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Integrating Public Environmental Expenditure within Multi-year Budgetary Frameworks

A background report for the joint **Environment and Development Task Team on Governance and Capacity Development for Natural Resource and Environmental Management**

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INTEGRATING PUBLIC ENVIRONMENTAL EXPENDITURE WITHIN MUTI-YEAR BUDGETARY FRAMEWORKS

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Keywords: Budget systems, medium-term budgeting, medium-term expenditure frameworks, direct budget support, environmental management, environmental public expenditure management, environmental investment programmes, development cooperation.

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ABSTRACT

Medium-term approaches to budgeting are now common in OECD countries and are being adopted increasingly by developing countries. This reflects a realisation that the annual approach to budget making actually undermines budgetary performance, contributing to fiscal instability and, perhaps even more fundamentally, to resource misallocation and the inefficient and ineffective use of resources.

The purpose of this study has been to analyse how multi-year budgetary processes work in practice in both high income OECD countries and in aid-receiving countries, with a view to identifying the opportunities for, and limits to, financing environmental management. It also provides suggestions to the donor community on how to make better use of multi-year budgeting when providing general support to the budgets of developing countries in order to ensure that environment is included in this process.

In this context, the report may be of interest to various audiences. On the one hand, representatives of the ministries of environment and other relevant government agencies with responsibilities for environmental and natural resource management who struggle to prepare medium-term budgets may find this analysis useful. On the other hand, the report is targeted at experts from the ministries of finance and economy who are charged with assessing environmental programmes and taking decisions for their financing. The third target group are those donors who even if they are moving to direct budget support, may still be concerned that the environment sector is adequately funded.

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RÉSUMÉ

La budgétisation à moyen terme est désormais courante dans les pays de l'OCDE, et les pays en développement y ont de plus en plus recours. On s'est rendu compte, en effet, que la budgétisation annuelle nuisait en réalité à l'exécution du budget, favorisant l'instabilité budgétaire et, de manière peut-être encore plus fondamentale, une mauvaise allocation et une utilisation inefficace des ressources.

La présente étude a pour objet de voir comment la budgétisation pluriannuelle fonctionne concrètement dans les pays de l'OCDE à revenu élevé et dans les pays qui bénéficient d'une aide, afin de déterminer les possibilités et les limites en matière de financement de la gestion environnementale. La communauté des donateurs y trouvera également des propositions quant aux moyens de mieux exploiter la budgétisation pluriannuelle, lors du versement d'une aide budgétaire générale aux pays en développement, pour que l'environnement soit pris en compte dans ce processus.

Par conséquent, l'étude est susceptible d'intéresser des publics divers. Tout d'abord, les fonctionnaires chargés d'établir les budgets à moyen terme dans les ministères de l'environnement et autres organismes publics jouant un rôle dans la gestion de l'environnement et des ressources naturelles y trouveront sans doute des informations utiles. Ensuite, l'étude est destinée aux experts des ministères de l'économie et des finances qui s'occupent d'évaluer les programmes de protection de l'environnement et de se prononcer sur leur financement. Enfin, le troisième public visé est celui des donateurs qui, bien que s'orientant vers l'aide budgétaire directe, continuent de veiller à ce que le secteur de l'environnement perçoive un financement suffisant.

Classification JEL : H61 ; E61 ; O13 ; O19 ; Q01 ; Q56 ; Q57

Mots-clés : systèmes budgétaires ; budgétisation à moyen terme ; cadres de dépenses à moyen terme ; aide budgétaire directe ; gestion environnementale ; gestion des dépenses publiques de protection de l'environnement ; programmes d'investissement en matière d'environnement ; coopération pour le développement.

FOREWORD

This study is conducted within the framework of the work of the OECD Task Team on Governance and Capacity Development for Natural Resource and Environmental Management, a joint Task Team of the OECD Development Assistance and Environmental Policy Committees. The report is based on five country cases studies, including Armenia, Australia, South Africa, the Netherlands and Uganda. The individual country case studies were prepared by Nina Hajoyan (Armenia), Malcolm Holmes (Australia), Alta Fölscher (South Africa), Flip van Helden (the Netherlands) and Alice Ruhweza and Paul Bagabo (Uganda).

The project has been managed by Nelly Petkova (OECD Environment Directorate) and implemented with support by the Overseas Development Institute (ODI), London, UK (Neil Bird, Malcolm Holmes and Geoff Handley). Earlier drafts of this study have been reviewed by Brendan Gillespie, Xavier Leflaive, Angela Bularga, Helen Mountford and Shardul Agrawala, all from the OECD Environment Directorate. Tamara Levine and Sara Fyson, from the OECD Development Cooperation Directorate, have also reviewed the paper. These contributions are gratefully acknowledged. The support, guidance and patience of Roberto Martin-Hurtado (OECD Environment Directorate) are particularly appreciated.

We would like to express our special thanks to all the staff of the governments, the NGOs and the development agencies working on environment and budgetary issues in the five case study countries who contributed their views under this study as well as the Task Team participants, and particularly Olof Drakenberg (SIDA Helpdesk for Environmental Economics, University of Gothenburg), for their support throughout the implementation of this project.

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LIST OF ABBREVIATIONS

DFID	UK Department for International Development
GDP	Gross domestic product
IMF	International Monetary Fund
MNP	Ministry of Nature Protection (Armenia)
MTEF	Medium-Term Expenditure Framework
MTSF	Medium-Term Strategic Framework (South Africa)
OECD	Organisation for Economic Cooperation and Development
O&M	Operation and maintenance (costs)
PEAP	Poverty Eradication Action Plan (Uganda)
PRSPs	Poverty Reduction Strategy Papers
SBFPs	Sector Budget Framework Papers (Uganda)
SWGs	Sector Working Groups (Uganda)
USD	US Dollar

EXECUTIVE SUMMARY

Background

This report presents the main findings and lessons learnt from a survey of two OECD and three aid-receiving countries (Australia, the Netherlands, South Africa, Uganda and Armenia) with integrating environment into multi-year budgetary frameworks. In aid-receiving countries, where multi-year budgeting has received renewed attention in the context of the formulation of Poverty Reduction Strategies, the study also seeks to examine the implications for the environment sector from the progressive shift in aid modalities towards sectoral and general budget support. It also discusses what donors can do to help integrate the environment sector into multi-year budgets.

The term used in this paper for the specific instruments supporting a broad-based approach to multi-year budgeting is the Medium-term Expenditure Framework (MTEF), but different countries may name it differently. Some of these terms, include: multi-year expenditure framework, multi-year budget, forward budget, multi-year estimates and forward estimates.

From traditional to modern approaches in budgetary formulation

Multi-year approaches to budgeting are now common in OECD countries and are being adopted increasingly by developing countries. This reflects a realisation that the annual approach to budget making can actually undermine budgetary performance, contributing to fiscal instability and, perhaps even more fundamentally, to resource misallocation and inefficient and ineffective use of resources.

To reduce the large fiscal deficits experienced in the late 1980s – early 1990s, many OECD countries launched significant public sector reforms which included new approaches to budgeting. Gradually, they started moving away from the traditional line-item budgeting implementation to a top-down budgeting model.

The more ‘modern’ approach to public finance management with which the MTEF approach is associated encompasses the top-down and bottom-up approaches in a formal manner and creates the institutional basis that supports its implementation. MTEF seeks to structure the budget around broad programmes which are defined along government policy objectives and linked to specific outcomes, thus aiming to integrate policy, planning and annual budgets. This makes it clearer what a given level of expenditure is intended to deliver and thus makes it easier to focus more on performance. In return, sector managers are granted more discretion over detailed budget management and empowered to use their greater informational advantage to deliver results.

The transition from input to results oriented budgeting is notoriously difficult. It requires approaches tailored to the political and institutional contexts within the ministry of finance and sectoral ministries. It is notable that countries that have successfully introduced such systems started from a strong base in terms of public sector capacity and strength of public finance management systems, and did so over a number of years.

Medium-term expenditure framework and the environment in the five reviewed countries

While in all five countries, environment ministries are integrated into the national budgeting and medium-term expenditure planning systems, and follow the same rules and procedures as the rest of the government administration, their actual involvement in the process differs significantly. In Australia and the Netherlands, where the MTEF is fully institutionalised and internalised by staff in government agencies, the environment sector is an equal partner in the reforms. In Uganda and South Africa this process is maturing only now. Armenia is a newcomer and the environment sector was included in the MTEF framework only a couple of years ago. As a result, the environment ministry's staff have just started to understand the challenges posed by the MTEF process. The experience of these countries shows that institutionalising the MTEF, and the meaningful integration of the environment sector in it, is a long and difficult process. This process is most successful when there is high-level political support and commitment to implementing the reforms by investing sufficient financial and human resources.

There is some evidence that introducing an MTEF has helped strengthen fiscal discipline and has brought about greater budgetary predictability for line ministries, in general. The three aid-receiving countries have seen a reduction of their fiscal deficit compared to the pre-MTEF period. The data provided by the countries suggest that budget predictability for the environment sector has also increased.

The OECD case studies testify that the long-term nature of some environmental (particularly infrastructure investment) policies clearly benefit from the stability created by the medium-term expenditure framework and the government commitments to stick to the financial ceilings allocated to the sector. In South Africa and Armenia, actual allocations have been higher than requested in recent years. This also points to the fact that some re-allocation of resources to the environment sector within the MTEF framework has been taking place. However, these increased resources for the environment should be seen against the low levels of environmental expenditure as compared to other (social) sectors, such as health and education which are currently political priorities in these countries.

Experience from the reviewed countries also shows that as a result of introducing an MTEF the budget process has become more-policy oriented and more credible. This is particularly true where budget allocations are based on programmes, as in Australia and the Netherlands, rather than allocated by departments (South Africa) or economic classification (Uganda). Developing economically-sound and realistic programmes which can serve as a basis for annual budget allocations is key to the success of ministries of environment in the MTEF process. The OECD experience shows that where environmental programmes are well-designed and justified in economic terms, such programmes stand a higher chance of being funded through the regular budget process.

There is also some evidence that donors have started to provide higher levels of their aid as direct budget support. But the lack of predictability of donor flows is still a major concern in aid-receiving countries as it may seriously undermine the credibility of the MTEF and budgetary process. This is the case in Armenia, where significant shortfalls in donor funding in the environment sector meant that in 2004 and 2005 spending on some areas was less than 50 percent of the budgeted amount. Uganda has extended its conservative approach to estimating domestic revenue to encompass donor funding. It now bases the estimates incorporated in the budget on previous releases rather than on promises. This has led to surprisingly accurate estimates. Although direct budget donor support is on-budget now and has become better integrated into existing management systems and processes of the countries, donors and developing countries need to agree on strict rules for disbursing aid in order to facilitate the smooth execution of budgetary payments.

The aid-receiving countries have invested significant efforts to develop national environmental and sustainable development programmes, as reported by both Armenia and Uganda, but these programmes are often poorly designed and costed. They are not supported by valuation and analytical studies which can show the value added of environment for the development of the economy in these countries. As a result, such programmes do not get sufficient attention in government and remain chronically under-funded. Another project within this Task Team, Greening Development Planning, discusses various approaches for making the economic case for improved management of environment and natural resources. However, there is a lack of capacity in environment ministries in the aid-receiving countries to conduct such analysis. In the MTEF context, these challenges are further magnified.

The complexity of the environment sector both horizontally (across government agencies with responsibilities for environmental management) and vertically (across different levels of government) coupled with the understaffing of ministries of environment can further undermine the quality of environmental programmes as their preparation requires strong cooperation among all actors involved. Environmental programmes prepared by other sectoral ministries and particularly at the local level suffer similar problems. In addition, staff in finance ministries often lack the understanding of how environmental investments can contribute to overall economic growth which further constrains allocations to the environmental sector.

Capacity-development needs

Given the cross-sectoral nature of the environment, the preparation of robust sectoral strategies and programmes is a serious challenge in the three aid-receiving countries. Significant capacity development in this area is needed among a range of government agencies and levels. There is also a need to work and further support civil society organisations and the private sector in these countries in order to help create popular demand for environmental improvements which can push the environment up the political agenda.

In general, international development organisations play an important role in providing advice and technical assistance in relation to environmental policy. The MTEF process provides a new opportunity for donors to support capacity development in environmental and natural resource administrations in the competition for government resources. To help these administrations to better respond to the challenges posed by the MTEF process, donors could focus their technical assistance on developing particular skills of ministries' staff as well as the preparation of relevant tools. Skills related to valuing the economic costs and benefits of environmental policies and preparing public expenditure reviews for the sector are crucial. Strengthening the information base that supports such analysis is equally important. Support could also be provided for preparing methodologies and guidelines for how environmental programmes should be developed so that they could be integrated into MTEFs and subsequent annual public budgets, and demonstrate their contribution to Poverty Reduction Strategies. These tools however should not be developed without the active involvement of finance ministries in these countries.

Some tools exist in donor country environmental agencies, donor agencies and/or international organisations. However, there is a need to better understand what is already available and how these tools could be adapted to the national level in aid-receiving countries. Donors could work together to identify existing tools and review their appropriateness for developing countries. Where specific guiding documents are missing, country-focused initiatives could be complemented by some upstream work in developing such guidelines.

Major lessons learnt

In the light of the above analysis, the main lessons learnt from this study can be summarised as follows:

- **Allocation of budget resources on the basis of well-designed programmes**: Allocating budgetary resources on the basis of programmes rather than by departments or economic classification can help strengthen the policy/planning/ budget process. Best results are achieved where annual budget proposals are derived from well costed and economically sound environmental programmes, as exemplified by Australia and the Netherlands. The programmes are more credible if developed and costed by professional entities (e.g. the Dutch Environmental Assessment Agency).

- **The importance of budgetary basics**: Experience from OECD countries shows that the success of the reform process depends on addressing budgetary basics such as budget structure, scope and classification, accounting, information, evaluation and auditing before introducing more sophisticated techniques. Unless, these basics are well established, introducing MTEF may not generate the anticipated benefits.

- **The importance of analytical and costing studies:** To be credible, programmes need to be based on sound analytical studies of costs and benefits of environmental programmes and expenditure reviews which can support requests for higher levels of resources. Knowledge in conducting valuation studies and preparing financially sound programmes is particularly poor in aid-receiving countries. In addition, the data used for the preparation of such studies are often missing and unreliable.

- **Awareness raising within ministries of finance**: The lack of understanding in ministries of finance of how environment can contribute to economic growth in aid-receiving countries further constrains obtaining adequate support for the environment sector. Staff from these ministries need to be part of any technical assistance programmes focused on environment. Ministries of finance need to be fully involved in the development of any guidance and analytical documents related to the environment sector.

- **Public disclosure, transparency and accountability**: Publishing information on the costs of programmes and making it available to parliamentarians and the public at large helps improve transparency of public spending and holds politicians accountable for their promises, as this is done in Australia and the Netherlands. Aid-receiving countries can aim to adopt similar practices.

- **The role of donors:** In aid-receiving countries, donors can be instrumental in helping build capacities of environmental and natural resource administrations in developing and costing environmental programmes in order to more successfully compete for budgetary resources. Donors can also support the preparation of relevant analytical studies and methodologies. Strengthening the data information systems in these countries is of paramount importance if they are to inform the strategic planning and budgeting process.

- **Better cooperation among donors**: Donors could work together to identify existing tools and review their appropriateness for developing countries. Where specific guiding documents are missing, country-focused initiatives could be complemented by some upstream work in developing such guidelines.

- **Need for improved predictability of donor flows**: The lack of predictability of donor flows may undermine the credibility of the MTEF and the budgetary process. This is even of more importance in the environment sector, which is largely financed by donor funds. Donors and developing countries need to agree on strict rules for disbursing aid (and stick to them). These rules need to be built into the MTEF process in order to facilitate the smooth execution of budgetary payments.

1. INTRODUCTION

Background

In line with the Paris Declaration on Aid Effectiveness, donors have committed to move away from direct project interventions to more upstream forms of support, aligned with developing country priorities and channelled through those countries' own systems and procedures. Under these changing conditions of aid delivery it is important for environment ministries to integrate environment into national programmes and associated budgetary processes if they are to benefit from external support.

There is also a growing recognition that strong national public finance management systems, including budgetary processes, are valuable public goods in and of themselves. One set of reforms designed in recent years to strengthen the budget process has been the introduction of a multi-year budgeting process, which most often takes the form of Medium-term Expenditure Frameworks (MTEFs). For definitional clarity, the term MTEF is referred to throughout this report as a specific term for the more general concept of a medium-term budget planning and preparation process that links expenditure allocations to government policy priorities. The MTEF is a rolling 3-5 year process, revisited every year, which aims to reduce the imbalance between what is affordable and what is demanded by line ministries, with adjustments taking place through policy changes. Given that there is often disconnect between policy making, planning and budgeting, MTEFs are seen as a way to align budgetary decision-making with government strategic orientation on a multi-year basis.

Originally pioneered in OECD countries such as Australia and New Zealand which began to develop a 'modern' approach to public finance management, MTEFs are now being adopted wholly or in part in many developing countries too. They are seen as particularly useful as a means of mapping national priorities set out in Poverty Reduction Strategy Papers (PRSPs) into government budgets. However, while ministries of finance have made progress in using MTEFs to translate national policy objectives into public expenditure allocations within a multi-year macroeconomic and fiscal framework, one of the main concerns in this process is the lack of capacity of sector agencies to prepare economically-sound, medium-term expenditure programmes which achieve their objectives in an effective and efficient manner. This is a particularly acute problem in ministries of environment and those involved in natural resource management. The cross-sectoral nature of many environmental issues, requiring coordinated action from a broad range of public sector institutions, presents a major challenge.

