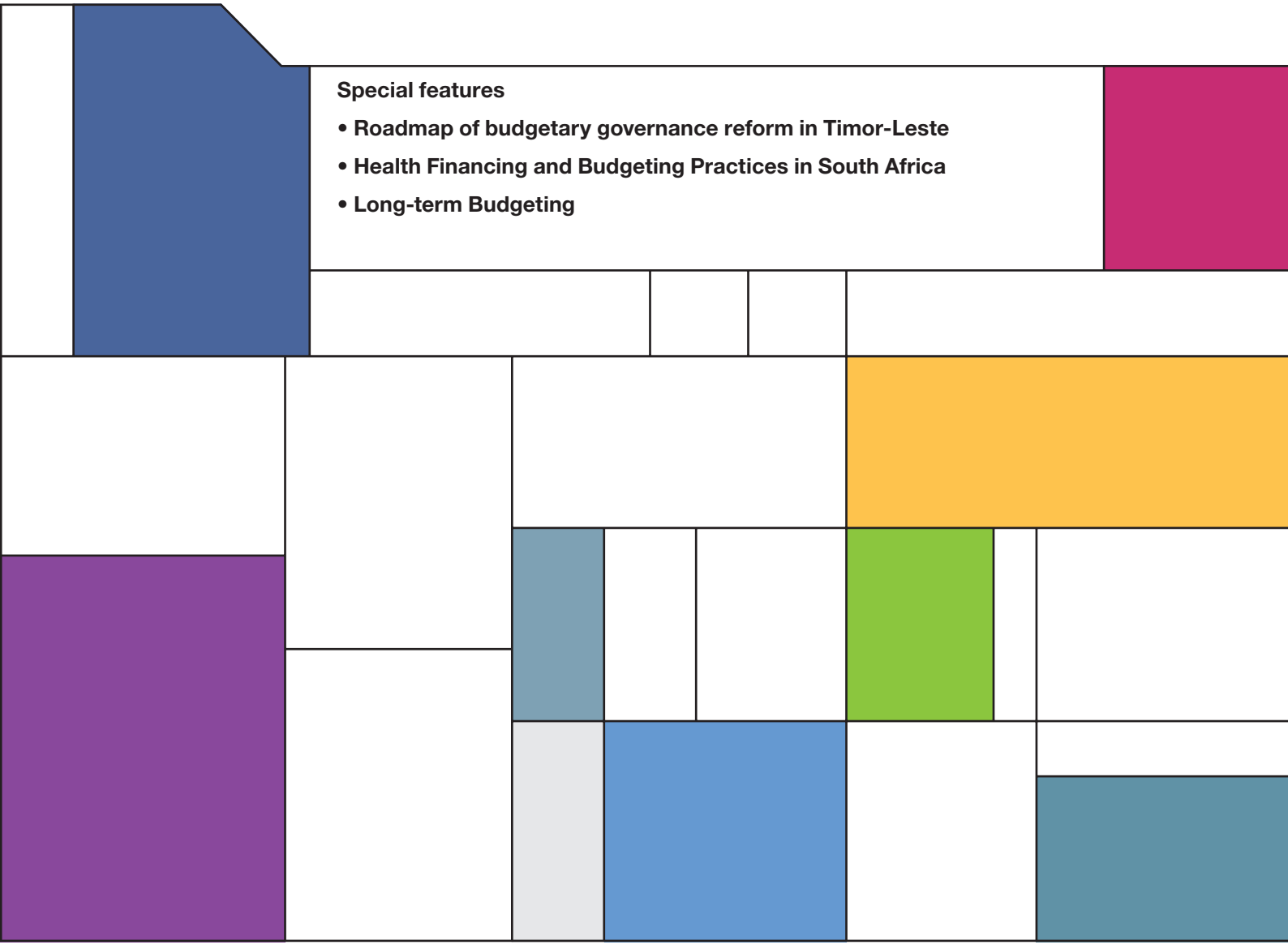
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Budgeting for a sustainable future: Towards a roadmap of budgetary governance reform in Timor-Leste

by
Ronnie Downes, Emilie Gay *and* Dirk-Jan Kraan*

Despite being one of the newest countries in the world today, Timor-Leste has made great progress in building its institutions and economic capacity. With international support, Timor-Leste aims to improve its public financial management systems according to global benchmarks. Grounded upon the principles of the OECD's Recommendation on Budgetary Governance and building on existing diagnostic and analytical materials this review performs a fresh assessment of the country's current financial management systems and outlines a practical "roadmap" for progress in key areas of budgeting and planning over coming years.

JEL Codes: H50, H61, H83

Keywords: Timor-Leste, budgetary governance, MTEF, spending reviews, programme budgeting

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Foreword

Since adoption of its independent Constitution in 2002, Timor-Leste has made great strides in building its institutions and its economic capacity. Timor-Leste has identified progress in its budgeting and planning processes as essential components of a strategy to achieve national goals for development and prosperity, while overcoming a range of challenges for fiscal policy and for institutional delivery.

Timor-Leste benefits from the active engagement of aid and development agencies, reflecting international interest in, and goodwill for, the country's continued progress. There is also an extensive corpus of useful and insightful analysis comparing the country's current systems for budgeting and public financial management with global benchmarks. The aim of this OECD Budget Review is not to duplicate this analytical work, but to perform a fresh assessment that builds upon the existing diagnostic and analytical materials, while also outlining a practical "roadmap" for progress in key areas of budgeting and planning over coming years. The OECD approach is grounded upon the principles of modern budgeting set out in the 2015 *Recommendation on Budgetary Governance,* coupled with reflections upon other related aspects of good public governance.

It is hoped that this Budget Review will assist the authorities in Timor-Leste in shaping a practical agenda of continued reform, which can command the support of institutions across government, and can assist in co-ordinating supportive efforts among the community of international aid and development agencies.

This Budget Review was written on behalf of the OECD by Ronnie Downes, Emilie Gay and Dirk-Jan Kraan.

March 2017

Abbreviations

ASEAN	Association of South-eastern Asian Nations
CAFI	Council of Administration of the Infrastructure Fund
ESI	Estimated Sustainable Income
FMIS	Financial Management Information Systems
GDP	Gross Domestic Product
GRFE	Guide for Reform and Economic Growth of Timor-Leste
HCDF	Human Capital Development Fund
IF	Infrastructure Fund
IGS	Inspector-General of State
IIA	Institute of Internal Auditors
INAP	Instituto Nacional de Administração Pública/National Institute of Public Administration
IPSAS	International Public Sector Accounting Standards
INTOSAI	the International Organisation of Supreme Audit Institutions
KPI	Key Performance Indicators
M&E	Monitoring and Evaluation
MOF	Ministry of Finance
MTBF	Medium Term Budget Framework
MTEF	Medium Term Expenditure Framework
NDP	National Development Plan
OBI	Open Budget Index
OBS	Open Budget Survey
ODA	Overseas Development Assistance
OECD	Organisation for Economic Co-operation and Development
OGP	Open Government Partnership
OIA	Office of Internal Audit
PEFA	Public Expenditure and Financial Assessment
PFM	Public Financial Management
PSC	Public Service Commission
UPMA	Unidade de Planeamentao, Monitorizacao e Avaliacao/Unit of Planning, M&E
SAI	Supreme Audit Institution
SDP	Strategic Development Plan
SEFI	Secretary of State for Institutional Strengthening
SEM	Secretary of State for Socio-Economic Empowerment of Women
SDG	Sustainable Development Goals
SIGMA	Support for Improvement in Governance and Management
VAT	Value Added Tax

Executive summary

Timor-Leste is a young country in South-east Asia, constitutionally independent since 2002, with ambitious goals to progress to upper-middle-income status by 2030. The *Strategic Development Plan 2011-30* maps these goals across a number of sectors. With the projected expiry of Timor-Leste's dependence on oil and gas revenues in coming decades, the national economic strategy aims at investing in the country's development as a "small open economy" and dynamic regional trading hub.

Programme budgeting has been prioritised to link resources with plans, and the national budgeting processes and Financial Management Information Systems (FMISs) have been revised and adapted over the last two years to facilitate this innovation. This OECD study aims to review progress made, and offer suggestions on a medium-term "roadmap" of broader budgetary governance reforms. The OECD analysis has benefited from extensive consultations with officials, ministries, parliament, civil society organisations, private sector and academia, as well as from the network of aid and developmental agencies and experts within Timor-Leste. The OECD analysis is grounded upon principles of i) developmental ambition ii) modernisation iii) building upon solid foundations iv) promoting trust and v) effective communication.

A. Core priorities of PFM reform

Timor-Leste's constitutional and legislative framework is well-specified and provides a solid basis for effective public financial management (PFM). However the framework was not designed with the requirements of modern budgetary governance in mind, including programme budgeting, medium-term budgetary management and sound aggregate fiscal discipline. A developmental priority will be to modernise and update the legal framework for budgeting, including to accommodate the reforms adopted by the government on foot of this roadmap agenda.

The central logic of linking the budgeting and planning processes should be carried through the whole of government by implementing the programme budgeting initiative across all ministries. Drawing on international good practice, future reforms should aim at clarifying core priority goals in each area, and enhancing leadership and accountability for delivery of results. The planning-linked, programme approach should be gradually deepened, so that it serves as the standard conceptual basis – within ministries and with other stakeholders – for all political prioritisation, resourcing, accountability and (in time) appropriation.

Medium-term aspects of budgeting need to be developed, on a progressive basis, so that links between budgeting and planning can be made more meaningful. This will involve multi-year forecasting on clear assumptions, applied over time on the basis of programmes, leading to expenditure envelopes which have stability and relevance for policy makers. In parallel, **the medium-term dimensions of planning** need to be elaborated, with clear goals which will serve as "anchors" for budget programmes. This process should also clearly integrate gender equality (via gender-responsive budgeting) and other cross-cutting priorities. Timor-Leste's role as a "regional champion" in addressing the UN Sustainable Development Goals (SDGs) may assist in the elaboration, tracking and public communication of these medium-term goals.

B. Supporting Pillars of Budgetary Governance

Budget transparency should be adopted as an over-arching principle of continuing reform, highlighting achievements to date (e.g. budget transparency portal) while moving systematically to address gaps from international assessments. This can promote confidence among both internal and external stakeholders, as well as supporting the overall quality of budget policy-making and accountability. In this context, the **citizen's budget** should be re-configured on a programme basis and the extensive budget material should be accompanied with a **concise policy summary** for political/parliamentary decision-makers.

Introducing **accrual accounting** practices should be addressed in stages, including through developing a sound balance sheet and valuing assets and liabilities; the future pace and direction of progress should be considered in light of staffing and IT capacity constraints.

The existing good parliamentary engagement in budgeting could be enhanced further, and the established *Jornadas Orçamentais* (Budgeting Days) pre-budget consultative conference could be upgraded to a forum for meaningful ***ex ante* consultation with Parliament and civil society, including women's organizations and other vulnerable groups**.

Clearer communication of fiscal objectives and budget constraints in the early part of the year would promote realism in *ex ante* budget planning and in discussions with civil society. Withdrawals from the Petroleum Fund have exceeded the upper sustainable limit in recent years, and it may be timely to consider **a supplementary fiscal rule** to enhance the government's ability to maintain the budget within sustainable limits. An expenditure rule, linking expenditure growth to trend non-oil GDP growth, and to additional increases in the revenue base, could be a good fit for Timor-Leste for various reasons.

Tools of expenditure Monitoring and Evaluation (M&E) and re-prioritisation will need to be developed on a progressive basis, in order to ensure that resources are allocated efficiently and to assist in identifying additional "fiscal space". An initial expenditure baseline analysis could provide a good sense of the areas of flexible versus fixed expenditure, discretionary versus committed resources, and drivers of expenditure growth. Efficiency reviews, programme evaluations and sectoral spending reviews could also, over time, enhance the rigour and quality of resource allocation policy.

Annual budget processes should be consolidated and enhanced to provide a solid foundation for multi-year and enhanced programme budgeting. This would include improving the continuity of budget execution, delegation and streamlining of authorisation procedures, upgrading of budget profiling and cash management, clear centralised documentation of public financial procedures, and clearer specification of the requirements of FMIS systems to meet the needs of Timor-Leste's modernised budget framework.

Sound infrastructure governance is essential to achieve Timor-Leste's developmental ambitions. Clearer medium-term planning and budgeting processes are supportive of a more integrated, coherent approach to capital investment. The central procedures for infrastructure planning, appraisal and review (including post-project review) should be continually enhanced and made more transparent, drawing on the findings of international assessments.

Internal audit systems should continue to be developed and embedded across all government departments. In addition, external audit via the ***Câmara de Contas*** (Court of Audit, the supreme audit institution) is key for promoting trust, quality and accountability in national budgeting. The continued development of the Court of Audit should take

account of international good practice, drawing on extensive networks of peer learning in this important area.

C. Broader Public Governance Issues

In support of its budgetary governance strategy, Timor-Leste may also wish to consider other important strands of good public governance which will have a direct bearing on the success of the overall reform agenda.

Public Management and Human Resource Development strategies are important to promote capacity, leadership and accountability within Timor-Leste's public administration, including a clear professional and meritocratic framework for career progression, while taking gender disparities into account. International experience shows that programme-/performance-budgeting systems are most effective when linked with organisational and management performance frameworks.

Timor-Leste's open data/digital government strategy is relevant for budgetary reform, including with regard to the quality and openness of the FMIS and the accessibility of data on achieving national targets. National accounts and statistics systems should be continually upgraded in line with international standards, and with the requirements of programme budgeting (including indicator development) in mind. Early progress in this area will potentially equip Timor-Leste to move to international best practice in areas such as area-based social impact analysis and gender-responsive budgeting.

Public procurement is an area where Timor-Leste has made considerable progress in recent years. Recently a policy paper options on procurement was approved and it is anticipated that a new Decree-law is approved early in 2017.

Co-ordination and coherence of international aid will benefit from closer integration within the programme budgeting model, to enhance visibility over the level of resources in particular areas and their overall impact. This will involve building upon the Aid Transparency Portal and more direct liaison with government ministries and agencies. Advancing overall budget transparency and consolidating the basis for annual and multi-annual budgeting should facilitate progressive movement in this direction.

More generally, Timor-Leste may consider joining the **Open Government Partnership** as a means of showcasing its progress on the world stage, and to assist in specifying a continuing agenda of reform and development.

Finally, **high-level political communication of the benefits and impacts** of the reformed budgeting system, in terms of promoting the wellbeing of the citizens of Timor-Leste, is important for maintaining support and momentum for the overall reform agenda.

Table 1. **Roadmap of Budgetary Governance Reform for Timor-Leste**

Year	Leading entity	Key goals
2017	MoF and UPMA	PFM working group set up and functioning in accordance with Terms of Reference (including policy papers on MTEF, Fiscal rule, virement procedure, number and composition of Budget Books)
	MoF and UPMA	Policy guidelines on gender budgeting
	UPMA	Update Strategic Development Plan
	UPMA, MoF and Line Ministries	Programme structures in Chart of Accounts for 100% of ministries and autonomous agencies (except National Parliament and Presidency)
	UPMA, MoF and Line Ministries	Programme budgeting applied to second phase of ministries and agencies
	MoF and UPMA	Improved transparency and accountability (including: developing a policy summary that explains the major 2018 programmes and objectives)

Table 1. **Roadmap of Budgetary Governance Reform for Timor-Leste** *(cont.)*

Year	Leading entity	Key goals
	UPMA, MoF and line Ministries	Strategy paper on how to build M&E capacity in UPMA, Ministry of Finance, line Ministries and municipalities
	MoF	New procurement law approved
	PMO/ITC unit	User requirements and specifications for FMIS system developed
	MoF	Policy paper to consider benefits and costs of moving from cash accounting to accrual accounting
	MoF, MAE and UPMA	Support the implementation and institutionalisation of Municipalities
	MoF and Fiscal Reform Commission	Alignment of the work plan of the Fiscal Reform Commission with the further implementation plans for the Roadmap
	MoF and UPMA	Obtain baseline expenditure data and analysis to inform future forward estimate and identify fiscal space
	PSC and INAP	Human resource management and development (including development of job descriptions and KPIs)
	UPMA and SEFI	Review the composition and structure of Government
2018	MOF and UPMA	PFM Working group (including review of budget execution and development of PFM Procedures Handbook)
	UPMA	Medium Term National development framework (including development of sector strategic plans)
	UPMA, MoF and Line Ministries	Programme budgeting applied to all ministries and autonomous agencies
	MOF and UPMA	Budgetary governance reform (including development of MTEF Template)
	MOF and UPMA	Improved Transparency and Accountability (including adjusting Citizen's Budget to highlight programmatic and medium-term aspects and explain links to the SDGs)
	MOF	Procurement law implementation
	PSC and INAP	HR Management and development (including assigning managerial responsibility to senior staff for programme achievements start in 2019)
2019	MOF and UPMA	Functioning PFM Working Group (including review of roadmap implementation to date)
	UPMA	Medium Term National Development plan in place
	MOF and UPMA	Budgetary governance reform (including rolling MTEF forward estimates in place)
	MOF and UPMA	Improved Transparency and Accountability (including institutionalising public participation)
2020	MOF and UPMA	PFM Working Group (including reporting on roadmap progress)
	MOF and UPMA	Budgetary governance reform (new budget books and content consolidated)
	MOF	Improved transparency and accountability (including development of a Pre-budget civic forum)
	MOF+DG Statistics	Development of existing Directorate-General of Statistics into an independent Institute/Bureau of Statistics
2021		Transition to programme-based budgeting is complete For 2022 budget and beyond, Parliament approves appropriations for programmes, rather than simply on the basis of inputs Independent review by OECD or other international partner to take stock of implementation of the reform (2017 until 2020) and continue to support the implementation of the roadmap in future years

1. Economic, social and developmental context for reform in Timor-Leste

1.1. Historical and political context

Timor-Leste is a young country having gained full independence in 2002. The country includes the Eastern part of the island of Timor and the enclave of Oe-Cussi, as well as the islands of Atauro and Jaco. Timor-Leste's population was recorded at 1.2 million in 2015, with 253 000 people living in the capital of Dili.[1]

Timor-Leste inherited a Lusophone administrative system, having been under Portuguese rule until 1975; Tetun is widely spoken along with other local languages. After a period of Indonesian rule and United Nations administration, the country adopted its own constitution in 2002 and elected its first president. The period of nation-building has been marked by steady progress from a very low level of economic and social infrastructure, alongside gradual political stabilisation.

The country has a unicameral parliamentary system and the head of state is the president, whose powers are limited but who possesses, amongst others, some rights to veto government policy. Since 2015, Timor-Leste has been under its 6th constitutional government, formed on a coalition basis. Timor-Leste is increasingly taking its place in the international community – it is part of the *Community of the Portuguese Language Countries* and

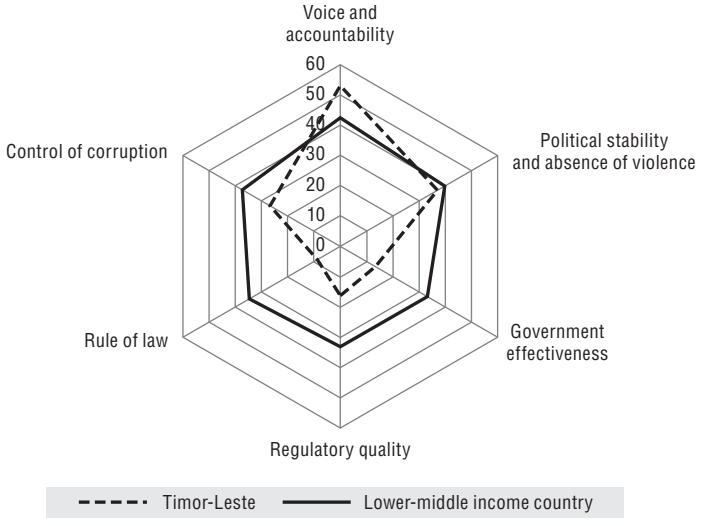
is currently working towards meeting the eligibility criteria that would allow for the country's accession as the eleventh member of the Association of South-eastern Asian Nations (ASEAN).

1.2. Social and developmental progress

Since independence and the establishment of the constitution in 2002, Timor-Leste has seen a gradual strengthening of state institutions, despite progress still to be made (see chart below).

In the first decade following independence, Timor-Leste benefited from relatively stable and strong economic growth on the back of high oil revenues. The latter represented 81% of total Gross Domestic Product (GDP) in 2012. Since then, this share has decreased – in part due to the trend reduction in global oil prices – and in 2015, oil GDP represented approximately half of total GDP.[2] Since 2012, non-oil GDP growth moderated somewhat and has averaged 4.8% annually.[3] Non-oil annual GDP growth is expected to average 5% from 2015 to 2020.[4] This stability has supported Timor-Leste's government in achieving impressive developmental progress, as well as providing its people with security and peace. Over just 14 years, the standard of living of the Timorese people has greatly improved in part due to generous social transfer programmes, amongst other policies. In 2017 the government's social transfers and grants will account for 20% of public spending.[5] Since 2000, Timor-Leste's Human Development Index increased from 0.468 to 0.595 in 2014, an increase of 27%.[6] Between 2000 and 2014, Timor-Leste's life expectancy at birth increased by 8.8 years, reaching 68.2 years in 2014, mean years of schooling increased by 1.6 years and expected years of schooling increased by 1.9 years. Another positive evolution to note is Timor-Leste's Gross National Income (GNI) per capita, which increased by about 145% between 2000 and 2014.[7]

Figure 1.1. **Governance indicators in Timor-Leste**



Note: Number indicates percentile ranking out of 100, among all countries in the world (Worldwide Governance indicators, 2015).

This progress led to Timor-Leste's transition from low to lower-middle income country status in 2011. The country's developmental strategy was underpinned by the vision detailed in the 2002 National Development Plan (NDP). Timor-Leste's current developmental strategy is anchored in the ***2011-30 Strategic Development Plan (SDP),*** which builds on the

achievements of the NDP and was approved by Parliament. The SDP is based upon a bold vision for the future of the country as a trading hub and an open and diversified economy, based on a developed agricultural and tourism sector. The strategy aims to transform Timor-Leste into an upper middle-income country by 2030. It prioritises large investments in infrastructure and improvements to human resource capacity and is built around four key themes:

1. *Social capital:* health, education and social protection;
2. *Infrastructure:* transport, telecommunication, power, water supply and sanitation;
3. *Economic foundations:* the sectors of agriculture, tourism and petrochemicals are targeted to bring about growth, jobs and new sources of public revenues beyond oil; and
4. *Institutional framework:* macroeconomic management and improving the capacity and effectiveness of government institutions.

1.3. *A context of fragility*

Timor-Leste is a leading member of the G7+ grouping of "fragile states" – i.e. states still in an active developmental stage of state-building, often in post-conflict situations – and has been consistently part of the grouping since its creation.[8] As such, Timor-Leste also remains a strong beneficiary of Overseas Development Assistance (ODA). The country was until recently one of the highest recipients of ODA in the world in *per capita* terms, with ODA representing 20.9% of GDP in 2012.[9] Timor-Leste receives support from a large spectrum of agencies, including NGOs, bilateral and multilateral agencies. The three leading Development Partners in Timor-Leste are Australia, the EU and the ADB. In recent years Timor-Leste has made significant strides in securing direct budget support from its donors, ensuring that aid is channelled through national systems and directed towards national priorities. In 2017, external assistance, taking into account concessional loans and grants, is expected to represent about 17% of total budget expenditure in Timor-Leste.[10] 2017 is an election year and another peaceful and smooth political transition will be an important signal of Timor-Leste's developmental progress and maturity.

1.4. *Fiscal context*

With regard to economic foundations, international analysis points to particular risks to Timor-Leste's longer-term fiscal sustainability. In fact, Timor-Leste is heavily reliant on the revenues provided by its Petroleum Fund (PF). Revenue from the PF has become an essential part of the economy – in 2014, it represented 98% of Timor-Leste's export earnings, 61% of GDP, and currently represents 84.5% of total government revenues.[11]

The PF is designed in accordance with the best-practice Santiago Principles,[12] which recommend that assets of wealth funds should be preserved to provide an adequate stream of investment incomes for future generations. Timor-Leste's PF was modelled on Norwegian practice, including the specification of an Estimated Sustainable Income (ESI). The guideline specifies that the government can make transfers from the fund on the basis of the ESI, which is set at 3% of total petroleum wealth, thus preserving the underlying value of the Fund in perpetuity. The value is defined as the current balance of the Petroleum Fund plus the net present value of future petroleum receipts.

While the government acknowledges the need to adhere to the ESI rule in the long-run, this guideline is not currently being enforced as the government has been making excess withdrawals from the PF. Making excess withdrawals is a deliberate decision by Government

reflective of its "front-loading" strategy, by which it is financing investments in infrastructure, in particular roads, bridges, ports and airports. This includes the multi-year development of the Tasi Mane industrial project on the south coast requiring government investment of USD 0.7 billion, close to a quarter of total capital spending in 2017-20.[13]

In 2017, the government will withdraw a total of USD 1.1 billion from the Fund, which will finance 78% of the government Budget.[14] While the balance of the PF stood at USD 16.2 billion in 2015, current estimates project oil production from existing fields will terminate around 2020.[15] If current rates of PF withdrawals are maintained, international analysis suggests that the Petroleum Fund could be depleted in the medium to longer term, which would lead to a major sustainability challenge in the coming decades. In addition, the recent slump in oil prices has affected Timor-Leste's economic outlook and underscored the country's vulnerability and exposed dependence on oil revenue.[16]

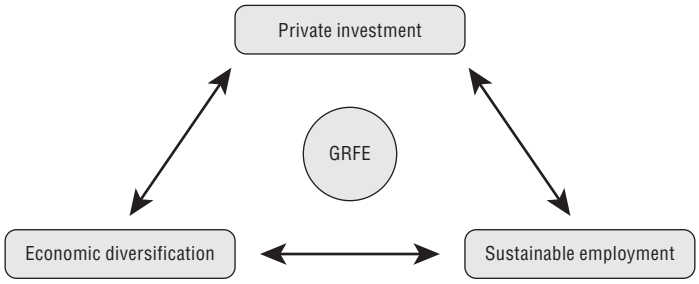
The government's strategy for addressing the fiscal challenges outlined above is the expectation that front-loaded investments will enhance economic capacity, enabling economic diversification, including in tourism and agriculture, thereby generating an increase in domestic revenue. The **Fiscal Reform Commission** was set up in 2015 to develop this strategy. One of the goals of the Commission is to raise domestic non-petroleum revenue from the current rate of 6% of GDP to 15% in 2020. Such a strategy relies on the introduction of new taxes, including Value Added Tax (VAT) expected in 2019, and a greater and more effective collection of Personal Income Tax, Business Tax and customs duty based on a broadening tax base. By reaching this target for domestic non-petroleum revenue, the Fiscal Reform Commission foresees that the ESI rule can be complied with by 2020. Some government departments and international analysis underline the ambitious nature of reaching such a target by 2020, suggesting that prudence requires that Timor-Leste prepares itself for fiscal consolidation nonetheless, including a careful analysis of expenditure and investment prioritisation.

In order for Timor-Leste to achieve higher domestic non-petroleum revenues, the private sector will need to flourish. The resolution of certain outstanding issues will be important in this regard. These include, amongst others, improving the business environment, resolving land and property rights disputes sustainably, encouraging lending to small and medium enterprises and pursuing the formalisation of the economy through such measures as comprehensive and reliable company registers, as well as tackling arrears. In 2016, the World Bank's Ease of Doing Business Index ranked Timor-Leste lowest in the region.[17]

The Sixth Constitutional Government approved the Guide for Reform and Economic Growth of Timor-Leste (GRFE). The GRFE prioritises the implementation of structural economic measures under each of the priority areas identified in the Government Programme and Timor-Leste's Strategic Development Plan for 2011-30. The objectives of the GRFE are to facilitate private investment, promote economic diversification and create sustainable employment. Timor-Leste has many strengths, resources and richness, however there are still key challenges that hinder private-sector-led growth. The private investor expects and requires a secure, predictable and transparent framework, supported by adequate legislation and regulation, and suitable infrastructure to facilitate investment and support business activity.

Timor-Leste is committed to becoming a full member of the Association of Southeast Asia Nations (ASEAN) by 2020 and the GRFE as well as the rest of the government reforms implemented by the Sixth Constitutional Government are fully aligned with ASEAN guidelines.

Figure 1.2. **GRFE Objectives**



The private sector environment in Timor-Leste will be greatly improved and substantially more attractive in the near and medium term, allowing domestic and foreign investors to benefit from the wide range of opportunities that Timor-Leste offers: potential mineral, agricultural and marine resources, an ecosystem still mostly undamaged by human action, favourable climate for the cultivation of high commercial value products, great tourist potential, cultural richness and an excellent location in the Southeast Asian region, among others.

Box 1.1. **Key interventions and legislation under GRFE**

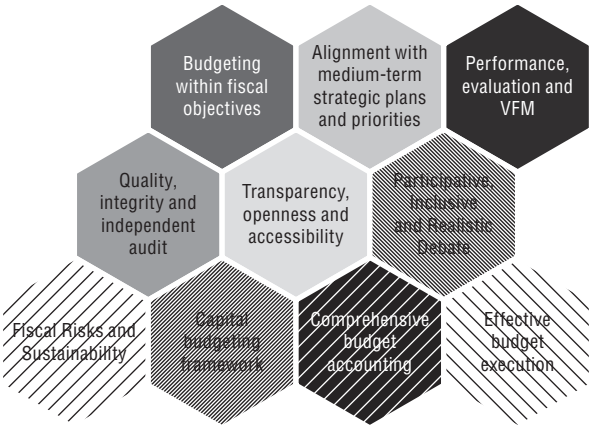
The GRFE is organised into a matrix, composed of five economic priority sectors (or pillars) and six transversal interventions. Timor-Leste has considerable advantages in each of these sectors: 1) Oil and Gas, 2) Agriculture, 3) Tourism, 4) Fisheries and 5) Manufacturing Industry; given the natural resources, the geographical location and the economic potential in each sector. The transversal reform interventions are: 1) The Regulation of Land and Property, 2) Development of Economic Infrastructures, 3) Labour Regulation and Workforce Development, 4) the Reform of the Business Environment, 5) the Tax Reform, 6) the Reform of the System of Private Investment and 7) the Reform and Development of the Private Sector. Under these sectors, key interventions include:

- Sector development plans for agriculture (coffee, forestry, livestock, among others);
- Timor-Leste Investment Reform Map, including the Private Investment Law;
- Timor-Leste Tourism Policy;
- Timor-Leste Industrial Policy;
- Timor-Leste Civil Aviation Policy;
- Land and Property Law;
- Creation of Trade Invest TL – Timor-Leste Promotion of Investment and Export Agency, I.P;
- Export Promotion Law;
- Commercial Company Law;
- Regulation of licensing and business activities;
- Law on Bankruptcy and insolvency;
- Competition Law;
- Consumer Protection Law;
- Consumer Protection Law;
- Revision of the Timor-Leste National Employment Strategy.

1.5. Developing a modern budgetary governance roadmap for Timor-Leste

While the government's most recent efforts have focused on the development of a programme based budgeting approaching, enabling a stronger linkage between strategic planning and resource allocation, the success of this approach is intrinsically linked to consolidation of other inter-connected and mutually supportive elements of budgetary governance. Accordingly in designing a proposed Roadmap of Budgetary Governance Reform, the OECD's Ten Budgetary Governance Principles act as a guiding framework.

Figure 1.3. **The ten principles of Budgetary Governance (OECD, 2015)**



The ten principles listed are:

1. Manage budgets within clear, credible and predictable limits for fiscal policy
2. Closely align budgets with the medium-term strategic priorities of government
3. Design the capital budgeting framework in order to meet national development needs in a cost-effective and coherent manner
4. Ensure that budget documents and data are open, transparent and accessible
5. Provide for an inclusive, participative and realistic debate on budgetary choices
6. Present a comprehensive, accurate and reliable account of the public finances
7. Actively plan, manage and monitor budget execution
8. Ensure that performance, evaluation and value for money are integral to the budget process
9. Identify, assess and manage prudently longer-term sustainability and other fiscal risks
10. Promote the integrity and quality of budgetary forecasts, fiscal plans and budgetary implementation through rigorous quality assurance including independent audit.

1.6. Principles guiding Budgetary Governance Reform

The roadmap that is detailed in further chapters is guided by five core principles, which are of particular relevance and importance to Timor-Leste's current context and approach to budgetary governance reform.

1. **Ambition:** Timor-Leste's vision for strategic economic development is marked by boldness and ambition. This ambition is reflected in the country's *Strategic Development*

Plan, as well as in the leadership role that Timor-Leste provides for the G7+ grouping of peer countries. As a host to the G7+ Secretariat in Dili, Timor-Leste can be an example for other emerging states to follow when seeking to reform their budgetary governance systems. Currently, Timor-Leste is among the leaders in G7+ countries in terms of its performance in public financial management as measured by the Public Expenditure and Financial Assessment (PEFA) framework. The future budgetary governance strategy should hence reflect and support the country's level of ambition.

2. **Modernisation:** Timor-Leste is a young country – its developmental challenges are matched with opportunities for swiftly moving towards good international practices, potentially matching and surpassing other countries with more embedded systems, thereby accelerating economic and social development. The current rates of improvement in the budgetary system are encouraging, as measured by PEFA, which suggests a consistently positive and rapid direction of change since 2010.
3. **Building on solid foundations:** A comprehensive system of programme budgeting and medium-term budgetary management must be built upon a sound, stable budgetary governance framework. This has implications for the re-design and renewal of central budgetary functions and the streamlining and clarification of procedures and responsibilities; issues which are intended to be addressed under the forthcoming new financial management law.
4. **Trust:** Budgeting is central to the delivery of national goals, and the process – in all its aspects – should command the understanding, engagement and confidence of internal and external stakeholders. This includes the public and parliament of Timor-Leste and also the full public administration, as well as the international community of investors and aid partners. Open, transparent and inclusive budgeting should accordingly be a core, guiding principle of reform.
5. **Communication:** The benefits of an integrated approach – including helping to make the vision of the SDP into a reality and improving people's lives – should be brought to the fore in messaging to the public. The Sustainable Development Goals (SDG) offer one opportunity for fresh, clear, internationally relevant communication. There has already been progress in this direction, with efforts by Timor-Leste to align the SDGs with the 2011-30 SDP and the development of a national SDG monitoring tool.

1.7. Risks and Inter-dependencies for Successful Budgetary Governance Reform

Creating a practical roadmap is one important way of demonstrating commitment to a future of sequenced and sustainable reforms. For successful implementation of such a roadmap, a number of factors need to be in place, so that risks and inter-dependencies can be managed. Addressing these factors is a matter for national political and administrative leadership; any deficiencies in this regard would pose clear risks to the prospects for effective and enduring implementation.

- **Cross-governmental, institutional and political commitment:** The programme budgeting initiative has made significant strides forward in 2015 and 2016, having been championed and driven by the Prime Minister's office. Many line ministries and agencies demonstrate an understanding of, and indeed an enthusiasm for, the motives of creating clearer links and "lines of sight" between budgeting and planning. In some cases, line ministries have found the pace of change to be unsettling, and the transition to the new process has involved additional tasks. It will be important to ensure that, as these and other budgetary

reforms are mainstreamed, attention is paid to the need for consultation, and an open approach to listening to concerns and inputs from practitioners and stakeholders to ensure continual improvement and cross-institutional "buy-in". Likewise, it will be important to cement the role of the Ministry of Finance as a partner and co-leader in the next stages of designing and implementing budget-related reforms.

- **Co-ordinated support from the international Aid and Development community:** Timor-Leste commands much goodwill from the international community for the progress it has made in addressing its developmental challenges, and in support of its ambitions for future growth. This goodwill finds expression in the significant aid funding available to the country and the multiplicity of agencies providing support for various projects. In any country at this stage of development, co-ordination among external donors can pose a challenge. A potential role for the Budgetary Governance Roadmap is to assist the aid and development community in coming to a shared understanding, with the authorities of Timor-Leste, on priorities for budget-related reform, thus facilitating more focused, coherent and mutually-supportive approaches to channelling available funds and expertise.
- **Sequencing and sustainability of broad-based budgetary governance reform:** As outlined in this report, progress in particular areas of budget reform – e.g. programme budgeting and medium-term budgeting – depends crucially on progress in other fundamental issues – e.g. sound budget execution, developing human resource capacity, and budget transparency. Taken as a whole, the broad agenda outlined in this report might appear overwhelming: however, the essential task of government is to form a shared, multi-year vision of the key priorities for national reform, and to ensure that the efforts of the various ministries, agencies and external stakeholders are all aligned with the progressive achievement of these priorities.

2. Legal and institutional framework for budgetary governance

This section outlines the legal and institutional basis of budgeting in Timor-Leste and provides an initial overview of where the country currently stands by reference to the various principles of budgetary governance.

