
Sector	Out-turn	Out-turn	Out-turn	Out-turn	Out-turn	Out-turn	Budget
Security	19.9%	15.4%	13.9%	12.6%	14.1%	10.6%	11.0%
Roads & Works	6.2%	8.1%	8.5%	8.3%	7.3%	10.4%	11.9%
Agriculture	1.0%	1.5%	1.5%	2.2%	2.3%	3.2%	3.4%
Education	26.9%	26.3%	24.9%	24.1%	23.3%	18.8%	18.4%
Health	6.5%	6.5%	7.4%	8.6%	9.0%	12.4%	11.3%
Water	1.2%	1.5%	2.4%	2.6%	2.6%	3.1%	3.3%
Law & Order	7.2%	7.3%	6.5%	6.7%	6.9%	5.2%	5.2%
Accountability	0.6%	0.8%	1.1%	1.1%	1.2%	8.0%	6.0%
EF & SS*	2.7%	4.6%	5.0%	6.5%	7.2%	8.9%	9.3%
Public Admin.	20.7%	20.3%	20.2%	19.3%	17.4%	12.0%	12.5%
Interest payments	7.1%	7.7%	8.5%	8.1%	8.6%	7.3%	7.7%
All sectors	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%

Source: Ministry of Finance, Planning and Economic Development
Note: * EF & SS = Economic Functions and Social Services

9.3.3 The Poverty Action Fund (PAF)

The PAF consists of a sub-set of expenditures within the MTEF, which are seen as directly contributing to poverty reduction. These expenditures are funded from the same revenue sources as non-PAF expenditures; therefore, the PAF does not refer to a separate specific purpose fund. Rather it is a virtual grouping of expenditures in the budget, linked to the priority of poverty reduction. It was set up in 1997/98 in order to channel the additional resources received under the Highly Indebted Poor Countries (HIPC) initiative directly to poverty reducing areas. Since that time, the PAF has expanded as donors are providing additional funds through budget support, and the year-on-year government contribution has been increasing steadily.

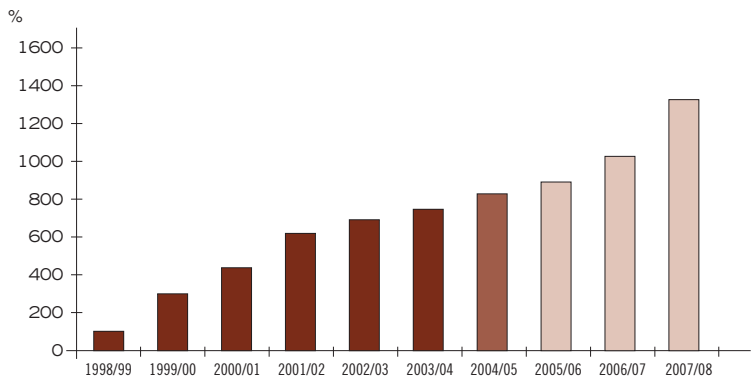
The HIPC initiative has generated substantial resources for the Ugandan budget. An average of US$84 million per annum has been saved in the last four years, the equivalent of 21 per cent of the average annual budget support received over the same period. Average HIPC savings are projected to remain relatively stable over the medium term.

Though the original purpose of the PAF was to create a transparent mechanism for ensuring that all resources saved from the HIPC initiative were channelled to poverty eradication programmes, the PAF has evolved into much more than this. It has attracted additional donor funding for poverty programmes over and above the regular donor programmes and, in effect, has become a mechanism for ensuring reallocation of incremental expenditures directly to poverty reducing public services. Overall budget support in Uganda has increased more than threefold since 1998, reaching US$451 million in FY 2003/04.

Expenditures under the fund are also managed and audited through more robust procedures. This means that scarce management capacity in the system is directed towards the most critical expenditures for poverty reduction.

Most of the growth in budget support that accompanied the HIPC initiative was the result of a shift from the traditional project support modalities on the part of donors. Government has welcomed this move, which now forms part of its fiscal consolidation strategy, because it strengthens public expenditure management and leads to more effective use of foreign aid. The trends in total PAF expenditures, as well as their projections for the medium term, are shown in Figure 9.6.