Objectives, scope and methodology

A key objective of the study is to analyse how multi-year budgetary processes work in practice in both high income OECD countries and in aid-receiving countries, with a view to identifying the opportunities for, and limits to, financing environmental management through general budget support. The report aims to combine a focus on how MTEFs are being implemented with sector-specific analysis of how environmental programmes may be better designed and put into practice in a multi-year context. It does this by analysing the experience of five selected countries.

The analysis is centered around the main objectives of MTEF and how these are achieved in the reviewed countries. Two OECD countries (Australia and the Netherlands), where the MTEF process is long established, provide a basis for comparison with aid-receiving countries where the MTEF is a more recent initiative (Uganda and Armenia). South Africa has been included in the sample, as it provides a possible mid-way position towards a 'maturing' MTEF that contributes to a more stable public finance environment. In each country, a national researcher interviewed relevant experts from both ministries of environment, natural resources and finance using a standard questionnaire (see Annex XII).

This work was carried out within the framework of the Task Team on Governance and Capacity Development for Natural Resource and Environmental Management which consists of representatives of the donor community from both the environment and development sectors. This is a summary report supported by a more detailed analysis conducted through the five individual case studies.

Definition of terms

Medium-term expenditure framework

There is no single, concise definition of the term 'MTEF'. Rather, it represents a set of broad principles for sound budgeting that are implemented in different ways in different institutional settings. Indeed, this sensitivity to institutional setting is a crucial component of the design of a successful MTEF. As mentioned, at its heart, the MTEF approach seeks to link expenditure allocations to government policy priorities using a medium-term (i.e. three to five year time horizon) budget planning and preparation process. In addition, this methodology typically involves a number of common core elements:

- A **unified 'whole-of-government' approach** that encompasses all sectors. If it is to be a genuinely strategic resource allocation mechanism the MTEF cannot be partial in coverage and cannot be meaningfully piloted in a sub-set of sectors. This is very often undermined by sectoral access to external funds through bilateral relationships with donors in aid-recipient countries and by the fragmentation created by earmarked donor funding – direct budget support helps to avoid these negative aid impacts.

- A **'top-down' hard budget constraint** consistent with macroeconomic sustainability that limits overall levels of spending over the medium-term. This should involve credible, realistic resource projections that are in turn based on explicit and carefully considered macroeconomic assumptions. It should ideally be backed by political commitment from the executive and legislative branches and set in coordination with the various levels of government involved in the conduct of fiscal policy. Aid unpredictability undermines this component in many aid-recipient countries.

- A '**top-down' set of strategic policy priorities** that together with the hard budget constraint drive, and are reviewed during, the strategic 'front-end' phases of budget preparation. In turn, decisions during the strategic phase on policy or ceilings will then drive the detailed preparation of budget and MTEF estimates.

- **'Bottom-up' forward estimates** of the costs of existing policies, programmes and activities over the medium-term supported by expenditure reviews.

- A single **nationally owned political process at the centre of government** that reconciles the bottom-up and top-down components, forcing policy priorities to be established within the overall resource constraint through resource allocation decisions. This includes the reallocation of resources from one sector to another (on the basis of transparent rules) as well as the allocation of any additional money or 'fiscal space' that arises. This process should ideally promote early decisions and limit the number of key decision moments.

- A **strong and clear link between MTEF projections and the annual budget process**, so that multi-annual targets (duly updated for changes in the macroeconomic situation) set in the previous years should form the basis upon which the budget is prepared. Ideally, there should be no meaningful distinction between the MTEF and the budget process: they should be one and the same thing.

- A **focus on results** (i.e. outputs and outcomes) rather than on financial inputs both in the structure of the budget and in terms of accountability. This means that sector managers are given a more predictable flow of resources coupled with more discretion over detailed budget management (on the basis that they have an informational advantage as to how best to spend public money) and are held accountable for delivery of results. It also means that budgets are structured on a programme basis with strong contestability of allocations from year to year, rather than on a traditional 'line item' basis whereby sectors are 'entitled' to their previous year's allocation plus some small additional increment. Thus, "*policy priorities drive funding and not the other way around*" (Holmes and Evans, 2003).

As will be discussed in more detail in Chapter 2, many of the elements of an MTEF are inseparable from good public finance management more generally. One of the key ways in which an MTEF approach adds value is to encourage a systematic overview of the public finance management system, focusing attention on the benefits of having key components of the process (e.g. macroeconomic and revenue forecasting, costing of policy options, the comprehensiveness and structure of the budget, monitoring and evaluation) working well together as a coherent whole. In turn, the MTEF approach also highlights the considerable requirements of good public finance management for environment (donor alignment with government policies *and* systems, lack of aid recipient countries in terms of both capacity (human resources in particular) and enabling fragmentation, inclusion of all spending 'on-budget'). Delivering an MTEF in aid recipient countries is an enormous challenge that requires a realistic and properly sequenced reform process tailored to the institutional setting.

Environment sector

In addition, since this study seeks to examine the MTEF process from an environmental perspective, it is important to establish what is meant by the 'environment sector'. There are two contrasting approaches to environmental policy development, depending on whether environmental management refers to the activities of natural resource sectors or is considered a cross-cutting theme associated with all sectors alike. The environment can be considered in two ways:

- **as a productive sector** (i.e. making use of natural resources for productive purposes) – overseen by a Ministry of Natural Resources or other relevant government agency.

- **as a cross-cutting theme** aimed at avoiding environmental pollution and degradation (e.g. water pollution, air pollution, noise, waste management) – overseen by a Ministry of Environment and environmental units in sector ministries.

A definition that embraces both of these approaches (while recognising that they have both complementary and conflicting elements in them) may increase the likelihood of environmental issues being budgeted for in all the relevant sectors in a coherent and more consistent manner. The study will therefore look at environmental policy, planning and budgeting from both of these perspectives and cover ministries of environment and natural resources to the extent possible. (Other ministries/agencies with responsibilities for environmental management have not been included in this study.)

This report may be of interest to various audiences. On the one hand, representatives of the ministries of environment and other relevant government agencies with responsibilities for environmental and natural resource management who struggle to prepare medium-term budgets may find this analysis useful. On the other hand, the report aims to draw the attention of experts from the ministries of finance and economy, who are charged with assessing environmental programmes, to the specific challenges facing the environmental sector in the MTEF process. The third target group are donors who despite moving to direct budget support would like to ensure that the environment sector in aid-receiving countries is not marginalised in this process. In this respect, the report offers some ideas as to how donors can help improve public environmental expenditure management within the framework of medium-term budgeting.

The report is divided in three main parts. The second chapter introduces the main premises of the MTEF process. The third chapter presents the actual MTEF practices in the five countries. The fourth chapter analyses the extent to which the environment is integrated into the MTEF/budget process in each of the reviewed countries. Each chapter draws conclusions and discusses the main lessons learnt from the case studies experience.

While chapters two and three may be of less interest to representatives of environment agencies, they still need to be aware of the basics that underpin the MTEF process. Although it may look like the ministries of environment staff are not directly concerned with MTEF, in reality, they participate in the process. This is done through the preparation of environmental programmes which need to compete for public resources within the MTEF/budget framework. To be successful, these programmes have to be supported by robust expenditure reviews, financing strategies and prioritisation mechanisms which need to be developed. While these elements will not be in place from the outset of the process, the MTEF framework provides an opportunity to gradually improve the analytical capacity and information set which are needed in the environment sector.

2. MULTI-YEAR BUDGETING

Medium-term approaches to budgeting are now common in OECD countries and are being adopted increasingly by developing countries. This reflects a realisation that the annual approach to budget making actually undermines budgetary performance, contributing to fiscal instability and, perhaps even more fundamentally, to resource misallocation and the inefficient and ineffective use of resources.

In developing countries the disintegration of the links between policy making, planning, budgeting and sector and agency management of policies and resources have been both a cause and a symptom of this focus in the short term. Policy making and planning (and, in fact, management) have been inadequately disciplined by the lack of any sense of a sustainable aggregate resource constraint (donor practices often contribute to this). Development impacts, which require a medium to longer-term perspective, have been all too frequently, and often unnecessarily, undermined by the short term imperatives of fiscal policy. In the meantime, it is only through being able to see how budgets are a time slice of medium to longer term priorities that the inevitable instability of the annual budget can be more effectively managed.

Until budgeting is required to take account of longer term resource realities and becomes more focused on policy priorities (taking account of the consequences of individual spending decisions over the longer term), the annual budget is likely to continue to lurch from crisis to crisis, with increasing recourse to quick fixes. Over the years, traditional, bottom-up budgeting, has been complemented by other approaches, such as top-down, medium-term expenditure frameworks and performance budgeting, which have been introduced to guide the annual budget process.

This chapter looks into the major (theoretical) premises of medium-term budgeting. It is based on a review of existing literature and analytical studies. It discusses the main elements of public finance reforms that have been taking place with the aim of improving the effectiveness and efficiency of the allocation of scarce resources across different sectors.

The term used in this paper for the specific instruments supporting a broad-based approach to medium-term budgeting is the Medium-Term Expenditure Framework (MTEF), but there are other terms. Some of these terms, used mostly in the OECD countries, include: multi-year expenditure framework, multi-year budget, forward budget, multi-year estimates, forward estimates. The MTEF concept was developed by the World Bank and promoted in developing countries, particularly in the context of the Poverty Reduction Strategy Papers (PRSPs).

Budgetary reform

The annual budget

In essence, the budget is a document which, once approved by parliament, authorises the government to raise revenues, incur debts and effect expenditures in order to achieve certain goals. Since the budget determines the origin and application of public financial resources, it plays a central role in the process of government, fulfilling economic functions (the budget is the state's financial plan), political (the budget process ensures that the people's representatives scrutinise and approve the raising of taxes, the contracting of debts and the application of public funds by government), legal (the enactment of the budget in law by parliament limits the powers of government, since the government may not raise taxes that have not been approved by parliament and may not exceed parliament's expenditure appropriations) and managerial functions (the budget communicates government policy to public institutions by informing them how much may be spent for what purpose, thereby guiding policy implementation).

In order to adequately fulfil these functions, the budget should be comprehensive and transparent, following clear rules and procedures which establish the relationship between the key institutions in the budget process. In most OECD countries, and an increasing number of developing countries (including in the reviewed countries), these goals are achieved by establishing budgetary principles and procedures in a budget framework law. Some of these principles include: annuality (the budget is prepared annually and executed over a period of one year), universality (all state revenues and expenditures should be presented in the budget), unity (all revenues and expenditures, and financing requirements, should be presented within the same budget), pooling of resources (revenues should be directed to the common fund for the financing of all expenditures rather than earmarked for the financing of a particular institution, programme or expenditure item), classification of financial operations (public financial operations are often discriminated by institutional, territorial, functional and economic classifiers) (see Annex VI and VII for more information on the administrative process of the traditional budget cycle and budget classification system).

Common problems with annual budgeting

Most budgets are prepared using an annual bidding system. This has the advantage of decentralising responsibility for budget preparation to the agency responsible for budget execution, while ensuring that the Ministry of Finance has the final say on the overall budget allocations, thereby ensuring their consistency with national expenditure targets. However, the bidding system has been criticised extensively on the following grounds[1]:

- **Failure to review the base budget.** Departmental bids generally take the previous year's budget as the base and request additional increments, ideally on the basis of an expansion of the services to be provided, more often as a percentage increase. Negotiations with the Ministry of Finance focus on the increment, giving little consideration to the bulk of expenditure. Consequently, the bid system gives little scope to review the relevance, efficiency and effectiveness of existing programmes or administrative overheads.

- **Departmental rather than programme or output orientation.** Budgets are prepared by and for administrative units rather than on the basis of the Government's objectives, programmes and activities. Emphasis is placed on the inputs required to ensure that the administrative machinery operates smoothly, with little attempt to relate inputs to activities or performance as measured by the services provided (outputs) or their impact on the public (outcomes). In resource constrained economies, this can result in divergence between the functions fulfilled by institutions on paper and reality. Where funds are scarce they will tend to be channelled into payroll expenses, leaving inadequate resources for activities, resulting in schools without books or incomplete wastewater treatment plants.

- **Inadequate timeframe for analysis of expenditure.** An annual time frame will not capture the long–term implications of expenditure decisions: for example, the recurrent cost implications of on-going capital expenditures. This is particularly true for infrastructure, including environmental infrastructure projects, such as wastewater treatment plants construction, whose costs will not be reflected in the budget until they become operational. Similarly, the short-term focus is likely to subordinate longer-term development priorities to immediate needs.

- **Encouragement of a cynical attitude**. Spending agencies will tend to bid high because they

[1] Based on a discussion by Foster, M. and Fozzard, A. (2000).

expect their proposals to be cut back. As a result, Ministries of Finance will be faced with overall spending proposals that greatly exceed the overall targets and, under pressure of time, impose arbitrary cuts on agency proposals. Since the spending agency does not feel directly responsible for the final budget figures it has little commitment to the limits imposed. There is, moreover, an incentive for the agency to fully spend its budget, since the Ministry of Finance will generally take execution rates into consideration when setting the following year's budget limit. To avoid under spending, there is often a surge in agency spending in the last quarter, often on frivolous items. Moreover, spending agencies have no incentive to make savings which they fear will be sent back to the centre, and hence continue to plan budgets which feature a range of activities, facilities and staff which cannot feasibly be funded at efficient levels of activity.

Awareness of these problems is nothing new. There is a long history of attempts at budgetary reform, most of which were initiated in the United States and Europe and subsequently filtered down to developing countries (e.g. zero–based budgeting of the 1970s). These reforms met with little success, largely because they sought to address technical problems and failed to improve managerial capacity at operating levels. More recent reforms have, in contrast, sought to combine technical innovation with managerial reform by increasing the autonomy and accountability of government agencies, giving them greater flexibility in the use of resources while holding them responsible for results. Some of these reforms include the introduction of MTEF and performance budgeting.

From bottom-up to top-down budgeting

Introducing multi-year budgeting is not an end in itself. In most countries, the main reason for introducing a medium-term perspective to budgeting was strengthening fiscal discipline. In the late 1980s-early 1990s, many OECD countries (including Australia and the Netherlands) suffered huge fiscal deficits, brought on by shrinking tax revenues and sustained increases in public expenditure. Policy measures that had been implemented to counter the growing fiscal deficits by controlling public expenditure did not prove effective against deteriorating fiscal situations. As public finance worsened, OECD governments decided to reform their existing budget formulation systems.

Until then, the bottom-up budgeting system was the main approach to budgeting. Budget formulation in the **bottom-up budgeting system** begins when all agencies and ministries send their requests for funding to the Finance Ministry. These requests typically far exceed what the agencies or ministries realistically expect to get. Starting from these requests, the Finance Ministry and line ministries will go through iterative rounds of negotiations until some common point is found. This is time-consuming and essentially a game between the finance ministry and line ministries. Most importantly, however, the negotiating process is bogged down in details and the ministry of finance loses track of the bigger picture. In addition, given the annual perspective of the budget, expenditure which would accrue in the near future would remain hidden or disregarded by politicians whose political mandate might have terminated by then. As a result, in the late 1980s–early 1990s, fiscal deficit became a permanent feature of many OECD economies.

To overcome this unsustainable public expenditure and budget formulation practice, a number of OECD countries (including the two OECD countries reviewed here) introduced **top-down budgeting**. The main feature of this new budgeting approach is that it allows the ministries of finance (or the respective government planning authority) to focus on setting aggregate limits and sector expenditure ceilings for line ministries, according to national objectives and priorities. This allows line ministries to decide on the allocation of resources across individual programmes within their assigned spending ceilings. Thus, the ministry of finance does not need to intervene in detailed resource allocations made by line ministries. The main role of the ministries of finance is to monitor that allocations are conducted in accordance with set rules. As such, line ministries can use their best expertise to allocate resources internally in order to achieve their policy objectives. Therefore, the budget process started creating a sense of ownership in line ministries for the actions they take. Most importantly, to be effective, this process needed a longer-term perspective, so countries chose to design their fiscal and expenditure envelopes on a 3 to 5 year basis.

The credibility of this system lies in the first place in the capacity of the government to estimate total available resources for the public sector over a multi-year period, usually within a multi-year macroeconomic and fiscal policy framework. While the estimation and modelling process is mostly a technocratic exercise, there are a number of strategic and political decisions that depend on government choices which will shape the economy and thus the strength of the fiscal base of the country. Some of these include what structure of the economy will be supported by the government, the level of debt that will be incurred by the government or guaranteed by it and the overall taxation policy. The development of sound conservative macroeconomic forecasts for budget formulation is crucial. Most governments identify at a minimum pessimistic and optimistic scenarios. Being optimistic, which serves primarily a political purpose, is likely to lead to excessive spending relative to likely revenues, as well as higher deficits and debt. Good practices show that comparing government estimates to estimates prepared by economic researchers from private sector institutions or non-governmental organisations (and using consumer confidence surveys) usually provide a more realistic picture.[2]

While top-down budgeting gained importance in many OECD countries in the 1990s, experience shows that this system needs to incorporate elements of the bottom-up approach as a complementary method in the budget process. In developing new initiatives, funding decisions should be made through a programme/project-based review (a typical element of a bottom-up approach), since the finance ministry will often lack information and data on the programme/project to judge the fiscal implications of the proposed initiative, such as performance data and total programme cost projections over the long term. Therefore, line ministries are usually required to submit detailed proposals to the finance ministry. In addition, individual programmes need to be reviewed in order for the finance ministry to monitor whether they are consistent with the fiscal rules.

Box 1: Comparison between bottom-up and top-down approaches

Bottom-up

- Ministry by ministry analysis that largely ignores economic forecasts
- Annual
- Time-consuming
- Ownership of proposals is more agency-specific
- Reactive

Top-down

- Aggregate fiscal analysis that takes into account economic forecasts
- Multi-year
- Delegated authority
- Creates joint ownership of proposals
- Proactive

Source: OECD (2005).