2.1. Background to Public Financial Management (PFM) reform

The government of Timor-Leste has made large steps forwards since independence (2002) in the reform of its procedures of public financial management. This period can be divided in three stages.

1. In the first stage, from 2002 to 2007, the core functions of the budget were established.
2. In the second stage, from 2007 to 2014 the emphasis lay on capacity building in the Ministry of Finance and related institutions.
3. In the third stage, from 2015 until the present, budgeting for results has become a central objective of financial management, alongside others fiscal reforms aimed at promoting long term sustainability.

At the start of the **first stage** the national budget of the newly independent state of Timor-Leste in 2002 was USD 72 million. This contrasted dramatically with the *Trust Fund for East Timor,* administered by the World Bank, which could spend USD 270 million. The most pervasive problem during this initial stage was that of fragmentation. Most of the development investments were either financed by the Trust Fund or by various UN organisations and donors. There were hundreds of separate projects all with different

systems for planning, executing and monitoring. This fragmentation meant that there was little space for the newly elected government to gain legitimacy with its citizens through the improvement of public services. Despite these challenges much was achieved. The first foundations of the budget procedure were put in place. The budget office initiated a regular budget process, including budget submissions from line ministries, scrutiny by the Ministry of Finance, review by the Council of Ministers and approval by the Parliament. A chart of accounts was established with administrative and economic classifications. The Treasury established basic functions to check and manage payment orders, make payment orders and account for expenditure. Perhaps the most notable achievement was the establishment of the Petroleum Fund for the administration of oil revenues in accordance with the Norwegian model (see Section 1).

The **second period** started with the election of a new government in 2007 after a period of social and political instability. The government embarked on a strategy of front-loaded investments to drive development, financed from the Petroleum Fund. This strategy was set out in the Strategic Development Plan 2011-30 established in 2011. Much attention was also given to the internal processes of the Ministry of Finance, in particular to upgrade the Financial Management Information System (FMIS). As part of this project, up to 13 modules were integrated, including payroll, procurement, contracts and assets. Furthermore, between 2007 and 2014, the organisation and operational practices of the Ministry of Finance were thoroughly reformed in order to manage the challenges ahead. For this purpose a leadership group was created in 2009 including the Minister, the Deputy Minister and the senior managers (known as the Co-ordinating Council for Financial Management). This group continues to function as a strong force to drive reform in the Ministry of Finance and throughout government. The results that have been achieved in this period clearly stand out by comparison of the PEFA assessments of 2007, 2010 and 2013.

The period starting in 2014 is marked by the emphasis that the newly elected government (in office since 2015) is giving to implementing far-reaching reforms, both in the area of mobilising domestic resources as the main source of future government funding (via the work of the **Fiscal Reform Commission** described in Section 1), the Guide for Reform and Economic Growth of Timor-Leste and through programme budgeting to link the budgeting and planning processes (see in particular Section 3). The Sixth Constitutional Government has also put an increased emphasis on Inclusive Governance through introducing Gender Responsive Planning and Budgeting.

2.2. Legal framework for budgeting

The ***Constitution of Timor-Leste*** defines the roles of the National Parliament and government in the budget process and establishes the authority of Parliament to approve and amend the annual budget law and to monitor the execution of the budget. Article 97 states that Parliament is not allowed to submit bills or amendments that involve an increase in the expenditures or a decrease in the revenues as proposed or enacted in the annual budget bill or law. Art. 115 states that the government will prepare the State Plan and the State Budget and will execute them after approval by Parliament. Art. 145 determine that the Budget Law shall provide a breakdown of state revenues and expenditures, and prohibits the existence of secret appropriations or funds. It also states that the execution of the budget will be monitored by the High Administrative Tax and Audit Court and by the Parliament.

The government of Timor-Leste has made large steps forwards over the last decade in the reform of its procedures of public financial management. An important milestone in

this process was the establishment of a modern budget code: the ***Law on Budget and Financial Management of 21 October 2009***. It provides for budget principles and rules and regulates public debt and guarantees and loans granted by the government, content and structure of the General government Budget and of the annual State Budget Law, including the rules for Special Funds, the procedures for budget alterations and the contingency expenditures, the procedures for budget execution, including the contents of annual budget execution decree, including those for expenditure authorisation notification, budget and accounting records, including progress reports on budget execution and the final report on the budget, the audit of the records by the Superior Administrative, Tax and Audit Court, and the responsibility for budget execution.

The ***decree law on planning, budgeting, monitoring and evaluation*** sets out the rules for the preparation and implementation process including the monitoring of budget execution during the budget year. According to this decree law the UPMA unit ("Unidade de Planeamento, Monitorizacao e Avaliacao") in the Prime Minister's Office is responsible for the co-ordination, organisation and supervision of the process of planning, monitoring and evaluation of all government policies and programmes and of the State Budget. UPMA develops the planning, monitoring and evaluation tools needed to conduct its mission, including the Annual Plan and the annual Performance Report. UPMA ensures the consistency of the Annual Plan with the Strategic Development Plan as well as the consistency of all sectoral programmes with the Annual Plan and the Strategic Development Plan. UPMA also compiles the quarterly performance reports and the annual performance report that are submitted to the Parliament and the Audit Court.

The Ministry of Finance is responsible for the creation and submission of the Budget law and budget books to the Council of Ministers and to the National Parliament, as well as the execution of the budget. The Ministry of Finance is also responsible for reviewing any legal act that has financial implications for the State budget in a given fiscal year, and for authorising virements of funds. Line ministries are responsible for elaborating sectoral plans and submitting budget proposals to the Ministry of Finance and UPMA for analysis. They are also responsible for monitoring the implementation of the Annual Plan and budget execution by their ministries and sending quarterly and annual performance reports, including procurement reports, to UPMA as input to the quarterly and annual performance reports. Autonomous agencies are responsible for preparing and submitting their annual plans and budget proposals to the line ministries by which they are supervised, as well as relevant performance data. As from the fiscal year 2016, the government decided to grant more financial autonomy to these agencies, through the decree-laws by which they are established. These agencies are still subject to the State Budget, but they have now control of their own expenditures and revenues, subject to the limits set forth in the State Budget.

A special law that has an important impact on the budget is the ***Timor-Leste Petroleum Fund Law of 2005***. This law provides for the transfer of all public revenues from petroleum extraction in the territory of Timor-Leste to the government owned Petroleum Fund. The Fund's only outflow consists of the transfers to government budget. Furthermore, the law defines the sustainable annual contribution from the Fund to the government budget, the so-called Estimated Sustainable Income (ESI) as outlined in Section 1. The Ministry of Finance is responsible for the overall management of the Fund. The law makes the government accountable to Parliament through various reporting requirements. The operational management is carried out by the Central Bank of Timor-Leste.

Draft laws that are still in development concern both the expenditure and revenue sides of the budget. At the expenditure side the procurement of goods and services is regulated by some ten different laws, including the ***Decree Law on the Procurement Legal Regime of 2005***. The government is working currently on the streamlining of the procurement regime in an Omnibus Procurement Law. On the revenue side, the government is making large efforts to ensure the gradual substitution of oil revenues by tax revenues when the oil resources are depleted and public needs keep growing in pace with GDP. For this purpose the government has established the **Fiscal Reform Commission** (see Section 2.1).

Table 2.1 summarises the main legal documents by which the budget process and practices of public financial management are regulated in Timor-Leste.

Table 2.1. **Legal Framework of Budgeting in Timor-Leste**

Name of legal document	Objective of the law
Budget process	
Constitution (2002)	Responsibilities of the main State organs
Law on Budget and Financial Management (2009)	Budget code, covering all principles and stages of the budget process
Decree Law on Planning, Budgeting, Monitoring and Evaluation	Defines the policy planning process and the co-ordination with the budget process
Annual laws	
Annual Budget Law	Authorises appropriations and revenues of the State
Annual Execution Decree	Provides the rules for budget execution
Revenue side	
Timor-Leste Petroleum Fund Law (2005)	Prescribes the use of the proceeds from petroleum extraction, including the management of the Petroleum Fund and the definition of the Estimated Sustainable Income (ESI) contribution to the State budget
Draft Law on Value Added Tax	This draft is being developed by the Fiscal Reform Commission and is aimed at the introduction of VAT in Timor-Leste
Public Financial Management	
Decree Law on the Procurement Legal Regime (2005)	This is the most important of several laws in the area of procurement. The government is currently working on the unification of the procurement regime in a new law

Sub-national aspects of budgeting

Currently Timor-Leste does not have a distinct sub-sector of local government. However, based on a ***Decree Law of 2016***, an inter-ministerial technical group for administrative decentralisation has proposed to start with a provisional arrangement that will offer twelve municipalities. This will involve among other things the transfer of personnel that are currently on the payroll of line ministries but working in local administration, onto the payroll of municipalities.

Through the decree-law above, the government of Timor-Leste seeks to sequence the establishment of sub-national government system in the country by going through three phases:

1. *Administrative de-concentration:* during this phase, administrative services of municipal administrations and municipal authorities will be established as direct administration of the state;

2. *Institutional administrative decentralisation:* in this phase, services of municipal administration and municipal authorities will be transitioned from direct administration to indirect administration of state;
3. *Territorial administrative decentralisation:* during this phase, services of municipal administrations and municipal authorities will be transitioned to the sphere of autonomous administrations.

As direct administration of the state, both municipal administrations and municipal authorities have been attributed the competencies and funding to provide services in the areas of education, health, social action and natural disaster, agriculture, public works and transportation, water and basic sanitation and environment, market management and tourism, register and notaries and land services. These eight basic competencies are referred to as programmes in the approved municipality annual action plan and budget for 2017.

More competencies would be added once those eight line ministries or other ministries assigned with basic service delivery responsibilities have decided to delegate some of their functions to municipalities.

Given that the government of Timor-Leste has made necessary effort in decentralisation reform towards establishing an autonomous administration at the sub-national level, it is important to sequence the inclusion of municipalities in budgetary governance reform in anticipating future discretionary budgets assigned to municipalities within these three phases.

2.3. Budget Practices and Procedures within Timor-Leste

2.3.1. Budgeting within fiscal objectives

In Timor-Leste the annual budget cycle begins with the Ministry of Finance setting out the timelines of the budget calendar. All line ministries are then required to draw up annual action plans, which show their programmes and activities for the upcoming fiscal year. A budget conference, known as *Jornadas Orçamentais* or "Budgeting Days" (formerly known as the "Yellow Road" workshop) is held in late April/May where the overall envelope for the budget and the envelopes for the ministries are discussed. The conference is attended by ministers and senior civil servants, and members of Parliament may attend as observers.

Subsequently, the Ministry of Finance prepares a proposal for the Council of Ministers that contains the overall budgetary envelope and the ministerial envelopes. Once this is agreed, the Budget Office of the Ministry of Finance prepares a circular, which explains the government's strategy for the coming budget year (including the planning and financial templates). The budget circular is distributed to all State institutions with the request to submit budget proposals for consideration by the Budget Review Committee. This Committee consists of ministers with a responsibility for economic and financial policy. The Budget Directorate and the UPMA analyse these proposals and prepare so-called **Green Briefs** for each State institution. The Green Brief includes: i) national priorities, ii) information on objectives and budget requests by programme, iii) information on budget execution, iv) main results achieved in the previous year, v) information on donor's commitments and vi) recommendations by the Ministry of Finance and the Prime Minister's Office on the budgetary choices to be made by the Committee. The Budget Review Committee meets and reviews the proposals in July and August. Ministers are invited to defend their proposals. The draft budget is then elaborated by the Ministry of Finance and approved by the Council of Ministers in September. It has to be sent by the government to Parliament by the 15th of October.

In practice, the overall expenditure ceiling that is discussed in the *Jornadas Orçamentais* conference and decided in the subsequent meeting of the Council of Minister is largely determined by the non-oil revenue forecast and the ESI contribution from the Petroleum Fund. However, in 2015, substantial additional withdrawals from the Fund had been approved by the government and the Parliament, mostly to finance major infrastructure projects. Excess withdrawals in 2015 were six times the level of that in 2014. Furthermore, under the budget scenario included in the budget 2017, excess withdrawals will further increase, amounting to USD 4.4 billion during 2017-20, which is 28% of the balance of the PF at end 2015 (the ESI withdrawal would amount to USD 2 billion over this period). The government has justified these excess withdrawals on the basis of their expected contribution to economic growth. In this reasoning the withdrawals are seen as front-loaded funding arrangements that will be paid back in the medium term by additional non-oil tax revenues. In recent years, the government has also allowed a substantial increase in the overall budget deficit, partly on the basis of the same reasoning, and partly on the reasoning that the incurrence of public debt is subject to better safeguards for budgetary discipline than the take-up of excess withdrawals from the Petroleum Fund.

2.3.2. Alignment with medium-term strategic plans

Planning and budgeting in Timor-Leste takes place on the basis of the SDP. The implementation of the annual plans proceeds through the government Programme (for 5 years) The line ministries also produce sectoral plans, both for the medium term and annual plans, but until now there is no structured process for co-ordination with medium term fiscal planning.

2.3.3. Capital Budgeting Framework

Capital budgeting in Timor-Leste is focused on economic development in accordance with the SDP. There are various different sources of funding for capital investment:

- the Infrastructure Fund (IF) for major projects with a budget over USD 1 million;
- smaller investments on the budgets of line ministries up to USD 1 million; and
- smaller investments at Municipality level up to USD 50 000 000;
- some Private-Public-Partnerships projects, such as Tibar Port.

The rationale for the IF has been to protect the investment budget and to make it easier to carry over unused funds to a next budget year (although this facility is currently not yet in use). Furthermore, since the IF finances the investments of several ministries, the IF governance structure makes it easier to ensure the participation of these ministries in the decision-making process through the composition of its board, which is called Council of Administration of the Infrastructure Fund (CAFI). Hence, unlike in many other countries which have set up such funds, the rationale for the fund's development was not primarily for it to be financed by different sources of revenue.

The budget of the IF is divided in ongoing contributions to projects that have been approved in the past and new projects proposed by line ministries and approved by CAFI. The budget of the IF is decided in the annual budget process in the light of the execution capacity of the line ministries, based on historical records. Once the ceiling is decided, then the technical team of the Ministry of Public Works, the Ministry of Planning and Strategic Investment and other relevant line ministries discuss the priority of new projects and develop a proposal to CAFI for the allocation of available resources, taking into account the contributions that have to be made to on-going projects.

2.3.3. *Transparency, openness and accessibility of budget documents*

The 2009 Budget and Financial Management Law prescribes that the budget has to be submitted to Parliament by the 15th of October. After an initial consideration Parliament refers the proposed budget to its committees for about one month. A plenary session on the budget is held in November, where the Prime Minister defends the proposed budget. The committees then prepare a report to Parliament with their findings. The financial committee of Parliament (so-called "commission C") is responsible for the co-ordination of the Parliamentary budget process. The budget is debated in Parliament for around two weeks in December. Amendments may subsequently be proposed and debated. The approved budget is then sent to the President to be signed and promulgated, normally by the end of December.

All six budgets books are submitted to Parliament for approval as follows:

- **Book 1** is an overview that describes the overall strategy of the government, and contains the macroeconomic forecasts on which the budget is based.
- **Book 2** contains the Annual Action Plan for all state institutions and, in the budget for 2017, the appropriations per programme, sub-programme and activity for the ministries and agencies that are included in the programme budgeting initial phase.
- **Book 3** contains the appropriations for the Infrastructure Fund, the Municipalities and the Oecusse Ambeno and Atauro Special Zones.
- **Book 4** (in two parts) contains the detailed appropriations for the line ministries. It specifies the expenditure by administrative division, economic category and purpose. Authorisation takes place by administrative division and economic category (the line items that divide the economic categories by spending purpose are not authorised and have no formal legal status).
- **Book 5** describes the interactions with donors, including on budget and off-budget donor funding.
- **Book 6** contains appropriations for the Capital Development Fund. The Budget Books do not contain an overview of tax expenditures.

The government produces quarterly and annual performance reports and budget execution reports that are submitted to Parliament. The **transparency portal** provides information on budget execution by ministry. The draft budget books are normally made available in mid-October. They are sent to Parliament and made available on the transparency portal. They are published in Tetum, English and Portuguese. After Parliamentary approval, the final books are published around January. There is a separate **Aid Transparency Portal** (ATP). The ATP is the central repository for all aid information in Timor-Leste, and aims to improve aid transparency, accuracy and predictability and to ensure assistance provided is efficient and effective. The Ministry of Finance Development Partnership Management Unit oversees the ATP.

Every year a **citizen's guide to the Budget** is published in Tetum as a summary of all budget books (Books 1-6). The citizen's budget is also available online in the ATP – see Section 4.

2.3.4. *Gender Mainstreaming in the Budget Process*

Gender Mainstreaming has been adopted as a strategy for achieving Gender Equality since 2002, and the SDP has set a goal that "in 2030 Timor-Leste will be a gender-fair

society where human dignity and women's rights are valued, protected and promoted by our laws and culture". A Parliamentary Resolution was approved in 2009 under the Fourth Constitutional Government to introduce Gender Responsive Budgeting. The Secretary of State for Socio-Economic Empowerment of Women (SEM) has the mandate to provide technical support and guidance on Gender Issues.

2.3.5. *Participative, inclusive and realistic debate*

The Budget and Financial Management Law prescribes that the budget has to be submitted to Parliament by the 15 October. As outlined above, the parliamentary phases of budget scrutiny and deliberation are well-specified and the Budget Books contain extensive information.

Public participation in the budget debate is also promoted through the publication of the citizen's budget.

The Parliamentary Commission C gives the opportunity to civil society organisations to explain their views during hearings, when it reviews the budget. The Budget debates in Parliament may also be televised to allow for greater civic engagement.

2.3.6. *Effective Budget execution*

In Timor-Leste the administrative organisation of budget execution has improved steadily over the years. Line ministries in 2017 started to approve their own commitments and payments that send to Treasury to prepare the transfer payment order to the Central Bank. Since 2016, the autonomous agencies approve their own commitments and payments and the transfer payment orders are not sent from Treasury to the Central Bank but instead from Autonomous Agencies directly to Central Bank to debit their own sub-account.

Once the budget has been approved by Parliament and promulgated by the President, the Ministry of Finance authorises spending for periods of three months through **Expenditure Authorisation Notices**. These are allocated at Ministry, Division and Category via the ICT system Freebalance (the current system for budget execution). Spending (through making commitments) can only commence after the funds have become available through notification of expenditure authorisation.

The Single Treasury Account consists of the CFET account for the line ministries, with sub-accounts for the Autonomous Agencies, the Human Capital Development Fund account (HCDF) and the Infrastructure Fund account (IF). The government also holds accounts at commercial banks, but these are only used for the receipt of revenues. No payments can be made from these accounts other than bank charges. All collections in these accounts are swept daily into the Single Treasury Account.

The Treasury has a dedicated cash management unit. Cash flow projections until the end of the year are prepared monthly on the basis of historical cash patterns and notifications from the line ministries and funds on payment dates. Subsequently, taking account of projections of receipts of non-oil revenues, the Petroleum Fund is notified of monthly cash needs, which are then transferred to the Single Treasury Account. This allows an orderly retention of Petroleum revenues prior to investing, so that unnecessary investment charges and early liquidation of assets are avoided.

Notwithstanding the above measures, some issues have arisen with regard to the timeliness of budget execution in practice. This issue is addressed further in Section 3.

2.3.7. Performance, evaluation and value for money

Since 2009, line ministries have produced annual performance plans in the overall context of the budget process, but without explicit links to the budget allocations. The plans have no financial paragraph that explains the costs of the activities to be undertaken and the way these costs are reflected in the budget. In addition, since 2009 the Prime Minister's Office is responsible for the Annual Plan of the government. The objective of this report is to make clear how the broader strategy of the Government is carried through in the budget proposal.

After the SDP was approved, the Prime Minister's Office took the initiative to structure the governmental planning process around programmes. For that purpose it launched an operation in 2016 to establish a programme classification, starting with an initial phase of ten line ministries and 15 autonomous agencies. An agreement between the Prime Minister's Office and the Ministry of Finance sets out the requirements for integration of the programme classification into the chart of accounts and into the ICT system of Freebalance. The goal of the programme classification was i) to link the programmes to the outcomes and overall vision set out in the Strategic Development Plan and any relevant sectoral plans, ii) to use consistent, standardised definitions of "programme", "sub-programme", "division", "activity" and "COFOG codes" and iii) to present the programmes of the ministries in as streamlined and concise a manner as possible, whilst still adequately representing the responsibilities of the ministry.

As a consequence of the operation, the Chart of Accounts underlying the Freebalance ICT system was amended to reflect programmes and activities, thus allowing the ICT system to accommodate programme budgeting. Overall the operation resulted in 83 programmes for the 25 entities included in the initial phase (ministries and autonomous agencies) instead of the 159 programmes that had been used in the 2016 planning process. These programmes and their budgets were presented for the first time in the budget 2017 (Book 2).

For the budget 2017 the programme classification will not yet be used for authorisation. The basis for parliamentary authorisation remains the classification by ministerial divisions and economic categories and the items presented in books 4a and 4b of the budget. It should be noted that appropriations (parliamentary authorisations) and budget laws are not on the line item level of book 4 (which contain a detailed sub-division of economic categories by spending purpose) but on the level of Ministry, division and categories.

Current intentions for further development of programme budgeting include better costing of activities included in the programmes, training and capacity building focused on costing of activities in the line ministries and on planning, monitoring and evaluation on the programme level, further improvement of the Charter of Accounts including more systematic use of nomenclature and rolling out of the programme classification in the Chart of Accounts to all ministries and agencies, with exception of the Sovereign Organs.

There is not yet a regular procedure of programme evaluation in Timor-Leste, but the government and donors do conduct sectoral evaluations from time to time on an *ad hoc* basis.

Having set out above the general elements of budgeting at present in Timor-Leste, the following sections turn to the question of how to design, sequence and implement a programme for continued budgetary governance reform, building upon the national framework that is already in place.

3. Budgeting, planning and achieving strategic goals: Advancing the core elements of budgetary governance reform

This section outlines the approach currently being pursued to implement programme budgeting and medium term budgeting in Timor-Leste. The chapter provides suggestions and recommendations for the future development and direction of these initiatives, taking account of international practice, technical considerations and risk factors. This includes the option of designing a rolling medium-term expenditure framework in a manner that would support the effective roll-out of programme budgeting, while also introducing a stronger medium-term framework for planning.

3.1. Programme budgeting: concepts and international approaches

3.1.1. Benefits and definitions

Programme budgeting involves the structuring of the budget by reference to functional and/or strategic programmes (as distinct from traditional financial "line items", heads and subheads of expenditure) in order to facilitate a clearer focus on the outputs and impacts of public spending, and thus to promote closer linkages with the medium-term planning and developmental processes. Programme budgeting is one common technique of "performance budgeting" and has been embraced by many countries. The perceived advantages of the approach include enhanced monitoring of programme effectiveness; improved allocative efficiency; and greater transparency to stakeholders (especially parliamentarians) with respect to the use and impact of public funds.

The OECD (2007a) has identified three broad "models" or categories of performance budgeting systems:[18]

1. *Presentational* – whereby performance information is presented alongside budgeting documents, not necessarily linked to budget allocations
2. *Performance-informed budgeting* – whereby performance information is presented within the context of the budget documentation, in order to inform and influence budgetary decision-making in a general and indirect manner
3. *Direct/formula performance budgeting* – which involves a direct linkage between the allocation of resources to units of performance, generally outputs.

The international experience over recent years has been for a convergence towards a "performance-informed" approach whereby a limited range of priority information is made available as useful context for budgetary decision-making. Only a small number of OECD countries have implemented a direct performance budgeting approach.

3.1.2. General considerations for the introduction of programme budgeting

International experience suggests that programme budgeting should be implemented in a progressive manner, shifting from detailed financial "line-item" budgeting to programmatic and thematic budgeting, in an effort to promote greater engagement with the policy content and "meaning" of budget allocations. In many countries, programmes are selected within the context of a policy "cascade" from high strategic and developmental goals which inform medium-term and specific outcome goals, in turn informing departmental or sectoral objectives and associated output targets and deliverables. Once programmes have been selected, countries can then move to allocate clear assignment of responsibility (organisational and ideally, managerial) for the achievement of the selected programmes and targets.

A critical lesson from OECD countries in advancing with a programme budgeting system has been the need to avoid information overload, and to secure the interest and buy-in of parliament, the public and indeed the government-wide system of public administration for the programme budget as the focal instrument of policy-making. International experience (OECD, 2007b)[19] also found there to be two main success factors in undertaking a reclassification of the budget on the basis of programmes:

1. Budget estimates and multi-annual estimates should be well explained, preferably in terms of outputs and cost per unit; and
2. Strict rules of budgetary discipline should be put in place to guarantee that overspending on ministerial ceilings cannot occur.

A programmatic classification is recognised to be more appropriate for a policy-prioritisation function of the budget; it can also enhance the budget's managerial and macro-economic control functions. In order for the macro-economic control to function fully, budgeted programmes should not only contain estimates for the budget year but also estimates for the medium-term. In practice, multi-annual estimates may not be legally adopted and may have no binding status as "appropriations" but can be highly relevant for macro-budgetary planning.

Programme setting should be guided by bottom-up reasoning based on the sectoral laws and policy structures that are currently in place. In the countries that have introduced a programme classification, it is generally done under the common responsibility of the line minister and the central budget authority (usually the minister of finance). Usually, every director general is made responsible for one or more programme headings and there are no overlapping responsibilities – although "cross-cutting" programmes (that depend upon inputs from more than one ministry) may require special arrangements. Thus directors general are appointed as budget holders and made responsible for results as well as budgetary discipline for the programme(s) assigned to them. In this context, countries that have introduced programmatic classifications have initially stayed as close as possible to existing organisational structures on the assumption that, once the programme classification is in place, pre-existing challenges in organisational structures can be addressed.

With regard to the second point of budget discipline, it is often recognised that a programmatic budget classification may lead – almost by definition – to a certain relaxation of input controls and may thus be seen by the central budget authority as involving additional risks to budgetary control. In order to minimise such risks, budget estimates and multi-annual estimates should be well explained, preferably in terms of outputs and cost per unit. Strict rules of budgetary discipline should also be put in place to protect against overspending on ministerial ceilings. The possibility to shift resources between inputs within the programme classification is a contract between the central budget authority and the line ministries in which discretion over inputs is exchanged for the acceptance of rules of budgetary discipline.

One issue that sometimes gives rise to concern for the central budget authority and parliament is authorisation of the administrative expenditures of line ministries. The concern is that resources intended as subsidies, cash transfers to citizens, and grants to local governments will instead be used for items such as the recruitment of additional staff or improvement of office buildings. Keeping the administrative budget of the core ministry separate can minimise this risk as in such a case, the administrative budget cannot be increased by moving programme spending into the administration budget. In more advanced

models of programme budgeting, administrative costs are apportioned across programmes using an objective methodology (ideally agreed in advance with line ministries and with key stakeholders including the supreme audit institution), but pay and non-pay administrative costs are reported as separate items alongside the programme details. This approach allows for monitoring and comparison of staff efficiency ratios in different programme areas.

Box 3.1. **Key challenges in implementing programme budgeting in OECD countries**

Some common challenges in implementing programme and performance budgeting in OECD countries, regardless of approach, concern the use of performance information, which is at the most advanced stage of implementing a performance informed budgeting system. These challenges include improving measurement of performance, finding appropriate ways to integrate performance information into the budget process, gaining the attention of key decision makers, and improving the quality of the performance information. Although there are exceptions, most governments have found it difficult to provide decision makers with good quality, credible and relevant information in a timely manner, as well as providing incentives for stakeholders to use this information in budgetary decision making. Some OECD countries have faced some level of resistance from public servants to changing practices, as well as difficulties in developing the institutional capacity of the Ministry of Finance and line Ministries in using performance information.

As one of the first countries to implement programme budgeting, Australia's approach to incorporating a focus on performance has been a long-term, iterative process. This has provided many benefits, not least the opportunity to learn from experience before proceeding with further reforms. This has also been important because of the interrelationship between performance and other aspects of the financial, accountability, political and management environment. The complexity of interactions and incentives is difficult to comprehend in isolation from practical experience, making "big bang" changes potentially high risk. Two recurring themes in establishing good performance information that Australia has faced are:

- The quality of performance information in relation to agency contributions to outcomes and outputs.
- The limited use of the performance information for decision making in the budget context.

With respect to outcomes and outputs, it is important to ensure that links between programmes, outputs and outcomes are clear and measured effectively, particularly if this performance information is to be relied on for budget decision making. It is crucial that new policies and practices are well understood by people in line agencies and that they have the skills, capacity, resources and authority to implement the initiatives effectively. With respect to enhancing the utility of performance information for budget decision-making, a major challenge in introducing a systematic approach to programme reviews has been to ensure that it adds value to government considerations, uses agency resources efficiently, and does not become a mechanical exercise.

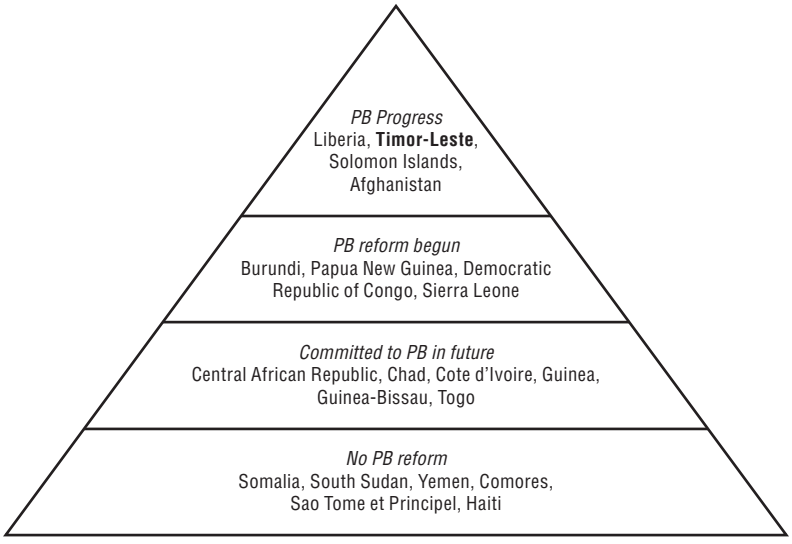
Source: Performance Budgeting in OECD Countries, OECD (2007).

3.1.3. Programme budgeting in developing countries – relevance for Timor-Leste

Based on the OECD's framework, few if any lower middle-income countries currently fall in the category of *Direct/formula performance budgeting*. Timor-Leste has made notable progress in 2015 and 2016 towards budgeting on a programme basis. Based on the OECD's framework, Timor-Leste currently has a *presentational programme budget*. Timor-Leste

compares favourably with countries at similar income levels and with similar contexts, including post-conflict countries. Indeed, when compared to countries belonging to the fragile states grouping of the G7+, Timor-Leste is amongst countries that have made most progress with the reform (see Figure 3.1). In the figure, the category *progress with programme budgeting* is used when programmes are presented in annual budget documents. One considers that *programme budgeting reform has begun* when programme-based medium term sectoral strategies are in place. *Commitment to programme budgeting* is measured, amongst other means by the inclusion of programme budgeting in budgetary governance reform strategies or in some instances, when the Public Finance Management Act has already been revised to account for such changes in the future.

Figure 3.1. **Programme budgeting (PB) reform in G7+ countries**



Source: CABRI (2012),[20] adapted and updated by OECD, country PEFA reports.

None of the G7+ countries possess a system whereby budget appropriations are made on a programme basis, nor does a G7+ country have a fully functioning performance information system by which performance targets are included in budget documentation, linked with budget allocations and thereafter explained and monitored during budget execution.

3.2. Programme budgeting approach in Timor-Leste

3.2.1. Programme budgeting approach, structure and guidelines

Compared to its peers, Timor-Leste is relatively advanced in pursuing a performance informed budgeting approach and this in a relatively short time span. Despite some attempts to introduce a planning framework with a programme based structure in 2009, reforms have directly influenced the budgetary documentation only in 2015 (i.e. the 2016 Budget), which is when for the first time some budgetary information based on a programme structure was included in budget documentation alongside the traditional "line-item budget".

Programme budgeting in Timor-Leste has been spearheaded by UPMA (Unit of Planning, Monitoring and Evaluation) within the Prime Minister's Office, with dedicated technical support and expertise provided by aid partners. Programme budgeting has been

communicated across government as a means to bring closer alignment between policies, plans and budgets.

For the 2017 Budget, UPMA has worked in collaboration with ten line ministries (see Box 3.2) and fifteen autonomous agencies to refine and develop the programme structure. This means that about 58% of the total recurrent budget of government[21] is presented on a programme basis for the 2017 budget. The initial group of ministries were selected based on the public-facing nature of their public service deliverables.

Box 3.2. **Initial group of ministries for the 2017 presentational programme budget**

Ministry of Health
Ministry of Education
Ministry of Agriculture
Ministry of Public Works
Ministry of Planning and Strategic Investment
Ministry of Commerce, Industry and Environment
Ministry of Social Solidarity
Ministry of State Administration
Ministry of Tourism, Arts and Culture
Secretariat of State for Vocational Training Policy and Employment.

Accordingly, budget information for 2017 has been presented in a programme format in **Budget Book 2,** which contains 83 programmes across 25 entities, while also preserving the traditional line item budget contained in **Budget Books 4a** and **4b**. There are also cross-references between Budget Books 2 and 4, enabling the information to be more accessible to stakeholders and citizens and providing for a smooth transition to programme-budgeting.

There has been considerable progress, in a short space of time, in setting out a comprehensive framework and clear guidelines to develop the programme structure, with clarifications and definitions of key terms and concepts. In this process, UPMA has provided line ministries with some training on how to develop their programme structure, as well as costing, monitoring and evaluation.

The approach taken by Timor-Leste, similar to many other developing countries, is to include a single administrative programme under each Ministry, rather than apportioning administrative costs under each programme. In addition, line ministries have been advised to adopt around ten programmes per ministry. Inter-ministerial cross-cutting programmes have not been pursued, in favour of a simplified approach. Similarly, the approach taken is not to change organisational structures within ministries and agencies in order to suit the programme structure, but rather opt for a programme structure which is simple and fits the current organisational structure. This leaves the possibility, as the reform matures, to adopt a more complex approach of reconfiguring organisational structures to better suit programmes, as well as to potentially, if needed, re-evaluate the approach taken for administrative costs.

As outlined in the *Guidelines*, the structure has been developed around eight simple principles:

1. Know your customer;
2. Base programme structure on existing organisational structures and duties;
3. Limit the number of programmes;
4. Limit the number of outputs and activities within the programme;
5. Standardise nomenclature;
6. Establish a strict system for making changes to programme, output and activity nomenclature;
7. Avoid focus on performance indicators in initial stages; and
8. Develop an internal management programme.

This general approach, and in particular the delayed introduction of performance information, is appropriate to Timor-Leste's current stage of budgetary reform. The 2017 Budget exercise made significant progress compared with the 2016 exercise, when the number of programmes per ministry was too high with many of these being focused on internal administration rather than service delivery. In parallel, in 2016, the chart of accounts has been updated for programmes and activities with specific coding for programme, sub-programme and activity levels, preparing the ground for further implementation.

3.2.2. Challenges and priorities

The guidelines have been produced and applied only in 2016 for the 2017 budget. The second phase of programme budgeting for the remaining line ministries is scheduled to start in time for the 2018 budget process with an updated version of the guidelines issued and disseminated to the relevant line ministries.

In addition, within line ministries, there appears to be a varying degree of understanding and buy-in of the reform. The above-mentioned revised guidelines should assist in promoting uniformity in the continued implementation of the Decree Law 22/2015, by clarifying some of the key steps in the planning and budget preparation process. Some line ministries including the Ministry of Education and Ministry of Health have embraced the approach and have adopted a sound structure of programmes, outputs and activities. Some other Ministries do not yet appear to have a similarly high understanding of either the technical considerations or the potential benefits of the programmatic approach. **Maintaining a uniform approach to implementation will be a challenge** as the reform agenda rolls forward but the first steps need to be consolidated with the existing legal framework outlined above.

It remains to be seen whether, and to what extent, **the planning-linked programme structure will be used by parliamentarians** as a tool for the oversight role. At present, parliamentary budget hearings remain centred on relatively detailed financial line item discussions, disconnected to a degree from substantive assessment of policies. While civil society organisations appear to have started analysing the programme budgeting information, capacity for the media to work with the information is limited at present.

Some stakeholders have raised concern about the risk of overloading line ministries with demands and expectations regarding programme budgeting. Currently, once budget ceilings have been decided upon and communicated, the initial group of line ministries receive two templates to complete their budget submissions – one provided by UPMA, which contains the programme structure, and one provided by the Ministry of Finance, which

contains the traditional line item structure. There is also a relatively small timeframe for line ministries to complete these templates. In practice the traditional line-item template provided by the Ministry of Finance remains the default option used in the first instance by several line ministries, in keeping with the perceived primary role of Budget Books 4a and 4b.