Figure 9.6: Trends in total PAF expenditures (Shs billion) and projections for the medium term



9.3.4 Poverty monitoring and performance

The rapid developments in the governance structures and policy arena have necessitated that the PEAP, which is also Uganda's Poverty Reduction Strategy Paper (PRSP), is revised every three years to reflect new developments. Regular revision of the PEAP is now an essential element of this process and is carried out in a highly participatory manner for maximum ownership of the policy and strategies. For example, it was revised in 2000 to take account of the findings from the 'voice of the poor' in the Uganda Participatory Poverty Assessment Project (UPPAP), conducted in nine districts of Uganda. Findings from the Participatory Poverty Assessment (PPA) have influenced major policy changes, resulting in substantial shifts in resource allocation towards the water sector, governance issues, HIV/AIDS and justice, which are major concerns of the poor. A third revision of the PEAP has just been concluded. A PPA undertaken in 12 districts of Uganda in 2001 has formed a basis for the policy review process. Intense analytical work is already proceeding, using both quantitative and qualitative data sets.

The National Household and Budget Surveys, conducted by the Uganda Bureau of Statistics since 1992, have contributed immensely towards poverty monitoring in Uganda. The survey data sets have been extensively analysed, producing a series of poverty trends since the early 1990s. These poverty trends have continually informed government on the impact of its programmes on poverty, thus giving the timely evidence needed to guide budget policy and, in particular, the mainstreaming of gender and equity concerns in the fiscal transfers to local government.

Over the years, there has been an overall reduction in the number of people living in poverty in Uganda, from 56 per cent in 1992 to 44 per cent in 1997, before falling further to 34 per cent in 2000. However, between 2000 and 2003 poverty increased slightly to 38 per cent. The reasons for the recent patterns include a slowdown in agricultural growth during the last three years, declines in farmers' prices reflecting world market conditions, insecurity and the high birth rate.

9.4 Expenditure efficiency and effectiveness

Despite the increased spending in the social sectors, the attainment of the desired development outcomes remains one of Uganda's biggest budget challenges. For instance, the infant, child and maternal mortalities have remained high and stagnant over the last five years, in spite of the increasing budgetary allocations to social sectors and good macroeconomic performance. Cognisance has been taken of the fact that efficiency and effectiveness in public spending are also important for the realisation of PEAP objectives.

9.4.1 Outcome and output orientation

Government is committed to refocusing budgeting and management away from the provision of inputs, towards the required outputs and outcomes, and monitorable targets and performance indicators. Such a focus is expected to improve the monitoring and evaluation of government programmes.

Outcome and output orientation to planning and budgeting, supported by results-oriented management (ROM), involves the determination of the costs of the respective interventions that need to be undertaken in order to achieve specific outputs. The breakdown of costs helps in determining which are directly attributable to a given output and which are shared with other outputs. The aggregated cost of all sector outputs determines the sector budget and therefore resource allocation.

All sectors are required to ensure that their budgets are output and outcome oriented. The outputs become the monitoring benchmarks of budget implementation. Where achievement of particular outcomes and/or outputs falls under more than one sector, SWGs are required to work collaboratively to ensure that the outcomes and/or results are achieved. Because some of the sectors, like Education and Health, are ministries in themselves, while others are an amalgamation of various ministries, institutions and departments, a sector's ability to identify realistic and objective outputs, prioritise and cost them varies greatly. Reorganisation of sectors is ongoing until capacity is built for all to work in the same direction and at the same level.

9.4.2 The sector-wide approach (SWAP)

As a means of implementing the PEAP and to improve budgeting at the sectoral level, government introduced the sector-wide approach (SWAP). Its purpose has been to improve the efficiency with which government's limited resources are used, thus improving expenditure outputs. SWAPs enable sectors to take a holistic approach to budgeting, ensuring that available sector resources are allocated to costed sectoral priorities, and that duplication and wastage are minimised. Although SWAPs were first implemented in the social services sectors, they are currently being developed across all areas of government, in line with the sectors spelt out in the MTEF.