2 Countries use a variety of techniques to assure sound economic estimates, some during the budget development stage (*ex ante* to budget enactment) and some after budget passage. Among *ex ante* good practices are: comparison with private or academic forecasts during forecasts development, using the median forecasts of several reputable non-government organisations, economic updates prior to the budget enactment that allow for modifications to the budget proposals to fit emerging trends, inclusion in the budget of a table comparing the key economic variables of the government forecast with several reputable private or public forecasts with explanations for significant variation in median forecasts and having multiple government forecasts that could be the basis of budget development. Good practice also includes setting aside “reserves” during budget formulation to account for some variation in forecasts after budget passage, mid-fiscal year economic updates after budget passage combined with required proposals to bring the budget in line with emerging trends during the fiscal year, formal procedures for passing supplemental budgets during the fiscal year.

From top-down budgeting to medium-term expenditure framework

Experience in OECD countries shows that the top-down budgeting system cannot work as expected without an effective medium-term expenditure framework. Most countries that employ top-down budgeting have also adopted MTEFs. The more 'modern' approach to public finance management with which the MTEF approach is associated seeks to structure the budget around broad programmes which are defined along government policy objectives and linked to specific outcomes. An example of a programme might be the 'policy articles' which comprise the Netherlands' budget, with specific articles such as 'Landscapes and Recreation' in the Ministry of Agriculture, Nature and Food Quality's budget. This makes it clearer what a given level of expenditure is intended to deliver and allows accountability to focus more on performance. In return, sector managers are granted more discretion over detailed budget management and empowered to use their greater informational advantage to deliver results.

The MTEF cycle can either be rolling or periodical. Rolling frameworks are drawn up during budget preparation every year or every two years. Year 1 in the previous year's framework becomes the basis for the budget and a new year 3 is added (in case of 3-year frameworks). Thus, an MTEF cycle in a rolling framework will necessarily overlap with the previous and subsequent cycles by one or two years by design. By contrast, a periodical framework has cycles that run in sequence one after another. Specifically, a periodical MTEF is drawn up at the beginning of the period to which it applies and stays effective until that period has elapsed. Both rolling and periodical frameworks may be revised in the middle of their lifetime. The time span of an MTEF may run for two, three, four, or five years, including the upcoming fiscal year. The most commonly used period is three years.

Characteristics of an MTEF

According to the World Bank's *Public Expenditure Management Handbook* (1998), "The MTEF consists of a top-down resource envelope, a bottom-up estimation of the current and medium-term costs of existing policy and, ultimately, the matching of these costs with available resources…in the context of the annual budget process." The "top-down resource envelope" is fundamentally a macroeconomic model that indicates fiscal targets and estimates revenues and expenditures, including government financial obligations and high cost government-wide programmes such as civil service reform. To complement the macroeconomic model, the sectors engage in "bottom-up" reviews that begin by scrutinising sector policies and activities with the aim of optimising intra-sectoral allocations.

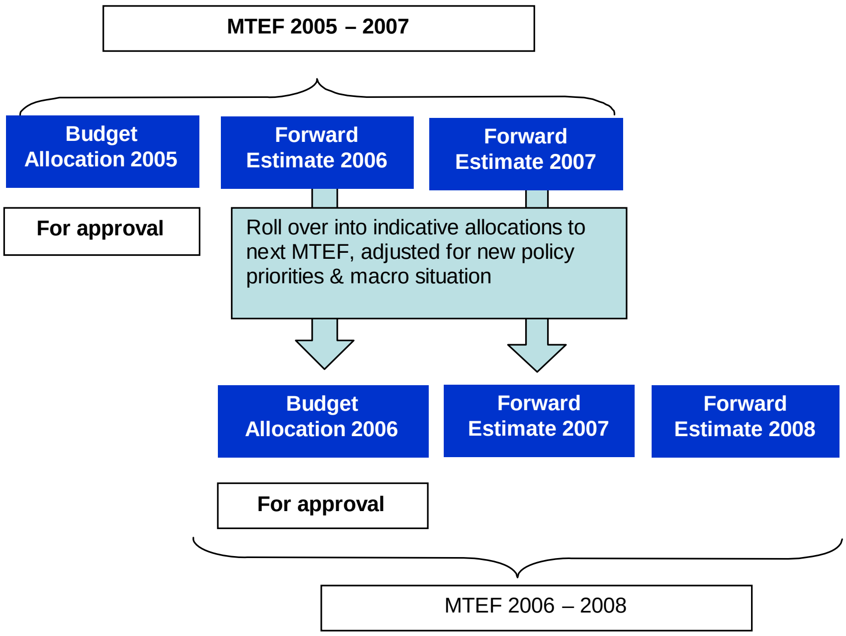
The value added of the MTEF approach comes from integrating the top-down resource envelope with the bottom-up sector programmes. These sector programmes are extensively discussed in the government as a result of which resource allocations by sector are agreed upon. It is at this stage of consensus building and negotiating inter- and intra-sectoral trade-offs (sectoral expenditure frameworks) that the policy making, planning, and budgeting processes are joined. Once the strategic expenditure framework is developed and the sectoral resource allocations defined, these are then used by the sectors to finalise their programmes and budgets. Key to the sectoral review process is the notion that within the broad strategic expenditure framework, which reflects the resource constraint as well as government policy, sectors have autonomy to manage resources to maximise technical outcomes such as efficiency and effectiveness. Once the MTEF has been developed it is rolling in the sense that the first outward year's estimates become the basis for the subsequent year's budget, once changes in economic conditions and policies are taken into account. The integration of the top-down envelope with bottom-up sector programmes occurs by means of a formal decision making process.

As such, the main objectives of the MTEF are:

- Improved macroeconomic balance, especially fiscal discipline;
- Better inter- and intra-sectoral resource allocation through liking policy, planning and budgeting;

- Greater budgetary predictability for line ministries;
- More efficient use of public money through achieving performance and service delivery at least cost;
- Greater credibility of budgetary decision making (political restraint);
- Greater political accountability for public expenditure outcomes through more legitimate decision making processes.

Chart 1: Rolling baselines and MTEF



Source: ODI, Good Practice Guidance Note.

Central to the MTEF concept is the acknowledgement that the budget preparation phase is (and should be) fundamentally **political**, because it is about making real policy choices based on societal preferences and linking them to practical plans and resources. To make real policy choices the political process must be supported by certain **technical** elements, which include:

- a medium-term fiscal framework setting out the aggregates;
- estimates of the future costs of existing policy, and
- sector strategies setting out sector and sub-sector priorities for future spending.

Not all of these technical elements are going to be in place at the start of an MTEF process, but making progress towards them is a critical part of early MTEF development. While setting the medium-term fiscal targets and sector ceilings is usually a responsibility of the Ministries of Finance and/or Economy, estimating the costs of future policies and sector strategies and programmes lies with line ministries. This is the **entry point** for the sectoral ministries in the MTEF process and depending on the quality of the financing strategies and programmes prepared by these ministries, the programme cost estimates could be used as a basis for annual budget allocations, as is done in Australia. As discussed in the next chapter, one of the main problems in aid-receiving is the lack of capacity and expertise to prepare credible programmes and strategies.

The most successful public finance reforms are those that have recognised the interdependence of these objectives. All these come together in the budget. A lesson from a number of African countries (including Uganda and South Africa) is that an MTEF can play a catalytic role in making the public sector more focused on achieving both fiscal discipline and results from government policies and spending. Implementing performance-based budgeting as part of the MTEF process could further strengthen the achievement of such results.

Table 1: Comparison of single year budgeting and MTEF

	Traditional budget (at ministry level)	**MTEF (3-year rolling programme at sector level)**
Aggregate fiscal discipline (To keep expenditure within the means)	Focused on short-term macro-economic concerns (with international agencies providing the discipline in many countries).	Situates short-term macro-economic concerns within a medium-term macro-economic and sector perspective. Involves building domestic macro-economic modelling capacity.
Link between policy, planning and budgeting (Reflecting the government's capacity and willingness to prioritise expenditure programmes)	Very weak because policy choices are made independent of resource realities. Thus, policy is not sustainable and spending patterns may not reflect the priorities articulated by government.	Policy-making tightly disciplined by resource realities. Thus, a much stronger link exists between policy-making, planning and budgeting. Spending reflects the stated priorities of government.
Performance and service delivery (Relating to operational performance of all resources both human and financial)	Incentives for results in terms of outputs and outcomes are generally low because emphasis is on input control. Little attention paid to the predictability of budget funding.	Emphasis is on the delivery of agreed outputs and outcomes with available resources. Incentives are structured to increase the demand for evidence of good performance (accountability of sector managers for results). Consequently, service delivery should improve.
Autonomy of managers	Generally low, because lack of discipline within the traditional budget framework is translated into detailed input controls.	Generally high because of greater discipline in setting and enforcing hard budget constraints plus accountability mechanisms that makes it possible for managers to be given more authority and autonomy to determine how agreed outputs and outcomes should be achieved.

Source: The World Bank and Korea Development Institute (2005).

Experience from OECD countries shows that **the success of the reform process depends on the budgetary basics** such as budget structure, scope and classification, accounting, information, evaluation and auditing. In many developing countries, the budget structure is too complicated, its expenditure classification too subdivided, the coverage of the budget is too limited, excluding some important fiscal activities of the government. Current coverage of the budget is often not consistent with the Government Finance Statistics, an international standard for public expenditure statistics issued by the IMF. Another problem is the lack of well-developed information base and efficient channels to ensure sufficient information flows to facilitate strategic decision-making. Unless, these basics are well established, introducing MTEF may not generate anticipated benefits due to a weak public expenditure management environment[3].

In all countries, a credible annual budget is the cornerstone of a successful MTEF. For medium-term expenditure projections to play a meaningful role in shaping future resource allocation decisions, they have to be rooted in a clear understanding of how much is being spent in the current financial year on a given

[3] Prof. Allen Schick, Look before You Leapfrog, 1998.

activity. In addition, if an MTEF is to be more than a run of numbers in a document, they need to be supported by a set of rules and procedures that lend those numbers credibility. These procedures include an expenditure planning and arbitration process, accountability arrangements, rigorously enforced adjustment mechanisms, and medium-term commitment controls. A strong capable ministry of finance and a strong executive in parliament are crucial to ensuring that these "rules of the game" are both clearly defined and consistently enforced.

Box 2: Key lessons from the OECD countries

Experience of implementing medium term approaches to budgeting in OECD countries has provided a number of important lessons, including:

- The potentially damaging effects of over-optimistic assumptions about future economic growth. OECD experiences point to the importance of conservative estimates for economic growth, revenue and the resource envelope.

- A tendency for line agencies to view the out-year estimates as entitlements. A crucial lesson is to be clear about the status of out-year estimates and their binding nature (subject only to future policy change).

- Bottom-up budgeting alone does not fit well with a medium term approach. OECD countries have gradually moved to a more top-down approach to budget formulation, while agencies continue to prepare estimates within this framework 'bottom-up'.

- Political engagement is key with individual ministers engaging in decisions about allocating the top-down ceiling for their expenditure area, and much greater discipline in the parliamentary approval process.

Source: ODI, Good Practice Guidance Note.

3. MULTI-YEAR BUDGETING IN THE CASE STUDY COUNTRIES

It is important to understand the reasons behind the introduction of a more medium-term perspective to budgeting in any country as they will largely dictate the extent to which it becomes institutionalised. While the circumstances of the introduction of a more medium-term perspective in Australia (mid-1980s), the Netherlands (mid-1990s) and South Africa (mid to late-1990s) vary, they did share a very explicit commitment to aggregate fiscal discipline and were seeking to use the budget to achieve their policy objectives more effectively.

This chapter looks at the experience of the five reviewed countries with implementing the MTEF. Of the five countries, only the Netherlands has a periodical medium-term expenditure framework (prepared every four years), the other countries use rolling MTEFs. All five countries prepare MTEF documents which set out the strategic priorities, fiscal targets, revenue estimates, an estimate of resources available for new spending and the division of revenue between levels of government. Ministries of environment are fully involved in the MTEF process but they are at a different stage of actual integration, ranging from being fully integrated in Australia and the Netherlands, with South Africa and Uganda still struggling to put all elements in place and Armenia – where the Ministry of Environment has been included in the process only recently.

Introducing the case studies

Australia

At a programme policy level, Australia (which launched the MTEF in the mid-1980s) explicitly saw an MTEF as a way to link policy and budgeting much more tightly. Policy was increasingly made within the MTEF/budget context and the medium-term estimates, and their automatic adjustment for policy changes. The Australian experience of over more than 20 years is of particular interest because the MTEF estimates represent the best possible estimate of the cost over the period covered (and, implicitly, in the years that follow) of the current policies of the government[4]. Perhaps the key factors that have supported its ongoing role at the centre of budgeting in Australia are that:

- out-year estimates are, subject to revision for parameter changes, automatically rolled over into the annual budget unless there are policy changes; and
- the MTEF has supported both strategic planning and management and improvements in operational performance at the agency level because of the greater predictability of funding (and policy) over the medium-term.

The Netherlands

The particularly noteworthy feature of the Netherlands' approach to MTEF (launched in the mid-1990s) is that it provides the mechanism, leading up to and after elections, for converting the incoming government's policies into disciplined and costed programmes over the 4-year parliamentary term. This is

[4] One important caveat to this is that the economic parameters (inflation, exchange rate, GDP growth) used for the outer years are projections, based on historical experience, and not estimates. This is one reason why parameter changes can be significant from one year to the next.

known as the Coalition Agreement[5]. The reality is that the fragility of coalitions means that it is in the interest of almost all the players to avoid reopening the big policy (political) issues with each annual budget.

Box 3: Main elements of the Coalition Agreement in the Netherlands

The three key ingredients of the Coalition Agreement are:

- an overview of the general policies that the new government intends to implement, including an overview of the main macroeconomic targets that the government aims to achieve by the end of its term;
- a detailed set of budgetary rules specifying the manner in which the coalition will deal with possible financial shortfalls or windfalls; and
- multi-annual expenditure ceilings in real terms for the three sectors that make up the budget (health care; social security and labour; and core government – the rest).

Source: Van Helden, F. (2008).

While the sectoral ceilings within the aggregate ceiling (based generally on the more conservative of the two economic forecasts provided by the Central Planning Office) reflect policy priorities, the Netherlands approach to MTEF is relatively more financial than policy based compared to Australia. The disciplining role of the financial limits is confirmed by the fact that when there are unexpected expenditures or policy proposals that were not part of the original Coalition Agreement it takes the consent of all ministers and the supporting political parties in Parliament to allow for additional expenditure. All of this means that projected and actual expenditure for the three broad sectors are usually very similar, in real terms.

South Africa

The MTEF was formally introduced in the second half of the 1990s following a period where the focus of budget making was fiscal sustainability. The MTEF was intended to provide a medium-term budget planning framework that would allow government to reconcile its policy of deficit reduction with high expenditure demands, given its transformation agenda. The (political) need to coordinate national and provincial tax and spending policy led to a distinctive feature of the South African MTEF, namely an integrated national/provincial and, more recently, local government MTEF. The annual MTEF decision making cycle is effectively begun with meetings between Finance Ministers of the national and provincial government in the Budget Council and, subsequently, the Budget Forum which sees local government added to the Budget Council. The work of the ministries is guided by annual budget guidelines.

Uganda

The evolution of the MTEF in Uganda (initiated in 1992) has a number of similarities to that of South Africa, at least in the sense that it has been a step-by-step process, beginning with a focus on disciplining the fiscal aggregates, then moving to introduce a more strategic focus to resource allocation and now focusing on linking resources to results. It is interesting to note that a 2003 study[6], which included a case study of the Ugandan MTEF, suggested that this step-by-step approach might have been overdone and that

[5] The Netherlands electoral system inevitably produces coalition governments.

[6] Holmes, M. and Evans, A. (2003).

operational performance (the link between resources and results) could have received earlier attention[7]. The current case notes that it will only be in the 2008/09 MTEF/budget cycle that there will be 'an attempt to link resource allocation to outputs and outcomes in various sectors'.

There are a number of path breaking approaches to resource allocation decision making that have reinforced, and that have been reinforced by, the MTEF. The first of these is the Poverty Eradication Action Plan (PEAP), which was the model for PRSPs. The PEAP is the basis for all planning related to the MTEF and guides the setting of priorities for the annual budget process. It is reviewed annually, involving very broad based consultation. For the annual budget, Cabinet translates this broad based consensus into guidance on priorities. Sectors then prepare sector budget framework papers (BFPs), which are also informed by sector strategic plans and any new policy decisions by government. This leads into the second path breaking approach, namely the creation of Sector Working Groups (SWGs).

Box 4: Sector Working Groups in Uganda

Each Sector Working Group consists not only of relevant officials of the respective agency but also donor, civil society and private sector representatives. This group is responsible for preparing the sector budget request, including new policy proposals, in the form of a sector budget framework paper. In addition to donors being members of SWGs, they also participate actively in the annual Public Expenditure Review process (managed by the Government, not donors) that culminates in a national budget framework paper that is presented to the Parliament. This close interaction has led donors to gradually shift towards budget support and away from projects.

Source: Ruhweza, A. and Bagabo, P. (2008).

Armenia

The MTEF in Armenia is the youngest of the five cases (2003 was the first year). Not surprisingly, it has the furthest to go in institutionalising the MTEF as the way medium-term budgeting is done. In 2003, when the MTEF was introduced as a 'whole-of-government' approach, one of its key objectives was the integration of top-down and bottom-up planning processes.

Until now, the emphasis in the approach to the MTEF has been on financial controls at the aggregate and state budget agencies level. The challenge will be to develop and then tighten the policy/MTEF/budget links. A number of the building blocks are in place, notably the fact that the Prime Minister chairs the MTEF Steering Committee, the key decision making body for the budget. Aspects of the Ugandan approach, particularly around sector and donor coordination, may well have an appeal. With DFID support, Armenia has piloted programme budgeting which is intended, among others, to improve coordination across agencies around programmes including by highlighting the links between resources and results.