Some stakeholders have expressed concern with the risk of an overly top-down reform, and have shared a need to ensure that feedback loops are enabled between line ministries, Ministry of Finance and UPMA. As in any country pursuing an ambitious reform agenda, **the role of the centre in driving forward and championing reform should be balanced with mechanisms to ensure buy-in and "ownership" of reform across government as a whole**. Failure to do so could lead to lapses in co-ordination and commitment from other ministries which need to have a clear sense of their roles and domains of responsibility in the overall reform effort.

3.3. Broadening and deepening the programme budgeting agenda

3.3.1. Sequencing the reform

Currently, the programme structure used in Timor-Leste can be characterised as "presentational" in that while the parliament has access to a version of the budget configured according to the programme structure, in practice appropriation of the budget law for the coming year is undertaken on the basis of the line item budget in Books 4a and 4b, at the so-called category level. In addition, in Timor-Leste, the programme structure still being relatively novel, has not yet become the main basis for policy discourse.

Deepening the transition to programme budgeting has the potential to unlock the full benefits of this approach for Timor-Leste, with an emphasis on performance, evaluation and value for money becoming an integral part of the budget process. Other incidental benefits raised by some stakeholders include enhancing clarity necessary for effective expenditure control; enhancing line ministries' bargaining power by making explicit the public-policy dimensions of their financial allocations; and diminishing the scope for arbitrary reallocations during the budget process. Oversight actors will greatly benefit from accessing information in an accessible programme budgeting structure.

In considering the pace and sequencing of the reform looking forward, it is useful to look at OECD experiences and good practices. Countries around the world have taken very different steps in their reforms and progress in adopting performance budgeting has been carried forward at various speeds and to various degrees. A number of OECD countries have taken more than a decade to fully implement programme budgeting, mostly as they progressed iteratively to implement an approach, which was relatively novel at the time of the first reforms. Likewise, in non-OECD countries it is common for reforms to be staged over a decade, especially in large federal states, while in small-centralised states progress has been more swift (see the Box 3.3 for example from Mauritius, which may be in certain respects a useful comparison for Timor-Leste given country context).

3.3.2. Developing indicators to support programme budgeting

Selecting and using performance indicators to monitor and measure progress in achieving targets are among the most challenging dimensions of a programme budgeting reform. However when the correct set of indicators is in place, this can help to leverage the performance system as a catalyst for progress in other dimensions of public policy (see Box 3.4 below for some international examples).

Box 3.3. **The multi-year transition to programme budgeting in Mauritius, 2003-11**

2003	PPBB and an MTEF were prepared for six ministries on a pilot basis
2006	Government decision to implement PPBB; this was part of an overall fiscal reform programme
2007/08	A parallel programme-based budget was published, while the annual budget adopted was still on a line-item basis
2008/09	Parliament approved budget spending by programmes Changes in the Finance and Audit Act in May 2008 allowed for a programme-based budget with effect from 1 July 2008
2011	The framework for strategic planning was made consistent with the programme-based budget framework Ministries/departments requested to prepare strategic plans to improve budget planning activities Finalisation of a new chart of accounts adequate for monitoring spending by programme Modernisation and computerisation of the Treasury accounting system, in line with programme budgeting requirements and the new chart of accounts Ministries/departments put in place adequate systems for monitoring and reporting progress on programme budgets and performance targets Issue of a programme budgeting manual and an investment projects process manual Extensive training conducted for budget, accounting and internal audit staff of all ministries/department

Source: CABRI, Performance and programme-based budgeting in Africa – a status report, 2013.

Box 3.4. **Key performance indicators and public policy**

Austria has over recent years reformed and streamlined its budgetary framework so that each ministry presents its estimate on a programme basis, with a small number (no more than 3-5) of performance objectives specified for each programme. At least one of these programmes must relate to gender equality. Both the resources allocated to each programme, and the performance relative to the objectives, are subject to audit by the supreme audit institution.

Example of indicators: Number of men and women who attend preventive health examination; percentage of women between 45 and 75 years who participate in breast cancer screening

Likewise, **New Zealand** has a well-developed results approach, whereby agencies are organised around the outcomes that matter to citizens, and in this context each agency must specify the "vital few" indicators that will tell whether these goals are being achieved.

Example of indicator: Percentage of children sitting and achieving School Certificate in five subjects

The **United States** has also placed a high priority on articulating clear performance objectives for each agency, including a small number of "agency priority goals"; these objectives have become an organising principle for public accountability and also for internal management and staff engagement.

Scotland's National Performance Framework involves a co-ordination mechanism to ensure alignment of strategies and programmes across sectors, in support of broader national outcomes.

Example of indicators: Proportion of driver journeys delayed due to traffic congestion; Total additions to the supply of housing, including public and private new house building; conversions of existing buildings to housing use; and refurbishment of dwellings

Source: OECD, *The Governance of Inclusive Growth*, 2015.

Currently, UPMA has been compiling quarterly performance reports and annual performance reports drafted since 2009, from inputs provided by line ministries. The quality of these reports has been variable, mainly on account of varying degrees of standardisation, lack of specification and adoption of performance information by line ministries. For the 2016 Budget, UPMA introduced performance information in the planning tool, building upon the concepts of goals, targets and expected results that have been in use since 2009; although it appears that there is still progress to be made in ensuring that these concepts are correctly and widely understood across all line ministries and agencies. In addition, owing to the lack of full synchronisation between the approved budget and the development of action plans, performance monitoring is for the present limited to financials only.

At a higher level, the process of defining key indicators to assess progress in the achievement of the priorities defined in the SDP has faced some challenges, notably on reaching agreement amongst line ministries and in co-ordination with key budgetary institutions. For the future, Timor-Leste will need to move towards adopting guidance for selecting and developing indicators, both quantitative and qualitative and at various levels, sex-disaggregated data, including through good practice criteria (for example: SMART or FABRIC criteria[22]). Another priority will be to formalise the process of selecting indicators in the planning process and to harmonise with sectoral plans (see Section 3.6).

3.2.3. Other aspects of programme budgeting implementation

Bearing in mind international and developing country experience, and given that Timor-Leste is a relatively small and centralised country, one can expect the transition to a full programme budgeting system to take a number of years. The transition will need to be carefully crafted and sequenced in line with other reforms considered in the following sections. Regularly tracking and monitoring progress with the reform will also support effective implementation.

The Chart of Accounts of the government's FMIS (Freebalance) was restructured in 2009 to enable programmes and activities to be entered into the system and therefore link budgets with plans, i.e. the FMIS system is set up to accommodate programme budgeting. However, the titles of the programmes and activities within the current system do not yet provide meaningful data for line ministries on the actual costs of their programmes and activities. It is notable that the FMIS is not yet set up for the inclusion of performance information. Other issues surrounding the development of the FMIS are outlined in Section 4.

One of the shortcomings of the programme budgeting system, at this early phase of its development, is the mismatch between the programme structure which highlights the linkages with the SDP, on the one hand, and the category/line item structure which forms the basis of appropriation and of virement, on the other hand. As some stakeholders have observed, a number of the traditional categories are common to all or most of the programmes, so that after the budget is adopted, ministries have a wide discretion to move funds away from one programme area to another, without any requirement for advance authorisation. This is at odds with the vision of a programme budgeting model whereby the government proposes that various aspects of the SDP be prioritised for resource allocation, with parliament assenting to these proposals. Into the medium term, the logical way to address this issue is that the parliament should vote on allocations on a programme basis, and/or that virement of funds between programme areas should be restricted. This may require extending Plenary work under the budget legislative process and the rules of procedure of the National Parliament may need to be revised to reflect such modifications.

Further down the line, one could assign clear responsibility for achievement of targets. In many countries, a programme manager is assigned in line ministries based on organisational programme structures. In such cases, programme managers are responsible for the progress and achievements of their programmes. Providing programme managers with the formal authority and resources to fulfil their duties can support their effectiveness.

The soft dimensions of the reform will also need to be carefully managed, including the role of various key partners and stakeholders, in particular that of the Ministry of Finance. One option would be to set up a PFM working group for the reform; such a steering group could consist of members of the MoF, UPMA and other key stakeholders. Reform will need to progress in line with capacity development in a predictable and sequenced manner. Systems will also need to be updated gradually, including the FMIS which is currently not ready to handle performance information.

Finally, Timor-Leste's Budget and Financial Management law, dates from 2009, and while comprehensive, does not reflect the more recent advances in budgeting in the country. Since 2009, the Budget and Financial Management law has been updated with the Organic Law of the Audit Chamber of the Higher Superior Administrative, Tax and Audit Court, as well as via clauses in the annual budget law. Currently, these latter clauses are not reflected in a consolidated manner in the Budget and Financial Management law, which diminishes the clarity of processes and procedures for stakeholders. Timor-Leste will need to proceed with the planned revision of its Budget and Financial Management law in order to provide a consolidated basis for public financial management, including specifically the requirements of programme budgeting and medium-term budgeting.

Roadmap Box 1: Programme Budgeting

Adopt a carefully sequenced transition to programme budgeting, ensuring buy-in and consultation from all stakeholders

2017	Undertake a consultation with line ministries to gain feedback on progress to date, to ensure that the programme structure satisfies the needs of each Ministry and is understood by all levels within the administration, especially at operational levels; consider establishing cross-stakeholder working group as a standing consultation/co-ordination mechanism.
2017	Apply the programming format to a second phase of ministries and autonomous agencies.
2017-18	Consider one streamlined template to be sent to line ministries as part of budget circular (covering both programmes and financial allocations) for clarity, efficiency and improved co-ordination. ***Synergy:*** Will benefit from the proposed review of institutional roles and responsibilities within the public administration as outlined in section 5.1.
2018	Complete the mainstreaming of the programming format, so that the central logic of linking the budgeting and planning processes can be carried through in all ministries and autonomous agencies.
2018-19	Consider consolidating the financial and performance information within the budget books.
2019	Assign managerial responsibility to senior staff for programme achievements ***Dependency:*** **Requires review of human resource management, including development of job descriptions as outlined in section 5.2**.
2019	In line with development of sectoral plans, adopt guidance on selecting, developing and collecting data for performance indicators and standardise the timing of these exercises, as well as monitoring and evaluation exercises. ***Dependency:*** **To be effective and to ensure the quality and credibility of information, this requires increased statistical capacity as outlined in section 5.3**.
2019-20	Begin to include performance targets/indicators within budget documentation.
2019-20	Consider a transition to budget appropriation and control on the basis of programmes. ***Dependency:*** **To be effective, requires updating and modernising FMIS as outlined in section 4.2**.

3.4. Medium-term expenditure management

3.4.1. Medium term budgeting approaches and concepts

The OECD's second budgetary governance principle emphasises the importance of medium-term strategic alignment (see Box 3.5 below).

Medium-term budgeting is used to improve aggregate spending control and to allocate budget resources between sectors or programmes. With effective medium-term budgeting, medium-term projections of budget programmes are based on existing spending policies, together with the impact of proposed new budget policies, which are clearly linked to annual budgets, all on a programme-basis. In such a manner, medium-term budgeting can serve as one vehicle for i) providing greater assurance to policy planners about multi-year resource availability; and ii) identifying appropriate medium-term goals, with which the resources should be aligned. Hence, effective medium-term budgeting is a supportive measure towards creating a greater link between budgets, plans and policies – complementary to programme budgeting – and an integral part of providing predictability to policy-making.

As for other reforms, there are several levels at which medium-term budgeting can be undertaken. According to a typology developed by the World Bank, at a first level a *Medium Term Fiscal Framework (MTFF)* contains a statement of fiscal policy objectives and a set of integrated medium-term macroeconomic and fiscal targets and projections. A *Medium Term Budget Framework (MTBF)* builds on an MTFF by developing medium term budget estimates for individual spending agencies. The objective of an MTBF is to allocate resources to strategic priorities and ensure that allocations are consistent with overall fiscal objectives. The advantage of this approach is to provide some degree of budget predictability to spending agencies, while safeguarding overall fiscal discipline. A *Medium Term Expenditure Framework (MTEF)* then adds further detail to this approach by providing additional elements of activity and output based budgeting. These additions aim to further enhance an emphasis on value for money of public expenditure, in addition to reinforcing fiscal discipline and strategic prioritisation.[23]

3.4.2. Progress with medium-term budgeting in Timor-Leste

In Timor-Leste, some basic foundations of medium-term budgeting are in place. The budget contains a five-year perspective, with estimates for the current year and for four outer years included in annual budget documentation. Forecasts of fiscal aggregates are prepared based on main categories of economic classification, including salary and non-salary expenditure, and the programmatic classification is presented on a rolling annual basis. However, the four outer-year figures are not currently based on programmes or on an analysis of policy needs and prioritisation, but on an extrapolation of figures from the previous year based on an annual increase set at 4%, presumably in line with inflation forecasts. The 4% annual increase applies to recurrent expenditures, with forecasts for capital expenditure analysed and set by the Major Projects Secretariat.

There has however been positive direction of change in recent years when it comes to medium-term budgeting in Timor-Leste. The PEFA evaluation undertaken in 2013 points to progress in this domain, with the score for P-12 which measures *Multi-year perspective in fiscal planning, expenditure policy and budgeting*, improving from D+ in 2010 to a C+. A rapid PEFA analysis undertaken in 2015 suggests that progress has stalled since then, with a tentative score of C+. It is apparent that authorities are aware of, and are acting upon, the need to further advance this aspect of overall budgetary governance reform.

Box 3.5. **OECD Budgetary Governance Principle 2**

Closely align budgets with the medium-term strategic priorities of government, through:

1. developing a stronger medium-term dimension in the budgeting process, beyond the traditional annual cycle;
2. organising and structuring the budget allocations in a way that corresponds readily with national objectives;
3. recognising the potential usefulness of a medium-term expenditure framework (MTEF) in setting a basis for the annual budget, in an effective manner which
   i) has real force in setting boundaries for the main categories of expenditure for each year of the medium-term horizon;
   ii) is fully aligned with the top-down budgetary constraints agreed by government;
   iii) is grounded upon realistic forecasts for baseline expenditure (i.e. using existing policies), including a clear outline of key assumptions used;
   iv) shows the correspondence with expenditure objectives and deliverables from national strategic plans; and
   v) includes sufficient institutional incentives and flexibility to ensure that expenditure boundaries are respected.
4. nurturing a close working relationship between the Central Budget Authority (CBA) and the other institutions at the centre of government (e.g. prime minister's office, cabinet office or planning ministry), given the inter-dependencies between the budget process and the achievement of government-wide policies;
5. considering how to devise and implement regular processes for reviewing existing expenditure policies, including tax expenditures, in a manner that helps budgetary expectations to be set in line with government-wide developments.

3.4.3. Challenges and priorities

There are a number of issues facing Timor-Leste regarding the development of medium-term budgeting. One of these includes the current lack of a medium-term budget statement or a medium-term socio-economic policy framework. This leads to a low level of buy-in and understanding of the resource envelope in the current year, and hence in the medium term. **The medium-term dimension is not discussed during the annual consultative *Jornadas Orçamentais* (Budgeting Days) conference,** which takes place in May. Hence, technical and strategic planning guidance necessary for delineating the medium-term budgeting process are missing for the most part. A medium-term budgetary policy statement would enable better establishing and explaining ministry budget ceilings and underpinning an integrated planning and performance framework.

A second consideration is the process by which investment budgets are developed. **Currently linkages between investment budgets and forward expenditure estimates remain weak**. There are no technical guidelines for the preparation of investment budgets, the distinction between capital and operating expenses, and the analysis of future recurrent cost implications. In addition, the absence of a systematic approach to investment budgeting makes it more difficult to allocate resources in a clear manner to where they are needed. There is a certain level of fragmentation by which the investment budget is managed across institutions. The Ministry of Finance characterises this as a weakness explaining that "*major*

infrastructure projects are initiated in line ministries, appraised by the Major Projects Secretariat, approved by the Council of Administration of the Infrastructure Fund, implemented and monitored by line ministries, verified by National Development Agency, supervised by AND disbursed through the Treasury. This system involves many people and organisations at different stages in the process and the smooth conduct of the infrastructure programme will require good co-ordination, sound advice at each point and a robust information system".[24] In addition, there is a poor recognition of certain types of multi-year expenditure, including maintenance costs, associated with some investment projects. This dimension links to the needs of strengthening the procurement system as explained later in this report.

A third challenge to advancing medium-term budgeting in Timor-Leste is the current presentation and availability of information provided by development partners with regard to Overseas Development Assistance (ODA). **ODA receipts and expenditures are not currently considered as an integral part of the medium-term budget outlook**. At present the development budget is contained in a separate Budget Book, Book 5, which details the programmes that development partners will be funding. Budget Book 5 includes comprehensive information on planned obligations covering most development partners for the forthcoming fiscal years. Budget Book 5 provides aggregate information by project loan and grant-financing, and further disaggregates data by attributing obligations to the administrative categories (votes) of the budget classification. Foreign aid projects (grants) do not form part of budget appropriation, as the Budget Law is based on Budget Books 4. However, article 23 of the Budget and Financial Management Law requires that budget appropriations indicate future revenues from foreign donors.[25]

Some stakeholders have raised concern with the poor linkage between government programmes and development partner programmes. These programmes are not directly linked to the government's programmes. In most cases, line ministries are not privy to discussions with development partners, which directly make agreements with the Ministry of Foreign Affairs. Sometimes information on grant agreements is not made transparently available. For the Ministry of Agriculture, Health and Education, the three ministries receiving the highest ODA budget in 2017, this can cause a considerable challenge for planning. More specifically, there is concern with respect to the credibility of forward ODA estimates. In 2016, actual disbursements were lower than planned disbursements, at a proportion amongst the highest within aid recipients (see Table 3.1).

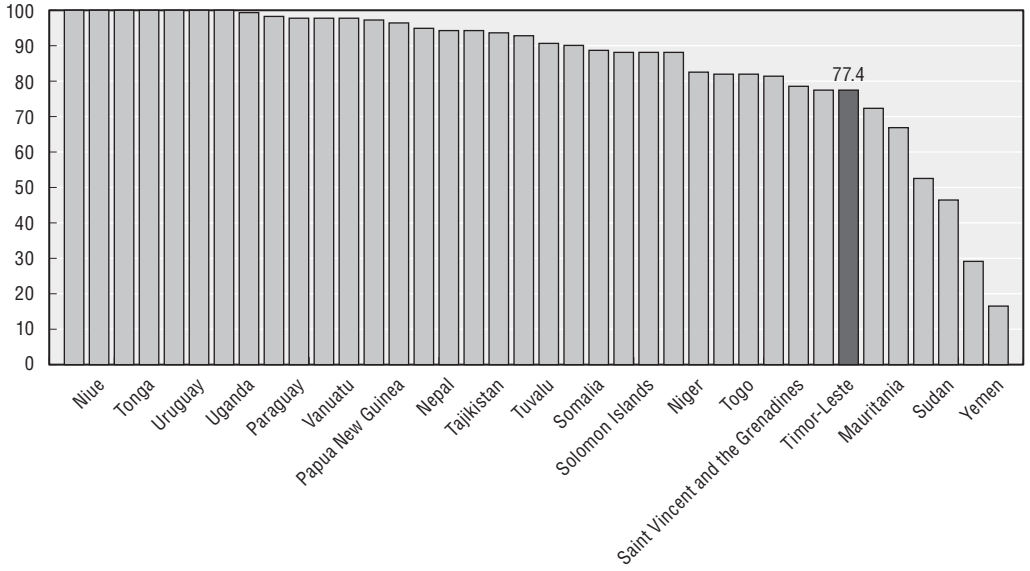
Table 3.1. **Selected PEFA indicators**

		2010 PEFA	2013 PEFA	2015 Rapid PEFA Assessment
D-2	Financial information provided by donors for budgeting and reporting on project and programme aid.	D+	C+	C+
D-3	Proportion of aid that is managed by use of national procedures.	D	D	D

The Aid Transparency Portal brings together much useful information, although it is not yet at the stage where it fully meets the needs of users. The Portal does not yet contain detailed, timely and updated "real time" information on the level of spending that donors are providing to each programme. For example, transparency portals usually publish official grant agreements and donor project documents. The low predictability of aid information is combined with the difficulty for line ministries to receive information at the right time. These challenges are driven by external factors such as several development

partners have differing fiscal year calendars, as well as other external factors such as many donors being limited by single year budgets that do not allow for multi-year budgeting. These issues add obstacles to Government obtaining accurate and timely information. The use of country systems and the status of implementation of the Busan Partnership agreement continue to be very low in Timor-Leste as highlighted by the recent UNDP/OECD *2016 Monitoring Framework of the Global Partnership for Effective Development Co-operation*[26] – Use of Country Systems (UCS) is 7% of total recorded aid to government. These weaknesses are reflected in the latest PEFA assessments (see Table 3.1).

Figure 3.2. **Annual predictability of development co-operation**



Source: Global Partnership for Effective Development Co-operation Monitoring Report, UNDP/OECD, 2016, Indicator 5a: % of scheduled disbursements planned, 2015.

In combination, these elements pose a significant challenge in effectively planning resources around strategic priorities in a medium-term perspective. The government is currently developing an Aid management policy and strategy, which is a necessary step in order to strategically consider how aid information and predictability can best be managed and improved in the country. Donors are aware of the challenges that ODA creates for medium term planning and should strive to ensure that the assistance provided is more timely, predictable, and makes appropriate use of the country systems

3.5. Proposed steps to advance medium-term expenditure management

In order to achieve a rigorous and effective process of medium term budgeting, procedures would need to be progressively aligned with the following principles:

1. the multi-year projections of revenues and expenditure should evolve from technical extrapolations to **realistic forecasts,** based on information and realistic assumptions about the consequences and costs of current policy (taking into account the development of demand) and of alternative/proposed policies.
2. the ceilings for total expenditures and ministerial envelopes should apply to the **medium term** (just as the current estimates at the line item level do);

this would entail that the annual ceiling-setting exercise following the annual Jornadas Orçamentais conference should be expanded to the medium term, covering two, three or four years after the budget year.

3. the medium term estimates should apply to **policy areas or programmes**, rather than to the current line items;
4. *this entails that the medium term financial projections should be applied and made public in the context of the programmes (now in Book 2 of the Budget) although the projections would need to be calculated on the basis of the underlying line items (Book 4)*;
5. the **ceilings for total expenditures and the ministerial envelopes** should be based on a trade-off/reconciliation of medium-term sectoral plans and revenue options;
6. *this entails having full information, at the time of annual ceiling-setting, regarding the implications of existing plans and of new policy proposals in each area, allowing for a policy discussion in which policy measures can be reconciled/traded-off both against each other and against revenue options. This is in contrast to the existing practice of re-opening and re-negotiating the expenditure envelopes, a practice that can lead to "permanent budgeting". Consideration should be given to re-scheduling the involvement of the political Budget Review Committee to this important stage of the budget process, rather than having it do its work after the ceilings are supposed to be fixed.*
7. the **medium-term estimates for each ministry** should be reconciled with the ceilings for total expenditures;
8. *this entails that after ceilings have been set, the line ministries consider what policy measures may be necessary in order to fit the programmes within the ceilings. Any such policy measures should be explicitly acknowledged in the budget documentation.*
9. reconcile and **align existing medium-term sectoral plans** with the new medium term estimates.

   No new plans or proposals with significant budgetary implications should be tabled outside of the budget process during the year; or alternatively, any such policy proposals should contain a financial paragraph that explicitly reconciles the new policies with the prevailing medium term estimates. This may also involve virement of medium term estimates in any year covered by the estimates.

At a later stage, a **carry-over facility** should be considered which allows for programmes that have incurred delays to be moved over to the following year within certain conditions (for an example of how this is set up in an OECD country, see Box 3.6). Developing a carry-over facility will also enable a closer integration of special funds, including investment projects within the budget process, ideally under closer remit of line ministries. Capital and recurrent budgets need to be integrated and management of investment projects streamlined. Annual investment plans and medium-term investment plans can be developed, taking into account medium-term maintenance recurrent costs. The credibility of forward estimates is also weakened by procurement constraints and issues relating to the infrastructure budget (see later proposals regarding these issues).

Such an approach, when fully implemented, also provides the government with an opportunity to strengthen the co-ordination and predictability of the Overseas Development Assistance (ODA) which it receives.

Box 3.6. **The carry-over facility in Germany**

Carry-over: Section 19 of the Federal Budget Code allows for appropriated funds from one year to be carried over for use for the same purpose in the following year, subject to conditions. The main condition is that the carryover must be justified in each case by an objective requirement to do so (e.g. a legal or contractual obligation) in practice this means that the carryover facility is not a tool routinely or arbitrarily available for budget managers. Investment expenditures (and expenditure from earmarked revenues) are automatically eligible for such carry-over; other types of expenditure may be declared eligible "if this promotes their efficient and economic use". In practice, the latter procedure is occasionally followed for current programme expenditure, although there is some flexibility allowed with respect to administrative expenditure. A distinctive feature of Germany's approach to carry-over is that any such expenditure in the second year must be explicitly financed through savings in other areas of the departmental budget.

This approach ensures that carry-over does not entail any adverse impact on budgetary plans and the public finances, and it requires departmental budget managers to prioritise within their overall allocations and to pay special attention to timely budget execution. On the other hand, the incentives for managers to realise savings and efficiencies in budget execution would appear limited under this model compared to the experience of other OECD countries which allow departments to retain the benefits of year-end savings for carry-over purposes, without the requirement to "cover the use" of such funds through offsetting revenue or savings measures.

Source: Germany Budget Review, OECD Journal of Budgeting, Volume 2014 Issue 2, 2014.

Roadmap Box 2: Medium Term Expenditure Management

Adopt a progressive approach to enhancing medium-term expenditure management to effectively resource strategic programmes:

2019	Establish multi-year estimates for the future costs of current policy at the programme level. The budget ceilings for total expenditures and ministries comprised in the MTEF should cover the same number of years as the multi-year estimates. Base the annual ceiling setting exercise on i) the prevailing medium term estimates at the programme level, ii) policy letters of line ministries concerning proposed changes in existing sectoral programmes and new policy initiatives and iii) revenue options. After the ceilings have been set, they should be kept as stable as possible. After the ceilings have been set, line ministries have to take policy measures to fit their programmes under the ceilings. The resulting medium term estimates should be explicitly reconciled with the ceilings (in the sense that the sum of the estimates do not exceed the ceiling). Policy measures that change existing medium term sectoral programmes should be explained in the budget documentation. Any sectoral plan that is submitted to Parliament should contain a financial paragraph, which explains that the plan is consistent with the prevailing medium-term estimates, or that virement of medium-term estimates has taken place in order to accommodate the plan.
2020	Institutionalise a medium-term policy statement and communicate binding medium-term ceilings to line ministries.
2020-21	Introduce a carry-over facility with clear conditions and budgetary safeguards.
2021-22	In line with Aid management policy to be developed, and depending on aid dependency vision, consider integrating Book 5 with Book 2/Book 4a and Book 4b in order to more effectively control overall resource envelope in medium-term.
2022-23	Consolidate and streamline the budgeting of investment projects, integrate special funds in main Budget Book.

3.6. Medium-term planning and objectives

3.6.1. Concepts and approach

The government of Timor-Leste has embraced programme budgeting and medium-term budgeting to encourage a greater link between budgets and plans and support a process of policy prioritisation and allocation. Hence, medium-term planning is a starting block to ensure that the country benefits fully from undertaking programme budgeting.

Many developing countries have developed a longer-term vision that outlines their ambition for their country's development. Developing countries then often support this layer of planning with National Development Plans, which have a medium-term timeframe, usually a span of three or five years. National Development Plans are comprehensive exercises, ideally undertaken through extensive consultation with citizens, civil society organisations (including through local level administrations such as municipalities or national surveys at occasions), and with line ministries, amongst others. The process ideally combines such a bottom-up approach with top-down objectives developed by the centre of government, thereby ensuring buy-in for the plan.

Effective national development plans are costed, include indicators, targets and measurable goals and provide a useful tool for line ministries to develop sectoral plans and thereafter annual plans. This layering of planning tools, in particular medium-term planning, is the backbone to establishing effective medium-term expenditure management. Medium-term expenditure estimates are developed on the basis of the first level policy conceptualisation and prioritisation that has been developed in these plans, ensuring that budgets are carefully crafted.

3.6.2. Medium-term planning in Timor-Leste

Timor-Leste's *Strategic Development Plan 2011-30 (SDP)* provides a broad guiding vision for the country's developmental strategy. While there is no national medium-term development plan, the SDP outlines medium-term targets (2016-20) and long-term targets (2021-30) providing some level of clarity over medium and long-term priorities. Some, if not all line ministries have developed sectoral plans and line ministries produce annual plans. For example, the sectoral plan for the Ministry of Commerce, Industry and Environment is currently being developed, while the Ministry of Tourism, Arts and Culture does not currently have such a plan. Some sectoral programmes have been developed before the SDP (for example the Ministry of Justice) and some sectoral plans have varying timeframes. UPMA undertakes the analysis of the annual plans and ensures their consistency with the SDP, with the government and sectoral programmes and provides this relevant information to Ministry of Finance, to be included in the Green Briefs that inform the political review committee.

The government has also been leading efforts on the implementation of the seventeen Sustainable Development Goals (SDGs). **Timor-Leste is part of a High-level Champions Group together with eight other countries**. A national working group has also been established to provide linkages between the country's *SDP* and the SDGs. The working group is led by the Prime Minister's Office with participation from various relevant directorates within Ministry of Finance. As a guiding framework, 19 indicators of the SDGs indicators were selected by the G7+ grouping as priorities for the caucus. Timor-Leste has also undertaken a mapping of SDG targets against existing national priorities.

The approach taken by Timor-Leste with regard to adopting the SDG framework is to prioritise 3 of the 17 SDGs, namely *Goal 2 – zero hunger, Goal 3 – quality education* and *Goal 9*

– *industry, innovation and infrastructure*. The government aims to identify three indicators per objective. According to the mapping exercise, 36% of total government budget has been allocated to programmes aligned with these three SDGs. In the near future, the government will focus on goals key to human development to include Goals: 3 *(health)*, 5 *(gender equality)*, and 6 *(water and sanitation)*. In the medium-term, the government aims to focus on goals that will enhance sustainable economic development *(Goals 7-12)* and in the long term, on *Goals 13, 14* and *15* that relate to the environment. By achieving these goals, the government's aim is to ultimately achieve *Goal 1 – poverty eradication* and *Goal 16 – ensuring peace, stability and effective institutions* (see table below[27]).

Table 3.2. **Timor-Leste's SDG Framework**

Phase	Strategic Development Plan	SDGs			
2026-30	**Long Term Strategic Goals** PHASE III ● Poverty Elimination; ● Strengthening of the Private and "Co-operative" Sectors; ● Modern and Diversified Economy	→→→→Goal 1	←←←← Goal 16 →→→→	● Goal 7 ● Goal 13 ● Goal 14 ● Goal 15	
2021-25	**Medium Term Strategic Goals** PHASE II ● Infrastructure Development; ● Consolidate Human Resources; ● Increase Economic Competitiveness			● Goal 8 ● Goal 10 ● Goal 11 ● Goal 12	
2016-20	**Short Term Strategic Goals** PHASE I ● Human Resources ● Infrastructure ● Institutions strengthening ● MDGs and "New Deal"			● Goal 3 ● Goal 5 ● Goal 6	
				2017	● Goal 2 ● Goal 4 ● Goal 9

3.6.3. Challenges

Stakeholders have stressed the need to implement the motto "one plan, one vision", as well as concerns with effectiveness and efficiency of spending, and the fact that more time is needed to undertake a comprehensive planning exercise. Some stakeholders raised concerns that the Strategic Development Plan and the Sustainable Development Goals are not well known at local level and within more operational levels of public administration. UPMA is currently conducting evaluation of the targets met in SDP for the phase of implementation (2011-15) to assist in further implementation of SDP. Such an exercise can consider the above challenges in the way forward. One important issue, for consideration and decision at national level, is how the proposed update of the SDP should interact with the need for medium-term plans to be articulated at sectoral levels; and in particular whether these sectoral plans should be developed alongside, or after, this SDP update.

3.6.4. Suggestions for a way forward

Policy-making usually follows a cascade, whereby the government sets strategic goals that are mapped onto high-level objectives and "output" goals for line ministries and agencies. In turn, these strategic goals are translated into performance targets and specific activity objectives for divisions and individuals. However, many higher-level outcomes depend for their success not on a single line of outputs and activities, but on multiple strands and streams of different factors, as objectives of inclusive growth are often multi-dimensional.[28] In this light, some OECD countries, such as France and New Zealand, are

developing high-level indicators to broaden policy analysis beyond traditional economic metrics and incorporate a well-being perspective in policy making more explicitly.

With this in the backdrop, a guided whole-of-government co-ordination exercise needs to support a process to update the *Strategic Development Plan* with more specific, identifiable medium-term goals and objectives, which can in turn serve as "anchors" for the programme budgeting system. In addition, the SDP's value and usefulness would be greatly deepened by costing the various policy priorities. Some stakeholders also mentioned the need to prioritise policies within the SDP and detail how goals would be achieved. These revisions need to be undertaken in a manner that is consultative and combines a bottom-up needs-based approach with a top-down approach that reflects fiscal constraints and realities.

In many respects, Timor-Leste may also benefit from developing a *medium-term* national development plan, which it does not currently have. Such a document would bridge the gap between annual planning exercises and sectoral plans on the one hand and the longer-term vision of the country as detailed in the SDP on the other.

In addition, the mapping undertaken with regard to SDG is a very useful one and could be revised and refined to ensure accuracy, relevance and usefulness of tracking targets and goals in the coming year. The relevance of the SDG framework can be used as a powerful communication tool both within and beyond government.

Finally, sectoral plans need to be developed and co-ordinated in a consistent and relatively standardised manner across ministries. Developing and communicating a planning calendar and guidelines could assist in this regard.

Roadmap Box 3: Medium-term Planning

Strengthen medium-term planning, clarify measurable targets and consider explicit linkages to the Sustainable Development Goals

2017	Update and cost the SDP in consultation with priority stakeholders and line ministries.
2018	Establish linkages with the SDGs at various levels of the planning process by establishment a Medium Term National Development Framework for 5 years (aligned with new program of the government).
2018	Produce guidelines and/or guidance to line ministries in order to standardise and harmonise the process of developing sectoral plans and their content, including with measurable targets. ***Dependency*: The updating and development of all sector plans in line with developed guidance would greatly ease the development and fine-tuning of programmes to all line ministries (see Section 3.3).**
2020-22	Address the medium-term gap between the SDP and annual budget/plan, by developing a medium-term national development plan with measurable targets; linked to progress inl broadening and deepening the programme-budgeting model.

4. Key supporting pillars of modern budgetary governance: Priorities for supporting reforms

The further development of programme budgeting and medium term fiscal planning in Timor-Leste depends, for its success, on broad-based and well-co-ordinated reforms in various areas of public financial management. As outlined in Section 1, the OECD regards the various elements of budgetary governance as inter-connected and mutually supportive, so that progress in one area can have a synergistic effect in supporting progress in other related areas. This Section provides an overview of such reforms that are deemed

particularly important in supporting the achievement of the core elements of budgetary governance reform in Timor-Leste.

The proper sequencing and prioritisation of these reforms is considered at the end of this section.

4.1. Adopt an over-arching principle of Open, Transparent, Inclusive Budgeting

Budget transparency involves being fully open with people about how public money is raised and used. There are many international codes and guidelines on open, transparent and inclusive budgeting – including from the OECD, IMF and the Global Initiative on Fiscal Transparency (GIFT) – and these various perspectives are summarised and referenced in the international *Toolkit on budget transparency* (OECD, 2017). The *Toolkit* summarises the recognised benefits of budget transparency as the following:

- **Accountability:** Clarity about the use of public funds is necessary so that public representatives and officials can be accountable for effectiveness and efficiency.
- **Integrity:** Public spending is vulnerable not only to waste and misuse, but also to fraud. "Sunlight is the best policy" for preventing corruption and maintaining high standards of integrity in the use of public funds.
- **Inclusiveness:** Budget decisions can profoundly affect the interests and living standards of different people and groups in society; transparency involves an informed and inclusive debate about budget policy impacts.
- **Trust:** An open and transparent budget process fosters trust in society that people's views and interests are respected and that public money is used well.
- **Quality:** Transparent and inclusive budgeting supports better fiscal outcomes and more responsive, impactful and equitable public policies.