A working team of representatives from the various stakeholders (government, donors, NGOs, and so on) constitute a SWG, which is charged with the duty of preparing, budgeting, implementing and monitoring the SIP. The SWGs also work more widely in the MTEF and develop sector papers, detailing sector achievements, challenges and policy proposals, as an input into the Budget Framework Paper. Most of the SWGs have been institutionalised with the day-to-day management of the business of the sector. Sectors like Education, Health, Water, Justice, and Law and

Order have advanced in the use of the SWAP. Efforts are underway to build capacity for the remaining sectors, Public Administration, Economic Functions and Social Services, and to mainstream their sector activities in the existing planning and budgeting arrangement.

9.4.3 Rationalisation of project aid into the MTEF

Beginning this financial year, government is enhancing expenditure prioritisation, efficiency and value for money further by establishing integrated sector ceilings, which reflect realistic funding for the sector. This means that both the government and donor project components of each sector's expenditure have to be accommodated within the MTEF. The purpose of this reform is threefold. Firstly, it will enable government to control its deficit more effectively. Secondly, it will enable overall sectoral expenditures to be aligned with PEAP priorities. Thirdly, it will give individual sectors an incentive to align their donor projects with their sectoral priorities.

Unless sectors are subject to a single, hard budget constraint, covering both the government and donor project components of their expenditure, they face little incentive either to limit or to prioritise their donor project expenditures, as donor projects effectively carry zero opportunity cost. The lack of incentive to limit project expenditures at a sectoral level has placed upward pressure on the aggregate fiscal deficit, which in turn has complicated monetary policy and exchange rate management. The lack of incentive to prioritise project expenditures at a sectoral level has undermined budgetary efficiency and driven up unit costs on non-tradable items such as wages.

In addition, under the existing budget system, donor projects are not subject to the normal budget controls imposed on expenditures under the government budget. For example, project expenditures do not require audit warrants from the Accountant General. This adds to the tendency for spending agencies to circumvent the hard budget constraint placed on their government budget allocation during the year by seeking donor funds directly through the project modality.

Integration of donor-funded projects into the MTEF will help government improve its management of the overall fiscal deficit, and will strengthen expenditure prioritisation at a sectoral level. In addition, it will complement other government reforms, such as development budget rationalisation. Other benefits include enabling more accurate projections of total government expenditure, which is essential for programming purposes, and better integration of planning for donor-funded projects into the annual budget process. Further, the integration of donor projects into sectors' hard budget ceilings will increase the incentive for donors to shift their aid from project support to budget support.

9.4.4 Fiscal decentralisation

Decentralisation of public service delivery in Uganda, as in many countries, was implemented to increase efficiency and effectiveness of public service delivery, as well as its responsiveness to the needs of local populations. The enactment of the Local Government Act of 1997 marked the beginning of devolution of political power to local governments, and with it the power to manage the development process, including public finance at the local government level. Already, there has been almost 100 per cent devolution of political and administrative responsibility to local governments, and emphasis is now shifting to fiscal decentralisation.

However, one of the key challenges is that line ministries have a great influence over the type and quality of service delivered, because of weak capacities in local government. To further strengthen the intended focus under decentralisation policy, at the same time enhancing expenditure management for effective and efficient service delivery, a Fiscal Decentralisation Strategy (FDS) was developed and finalised in 2002. Under the FDS, the present systems and processes of transfer of funds to local governments will be streamlined and harmonised while at the same time allowing local governments to exercise autonomy in decision-making. In addition, local governments will be restructured in order to put in place the right structures and staff qualifications commensurate with local governments meeting the overall decentralisation objective.

9.4.5 Monitoring and reporting

Since 1999, public expenditure reviews (PERs) have been conducted in selected sectors and on cross-cutting issues with far-reaching policy implications. It is becoming clear that increases in public spending are not enough to guarantee either greater public access to social and infrastructural services or the desired impact on development outcomes. This recognises that public resources are unlikely to increase significantly. Government is committed to improving efficiency in the use and management of public resources, including tackling corruption. The PERs, which date back to 1995, have focused on three perspectives: efficiency of public expenditures, categorised into allocative efficiency and operational efficiency; procurement; and financial management.