MTEF structure and coverage

The main elements of an MTEF are: **duration, comprehensiveness, levels of government covered, and, the structure of the MTEF estimates**. At the most basic level, the MTEF estimates for the case study countries cover the budget year plus two (Australia, South Africa, Uganda, Armenia) or three (the

[7] In making this point it is acknowledged that as early as the mid-1990s Uganda was undertaking innovative measures to improve operational performance. Perhaps the most notable of these was the expenditure tracking survey that led to a dramatic improvement in the flow, particularly, of budgeted resources to schools.

Netherlands) years[8]. This is a reasonably standard practice. Australia, the Netherlands and South Africa have quite explicit medium-term fiscal targets. To the extent that Armenia and Uganda have a medium-term perspective to fiscal policy, any medium-term targets have limited credibility. The role of donor funding in either supporting or undermining a medium-term perspective to fiscal policy needs more detailed analysis but the evidence from the cases suggests that of undermining due to the unpredictability of donor flows.

In Australia and the Netherlands, the coverage of fiscal activities is **comprehensive** in both the annual budget and the MTEF. The most obvious common factor in reducing comprehensiveness is the extent to which donor funding is not on budget. While this is not so important in South Africa, where external financing is less than two percent of domestic revenue, it becomes increasingly so in Armenia and Uganda. In South Africa, it is noted that even where external funding is included in budget figuring (usually through the Reconstruction Development Fund), it is not integrated 'in any real sense … into budget planning, execution and reporting'. This must be a much greater challenge in Armenia and Uganda. In the case of the environment sector in Armenia, it is noteworthy that over 60 per cent of expenditure is financed by donors. In terms of domestically financed expenditure, South Africa and Uganda have comprehensive coverage and Armenia is expecting to reduce its off budget expenditure to less than 5 per cent. As noted in the chapter on the environment sector, significant environmental expenditure is off budget in Armenia.

In terms of the **levels of government**, the general practice is that the MTEF applies to the national level of government. In Australia, with its federal system of government, each of the States has its own MTEF. It is standard practice that payments to other levels of government are included in the national MTEF. In the case of Uganda, the only programmatic detail included in the out-years of the MTEF are local government conditional grants. South Africa, as noted elsewhere, is a genuine outlier in that it has a single MTEF process embracing national, provincial and local government. This is very much a product of its recent history. A recent study[9] has highlighted that where more than one level of government is involved in the MTEF, it requires proper coordination when setting targets so that all players 'own' them. In South Africa, there is also an agreement on key policy priorities. It is arguable that it works in South Africa because of the particular political circumstances following the dismantling of apartheid. Armenia's MTEF does cover both national and regional/local government but it seems probable that the MTEF is, in fact, a creature of the national level.

The structure of the MTEF estimates is more difficult to summarise. This is because of the different roles/meanings of the MTEF estimates which also reflects different stages in moving towards more performance based budgeting systems and associated rules around virement[10]. The former is discussed in some detail in the next sub-section and the latter in a later section on performance based budgeting. The structures range from the Australian case where the outputs and outcomes presentation is the same for the MTEF out-years as it is for the annual budget, through South Africa where the structure is the same although the output/outcome framework is much less developed, to Armenia where the out-years are much less detailed than the annual budget (and where performance based budgeting is only now being piloted).

[8] It should be noted that Uganda intends, beginning in 2008/09, to extend coverage of the MTEF to five years in line with the time frame of the newly introduced National Development Plan.

[9] Holmes and Evans, 2003.

[10] Virement is the transfer of expenditure provision from one line item to another during the budget year.

Table 2: Main MTEF elements of the reviewed countries

Country	Coverage				Level of detail	Time horizon	Discipline	
	National government	Debt interest	Local government	% of public spending			Rolling or fixed	Frequency of revision
Netherlands	yes	no	some	80%	4 sectors 13 ministries	4 years	4 fixed	Every four years
Australia	yes	yes	yes	100%	27 Departments 267 progammes	3 years	Rolling	Every year
Uganda	yes	yes	Yes (local government conditional grants)	100%	16 sectors 162 programmes	3 to 5 years	Rolling	Every year
Armenia	yes	yes	yes	95%	16 sectors	3 years	Rolling	Every year
South Africa	Yes (+provincial)	yes	yes	100%	37 sectors	3 years	Rolling	Every year

What does the MTEF represent?

The key question, really, is do the out-year estimates mean anything (a question asked later is do the annual budget figures mean anything?[11])? The answer depends crucially on whether the MTEF is fully integrated with the annual budget. The South African case captures this most dramatically when it states that the MTEF consists of one year of spending allocations (i.e. the annual budget) and two outer years of projections. The MTEF process is the budget process. All the evidence indicates that where the MTEF is not tightly linked with the annual budget or is not being developed to make the link tight, having out-year estimates is probably a waste of time. The out-year estimates and the annual budget are so tightly linked that, should the government wish, the first out-year could be automatically rolled over into the annual budget and, appropriately adjusted for economic parameter changes presented to the parliament for appropriation.

This is important in this context because whether or not the environment is a political priority of government, credible out-year estimates are perhaps the biggest contribution the budget can make to creating an incentive for the environment sector, along with all other sectors, to engage in strategic planning and management. While credibility in funding terms is a significant step forward, it is when this is combined with clarity on the underpinning policy and greater policy certainty that the real pay off from an MTEF begins to emerge.

The Australian, Dutch and South Africa cases illustrate some of the range of meanings of the out-years, but they all share two of the essential ingredients of a fully functioning MTEF:

- the first out-year of the MTEF estimates is the starting point for the next year's annual budget process;
- they have strong policy underpinnings.

[11] This is not *a priori* question, as most seem to believe, as the introduction of an MTEF has been shown to increase the demand for an improvement in budget execution.

Despite the progress made in Armenia and Uganda, these two essential ingredients are undeveloped there. This is of particular significance where the environment is not necessarily a high priority. Experience in a range of developing countries is that where there are discontinuities between the annual budget and the MTEF there is greater arbitrariness in resource allocation decisions and it is lower priority sectors that suffer particularly. Such arbitrariness is multiplied where policy is not underpinning the estimates. This is not to suggest that a country should expect to see these ingredients pop up, fully formed, with the introduction of an MTEF. Nor is it to suggest that an MTEF should not be implemented in a country where the elements for these ingredients are in short supply. What it does mean is that if an MTEF is going to be worth the effort, considerable attention needs to be given to moving in these directions.

In the Netherlands, there is more of a funding approach to the MTEF. This tends to be cascaded down from the firm aggregate expenditure commitment over the four years of the parliamentary term, and set out in the Coalition Agreement, to the three sectors, where the aggregates are again quite firm. While the MTEF determined in the context of the Coalition Agreement is very much underpinned by policy priorities, the estimates at the ministry level have a strong flavour of funding predictability. There is substantial renegotiation in the annual budget context at the Cabinet level, and between Finance and individual ministries, of allocations within MTEF ceilings. This is very much around policy priorities, however. It is noteworthy that key issues discussed at the annual Cabinet meeting that sets the budgetary framework for the following year are the possible need for transfers between the three sectors due to cost overruns or surpluses and the distribution of windfalls or shortfalls. This is in contrast to Australia where any such overruns or surpluses are simply reflected in the revised out-year estimates.

The out-year expenditure estimates in the case of South Africa represent an indicative allocation of funds to a department/agency/programme. As the case study notes, in principle, these estimates represent the forward cost of existing policies prior to the allocations of the new budget year plus allocations for new spending proposals that are being funded. It is noteworthy, however, that Treasury does not allocate to programmes but to departments. This indicates that out-year estimates have somewhat more of a predictable funding basis than predictable policy base.

Despite the variations, the key points to note here with regard to the above three case studies are:

- the financial discipline in all three;
- the importance of predictability, whether largely funding or largely policy, to support strategic planning and management at the entity level; and,
- the symbiotic relationship between policy and the MTEF process.

As emphasised in the South African case, the determination of the MTEF allocations is very much an iterative process between the top-down and bottom-up. One powerful point characterising a functioning MTEF that is captured above is that the aggregate resource constraint should not only be signalled at the outset of the annual budget process but that this should be part of medium-term fiscal targets consistent with fiscal sustainability. This is a key framework (top-down) issue. The other key framework (top-down) issue is the existence of a set of policy priorities and processes for revisiting those each year at the outset of the annual budget process (even in the Netherlands where the Coalition Agreement is designed to minimise the reopening of budget allocations and policy priorities annually). Iterative decision making within the budget context, informed and disciplined by the resource constraint and the priorities of government, is at the heart of the MTEF. The bottom up process enriches the consideration of policy priorities and provides analysis of what is working and what is not.

Policy/MTEF/budget interaction

There are two particularly important reasons why having policy determined within the MTEF is significant:

1. Policy making is disciplined by the resource reality and the best ideas, underpinned by quality analysis, should win out in the competition for funding. The contrast between the situation where policy is made on an *ad hoc* basis throughout the year, with the consequent undermining of sound budgeting, and this disciplined approach is stark. The reality is that under *ad hoc* policy making every policy proposal seems a good idea. Force all these proposals to compete, within the resource constraint, then priority, high quality proposals are more likely to win out.

2. An orderly, disciplined process that engages all the key players in a debate on priorities is much more likely to lead to the agreed policies being implemented. This is linked to the argument that budget implementation will suffer where budget preparation has not engaged all the key decision makers in reaching consensus on priorities and associated resource allocations[12].

In Australia, in recent years the annual MTEF/budget cycle began in September with Cabinet agreeing on the process and requesting Ministers to write to the Prime Minister with any proposals for new spending. Interestingly however, during the past years these new proposals have not been subjected to the same rigorous MTEF process and an increasing number of high priority policy decisions have been made outside the MTEF/budget context. After 10 years of growing budget surpluses it is unsurprising that budget discipline broke down. A reflection of the growing priority of the environment is that one of the costliest of these decisions related to water.

In the Netherlands, the MTEF translates the policy agenda of an incoming coalition government into a four year MTEF. Top-down, in each subsequent annual budget, the policy priorities agreed to in the Coalition Agreement drive the allocation of resources. As noted above, any policy proposal that was not part of the original Agreement requires the consent of all Ministers and support of the coalition partners in Parliament. While the Coalition Agreement provides a disciplined framework within which policy decisions are made throughout the next four year term of the Parliament, much of the detail of policy is left to individual ministers. There is also considerable room for reallocation between and within ministries as the estimates that are firmest are the aggregate and, to a lesser extent, the allocations (in real terms) to the three broad sectors (health, social security, core government). The actual process of decision making in the annual budget context has many similarities with the approach in Australia. The budgetary framework for the following year is determined by Cabinet and, in contrast to Australia, this includes explicit sectoral and ministerial expenditure caps. While the policy agenda set out in the Coalition Agreement is always there, there is a sense, as previously noted, that the financial constraint commitments are even more binding.

Despite its own unique features, the basic characteristics of policy making within the MTEF/budget context in South Africa are very similar to those of Australia and the Netherlands. Since 2004, when the most recent elections took place, a medium-term strategic framework (MTSF) has been introduced as a vehicle for defining the strategic objectives and targets for the parliamentary term (2005-09). This is a Presidency/Cabinet document. It does not contain policies, rather it establishes priorities which will drive policy making in the subsequent annual MTEF/budget contexts. The MTSF informs the five year strategic plans that national and provincial departments table alongside their budgets. Within the framework of the MTSF, new policies are developed mostly at the departmental level and submitted as part of the annual MTEF/budget process to compete for the available fiscal space[13].

It is interesting to note the role of off-setting savings in the allocation and reallocation process. Generally speaking, a requirement to find off-setting savings is preferred to regular reviews of the base as a way to identify savings. There are formal rules and requirements with regard to off-setting savings in all 5

[12] This is not to suggest that a sound policy formulation process guarantees effective implementation.

[13] Fiscal space is most commonly understood to mean the ‘room in a government’s budget that allows it to provide resources for a desired purpose without jeopardising the sustainability of its financial position or the stability of the economy’ (for more information see Annex VIII).

countries. In the case of the Netherlands, this requirement is captured in the rules of budgeting set out in the Coalition Agreement at the outset of each parliamentary term. In the case of South Africa, the base has been relatively untouched with new policy funding being confined to the available fiscal space. When the fiscal situation of the late 1990s did require reductions in the base this was done largely across the board, but with some protection of priority areas. In Australia, the rules on off-setting savings are established at the outset of each budget cycle. It is apparent that lower priority sectors will be expected to offset a higher proportion of any new spending proposals than will high priority sectors. Taking a 20 year view of the MTEF in Australia, it is notable that the reallocations within sectors have been even more significant than between sectors.

The off-setting savings route represents in many respects the easy way out for Cabinet. It avoids having to confront difficult policy review processes. Off-setting savings have not been employed in Armenia. Policy appears to be made largely outside the MTEF/budget context and it is then the task of the MTEF Steering Committee, chaired by the Prime Minister and including senior Ministers and officials, to allocate the available fiscal space to the agreed policies. The use of Sector Working Groups in Uganda to develop budget proposals has been a powerful tool for debating sector policy. Implicit in this approach is a form of off-setting savings. Uganda is a notable example where re-allocations within the MTEF/budget framework favouring environment have been made. The experience of some other countries in Africa shows that strategic re-allocation of resources under MTEF is still possible even in less mature medium-term budgeting systems.

Generally speaking, the policy/MTEF/budget link has been tight in the Netherlands, South Africa and Australia (in the latter this has broken down somewhat in recent years due to years of surpluses). Considering the importance of donor funding, the extent to which policy has been made inside the MTEF/budget context has been quite impressive in Uganda. In Armenia, there would appear to be a case for strengthening the policy/MTEF link further. In all countries, there is a suspicion that there is a need for policies, programmes and activities in the base to be subject to more rigorous review.

Setting aggregate limits and broad allocations

In all case countries, the setting of aggregate limits follows quite intensive macroeconomic analysis. In the Netherlands, medium-term fiscal targets are set out in the Coalition Agreement and these, together with the more conservative of the two economic forecasts prepared by the Central Planning Office, dictate the overall limit. In Australia, the Budget Honesty Act requires that the budget be balanced over the business cycle. In recent years, there has been a more explicit commitment to run a surplus of 1 per cent of GDP. As in the Netherlands, the overall constraint is derived from this commitment and the Treasury’s economic forecasts. It is relevant to note that in many respects the greatest impetus to the institutionalisation of the MTEF in the 1980s was the commitment of government that aggregate expenditure would be maintained at the same real level for the life of the next parliament (1987-1990) – this was a very explicit aggregate limit.

In South Africa, the commitment to and focus on fiscal discipline has been very strong. Fiscal policy targets have included reducing the tax burden, reducing general government dissaving and reducing public debt as a proportion of GDP. At the outset of the annual MTEF/budget process updated macro forecasts for the medium-term are used to reset the key fiscal targets. This produces an aggregate resource constraint within which the process of resource allocation begins. A key point in the case of South Africa, as in the Netherlands and Australia, is that fiscal targets are set in advance of any expenditure bids. Both Armenia and Uganda are moving towards this approach, but with the uncertainties that inevitably surround donor flows complicating the setting of hard aggregate limits.

Again, for all case countries, the focus of resource allocation is on the distribution of the available fiscal space. There is a bias towards basing this on individual policies rather than using ceilings to signal priorities. Australia basically does not use a ceiling approach at all as allocations are underpinned by the forward estimate of the cost of existing policy. South Africa is somewhat similar in that the baseline (forward) estimate underpins broad allocations.

Resource reallocation together with ensuring fiscal discipline are among the major MTEF objectives. While ensuring fiscal discipline is the main concern of ministries of finance, it is difficult to say, based on information from the survey alone, to what extent the introduction of the MTEF in these countries has contributed to improved macroeconomic balance. Available statistics shows that in Armenia which has experienced strong economic growth over the past years the fiscal deficit has been falling from the pre-MTEF period – from about 5% of GDP in 1999 to 1% in 2005 and 0.3% in 2006. Similarly, South Africa - has moved from a pre-MTEF budget deficit of about 5.2% of GDP to about 0.4% and 0.9% in 2005-2006. In Uganda, despite strong economic growth and the continued reduction of its fiscal deficit from 4.6% in 2005 to 4% of GDP in 2006 against its pre-MTEF ratio of 6.4% of GDP. The Netherlands case study states that introducing multi-year budgeting has helped contain fiscal deficit although it has been fluctuating over the past years. Australia has actually seen surpluses over the past 10 years. While there is no single straightforward relation between the existence of the MTEF and the level of fiscal deficit, as there are a number of casual factors that affect the level of fiscal deficit, such as unforeseen macroeconomic shocks, adjustments, or fluctuations in debt payments, it seems that in all five countries the introduction of MTEF has had some positive effect on disciplining fiscal deficit.

Performance based budgeting

All case countries have moved to, or are moving towards, some form of performance based budgeting. It is apparent that an MTEF, with its emphasis on policy, must eventually be supported by some form of performance based budgeting. The translation of policy priorities into results on the ground for citizens requires that the budget structure be supportive of a more programmatic approach. At the same time, it is important that budget structures should not be so restrictive that they limit the ability of agencies to deploy the administrative resources available to them to maximise efficiency and effectiveness. Australia has one of the most sophisticated performance based budget systems but the case study highlights that this is no guarantee of clear and unequivocal measures of cost effectiveness.

A gradual process of bringing like expenditures (in a policy sense) together, developing policy and programme objectives and associated performance indicators and targets, and beginning to establish monitoring and evaluation systems has much to commend it. If nothing else, such steps will begin to make budgets more transparent.