Budget documents are critical in enabling budget transparency. They should provide a comprehensive overview of the fiscal activities of the public sector in a regular and timely manner, to inform better scrutiny and decision-making at each key stage of the budget cycle. The OECD's fourth budgetary governance principle specifies that budget documents and data must be open, transparent and accessible, including through:

1. the availability of clear, factual budget reports informing the key stages of policy formulation, consideration and debate, as well as implementation and review;
2. the presentation of budgetary information in comparable format before the final budget is adopted, providing enough time for effective discussion and debate on policy choices; and
3. the publication of all budget reports fully, promptly and routinely, and in a way that is accessible to citizens, civil society organisations and other stakeholders.

With this in mind, the *Toolkit* provides a useful framework for current good practices regarding budget reports (see Table 4.1 for an outline).

The Open Budget Index (OBI) more specifically, in its two-yearly Open Budget Survey (OBS), focuses on A1-A3, A6-A9 from the *Toolkit* above, as well as on the publication of a Citizen's Budget (see Section 4.1.1 below for more details and proposals in this regard).

According to the 2015 OBS, the government of Timor-Leste provides the public with limited budget information. Timor-Leste's OBI score of 41 in 2015 was slightly below the global average of countries surveyed and comparable to that of other countries in the

region, such as Thailand and Malaysia. A positive achievement is that Timor-Leste's score has been increasing, albeit at a slow pace, but consistently since OBS scores begun in 2010. However, Timor-Leste publishes only five of the eight key budgetary documents considered by the OBI; it does not publish the Year-End Report, a Pre-Budget Statement and the Mid-Year Review, leaving potential for further progress. A Year-End Report analyses budget execution for a given fiscal year and includes, amongst other elements a comparison between forecasted expenditure and actual expenditure. A Mid-Year Review covers budget execution in a similar manner but for the first half of the year. Since 2015, one can see moderate progress in the production and publication of these three documents, suggesting that Timor-Leste's OBS score for 2017 will most likely not show a significant improvement.

The 2013 Public Expenditure and Financial Accountability (PEFA) assessment, and the rapid 2015 PEFA assessment meanwhile, analysed budget transparency in Timor-Leste as part of the overview assessment of the budgetary governance system.[29] These suggest that in the four performance indicators relating to budget transparency (6, 10, 24 and 25),[30] the level of performance in the extent of reporting is generally satisfactory, with Timor-Leste obtaining either A or B grades across these dimensions. However, it is worth noting that the PEFA framework was originally created as a tool to be used for the specific purpose of development partners assessing fiduciary risk. The PEFA framework has since been revised in 2016 for broader purposes and to take into account evolving good practice in budget transparency internationally.

Table 4.1. **Extracts from OECD Toolkit on Budget Transparency: Budget Reporting by Government**

		Government
Budget Formulation	**A.1**	**The pre-budget statement**
		● To publish at least one month before the executive's budget proposal
	A.2	**The budget proposal**
		● To be submitted in good time to allow for proper review by the legislature and published at that same point in time
Budget Approval	**A.3**	**The approved budget**
		● To be published as soon as it is approved by the legislature
Budget Execution	**A.4**	**The supplementary budget**
		● To be published if necessary and brought forward once, to include all supplementary budget measures together
	A.5	**Pre-execution budget profiles**
		● To be published close to, or ideally before, the start of the budget year
	A.6	**In-year budget execution reports**
		● To be published quarterly or (ideally) monthly, shortly after the end of each period
	A.7	**The mid-year implementation report**
		● To be published within six weeks of mid-year
Budget Review	**A.8**	**Year-end reporting**
		● To be released within six months of the end of the fiscal year
	A.9	**The external audit report**
		● To be produced as soon as possible after the end-year reporting
	A.10	**The long-term report**
		● To be produced at least every three to five years, supplementing its long-term technical projections with near-term policy messages
	A.11	**Reporting on fiscal risk**
		● Ideally to be presented in a single, comprehensive annual fiscal risk report

Within the wider net of government reports, stakeholders have raised issues in the inconsistency in the availability of information. For example, the budget circular is not easy to find and quarterly performance reports are made available only to parliament and not to the public. In terms of content, while economic forecasts are published, there seems to be weak transparency and clarity regarding economic policy assumptions used.

Information on financial assets and liabilities of the government is also not widely available, as well as information regarding contracts awarded in amounts below USD 500 000. More could also be done to improve the comprehensiveness of the quarterly reports to include information regarding overseas development assistance, such as budget execution rates of donor-funded programmes and updated forecasts on spending in further quarters on donor funded programmes.

In terms of broader transparency dimensions, an encouraging aspect is the Timor-Leste's membership since 2007 to the Extractive Industry Transparency Initiative (EITI) which is designed to provide safeguards and reassurance regarding the integrity and probity of financial transactions in these sectors which tend to be, internationally, more prone to corruption and to misdirection of funds.

In general terms, Timor-Leste should commit itself publicly to continued improvement in the various aspects of open, transparent and inclusive budgeting, building directly upon the findings of the analyses conducted to date, in order to promote confidence among national and international stakeholders about the quality and openness of the budget and related policy processes. In the short to medium-term, Timor-Leste can consider an international Budget Transparency Implementation Review in order to work directly with national authorities and stakeholders to promote transparent, open, participative approaches to budgeting. Specific priority actions would likely include producing and publishing a report to accompany the *Jornadas Orçamentais* conference, and/or work on publishing the budget circular as a mid-way point to this objective. Currently, an outline presentation is made available but this is not sufficiently comprehensive or detailed to be regarded as a "Pre-Budget Statement". Another priority should be to publish the year-end report in a timely manner, and to produce and publish a mid-year review. For all of these dimensions, in the next two to three years, government must consider how to best present medium-term budgetary information, programme structure and performance indicators in a way that leads to the constructive engagement of oversight actors and the public.

4.1.1. *Updating the Citizen's Budget*

Publishing a citizen's budget along with the formal public budget helps to promote citizens' understanding of government policies and increases the transparency of policy-making. A citizen's budget is a simpler, less technical version of a government's budget specifically designed to present key information to the public, by summarising key content from the budget document in a user-friendly way. Ideally, citizen-friendly documents should be produced for all key publications linked to the budget cycle (e.g. audit reports, mid-term budget reports, spending reviews).[31]

Currently, Timor-Leste produces and publishes a Citizen's Budget of the Enacted Budget in Tetun, which is a very positive achievement. As the programme budgeting reform becomes mainstreamed, the Citizen's Budget will need to be updated to reflect a programme presentation of budgetary information in relation to current Book 2. In the same vein, the usefulness of this approach can be enhanced by presenting budgetary information in a medium-term perspective, and equally, by including linkages with the adoption of the SDG framework and Timor-Leste's priorities in this regard more specifically. Further down the line, Timor-Leste can consider producing a citizen's guide for the Audit report, as well as one for the Pre-Budget Statement in order of priority.

4.1.2. Enhancing parliamentary engagement in budgeting

In comparison to countries with similar levels of development, parliamentary budgetary oversight has a relatively robust basis in law in Timor-Leste and in practice is reasonably effective, functional and marked by good levels of technical capacity and engagement.

The *Toolkit on Budget Transparency* notes that parliaments should have sufficient time to consider the executive's budget proposal; and that, in international terms, three months is a useful benchmark, although the quality of debate is important. In Timor-Leste, article 30.1 of the Public Finance Act states that the Government should present the draft Budget Law for the following financial year to the parliament by 15 October. Parliament also has authority in law to amend the draft budget law as stated in Article 145 of the Constitution. In practice, parliament exercises this legal right by proposing amendments to the draft budget law and amendments are approved in the final budget law. In addition, Timor-Leste's parliament has financial independence, as it is able to prepare its own budget according to its needs.

The Parliament also has a sufficiently strong basis in law with regard to the management of excess revenues, which is an issue that can be of relevance to the circumstances in Timor-Leste. The executive is required by law to obtain approval from the legislature prior to spending excess revenues. Article 4 of the Public Finance Act states the State Budget is unitary and covers all revenues and expenses of the services and bodies of the State, which do not have administrative and financial autonomy, as well as of autonomous services and funds. With regard to the Petroleum Fund Law, article 9 highlights that no transfers from the Petroleum Fund in excess of the Estimated Sustainable Income (ESI) can be made in any fiscal year unless the Government presents in advance to the National Parliament: i) a report estimating the amount the ESI for fiscal years thereafter to be reduced; ii) an auditor's report, which certifies the estimates of reduction in the ESI; and iii) justification of the reasons that it is considered in the long-term interest of Timor-Leste, to transfer an amount greater than the ESI.

Parliamentary committees are a useful forum for focused, in-depth scrutiny and effective engagement with the budgetary process. Committee members build up specialised knowledge of budget-related topics, and committees can sustain an informed "accountability dialogue" with government ministries, as well as with citizens and civil society throughout the annual budget cycle, and from year to year. In Timor-Leste, "Commission C" acts as the Finance committee; it is currently composed of eleven members from the spectrum of different political parties. Sectoral committees (or standing commissions as they are termed in Timor-Leste) are also functional, routinely examining the budgets for specific sectors such as health and education.

In terms of oversight of the budget throughout the budget cycle, parliamentary oversight is currently mainly focused on the draft budget law. Having had the opportunity to consider and debate the draft budget law, Commission C prepares a report for the plenary with findings and recommendations prior to the budget being adopted. There is then an overall parliamentary debate on the budget in plenary session, which usually lasts for three days; followed by a further discussion in "speciality" (a discussion which tends to focus at item level) for around ten days. After parliamentary approval of the budget, the President holds power to veto the budget, which, if exercised, would requires two-thirds approval by parliament in order for a revised document to be sent back to the President. At that point, the president has eight days to promulgate the budget.

While the level of parliamentary involvement in the budget process is good in international terms, there are also opportunities to strengthen parliamentary oversight both *ex ante* and during budget execution. Currently, neither the full legislature nor any legislative committee debate budget policy prior to the tabling of the draft budget law. Members of parliament are invited to the *Jornadas Orçamentais* but a debate does not take place. In addition, the audit court presents the audit report to parliament and there is a discussion in plenary on the audit report on the basis of Commission C's examination and recommendations for the Audit Report; however, the committee's report and recommendations are not routinely made publicly available.

One important lacuna appears to be lack of a law or regulation requiring the executive to obtain approval from the legislature prior to shifting funds between administrative units; and in practice the executive exercises its latitude to shift funds between administrative units before obtaining approval from the legislature. Article 38.1 of the Public Finance Act states that *"The Government is responsible for altering the budgets of services without administrative and financial autonomy under a Ministry or Secretariat of State, provided that the amount of the transfer does not exceed 20% of the budget appropriation from which the amount is transferred."* This is a high threshold in comparison with usual international practice.

Hence, looking forward, there are several potential avenues to strengthen parliamentary engagement in the budget process in Timor-Leste. Commission C could take up a more active role during the pre-budgetary phase of the fiscal calendar and the Centre of Government (Prime Minister's office and Ministry of Finance) could take the initiative to enable such a role to develop. For example, Parliament could be invited to debate the analysis presented during the *Jornadas Orcamentais*; ideally this should be based on a pre-budget statement, which is not currently being produced in Timor-Leste.

To ensure a more thorough examination of the budget proposal, it would be ideal if Parliament and Commission C could be provided with the draft budget law two weeks earlier than the current constitutionally-mandated deadline of 15 October. This would make it easier for parliament to approve the budget at least one month before the fiscal year; in cases where the President exercises the right of veto, this schedule would also for additional time to deal with this matter in advance of the start of the budget year. In order for the Ministry of Finance to be able to submit the Budget Books earlier, enhanced resourcing and capacity within the Ministry of Finance could be considered and/or the documents to be submitted to Parliament and Commission C could be streamlined.

There is also scope to strengthen parliamentary oversight of budget execution – Commission C or a more specialised sub-committee could be set up to examine in-year budget execution based on monthly or quarterly reports and produce a report based on its examination of these documents. Parliament in Timor-Leste can also play a more active role in providing scrutiny of annual financial statements by working to ensure that the executive effectively addresses findings and recommendations arising from the audit report.

Generally speaking, there is scope for parliament to strengthen the accountability dialogue with citizens and civil society, for example by making hearings on various budgetary documents public throughout the budget cycle and by ensuring that participation in these hearings is not restricted to particular segments of the public or civil society.

Many of these priorities will require strengthened technical capacity within Parliament, Commission C or equivalent commissions. One option to consider, into the future, is to develop an enhanced budget scrutiny unit or a "Parliamentary Budget Office", which is a non-partisan body assisting parliamentarians with technical analysis and interpretation of information on budgetary and fiscal policy. To an increasing extent, both developed and developing countries around the world are setting up such institutions to strengthen the capacity of parliamentarians to work effectively with such technical and complex information.

Roadmap Box 4: Parliamentary engagement in budgeting

2017	Ensure that Commission C i) publishes all the reports that it produces on its examination of budget reports; ii) examines in-year budget execution based on monthly or quarterly reports and produces and publishes a report based on its examination of these documents.
2018	Consider the establishment of an enhanced budget scrutiny unit or Parliamentary Budget Office.
2019	Parliament to consider opportunities to develop open budget hearings for its examination of all budget reports.
2020	Parliament to participate in the *Jornadas Orçamentais* and to debate the to-be developed pre-budget statement.

4.1.3. Promoting civic participation in budgeting

In any democracy, budgeting is primarily a responsibility and prerogative of the government, acting with the authority and engagement of the parliament. However, international experience increasingly recognises the value of informed, responsible inputs from citizens and from civil society more generally.[32] Civil society organisations in Timor-Leste are relatively well organised and in a good position to contribute to the quality of budget discussions. Non-government bodies such as *Loa Hamutuk* and *Luta Hamutuk* already produce their own analysis of the draft budget, and encouragingly, some form of social auditing is taking place at the local level with regard to key social sectors and as a means to track effective implementation of budget execution.

However, there are opportunities to consolidate and regularise public participation in the budget process. For example, there are currently weak feedback loops with respect to civil society comments being taking into consideration in the Executive Budget Proposal. Civil society organisations have also raised issues regarding the budget cycle allowing only limited time for their participation at various stages. For an example of how pre-budget civil dialogue can be organised, one can draw on Ireland's recently-established National Economic Dialogue, a formalised process of consultation and debate with societal interests.[33]

Roadmap Box 5: Budget Transparency

Publicly commit to over-arching principle of open, transparent and inclusive budgeting

2017	Consider supplementing national efforts with an international Budget Transparency Implementation Review.
2017	Reconfigure the Citizen's Budget to highlight programmatic and medium-term dimensions in line with Budget Book 2 and include linkages with the Sustainable Development Goals.
end-2017	Make the end-year report publicly available in a timely manner.
2017-18	Parliamentary Commission C to publish all the reports that it produces on its examination of budget reports.
2018	Revision of the budget and financial management law.
2018	Produce and publish a comprehensive Pre-budget Statement to inform discussions at the *Jornadas Orçamentais* (Budgeting Days). ***Synergy:* To maximise its effectiveness, the document should ideally reflect the requirements of a potential new fiscal rule (see Section 4.4)**.
2018	Produce and publish a Mid-year Report.
2018	Consider the establishment of a Parliamentary Budget Office.
2019	Parliament to consider opportunities to develop open budget hearings for its examination of all budget reports.
2019-20	Institutionalise public participation principles in line with the Global Initiative for Fiscal Transparency (GIFT) principles. As a first priority, provide feedback to civil society regarding their comments and submissions on the Executive Budget proposal.
2019-20	Consider upgrading the *Jornadas Orçamentais* to a Pre-Budget Civic Forum for structured engagement from parliament and civil society.
2020-21	Develop Citizen Guides to different budget-related documents including Audit Report and Pre-Budget report.

4.2. Enhance the clarity and accessibility of the budget documentation

4.2.1. Accounting and Fiscal Reporting

Financial reporting is one of the foundations of good fiscal management. High quality financial reports are essential to ensure that government's fiscal decisions are based on most up-to-date and accurate understanding of its financial position. Financial reports are also the mechanism through which legislatures, auditors, and the public at large hold governments accountable for their financial performance. Finally, financial reports are a critical source of information for markets and other stakeholders to understand the government's financial operations and their implications for their own economic decisions. In around three quarters of OECD countries, governments have improved the completeness of their financial reports by moving away from pure cash accounting toward accrual accounting.

Accrual accounting is the accounting method by which financial transactions are budgeted or recognised in the financial reports at the time at which the underlying economic event occurs, regardless of when the related cash is received or paid, and assets and liabilities are reported in a balance sheet. Governments that have adopted accrual accounting establish balance sheets that a) report on their stocks of assets and liabilities, b) show whether liabilities are matched by corresponding assets, and c) measure whether their activities and decisions generate a fiscal burden.

Accrual accounting is a complex and advanced reform and should be considered in Timor-Leste in a gradual and sequenced manner, taking into account other reform priorities as well as the capacity constraints both of stakeholders that will need to prepare the information, as well as that of the users of information. Timor-Leste could consider starting to develop a balance sheet listing and valuing assets and liabilities, but should also take account of the complexity of the task by allowing entities sufficient time to prepare

and complete this transition. A second element that could be considered is to determine the requirements of the IT system for accrual accounting and reporting, in order to ensure that the modernisations of the FMIS system that are envisaged in the context of adopting programme budgeting and medium-term budgeting can also allow for accrual information in the future.

Box 4.1. **Accrual accounting and reporting in OECD countries**

Over the last decades, greater concerns with budget discipline and transparency have led to significant changes in fiscal reporting, including a widespread adoption of accrual accounting in OECD countries. A wider range of forward looking and backward looking fiscal information is now available to users in OECD countries, some of which are submitted for external audit.

Nearly half of OECD countries prepare accrual financial statements and cash budgets and budget execution reports. A third of OECD countries prepare accrual financial statements and budgets, the latter incorporating either accrual, or cash, or both accrual and cash appropriations and related budget execution reports. The remaining countries prepare cash budgets and cash financial reports. Some countries have neither implemented nor contemplated any accrual reform. The main reasons for this are the lack of political support and concern that the benefits are unlikely to exceed costs (for example in Germany).

Despite variations in the timescale, duration, and cost of reforms, OECD countries have encountered many similar challenges for preparing and implementing accrual accounting, which include:

- **The identification and valuation of assets and liabilities** are considered as the most challenging tasks during the preparatory stage of the reforms. In most cases, countries did not have reliable or complete records of assets – particularly non-financial assets – that were owned and identified, let alone the values of such assets. Similarly, the recognition and reporting of civil service and military pension liabilities, PPPs, etc., can present conceptual as well as valuation challenges.
- **Putting in place new IT systems** presented challenges at the implementation phase in most countries. Implementation of a new IT system is already difficult enough when the accounting framework remains unchanged. The challenges increase exponentially, however, when the accounting basis changes from cash to accrual and the new system is required to support this new framework.
- A number of countries also indicated difficulties for realising **changes in legislation**, **capacity building** for users of information, the preparation of **consolidated financial statements**, and the preparation of financial statements **within agreed timetable**.

The adoption of accruals has provided more financial information, but also increased the complexity of the information provided to parliaments. In response to this constraint, in some OECD countries, parliaments' practice has therefore led to a reliance on parliamentary budget officers and auditors for analysing this technical information.

Source: Accrual practices and reform experiences in OECD countries, (OECD, 2017; forthcoming).

4.2.2. Consolidating budget documentation

As mentioned in Section 2, Timor-Leste's Executive Budget Proposal is presented as six Budget Books. Book 1 provides an overview, Budget Book 2 presents annual action plans and the programme budget, Book 3 presents information on the infrastructure fund,

Book 4a and 4b present the detailed budget line items, Book 5 presents development partners' funds, and Book 6 contains information regarding the Special Fund. These books range between 60 pages and 500 pages each, implying a very comprehensive set of information provided to Parliament for its approval.

In any system of budgeting, such comprehensive budget information is essential for transparency and accountability, but must be balanced with safeguards against "information overload" and with measures to promote readability and accessibility of the key facts. In practice, very few people are able to assess in detail all the information included in the Budget Books. The 2013 PEFA also points out that there is not an overview table in the budget books providing a snapshot of budget allocations to line Ministries and Special Funds over the years.

While a Citizen's Budget (see above) is aimed at the general public, a different approach is required to meet the needs of parliamentary scrutiny and approval. A citizen budget presents information in a non-technical manner, in order for any citizen to understand the key policy proposals and spending priorities. A formal Policy Summary of the Budget should be introduced to bring to the fore the key elements of the Budget Books, cross-referencing directly the more detailed information, while also highlighting important programmatic and SDG linkages. Such a Policy Summary is a short executive summary of the Budget aimed at facilitating parliamentary oversight and which can remain technical in nature. Further down the line, careful consideration needs to be given to rationalising and consolidating budgetary information as a whole.

Roadmap Box 6: Financial reporting and budget documentation

Work towards consolidating and rationalising the amount and type of budgetary information included in Budget Books, so as to avoid information overload

2017	Include a policy summary to the overall Budget for the 2018 Budget.
2017	Consider benefits and costs of moving from cash accounting to accrual accounting in the medium to long run.
2020-22	Integrate the information on the Special fund and Infrastructure fund in Budget Book 2 and Budget Books 4a and 4b. ***Dependency:*** **requires progress in medium-term expenditure framework**.
2022-24	In line with deepening of the programme budgeting reform – and specifically when appropriation of the budget is made on a programme basis – merge Budget Book 2 and Budget Books 4 into one State Budget. Additional information can be provided via Annexes if necessary. ***Dependency:*** **requires progress in deepening programme budget reform**.

4.3. Strengthening and consolidation of the annual budget process

In order to make progress in achieving the ambitions of budgetary governance reform, it is necessary to build upon solid foundations and to ensure that the basic elements of sound budgeting are in place. Neglecting these essentials would pose a risk to the viability of higher-order, more qualitative and aspirational goals. This is the case for any country undertaking far-reaching budgetary reform: in the case of Timor-Leste, a number of issues fall to be considered under this heading and are dealt with in sequence below.

4.3.1. Timely and effective budget execution

OECD budgetary governance principle number 7 calls for "the full and faithful implementation by public bodies of the budget allocations, once authorised by parliament"

and "the prudent profiling, control and monitoring of cash disbursements, and clear regulation of roles, responsibilities and authorisations of each institution and accountable person".

As reported by many government ministries and agencies, the process of budget execution in Timor-Leste is prone to delays and is in need of refinement. According to the most recent PEFA assessment, actual expenditure deviated from the original budget appropriation by over 15% in 2010, 14% in 2011 and 24% percent in 2012. The deviation is broadly attributed to low budget outturns of capital infrastructure projects of the Infrastructure Fund and to over-budgeting of current transfers and grants to targeted beneficiaries by the Ministries of Social Solidarity and State Administration throughout the whole period. The low execution rates are particularly significant in capital spending. On average, the execution rate of capital projects in 2008-14 was 73% of planned expenditures.

More generally, it appears that there are bureaucratic obstacles to the timely release of funds to ministries and agencies, especially during the first half of the budget year. The causes of these systematic delays require further in-depth investigation. Article 31 of the Law on Budget and Financial Management provides for an adequate regime of ongoing authorisation in case of late approval of the annual Budget Law ("reversionary budgeting" on a rolling monthly basis). It appears, therefore, that the delays may relate to over-rigid procedures for authorisation of cash disbursements, as well as delays in the finalising of procurement and commitment processes. In general, countries that budget on cash basis need to have provisions in place that allow the government to incur commitments that fall due in future budget years. These provisions may have the form of general commitment limits or of commitment limits at appropriations level. Currently, the Law on Budget and Financial Management of Timor-Leste does not provide for the authorisation of commitments concerning cash payments in future years.

Furthermore, this problem may become reflected in the cash planning methodology. Currently, commitments can only be made in accordance with Expense Authorisation Notices, issued by the Director of the Treasury Department. These notices divide the available cash appropriations over the execution year and are based on cash flow projections of the Treasury for the ministries. The cash flow projections are updated monthly and are in turn based on historical cash patterns and notifications of line ministries. If Expense Authorisation Notices are thus determined by historical cash patterns the problem extends itself from year to year.

In view of these considerations, an appropriate response would be for the PFM working Group to form an inter-ministerial taskforce composed of relevant officials from the Treasury, the Budget Department, the Ministry of Public Works, Transport and Telecommunication and the Prime Minister's Office in order to investigate and diagnose the causes of execution delays and to provide recommendations for the improvement of the execution process.

4.3.2. Standardising and documenting public financial management procedures

More generally, it appears that the various procedures and regulations for public financial management are not uniformly understood and applied across all areas of public administration and in particular within certain line ministries; a circumstance that may impede the quality of budget execution and of budget processing. In many countries, all such procedures and regulations are officially documented in a Public Financial Handbook,

which serves as a universal reference (and training aid) for all officials involved in public financial management. Such Handbooks are an important tool to promote common understanding of the budgetary process and to avoid confusion and misunderstanding about the formalities of the various phases including planning, execution, evaluation, audit and accountability. This is particularly relevant with the introduction of new practices such as programme budgeting.

Roadmap Box 7: Budget Process Consolidation – Part 1

Improve budget execution and standardise public financial procedures

2017	The PFM working group investigate and diagnose the causes of budget execution delays and to provide recommendations for the improvement of the execution process.
2018	Document all procedures and regulations that are relevant for public financial management in an official Public Financial Handbook and disseminate it among all officials across government who are involved in financial management. ***Dependency:*** *linked to progress on Human Resource Management/training and staff development (see Section 4).*

4.3.3. Modernising ICT systems to meet the needs of modern budgeting

The Financial Management Information System (FMIS) of Timor-Leste is primarily designed to serve the process of budget execution. It is based on the chart of accounts, which uses an expenditure classification according to spending units, economic categories of spending and spending purpose. The system is filled manually after the parliamentary approval of the budget with the approved appropriations and line items. Parliament approves the budget at the level of spending units and economic categories. The government authorises the line items for spending purposes. The system is suitable to handle expense authorisation notification by the Treasury, payment orders by the line ministries, approval of payment orders by the Treasury and payment orders to the Central Bank. The system can also be used to produce quarterly and annual financial reports. The system is fully centralised, as is usually the case in developing and transition countries. In advanced economies, line ministries sometimes have their own execution systems and handle their own payment orders to the Central Bank or the private banks holding government accounts, and report only monthly to the central system of the Treasury.

The Timor-Leste FMIS system has recently been adapted to accommodate the programme classification. This makes it possible, at least in principle, to change the basis of appropriations in the future to the most detailed level of the programme classification, provided that the parliament would allow this (in such a scenario, parliament could of course remain informed about the line items estimates in the budget and financial reports in the usual way but without right of approval). The system currently does not handle commitments for cash payments in future years and the recording of asset depreciation. These facilities are needed for the production of a proper capital balance. The system will probably need additional modules if the Ministry wants to improve its capital balance. The same may be true for other functions of modern budget execution systems, such as facilities in support of cash and debt management.

Timor-Leste does not use the FMIS system or an automated ICT modality for budget preparation, relying instead on completion of Excel spreadsheets and manual adjustment to reflect the outcome of budgetary negotiations. This procedure is inefficient and prone to errors.

Likewise, the current system does not appear well-suited to medium-term budgeting. A functional FMIS system for budget preparation must ensure on the one hand reconciliation between budget and multi-annual estimates at the appropriations level and ministerial or sectoral ceilings, and on the other hand reconciliation between budget and multi-year estimates and sectoral planning documents. For that purpose the system should contain the budget and multi-annual estimates at the appropriations level, as well as the ceilings and be able to check their consistency. Furthermore budget and multi-annual estimates should be updated at least twice a year, namely at the occasion of the budget submission to the Ministry of Finance (in order to comply with the updated MTEF) and after the approval of the budget by Parliament (to reflect any changes made after the budget submission either by the government or the Parliament)[34]. The multi-annual estimates contained in the system should thus reflect at any time the future costs of current policy. In a new budget cycle the figures included in the system for the year t+1 from the previous budget cycle become automatically the default or starting figures for the new budget year. At the occasion of updates, all changes since the previous update have to be inserted. These may flow either from decisions in the budget process required to fit programmes under the ceilings or from the establishment of medium term sectoral plans that require virement within ministries or between ministries. The system must be filled regularly by the line ministries but must allow that all changes are approved by the Ministry of Finance.

It is most efficient if the ICT system for budget preparation is integrated in the system for budget execution, but this is not strictly necessary if it would lead to delay or additional costs. Several countries employ stand-alone systems for budget preparation.[35] It is important of course that the budget figures can be transmitted smoothly to the system for budget execution once the budget is finalised.

Taking account of the above considerations, the capabilities and suitability of the existing FMIS system, versus other market alternatives, will need to be evaluated in future by reference to a comprehensive set of criteria for modern budgeting requirements, and to a full evaluation of costs and benefits. Consideration should be given to conducting such a review in future with technical assistance of international experts.

Roadmap Box 8: Budget Process Consolidation – Part 2

Review FMIS system in light of objective criteria for supporting modern budgetary governance

2017	Specify the criteria to be met for a future FMIS system, so as to meet in a comprehensive manner the specific needs of Timor-Leste's future budgetary governance reforms: to include its applications for budget preparation, budget execution, cash management and monitoring, non-financial (performance) information and indicators, programme monitoring and evaluation, and multi-year budget planning and preparation.
2017-18	Initiate an internal review, possibly involving international experts, of the suitability and functionality of Timor-Leste's existing FMIS systems by reference to the above criteria.
2018-19	Subject to the findings of the internal review, conduct a full appraisal of alternative market solutions to provide an FMIS system that fully meets the criteria outlined above, involving technical assistance of international experts. ***Dependency:*** *requires progress in capacities for rigorous cost-benefit analysis to international professional standards.*
2018-19	Pending the consideration/implementation of the appraisal report, implement an ICT solution to a functional ICT system for budget preparation, allowing for regular updating by line ministries and effective oversight and control by the ministry of finance. ***Dependency:*** *Such progress will be critical in enabling a shift of the programme budget to being the basis of appropriation by parliament.*

4.4. Clearer fiscal policy constraints for budgeting

At present, Timor-Leste lacks a binding fiscal rule or fiscal objective that is based on the long term sustainability of public finances in the light of a realistic scenario for the development of the national economy. It can be argued that the ESI ("estimated sustainable income") provision of the Petroleum Fund Law of 2005 can serve as a constraint upon fiscal policy. However, the ESI rule is only intended to set limits to the contribution of the Petroleum Fund to the budget, and constrains neither total expenditures nor the deficit. Moreover, the government has generally not considered the ESI rule as binding and over the past years has approved substantial withdrawals from the Fund in excess of the ESI contribution, in pursuit of the economic policy of "front-loading" of investment.

In current circumstances, the public finances of Timor-Leste are not on a sustainable path. International and domestic projections show that the balance of the Petroleum Fund will decrease significantly over the coming decade, such that the Fund contributions will no longer be able to support the budget on the same scale as heretofore.

Fiscal rules are tools that countries can adopt in order to mitigate the fiscal risks of over-loose (or over-tight) fiscal policy. In recent years the introduction of fiscal rules has become an increasingly popular means of applying fiscal discipline. One weakness of the annual budget process in Timor-Leste at present is the lack of any real sense of an "upper limit" on spending each year: this is apparently part of the reason that the ceiling-setting exercise is relatively easily displaced at subsequent phases of the budget cycle. Accordingly a supplementary fiscal rule should be considered, with technical support from international organisations/experts, to help ensure the continued sustainability of the public finances into the future. An expert group could be convened in light of the findings of the Fiscal Commission (see Section 1) to ensure that a new fiscal rule is fully compatible with broader themes of fiscal policy reform. For example, one possible approach that may be suitable to Timor-Leste's circumstances is outlined in Box 4.2 for illustrative purposes: this example relates to an expenditure growth rule that would cap the rate of total expenditure growth in the budget year and years of the Medium Term Expenditure Framework, subject to extra flexibility being made available in line with increases in revenue growth. However, the precise specification and nature of a fiscal rule framework is ultimately a matter for national political reflection.

Roadmap Box 9: Consider the introduction of a country-specific Fiscal Rule

2017-18	Policy paper on a study the introduction of a fiscal rule, taking account of the (interim) findings of the Fiscal Reform Commission.
2018	Incorporate the proposed fiscal rule into the national legal framework, including a mechanism for public reporting and oversight. ***Synergy:*** *If timing and sequencing permits, it would be appropriate to include provision for the fiscal rule within a revised* Budget and Financial Management law *as outlined in section 3.3.*

Box 4.2. **Towards an Expenditure Growth Rule for Timor-Leste**

Expenditure rules typically take the form of a cap on nominal or real spending growth over the medium term. In 2015, expenditure rules were in place in 23 countries (11 in advanced and 12 in emerging economies). The cap is usually defined in terms of the structural growth rate or the level of GDP, an absolute nominal or real growth rate or a specific nominal or real target over the medium term (the latter case is equivalent to a fixed multi-annual MTEF). The fiscal compact of the European Union restricts the expenditure growth rate of EU members to the structural GDP growth rate plus the growth rate of proceeds from autonomous tax increases. The latter feature could be beneficial in particular for Timor-Leste because of the urgent need for the mobilisation of domestic resources and the development of the tax base. Indeed, the initial tasks of the Fiscal Commission of Timor-Leste centre upon the need to increase domestic revenues.

When considering the adoption of an expenditure rule, at least two caveats have to be taken into account.

1. First, GDP is rather volatile in Timor-Leste, due to the fluctuation in oil prices and the depletion of the oil reserves. This makes it difficult to produce a reliable estimate for structural GDP growth. Under this circumstance the cap for an expenditure rule could be defined either in terms of non-oil GDP growth, which is a much more stable indicator, or in terms of an absolute nominal or real growth rate.
2. Second, country-specific social and political realities have to be taken into account. A rule that would limit the annual rate of expenditure growth to the trend in non-oil GDP (somewhere around 4 per cent a year), and thus would stop the need for excess withdrawals from the Petroleum Fund, may not be politically feasible in the short run – at least before 2020, a period which would coincide with a number of already-planned "front-loaded" investment projects. Similarly, one of the structural economic weaknesses at present in Timor-Leste is the relatively low level of public expenditure of areas such as education. The rigidities of an expenditure rule could be balanced with more favourable treatment for additional expenditure growth in specific areas such as education.

4.5. *Capital budgeting framework*

Effective capital budgeting and infrastructure investment is essential to promote the capacity and growth potential of the Timor-Leste economy into the future. Given this imperative, particular attention should be paid to having in place a sound, rigorous system for allocation of capital funds, and for selection, appraisal and review of projects. A growing body of literature underscores the role that legal, institutional and procedural arrangements for public investment management play in determining the level, composition and impact of public investment (OECD, 2015; IMF, 2015).

In Timor-Leste there are currently 21 programmes under the Infrastructure Fund (IF) that have been approved for the Budget 2017. These IF programmes are designed to be in line with the Strategic Development Plan and emphasise capital investment in core infrastructure areas such as roads, water, power supply, irrigation, public buildings and port and airport development.

New investment projects are submitted to the Ministry of Planning and Strategic Investment as part of the annual budget process. Appraisal of new projects is based on "multi-criteria evaluation" methods, developed by the Major Projects Secretariat on behalf of CAFI. The appraisal is focused on the following criteria: i) invest in priority projects with

maximum economic and social impact, ii) improve infrastructure for economic development of Timor-Leste, and iii) support growth and key sectors of the Strategic Development Plan 2011-30. Apart from the criteria concerning the importance of the project, attention is paid to the factor of readiness (land availability, environmental impact, progress of preparation) of a project to be financed.

Many developing countries have centralised processes for investment planning. This is also the case in Timor-Leste where infrastructure, both in the economic sector (highways, airports, roads, railways, water and sewer systems, public electric and gas utilities, pipelines and telecommunications) and in the social sector (public schools, hospitals, prisons, etc.) is funded from the Infrastructure Fund and managed by the Council of Administration of the Infrastructure Fund (CAFI). In most advanced economies, centralised infrastructure planning fell out of favour in the 1960s and 1970s while the role of line ministries was increased. The line ministries were deemed best-placed to manage trade-offs within sectoral policies. More recently, centralisation of some aspects of capital planning has been reintroduced in some OECD countries: in particular new mechanisms have been introduced to ensure that investments are directed towards key infrastructure bottlenecks, that investment projects comply with unified standards of project appraisal, regardless of whether they are financed through public, private or hybrid financing mechanisms (including public-private partnerships or PPP's) and that expertise in project management is pooled and shared across ministries.

Both sides of this argument are relevant for Timor-Leste. For line ministries, the division of tasks with the Infrastructure Fund diminishes, to a degree, their authority over their sectoral policy domain and there is not always a right balance between capital stock and recurrent expenditures for operation and maintenance. On the other hand the Infrastructure Fund in principle ensures that investments for key infrastructure projects are protected, that uniform appraisal standards are applied and that project management expertise is shared. Against this background, the government may consider limited reforms in the current capital budgeting procedure, aimed at better integration in the overall fiscal planning process while maintaining and improving the uniform appraisal standards and the sharing of project management expertise.

First, government capital planning should be better integrated in the medium term planning process as described in Section 4.3.