The assessments have included:

- tracking studies on releases under the universal primary education system;
- teacher's recruitment and deployment, and payroll management;
- the value-for-money of the school facilities grant;
- tracking flows of funds under the primary health care conditional grant

(2001), drugs (2002), and the conditional grant for shared services (2003); and
- execution of the budget, focusing on actual expenditures versus the budget allocations.

PERs are very useful exercises for assessing issues of central concern with respect to local governments in the achievement of national objectives. At present, tracking of PAF expenditures at the local government level is facilitated by the fact that a large share of it is financed through tied grants transferred to local governments. However, the reforms in fiscal decentralisation envisage a move towards a higher proportion of block grants to local governments. This is likely to make monitoring specific PAF expenditures more difficult, although it should enable more comprehensive monitoring systems of sector performance to evolve.

Joint sector reviews are conducted annually to review sector performance and identify areas for improvement. The reviews bring together all stakeholders (donors, government, academia and civil society) to review sector strategy, in general, and progress made towards development indicators, as well as issues related to allocative and operational efficiency.

For example, education sector reviews in the recent past have begun to look at sector priorities, with a view to reducing primary education's current share of 65 per cent of the education sector budget, so as to find resources to fund technical and secondary education. Enrolment in technical and secondary education institutions is projected to grow significantly because of the increased number of students completing primary education as a result of the introduction of universal primary education (UPE) seven years ago.

A follow-up action plan is formulated at the conclusion of each review or study, and implementation is ensured by integrating the sector-specific or cross-cutting issues into the relevant policy agenda.

9.5 Financial management and accountability

Accountability has important implications for all stakeholders who deal with government, either as funders or as recipients of the services they provide. To the extent that a government makes decisions on behalf of the people, it is necessary that it is accountable for the outcomes of these decisions. There is a strong rationale for a high degree of government accountability – it facilitates openness and understanding of what government is doing and leads to informed judgements concerning government actions.

In this context, the Ugandan government is committed to improving the efficiency

of resource allocation and to tackling corruption from all angles. The initiatives involve reduction of bribery and corruption, effective detection, investigation and prosecution of offenders, and the recruitment and training of qualified staff in the accounting, procurement and auditing professions.

One of the bases for strengthening financial management and accountability in the public sector is the legal framework that prescribes the controls and administrative structures for the management and accounting of public funds. In Uganda, government has put in place various laws to enhance financial management and to promote accountability at all levels of government. These include the Constitution of 1995, the Local Government Act of 1997, the Budget Act of 2001 and, more recently, the Public Finance and Accountability Act of 2003.

9.5.1 The Accountant General

The office of the Accountant General (AG) was created under Section 7 the Public Finance and Accountability Act of 2003. Prior to the coming into force of the Act, the office was referred to as Director Accounts. The AG is charged with the responsibility of compiling and managing government accounts, and providing for the custody and safety of public money and resources. These responsibilities empower the AG, according to the Act, to give general or specific instructions to accounting officers with respect to production of accounts, system of accounting, internal controls, internal audit, system of payment, custody of public money, property securities and accountable documents, and precautions to deter occurrence of fraud, embezzlement or mismanagement.

Government recognises that its existing systems do not provide a sound basis for accounting and financial reporting. Consequently, government is piloting a major reform – the Integrated Financial Management System (IFMS). The piloting began in six ministries and four local governments, and is expected to enhance the internal controls and financial reporting systems to support proper documentation and the completeness, accuracy and timeliness of reporting and reconciliation.

The reforms call for a restructuring of the office of the Accountant General to facilitate realisation of the benefits of government's investments in the Public Finance and Accountability Act and the IFMS. The restructuring is expected to promote sustainability and to maximise the opportunity for capacity building in the new skills required for enhanced financial management, treasury inspection and reporting at all levels of government.

9.5.2 The Auditor General

In recognition that civil servants work in accordance with the will of the executive,

which is accountable to Parliament, which is accountable to the electorate, there is need for an independent and competent institution to attest to the accountability of central and local governments. In Uganda the Auditor General's office is legally provided for as an independent office that shall not be under the control or direction of any person or authority.