All the cases point to monitoring and evaluation being the weak links in the chain. Experience over many years now has highlighted that there is rarely a direct link between particular indicators or results and resource allocation. This appears to have contributed to the often substantial efforts to create the front end of a performance budgeting system not being matched by the back end monitoring, evaluation and reporting of performance systems. These latter elements must be seen as essential parts of the process of understanding what works and what does not. Over time, they will enrich the analytical base which should support decisions not only on the allocation of the available fiscal space but also on the reallocation within the existing base from poorly performing programmes and activities to higher impact activities.

The MTEF and budget credibility

As previously indicated, an elaborate budget formulation process, supported by an MTEF, but not followed up by sound budget execution will quickly undermine the MTEF. There is enough evidence that an MTEF, by helping to bring policy priorities back into the budget debate, can be a catalyst for improvements in budget execution. The key point to highlight here is that the major problems with budget execution tend not to be technical but rather flow from *ad hoc* policy making, outside the budget context. It is for this reason that so much attention is given in this chapter to the policy/MTEF/budget link.

The cases highlight an area of significant improvement in budget practices, namely the increasing use of conservative revenue estimates to underpin the calculation of the available fiscal space. This has meant that agencies can plan with greater certainty on the basis that the resources budgeted will in fact be available to them. The major exception is donor funding. This is stark in the case of Armenia, where significant shortfalls in donor funding in the environment sector meant that in 2004 and 2005 spending on some areas was less than 50 percent of the budgeted amount. It is suggested that most of the fault lies on the Armenian side but the question must be asked why donors programme such levels of expenditure when capacity constraints, broadly defined, are so great. But it poses the question about the quality of budgeting processes in donor countries as well. Unlike Armenia, Uganda has extended its conservative approach to estimating domestic revenue to encompass donor funding. It bases the estimates incorporated in the budget on previous releases rather than on promises. This has led to surprisingly accurate estimates.

While unpredictability of funding (up or down) is not symmetrical in terms of its impact, the reality is that the provision of additional funds to agencies during the year because of higher than estimated revenue can also be a source of inefficiency. The rules for managing ‘windfalls’ set out in the Coalition Agreement in the Netherlands have much to commend them in this regard. A better revenue performance does not automatically translate into higher expenditure but is used for agreed purposes, such as reductions in the deficit and public debt or tax relief. As a minimum, any expenditure increases should be consistent with priorities and agency strategic plans or represent one off payments, such as reducing arrears.

Major lessons learnt

All the five case studies have adopted comprehensive MTEFs. While by introducing the MTEF governments sought to achieve similar objectives, the actual implementation and MTEF specifics, defined by the country governance tradition, vary. There is no “one size fits all” model. In this context, the major lessons learnt from the case studies are:

- To be successful and credible, the MTEF and the annual budget should be the same thing. They should be prepared at the same time and as part of one and the same process. If prepared separately, the MTEF risks remaining a technical exercise without any link to policy formulation and budgets. If the MTEF is not tightly linked with the annual budget or is not being developed to make the link tight, having out-year estimates is probably a waste of time.

- Introducing MTEF is not a one-shot exercise. Institutionalising MTEF is an on-going process. High level political commitment is crucial for internalising MTEF by regular staff in ministries.

- MTEF is a complex process. Hence the sequence of reforms matters. It seems that a step-by-step approach might be more appropriate for countries where the budgetary basics are not in place (such as: clear budget structure, scope and classification, accounting, information, evaluation and auditing systems). Unless, these basics are firmly established, introducing MTEF may not generate anticipated benefits due to a generally weak public expenditure management environment.

- Allocations based on programmes rather than by departments or economic classification better promote the policy/planning/budget link and encourage deepening this link. Introducing performance indicators in programmes has lead to a gradual shift towards performance-based budgeting. However, unless there is a real demand by politicians and society for performance indicators, particularly in the budgetary process, and unless a strong system is in place to monitor these indicators, engaging in such a reform may be an end in itself.

- Experience from the reviewed countries shows that due to the MTEF the budget process has become more-policy oriented and more credible. There is some evidence that introducing an MTEF has helped strengthen fiscal discipline and has brought about greater budgetary predictability for line ministries, in general.

4. PUBLIC FUNDING FOR THE ENVIRONMENT THROUGH MULTI-YEAR FRAMEWORKS

This chapter addresses the particular challenges facing the financing of public environmental actions within the MTEF/budget process. The environment is substantially different from most other sectors in that it is strongly cross-sectoral in nature. This raises a number of issues that are less prominent in other parts of the government administration:

- First, coordination is critical for success. In many countries, environmental ministries are not spending agencies and most of the public environmental investment expenditure is done in other ministries and agencies. For this reason, the way environment sector strategies are developed must take into account the need for a strong cooperative approach.

- Second, targets and accountabilities are harder to define as many actors contribute to a given output or environmental outcome. Indicators often lack hard, quantifiable targets for performance measurement.

- Third, the accurate costing of environmental programmes can be hampered by the many actors involved, as well as the long-term nature of some environmental programmes and the lack of reliable data.

- Fourth, in aid-receiving countries where ministries of the environment find difficulty in addressing their core monitoring and regulatory roles, their attention is often diverted from the national budget by the many funding streams of donor projects. It is however important to recognise that both the Paris Declaration and the Accra Agenda for Action promote demand-driven aid aligned with country systems which ostensibly means the progressive shift to direct and sector budget support.

- Fifth, in many developing countries environment is not a top priority. Social sector spending is the focus of national poverty reduction strategies and this had led to a squeeze on international development assistance for environmental themes. In addition, at times of budget deficit, the environment sector is often among the first ones to suffer budget cuts.

Each of these challenges is now reviewed, based on the experience recorded in each of the case study countries.

Sectoral strategies and programmes and expenditure frameworks

Development of sector strategies and programmes (including agreeing on objectives, outputs and targets as well as costing of programmes and sub-programmes) is the key entry point for the environmental ministries in the MTEF process. The quality of these programmes will determine to a great extent the resource allocations that will be assigned to the sector (the overall expenditure framework) by the government. Based on these allocations, the environment and other sectoral ministries then need to translate the sectoral programmes into annual plans and budgets.

Sector strategies and expenditure frameworks are being strengthened in an effort to produce coherent and responsive public actions on the environment. One aspect of this strengthening is the introduction of a medium-term planning horizon. Sector strategies clearly need to relate to national policy initiatives, which are expressed in a number of ways. In all reviewed countries, in preparing their mid-term budgets, sectoral ministries are required to clearly identify their missions, objectives and how these fit into and support the overall government priorities. The government’s election manifesto is one major source of policy intent, and this is supplemented by a range of in-term policy documents and pronouncements. In both Australia and the Netherlands election promises are legally obliged to be costed and made public before each general election. This is a good practice that can be broadly recommended to aid-receiving countries. At its most developed, there is a strong linkage between policy goals, strategic planning and medium-term and annual budgeting. These linkages are often less developed in non-OECD countries.

Box 5: Costing of electoral promises in the Netherlands

In the Netherlands, the promises made by the politicians in the manifesto are the basis for the assessment of the government at the end of its 4-year term. As such, the Dutch politicians are very careful in preparing their election programmes. The Dutch political parties use technocrats and economic research institutes to prepare macro-economic projections and cost the major electoral programmes they propose. The aggregate results are published before the elections. The Dutch Environmental Assessment Agency also reviews the environmental programmes of political parties prior to elections, thus to a certain extent mirroring the work of the Bureau of Economic Policy that conducts analysis on the state of the economy. Such a situation gives a great deal of credibility of the MTEF process as it is fully supported by the politicians and is then internalised by the sectoral ministries. There are some similarities in Australia where, under the Budget Honesty Act, the Treasury and Finance are required to make public the costings of the election promises of the government and opposition before the election.

Source: Van Helden, F. (2008).

All five countries prepare strategic plans for the environmental sector. Due to the cross-sectoral nature of environmental management, these sectoral plans are developed by different ministries and agencies with responsibilities for environmental management. In most cases, however, these sectoral plans are not supported by dedicated budgets. Environmental policy papers in the Netherlands have a different purpose, namely to determine political priorities and strategies. New policy initiatives may lead to a reconfiguration of operational spending within the overall government and departmental spending ceilings or new allocations from the available fiscal surplus. Similarly, in Australia, the corporate and strategic plans do not include costed programmes as these are represented by the forward estimates that are published with the annual budget. This situation in Australia shows a certain divergence between strategic planning and the multi-year forward estimates. Strategic plans, like in the Netherlands, are mostly prepared to identify strategic priorities but are less significant as a planning financial tool. In South Africa, the development of all policies has to take into account the cost of implementing the policy and the medium-term framework. Major new policy initiatives are less disciplined than policies developed through the routine strategic and operational planning processes. However, resource constraints do enter as a check on realism even with these major policies.

In Uganda, strategic environmental sector plans contain detailed programmes to be undertaken by the sector during a set period of time. These sector plans contain full work plans outlining the specific tasks to be accomplished, the costs or resource requirements for accomplishing the tasks and the time frame within which the tasks are to be accomplished. Yet these appear to remain largely planning documents with limited linkages to the budget.

In Armenia, there is a lack of an integrated strategic planning process and the development and updating of sector strategic plans are not yet well established. Sub-sector policies, strategies and programmes are developed for medium to longer-term periods, but are usually not costed and do not include medium-term expenditure scenarios. The development of such strategic plans raises the issue of the quality of the medium-term expenditure estimates made available as part of the MTEF and subsequently of the annual budgets approved by the legislature.

The anecdotal evidence from Armenia suggests that the time spent by the ministry of environment staff to prepare their three-year programme expenditure estimates is between three days and a week. Ministry staff are aware of these limitations but they could not do any better given the limited human resources they have available. They are currently pooling resources to outsource this function to a specialised consultancy which will be working under the supervision of the ministry.

The experience of Armenia and Uganda shows that sectoral environmental strategies and programmes, where they exist are usually prepared without much consideration for the actual costs and budgetary implications of planned policies. There is usually an abundance of policy and strategic documents but these often remain on paper only. However, it is a good practice that all these policy and strategic documents are published and made available to the public at large. This is a first necessary step towards improving transparency and laying the basis for accountability. In addition, in many developing countries such strategies are often prepared mainly as a result of the push by donors and international financing institutions where aid-receiving countries hope that the mere production of such papers will bring about much needed external funds. Such an approach does not create a sense of ownership and is counter-productive. It can lead to frustration and cynicism among developing countries' partners.

Due to the explicit sector expenditure framework, in both Australia and the Netherlands, the sectoral planning process is supported by and based on specific programmes. These environmental programmes contain clear targets (in terms of both outputs and outcomes) and are costed in detail. The financial outlays are closely linked to the achievement of policy goals through selected policy interventions. All programmes are costed and, outputs are then 'priced'. Detailed guidance is provided by the ministry of finance on both costing and pricing. This raises the possibility of placing an economic value on differing environmental outcomes.

There exist different models for calculating the financial implications of environmental strategies and programmes. One such computerised decision support tool, FEASIBLE, helps develop financing strategies for selected environmentally-related sectors involving costly public infrastructure. This tool enables the modelling and calculation of the costs of a policy at a sector level and develops scenarios for closing the financial gaps. The FEASIBLE model has been developed as part of the work of the OECD Environment Directorate with non-member countries. The model has been widely applied in the water supply and sanitation sector and the solid waste management sector in a number of former Soviet Union republics. Most recently, its application has been launched in some countries in Africa (Egypt, Lesotho).

Box 6: Financing strategies for water and environmental infrastructure – the *FEASIBLE* Model

The basic approach underlying the FEASIBLE method is to collect detailed technical data on the existing state of infrastructure, select public policy targets in areas like water supply and sanitation, determine costs and timetables for achieving them, and compare the schedule and volume of expenditure needs with available sources of finance. This analysis generally reveals financial deficits which would likely arise during the planned implementation. FEASIBLE can then develop various scenarios to determine how the gaps might be closed. This could involve identifying measures to help achieve the targets at lower cost; identifying ways to mobilise additional finance; adjusting the ambition level of the targets; or rescheduling tasks and targets.

An important feature of FEASIBLE is the emphasis on realism and affordability. The model can assess the levels of finance (public, private, domestic, foreign) that might be available under different macro-economic and fiscal conditions. In this way, it provides a check on what public budgets might realistically be expected to contribute. It can also help to assess the potential social implications of increasing tariffs by determining the impacts of such price increases on household income. It helps to systematically review the obstacles that would need to be removed in order to mobilise private sector and foreign financing for environmental infrastructure. Thus FEASIBLE can support a process of dialogue and consensus building among stakeholders and build bridges between policy development and implementation.

The assumption underlying the FEASIBLE methodology is that governments should not be expected to finance all or even most of the environmental expenditure required, or support all or even most projects. The main role of government in relation to financing is to establish the policy, regulatory and institutional framework as well as the incentive structure, within which resources from users, financial markets, capital markets, local budgets and enterprises can be mobilised in a complementary way, and be applied as cost-effectively as possible to achieve agreed goals.

Source: OECD (2003).

Recently, OECD worked with the Armenian government (Ministry of Territorial Development and State Committee of Water System) to prepare a comprehensive financing strategy for the urban and rural water sector. This is one of the few examples where Armenia has made progress in financial sector planning. However, the financing strategy still remains to be translated into actual budgetary spending. The existence of strategic plans is essential but it should not be an end in itself. Hence, the importance of the implementation phase.

This programmatic approach provides a means to link resources with intended results. Both OECD country case studies show that well-designed and costed environmental programmes stand a better chance of obtaining the resources requested. Even when there is a need for budget cuts, such programmes will suffer less damage. If found credible and well-justified, environmental agencies may even receive additional resources for high profile (and particularly new) policy priorities. As the two OECD country case studies testify, the long-term nature of some environmental (particularly environmental infrastructure investment) policies clearly benefits from the stability created by the medium-term expenditure framework and the government commitments to stick to the financial ceilings allocated to the sector. The two case studies also show that as the environment has risen as a priority on the political agenda generally more resources are made available for environmental actions and programmes. At the same time, environmental expenditure in these countries as any other expenditure is subject to the discipline imposed by the MTEF, including offsetting savings. This means that targets and resource availability are constantly monitored and reviewed.

Box 7. Essential elements of the expenditure (investment) programme

At a minimum, each public expenditure programme should have:

- Clearly defined objectives and priorities – these objectives should be specific, measurable, realistic and time-bound and priorities should be few and unambiguous;
- Clearly defined timeframe of the programme;
- Specified cost estimates of achieving the objectives;
- Specified sources of financing;
- Specified eligible project types;
- Specified eligible beneficiaries;
- Clearly defined terms of financing, including among others, financial instruments (eligible form of subsidy), co-financing requirements, maximum/minimum level of support;
- Well-documented principles, rules, and operating procedures for project cycle management;
- Clearly-defined and robust criteria for appraisal, selection, and financing of investment projects;
- Clearly-defined procurement rules;
- Selection of the best institutional arrangement to manage the expenditure programme, equipped with sufficient resources to meet its objectives, qualified staff and instruments to implement the programme;
- Performance indicators for the institution managing the expenditure programme.

Source: OECD (2007a).

Institutional capacity and coordination across the government

While the environmental policies prepared by the different agencies in Uganda and Armenia have become more consistent over the years and have been mainstreamed in related sectors, such as agriculture, energy, forestry, water infrastructure systems, the capacity for strategic planning and budget preparation in the environmental sector are still very weak. One of the main reasons is the poor capacity of environmental staff in all these ministries to cost environmental programmes. There is a shortage of valuation studies that can justify the programmes in economic terms and make them more meaningful for the ministries of finance and government as a whole.

This does not mean that environmental agencies' staff should always do the costing themselves, as this can be a very time-consuming exercise. But at a minimum, they need to be able to prepare relevant "Terms of Reference" for such studies and be capable of understanding, interpreting and communicating the results coming out of them. Another Task Team project can provide a useful background to the various economic valuation techniques and approaches that exist for making the economic case for improved management of environment and natural resources in the context of national planning processes[14].

Even where such studies exist they will necessarily need to use data produced domestically. The quality of these data, including of environmental expenditure, are often poor and unreliable and may undermine the quality and the findings of the studies. Strengthening the data information systems in these countries is of paramount importance if such studies are to be used to inform the strategic planning and budgeting process.

In addition, this situation is further aggravated by the poor coordination between environmental authorities at different government levels. For example, in Armenia, there have been cases when decisions

[14] Greening Development Planning - a review of country case studies for making the economic case for improved management of environment and natural resources.

made by government in other sectors have appeared to be in conflict with established environmental priorities, reflecting a general concern about the level of cross-sectoral coordination of activities relating to environmental protection. Coordination is, in many cases, particularly weak between the central government and communities. Often, the central government does not have adequate information on projects implemented at local government level.

Certain characteristics of how environmental issues are treated by government add complexity to the policy/planning/budget continuum. Perhaps of greatest importance is the institutional architecture that characterises environmental governance. This often entails agencies at different levels of government (national, regional and local) as well as across different sectors. Those sectors dealing directly with the utilisation of natural resources (e.g. agriculture, forestry, fisheries) or abatement of air, water or waste pollution (including health ministries) play a lead role in promoting environmental best practice, often through programmes that have sustainability as their goal. However, other sectors also have significant environmental impacts (e.g. manufacturing, transport, energy), which dictates that a ‘whole-of-government’ approach is necessary if environmental issues are to be addressed in a comprehensive way.

The institutional architecture has increased in recent years as a result of reforms that have attempted to separate different functions of government. Such reforms have led to environmental ministries retaining the policy development function, while environmental agencies are responsible for policy implementation and semi-independent agencies and authorities fulfil management and monitoring functions. The administrative structure varies, but generally there has been a progression to greater complexity that impacts strategic planning and resource allocation. This situation implies that capacity-building is necessary not only within the ministry of environment but also in other ministries and government agencies with responsibilities for environmental management. As experience from the reviewed countries show these other ministries rarely develop full-fledged environmental programmes. They usually restrain themselves to few projects with an environmental focus.