Second, the role of the Ministry of Planning and Strategic Investment needs to be focused more on the tasks that remain centralised. This concerns the application of uniform appraisal standards; the supervision of appraisals; providing advice to the centre of government (Prime Minister's Office and Ministry of Finance) on the overall envelope of Infrastructure Funds and the project adjustments and new projects proposed by the line ministries; the development of expertise on PPP projects and advice on PPP projects proposed by line ministries; and the development and sharing of project management expertise among line ministries.

Third, the Infrastructure Fund can remain intact as the financing vehicle for investments, while the envelope of the Fund and the budgets included in it for ongoing and new projects would in future be decided via the regular fiscal planning process. This arrangement would allow for an appropriate carry-over of funds at the end of each budget year. It would also ensure an inter-ministerial supervision of all major investment projects through CAFI and facilitate the central oversight of investment planning by the Ministry of Planning and Strategic Investment.

Fourth, project appraisal procedures need to be strengthened. While the criteria developed by CAFI for project appraisal are sound, the standardisation of cost and benefit estimation could be improved and the objectivity of the appraisals could be guaranteed more strictly through procedural requirements. Multi-criteria methods are useful in presenting a matrix of qualitative factors that influence policy decisions, however in the area of core infrastructure investment – which involves enormous sums of public money and where the stakes are so high, in terms of the consequences for economic development of the quality of decision-making – policies should be informed primarily by rigorous cost-benefit analyses conducted to international professional standards, and encompassing all stages of the project cycle (from project pre-selection, to mid-term review and post-project review).

This objective could be advanced by assigning the appraisal role to a specialist agency at arm's length distance from the Ministry of Planning and Strategic Investment. Potentially the CAFI Secretariat could serve for this purpose, given that there exists already relevant expertise in this office and that the inter-ministerial setup of CAFI ensures a certain objectivity. Another possibility would be to outsource this task to national or international economic research bureaus, based on a competitive procurement process led by the Ministry of Planning and Strategic Investment.

Roadmap Box 10: Capital Budgeting Process

2019-20	Integrate capital budgeting more fully within the medium term fiscal framework, with policy discussions and trade-offs informed by the *Jornadas Orçamentais (Budgeting Days)* discussions alongside other resource allocation decisions. ***Dependency:*** *requires progress in implementing MTEF and in developing/enhancing the pre-budget consultation forum.*
2019-20	Re-focus the role of the Ministry of Planning and Strategic Investment on the tasks that remain centralised, including application of uniform appraisal standards and providing advice to the centre of government (Prime Minister's Office and Ministry of Finance) on the overall envelope of Infrastructure Funds and the project adjustments and new projects proposed by the line ministries.
2018-19	Develop the quality and rigour of project appraisal and evaluation procedures in line with international professional standards. ***Dependency:*** *linked to progress on Human Resource Management/specialist training and staff development (see Section 4).*

4.6. Programme Monitoring and Evaluation (M&E)

One of the most challenging elements of budgetary governance is ensuring that public funds, once they have been allocated and spent, can be subject to ongoing monitoring and evaluation to ensure that value-for-money is being attained. OECD budget principle 8 calls for "*evaluating and reviewing expenditure programmes (including associated staffing resources as well as tax expenditures) in a manner that is objective, routine and regular, to inform resource allocation and re-prioritisation both within line ministries and across government as a whole*" and for "*taking stock, periodically, of overall expenditure (including tax expenditure) and reassessing its alignment with fiscal objectives and national priorities, taking account of the results of evaluations; noting that for such a comprehensive review to be effective, it must be responsive to the practical needs of government as a whole*". This section considers how the first of these objectives – monitoring and evaluating expenditure programmes – could best be advanced, while Section 4.7 will consider various approaches to introducing a suitable spending review model.

Programme monitoring and evaluation (M&E) is a tool for the assessment and improvement of policies, and for the reallocation of resources to where they can achieve the greatest impact. The **monitoring** dimension of M&E involves using data generated during the course of programme execution to ensure compliance with budgetary restrictions and to assess achievement of objectives. Systematic **evaluation** of programmes uses standardised, professional methodologies to allow a broader re-assessment of the policy rationale for a programme's continued existence, in light of other modalities and competing policy priorities, and to ensure that lessons learned can be integrated in policy revision.

M&E systems are not solely, or indeed primarily, for the use of the central budget authority (e.g. ministry of finance) but should form part of the normal toolkit of line ministries in managing their resources. It is sometimes said that line ministries are not interested in critical evaluations of their own policies, but this can only be true if evaluations are imposed on ministries by an external authority and if line ministries have no input in deciding what is done with the findings. A line minister has a clear interest in the quality of the policies for which he/she is accountable in parliament and in the public debate. For the development of a fertile culture of M&E in government it is therefore important that the line ministry has a primary role in the planning and timing of evaluations and that it can influence what is done with the results. The follow up of an M&E exercise may consist in decisions to change the design of a programme in order to make it more effective or efficient; and resources saved through more efficiency may be used to expand the level of service provided in this or in other programmes. In countries where evaluations are imposed upon line ministries by way of regulation, for instance through "horizon provisions" which limit the funding of programmes to a certain time period, it has often been observed that this may lead to non-critical or "rubber stamp" evaluations that do not contribute to the quality of programmes or the rational reallocation of resources.

In Timor-Leste, the system and structures for M&E are still in the developmental stages. In practice, the government and donors conduct *ad hoc* evaluations in specific areas. Going forward, the rollout of programme budgeting should set the foundation for a systematic adoption of M&E. The core elements of programme budgeting – including clarity about resources allocated towards particular objectives, clarity about programme objectives and setting of targets and indicators – go hand-in-hand with the implementation of M&E systems which depend upon the existence of this data. In turn, an active M&E phase of the policy cycle promotes a culture of accountability and performance, which tends to support the achievement of national planning goals.

Accordingly it is also important that the centre of government, through both the Prime Minister's Office and the Ministry of Finance, develops and issues guidelines on the conduct of evaluations, including provisions on developing the terms of reference, the participation of external experts or independent consultancy bureaus, the use of available data on performance and internal audit, and the presentation/publication of reports. Many countries have published such guidelines and Timor-Leste could usefully draw upon such international examples.

It is also important that line ministers are allocated primary responsibility for the planning and timing of M&E exercises and that they are afforded some role in influencing how the findings of these exercises are used. In this connection the binding character of multi-annual budget ceilings, once they have been put into effect, is an important supporting factor. A ministry will hesitate understandably to order an evaluation if the

results may become public before the budget negotiations are completed, and where there is a thus a risk that the savings will be moved away from the line ministry itself. The stability of the settled budget ceilings, with operational control and responsibility resting with line ministries themselves, are positive factors in promoting a culture of evaluation throughout public administration.

More generally, it should be noted that high-quality M&E exercises require the input of professional, analytically competent staff. The development of these competencies should be a priority for the human resource development strategy of Timor-Leste (see also Section 5). Given the system-wide importance of such analytical capacity, into the longer term it may be advisable for Timor-Leste to consider the development of a specialist economic *cadre* within the civil service, with staff mobility and promotion strands across related areas. As in other countries, such an economic *cadre* or service would be expected to service areas such as economic and budgetary forecasting, fiscal strategy, capital appraisal, programme evaluation, analysis of cross-cutting issues and spending reviews.

Finally, to be most effective, M&E exercises should go beyond *ad hoc* or arbitrary analysis of minor areas of spending, but instead should follow a structured multi-year programme designed to yield insights into broad areas of national and sectoral policy over time. In this way, M&E exercises can inform and contribute to the effectiveness of periodic spending reviews (see next Section).

Roadmap Box 11: Monitoring & Evaluation

2017-18	Specify the elements of an M&E framework to be introduced and applied progressively across all ministries, in tandem with the rollout of programme budgeting, providing clear guidance on design, implementation, and the respective roles and responsibilities of centre and line ministries/agencies.
2018	Line ministries and centre of government (MOF and UPMA) to specify the programme and schedule for M&E exercises; the overall programme to be brought before government for approval, as to its realism and ambition.
2019	Commence implementation of M&E exercises in all ministries/agencies on the basis of the guidelines and approved programme.
2020	Consider introducing a specialist *cadre* of economic and evaluation professionals within the civil service of Timor-Leste . ***Dependency:*** above steps require continued progress on implementation and government-wide understanding of programme budgeting approach, including specification of programme objectives and indicators. **Dependency:** sustained progress in implementing effective M&E systems, and potential introduction of an economic cadre, linked to progress on Human Resource Management/specialist training and staff development (see chapter 4). **Synergy:** progress in M&E implementation may facilitate, or indeed overlap with, the implementation of the spending review models outlined in section 3.8 and support the development of the performance framework and indicators (section 3.3). **Synergy:** progress in M&E implementation may also promote the relevance, quality and comprehensiveness of budget reports, facilitating more effective oversight by Parliament and Câmara de Cuentas.

4.7. Spending Review

Once funding is allocated to a particular area, it is often challenging for those resources to be re-assessed critically and potentially freed up for re-allocation to other areas. M&E systems can serve as a tool to increase the scrutiny of individual programmes as part of the broader approach to performance budgeting (see Section 2). However the problem of "inertia" in the allocation of public funds is even more significant at national level, when considering the overall stock of public expenditure. In order to bring greater scrutiny to bear at this level of expenditure, additional tools are needed. In many countries, different forms of spending

review are used to identify extra fiscal space and to provide assurance about the continued value-for-money and policy relevance of ongoing expenditure.

Table 4.2. **A typology of spending reviews and performance evaluation**

Primary objective		
Analysis: analyse management, structures and/or policy to improve efficiency and effectiveness	Create fiscal space: reallocate and/or reduce government expenditure for programmes or organisations	
Performance evaluation (programme, policy or organisational evaluation)	Spending Reviews	
	Efficiency reviews Primary criteria: efficiency – Identify how the existing policies can be conducted with less resource Examples: Finland "Productivity Programme"(2005-15) Korea "Self-Assessment of the Budgetary Programme" (2005-present)	*Strategic review* Primary criteria: efficiency and prioritisation – Identify what the government should or should not do Examples: Australia "Comprehensive expenditure reviews"; "Strategic review" (2007) Canada "Programme Review" (1994); "Strategic Review" (2009) Denmark "Spending review" (ongoing) Netherland "Interdepartmental Policy review" (1982; 2009-present) UK "Spending Review" (1998-present)

Source: OECD (2013).

Spending reviews are usually a complement of "top-down budgeting", i.e. budgeting within clear overall fiscal constraints, and of medium-term budgeting. Without spending reviews, the budget process – both annual and multi-annual – is at risk of becoming too mechanistic (as spending allocations for each line ministry are rolled forward from one year to the next) or too subjective and crisis-driven (as difficult decisions are put off until they are unavoidable, and decisions are made without sufficient reference to evidence and analysis). In addition, spending reviews are a natural complement of medium-term budgeting, with periodic reviews of resource priorities coinciding with the periodic re-calibration of medium-term spending envelopes and strategic plans.

The use of spending review procedures has increased rapidly over the last decade. Amongst OECD countries, around have such procedures in place (Robinson, 2014), but also in other parts of the world, experiments with spending review have increasingly taken place, especially in situations where public finances are on an unsustainable path and the need for a large budgetary correction is obvious.

4.7.1. *Expenditure baseline analysis*

For a country with no previous experience of conducting a spending review, a suitable starting point is to conduct a thorough analysis of the existing expenditure baseline. This analysis would examine the overall composition of expenditure in each sectoral area, and provide insights into the drivers of expenditure growth (see, for instance, OECD, 2017b) for a baseline analysis of the budget of Poland). The analysis can also shed light on the "rigidities" within the existing spending pattern: it is well known that some types of expenditure are easier to change in the short- and medium-term than others:

- some elements of spending are binding or pre-committed for constitutional, legal or contractual reasons (e.g. debt interest, parliamentary and judges' salaries; payments on capital projects and Public-Private Partnerships; public service pay);

- others form part of the legitimate policy expectations of the public (e.g. social welfare benefits);
- while other areas of spending may have policy sensitivity or particular value for other reasons.

The expenditure baseline analysis will not, in itself, yield conclusions about policy savings and about where resources should be re-allocated. Indeed, a typical finding of the analysis may be that the level of "discretionary" expenditure is very small – too small, in many cases, to meet the requirements of expenditure management into the future. Instead, the expenditure baseline analysis promotes a wider appreciation of the scale and nature of public expenditure, as well as a deeper reflection on the rationale for spending in the various areas; and it can thereby help to orient and inform a more policy-focused analysis of expenditure.

4.7.2. Efficiency Review

An efficiency-focused spending review examines the existing allocation of resources from the perspective of value-for-money, without necessarily questioning the policy rationale of the various programmes. Opportunities for efficiency savings can be found in areas of waste or duplication, but can also arise from inefficient policy instrumentation: subsidies on desirable behaviour instead of taxes on undesirable behaviour; the use of subsidies instead of well-designed regulation; in-house production instead of out-sourcing and external service delivery (whether by the private sector or by specific public agencies); earmarked grants to local government instead of block-grants or tax-sharing. More fundamentally, efficiency reviews may also encompass a systematic "establishment update" to examine the staffing levels, management structure and strategic mandate of public institutions.

The search for efficiency savings is not necessarily designed to lead to fundamental re-thinking about the rationale of the programmes under review. However it is appropriate in this context to consider current service levels and ask questions such as: What would happen if this programme were abolished or left to the market? What would happen if this particular policy instrument of the programme were eliminated? How does this programme fit with the policy priorities for the government as a whole? In order to promote such fundamental re-thinking, some countries have found it useful to establish an obligatory "savings/efficiency option" for every spending review, e.g. what measures would be necessary to yield public expenditure savings of 20% on this programme?

4.7.3. Strategic or Policy-focused Expenditure Review

Having achieved clarity about the composition and drivers of existing expenditure, and of levels of efficiency savings that can be obtained, it remains the case for many countries that fundamental policy-based assessments are required so that programmes can be prioritised within the finite resources that are available. Such strategic spending reviews should take place on a periodic basis (no more than once every 2-3 years), since they involve a high level of intensive effort and analysis that could not (and should not) be incurred every year. The opportunity of these reviews should be taken to undertake a detailed critical reappraisal of where public funds are being allocated, whether they are achieving impacts, and of their continued political validity.

There are a number of models for how to design and conduct an Expenditure Review. For Timor-Leste, a model should be carefully selected and implemented that meets

Table 4.3. **Towards an Expenditure Review model for Timor-Leste: Design considerations**

Basic design elements		
Who will conduct the review? ● line ministry officials ● MOF/UPMA officials ● specialist evaluation unit ● external consultants ● role of steering committee: administrative/ political engagement	Scope of the review? ("What?") ● all spending ("comprehensive") or sectoral/ programme ● efficiency review and/or national policies/ priorities ● ministries or cross-government programmes ● agency rationalisation	Methodology/approach ("How?") ● expenditure baseline analysis ● meet savings targets and/or meet expenditure ceilings ● type of public/civic engagement ● performance focused analysis: use of M&E framework ● present range of policy options or policy prescriptions
Strategic design elements – assessing impacts		
Impacts on people ● income distribution and equality: Gini coefficient ● Well-being indicators: access to key public services ● gender impacts ● environmental impacts	Impacts on growth ● public investment ● prioritising education (human capital investment) ● structural economic reforms ● regulatory policy/"red tape" ● anti-corruption agenda	Impacts on public sector ● staff numbers ● staff efficiency and work practices ● outsourcing/external service delivery models ● shared services ● digital government/open data

Source: OECD

national political requirements and that aligns with administrative structures and competencies. The dimensions that need to be considered, in designing a Spending Review model, are outlined in Box 3.4 above. Some key design elements are worth underlining:

a) ***who should conduct the review*** – e.g. analyses conducted by line ministries themselves; by the Ministry of Finance and Prime Minister's Office; by a competent team of evaluators within government; or by external professional consultants.

b) ***who should oversee and steer the review*** – e.g. a group of independent experts; the Ministry of Finance and the Prime Minister's Office; a panel of senior civil servants and possibly political advisers; or a sub-committee of the cabinet. In many countries, a small steering group including senior civil servants, political advisers and external experts is found to be effective in combining administrative credibility with political relevance.

c) ***which areas should be reviewed*** – e.g. a "comprehensive" approach seeking to cover the bulk of expenditure, or at least the bulk of the discretionary elements of expenditure; or alternatively a more selective and focused review of particular sectors; whether tax expenditures should be included; and to what extent other areas of government action in the sectors concerned – notably regulation – might be encompassed in the evaluation.

d) ***linkage with the performance/programme budgeting agenda:*** The review process should highlight how the objectives outlined in the budget narrative (see Section 3.2 above) correspond with the government's strategic plan; and thus the extent to which the budget allocations are supportive of the achievement of these government objectives. The results of this aspect of the review would inform the ongoing reform and developmental processes in this area.

e) ***what the output of the review process should be*** – e.g. a confidential report to cabinet in the context of the budget preparation phase, outlining policy options and trade-offs for consideration; or a public document published alongside the budget, showing the government's conclusions from the review exercise and showing how its medium- and longer-term priorities will be resourced and delivered.

As Table 4.3 illustrates, an expenditure review has the potential to stimulate debate and innovative thinking, within government, public administration and public alike, regarding the wide range of policy challenges facing a country. Within the context of the introduction of clearer medium-term dimensions to budgeting (see Section 2), and given the scale of the public finance challenges facing Timor-Leste, it is advisable that the government commit to undertaking such an exercise at an early date, and indeed that similar exercises be undertaken at approximately 2-3 yearly intervals as an ongoing component of the reformed budgetary system.

Roadmap Box 12: Spending Review

2018 – 1Q	Undertake an Expenditure Baseline Analysis to gain a more complete understanding of the components and drivers of public expenditure, including with regard to relatively "flexible" versus "discretionary" areas of spending.
2018 – 2Q	Building on the Baseline Analysis, undertake an Efficiency Review to examine the scope for savings within the existing policy framework, including by eliminating waste and duplication and streamlining the provision of services. ***Synergy:*** *The Efficiency Review could usefully be undertaken alongside the Government Institutional Review (see Section 4).*
2019 – 1Q	Undertake an Expenditure Review (a) to re-assess how closely the allocation of resources is aligned with national strategic and developmental priorities, and (b) to identify scope for significant expenditure savings and policy-based re-prioritisation. ***Synergy:*** The Monitoring and Evaluation (M&E) system, when fully up and running, should generate useful analytical material to support regular, more systematic Expenditure Reviews **Dependency:** linked to progress on Human Resource Management/specialist training and staff development (see Section 4).

4.8. Financial control and audit

OECD Budget Principle 10 calls on governments to "promote the integrity and quality of budgetary forecasts, fiscal plans and budgetary implementation through rigorous quality assurance including independent audit", including "acknowledging and facilitating the role of independent internal audit as an essential safeguard for the quality and integrity of budget processes and financial management within all ministries and public agencies" and "supporting the role of the supreme audit institution (SAI) in its role of dealing authoritatively with all aspects of financial accountability, including through the publication of its audit reports in a manner that is timely and relevant for the budget cycle."

Developing the internal audit capacity and the role and relevance of the supreme audit institution should accordingly feature as part of the Roadmap for budgetary governance reform in Timor-Leste.

4.8.1. Internal audit and control

The OECD Toolkit on Budget Transparency recognises that "Internal audit procedures are essential for guarding public funds from misuse, fraud and waste. Financial inspectors and internal auditors also play an important role in helping to improve overall levels of organisational effectiveness". The Toolkit also highlights three "suggested starting points", indicating that internal audit procedures should:

1. operate independently, in line with professional audit standards

2. involve regular audits of the main financial processes (e.g. payroll, cash management, revenue collection) and main spending and revenue units (e.g. ministry of defence, health agencies, revenue administration), and
3. communicate findings and recommendations to all relevant stakeholders, including the relevant public managers, the finance ministry and the external auditor.

The Office of Internal Audit (OIA) was established as part of the Ministry of Finance in 2013, in line with the provisions of the current Budget and Financial Management law. The OIA has four competencies: conduct of internal audit; investigation; consulting and acting as a focal point between the SAI and the MoF. Reviews are carried out by reference to the international standards of the Institute of Internal Auditors (IIA).

In addition, the OIA is assigned the functions of providing advice and guidance in the drafting of internal audit policies, and in the organisation, co-ordination and training of all public sector internal audit professionals in co-ordination with PFM training centre (see Section 4). Preparations are currently at an advanced stage to put these functions into effect.

The OIA also sends its reports to the SAI and maintains communications with that body in order to avoid duplication of work and to discuss with the SAI the areas considered as having a higher risk assessment.

As the levels of PFM capacity within the public administration develop, the most important priority will be to build the capacity and effectiveness of internal audit units within each ministry so that important signals about efficiency and quality of spending are relayed directly to management within each organisation.

Roadmap Box 13: Internal audit and control

2017	OIA/MoF should fully exercise its functions under the Budget and Financial Management law, including its central role in co-ordinating government-wide internal audit functions and first step of developing internal audit function in line ministries by piloting two audits involving line ministries internal auditors as first step in the process of developing a cadre of internal auditors in Timor-Leste.
2017	OIA/MoF to prepare and publish a plan for progressive development of internal audit capacity (institutional and professional) into the medium term with the view to incorporate performance audits.
2018-20	OIA/MoF to continue its central role in co-ordinating government-wide internal audit functions and training of more line ministries audit professional.
2020-22	Independent internal audit units should be established progressively in each ministry, with a mandate also to audit agencies under the remit of the ministry; except in the case of larger agencies where a separate Internal Audit unit may be appropriate. ***Dependency:*** *linked to progress on Human Resource Management/specialist training and staff development (see Section 4).*

4.8.2. *Inspector General of State*

The Inspector-General of State (IGS) was established with the Decree-Law n° 22/2009 to carry out routine and extraordinary inspections and audits, and other control actions in Government, such as investigations and inquiries. It also aims to review, evaluate the internal control systems and proposes measures based on the best international practice to improve structures, systems, and assist overtime in their implementation. It is also under their mandate to conduct inquiries and investigations of all government entities and sovereign organs if requested by them. Through its role as a high-level control service, the

IGS plays an important part in ensuring budgetary, economic, financial and the financial discipline in accordance with the principles of legality, regularity, sound financial management, economy, efficiency and effectiveness of the Public Administration. The IGS has technical independence and administrative autonomy and works directly under the Prime-Minister.

A review of the decree-law of the IGS is ongoing and to be submitted to the Council of Ministers for approval in March 2017.

4.8.3. Câmara de Contas: developing Timor-Leste's Supreme Audit Institution (SAI)

The OECD Toolkit on Budget Transparency notes that "Supreme audit institutions (SAIs) should be instituted in a way that allows them to undertake independent, regular and high-quality audits. SAI should be entrusted with providing assurance on the compliance of government expenditure with the applicable laws, regulations and rules; auditing the year-end financial report of the Government; and, increasingly, assessing the efficiency and effectiveness of public policies and programmes." The Toolkit provides "suggested starting points" in considering core aspects of SAI establishment and governance, to the effect that SAIs should:

- be granted assured and stable financial and human resources, and unrestricted access to information in order to perform their audit mandate
- maintain documented, public procedures and codes to underpin their professional standards (e.g. ethics and audit manuals)
- engage with a variety of stakeholders (including parliament, media and civil society) and provide relevant, timely information on their work programme and findings
- ideally, elevate findings on cross-cutting issues to provide insight on efficiency, effectiveness, sustainability and integrity in public expenditure across government.

Similarly, the Toolkit indicates that that external audit report prepared by the SAI should:

- be conducted using generally accepted international auditing practices
- be submitted to parliament as soon as practicable after the government's year-end reporting; and
- ideally, include audit of reported performance information.

The High Administrative, Tax and Audit Court *(Tribunal Superior Administrativo, Fiscal e de Contas)* established under Article 129 of the Constitution is the supreme audit institution (SAI) for Timor-Leste. On a transitional basis, pending the full establishment of the High Administrative, Tax and Audit Court, this function is exercised by the *Câmara de Contas* (Court of Audit) attached to the Appeals Court *(Tribunal de Recurso)* by virtue of Law No. 9/2011.

The SAI audits all accounts belonging to the Single Treasury Account, including the accounts of the budgetary funds. The minister of finance is obliged to respond to any queries raised either by the Court or by Commission C of the Parliament, which considers the reports of the Court that are submitted to Parliament. The Court establishes an Annual Audit Plan which is sent to Parliament and published. The Court produces an annual main audit report concerning the government accounts and special audit reports on separate expenditure and revenue topics. The annual audit report must be published before the end of the year following the budget year. Special reports are published throughout the year. Special reports include compliance audits as well as performance audits. Commission C

produces an annual report on the accounts based on the Audit Report for consideration in the plenary of Parliament.

The Court has over recent years developed its capacities and seeks to adhere to the international standards of external audit as laid down by INTOSAI (the International Organisation of Supreme Audit Institutions). The effective functioning of the Court of Audit is an important supporting pillar of modern budgetary governance in Timor-Leste. It is therefore important that the government provides sufficient resources for the continued development of the Court. In the future, consideration could be given to an international review of the state-of-play of the Court's development, by reference to peer-country experiences.

5. Broader agenda of public governance reform: promoting leadership, implementation and trust

This section addresses various aspects of modern public governance that would need to be addressed in future, in order to support the objective of advancing the budget as an effective tool at the centre of policy-making for government and citizens as a whole. These supportive measures involve strengthening and modernising the system of public administration as a whole; building human resource capacity, management and leadership; while also developing the capacity of other systems, such as the national statistics infrastructure. Other relevant issues include open government, digital government, integrity and anti-corruption. An in-depth examination of these issues is beyond the scope of this report, and indeed the government of Timor-Leste should consider what additional initiatives, including international supports, may be most helpful in order to ensure parallel progress along these other tracks of public governance reform.

5.1. *Re-considering the institutional/administrative structures of government*

The SIGMA[36]/OECD Principles for Public Administration (2014) recognise that "achieving good public administration requires reforms in numerous, diverse policy areas and many organisations. When planned and implemented on a fragmented and ad hoc basis, reforms may not enhance the functioning of the public administration as expected. Achieving results requires the government to steer and co-ordinate implementation of an overall vision for reform and prioritised objectives. Therefore it is important to approach public administration reforms sequentially and to develop a reform agenda with a whole-of-government perspective." The Principles specify that the organisational structure of public administration, procedures, as well as staff allocations and the role of ministries, should ensure that developed policies and legislation are implementable and meet government objectives.

The organisation of public administration must be efficient and effective in order to promote sound policy-making, support programme budgeting and to foster clarity about accountability for achievement of objectives.

Timor-Leste currently counts nineteen line ministries and fifty-eight Autonomous Agencies (including Municipalities and Secretariats of State). In practice, the structure of government is relatively large and fragmented in proportion to Timor-Leste's population. The government is a major employer, which is not unusual for a country with similar income levels and contexts, but the fiscal sustainability of a large public sector will need to be re-considered in light of the country's broader fiscal challenges. A number of

stakeholders have raised concern that the complex structure of government coupled with regular changes in the structure in recent years, pose additional challenges for the bedding-in of the programme budgeting reform. Indeed, such regular changes give rise to the need for revision to the programme structure, hampering continuity and stability and making it more difficult to analyse and project the baseline costs of public expenditure over the medium term.

Another feature of the current set-up of government is the combination of the Ministry of Planning and Investment, which manages the Special Fund and the Infrastructure Fund, as well as the Ministry of Public Works. Together in 2017 they will manage a budget of approximately USD 530 million, which accounts for 40% of the state budget. The current set-up creates some level of fragmentation in the overall investment budget process and difficulty in representing capital projects under a programme structure in a transparent way (see linkages with capital budgeting framework and overall budget transparency principles outlined in Section 3). In addition, the fact that all major investment projects are included in the budget of either the Ministry of Public Works or the Ministry of Planning and Investment, including projects within key social sectors, makes it difficult for stakeholders to accurately estimate the total level of resources assigned to these social sectors, and thus to trace the links between budget, plan and policies.

Going forward, Timor-Leste should consider undertaking an institutional review of its government structure in order to achieve a number of objectives:

a) to ensure that institutions are efficiently designed with clear and distinct mandates, clear delineation of institutional/political roles and responsibilities, while also making explicit the opportunities for joint action across ministries/agencies in particular cases
b) to optimise the alignment of institutional structures with Timor-Leste's priority goals as set out in the SDP and in the strategy for implementing the SDGs, making clear the levels of resources allocated to various areas and making it easier to identify areas of public spending and investment that may be under-resourced relative to the requirements of implementing the SDP, and
c) to introduce greater stability and predictability in the structures of government, to provide a more solid basis for programme budgeting and medium-term expenditure forecasting, management and planning.

Internationally, the period following a national election is often found to be the optimal period for undertaking such an institutional review, so that the newly-appointed government can consider afresh the tools at its disposal in order to achieve its policy goals. Such an institutional review would also have strong synergies with a broader spending review/efficiency review exercise (see Section 4).

5.1.1. *Ensuring balanced allocation of resources to social sectors*

Point (b) above links to concerns raised by some stakeholders regarding the scale of the investment and infrastructure budget relative to that of education and health. Balanced allocation of resources across the various economic and social sectors is ultimately a matter of political judgement, but it is important that political decision-making and parliamentary scrutiny is informed by clear budgetary information and by open articulation of the government's plans and aspirations in regard to these areas. Some countries around the world have found it useful to lay down legal norms or guidelines regarding the minimum proportion of national resources that should be allocated to social

sectors. For example, the constitution of Costa Rica specifies that at least 8% of GDP should be allocated to education; while under the auspices of the African Union, many African countries adopted the 2001 Abuja Declaration, committing to an allocation of at least 15% of the annual budget to the health sector. While such ear-marking of funds can have disadvantages as well as advantages, an institutional review may provide an opportunity for Timor-Leste authorities to reflect upon suitable mechanisms to ensure that all aspects of the SDP, and all commitments under the SGDs, are resourced in a balanced and sustainable manner into the future.

Roadmap Box 14: Re-considering the institutional/administrative structures of government

2017	Conduct a consultation with Line Ministries and a do a literature review of the Institutional Assessments done by Secretariat of State for Institutional Strengthening (SEFI) and present the findings to the Council of Ministers to support the streamlining and efficiency of the organisational structure and the service delivery models; with a view to supporting budgetary governance reforms including budget transparency, effective capital investment strategy, programme budgeting and medium-term budgeting. ***Link** – this exercise should ideally be conducted prior to the swearing in of the VIIth Constitutional Government and introduction of new organic laws, i.e. by mid-2017.*
2017-18	Consider suitable, nationally-designed mechanisms to promote balanced allocation of resources across economic and social sectors. ***Synergy:** such mechanisms could usefully be considered alongside the design of a fiscal rule for Timor-Leste (see Section 3).*

5.2. Public management and human resource development

The OECD's tenth budgetary governance principle focuses on "*the integrity and quality of budgetary forecasts, fiscal plans and budgetary implementation through rigorous quality assurance*". One of the elements emphasised is the need for "*investing continually in the skills and capacity of staff to perform their roles effectively – whether in the Central Budget Authority, line ministries or other institutions*". Capacity and issues of public management and human resource development more generally are indeed critical for the success of Timor-Leste in undertaking broad-based budgetary reform and in effectively implementing its SDP. Civil service performance in particular is directly relevant for the deepening of programme budgeting, in terms of promoting responsibility and accountability at organisational and managerial levels (see Section 3).

The authorities in Timor-Leste have been paying particular attention to understanding the current strengths and weaknesses of its public administration. In 2016, the Secretary of State for Institutional Strengthening (SEFI) undertook a diagnostic of public institutions in order to identify priority reforms. The diagnostic delved into seven standards aspects, including 1) strategy and leadership; 2) legal and structural framework; 3) human resource management; 4) systems and budgeting system, including Information and Communication Technology (ICT); 5) asset management and procurement; 6) cultural organisation issues; and 7) service delivery and partnership. This exercise is intended to set an agenda of reform and priorities for action in these areas. However, parliament is not at present included in the diagnostic and hence will not benefit from any support regarding institutional strengthening facility in this context. In addition to the work of SEFI, the Public Service Commission is providing guidance with respect to human resource development, career paths, labour

rights, wages and salaries in the public administration. A Public Financial Management Capacity Centre has also been set up to address low capacity in this field across Ministries, and will be an important focus for training and development including with regard to the implementation of the reform agenda based upon this Roadmap.

Some issues identified through the diagnostic exercises to date include:

- weak co-ordination within and between Ministries;
- human resource gaps in certain areas;
- language barriers, including lack of uniformity in the use of Portuguese, Tetun and English;
- lack of developed pathways for recognising and rewarding qualified and successful staff, including a perception that the meritocratic principle for promotion and career progression is not uniformly applied;
- a tendency to bypass decisions and rules, with frequent changes in regulations.[37]

In the context of preparations for this report, most of these themes were echoed. A number of stakeholders raised concerns about a tendency towards political appointments at various levels within the public administration, a factor which over time could undermine staff morale generally and weaken the perceived role of the civil service as a non-partisan, professional and high-quality administration. Concerns were also raised about the high turnover of staff, and the general absence of clear job descriptions and well-defined roles and responsibilities for managers and teams. These shortcomings are particularly important from the point of view of making a success of programme budgeting, which relies *inter alia* on assigning budget and managerial responsibility to a programme manager, with clear expectations of performance and lines of accountability.

Hence, Timor-Leste should maintain its efforts to develop professionalism and systematic capacity building in the civil service. It is important to strengthen a culture of meritocracy, to develop job descriptions and ensure that clear roles and responsibilities are assigned. In line with progress on these aspects, one could consider introducing key performance indicators to measure progress, for example by measuring the annual turnover of civil servants at the level of the central administration and on a qualitative level one could consider measuring the extent to which recruitment is based on the merit principle in all its phases. The OECD/SIGMA Principles for Public Administration provide one useful framework in considering these dimensions further (see Box 5.1).

Box 5.1. **SIGMA/OECD Principles of Public Administration: Public Service and HR Management**

1. The scope of public service is adequate, clearly defined and applied in practice.
2. The policy and legal framework for a professional and coherent public service is established and applied in practice; the institutional set-up enables consistent and effective human resource management practices across the public service.
3. The recruitment of public servants is based on merit and equal treatment in all its phases; the criteria for demotion and termination of public servants are explicit.
4. Direct or indirect political influence on senior managerial positions in the public service is prevented.

Box 5.1. **SIGMA/OECD Principles of Public Administration: Public Service and HR Management** *(cont.)*

5. The remuneration system of public servants is based on the job classification; it is fair and transparent.
6. The professional development of public servants is ensured; this includes regular training, fair performance appraisal, and mobility and promotion based on objective and transparent criteria and merit.
7. Measures for promoting integrity, and preventing corruption and ensuring discipline in the public service are in place.

Roadmap Box 15: Public management and Human resource development

2017-18	Develop job descriptions for all management grades (senior level, middle level and junior/team leader levels). ***Synergy:*** *the specification of management job descriptions could usefully be carried out in tandem with an Institutional Review (see Section 5.1), to ensure alignment of both organisational and managerial functions in support of the SDP.*
2018-19	Consider international support for advice on introduction of performance management and development systems.

5.3. *National accounts and statistics*

The development of a solid system for collecting national statistics, including those of national accounts, and ensuring the reliability of this data is an important supportive measure to developing indicators for programme budgeting and the wider exercise of strengthening a performance orientation in government. The availability of data and hence indicators, both qualitative and quantitative, is also critical for the process of implementing the Sustainable Development Goals framework in Timor-Leste (see Section 3 for linkages with developing indicators for programme budgeting).

At present in Timor-Leste, there is no established stand-alone institution to collect statistics; instead the function of data collection is handled by DG Statistics and DG Policy and Research within the Ministry of Finance. However, plans are in place to set up an independent Institute/Bureau of Statistics by 2020. The Ministry of Finance will work with other stakeholders to design and build the required professional statistical operation, to be separated off in future. The plans are for the Institute/Bureau to be an independent national statistics office, with medium-term planning processes in place, supported by a knowledgeable and competent workforce. Its tasks will include developing an expanded statistical work programme, with regular production of all key priority statistics and a considered role of District Offices.

These are noteworthy efforts and represent a sound approach to consolidating the statistical function in Timor-Leste, provided that the professional capacity of staff is developed in line with the function and the scope of the statistical bureau. In this regard, the scope of the bureau could be narrowly defined in the initial stages on core data-collection and statistical tasks, and then progressively expanded to produce more specific and broader data-types at more regular intervals. Since Timor-Leste is at an early stage in the development of its national statistical framework, the opportunity presents itself for the country to learn from the lessons and experiences of other countries and to design the data

collection system to support advanced, modern aspects of policy development. For example, administrative data sources – i.e. data generated routinely by public bodies in the course of their activities – should be regarded not as a neutral by-product of public administration, but as a potentially valuable source of intelligence on the effectiveness and efficiency of government. Administrative rules and standards regarding the quality, availability and use of this data should be developed, subject to necessary safeguards about individual privacy and data protection. More specifically, Timor-Leste could ensure that all policy-relevant data is tagged, from the outset, on a gender-disaggregated basis to support future initiatives in the area of gender-responsive policy-making and gender budgeting: in many countries, the lack of availability of gender-disaggregated data is cited as a significant impediment to the successful implementation of these approaches (OECD, 2017a).