Under the 1995 Constitution, the Public Finance and Accountability Act of 2003, and other enabling legislation, the Auditor General has statutory responsibility to report to Parliament on the propriety and regularity of the way in which government funds have been spent. The Auditor General is required to:

- Audit and report on the public accounts and all public offices including the courts, the central and local government administrations, universities and any public institutions or corporations established by an act of Parliament.
- Conduct financial and value-for-money audits in respect of any project involving public funds. Sections 32–36 of the Public Finance and Accountability Act amplify the duties of the Auditor General to include examining, inquiring into and auditing the accounts of: the Accountant General; all accounting officers; all persons entrusted with the collection, receipt, custody, etc. of public money; and classified expenditure centres.

The ability of the office of the Auditor General to fulfil its mandate is currently compromised by lack of independence and limited control over its own financial and human resources. Government recognises that existing poor accountability of funds and high fiduciary risks severely limit the role of the Auditor General as a public watchdog. Efforts are underway to revise the audit legislation to ensure adequate operational independence and to mobilise technical and financial support to enhance the auditing function.

9.5.3 The Inspector General of Government

The Inspectorate is one of the oversight bodies set up by an act of Parliament and mandated to supervise and enforce the Leadership Code, promote and foster strict adherence to the rule of law and initiate public awareness programmes, as well as conduct investigations. With the support of development partners, the Inspectorate has made significant achievements in terms of its mandate; for example, the analysis of 65 asset declarations, the initiation of a verification process, and the satisfactory handling of an increasing volume of complaints and investigations.

The public awareness programme has been effective in raising the profile of the anti-corruption initiative and in advising the public on how to complain about

corrupt practices. The biggest challenge is the growing public acceptance of bribery and corruption. Government is committed to intensifying its awareness programmes on the actual and opportunity costs of corrupt tendencies, and to punishing the culprits.

9.5.4 The oversight role of Parliament

Under the 1995 Constitution, the Budget Act of 2001, the Public Finance and Accountability Act of 2003, and the Local Government Act of 1997, Parliament is charged with:

- consideration and approval of the budget, spearheaded by the Parliamentary Committee on the Budget and ten sessional committees;
- scrutiny of the final accounts by the central and local governments' committees on public accounts: and
- approval of loan agreements, led by the Committee on the National Economy.

The major challenge for this arm of government is to improve its capacity and credibility as a watchdog of government activities. It must ensure that rules are enforced and must enhance the desire of all arms of government and the people to continue to obtain value for money from public expenditures. Public interest in value for money must be upheld, and the authority and capacity of other watchdog authorities should not compromised.

A strategic investment plan has been drawn up to improve the capability of Parliament and its supporting committees and technical personnel to understand and carry out their general functions.

9.5.5 The commitment control system (CCS)

The commitment control system (CCS) was introduced in 1999/2000 to help eliminate arrears and continues to be a landmark financial management tool that has helped reduce the creation of new domestic arrears and improve expenditure management, including enhanced accountability and financial discipline. The CCS was put in place to ensure that commitments do not exceed the ability to pay when they fall due. The CCS is also enhancing the implementation of the Public Finance and Accountability Act of 2003.

The CCS has enabled government to reduce but not to eliminate domestic arrears. In the first year of operation, a 78 per cent reduction in arrears was realised and a further 68 per cent was achieved the following year. Since then, the level of arrears

has remained at less than Shs10 billion, except in 2002/03 when unforeseen emergencies had to be catered for (see Table 9.2).

Table 9.2: CCS stock of arrears (Shs billion), 1998/99–2002/03

Budget type	1998/99*	1999/00	2000/01	2001/02	2002/03
Recurrent	87.000	19.000	6.000	6.400	8.894
Development	-	-	0.048	0.331	2.857
Total	87.000	19.000	6.048	6.731	11.751

Note: * Pre-CCS arrears

Prior to the introduction of the CCS, accounting officers did not have full control over what was happening on a daily basis in their respective departments; but now, because they are appraised regularly since they approve all commitments, the CCS has given them greater insight into what activities are being implemented. The CCS has also bestowed the responsibility of transparency and accountability for public funds on vote controllers. They are now aware of the sanctions and general consequences of not controlling commitments, and are forced to exercise caution when utilising public resources.