Consultative mechanisms are vital to ensure a cooperative approach on environmental issues across government and thus secure coherent policy making, planning and budgeting. This issue is receiving increasing attention. In South Africa, a national Environmental Coordinating Committee has been formed to fulfil this role and in Uganda the National Environment Management Authority acts to coordinate, monitor and supervise all activities in the field of the environment. Overlapping mandates concerning environmental governance are addressed by comprehensive consultative mechanisms in both the Netherlands and Australia, which take both formal and informal forms. Widespread and extensive consultation is a core principle of national policy development in both countries helping to secure demand for financial resources through the national budgetary processes and increasing consensus during subsequent implementation.

Methods for target-setting and monitoring of environmental expenditure

Whatever the timescale of planning and budgeting, target setting, monitoring and evaluation are key control elements that feature prominently in both Australia and the Netherlands. Considerable investments have been made to establish systems that provide feedback on the implementation and cost of government programmes. These systems are invariably electronic, requiring installed capacity of computer hardware and trained personnel to provide a reliable and timely service. There has been a steady progression with non-financial measures away from a focus on inputs and processes to performance-related attention to outputs and outcomes. This general trend has raised some challenges for measuring environmental actions, where the causal chain from inputs to outputs, and beyond to outcomes, can be less straightforward than in some other sectors. For example, evidence is lacking to demonstrate that investment in tree planting activities necessarily leads to increased areas under forests and reduced deforestation.

The case studies provide a rich set of experience with target-setting in the environmental sector. In the two OECD countries and South Africa, target-setting and performance monitoring are well-established. The targets are expressed both as outputs (laws, regulations, publications) and outcomes (actual changes in environmental conditions) and in quantitative (number of laws, regulations) and qualitative terms (e.g. percentage of area allocated for conservation purposes).

One particular challenge emphasised in these case studies is that there are too many targets and indicators, although it is acknowledged that it is not feasible to monitor all outcomes on an annual basis. These countries' experiences show that it is better to set few but realistic and monitorable indicators. Too many targets and indicators create a lot of problems for both the implementing agencies and for those who have to monitor them. Such an overloaded system runs the risk of losing credibility.

In contrast, in both Uganda and Armenia, target-setting and related indicators in the environment sector are very poorly developed, particularly at regional and district levels. Both countries are in the process of introducing targets and indicators. In Uganda, with effect from the 2008/09 budget, this process will include measuring results against indicators and benchmarks set during the budget preparation process. In Armenia, the government is now implementing a strategy of programme budgeting. As part of this strategy, each ministry annual plan, including the Ministry of Nature Protection, will contain more detailed information on non-financial performance, with a clear distinction between output quantity, quality and timeliness indicators. One particular problem cited by the two countries which has partially delayed the introduction of targets and specific indicators for their verification is the lack of reliable data which can support credible monitoring systems. Thus, the Ministry of Nature Protection in Armenia lacks the information and methodology for setting reliable outcome targets or other measures for its programmes. Environmental and financial monitoring is an area which needs particular development and support in these countries.

Monitoring and evaluation systems, as part of the MTEF process, are highly developed in the two OECD countries. The systems place emphasis on the outputs and outcomes rather than controlling inputs by individual budgetary lines. Monitoring is carried out both internally (by relevant ministry's departments) and externally (at a minimum by the legislature). In the Netherlands, the process is one that is very firmly rooted in the political sphere, with the national legislature playing the dominant role, assisted by independent audits. The output-based budget model clearly supports target setting and subsequent evaluation. Each government department submits an annual report on the basis of the same structure as the initial budget, containing both a narrative on actual policy outcomes as well as a more detailed overview of performance on each policy article. These annual reports are submitted to the independent Court of Audit which is mandated to audit departmental performance and expenditure and which submits its judgement on departmental annual reports to parliament. Within the environmental sector the annual 'Nature Balance' reports of the independent Netherlands Environmental Assessment Agency are of special importance. This annual report contains an overview of the state of the Netherlands environment, the implementation of environmental and nature policies and usually one or two topics or studies that warrant specific attention. These sometimes critical reports are made available to the involved ministries before submission to parliament, allowing the ministers to comment on the agency's findings to parliament. The Dutch monitoring and evaluation system of public expenditure in general, and the environmental sector, in particular, provides for several layers of control and strongly suggests that controlling on the exit is better than controlling the inputs.

In South Africa, apart from the standard budget process, environmental spending is monitored by the national presidency (and the provincial premier's offices in some provinces) which operates a government-wide monitoring and evaluation system which for each department utilises information on programme outputs and outcomes, data from evaluations and information from the national statistical system. It is not clear from the case study however to what extent the national statistical system is developed to be able to capture all necessary data and provide reliable information needed for the evaluation exercise.

On the other hand, the evaluation and monitoring systems in both Uganda and Armenia are still poorly developed. In Uganda, monitoring within the budget cycle continues to be directed at ensuring accountability of expenditure rather than being policy focused. In Armenia, MTEF and budget documentation do not contain outcome targets for the respective environmental themes and this has been a recognised weakness of environmental policy development. Evaluation methodology requires further development. With the introduction of indicators and benchmarks, the situation is expected to change in the two countries. But it can hardly be expected that improvements will happen automatically. It may take some time for the system to become operational. How quickly this will happened will also depend on the willingness and support of politicians for a system which can bring more transparency and accountability for public expenditure in these countries. This, as well as experience from OECD countries, shows that the institutionalisation of the MTEF is an on-going process which has room for further improvements.

Costing of budget proposals and allocation of resources

As new policy spending priorities emerge, environmental ministries usually have the task of preparing budget proposals that will stand up to the scrutiny of the ministry of finance. However, once the spending has been agreed and set within the budget and MTEF the role of the ministry of finance is normally significantly reduced, giving sector managers discretion over the detail of budget management.

In both Australia and the Netherlands, the annual budget is fully integrated with the MTEF, with departmental budgets (including those of the environmental ministries) all having the same structure. In the Netherlands, government departments receive one overall appropriation for all expenditures. However, the appropriation is then broken down into a number of policy articles (programmes) and sub-articles that together constitute the departmental budget, and expenditure can only be reallocated with approval by the ministry of finance.

In Australia, as noted earlier, in recent years, and after 10 years of budget surpluses, an increasing number of new spending decisions have been made outside the budget/forward estimates context. For example, the major National Plan for Water Security was developed in the Prime Minister’s Department. However, once a decision to fund such a proposal is made it is immediately reflected in, and disciplined by, the forward estimates. In addition, there is very limited guidance provided by the Ministry of Finance regarding the internal allocation of financial resources. Ministries have discretion over the allocation of their funding for departmental outputs. The Ministry of Finance’s role is limited to probing the estimates of new funding to ensure that they are the minimum required to do the job.

In South Africa, an interesting feature is that Treasury allocates to the department, or to the public entity, not to programmes or economic items within the entity’s budget. However, once the department has submitted its programme allocations for publication in the budget/MTEF documentation, it is voted by parliament at programme level and the department is limited as to the shifts it can make without reverting back to parliament. South Africa has developed a consistent and coherent approach to assessing and comparing budget bids based on a scoring system that contains 10 criteria (see Annex X for more information).

In Armenia, the Ministry of Finance and Economy does not provide any specific guidance regarding the internal allocation of resources. It only provides information on priority sectors for the given MTEF period. The previous year’s approved MTEF contains information on allocation of funds within sectors to the level of sub-functions and programmes, as well as recurrent versus capital expenditure. In practice, the final MTEF version is usually prepared by the finance and/or economy unit in each ministry, and departments implementing the relevant programmes are not always aware of this final information on allocations.

In Uganda, the MTEF does not identify allocations by programmes, rather an economic classification is used (e.g. subsidies, transfers, etc.), which obscures any attempt to identify spending on policy priorities. There is little guidance provided by the Ministry of Finance regarding internal allocation of resources. Most of the work related to allocation of the resources within the ceiling set by the Ministry of Financial Planning and Economic Development is undertaken by the Sector Working Group in the Ministry of Water and Environment.

None of the countries reviewed as part of this project seems to have developed any specific guidance for the preparation of environmental programmes and projects. Not even the two OECD countries. While everywhere Ministries of Finance prepare guidelines containing the rules of the budget policy and the preparation of the MTEF documentation, environmental agencies lack such specific-guiding tools. The lack of such guidance is particularly important due to the cross-cutting nature of the environmental sector where many different actors are involved in the preparation of environmentally-related programmes. In the absence of joint guidelines, there is a huge risk of inconsistency in presenting the results of such programmes. One major issue is the choice of discount rates in the evaluation of environmental projects and policies, different ministries may use different rates and environmental costs and benefits may be discounted differently. This is an issue even in OECD countries. For example, in Australia, discounting practice varies across different states.

Box 8: The 2007 Budget Guidelines of South Africa

In 2007 – for the 2008/09-2010/11 MTEF – budget submissions had to include the following:

- the amount requested per year;
- quantification of service-delivery issues that the ministry would address;
- an explanation of the strategic significance of bids given the national policy agenda as set out in the guidelines;
- an evaluation of existing and recent interventions;
- the effectiveness of solutions and an appraisal of options;
- detailed costing; the specification of deliverables; an administration plan;
- an implementation plan;
- a risk analysis; the monitoring and evaluation framework; and
- a set of annexes that provide detailed financial and non-financial information.

The requirements for these annexes may change from one year to the next.

Source: National Treasury of the Republic of South Africa (2006).

In addition, there are different costing techniques, among others, averaging, calculating unit costs, preparing inflation-adjusted expenditure, sampling (when data are not readily available), and depreciation of assets. Any of these techniques can produce different financial outcomes if they are not consistently applied throughout government agencies. In turn, this makes the comparison across programmes largely irrelevant.

Incorporating infrastructure sectors, including environmental infrastructure, into annual budget processes is particularly challenging. One very common problem in this aspect is the calculation of investment costs which enter the annual budgets while disregarding or underestimating operation and maintenance and other related recurrent costs. There is often less attention to the latter as they will be incurred in the distant future, particularly in the case of long term environmental investment programmes. Such political short-sightedness rarely pays off. Some of the main challenges related to budgeting environmental infrastructure programmes are due to the fact that:

- Environmental infrastructure is capital intensive and investments are often "lumpy";
- Project selection is technically challenging and at risk of political capture;
- Financial planning is required over a multiyear timeframe. This requires sound knowledge of economic valuation and financial assessment of assets;
- Best environmental technologies are costly and not readily available in aid-receiving countries;
- Procurement may be complex and time consuming;
- Implementation is often subject to unforeseen delay.

Even if in many cases environmental investments are implemented by other sectoral ministries, the staff in these ministries need to participate in the preparation of the MTEF in order to ensure predictable funding flows over time. Staff need to work closely with the ministry of finance or planning in order to make sure that the characteristics of environmental investments are well understood by these ministries.

The lack of knowledge of ministries of finance in aid-receiving countries with regard to environmental programmes is particularly acute and this issue was raised by both Armenia and Uganda. Staff in ministries of finance do not sufficiently understand the nature of environmental investments and the potential benefits these can bring to the economy as a whole. Coupled with the poor capacity of environment authorities to defend their proposals, the end result is a chronic under-funding of environmental programmes. This situation shows the need for targeted training and capacity-building of staff of ministries of finance on issues related to environmental finance. In order to educate the ministry of finance staff, the preparation of guidelines for designing environmental programme can and should involve the ministry of finance staff from the outset of this process. Any training should involve both environment and finance ministries officers. Donors can be instrumental in initiating such a capacity building exercise among ministries of finance staff in these countries. Donor technical assistance programmes may be particularly helpful in promoting the preparation of guidelines for designing environmental programmes which can be followed by all ministries when they cost their environmental (investment) programmes.

Participation of the Ministry of Environment in MTEF implementation

Within all the country case studies, environment ministries are fully integrated into the national budgeting and medium-term expenditure planning systems, and follow the same rules and procedures as the rest of the government administration. In principle, new policy initiatives are subject to the same discipline as in other sectors and depend, to a large degree, on the political support such measures receive when spending priorities are negotiated within government. The allocation of budgetary resources is essentially a political process, usually involving the most senior members of government. This may disadvantage the consideration of environmental issues, as ministries of the environment are often relatively new elements of the government administration, overseen by junior ministers whose political influence may be limited.

The Dutch case study emphasises that environmental policy is treated in a similar way to all other political issues that require public investment. The extent to which certain political issues manage to obtain funding is not so much a technical issue related to budgeting procedures but largely a function of societal priorities and the political skill with which citizens and interest groups defend their interests. However, the existence of a strong grass-root environmental movement in the Netherlands is of crucial importance for raising the profile of the environment on the political agenda. Also, of importance is the political perception of these sectoral interests and the extent to which the involved ministers manage to obtain additional funding or lobby and defend existing allocations within Cabinet.

A similar conclusion comes across from the Australian case study. The forward estimates system is neutral between agencies and so if environmental agencies can make a case on public policy grounds for increased funding, they will get a hearing, as will any agency. It is widely accepted that all agencies have been the beneficiaries of the greater certainty of funding over the medium-term that is associated with the forward estimates.

The case of South Africa points to the skills of environmental agencies employees and particularly competent leadership. The Department of Environmental Affairs and Tourism is relatively well-run and this has significantly contributed to the successful integration into the MTEF process. It has therefore been able to put forward well motivated and technically sound proposals for funding. The Department of Water Affairs and Forestry has a similar track record. In contrast, in Armenia, the low level of policy development capacity in some areas of environmental protection limits the ability of the ministry to develop well-justified proposals. Another limitation is the lack of mechanisms for the Ministry of Nature Protection (MNP) to coordinate environmental programmes across the government.

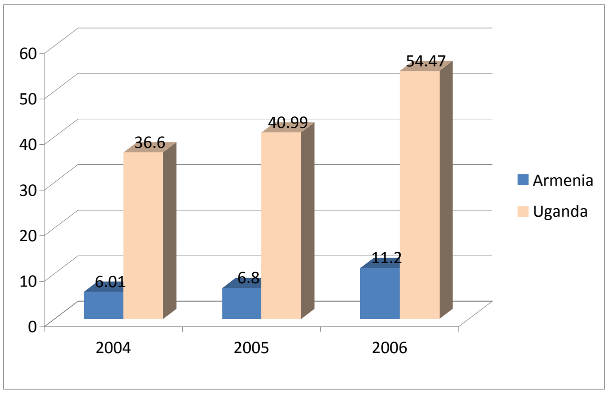
In addition, the Armenian MNP has expressed some dissatisfaction with the opportunities for it to participate in MTEF and budget negotiations. Although, the MTEF design suggests the active involvement of all ministries, the reality is that the level of this involvement varies. Some ministries (including the Ministry of Nature Protection) remain on the margins of the process. This marginalisation is also seen in the national poverty reduction strategy. In particular, environment policies and objectives in the PRSP are not supported by specific targets. This puts the environment ministry in a relatively weak position during the MTEF/budget process, since funding decisions are seen to be largely driven by priorities and targets determined within the PRSP. Therefore, in aid-receiving countries, if environment is not properly included in strategic policy documents (e.g. PRSPs), it is very likely that the sector will obtain sufficient attention in the MTEF/budget process either.

An important issue that influences the participation of ministries of environment in budgetary processes is the extent to which their funding is derived from the national budget. In the Netherlands, all environment-related public income flows directly into the consolidated fund and all environmental expenditure is derived from the same source. This provides a strong accountability mechanism, as the budget comes under the scrutiny of the national legislature and, through the publication of the budget, the general public can hold the Executive to account.

In aid-receiving countries, however, environmental funding is often fragmented by the presence of additional funding sources, including international development assistance. The environment has been an area characterised by large numbers of donor-funded projects. In addition, the creation of internally generated funds or special government funds, such as the National Environmental Funds in Armenia and Uganda, provide other possible sources of funding for environmental actions. The accountability of these separate funds is not of the same standard as that of allocations made from the consolidated fund. Their presence can also act as a disincentive for ministries of the environment to engage fully in the budgetary allocation system, namely the MTEF and annual budget, which may represent a more demanding discipline.

An institutional factor that may partially be responsible for the weak position of the environmental agency in Uganda within the MTEF process is that environmental mandates are not well set out between the relevant central government ministries. The situation is further confused by the decentralisation of the natural resource management remit to local government, without there being clarity of roles and responsibilities between the district level and the central government administration. As such, the MTEF process can be used to motivate the need for clarification of these roles in the country. It seems however that some re-allocation of resources for the environment sector within the MTEF framework has been taking place in Armenia and Uganda, as shown on Chart 1 below.

Chart 2: Environmental public expenditure, mln of USD



Source: Respective country statistics.

Donor support for the environment

In aid-receiving countries, official development assistance (and the influence of technical assistance) has been significant in the environmental sector. Donor-assisted environmental projects have often been ‘off-budget’ and therefore not subject to the same discipline as activities funded through the national budget. Such projects have different reporting, contracting and procurement standards, all of which tie up human resources, duplicating government’s own systems. This is only now being addressed through new aid modalities under the Paris harmonisation agenda. The MTEF framework provides another incentive for donors to further align reporting and evaluation processes with the developing country’s systems.

How far donor spending has impacted public expenditure patterns is clearly country specific, yet the proliferation of donor projects housed within environmental agencies that otherwise do not have a strong funding base should be a cause for concern. However, the influence of donor spending can also be benign, with international environmental project planning (e.g. Global Environmental Facility projects) having led to strengthened national capacity for multi-year financial planning, monitoring and control.

Donor support often exerts considerable influence over the implementation of environment-related government programmes in aid-receiving countries. This is clearly the case in Uganda, where donor funding for the environment has been very significant over the past years. Since 2003, more than half of the total allocation to the ministries of environment and natural resources has come from donor support. Donors currently play an active part in the environment Sector Working Group and budget proposals are presented to the donor group for discussion prior to being passed. This is a good practice which may be spread to other aid-receiving countries. Involving donors in the MTEF process at an early stage can help improve their awareness of the challenges facing environmental authorities in developing countries in the preparation of their multi-year plans (although donors need to be aware not to undermine the national process).