One of the main tasks of a new independent Institute/Bureau of Statistics will be the compilation of a system of national accounts to international standards. This is a large task which requires a substantial investment in qualified human resources. It has to start with the identification of the providers of data and the development of data provision forms. The data providers have to cover the main components of GDP and should include the banking sector, the oil fund, the main industrial sectors, the agricultural sector, the retail sector, the health and educational sectors and the government sector (through the Treasury and the Inland Revenue service). The system could make use of supply side approaches and demand side approaches. The system can be built gradually according to a multi-annual plan. This effort should be supervised by a taskforce that would include international experts, who have extensive practical experience in the building and maintenance of systems of national accounts in similar countries. International organisations, such as the IMF and the OECD have large national accounts divisions that may also be able to assist.

5.3.1. *Relevance of an Open Data framework*

Developing an effective statistical system is related to the broader issue of the availability and transparency of government data. In an effort to strengthen links between budgets, plans and policies and to ensure that public policies are sustainable, inclusive and predictable, many countries are moving towards developing government strategies for open data and digital government more broadly. Open government data involves a philosophy and a set of policies that promote transparency, accountability and value creation by making government data available to all. Public bodies produce and commission high quantities of data and information. By making their datasets available, public institutions become more transparent and accountable to citizens.[38] These issues are complementary to efforts in the transparency dimensions highlighted in Section 4.

The OECD Toolkit on Budget Transparency notes that "Making budget data publicly available in open digital form provides citizens and civil-society organisations with a valuable resource to analyse, evaluate and participate in public budgeting. Open budget data enables the public to understand and engage with the budgetary process and policy-making and to contribute new and innovative perspectives." The Toolkit goes on to provide starting points for the standards that open data should meet (e.g. machine-readable, open-source, bulk-downloadable data), its accessibility ("open by default" and linked to data visualisation tools) and its integration with other existing public portals (including the desirability of publishing such data directly from the underlying Financial Management Information System).

Timor-Leste can already point to significant progress in this general area. Since 2011, Timor-Leste has developed a Transparency Portal, which includes an Aid Transparency

Portal, a Budget Transparency Portal, an E-procurement Portal and Government Results Portal. The Results Portal shows outcomes information for the most important government goals, projects and programmes. Different information is displayed for each target, including purpose, physical and financial progress and photographs. Some stakeholders have raised concern with regard to the Aid Transparency Portal, which relies on data inputs from the various aid and development partner agencies for the reliability, timeliness and usefulness of its information. The Transparency Portal includes excel data information on expenditure, execution, balance at a very high level and provides a solid platform to expand availability of data at lower levels of expenditure.

The e-procurement portal (*www.eprocurement.gov.tl*) is a relatively basic portal, presented as a dashboard, with information on all open tenders, grouped by the type of business, and where one can access and review all awarded tenders. The data is not real-time but is updated regularly. Looking forward, the process of updating the portal can be systematised and more widely communicated across the public administration to support a transition to a full e-procurement portal, whereby service providers can submit tender proposals directly on-line. The potential of the e-procurement portal is significant and is supportive of wider procurement reforms and anti-corruption efforts.

Box 5.2. **The Open Government Partnership (OGP)**

The Open Government Partnership is a multilateral initiative that aims to secure concrete commitments from governments to promote transparency, empower citizens, fight corruption, and harness new technologies to strengthen governance.

Participating countries sign the Open Government Declaration, which has 70 country signatories and focuses on four elements: 1) Increase the availability of information about governmental activities; 2) support civic participation; 3) implement the highest standards of professional integrity throughout administration; 4) increase access to new technologies for openness and accountability. In addition, participating countries co-create a National Action Plan (NAP) with civil society. Action plans cover a two-year period and consist of a set of commitments that advance transparency, accountability, participation and/or technological innovation.

From the G7+ grouping, Sierra Leone, Liberia, and Papua New Guinea are currently developing OGP action plans.

A more fundamental challenge to advance open and digital government is to ensure that the internet is widely available and functioning throughout the country and that citizens have reasonable access to computers. It is not clear that the various transparency portals are widely known or used by citizens, parliamentarians or indeed by the media.

In order to address these and other issues, and to accelerate progress towards best international practice, the government of Timor-Leste may wish to consider membership of the Open Government Partnership (OGP – see Box 5.2). The OGP facilitates countries in developing a national strategy for modern, open and inclusive public governance and in showcasing national achievements, and in learning from the examples of peer countries at various levels of development. Such an initiative would be consistent with Timor-Leste's progressive movement to taking its place among the community of nations.

As one tangible initiative, Timor-Leste should also consider joining the World Bank's BOOST[39] initiative, which helps countries to make their budget data available in a standardised open format, to promote transparency, accountability and quality in policy-making. At present the BOOST approach is used in approximately 40 countries around the world. The BOOST initiative supports countries to develop a facility whereby expenditure data can be extracted directly from government FMIS to make it publicly available.

Roadmap Box 16: National Accounts, Statistics and Open Data

2018	develop official protocols for the quality, availability and use/re-use of administrative data sources across public administration, with a particular view to programme budgeting, indicator development and statistical uses. develop an access to information law which institutionalises the wider principles of budget transparency, openness and accessibility, in particular with regard to open budget data, and with due regard to privacy and data protection. ***Synergy:*** *the principles of openness and accessibility could potentially be considered for inclusion the proposed reform of the Budget and Financial Management law (see Section 3).*
2019	develop the specifications of a national framework of indicators and key statistical data/markers, informed by the requirements of programme budgeting, medium-term planning and monitoring/implementation of SDGs. ***Dependency:*** requires clarity regarding medium-term planning goals and linkages, and regarding SDG ambitions. **Synergy:** the data specification exercise should be closely aligned with the specification of programme budgeting indicators.
2020	consider joining the Open Government Partnership, and consider seeking international support and advice on the design of a multi-year open government strategy to global standards of good practice.
2020	establish Bureau for National Statistics with mandate for progressive development of data collection, focusing on quality assurance and on responding to policy-related needs.
2022-23	expand the scope and timeliness of data collection and develop policy-relevant statistical reporting.

Notes

1. Population and Housing Census, 2015, *www.statistics.gov.tl*, government of Timor-Leste.
2. Country Report No. 16/183, Republic of Timor-Leste, 2016 Article IV consultation, IMF June 2016.
3. Total annual real GDP is projected to contract in the medium term on account of declining oil production – the IMF foresees annual real GDP contractions until 2025.
4. Country Report No. 16/183, Republic of Timor-Leste, 2016 Article IV consultation, IMF June 2016.
5. 2017 State Budget, Book 1, government of Timor-Leste, 2016.
6. United Nations Human Development Report 2015: Work for Human Development, *www.hdr.undp.org*.
7. United Nations Human Development Report 2015: Work for Human Development, *www.hdr.undp.org*.
8. See further: *www.g7plus.org/en/secretariat*.
9. 2016 States of Fragility Report, OECD, 2016 (forthcoming).
10. 2017 State Budget, Books 1 and 5, government of Timor-Leste, 2016.
11. 2017 State Budget Books, government of Timor-Leste, 2016.
12. International Working Group of Sovereign Wealth Funds, Sovereign Wealth Funds, generally accepted principles and practices, Santiago Principles, 2008.
13. 2017 State Budget Book 1, government of Timor-Leste, 2016.
14. 2017 State Budget Books, government of Timor-Leste, 2016.
15. 2017 State Budget Book 1, government of Timor-Leste, 2016.
16. *Ibid*.
17. Doing Business 2017, Equal opportunity for all, World Bank, 2016.

18. Performance budgeting in OECD countries, OECD, 2007a.
19. Programme budgeting in OECD countries, Dirk-Jan Kraan, OECD Journal on Budgeting, Volume 7 – No. 4, 2007b.
20. CABRI, Performance and programme based budgeting in Africa – a status report, 2013.
21. Mapping and Chart of Accounts for Programmes and Activities by Divisions, Unit of Planning, Monitoring and Evaluation of the Cabinet of the Prime Minister, June 2016.
22. SMART criteria for the design of targets: Specific, Measurable, Action-oriented (or Ambitious); Realistic; Time-bound. FABRIC criteria for the selection of indicators: Focused on key goals; Appropriate and useful for stakeholders/users; Balanced, giving an overall picture of performance in different areas; Robust to withstand organisational changes; Integrated within organisational planning processes; Cost-effective to produce and use.
23. Beyond the annual budget, Global experience with Medium-term expenditure frameworks, World Bank, 2013.
24. 2011-30 Ministry of Finance Strategic Plan, government of Timor-Leste, 2011.
25. Repeat PEFA Assessment of Timor-Leste 2013, May 2014.
26. *www.oecd.org/development/making-development-co-operation-more-effective-9789264266261-en.htm*.
27. SDG working group report and memo, government of Timor-Leste, 2016.
28. The Governance of Inclusive Growth, OECD, 2006.
29. It is worth noting that to some extent, the PEFA framework used in the 2015 and 2013 assessments present lower criteria thresholds than the Open Budget Index. The new PEFA framework approved in 2016 includes in certain dimensions higher thresholds than the previous framework.
30. PI-6 measures the comprehensiveness of information included in budget documentation; PI-10 measures public access to key fiscal information; PI-24 measures the quality and timeliness of in-year budget reports; and PI-25 the quality and timeliness of annual financial statements.
31. Toolkit on Budget Transparency (OECD, 2017a).
32. See for example GIFT Principles of Public Participation in Budgeting (*www.gift.org*); Toolkit on Budget Transparency (OECD, 2017; forthcoming).
33. Review of budget oversight by parliament: Ireland, Preliminary draft, OECD 2015b.
34. Many OECD countries update the multi-year estimates more often than twice a year, but as a first step for getting the ICT system running, twice a year is an appropriate starting point.
35. For instance the Netherlands: the IBOS system (IBOS stands for inter-ministerial budgetary consultation system).
36. SIGMA (Support for Improvement in Governance and Management) is a joint initiative of the OECD and the European Union.
37. Timor-Leste Strategic Plan of the Ministry of Finance, 2011.
38. Open government Data: Towards Empirical Analysis of Open government Data Initiatives, OECD Working Papers on Public Governance, May 2013.
39. See *http://wbi.worldbank.org/boost/boost-initiative*.

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ANNEX

Roadmap of budgetary governance reform for Timor-Leste

END OF YEAR GOALS	CORE REFORMS	BROADER BUDGETARY GOVERNANCE REFORMS	SUPPORTIVE PUBLIC GOVERNANCE REFORMS
		2017	
		GOVERNANCE OF ROADMAP	
PFM working group set up and functioning in accordance with TOR Leading entities: MoF and UPMA	**Reform planning management** ● Develop a detailed terms of reference for the PFM working group, including nomination of members and secretariat, scope of work, reporting lines etc. Members to include MoF, UPMA, CFP, Line Ministries, MAE to represent Municipalities, etc. ● PFM working group to report on progress and challenges and present the plan of the following year to be approved by the Council of Ministers. ● Undertake review of 2016 budget execution and implementation issues affecting service delivery.	**Reform planning management** ● Policy paper about the Medium Term Expenditure Framework to be used in Timor – contributions to the new FML policy. ● Policy paper about the adoption of Government Finance Statistics to Timor-Leste – is linked with the update of the CoA in April/May 2018. ● Policy paper to review the desired level of the budget virement process – contributions to the policy paper on FML law. ● PFM policy paper to review the Budget and Financial Management law ● Policy paper about Indirect Administration and what needs to be integrated in the legal framework and in the new FML Law. ● Policy paper to review public grants law. **Gender Responsiveness** ● Policy guidelines on gender budgeting. **Fiscal policy** [pg. 57] ● Policy paper option in consultation with the Fiscal Reform Co-ordinator about the possibility of a fiscal rule to be included in the new PFM law.	● Sign data-sharing MoUs between government entities, especially with DG Statistics. ● Overview on PFM (Planning, Budget, Finance, Reporting, Monitoring and Evaluation) to the new Ministers of the VII Constitutional Government. Reference to the Resolution of the Government N° 34/2016 of 12 October that approved the Policy about Institutional Strengthening for the period between 2016-30, the working group and the Action Plan for 2016-20. This is part of the Guide for the Public Administration Reform. Ref PIS Plan 2016-30. **International engagement** ● Delegation to attend the OECD Senior Budget Officials meeting to present progress, challenges, lessons learnt and way forward. Consider inviting OECD to provide inputs and review the implementation status of the reform.
Updated SDP Leading entity: UPMA	Medium-term planning [pg. 43] ● TOR for the update of the SDP. ● Update the SDP. In particular: i) create clear links between the SDP and the programme structures; and ii) cost out the medium term goals (2018-22).	Medium-term planning ● Develop a Medium Term National Development Plan concept that integrates the Goals from the SDP, SDG, programme of the government, sector strategic plans and programme structures. To be completed after the SDP update 2 Q 2018.	

END OF YEAR GOALS	CORE REFORMS	BROADER BUDGETARY GOVERNANCE REFORMS	SUPPORTIVE PUBLIC GOVERNANCE REFORMS
Budgetary Governance Reform **Program structures in Chart of Accounts f or 100% of ministries and autonomous agencies (except National Parliament and Presidency of Republic)**. Leading entities: UPMA +MoF +LM	**Programme budgeting** ● Undertake consultation with line ministries who have implemented Programme Budgeting, gain feedback on progress to date, ensure that the programme structure is in accordance with the government programme. ● Agree on programme structures with all national ministries, agencies and Municipalities not included in the 2016 exercise. ● Ensure all programme structures are in the Chart of Accounts/FMIS. ● Train ministries, agencies and municipal authorities to ensure their payment requests (CPVs, EVs) use correct FMIS activity codes. ● Combine the Programme Budgeting budget tool into one budget proposal template for 2018 budget, which will produce data for annual plan, procurement plan and detailed budget.		
Improved transparency and accountability Leading entities: MOF+ UPMA		**Budget transparency** [pg. 51] ● Ensure 2017 programmes, with estimated and actual spending, are publicly viewable. ● Audit and publish the 2016 annual financial statements. **Budget documentation** [pg. 52] ● For 2018 budget: (a): include a policy summary that explains what the major 2018 programs are and what they will achieve. **Internal audit and control** [pg. 70] ● Publish a five-year plan to build internal audit capacity.	**Human resource and management development** ● Identify program managers for the programs of each ministry.
Strategy paper on how to build M&E capacity in UPMA, MoF and line Ministries including municipalities. Leading entities: UPMA+LM+Municipalities		**Monitoring and evaluation** [pg. 63] ● Specify, and then publish guidance on, the M&E framework, including roles and responsibilities, reporting, etc. This guidance will explain how to prepare the quarterly and Annual Reports (which will be publicly available from 2019 onwards). ● Publish a five-year plan to build M&E capacity in accordance with the framework and guidance.	
New law of procurement approved Leading entity: MoF		**Budget process consolidation** ● Socialization, training and manuals, SOP's are produced to start the implementation in FY 2018.	

END OF YEAR GOALS	CORE REFORMS	BROADER BUDGETARY GOVERNANCE REFORMS	SUPPORTIVE PUBLIC GOVERNANCE REFORMS
User requirements and specifications for FMIS system to be developed Leading entities: PMO/ITC unit		**Budget process consolidation** ● Define the future requirements for the FMIS based upon the roadmap with the aim of having a FMIS, which can accommodate the reform processes (Program budgeting, Accrual accounting, etc.). ● Determine the options and costs for developing a complete integrated system, which covers Planning, Budgeting, Execution, Procurement, Balance Sheet (assets and liabilities), Monitoring and Evaluation.	**Budget transparency and participation** ● Concept paper outlining strategy for Government engagement in openness and transparency to the citizens of Timor-Leste, through portals, e-governance etc.
Consider benefits and costs of moving from cash accounting to accrual accounting Leading entity: MoF		Accounting ● Develop policy paper on the possible transition from cash to accrual accounting, including setting the timeframe and a capacity development plan. Link with the FML and ICT development.	
Support the implementation and Institutionalisation of Municipalities Leading entities: MoF+MAE+UPMA		**Budget management at the local level** ● Define the Municipality planning framework and reporting system for policy analysis. ● Prepare Program Budgeting Guidelines to the Municipalities. ● Training and capacity building on planning, monitoring and evaluation.	
Alignment of the Fiscal Reform Commission White paper on further implementation plans for the roadmap Leading entities: MoF+ Fiscal Reform Commission		**Reform management** ● Two-day seminar in April 2017 with presentations from UPMA, IMF, World Bank, IFAC. ● Further implementation plans to be developed and implemented through the roadmap (including Accrual Accounting, standards and CoA and capacity development plans for the implementation).	
Obtain baseline expenditure data and analysis to inform future forward estimate and identify fiscal space. Leading entities: MoF+ UPMA		**Spending review** ● Actual spending data collected by programme to inform baseline spending review in 1Q 2018.	
Human resource management and development [pg. 76] Leading entities: PSC +INAP			**Human resource and management development** ● Track senior manager's performance in the public administration by using KPI – link with programme budgeting reform-performance. Ref PIS Plan 2016-30. ● Finalised job descriptions for all management grades (senior level, middle level and junior/team leader levels).

END OF YEAR GOALS	CORE REFORMS	BROADER BUDGETARY GOVERNANCE REFORMS	SUPPORTIVE PUBLIC GOVERNANCE REFORMS
Review the composition and structure of Government. Leading entities: UPMA + SEFI			**Institutional review** ● Provide analysis on how to improve the co-ordination and improve the efficiency of current structures of government (number of line ministries, agencies etc. and their mandates), with the view of the improving the VII constitutional Government Structure. Ref PIS Plan 2016-30. ● Policy paper to create a standardised organisational structure across whole of government, to effectively manage PFM functions. This is linked with the new organic structures of the VII Constitutional Government and also with the new FML. **Ref PIS Plan 2016-30**.
		2018	
		GOVERNANCE OF ROADMAP	
Functioning PFM Working Group Leading entities: MOF +UPMA	**Budget process consolidation** ● Public Financial Handbook published that explains all relevant processes and regulations to be implemented. ● Create guidelines to be used by MoF and UPMA on how to conduct planning and financial analysis of new policy proposals to CM. ● Policy note on adoption of a Diagnostic Framework for Assessing Public Investment (IMF, ADB, World Bank etc.). MPIE will lead. ● Undertake review of 2017 budget execution and implementation issues affecting service delivery, including municipalities. **FMIS** [pg. 56] ● Identify new FMIS that meets the requirements identified in 2017, with the aim of system being implemented in 2019. **Accounting** ● Implementation to be phased and considered according with the policy note.		**ODA management and co-ordination** ● Develop ODA policy, which may include a Sector Wide Approach (SWAP) agreement, with the aim of all DP's agreeing to utilise Government systems, including FMIS and PB structure to achieve the ultimate aim of One Plan One Budget. **International engagement** ● Establish a library on PFM material in UPMA and on-line access to OECD publications to all Line Ministries. ● Delegation to attend the OECD senior budget officer meeting to present progress, challenges, lessons learnt and way forward. Consider inviting OECD to provide inputs and review the implementation status of the reform. **Institutional review** ● The new FML to be submitted to the National Parliament approval – to start the implementation in 2019.

END OF YEAR GOALS	CORE REFORMS	BROADER BUDGETARY GOVERNANCE REFORMS	SUPPORTIVE PUBLIC GOVERNANCE REFORMS
Medium Term National Development Framework in place (5 years) Leading entities: UPMA	**Medium-term planning** [pg. 43] ● TOR for the update of the SDP. Update the SDP. In particular: i) create clear links between the SDP and the program structures; and ii) cost out the medium term goals (2018 -2022). ● Sector Strategic Plans developed and integrated in the first draft of Medium Term National Development Framework (5 years) – until 1 Quarter.	**Monitoring and evaluation** [pg. 63] ● Publish a five-year plan to build M&E capacity in accordance with the framework and guidance. ● Produce guidelines for line ministries to standardise and harmonise the process of developing sectoral plans, with measurable targets, selecting, developing and collecting data for performance indicators and standardise the timing of these exercises, as well as monitoring and evaluation exercises –1 Q. ● Develop a Medium Term National Development Plan concept that integrates the Goals from the SDP, SDG, and program of the government, sector strategic plans and program structures. To be completed after the SDP update 1 Q 2018.	
Budgetary governance reform Leading entities: MOF UPMA	**Programme Budgeting** ● Mainstream the programming format for the 2019 Budget, with its application in all ministries and autonomous agencies. Budget Transparency and participation ● For 2019 budget, consider the merits of merging books 2 and 4a/4b so there is now a single, consolidated book that links plans and budgets. **Medium-term expenditure management** ● Calculate realistic resource envelope within a sustainable fiscal strategy. ● Develop a MTEF template and calculate the forward estimates for each program, up to 2022 and to be linked to sectoral plans. ● Change the 2019 budget proposal template so that budget estimates are at the DIV-ACTIVITY-APPCAT (appropriation category).	**Expenditure Baseline Analysis** [pg.] – until 1 quarter *Using the programme structures and spending data from 2017, in late January 2018 review:* ● Components and drivers of public spending, including "flexible" vs "discretionary" areas of spending. ● Savings within the programme framework, including by eliminating waste and duplication, and streamlining service delivery. **Budget process consolidation** [pg. 54] ● All new policies are scrutinised by MoF and UPMA of the financial implication of the implementation and update the forward estimate. **Capital budgeting** [pg. 61] ● Develop the quality and rigour of project appraisal and evaluation procedures in line with international professional standards.	**Statistics and Open Data** [pg. 80] ● Develop official protocols for the quality, availability and use of data sources, with a particular view to programme budgeting, indicator development and statistical uses.
Improved transparency and accountability Leading entities: MOF+ UPMA	● Adopt an overarching principle of Open, Transparent, Inclusive Budgeting in order to ensure inclusiveness of the budget, information provided in the pre-budget statement, mid-year and year-end report, must allow for disadvantaged groups to easily understand and see how the issues key to their prosperity will be addressed.	**Budget transparency** [pg. 49] ● Publish a Mid-Year Fiscal Outlook in July (showing original and revised 2018 budgets, expenditure FYTD, updated macroeconomic data and information on any new policies). ● Adjust Citizen's Budget to highlight programmatic and medium-term aspects and explain links to the SDGs. ● Conduct an International Budget Transparency Implementation Review. ● Begin to provide capacity building to the independent internal audit units in each ministry. ● Consider introducing gender budget statement into the budget process.	

END OF YEAR GOALS	CORE REFORMS	BROADER BUDGETARY GOVERNANCE REFORMS	SUPPORTIVE PUBLIC GOVERNANCE REFORMS
Implementation of new procurement law Leading entities: MoF	**Budget process consolidation** ● Annual report of Procurement. Compliance, Challenges, Capacity Building and recommendations for improvement ● Implementation plan developed for the introduction of an e-supply catalogue.		
Human resource management and development [pg. 76] Leading entities: PSC+INAP		**Budget Transparency/Programme budgeting** ● Assign managerial responsibility to senior staff for programme achievements start in 2019. Link with FML.	
	2019		
	GOVERNANCE OF ROADMAP		
Functioning PFM Working Group Leading entities: MoF+ UPMA	● PFM working group to report on progress and challenges and present the plan of the following year to be approved by the Council of Ministers. ● Review the implementation of the Roadmap by OECD and/or other international body and provide support the PFM working group in the update of the roadmap. **Budget process consolidation** ● Undertake review of 2018 budget execution and implementation issues affecting service delivery, including municipalities. **Accounting** ● Continue capacity building plan in accrual accounting. Competencies to be developed and training delivered on core competencies. ● Continue the implementation of the accrual accounting according with the policy note.		**International engagement** ● Independent review by OECD or other international body to take stock of implementation of the reform and continue to support the implementation of the roadmap in future years ● Delegation to attend OECD Senior Budget Officials meeting to present progress challenges and lesson learnt and way forward.
Medium Term National Development Plan in place Leading entity: UPMA	**Medium-term planning** ● There is now a medium-term national strategy development plan, addressing the links between SDP and program structures and cost per year.	**Monitoring and Evaluation** [pg. 68] ● Begin the implementing of M&E exercises in selected LM ministries/agencies based on the guidelines and approved programme.	**Human resource and management development** ● Define a strategy to capacity development in Planning and Monitoring and Evaluation (in house training and overseas) with the goal by 2020 to have a [pg. 63] specialist cadre of economic and evaluation professionals within the civil service of Timor-Leste.

END OF YEAR GOALS	CORE REFORMS	BROADER BUDGETARY GOVERNANCE REFORMS	SUPPORTIVE PUBLIC GOVERNANCE REFORMS
Budgetary governance reform Leading entities: MoF+UPMA	**Medium-term expenditure framework** ● Forward estimates have started "rolling": the 2020 budget is based on forward year one of 2019, plus any estimate variations. **Budget transparency and participation** ● Publication of a Pre-Budget Statement and a Mid-Year Fiscal Outlook. **Capital budgeting** ● MPIE is using uniform project appraisal standards according with the best international practice. **Medium-term planning** [pg. 43] ● Consistent with the Handbook issued in 2018, beginning this year there are no longer zero-based budget proposals.	**Efficiency and Expenditure Review** ● Review: (a) alignment of resources with national strategic and development priorities; and (b) scope for savings and policy-based re-prioritisation. ● Based on the findings of the expenditure review, further examine areas where medium-term expenditure pressure studies should be conducted. Update the Forward Estimates and highlight trade-off in policy and or gains of efficiency by doing differently. ● Consider publishing yearly progress report on implementation of key gender equality commitments.	
Improved transparency and accountability Leading entities: MOF +UPMA	**Programme-budgeting** ● Ministries and autonomous agencies have published 2018 Annual Reports with programme-based financial and performance information.	**Budget transparency** [pg. 49] ● Publish Annual Reports for all ministries and autonomous agencies. These reports will include: a) Audited financial statements, showing what was budgeted for each of the entity's programs/activities vs what was actually spent; and b) performance information: showing results against program KPIs and commentary on whether the entity is achieving its objectives. ● Institutionalise public participation principles in line with the Global Initiative for Fiscal Transparency (GIFT) principles. As a first priority, provide feedback to civil society regarding their comments and submissions on the Executive Budget proposal. **Internal audit and control** [pg. 70] ● Continue to provide capacity building to the independent internal audit units in each ministry. ● Independent internal audit units should be established progressively in each ministry, with a mandate also to audit agencies under the remit of the ministry; except in the case of larger agencies where a separate IA unit may be appropriate (2019-22).	

END OF YEAR GOALS	CORE REFORMS	BROADER BUDGETARY GOVERNANCE REFORMS	SUPPORTIVE PUBLIC GOVERNANCE REFORMS
		2020	
		GOVERNANCE OF ROADMAP	
Functioning PFM Working Group Leading entities: MOF+UPMA	**Reform development and management** ● The PFM working group to report on progress and challenges and the approval of the plan for the following year to Council of Ministers. **Budget process consolidation** ● Undertake review of 2019 budget execution and implementation issues affecting service delivery, including municipalities. **Accounting** ● Continue the phased implementation and consideration in line with the policy note. ● Test FMIS system for implementation of accrual accounting as appropriate.		**International engagement** ● Delegation to attend OECD senior budget officials meeting to present progress, challenges and lessons learnt and way forward.
Budgetary governance reform Leading entities: MOF+UPMA	**Medium-term expenditure management** ● 2021 budget is based on forward year one of 2020, plus any estimates variations. ● New budget books and content as per the new FML.	**Medium-term planning** [pg. 43] ● Introduce a carry-over facility (if approved in the FML). ● Require donors to link their estimated funding to official programs/activities, when submitting information to the Aid Transparency Portal, etc.	**Medium-term expenditure management (pg87)** ● In line with Aid management policy and depending on SWAP agreement status, consider integrating Book 5 with Book 2/4Aand B in order to more effectively control overall resource envelope in medium-term.
Improved transparency and accountability Leading entities: MOF+UPMA		**Budget transparency** [pg. 49] ● Develop Citizen Guides to different budget-related documents including Audit Report and Pre-Budget report. ● Upgrade the Jornadas Orçamentais to a Pre-Budget Civic Forum for structured engagement from parliament and civil society.	**International engagement** ● Maintain international share of learning and experience and co-operation in the G7 + countries, CPLP, ASEAN countries and OECD international forums.
Independent Bureau of Statistics Leading entities: MOF+DG Statistics	**Statistics and Open Data** [pg. 80] ● Develop existing Directorate-General for Statistics into an independent Institute/Bureau for National Statistics with mandate for progressive development of data collection, focusing on quality assurance and on responding to policy-related needs.		

END OF YEAR GOALS	CORE REFORMS	BROADER BUDGETARY GOVERNANCE REFORMS	SUPPORTIVE PUBLIC GOVERNANCE REFORMS
		2021	
For 2022 budget and beyond, Parliament approves appropriations for programs, not inputs. **Independent review by OECD** with the views of taking the stocktake of implementation of the reform (2017 until 2020) and continue to support the implementation of the roadmap in future years.	**Programme budgeting** [pg. 33] ● 2022 Budget Law allocates funding to programmes, not inputs. **Medium-term planning** [pg. 43] ● Consolidate and streamline the budgeting of investment projects in main Budget Books and continue streamline the content. **Accrual accounting** ● Continue phased implementation and consideration of accrual accounting in line with policy note; potentially including implementation for fiscal year 2021 ● Subject to progress on broader implementation, potential for first accrual accounting financial reports to be prepared for fiscal year ending 2021 (IPSAS 33).	**Spending Review** ● Efficiency review to conduct in priority sectors. **Procurement** ● Compliance report of procurement is done and submitted to CM for action based on recommendations.	**Human resource management and development** [pg. 76] ● Continue the implementation of the performance management system of the managers of the programmes (PSC, LM, MoF, UPMA). **Statistics and Open Data** [pg. 82] ● Develop a national framework of indicators and key statistical data/markers, informed by the requirements of programme budgeting, medium-term planning and monitoring/implementation of SDGs. ● Develop an "Access to Information" law which institutionalises the wider principles of budget transparency, openness and accessibility, in particular with regard to open budget data, and with due regard to privacy and data protection. **International engagement** ● Maintain international share of learning and experience and co-operation in the G7 + countries, CPLP, ASEAN countries and OECD international forums.

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Health financing and budgeting practices for health in South Africa

by
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South Africa has made substantial progress in developing its health care system since 1994. Universal access is a fundamental principle of the Constitution and health sector policies, and health outcomes have improved on aggregate. However, health inequities remain an important challenge today. Focusing on public financial management and the budgeting process for health, South Africa has a clear, well-structured and transparent process to budget formulation from national to provincial governments. But this transparency does not fully transmit on allocation decisions to health from provincial treasuries. In terms of budget execution, up-to-date data reporting systems, strict enforcement of fiscal rules, and well-developed monitoring processes are good budgetary practices. However, despite good aggregate spending levels, there is great disparity in the way provinces execute their budget. Finally, South Africa has well-established monitoring processes. However, the link between performance indicators and the budget process remains limited and could be strengthened.

JEL codes: H51, H60, I11, I18

Keywords: South Africa, two-tier health system, private health insurance, NHI, budget formulation, budget execution

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Executive summary

Improving dialogue and mutual understanding between health and finance officials is critical to ensuring the fiscal sustainability of healthcare systems. The OECD Joint Network of Health and Budget Officials on the Fiscal Sustainability of Health Systems aims to identify and disseminate good practices in managing healthcare budgets, alongside other policies that can ensure fiscal sustainability. This Joint Network has recently expanded its activities to cover non-OECD countries, reflecting the fact that emerging economies face similar funding pressures, while also striving to attain and maintain universal health coverage.

In this case study, the specific challenges South Africa faces in health financing and the budgeting process for health are analysed. Good practices that could be shared with other countries are also identified. Findings show that South Africa has made substantial progress in developing its health care system since 1994. Universal access is a fundamental principle of the Constitution and health sector policies, and health outcomes have improved on aggregate.

However, health inequities remain an important challenge today. From an institutional perspective, a core issue is the continued *two-tier nature of South Africa's healthcare system*. Government health services principally serve those from the low and middle-income strata; whereas private facilities mainly serve the smaller subset of wealthier households and take up a significant share of overall health spending. Indeed, South Africa relies more on voluntary private health insurance financially than any other country in the world. Yet experience from both OECD and non-OECD countries shows that voluntary private health insurance rarely provides adequate coverage for the poor and those most prone to serious illness, and often has high administrative costs.

Reducing the disparities between these two systems is therefore a key priority. In this regard, the National Health Insurance (NHI) reform agenda has significant potential. Successful NHI implementation, though, requires careful consideration of institutional implications, particularly the impact on the roles of provincial departments of health and the private medical schemes. It also requires capacity-building to ensure the requisite capacity to effectively manage and purchase health services at the district level.

Focusing on public financial management and the budgeting process for health, this report finds good budgetary practices that can inspire other countries, as well as areas that could be further improved. South Africa has a clear, well-structured and transparent process to *budget formulation* from national to provincial governments. But this transparency does not fully transmit on allocation decisions to health from provincial treasuries. Improving how business plans submitted by provincial health departments to provincial treasuries are evaluated could help. Further, within health budgets there is even less standardisation and transparency on allocation decisions. Improving the capacity of district hospitals and managers of district health offices in budget formulation would be an important first step to ensure their needs are better reflected in budgets, and ultimately more strategic purchasing.

Budget setting processes also need to better account for staff costs and increases in wages, so that there is sufficient spending on other essential items which underpin quality of care.

In terms of *budget execution*, up-to-date data reporting systems, strict enforcement of fiscal rules, and well-developed monitoring processes are good budgetary practices. However, despite good aggregate spending levels, there is great disparity in the way provinces execute their budget. Giving health facilities greater decision-making power, and clarifying and simplifying the delegation framework could help health facilities increase their responsiveness to changing needs during the fiscal year. There is also a capacity challenge: not all facilities have sufficient management skills to handle increased delegations; and facilities need to have access to the Treasury's Basic Accounting System to ensure timely information on budget execution.

Finally, South Africa has well-established *monitoring processes*. These include measures by which national and provincial treasuries can support the execution of health budgets and help to avoid excessive overor underspending at the aggregate level. At the same time, national and provincial departments of health set and monitor targets related to health outputs and health system performance. However, performance monitoring that links the two perspectives remains limited and could be strengthened. Recent efforts at the district level (District Health Expenditure Reviews, District Health Barometers) linking health spending with non-financial health indicators provide a good example. Exploring possibilities to more closely align the existing performance monitoring efforts by Treasury, the Department of Health and other government institutions could further improve the information base.

1. Introduction

Improving dialogue and mutual understanding between health and finance officials is critical to ensuring the fiscal sustainability of healthcare systems, particularly in light of increasing public expectations for healthcare. In order to contribute to this objective, the OECD Joint Network of Health and Budget Officials on the Fiscal Sustainability of Health Systems was established in 2011. This joint network aims to identify and disseminate good practices in managing healthcare budgets, alongside other policies that can ensure fiscal sustainability. It also aims to improve institutional dialogue, clarity of roles, and common objectives between officials from both health and finance ministries, and other relevant policymakers.

Financing healthcare and ensuring the sustainability of healthcare expenditure is not only a challenge for OECD countries. Health systems of emerging economies face similar funding pressures, while also striving to attain and maintain universal health coverage. As a consequence, in 2013 the OECD started expanding the activities of the Joint Network to non-OECD countries, in partnership with the WHO, the Global Fund, CABRI, the Asian and Inter-American Development Banks (IDB, ADB) and the World Bank. The main objective of these expanded activities is to support the development of good budgeting and public financial management practices in countries, thereby helping achieve a sustainable Universal Health Coverage (UHC).

As part of this programme, the OECD carried out a case study in South Africa (alongside other case studies, regional surveys and regional network meetings). The main objective of this case study is to analyse specific challenges in health financing and budgeting practices for health in South Africa, and also identify good practices which could be shared with other countries.

The report is structured around two main parts. First, core characteristics of the South African health care system are analysed in Section 2. This includes a description of key achievements in the democratic era, an evaluation of health financing arrangements today, and how health expenditures in South Africa compare with other countries. Section 3 then provides a closer look at public financial management arrangements and the budgeting process for health in South Africa. Strengths and weaknesses of budget formulation, execution and monitoring for government healthcare spending are outlined. Finally in Section 4, conclusions and overall policy recommendations are provided.