The focus now is on making accounting officers fully responsible for the arrears created. This role is emphasised by the new legislation, which will be enhanced further with the full introduction of the IFMS. The major remaining challenges to the CCS are concealment of information by accounting officers due to fear of conveying a negative position of a ministry or government agency, and an inability of accounting officers to control commitments due to political pressure and unforeseen emergencies; this is characteristic of the votes linked to State House, Foreign Affairs and Uganda Prisons.

9.5.6 The Integrated Financial Management System (IFMS)

The IFMS is a computerised system for accounting and budgeting, which is to be implemented throughout government ministries and in some local governments. It links budgeting to financial management as a way of making output-oriented budgeting (OOB) and results-oriented management (ROM) operational. The IFMS is integrated in the sense that budget allocations are not broken down between recurrent and development expenditures; instead, they are linked to results or outputs. Furthermore, the IFMS electronically links local governments to the Ministry of

Finance, Planning and Economic Development (MFPED). Its implementation began on a pilot basis in February 2004 in six ministries and four local governments. Lessons learnt from the pilot exercise will assist in the full roll-out of the IFMS to cover all cost centres. Roll-out to the remaining ministries and seven more local governments will happen in the later part of the 2004/05 financial year.

The initial IFMS design provided for implementation of six modules, covering general ledger and reporting, budgeting, purchasing, payments and accounts payable, cash management, and revenue receipting. To increase the functionality available to users, additional modules (such as fixed assets, inventory management and fleet management) will be introduced. Because the current system of government accounting is on cash basis, there is the need for a phased change to an accrual basis of accounting so as to capture all assets and liabilities. This is part of the new requirements in the Public Finance and Accountability Act of 2003.

The expected benefits of the IFMS include enabling government to: effectively plan and control its budget; manage and report in timely fashion on its financial activities; deliver services to the public more efficiently, economically and effectively; improve monitoring and control of receipts and expenditures by accounting officers; increase internal control over financial transactions to detect and prevent potential fraud; strengthen efforts to demonstrate accountability to the citizens and development partners; and reduce government's overall investment in the development and maintenance of expensive accounting systems in each ministry and local government.

9.6 Transparency and openness

In the past, the government of Uganda, like many other governments around the world, tended to operate with considerable secrecy. This was partly because most government agencies were monopolies and found it easy to abuse that position. In addition, there were no established institutional mechanisms to hold government accountable. However, with the restoration of basic human rights (democracy, freedom of speech, freedom of the press and a functional parliament, among others) government is now becoming increasingly accountable.

9.6.1 Publication of government disbursements

With the advent of decentralisation in 1997, and given that local governments depend on the central government for 90 per cent of their funding, tracking the release and movement of funds from the centre to the respective local governments became part and parcel of Uganda's public finance management and accountability challenges. In recognition of the fact that information is power, government adopted the use of the

press to ensure that funds are not diverted, unnecessarily delayed or even misappropriated in the process of moving from the centre.

Today, central government releases to districts are published in all major daily newspapers and even announced on Radio Uganda. This increases the responsibility of the concerned officials to account fully to central government and the recipients of the services funded by such releases. In addition, some releases are conditional on fulfilment of performance criteria. Omission of a given local government from any one month's release immediately sends a signal of the likelihood of non-compliance, for which immediate remedial action is often sought.

9.6.2 Consultative meetings and participation

In recent years, several reforms have been enacted in order to make Uganda's planning and budgeting process as participatory and consultative as possible. Such reforms have included the participation of civil society organisations in the formulation and monitoring of policies and programmes and, in particular, the budget process. Civil society organisations have also been involved in the monitoring of PAF expenditures at both central and district level.

To ensure that the process continues to be highly participatory, popular versions of the PEAP, the annual budget and the budget-making process have been produced to enable easy engagement with the various sections of society that should contribute to the policy/poverty debate from an informed standpoint. It is surprising to note that summarised versions of the documents have proved to be more effective in engaging parliamentarians, policy-makers and implementers at central and local government level.