In recent years there is some evidence of a shift in aid modalities away from project interventions to aid delivery through general (or direct) budget support[15] although many donors still use sector programme aid as a main aid disbursement mechanism (see Annex IV). Within the MTEF context in aid-receiving

[15] Budget support is defined as a method of financing a partner country’s budget through a transfer of resources from an external financing agency to the partner government’s national treasury. The funds thus transferred are managed in accordance with the recipient’s budgetary procedures. A distinction might be made between general budget support and sector budget support. In the case of general budget support, the dialogue between donors and partner governments focuses on overall policy and budget priorities, whereas for sector budget support the focus is on sector-specific concerns (OECD, 2006).

countries, direct budget support becomes therefore ‘on-budget’. As such, donors contribute to further strengthening the overall discipline of the expenditure management practices of government. However, the level of budget support is often not directly known at the time of the budget, as reported by Uganda and Armenia. This support is estimated based on previous releases and predictions on the past performance and priorities of donors. In addition, the lack of predictability in donors’ funding is a real challenge for the developing countries which depend on it so significantly in the implementation of their policies. This may seriously undermine the MTEF and budgetary process. Donors and developing countries need to agree on strict rules for disbursing aid (and stick to them) which then need to be built into the MTEF process.

In addition, international development organisations play an important role in providing advice and technical assistance in relation to environmental policy. The MTEF process provides a new opportunity to donors to support capacity building in environmental and natural resource administrations in the competition for government resources. To help these administrations respond to the challenges posed by the MTEF process, donors could focus their technical assistance on developing particular skills of ministries’ staff as well as the preparation of relevant tools. Skills related to valuating the economic costs and benefits of environmental policies and preparing public environmental expenditure reviews for the sector (as part of the bottom-up process) are crucial. Strengthening the information base that supports such analysis is equally important. Support could also be provided for preparing methodologies and guidelines for how environmental programmes should be developed so that they could be integrated into MTEFs and subsequent annual public budgets, and demonstrate their contribution to PRSPs. These tools however should not be developed without the active involvement of finance ministries in these countries.

Many such tools exist in donor country environmental agencies or international organisations. However, there is a need to better understand what is already available and how these tools could be adapted to the national level in aid-receiving countries. Donors could work together to identify existing tools and review their appropriateness for developing countries. Where specific guiding documents are missing, country-focused initiatives could be complemented by some upstream work in developing such guidelines.

When advising countries that have launched an MTEF process or are considering launching such budgetary reforms, perhaps significant attention needs to be paid to the change of management capacity, including in the environment sector. It may be necessary to develop a check list that that will enable some assessment of this capacity and hence the likelihood of success in delivering technical assistance in this area. Box 9 below provides some relevant considerations for this risk assessment. When contemplating such a fundamental institutional change in switching from one budget system management model to another, it would be crucial to be able to answer such questions positively.

Although the Paris Declaration has been in place for several years there is still some inertia in switching to the new donor support mechanisms. Donors seem to prefer to still provide aid by project interventions and earmarking for certain sectors (earmarking within the budget through sector aid programmes). On the other hand, direct budget support can contribute to strengthening the MTEF in developing countries and thus to the more transparent spending of resources where they are most needed and best justified.

Box 9: Possible checklist for assessing the risks in technical assistance delivery

Are agents of change well identified?

- How deep in the administration is the recognition of the need for change?
- Is this recognition at the government level, the level of the minister of finance or lower?
- How stable/established is the reform team?

Do the reformers have an adequate base to work with?

- Is there an adequate level of fiscal stability to ensure success rather than the diversion of energies?
- Is there sufficient political and administrative stability?
- Can the up-front costs of reform be borne by the government in the short term?
- Does the present system have basic levels of fiscal control and financial management to support reform?

Does the overall environment provide incentives to support reform?

- What is the general level of managerial capacity to implement reform?
- Is the regulatory framework adequate for reform, or does it need to be changed?
- What is the general perception of the level of governance in the country?
- How empowered are consumers to demand better performance from government agencies?

Source: IMF (2003).

Major lessons learnt

Given the cross-sectoral nature of the environment, the preparation of robust sectoral strategies and programmes is a serious challenge, particularly in the three aid-receiving countries. This is not a problem of the ministries of environment only as capacity building is needed in all other government agencies with responsibilities for environmental management and most importantly in the ministries of finance.

The switch from donor-funded projects to direct budget support coupled with introducing a medium-term perspective into the budgetary process has opened a new window of opportunity for strengthening public expenditure management practices in developing countries. Donor support can become on-budget and be better integrated into existing management systems and processes of the country. This new situation however has posed new challenges to the environment ministries which fear they may see support for environment dwindling. They need to learn to better compete with other sectoral agencies for budgetary resources, including donor support. In this respect, the main lessons learnt from the five case studies are:

- Evidence from the OECD countries shows that the MTEF process is neutral in its treatment of different sectors and there is no inherent bias against environmental spending. However, given the complexity of this sector and the relative youth of environmental institutions, particularly in non-OECD countries, environment ministries need significant capacity-development in various aspects of public expenditure management in order to be able to successfully compete for budgetary resources against their more powerful counterparts in government.

- Introducing a medium-term perspective to budgeting is particularly favourable for environmental ministries and other agencies with responsibilities for environmental management as most environmental programmes are long term in nature and the rate of return on environmental infrastructure investments is usually very long. The MTEF process has forced weaker ministries, such as ministries of environment, to start thinking strategically and develop their capacities in policy formulation, financial planning and budgeting in order to compete for budgetary, including donor, resources.

- Best results are achieved where annual budget proposals are derived from well costed and economically sound environmental programmes, as exemplified by Australia and the Netherlands. If well-designed, environmental programmes can provide a strong link between policy, strategic planning and the budget. The programmes are more credible if developed and costed by professional entities (e.g. the Dutch Environmental Assessment Agency).

- Target-setting, monitoring and evaluation are crucial for the successful funding and implementation of programmes. Too many or too few targets and indicators create a great deal of problems for both the implementing agencies and for those who have to monitor them. Either way, the system runs the risk of losing credibility. The aid-receiving countries lack methodologies and guidelines for setting targets in the environment sector, which could be meaningfully incorporated into MTEF and budget expenditure decisions.

- To be credible, programmes need to be based on sound analytical studies of costs and benefits of environmental programmes and expenditure reviews which can support requests for higher levels of environmental expenditure. There is a lack of capacity in environmental ministries to conduct such analysis in the aid-receiving countries. Hence, support is needed in building the capacity of environmental authorities (including both ministries of environment and other relevant agencies) in preparing and justifying their programmes, also in a coordinated manner.

- The data used for the preparation of the programmes and analytical studies are often unreliable or even not available at all. Strengthening the data information systems in these countries is of paramount importance if they are to inform the strategic planning and budgeting process.

- The lack of understanding in ministries of finance of how environment can contribute to economic growth in aid-receiving countries additionally constrains obtaining adequate support for the environment sector. Therefore, staff from these ministries need to be part of any technical assistance programme focused on environment.

- By switching to direct budget support, donors contribute to strengthening public expenditure management practices and budget discipline in aid-receiving countries. External resources are now increasingly being included in the budget. However, to the extent possible, donor reporting and evaluation requirements need to be further harmonised across donor countries. In addition, they need to be aligned with the reporting systems of the partner countries' national budgetary cycles of policy formulation and implementation, and rely as much as possible on the partners' reporting and monitoring systems for their own reporting purposes.

- The lack of predictability of donor flows may seriously undermine the credibility of the MTEF and budgetary process. Donors and developing countries need to agree on strict rules for disbursing aid (and stick to them). These rules need to be built into the MTEF process in order to facilitate the smooth execution of budgetary payments.

- Donor support is crucial in building the capacity of environmental authorities. Helping to strengthen environmental agencies' capacity to prepare economically sound programmes and strategies (and manage them in accordance with good international practices) should be a major concern for donors who want to ensure that the environmental sector continues to receive support even when donor funds are channelled directly through the budget.

- Donors may provide further support by participating in existing consultative mechanisms on formulating environmental sector programmes in aid-receiving countries, such as this is being done in Uganda. This helps avoid creating parallel processes. Donors may have a more proactive role in such groups. While leaving country experts to decide on their priorities and strategies, donors can help by providing the resources for contributory studies (drawing where possible on in-country research and consulting capacity). In addition, donors may help clarify the functions of the agencies involved in environmental management in order to avoid duplications and overlaps in responsibilities and thus inefficient spending.

- Donors could work together to identify existing tools and review their appropriateness for developing countries. Where specific guiding documents are missing, country-focused initiatives could be complemented by some upstream work in developing such guidelines.

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ANNEXES

Annex I: Main economic indicators of the five case-study countries, 2006[a]

	Armenia	Australia	Netherlands	South Africa	Uganda
Land Area, km^2	28,200	7,682,300	33,880	1,214,470	197,100
Population, 1000 inhabitants	3,007	20,521	16,371	47,391	29,874
GNI, PPP (current international $)	5890	34060	37580	11710	1490
GDP per capita, PPP (current international $)	5797.477611	35492.5227	36219.21147	11960.20898	1518.856115
GFCF, as % GDP	30.3	18.3	19.5	18.5	24.6
General government expenditure, as % GDP	16.5	33.1	45.2	..	17.6
General government outlays for environmental protection, % ot total oytlays		1.4	1.8	..	0.3
Environmental expenditure of the public sector, as % of GDP	0.08	0.3	1.1	..	..

a) Or latest available year.
AUS) Data on general government expenditure are expressed on accrual basis.
Source: OECD; World Bank, *World Development Indicators* 2007.

Annex II: General and central government balance as a share of GDP

Cash surplus/deficit

	Pre-MTEF year	2003	2004	2005	2006	2007
Armenia	-5	-0.74	-0.85	-1	-0.3	..
South Africa	-5.2	-2.24	-1.71	*-0.42*	*0.91*	..
Uganda	-6.4	-10.7	-6.2	-4.6	-3.9	..
Australia		1.5	1.72	2.26	2.5	
Netherlands		..	..	..	..	..

Australia: data refer to general government.
Source: IMF, *Government Finance Statistics* .

Annex III: Environmentally-related aid to Armenia, South Africa and Uganda, 2003-2006

Million 2005 USD

	2003	**2004**	**2005**	**2006**
Armenia	7.7	62.6	34.6	157.7
Core environmental sector	1.6	0.2	13.5	5.4
Water supply and sanitation	0.3	52.8	20.2	0.1
Water resources management	2.7	9.6	0.5	152.1
Other environment related support	3.1	0.0	0.3	0.0
South Africa	72.7	135.5	86.1	86.8
Core environmental sector	8.1	5.0	65.2	4.4
Water supply and sanitation	46.2	68.2	16.4	54.5
Water resources management	7.8	0.2	0.1	2.1
Other environment related support	10.6	62.1	4.4	25.9
Uganda	70.1	36.3	112.6	109.7
Core environmental sector	2.1	2.2	1.2	3.5
Water supply and sanitation	46.5	31.8	18.1	70.0
Water resources management	0.7	0.7	27.4	5.2
Other environment related support	20.8	1.7	65.9	30.9

Notes:

Data refer to bilateral and multilateral commitments of ODA, including ODA grants and grants-like, ODA loans and equity investments.

for the purpose of this analysis the environment sector includes the following categories:

"Core" environment sector: general environmental protection (environmental policy, biosphere protection, biodiversity, environmental eduction/research), waste management, renewable energy and agricultural land resources.

Water resources management: water resources protection, flood prevention/control, river development, agricultural water resources.

Water supply and sanitation: basic drinking water supply and sanitation, large systems water supply and sanitation.

Other environment related support: urban and rural development, forestry and fishery development.

Source: OECD CRS Aid Activity Database at http://stats.oecd.org/WBOS/Index.aspx (accessed September 2008).

Annex IV: Environmentally-related aid to developing countries provided by Australia and the Netherlands, 2003-2006

Million 2005 USD

	2003	2004	2005	2006
Australia	88.14	20.15	27.50	52.28
Core environmental sector	12.23	1.65	16.17	23.15
Water supply and sanitation	9.79	7.57	1.26	6.59
Water resources management	42.20	8.61	5.74	9.05
Other environment related support	23.92	2.33	4.34	13.48
Netherlands	345.97	386.81	468.15	701.27
Core environmental sector	147.18	181.09	175.84	208.52
Water supply and sanitation	29.41	60.30	89.79	264.16
Water resources management	116.34	87.55	160.72	180.67
Other environment related support	53.04	57.86	41.80	47.93

Notes:

Data refer to bilateral and multilateral commitments of ODA, including ODA grants and grants-like, ODA loans and equity investments.

for the purpose of this analysis the environment sector includes the following categories:

eduction/research), waste management, renewable energy and agricultural land resources.

Water resources management: water resources protection, flood prevention/control, river development, agricultural water resources.

Water supply and sanitation: basic drinking water supply and sanitation, large systems water supply and sanitation.

Other environment related support: urban and rural development, forestry and fishery development.

Source: OECD CRS Aid Activity Database at http://stats.oecd.org/WBOS/Index.aspx (accessed September 2008).

Annex V: Aid provided by selected donors as direct budget support, 2003-2006

million 2005 USD

	2003	2004	2005	2006
Australia				
General budget support	24.8	..	6.1	0.4
Sector programme aid	..	..	10.9	382.6
Canada				
General budget support	4.4	102.3	69.9	16.2
Sector programme aid	77.8	258.1	157.1	133.5
France				
General budget support	62.8	98.0	79.6	342.4
Sector programme aid	..	34.2	..	..
Germany				
General budget support	5.0	60.7	40.9	100.7
Sector programme aid	..	..	..	..
Netherlands				
General budget support	166.2	136.3	429.0	299.6
Sector programme aid	197.6	226.8	323.6	1 535.5
United Kingdom				
General budget support	660.7	811.8	408.9	1 274.6
Sector programme aid	49.8	37.1	1 069.8	87.6
United States				
General budget support	2 116.7	12.8	453.0	369.5
Sector programme aid	3 358.6	6 322.3	2 931.7	1 790.5

Source: OECD CRS Aid Activity Database (Creditor Reporting System) at http://stats.oecd.org/WBOS/Index.aspx, accessed September 2008.

Annex VI: The administrative process of the traditional budget cycle

The administrative process of the traditional budget cycle is explained below assuming a 12-month budgeting period and a fiscal year starting on 1 January and ending on 31 December.

i. Revenue forecast
Starts in the second quarter of the fiscal year once the executed figures of the previous budget year are known and once central and state governments announce some estimates of intergovernmental transfers.

ii. Budget preparation
The government tentatively sets budget ceilings across all its administrative units. These expenditure ceilings are ideally determined based on a participatory national development plan.

iii. Budget revision
In principle, the ministry budget director, with each department or administrative unit, receives and reviews the corresponding expenditure proposals.

iv. Budget submission and approval
Once an agreement has been reached within the government, the minister submits the budget proposal to the council of ministers for its review, discussion, and final approval.

v. Budget execution
Immediately after the budget is approved by the end of the fourth quarter (usually in December) by parliament, the budget becomes a legal document that must be executed starting on 1 January. The budget implementation process usually involves the complex process of contracting services or public works that include detailed planning, writing the terms of reference, calls of interest, tendering, tender opening and selection, awarding of tenders, signing of memoranda of understanding/contracts with winning bidders and then execution of the projects.

Annex VII: Budget classification systems

Line item classification: structures expenditure by object according to the categories used for administrative control, for instance: salaries, travel allowances, telephone, and office materials.

Functional classification: structures government activities and expenditures according to their purpose, for instance: policing, defense, education, health, transportation and communication. The United Nations standard functional classification, used in the preparation of national accounts and government Financial Statistics distinguishes 14 major groups, 61 groups and 127 sub–groups.

Economic classification: structures government financial operations according to their economic impact, distinguishing: capital and current expenditures and revenues; subsidies; transfers from the state to families and other public institutions; interest payments: and financing operations. This classification is used in Government Financial Statistics prepared by the IMF.

Administrative classification: structures expenditure by the institution responsible for the management of funds. The structure of administrative classification will vary from country to country, as will the number and administrative level of the budget holder.

Programme classification: structures expenditures according to programmes, considered as a set of activities undertaken to meet the same objectives. The programme classification may correspond to a disaggregation of the administrative classification or may cross administrative units.

Territorial classification: structures revenues and expenditure by the geographical area of impact of the financial operation.

Source: Based on Schiavo–Campo and Tommasi (1999).

Annex VIII: Fiscal space

Although there are different uses of the term 'fiscal space', it is most commonly understood to mean the '*room in a government's budget that allows it to provide resources for a desired purpose without jeopardising the sustainability of its financial position or the stability of the economy*'. The basic rationale is that such space needs to exist or be created in order for governments to increase spending on national priority areas in a sustainable manner. By reconciling the top-down resource ceiling with bottom-up forward estimates of the costs of existing policies, an MTEF approach can help to clearly identify the available fiscal space over the medium-term, thereby allowing policy priorities to be financed in a predictable manner.

Fiscal space can be created by phasing out of existing public expenditures or through growth in total available resources, either in the form of additional revenue or aid inflows. Aid is less likely to be a source of genuine fiscal space than revenue because it is inherently unpredictable. This means that relying on it to finance expenditure commitments can jeopardise the sustainability of the government's financial position. Thus, most aid-recipient governments aim to maintain a positive current balance (the current balance is defined as domestic revenues minus recurrent expenditures) so as to avoid depending on aid to finance recurrent items that must be paid every year such as salaries and interest payments.