Findings presented here draw from in-depth interviews with key stakeholders in South Africa, as well as secondary data analysis, reviews of government documentation and the wider literature on health financing. An OECD team visited Cape Town and Pretoria in October 2016 and held extensive interviews with stakeholders involved at the state and regional level in the budget process for health. This included government finance and health officials, at national and provincial levels; and health policy experts from the private sector and academia. Additional meetings and conference calls were carried out after this visit.

Since 1994 and the end of apartheid, South Africa has made substantial progress in developing its health care system. Population health outcomes have improved on aggregate, thanks in part to gradual increases in health spending over time. However, whilst there have been overall improvements in key health indicators and access to quality healthcare, health inequities remain an important challenge today. From an institutional perspective, a core issue is the continued two-tier nature of South Africa's healthcare system, with parallel public and private systems. Government health services are available to all with no or minimal charge. However, they principally serve those from the low and lower-middle income strata that make up the majority of the population. In contrast, private facilities are oriented more towards the smaller subset of upper-middle income and high income households. Mostly financed through voluntary private health insurance, the private sector takes a significant share of overall health spending. Reducing the disparities between these two systems is a key priority, with South African policymakers discussing various policy options to ensure more equitable health financing arrangements that provide sufficient funding for health whilst being fiscally sustainable.

At the same time, maximising the effectiveness and efficiency of government spending on health is essential. In this regard, sound public financial management is required, so that the budget process contributes to rather than hinders health system objectives, while ensuring fiscal sustainability of health systems. In particular, budget rules and implementation need to ensure that funds for health are effectively allocated, executed and accounted for.

2. Core characteristics of the South African health care system, with a focus on financing

2.1. The South African health care system in the democratic era: Evolution and key achievements

Universal access to health care services is a fundamental principle of the South African Constitution and health sector policies

Following the transition to democratic rule in 1994, a fundamental principle from the Constitution of the Republic of South Africa (1996) has been an inclusive health system. In particular, the Constitution states that:

"Everyone has the right to have access to health care services, including reproductive health care and… no one may be refused emergency care."

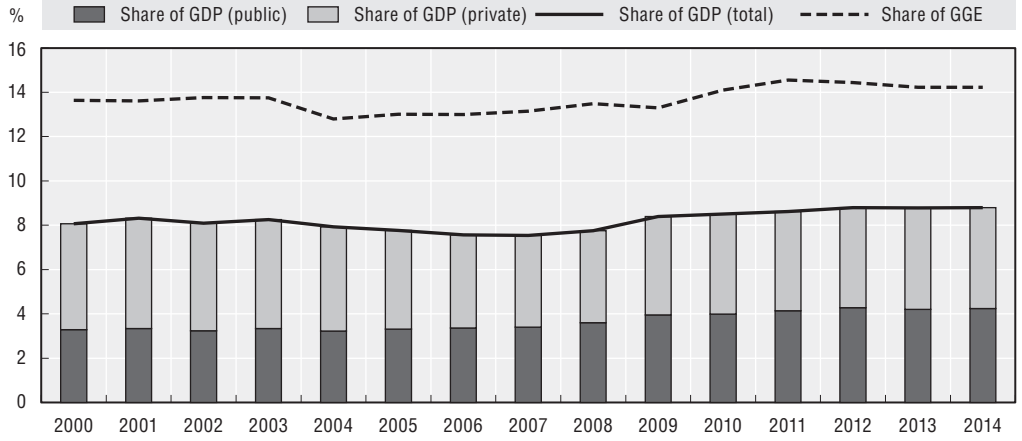
This principle was further developed in the 1997 White Paper on the Transformation of the Health Care System and the National Health Act, 61 of 2003, with a clear aim of uniting the various elements of the national health system, whilst establishing a health system based on decentralised management (NDOH, 2015a). Looking forward, the overall National Development Plan for 2030 envisions a more integrated national health insurance system that gradually integrates the private and public sectors into a more equitable, universal system (National Planning Commission, 2013).These overarching aims and principles have been accompanied by increased investment into the health system. As noted in the White Paper on National Health Insurance (NDOH, 2015b), between 1994 and 2014 the government implemented over 1 500 health infrastructure projects to build or revitalise health facilities; and recruited additional health professionals throughout the health system. There has also been a major shift to primary health care services delivered through the district health system since 1994. User fees were abolished for pregnant women, children under six years and people living with disabilities, with the government ensuring sufficient funding in place to offset lost revenues. Consequently, access to healthcare has improved, though challenges remain.

These government investments into the health system have been achieved whilst generally maintaining overall fiscal sustainability: a counter-cyclical strategy has helped keep a stable debt profile and strong sovereign ratings, though slow economic growth in recent years has proved challenging (Bhorat et al., 2013; OECD, 2015a).

South Africa has gradually increased health spending over time, contributing to significant improvements in health outcomes

Such health system reforms are reflected in an observed gradual increase of health spending in recent decades, though it is important to note that health spending per capita has remained virtually unchanged in recent years. In 2014, health spending per capita was about 40% higher in real terms than it was in 2000, but with real growth rates close to zero since 2012. Over time, spending on health has increased at a slightly faster pace than GDP, reaching 8.8% of GDP in 2014 (Figure 1).

Figure 1. **Health expenditure as a share of GDP and general government expenditure, 2000-14**

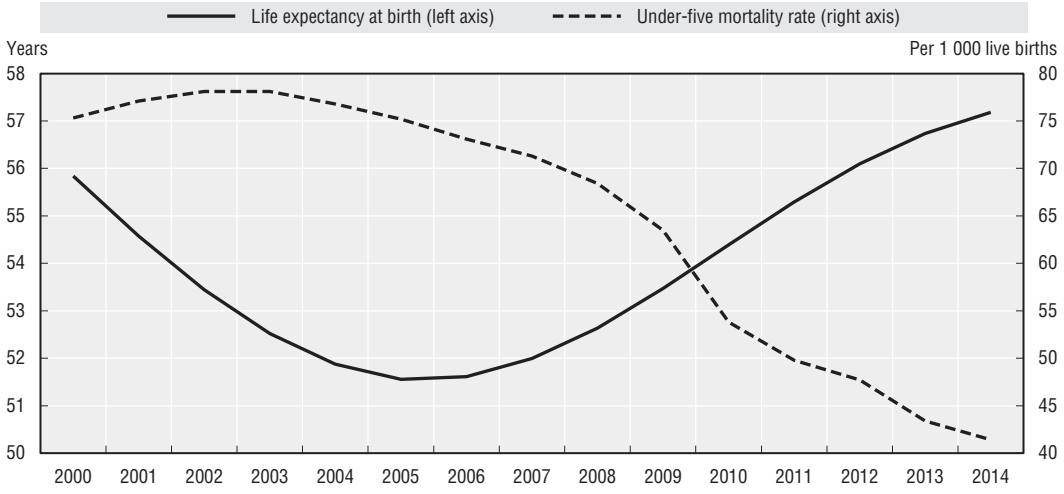


Source: WHO, Global Health Expenditure Database.

Public spending on health has accounted for a modestly increasing share of total health spending, reaching 48% of total health spending in 2014. However, there has been minimal spending growth in real terms in recent years, with public spending on health equivalent to 4.2% of GDP in 2014. The overall share of total government spending devoted to health has remained fairly stable over time, slightly higher in 2014 (14.2%) than it was in 2000 (13.6%). Note these figures also reflect health spending by non-health departments, such as education and defence.

Over the same time period, key health outcome indicators have shown considerable improvements. For example, the under-five mortality rate has nearly halved, from 75 children per 1 000 live births dying before the age of five, to 41 deaths per 1 000 live births in 2014. Figure 2 shows this declining trend in under-five mortality rates alongside growth in real health spending per capita.

Figure 2. **Evolution of health expenditure per capita in real terms and under-five mortality rate, 2000-14**



Note: Expenditure in real terms is derived using the economy-wide GDP deflator.
Source: WHO, Global Health Expenditure Database; World Bank, World Development Indicators.

Similar improvements have been observed in infant and maternal mortality rates. Life expectancy has also increased in recent years, following a period of falling life expectancy during the height of the HIV/AIDS epidemic in the 1990s and early 2000s. Such correlations between health spending and improved health outcomes do not guarantee causality, and wider social determinants of health are also crucial. Nevertheless, a number of econometric studies have found health spending to be a major contributor to better health outcomes (see, for instance, James 2016 for a further discussion of this literature).

However, whilst there have been overall improvements in key health indicators, important health inequities remain. For example, strong negative relationships exist between income, education and socioeconomic indicators on the one hand, and many health conditions on the other (diarrhoea, trauma, tuberculosis, drug and substance abuse, depression, high blood pressure, HIV and sexually transmitted diseases). Further, such inequalities have persisted over time (Ataguba et al., 2011). These health disparities in South Africa are due in part to the wider social determinants of health, and particularly continued high rates of poverty and income inequality (Ataguba et al., 2015, Mayosi and

Benatar 2014). But inequalities within the health system are also a contributing factor – as discussed in the following section.

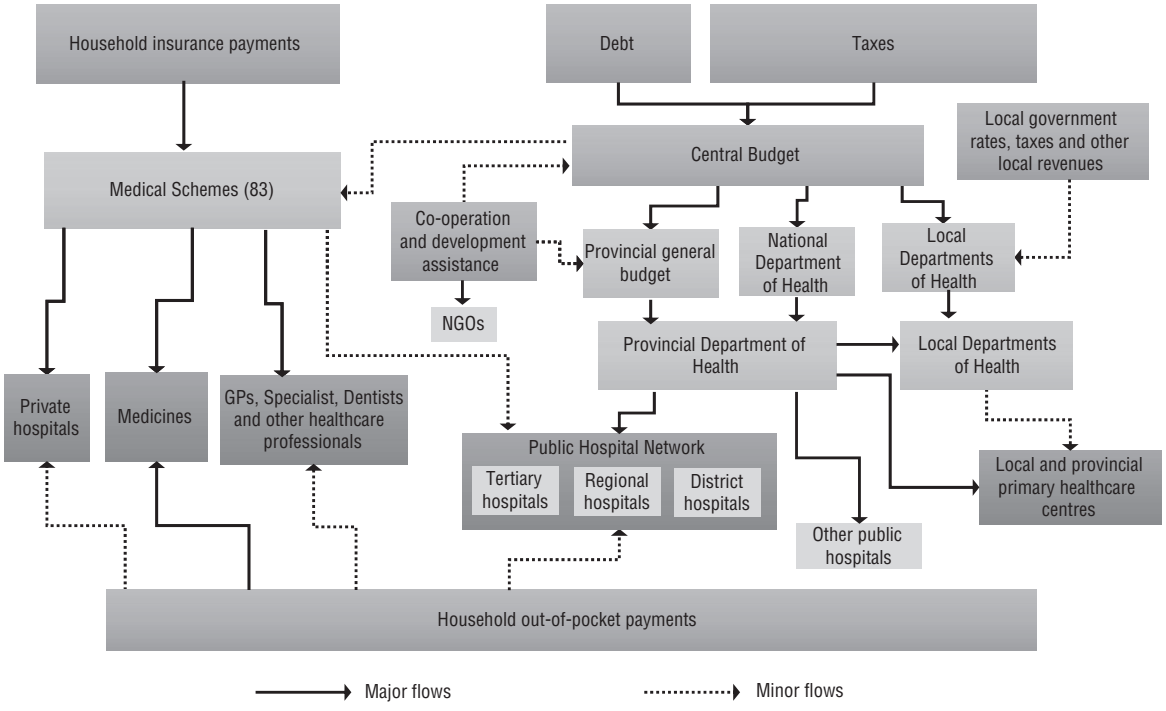
2.2. Financing of South Africa's health system today

Despite ongoing reform efforts since 1994, the South African health system remains two-tiered with parallel public and private systems

Although South African reform efforts and investments into the health system have contributed to significant improvements in health outcomes, important challenges remain today. From an institutional perspective, a core issue is the continued two-tier nature of South Africa's healthcare system, reflected in both the financing and delivery of health services. Public healthcare providers – mostly financed from general government revenues – are available to all with no or minimal charge. However, they principally serve those from the low and lower-middle income strata that make up the majority of the South African population. In contrast, private facilities – mostly financed through voluntary private health insurance – are oriented more towards the smaller subset of upper-middle income and high income households.

South Africa's healthcare financing and financial flows are a reflection of its two-tier nature (Figure 3). Public budgets for health come mainly from central government resources. The majority of government funding for health (and other services) flows from the National Treasury to Provincial Treasuries, who in turn allocate funding to Provincial Departments of Health. At the same time, the National Treasury ring-fences a significant portion of funds for health care through conditional grants. These funds are transferred via the National Department of Health to Provincial Departments of Health.

Figure 3. **Financial flows in South Africa's healthcare system**



Source: Authors based on McIntyre and Thiede (2007) and complementary information provided by the National Treasury and Department of Health (2016).

Most government health services are delivered by public providers owned and operated by provincial departments of health, with a lesser portion at the municipal level. In the private health system, medical schemes (voluntary health insurance funds) are predominantly financed with household contributions, complemented by payments from private employers and government. These medical schemes finance relevant health care services rendered through private hospitals, specialists, GPs, pharmacies and dentists. In addition to monthly insurance premiums, households contribute additional payments at the point of service as co-payments or for services excluded from health insurance packages.

As a number of policy analysts in South Africa have noted, this persistent duality is a policy concern because the public sector is underfunded relative to the private sector (see, for example, Blecher et al., 2011; McIntyre, 2010; Steenekamp, 2016). That is, there is an inequitable distribution of resources. Whilst public spending on health accounted for just under half (48%) of total health expenditure, the latest South African general household survey results indicate public clinics and hospitals were the first point of access for seven in ten households (Statistics South Africa, 2016). In contrast, private health facilities were only used by a quarter of households, yet private health expenditures (of which most is spent in private health facilities) accounted for 52% of total health expenditure.

Such disparities constitute an important equity challenge, even though South Africa's health financing arrangements generally offer good financial protection. This is because of concerns that the population utilising public health facilities may be receiving lower quality care due to these funding differences. For example, the South African general household survey found more people were satisfied with private health facilities (98%) than public health facilities (81%). Earlier results from the WHO World Health Survey provide a more detailed analysis of public and private differences in patient perspectives on provider quality (Peltzer, 2009). Waiting times, privacy, confidentiality, participation in treatment decision-making, and facility cleanliness were some of the main areas where public facilities scored much lower than private facilities. In contrast, provider skills, equipment and medicine availability were not seen as being significantly different between private and public facilities by survey respondents.

Organisational differences between public and private systems can also matter from an efficiency perspective. In particular, experience from OECD countries and elsewhere demonstrates the need for careful regulation of the private as well as public sector if costs are to be contained (OECD 2015). Indeed, a recent OECD analysis (using 2011-13 data from 625 940 patient cases) found that private hospital prices in South Africa were less affordable than in 20 OECD countries with comparable data (Lorenzoni and Roubal, 2016). That is, prices in South African private hospitals were on a par with countries with much higher GDP levels – including the United Kingdom, Germany and France – with prices particularly high for specialists and surgical services. Hospital prices have also been increasing faster than inflation. Improved regulation of the private sector is therefore an important policy priority.

Government health services are largely decentralised to the provincial level

Focusing in on the public healthcare system, the delivery and associated financing of government health services is largely the responsibility of provincial governments and municipalities. This structure mirrors the general public governance structure, namely three spheres of government – national, provincial (9) and local (8 metropolitan, 205 local

and 44 district municipalities) – and an intergovernmental system whereby provinces autonomously decide how to allocate and spend funds.

That is, the majority of funds provinces receive from the national treasury are non-earmarked funds that on average make up 80% of provincial health budgets. From this, provincial treasuries then choose what share of these non-earmarked funds is allocated to health. The budget is allocated amongst the nine provinces based on a provincial equitable share formula that reflects population, economic activity, poverty and demand for services such as education and healthcare (National Treasury, 2016a). But how this allocation is spent within a province is entirely a province-level decision (even if treasury and line ministries at the national level offer advice on allocations). Consequently, the budgetary allocation to health depends on the relative priority afforded to health by each of the nine provinces and their legislatures.

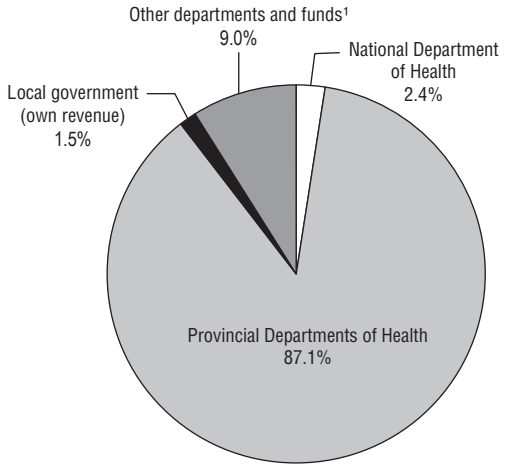
At the same time, conditional grants from national to provincial governments are provided for selected priority areas, which make up around 20% of provincial health budgets on average. Such grants are essentially earmarked funds based on measured need, and designed to protect spending on priority services. As conditional grants have to be spent on specific programmes, they imply greater control and stability over provincial health expenditure at the national level (for the programmes funded through these grants), but less flexibility for provinces. For health, the major conditional grants relate to HIV/AIDS interventions, national tertiary services and health infrastructure. Examples of major conditional grants beyond health include other infrastructure spending and improved housing.

In 2014/15, provincial health departments oversaw 87% of public health expenditures (Figure 4). Most of these funds are transfers from the national treasury in the form of equitable share allocations and from the national department of health in conditional grants. A small share of provincial health spending comes from a provincial government's own revenue, which includes patient fees (note that such funds are not earmarked for health). In contrast, only 2.4% of spending can be attributed to the NDOH (used for policy development, legislation, regulation and programme leadership, including technical support to provinces); and 1.5% to local government (mainly for environmental health services).

Figure 5 gives an indication of relative budget priorities overall. Out of the consolidated budget, 11.6% was spent on health in the financial year 2014/15. This is comparable to the amounts allocated to housing and community amenities (11.5%); economic affairs (12.5%); and defence, public order and safety (12.8%); but lower than spending on social protection (14.7%) and education (20.1%). Note that the health expenditure share in Figure 5 is based on a narrower definition than those based on the Health Accounts methodology used in Figure 1. That is, Figure 1 covers a broader range of public health spending that includes local government and health-relevant expenditure by non-health government departments and entities (notably the Departments of Defence, Basic Education, and Correctional Services and the Compensation and Road Accident Funds). Figure 5 only refers to health spending by national and provincial departments of health.

Taken together, public spending on health is designed to cover the running costs of government health facilities, as well as public health interventions and other national-level initiatives. Public clinics offer services without charge. Public hospitals charge fees, but these fees are reduced for low-income individuals (using means testing, with differing degrees of subsidisation). Further, some services for particular population groups

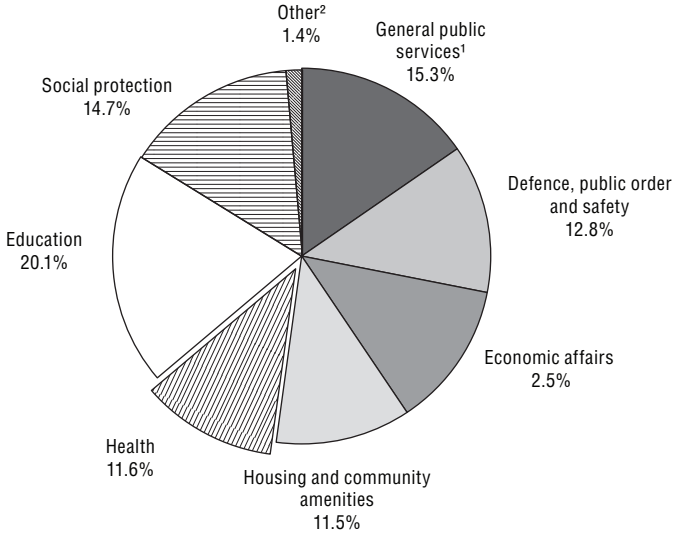
Figure 4. **Public health expenditure by sphere of government, 2014/15**



1. Includes Departments of Defence, Basic Education and Correctional Services; and Compensation and Road Accident Funds.

Source: National Department of Health.

Figure 5. **Consolidated government expenditure by function, 2014/15**



1. Includes debt-service costs.
2. Includes expenditure on environmental protection as well as recreation and culture.

Source: National Treasury, National Budget.

(e.g. pregnant women and children under six) are provided without charge. Although these charges are only a small fraction of total health spending, South African analysts argue they can still be a financial burden for some, especially when additional transport and other related costs are considered (Goudge et al., 2009; Steenekamp, 2016).

Private health services are mainly financed through voluntary private health insurance

The private sector plays a major role in South Africa's health system, accounting for about half of total health spending. Despite this high share, household out-of-pocket (OOP) payments are limited. This is a key strength of current health financing arrangements, since countries with a high reliance on OOP payments typically have more households

facing severe financial hardship and impoverishment because of the costs of healthcare (WHO 2010).

Most private spending on health is instead in the form of voluntary private health insurance (PHI). This insurance is predominantly used to fund hospital care in private facilities, with limited coverage for primary health care services. Such private hospitals and clinics are concentrated in wealthier urban areas, with most specialists working in the private sector.

The parastatal Council for Medical Schemes (CMS) regulates voluntary private health insurance, with 83 medical schemes offering voluntary PHI at the end of 2015 (CMS, 2015). Spending on voluntary PHI in South Africa accounted for about 43% of total health spending in 2014, but only covered about 16% of the population. Moreover, households with voluntary PHI are typically from the upper-middle or high-income strata. This reflects that premiums are based on ability-to-pay. Further, premiums have been steadily increasing over time and at a more rapid pace than inflation. Today, the average premium paid per insured is much higher than government health spending per capita and per non-insured. Whilst increases in premiums might reflect in part justifiable increases in costs, South African health policy experts have also pointed to the limited ability of some medical schemes (especially small and medium sized schemes) to negotiate with private health providers, who drive the price-setting process and are still predominantly paid on a fee-for-service basis (CMS, 2015; McIntyre, 2010).

People join these medical schemes primarily for better financial access to private health facilities. The CMS has a range of legislative and regulatory tools to try to limit risk selection and cream-skimming (the core challenges of all voluntary PHI schemes). In particular, "prescribed minimum benefits" are defined to ensure the same minimum benefit package across all schemes without co-payments. Further, the principle of open enrolment to some extent limits risk selection, since it does not allow schemes to refuse membership based on age or gender (but there are condition-specific waiting periods for pre-existing conditions). Medical schemes are designated as mutual non-profits, although in practice profits can be made since administrative fees are built into premiums and for most schemes administration is contracted out. The CMS can also in principle issue circulars and directives on pricing, but these are on a purely advisory basis.

Despite these regulations, the private medical schemes are still able to markedly differentiate their products. They achieve this by offering multiple benefit options, such as different supplementary benefits and premiums, savings accounts options, and varying choices of health provider. This enables schemes to tailor packages according to different risk profiles. Indeed, there were 319 different options available across the 83 medical schemes, with the prescribed minimum benefits constituting only 51% of total risk benefits paid in 2015. Such a proliferation of schemes leads to risk selection and small, fragmented risk pools. Indeed, cost and range of options were two primary themes emerging from a recent healthcare consumer survey on what specific scheme to join, with cost appearing to be the main factor for younger age groups, and the range of options the main factor for older age groups (Health Market Inquiry, 2016).

Whilst the financing of private medical schemes is sound in the sense that each scheme has to maintain reserves equivalent to 25% of their income, small risk pools threaten the long-term sustainability of medical schemes. This is compounded by a lack of

risk equalisation between schemes, leaving schemes vulnerable to insolvency if they are not able to attract people with lower health risks. Consequently, it also incentivises risk selection. Small risk pools without risk equalisation mechanisms is historically an important reason behind a marked consolidation in the number of schemes over time, down from 144 schemes in 2000 and about 250 schemes in the mid-1990s, to 83 today.

Many of these challenges with voluntary PHI in South Africa are consistent with OECD experiences. In particular, experience from both OECD and non-OECD countries shows that voluntary PHI schemes rarely provide adequate coverage for the poor and those most prone to serious illness, and often have high administrative costs (OECD, 2004; Kumar et al., 2014; Sagan and Thomson, 2016). Note that the few countries with a *mandatory* private health insurance set-up (such as the Netherlands and Switzerland) are highly regulated, with risk equalisation measures in place and limited scope to differentiate plans between individuals on the basis of their health risks.

Bringing the parallel systems together: the National Health Insurance reform initiative

A key health financing challenge in South Africa is therefore how to transform its system into one that is more equitable. Various policy options have been discussed, with different stakeholders contributing to an intense debate around the design and establishment of National Health Insurance. Whilst a full discussion on the advantages and disadvantages of different health financing policy options is beyond the scope of this report,[1] some of the key design issues being discussed today include:

- *Strategic purchasing*, through a single-payer and single-purchaser fund. This NHI fund will be established as an autonomous public entity. It will contract with both public and private health facilities (that have been accredited). Reform of provider payments (reduced reliance on fee-for-service) and rigorous health technology assessment are some of the main tools that will be used to ensure value-for-money.
- *Organisational changes*, particularly at the primary healthcare level. This includes a re-engineering of primary healthcare services (new outreach teams, school health services, district clinical specialist teams, contracting of private health practitioners); and more decentralised management through new district health management offices and hospitals with more flexibility and autonomy to respond to day-to-day needs.
- *Financing*: the NHI reforms will require additional public funding. Discussions for expanding public funding are ongoing, with different combinations of a payroll tax, surcharge on taxable income, increased value added tax considered in five different scenarios. This increased tax burden on households should be offset in part by households needing to spend less on private insurance premiums.
- *Phased implementation*: given the wide-reaching nature of the NHI reforms, implementation will be gradually introduced through three phases, with full implementation envisaged for the 2024/25 financial year.

Along with these design issues, the proposed National Health Insurance reform will have significant institutional implications within the South African health system. Key among these is how to adapt the roles of provincial departments of health and the private medical schemes, and how to ensure district health authorities and smaller hospitals have the requisite capacity to effectively manage and purchase health services.

The specific challenge of sustainable financing for vertical programmes: the example of HIV/AIDS

Within this overall health financing context, ensuring a sustainable financing for HIV/AIDS represents a major policy challenge, especially in light of a transition away from donor funding. In recent years there have been substantial investments in antiretroviral therapy and HIV prevention strategies, with allocations to HIV by the South African government tripling in real terms since 2007/08, reaching R17.5 billion in 2016/17 (Blecher et al., 2016). Government investments have been supported by external partners, notably the Global Fund to Fight AIDS, Tuberculosis and Malaria (GFATM) and the United States President's Emergency Plan for AIDS Relief (PEPFAR). Such increased spending has led to more HIV/AIDS patients having access to antiretroviral treatments (ARTs), and declining HIV incidence and AIDS deaths over time.

Despite these major improvements, South Africa has a continued high rate of new infections, and accounted for 19% of the global burden of HIV infection at the end of 2015 (calculated from UNAIDS data). HIV infection has also worsened the tuberculosis (TB) epidemic, including multidrug-resistant TB and the most cases of extensively drug-resistant TB cases in the world (Mayosi and Benatar, 2014).

An important issue from a budgeting perspective is ensuring external support is well aligned with government budgeting processes and priorities. The GFATM move away from round-based funding has improved predictability of external funding from one of the main sources of external funds. Further, in the Western Cape province, GFATM support has been integrated into the provincial budgeting system, making it easier for government officials to plan. However, other international donors have different financial schemes, transferring resources directly to government departments and NGOs or their facilities.

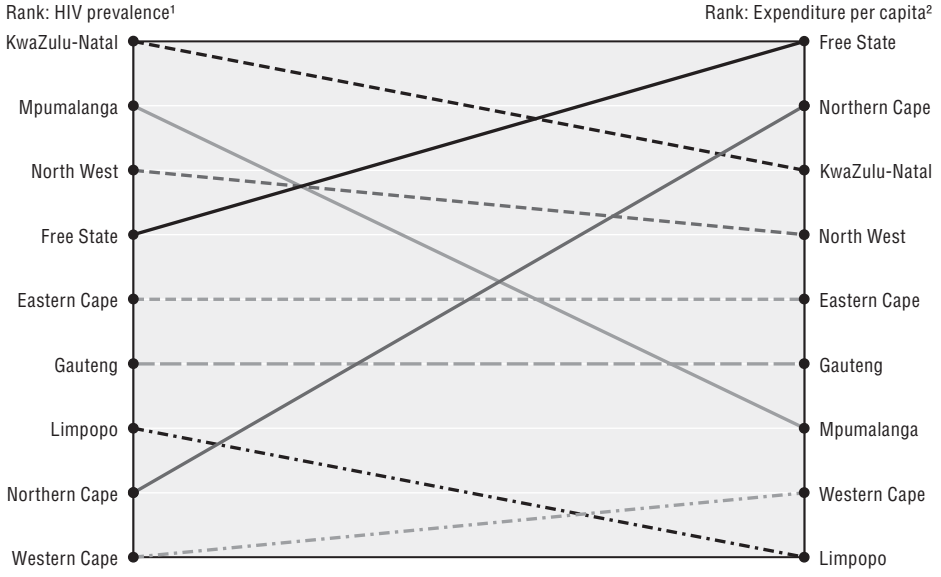
South Africa has developed interesting mechanisms to increase coordination and alignment between external support for HIV/AIDS and the central budget process. The International Development Cooperation of the National Treasury collects information from all international donors, regardless of the way these resources are allocated and transferred. Donors are requested to include all funds committed and disbursed. This information allows government to have a broader perspective on HIV/AIDS financing, but it relies on information voluntarily provided by donors and there is still data lacking.

Lack of flexibility in the budget structure to fund cross-sectoral initiatives is a key challenge for increasing efficiency of HIV/AIDS interventions. In South Africa, the budget programme and classification is based on sector and line items rather than on programs and policy objectives, hindering articulation of cross-sectoral initiatives to achieve wider policy objectives. For example, conditional grants (see section 3.1 for further detail) aim to strengthen government priority areas that are usually cross-sectoral issues (such as HIV/AIDS). However, they are designed and implemented by one particular national department, without fully articulating this initiative with other relevant departments. SANAC has played a major role in developing and strengthening multi-sectoral responses to HIV/AIDS. Nevertheless, the country would greatly benefit from having a more flexible set-up to translate these initiatives in the budget document.

An equitable distribution of HIV/AIDS funding across localities is an important concern in South Africa. In principle, the HIV/AIDS conditional grant, which is based primarily on the disease burden, should help ensure an equitable distribution of government funds. But there is not a perfect relationship between need and provincial spending on HIV/AIDS, as Figure 6

shows. For example, although Mpumalanga province has the second highest HIV prevalence, its provincial government is ranked 7 out of 9 for per capita spending on HIV/AIDS. In contrast, Free State and the Northern Cape are ranked first and second respectively on provincial HIV/AIDS spending per capita, whilst their HIV/AIDS prevalence were only the fourth and eighth highest amongst the nine provinces. For the Northern Cape, this reflects in part its relative geographic inaccessibility and low population density.

Figure 6. **HIV prevalence and expenditure on HIV/AIDS per capita by province**



1. Refers to HIV prevalence (%) (total population), 2015.
2. Refers to provincial expenditure on the sub programme "HIV and AIDS" per capita, 2014/15.

Note: Provinces are ranked from highest (top) to lowest (bottom) HIV prevalence and from highest (top) to lowest (bottom) per capita HIV/AIDS expenditure.

Source: National Treasury, Provincial Budgets; Health Systems Trust, 2016; own presentation.

Looking forward, the challenge is to provide sufficient and co-ordinated funding to counter the HIV/AIDS epidemic. The National Treasury has substantially increased funding through the HIV/AIDS and TB conditional grant in recent years, including additional funding to ease the transition from PEPFAR funding. More co-ordinated funding is also important. For example, current initiatives whereby provinces partner with local NGOs to provide HIV and TB prevention activities show particular promise, given these NGOs expertise in reaching out to high-risk groups. Sustaining such initiatives in light of declining external funds requires analysing contracting modalities between provinces and NGOs.

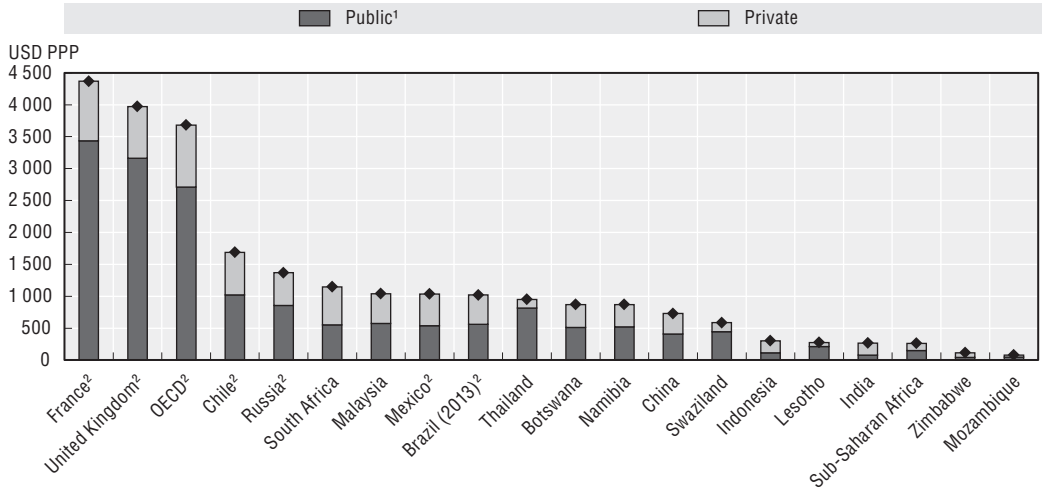
More generally, sustainable financing solutions for HIV/AIDS activities require a careful assessment of staffing and other resource needs. Building on the national HIV and TB investment cases developed by the NDOH and the South African National AIDS Council (SANAC), Blecher et al., 2016 find that the HIV/AIDS 90/90/90 targets[2] are affordable and cost-effective. However, this is only if such targets are phased in gradually. They also note the particular challenge of having sufficient personnel. While civil service personnel hiring restrictions may slow recruitment, they are essential to ensure a co-ordinated recruitment strategy that avoids further fragmentation within the healthcare sector.

2.3. An international perspective: how does South Africa compare with other countries in terms of the level and composition of health spending?[3]

Total health spending in South Africa is largely in line with its level of national income, and accounts for a similar share of GDP as the OECD average

In 2014, South Africa spent an average of USD 1 146 per capita on health (in purchasing power parity terms). This amounts to about one-third of the OECD average of USD 3 683. However, per capita spending is broadly comparable with other upper-middle income countries like Brazil, Malaysia and Thailand. It is also higher than in most neighbouring countries and Sub-Saharan African countries in general (Figure 7).

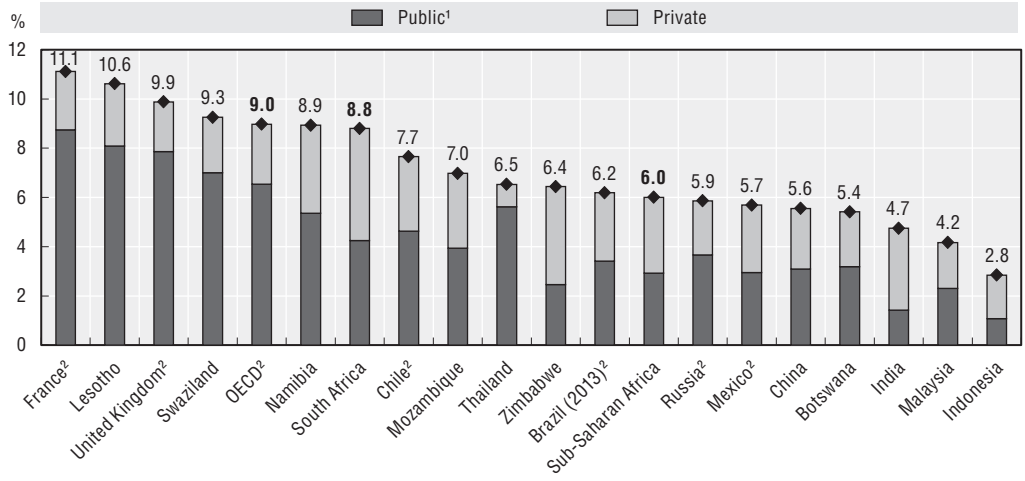
Figure 7. **Health expenditure per capita, 2014**



1. For OECD countries, "Public" refers to government/compulsory insurance schemes and therefore includes compulsory private insurance.
2. Data refer to current health expenditure which excludes investments.

Source: OECD Health Statistics 2016; WHO, Global Health Expenditure Database.

Figure 8. **Health expenditure as a share of GDP, 2014**



1. For OECD countries, "Public" refers to government/compulsory insurance schemes and therefore includes compulsory private insurance.
2. Data refer to current health expenditure which excludes investments.