9.6.3 Budget framework papers (BFPs)

There are three major types of budget framework papers (BFPs) that are usually prepared in the course of Uganda's budgeting process. Based on sectoral plans, the SWGs prepare the Sector Budget Framework Papers (SBFPs). In addition, local governments prepare Local Government Budget Framework Papers (LGBFPs) in consultation with the centre. The SBFPs and LGBFPs inform the budgeting process by identifying all funding sources, reviewing individual sector performance, and specifying objectives and outputs to be achieved in those sectors over the medium term, given the resource constraints. Therefore, the BFPs are a tool for integrated planning and budgeting. Once a local government or sector, through its LGBFP/SBFP, has identified what it wants to achieve within its total funding, it is in a position to prepare its annual work plan. The work plans identify the specific activities to be carried out in each sector in a financial year.

Following the preparation and submission of SBFPs and LGBFPs, the MFPED consolidates and prepares the National Budget Framework Paper (NBFP), which is then called the Macroeconomic Plan and Indicative Budget Framework Paper, in which key macroeconomic issues and sector specific strategies are analysed. The problems to be addressed, and alternative actions and procedures are all considered. Thus, the NBFP presents policy priorities, which are discussed by Cabinet to ensure that available resources can be aligned to support these priorities.

9.6.4 Popular versions of government documents

In order to improve participation in the national budget process, government publishes a number of popular versions of its documents. These include the Budget at a Glance, a Citizen's Guide to the Budget Process, the Budget in Brief and the Popular and Summary Versions of the PEAP.

The Budget at a Glance is composed of three major tables: the resource envelope, resource allocation by major expenditure category, and sectoral allocation of the government budget excluding donor-funded development expenditures. The Citizen's Guide to the Budget Process informs the general public about the budget process and how they can get involved. The Budget in Brief outlines the theme of each budget, achievements and out-turns of the previous year's budget, policy impacts of the previous budget on the poor, the medium-term budget outlook and the specific outlook for the forthcoming budget. The Summary and Popular Versions of the PEAP summarise and present the PEAP in simple everyday language for easy comprehension by average Ugandans.

9.7 Conclusion

Public expenditure reform is an ongoing process. New challenges in the rapidly changing socio-economic environment continually call for revision of government policies and programmes. As the government of Uganda forges ahead with the implementation of reforms outlined in this paper, it recognises areas where reform has proved to be very challenging or is urgently called for.

A 10-year public sector and pay reform initiative was launched in 2001, and in the first three years of implementation some notable achievements have been made, including the reduction in pay differentials between higher-level and middle-level civil servants. Recently, Parliament was presented with a new Public Service Bill, which is consistent with changes put forward by the Constitutional Review Commission, and several proposed changes in the field of human resources management, including the devolvement of human resources capacity in local governments.

However, significant challenges remain and the progress of reform has slowed down for a variety of reasons. There is concern about the size and efficiency of the public sector and its impact on the achievement of many of the goals set out in the PEAP. In response to these concerns, the World Bank has agreed that the Fourth Poverty Reduction Support Credit (PRSC 4) policy action will be for the establishment of service delivery and the conduct of beneficiary assessments.

Government also recognises the fact that the current arrangements for funding and providing pensions and other social security benefits in Uganda are far from satisfactory, and are in urgent need of reform. A task force has been formed and charged with the responsibility of liberalising the pension sector under a Pension Regulatory Framework. This is aimed at improving the efficiency of the pension provisions and at mobilising domestic savings for long-term capital formation. However, because of budgetary constraints, it is not currently feasible for government to provide basic social security to all Ugandans, including those not in employment. The strategy in the reform process is to create a regulatory framework and an enabling liberalised pension system that will encourage new product development to meet the needs even of those in the informal sector.

There is also increasing recognition of the challenge posed by the degree of political commitment to reform. The success with which Uganda has been able to implement macroeconomic reforms and maintain a stable macroeconomic environment for over a decade has largely been a direct result of full political support for the reform efforts. However, it is uncertain what the level of support is for ongoing reforms.