In the long-term, the main source of additional fiscal space is economic growth. The concept of fiscal space is therefore often accompanied by the argument that the additional spending should be focused on areas that boost growth, thereby increasing future fiscal revenues and hence wholly or partially paying for itself. Although increased spending on the environment does not necessarily boost national income growth, it is arguable that economic growth demands additional environmental spending in order to mitigate its negative environmental impacts.

Source: Heller, P. (2005) "Understanding Fiscal Space." IMF Working Paper PDP/05/4, March, 2005.

Annex IX: The six stages of a comprehensive MTEF

	Stage	Characteristics
1.	Development of macroeconomic / fiscal framework	• Macroeconomic model that projects revenues and expenditure in the medium term
2.	*Development of sectoral programmes*	• *Agreement on sector objectives, outputs and activities* • *Review and development of programmes and sub-programmes* • *Programme cost estimation*
3.	*Development of sectoral expenditure framework*	• *Analysis of inter- and intra-sectoral trade-offs* • *Consensus-building on strategic resource allocation*
4.	Definition of sector resource allocations	• Setting medium term sector budget ceilings
5.	Preparation of sectoral budgets	• Medium term sectoral programmes based on budget ceilings
6.	Political approval	• Presentation of budget estimates to cabinet and parliament for approval

Source: PEM Handbook (World Bank, 1998).

Annex X: South Africa - Assessing budget bids

Some budget analysts in South Africa have systematised how they approach their assessment of bids by establishing a consistent and coherent scoring system. This also helps to make decision-making more transparent. The table below shows how this system works. Each initiative is listed together with the amount required for it over the medium term. It is then scored against 10 weighted criteria and a percentage rating assigned to the initiative.

Evaluation of Initiatives														
	Amounts requested R(000)			Evaluation criteria										Ratings
Description of initiatives	2007/08	2008/09	2009/10	1	2	3	4	5	6	7	8	9	10	(%)
Initiative No.1	10,000	11,000	12,000	2	2	2	1	1	0	1	1	0	1	85%
Initiative No.2	100,000	200,000	300,000	2	2	2	1	0	1	1	0	0	1	77%

The 10 criteria are as follows:

1. Is it clear that the initiative contributes to government policy priorities? (Yes = 2, No = 0)
2. Has the department provided credible service delivery information with initiative submitted? (Yes = 2, No = 0)
3. Is the initiative aligned to the core functions? (Yes = 2, No = 0)
4. Have alternative policy options been considered? (Yes =1, No = 0)
5. Has the department undergone a thorough re-prioritisation with a view to fund part of the initiative from within budget? (Yes = 1, No = 0)
6. Is the costing/initiative realistic? (Yes = 1, No = 0)
7. Has the department consistently underspent its budget (by a margin of more than 3 percent) over the last 2-3 years? (No = 1, Yes = 0)
8. Has the effect on other entities/individuals been considered? (Yes = 1, No = 0)
9. Are the risks manageable? (Yes = 1, No = 0)
10. Has there been adequate political involvement in the budget formulation process? (Yes = 1, No = 0)

Criteria 1-3 must be satisfied in order for a spending bid to be considered. Bids are unlikely to be funded if a combination of the following factors is present: if they are already funded in previous MTEFs and changes to funding are not justifiable; when they are not directly linked to stated priorities and functions; when they are not properly planned and costed, or when there is evidence of under-spending or unwise spending. Bids that score well in the system and fit within the resource envelope are fully funded.

Source: Brown, K, and De Bruyn, J, 2007: Policy and Budget Analysis. Presentation at the June 2007 World Bank Institute and CABRI study tour of the South African National Treasury, CABRI, Pretoria.

**Annex XI: Questionnaire used in the survey
on the
Study on the experience with public environmental expenditure
in multi-year budgetary frameworks within five selected countries**

Checklist of issues

SECTION I: STRATEGIC PLANNING WITHIN THE ENVIRONMENT SECTOR

1. Defining the environment and environmental institutions

There are two contrasting approaches to environmental policy development, depending on whether environmental management refers to the activities of natural resource sectors or is considered a cross-cutting theme associated with all sectors alike. The environment can be considered in two ways:

- as a productive sector (i.e. making use of natural resources for productive purposes) ***– overseen by a Ministry of Natural Resources or other relevant government agency***;
- as a cross-cutting theme aimed at avoiding environmental pollution and degradation (e.g. water pollution, air pollution, noise, waste management) ***– overseen by a Ministry of Environment and environmental units in sector ministries***.

A definition that embraces both of these approaches (whilst recognising that they have both complementary and conflicting elements in them) may increase the likelihood of environmental issues being budgeted for in all the relevant sectors in a coherent and more consistent manner. The study will therefore look at environmental policy, planning and budgeting from both of these perspectives and cover ministries of environment (MoE) and natural resources (MoNR).

1.1. What are the government institutional arrangements for addressing environmental issues?

1.2. What organisations (Ministries, Departments, and Agencies (MDAs)) have an environmental remit/responsibility?

1.3. How well are environmental mandates clearly set out between the various MDAs? *Table 1*

1.4. What is current government spending on the environment (with MoE and MoNR acting as a proxy for the national environmental spend)? *Table 2*

1.5. How significant is international development assistance in support of public environment actions? *Table 3*

2. Is there strategic capacity at sector level?

2.1. Are there published public environmental policy priorities? If so, how have these been defined and where do they appear (e.g. in the Annual Budget Statements, departmental planning documents or annual reports)?

2.2. Do the MoE and MoNR have strategic planning processes? If a strategic sectoral plan is produced, what does it contain – are there costed programmes? Are there guidelines for preparing sector analysis? Are medium-term expenditure scenarios prepared (if so, please describe)?

2.3. How consistent are the environmental policies and strategic plans that are prepared by different environmental agencies, e.g. MoE and MoNR? Please describe any overlaps or conflicts.

2.4. Is there a programmatic approach to budgeting and can policy priorities be identified in the budget? Is it possible to link resources with results?

2.5. At what points in the budget cycle is there consideration or integration of environmental spending plans and the MTEF/budget? E.g. are environmental budgets explicitly coordinated with the MTEF process? What kind of institutional arrangements are in place to integrate the two processes (such as monitoring)?

2.6. What Monitoring and Evaluation systems are in place, and at what level do they operate (within the sector MDAs, within the planning ministry, elsewhere (please specify))? What types of indicators of success are used – do they distinguish between inputs, outputs, outcomes and impacts? Please provide some examples.

2.7. Who are the key players involved in taking decisions about environmental priorities/targets? To what extent are these same players responsible for taking decisions in the budget process? Is there a clear decision-making link between the two processes?

2.8. Have consultations around environmental policies included reviews of the expenditure framework?

2.9. Are there specific targets set for the respective environmental themes (e.g. water pollution, air pollution, noise, waste management)? Can you provide examples? How are targets set? If there are public programmes designed to support meeting specific environmental targets, are these programmes costed? If so, please describe the methodology used for costing these programmes.

2.10. To what extent has environmental policy-making been disciplined by the realities of the resource constraints over the medium to longer term e.g. have environmental targets been adjusted to take account of resource availability?

SECTION II: MULTI-YEAR BUDGETTING

In this section the experience of MTEF implementation by environmental MDAs should be emphasised.

3. MTEF structure and coverage

3.1. When/why was the MTEF introduced? What were the specific problems it was intended to address? Please describe the legal basis of the MTEF.

3.2. What is the time-frame covered by the MTEF? Is MTEF a bottom-up or top-down process?

3.3. Please describe the main actors in the MTEF process and their main responsibilities (ministry of finance, ministry of economy, line ministries, cabinet of ministers, parliament). Where is the MTEF management organisationally located?

3.4. What is the scope of MTEF, are all sectors covered or only selected sectors are included? Was MTEF adopted as a step-by-step approach or were all sectored included from the outset? If the latter, what were the main criteria for including the selected sectors?

3.5. What is the level of government encompassed by the MTEF (central, regional and/or local)?

3.6. Please characterise the nature of the out-year expenditure estimates of the MTEF (ranging from the costs of existing policies and programmes in those years, to an indicative allocation of funds to a sector/agency/programme for those years, to a forward budget).

3.7. Does the MTEF cover all domestic revenues, external financing and expenditures? If not, please describe what is excluded.

3.8. Please describe the structure of expenditure (e.g. recurrent and/or capital, foreign aid) and financing categories used in the MTEF. Are these identical to the categories used in budget appropriations? If not, indicate in what manner they differ (e.g. basis for classification, degree of aggregation). Please provide specific examples from the environmental sector, as well as two other sectors. How do these categories relate to those used by environment ministries for managing their resources?

4. The policy/MTEF/budget interaction

4.1. Are the fiscal framework and relevant policy issues discussed and are national priorities determined at the outset of the annual budget process, which are then used as the basis for initial budget ceilings?

4.2. Is there some form of a budget strategy paper that supports debate on the strategic issues (e.g., outlines the macro framework, recommends/defines sustainable fiscal targets, discusses progress against the development agenda, identifies spending pressures, presents policy options and choices, and recommends ceilings)?

4.3. Is there a process, either as part of the process described in the first two bullets or elsewhere, whereby the ‘available fiscal space’ – i.e. additional funding available to finance new policy over and above that needed to finance ‘baseline’ policies – is identified and allocated? If so, please describe the process.

4.4. How are new policy proposals (both centrally and at sector level) developed and decided upon? What is the nature of participation in these various processes?

4.5. Are there review processes for existing policy/programmes? If so, please describe. What is the level/type of participation?

4.6. To what extent is policy made during (a) the planning process (b) the MTEF/budget process or (c) some other process (such as the Poverty Reduction Strategy Paper (PRSP) or national environment plans)? Please describe.

4.7. To what extent is policy change driven by (a) Cabinet (b) President/Prime Minister (c) Planning Ministry (d) Finance (e) Sector Ministries/Departments (f) IFIs/Donors (g) Other?

4.8. Does the legislature have the authority to amend the draft budget? If so, in what way (e.g. change the composition, increase and/or decrease allocations)?

4.9. What is the structure of the legislature's appropriation – is it by programmes, organisational/economic categories or line items?

5. Basis and process of setting aggregate limits and broad allocations

5.1. Is there some form of top-down ceiling provided to MDAs at the outset of the annual budget process? If so, does it reflect a realistic assessment of expected revenue and incorporate the policy priorities of government? What is the extent of adherence to budget ceilings? If there is not a top-down ceiling process, describe the nature of the guidance for the bottom-up process and the extent of MDA adherence to that guidance.

5.2. Is there a single overall expenditure limit for public spending in MTEF and respective annul budgets? Are there separate limits for the recurrent and development (capital investments) budget? On what basis are expenditure limits for development and recurrent expenditures set?

5.3. What other limits (departmental, programme, output, line item) are provided to line ministries?

5.4. Are budget allocations subject to revision during the budget formulation process, thereby altering the structure of the budget relative to the MTEF? If so please indicate by whom and how these alterations are justified.

5.5. How and on what basis are budget ceilings within a medium-term expenditure framework set? Please briefly describe how decisions on these ceilings are made and by whom?

5.6. On what basis are organisational resource allocations prepared? If there are statutory or policy guidelines for the attribution of organisational shares, please briefly describe these.

5.7. Where there are changes in organisational and/or programme resource allocations between MTEF exercises, are these clearly identified in the MTEF documentation? Is the Ministry of Finance required to justify these alterations? To what extent are changes driven by policy changes of government (as opposed to parameter changes, such as inflation and demographics, or incorporation of one-off adjustments or recurrent costs of completed projects)?

5.8. Are broad organisational allocations linked to performance targets in terms of output and outcomes? If so, please provide examples from the environment and other sectors (e.g. education, health and defence). Is there a formal performance based budget system (i.e. a formal linking of inputs to outputs and/or outcomes)? If yes, please briefly describe the main features.

5.9. On what basis are any programme performance targets set? How much public consultation is there about the setting of targets and selection of indicators?

6. The MTEF and budget credibility

6.1. To what extent is the first out-year of the MTEF rolled over automatically to be the starting point for the next year's annual budget?

6.2. Are there transparent rules for any deviations from the MTEF estimates? Are deviations between projections and actual allocations explained? If so, please indicate the justifications given. Please provide MTEF projections prepared and the actual allocations for expenditure and revenue at both aggregate level and for the environment and other selected sectors (health, education, defence). *Table 4*

6.3. Is the annual budget executed, as approved? Do funds spent match expenditure allocations, both in aggregate and for environmental spending? Please indicate on whose authority and how any alterations are justified. *Table 5*

6.4. What are the principal causes of deviations between budget allocations and budget receipts (e.g. in-year revisions due to new policies/projects or reallocation between existing programmes/projects/activities, failure to release funds under cash budget, low implementation by ministry/agency, shortfalls in donor funds)? Are there transparent rules/processes for any reallocation during budget execution? If so what are they?

6.5. What specific measures are being taken to address these problems?

6.6. Are actual expenditure (including arrears (if such exist) and agency performance monitored during and at the end of the budget year? What are the consequences of failure to live within budget and/or meet performance targets?

6.7. Is the budget (and any assessment of the financial risks) comprehensive, and is financial and budget information accessible to the public?

6.8. Are all environmental and natural resources activities and spending 'on-budget'? If donor project activities are 'off-budget' what percentage of 'on-budget' spending does this represent?

7. Basis and process of environmental expenditure planning

This section is included to ensure that MTEF implementation by the environmental agencies is detailed – over and above the aggregate ways of working. Any specific differences between how the process is managed in environmental agencies and other parts of the government administration need to be described.

7.1. Please describe how MTEF proposals are prepared within the environment sector (e.g. centrally within the sector ministries or bottom up by regional/local departments or agency, and whether they are then (a) submitted to the sector ministry or (b) submitted directly to Ministry of Finance (MoF) and how this process is linked to the planning process.

7.2. What guidance is provided by Ministry of Finance regarding the internal allocation of resources? e.g., by component (personnel), by function/programme (environmental assessments), by source of financing (domestic/donor) or other?

8. Donor interaction (where applicable)

8.1. How well integrated is any budget support dialogue with national policy-making processes? Are there sector working groups and do they play any role in promoting integration?

8.2. Is direct budget support, if provided, predictable (i.e. known at the time of the annual budget/MTEF preparation for the period of the annual budget/MTEF and subsequently delivered)? What proportion of aid is 'on-budget'?

8.3. How important are external development partners in determining allocations (e.g. through IFI or other donor conditionality)?

8.4. Has the development of the MTEF been supported directly by external assistance? If so, please indicate the source and nature of the support provided.

SECTION III: THE POTENTIAL FOR PUBLIC FUNDNG FOR THE ENVIRONMENT

9. Conclusions – how can environmental agencies make a better case?

9.1. Please identify the strengths and weaknesses of the present MTEF design, process and organisational framework, with particular attention to sequencing and the three levels of budget outcomes (aggregate fiscal discipline, strategic prioritisation (allocative efficiency) and operation performance (technical efficiency)). On the basis of the above, please suggest possible ways regarding improvements in the MTEF process, distinguishing measures to be taken in the short and medium-term.

9.2. Overall, in your opinion, how well integrated are environmental issues in the MTEF? Do environmental policies take account of the financing constraints? Does the MTEF reflect the strategic priorities of the national environmental policy? What needs to happen if these processes are to be better linked? What specific guidance is required to help environmental agencies improve their multi-year budgeting?

9.3. From a top-down perspective, are environmental agencies 'beneficiaries' or 'victims' of the system created by the MTEF? From a bottom-up perspective, to what extent do environmental agencies have access to policy (or planning) processes that influence national resource allocation (e.g. the poverty reduction strategy)?

9.4. To what extent does the environment as a policy issue already feature in government's spending agenda? What are the entry points within government and parliament to promote increased public expenditure on the environment?

9.5. What demand exists for greater public expenditure on the environment? Where does this demand originate? What are the likely future trends?

9.6. What demand is there for better public services in the environment sector including improved pubic environmental expenditure management practices (e,g., improved institutional arrangements for managing public environmental expenditure, preparing economically-justified public environmental expenditure programmes, selecting investment projects for financing)?

Data tables

Table 1: Overview of primary MDAs with formal responsibilities for environmental matters

Organisation	Mandate & Mission	Environment functions (not exhaustive)
Ministry of Environment		
Ministry of Natural Resources		
Ministry of Agriculture		
Ministry of Fisheries		
Ministry of Tourism		
Ministry of Energy		
Mining Commission		
Forestry Commission		
Other (please specify)		

Table 2: Comparison of Government allocation of the national budget to MoE & MoNR, as compared to the other sectors

Year	% allocated to MoE & MoNR	% allocated to health sector	% allocated to education sector	% allocated to defence sector
2003				
2004				
2005				
2006				
Average				

Table 3: Government and donor contribution to Ministries of Environment and Natural Resources

Year	Total allocation (all data in local currency, current prices)		% contribution donors	
	MoE	MoNR	MoE	MoNR
2003				
2004				
2005				
2006				
Average				

*Table 4: Government MTEF allocations in outer year to environmental ministries and other sectors**

Amount (all data in local currency, current prices)		2003	2004	2005	2006
Total	MTEF (n + 1)				
	Budget allocation (n)				
MoE	MTEF (n + 1)				
	Budget allocation (n)				
MoNR	MTEF (n + 1)				
	Budget allocation (n)				
Mo Health	MTEF (n + 1)				
	Budget allocation (n)				
Mo Education	MTEF (n + 1)				
	Budget allocation (n)				
Mo Defence	MTEF (n + 1)				
	Budget allocation (n)				

Note: *“outer year” refers to the allocation proposed for year n+1 in MTEF projections (where year n is the first year and corresponds to the annual budget).

Table 5: Government budgetary execution by environmental ministries

Amount (all data in local currency, current prices)		2003	2004	2005	2006
Total budget	Amount allocated				
	Amount spent				
	Percentage spent				
MoE budget	Amount allocated				
	Amount spent				
	Percentage spent				
MoNR budget	Amount allocated				
	Amount spent				
	Percentage spent				