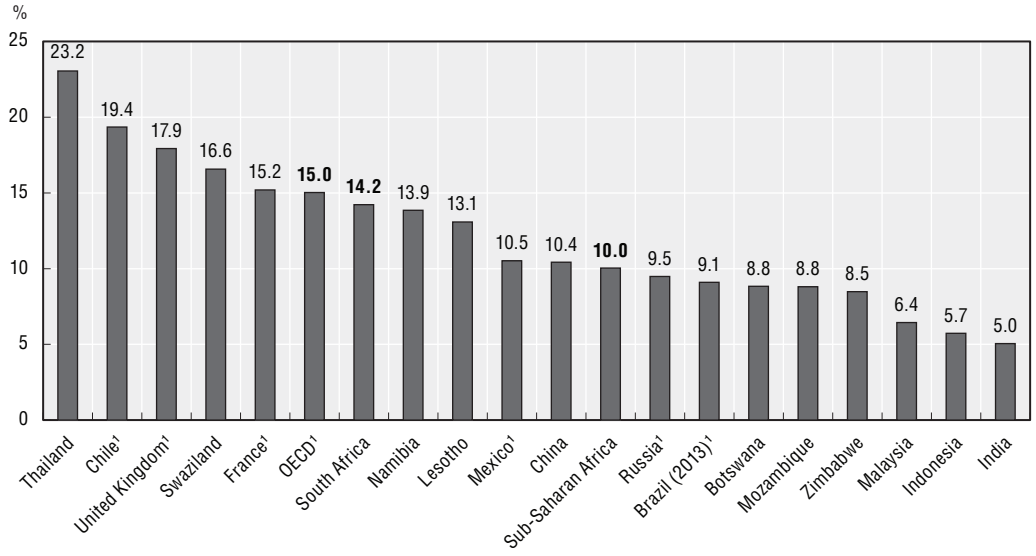
Source: OECD Health Statistics 2016; WHO, Global Health Expenditure Database.

These per capita comparisons suggest that total health spending in South Africa is largely in line with its level of national income. Indeed, when measured as a percentage of GDP, South Africa devotes a share of GDP to health (8.8%) that is close to the OECD average (9.0%). However, it is worth reiterating here the dual nature of South Africa's health care system, with the majority of the population reliant on public spending, yet private health expenditure still accounting for about half of total health expenditure.

Though South Africa allocates a reasonable share of its overall budget to health, it still relies more on voluntary private health insurance financially than any other country in the world

The relative priority given to health in the South African budget (14.2% of all government expenditure) is also not far from the OECD average (15.0%) and higher than in many other upper-middle income and Sub-Saharan Africa countries (Figure 9). However this also reflects overall government spending accounting for a relatively modest share of GDP in South Africa.

Figure 9. **Public health expenditure as a share of general government expenditure, 2014**



1. Data refer to current health expenditure which excludes investments.

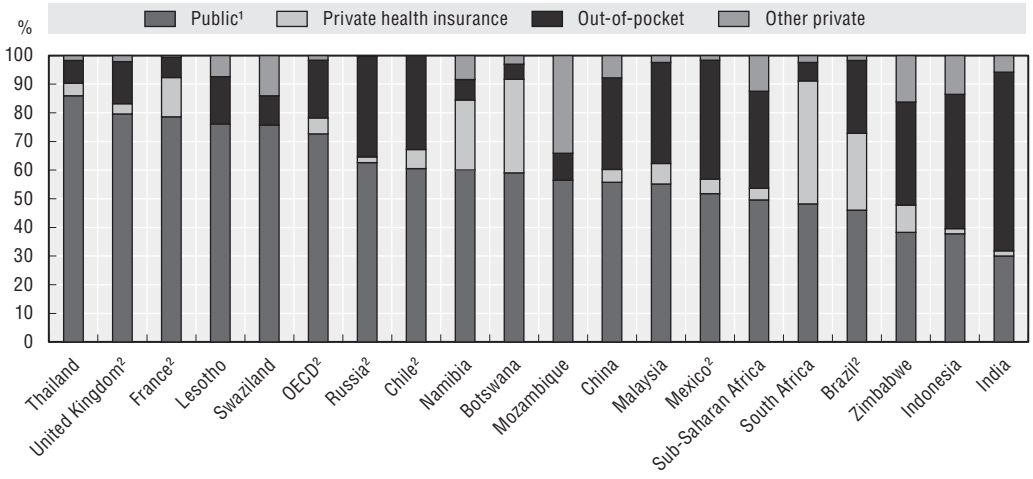
Note: For OECD countries, public health expenditure refers to government/compulsory insurance schemes and therefore includes compulsory private insurance.

Source: OECD Health Statistics 2016; WHO, Global Health Expenditure Database; IMF, World Economic Outlook Database.

About half of South Africa's spending on health is financed from private sources. This is a much higher proportion than in most OECD countries (Figure 10). A further disaggregation shows that most of this private health expenditure comes from voluntary private health insurance (PHI). In fact, South Africa finances a higher share of its health spending through voluntary PHI than any other country in the world, with its 42.9% share much higher than the average share for OECD member states (5.6%) and Sub-Saharan Africa (4.1%). Other countries with a significant share of health expenditure financed by voluntary PHI include neighbours Botswana (32.8%) and Namibia (24.5%), Brazil (26.8%) and the United States (34.4%).

In contrast, household out-of-pocket (OOP) payments are relatively low, accounting for only 6.5% of total health spending.[4] OOP payments are primarily in the form of

Figure 10. **Health expenditure by type of financing, 2014**



1. For OECD countries, "Public" refers to government/compulsory insurance schemes and therefore includes compulsory private insurance.
2. Data refer to current health expenditure which excludes investments.

Source: OECD Health Statistics 2016; WHO, Global Health Expenditure Database.

co-payments or upfront payments to access private health care. Finally, donor funding for health made up less than 2% of overall health spending.

3. Public financial management and the budgeting process for health

3.1. Budget formulation

Allocations from national to provincial and local governments are based on transparent criteria

In a decentralised governmental system, an *equitable share formula* based on transparent criteria ensures a largely equitable allocation of overall public funds between the nine provinces. The budget is allocated amongst the nine provinces based on a provincial equitable share formula that reflects population, economic activity, poverty and demand for services such as education and healthcare (National Treasury, 2016a). How this allocation is spent within a province is entirely a province-level decision (even if treasury and line ministries at the national level offer advice on allocations). Consequently, the budgetary allocation to health depends on the relative priority afforded to health by each of the nine provinces (these provincial allocations are analysed later in the section).

This is complemented by *conditional grants* for specific programmes from national to provincial governments. For health, there are the following conditional grants:[5]

- *Comprehensive HIV, AIDS and TB grant* (43% of direct conditional allocations to health in 2015/16): Supports HIV/AIDS prevention programmes and specific interventions, including voluntary counselling and testing, prevention of mother-to-child transmission, post-exposure prophylaxis, antiretroviral treatment and home-based care. From 2016, the scope of the grant has been extended to include tuberculosis.
- *National tertiary services grant* (33%): Provides strategic funding to enable provinces to plan, modernise and transform tertiary hospital service delivery in line with national policy objectives. The grant operates in 33 hospitals across the nine provinces. The urban areas of Gauteng and Western Cape receive the largest shares of the grant because they provide the largest proportion of high-level, sophisticated services.

- *Health facility revitalisation grant* (17%): Funds the reconstruction and maintenance of health infrastructure. It was created in 2013/14 through the merger of three previous grants. A wide range of health infrastructure projects are funded, including large projects to modernise hospital infrastructure and equipment, general maintenance and infrastructure projects at smaller hospitals, and the refurbishment and upgrading of nursing colleges and schools.
- *Health professions training and development grant* (7%): Funds the training of health professionals, and the development and recruitment of medical specialists. It enables the shifting of teaching activities from central to regional and district hospitals.
- Smaller grants, including piloting of the national health insurance initiative, health professionals contracting, information systems, and introduction of the human papillomavirus vaccine.

The NDOH plays a central role in the design, allocation and monitoring of these conditional grants for health. Conditional grants are designed to reflect differential need across provinces. For example, the HIV/AIDS grant is mainly calculated on the basis of the disease burden in each province and related needs for antiretroviral treatment. As conditional grants have to be spent on specific programmes, they imply greater control and stability over provincial health expenditure at the national level (for the programmes funded through these grants), but less flexibility for provinces.

Finally, a very small share of provincial governments revenues come from their own receipts. These are predominantly in the form of patient fees, which are given to the provincial revenue fund (who have discretion on where these funds are allocated).

A well-structured budget formulation process offers advance predictability on budget allocations to national and provincial health departments

There is a very clear and structured process to budget formulation in South Africa. Indeed, South Africa was ranked third in the world for central government budget transparency in the latest Open Budget Index, behind only New Zealand and Sweden (*www.internationalbudget.org/*). The budget setting timetable is well established, with specific committees and timelines. In particular, the timetable can be grouped into five broad stages:

1. In a first stage, *fiscal policy* is set, detailing overall spending limits in April for the next financial year.[6] Guidelines for the three-year *Medium-Term Expenditure Framework (MTEF)* are provided soon after. For health, the NDOH submits its *business plans* (including new bids) to the National Treasury, with the nine provincial health departments submitting business plans to their corresponding provincial treasuries.
2. Initial negotiations then take place. For health, *bilateral meetings* between National Treasury and senior health officials are held, with equivalent meetings held between provincial treasury and provincial health departments, to discuss whether programmes are adequately funded. It is worth noting that within the National Treasury there is a specific directorate responsible for social affairs, including health. Broad *functional groups* are also convened (health is currently one of nine groups). The health functional group is composed of the nine heads of provincial health departments plus the NDOH lead, alongside their finance counterparts. This group discusses and provides recommendations on overall budget allocation decisions for health, including linkages of programmes to outcomes.
3. The *Medium-Term Expenditure Committee (MTEC)*, taking recommendations from the aforementioned functional groups into account alongside funding availability and other

factors, then produce a set of recommendations on budget allocations. The MTEC includes senior officials from the Departments of Planning, Monitoring and Evaluation (DPME), Public Service and Administration (DPSA) and the Cooperative Governance and Traditional Affairs Ministry (COGTA), alongside the National Treasury. MTEC recommendations are reviewed by the Ministers Cabinet Committee (MINCOMBUD), Budget Council and Cabinet, chaired by the Minister of Finance.

4. A *mid-term budget policy statement* is announced in October, including any amendments to the budget. *Allocation letters* are issued soon after to line ministries at central and provincial levels, providing draft budget ceilings. These can be adjusted (for instance, if there is a worsening macroeconomic environment), but they are a good guide.
5. In the final stage, an *annual budget review* report details the overall budgetary system, followed by further review from MINCOMBUD. Once approved, an *Appropriation Act and Division of Revenue Act* are ratified by parliament at the end of the financial year.

This budget formulation process means that the NDOH and provincial departments of health are informed well in advance of approximate budget ceilings (as are other line ministries), providing a good level of predictability that helps with the budget planning process.

However, the structure and transparency in budget setting between national and provincial levels does not fully transmit on allocation decisions to health (and other line ministries) in provinces

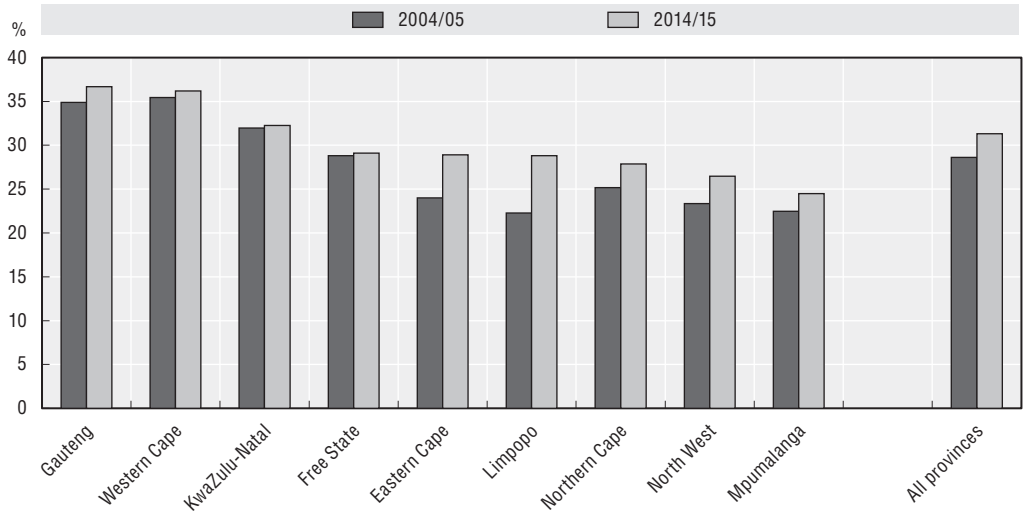
Whilst allocations from national to provincial governments are based on transparent criteria, and the budget formulation process offers advance predictability of budget ceilings, health policymakers are concerned about how allocations to health are decided. In particular, decisions on allocations given to provincial health departments by provincial treasuries are seen as being less transparent, depending critically on the strength of the provincial DOHs to negotiate.

Developing sound business plans is a crucial part of this negotiation process, with health (and other line ministries) required to show how outcomes will be improved over the medium term by incremental increases in budget allocations. Such an approach represents good practice in budget formulation. At the same time, though, there is a perception from the health side that actual allocation decisions are still largely determined by less tangible factors such as interpersonal relationships and subjective rather than objective evaluations of these business plans.

The NDOH also negotiates with the National Treasury for increased health funding needs overall. If they make a strong case this can lead to increases in conditional grants for health. It could also lead to an increase in the health component within the provincial equitable share formula, but there is no guarantee that any such increase then actually goes to health in provinces.

Looking at the health expenditure shares across provinces, some variation in provincial prioritisation of health is evident (Figure 11). While health expenditure on average accounted for 31% of total provincial expenditure in 2014/15, Mpumalanga province only allocated 25% and the North West 26% to health. On the other hand, Gauteng and Western Cape spent over 36% of their provincial funds to health – this reflects in part that Gauteng and Western Cape provinces include major teaching hospitals that provide specialised tertiary care. At the same time, Figure 11 also shows that in all provinces, health has been given an increasing share of

Figure 11. **Provincial health expenditure as a share of total provincial expenditure**

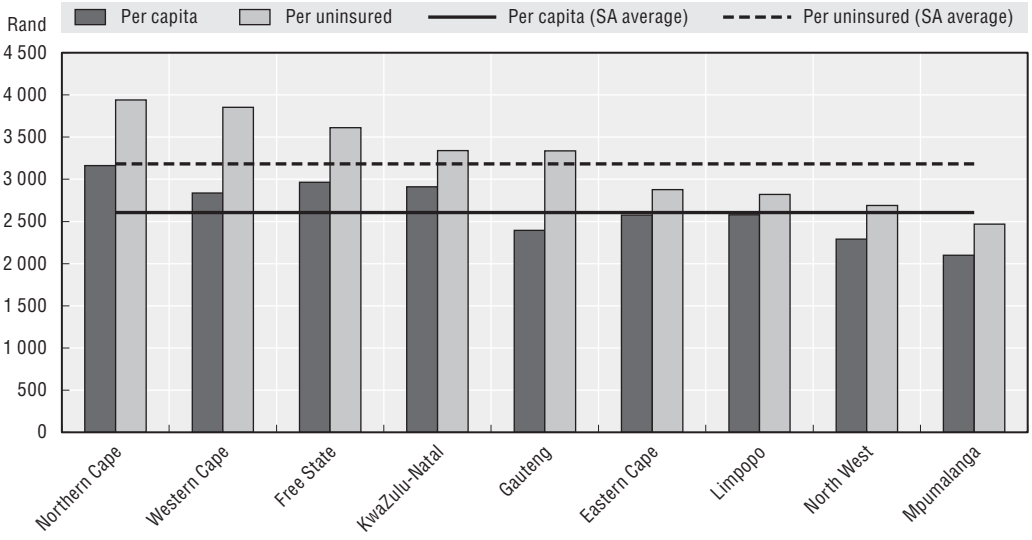


Source: Based on data from National Treasury, Provincial Budgets.

provincial budgets over the past decade. Furthermore, the provinces with the lowest health expenditure shares in 2004/05 generally saw the biggest increases in allocations to health.

Such differences suggest the importance negotiation skills play in budgetary allocation decisions. This is further supported when one compares provinces in terms of per capita and per uninsured health expenditures (Figure 12). Comparing spending per uninsured person is a better indicator (though still approximate) of unwarranted variation. This amount should be similar across provinces since the uninsured are the main recipients of provincial health services. Poorer provinces such as Eastern Cape or Limpopo, which have lower medical scheme coverage, also have lower spending per uninsured than richer provinces such as Western Cape or Gauteng. At the other end of the scale, Northern Cape has high spending per uninsured (and per capita), though this largely reflects geography and the sparse population across a large surface area, making service delivery costlier.

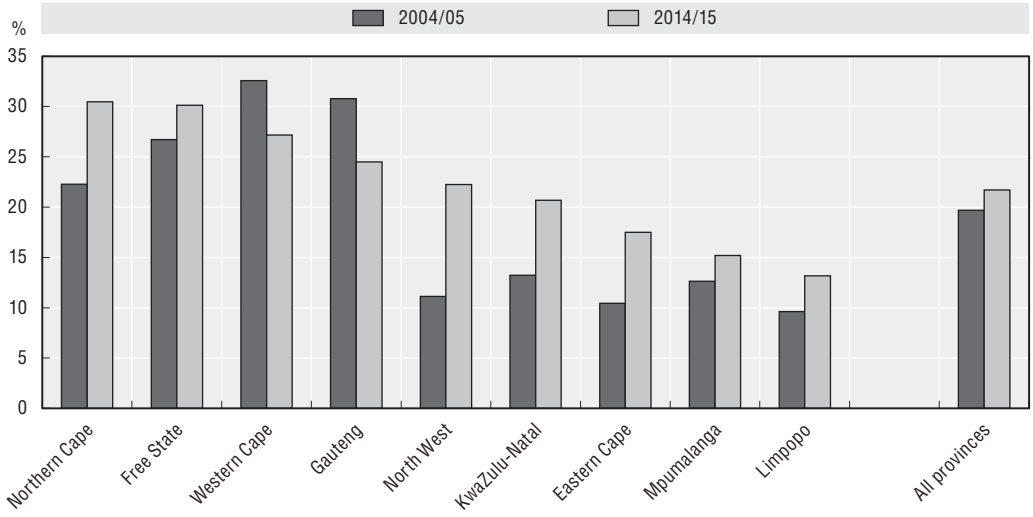
Figure 12. **Public provincial health expenditure per capita and per uninsured, 2014/15**



Source: Based on data from National Treasury, Provincial Budgets, Health Systems Trust, 2015.

Analysing the revenue sources for provincial health departments provides further insights. In particular, while funding from the provinces general revenues (i.e. a portion of the province's equitable share) constitutes the largest source of revenues for health, conditional grants have become a growing revenue source for health in the past decade in seven of nine provinces (Figure 13). They accounted for 22% of total provincial health departments' receipts in 2014/15, and more than 30% in Northern Cape and Free State.

Figure 13. **Conditional grants as a share of total receipts of Provincial Health Departments**



Source: Based on data from National Treasury, Provincial Budgets.

Within health budgets at the provincial level there is less standardisation and transparency on allocation decisions, with health service providers minimally engaged in the budget formulation process

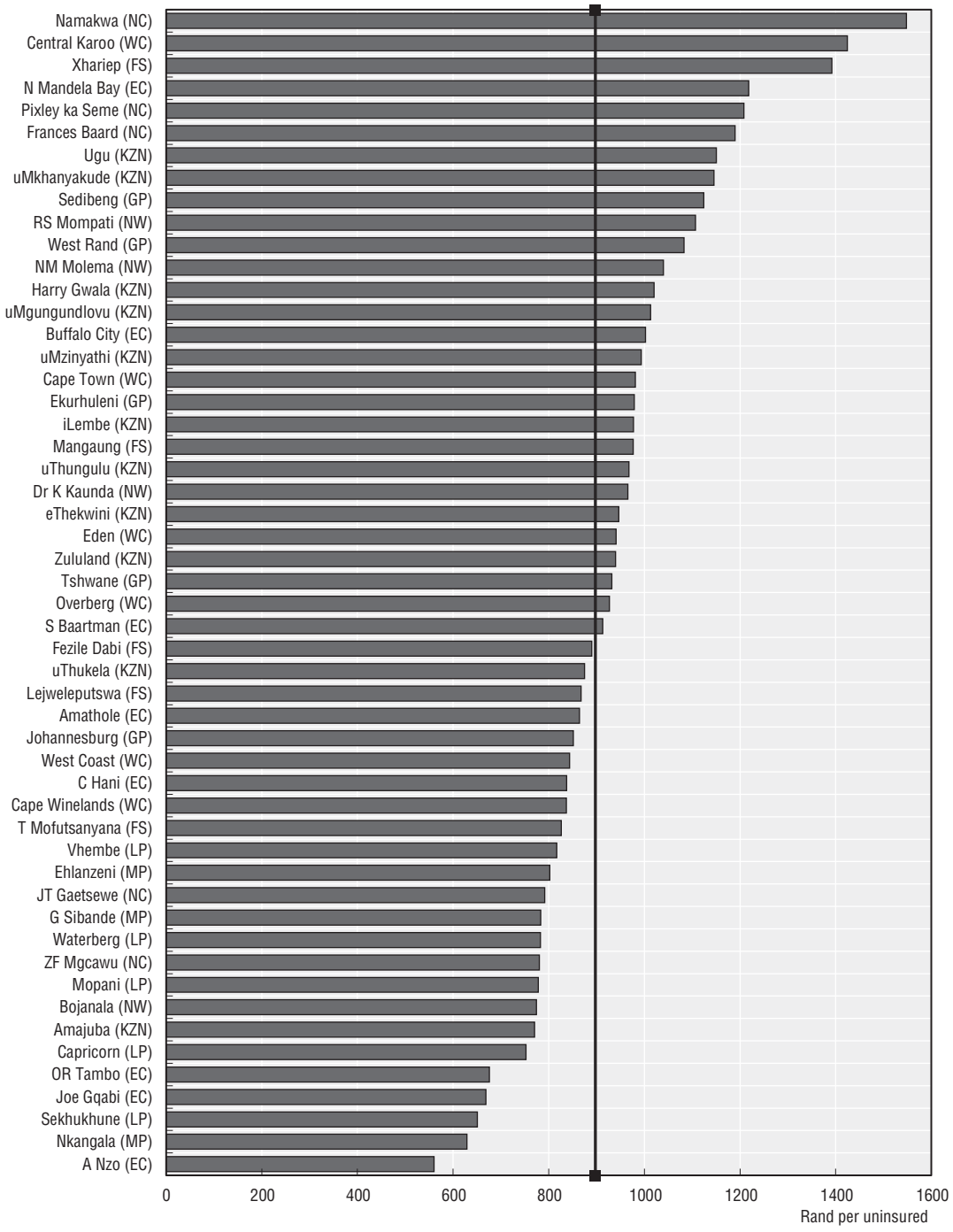
Decisions on budget allocations within provincial health budgets are less standardised. Budgets for district hospitals and district health offices (responsible for health clinics and other local service providers) are not gazetted. Provincial health departments typically set budgets for these health institutions responsible for service provision, with some limited negotiation by the larger and more technically competent hospitals.

Health facility budgets are not standardised across provinces: for district hospitals, though budget ceilings typically reflect patient load, there is often no or limited adjustment for patient case-mix. For smaller primary healthcare facilities, incremental budgeting based on historical amounts is a more common approach. Reforms on facility budget setting is therefore an important policy area – ongoing provider payment reform initiatives such as the potential use of diagnosis-related groups can help make budgets be more needs-based.

There is minimal negotiation on these budget ceilings, even though health service providers do submit budget requests to provincial departments of health. Service providers do not always receive clear guidelines on general budget envelopes to work with when submitting draft budgets. This is understood to be an important reason why requests from health service providers are often seen by provincial health departments as being too high to be realistic.

One potential consequence of this lack of standardisation and continued reliance on historical budgeting is unwarranted variation in funding for health service providers across localities. Indeed, the earlier Figures 11 and 12 showed marked differences in the relative priority given to health by provincial governments. Figure 14 also shows considerable

Figure 14. **Public PHC expenditure (non-hospital) per uninsured at the district level, 2014/15**



Note: The vertical line indicates expenditure per uninsured across all districts. The relevant province is indicated in parentheses: EC = Eastern Cape; FS = Free State; GP = Gauteng; KZN = KwaZulu-Natal; LP = Limpopo; MP = Mpumalanga; NC = Northern Cape; NW = North West; WC = Western Cape.
Source: Based on data from Health Systems Trust, District Health Barometer 2014/15.

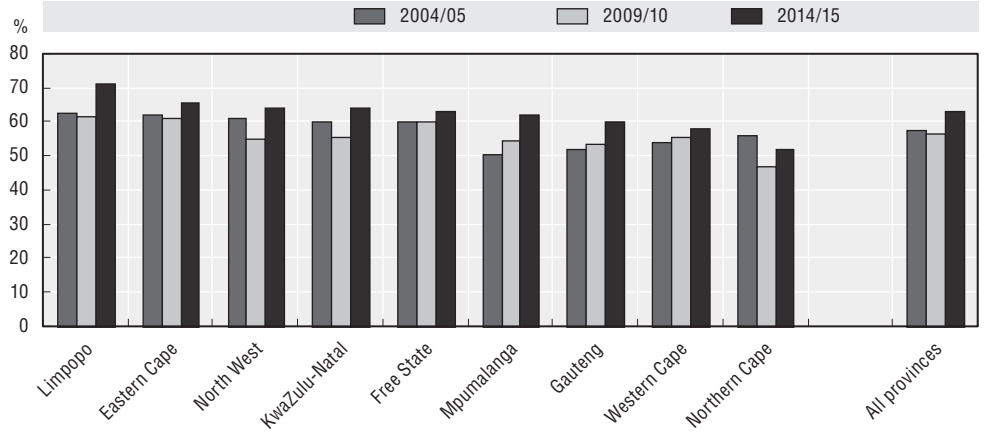
variation at the district level, with public spending on primary health care services varying from less than ZAR 600 per uninsured in A Nzo district to over ZAR 1 500 in Namakwa district. Despite these health spending disparities, the distribution of public sector resources has become much more equitable since the end of apartheid (see McIntyre, 2012 for a historical analysis).

Wages consume a large and growing share of the budget in most provinces, making budget planning challenging at all levels

Even if local health service providers were given a more active role in budget formulation, a fundamental constraint faced is the substantial share of health budgets that are consumed by wages. This evidently limits other essential spending at the service provider level and is also a constraint for provincial health department activities.

In particular, almost two-thirds (63%) of provincial health expenditure went to salaries in 2014/15 (Figure 15). Compensation of employees ranged from 52% in the Northern Cape to 71% in Limpopo. Further, the share of budgets devoted to salaries has increased in recent years, from 57% in 2009/10 to 63% in 2014/15. This is in contrast to the period 2004/05-2009/10, when the share of budgets devoted to wages was fairly constant. Such increases put pressure on provincial health budgets and also decrease the amounts available for goods and services.

Figure 15. **Compensation of employees as a share of total provincial health expenditure**



Source: Based on data from National Treasury, Provincial Budgets.

The latest Provincial Budgets and Expenditure Review has analysed the reasons behind this increased share of provincial health expenditure allocated to salaries (National Treasury 2014a). The report found that both substantially higher salaries (wages are negotiated at the central level) and increased personnel numbers explain the recent trend. This reflects in part the strength of South Africa's labour unions, making downsizing of departments difficult.

In particular, revised salary structures – legally termed Occupation Specific Dispensation – was implemented for nurses from 2007/08, for doctors from 2009/10 and for allied health professionals from 2010/11. There was also a re-grading of clerical staff in 2013/14. Combined with across-the-board civil service wage agreements, annual salaries increases have exceeded inflation for several years. The average cost per health sector

employee rose from ZAR 203 137 per year in 2010/11 to ZAR 266 380 in 2013/14 – a 31% increase and considerably higher than the 17% increase in consumer prices between 2010 and 2013 (OECD, Consumer price index, February 2017). Over the same time period, the number of provincial health sector employees has increased from 289 986 to 307 042. Within this increase of 17 056 employees (or 5.9%), the number of nurses grew by 7 800 (+5.9%) and the number of practising medical doctors by 2 494 (+14.3%).

Comments and recommendations

South Africa has a very clear, well-structured and transparent process to budget formulation from national to provincial governments. Central line ministries, including the NDOH, provincial governments and provincial line ministries are all informed well in advance of approximate budget ceilings, providing good predictability that helps with the budget planning process. This is an excellent quality of the South African budgeting process, with useful lessons for other countries.

Nevertheless, there is room for improvement. In particular, transparency in the budget formulation process from national to provincial governments does not fully transmit on allocation decisions to health from provincial treasuries. Improving how business plans submitted by provincial health departments (and other line ministries) to provincial treasures are evaluated could help. In particular, providing more objective criteria on which these business plans are evaluated would give health (and other) departments more confidence in the budget allocation process and incentivise them to better refine their business plans.

Further, within health budgets there is even less standardisation and transparency on allocation decisions. In particular, the budget a health facility receives often reflects an incremental change to historical amounts received rather than being based on clearly defined allocation criteria. Improving the capacity of district hospitals and managers of district health offices in budget formulation would be an important first step to ensure their needs are better reflected in budgets, and ultimately more strategic purchasing.

Finally, budget setting processes at all levels of government need to better account for staff costs and increases in wages. Nationally negotiated wage increases put pressure on budgets, limiting spending on other essential items which underpin quality of care, such as spending on pharmaceuticals and medical devices. Staffing decisions need to reflect these increases, so that a minimum amount of spending on goods and services is maintained for effective health service delivery. That is, there is an urgent need to contain staff costs in order to preserve health services.

3.2. Budget execution

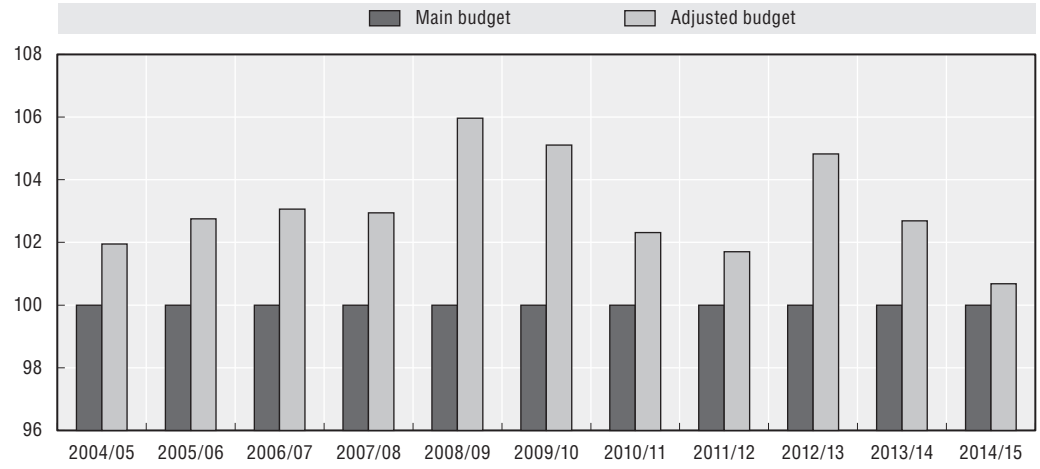
Strong public financial management rules help limit over-spending and under-spending in aggregate

Strong public financial management systems help ensure health spending is close to budgeted amounts. Up-to-date data reporting systems warn of potential over-spending and under-spending. This is combined with strict enforcement of fiscal rules to limit over-spending. Rules on carry-overs are designed to also limit under-spending: if provincial health departments, the NDOH or other line ministries do not fully execute their budget, these unspent funds are normally withheld in the following financial year and until the implementing agency has demonstrated capacity to spend as planned.

There are some exceptions to this which allow greater flexibility. For example, in the Western Cape, under-spending for non-recurring items can sometimes be carried over to the next financial year. Such an arrangement works because of the high level of trust between the Western Cape treasury and health department, and also thanks to regular training on budget management.

Further, while budget execution rules on underand over-spending are fairly rigid, the National Treasury does provide some flexibility through a two-step budget ceiling approach. That is, after the main budget is set at the beginning of the financial year, an adjusted budget is tabled halfway through the financial year (in October/November). The adjustment process provides an opportunity to take account of a number of developments affecting government spending plans, such as rollovers of unspent funds from the previous financial year, unforeseeable and unavoidable expenditure, the appropriation of expenditure earmarked in the main budget speech for future allocation, shifts of unused funds between and within budget programmes as well as the declaration of funds that will not be spent in the current financial year (National Treasury 2016b) Adjusted provincial health budgets have always shown an upward adjustment to the budget ceiling in the last decade (Figure 16).

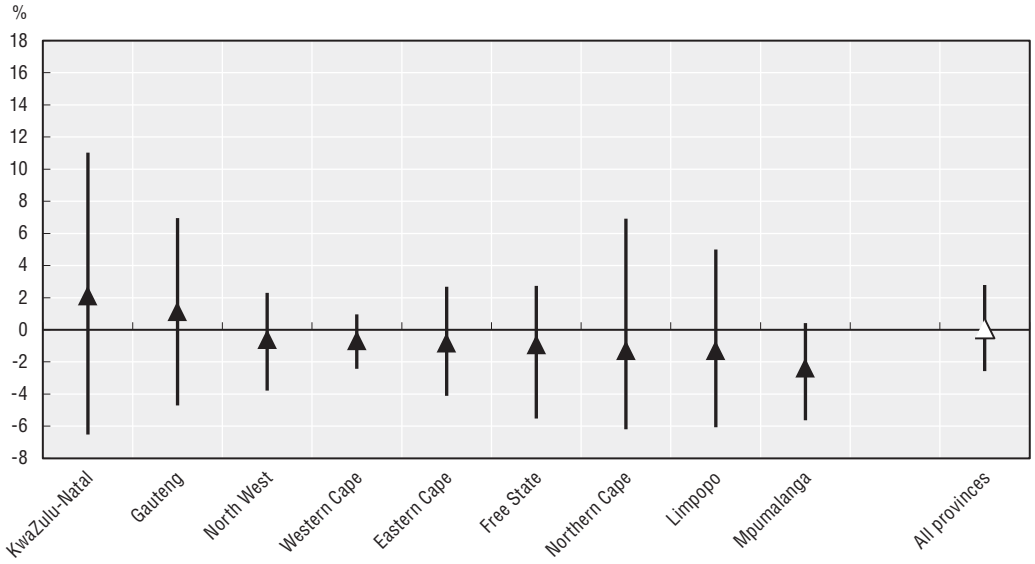
Figure 16. **Main Vs Adjusted provincial health budget**



Note: The main budget is set to 100 each year so that the adjusted budget shows the percentage difference.
Source: Based on data from National Treasury, Medium Term Budget Policy Statements 2005-2015.

Actual health spending by provinces has typically been close to the Adjusted Budget (Figure 17). The average of provincial deviations from the adjusted budgets over the 2004/05-2014/15 period is within a band of -2.4% (Mpumalanga) and +2.1% (KwaZulu-Natal), with most provinces slightly under-spending on average. Moreover, the dispersion around the average shows that over-/under-spending during the 2004/05-2014/15 has in most provinces not been severe, with some exceptions (notably KwaZulu-Natal has over-spent by 11% and under-spent by 6.5% during this time period).

Figure 17. **Provincial health expenditure, deviation from adjusted budget, 2004/05-2014/15**



Note: Positive (negative) values indicate overruns (underspending) relative to the adjusted budget allocation.
Source: Based on data from National Treasury, Medium Term Budget Policy Statements 2005-2015.

A range of processes help ensure budgets are spent on planned activities at the provincial health department level and above

Alongside aggregate controls on spending, there are various monitoring processes in place to ensure budgets are spent on planned activities. Such processes are mainly at the line ministry and provincial level, with more limited monitoring at the health facility level. Budget appropriations are checked by eight programme areas (administration, district health services, emergency health services, provincial hospital services, central hospital services, health sciences and training, health care support services, health facilities management) and then line items (broad economic classifications for current payments are compensation of employees; goods and services; interest and rent on land).

Each year the Inter-Governmental Relations Directorate of the National Treasury visits all of the provinces to discuss budget execution challenges, including those specific to health. There are also more frequent (monthly and quarterly) e-monitoring by National Treasury to check that money has been spent as programmed.

The results from these monitoring exercises are then discussed in benchmark budget meetings (nearer the end of the financial year) between the national and provincial treasuries. The purpose of these meetings is to check that funds have been received on time and spent as planned in the budget. Results of such benchmarking meetings are non-binding, but reports based on these meetings provide transparency on provincial treasuries' fund distributions and alignment with budget lines.

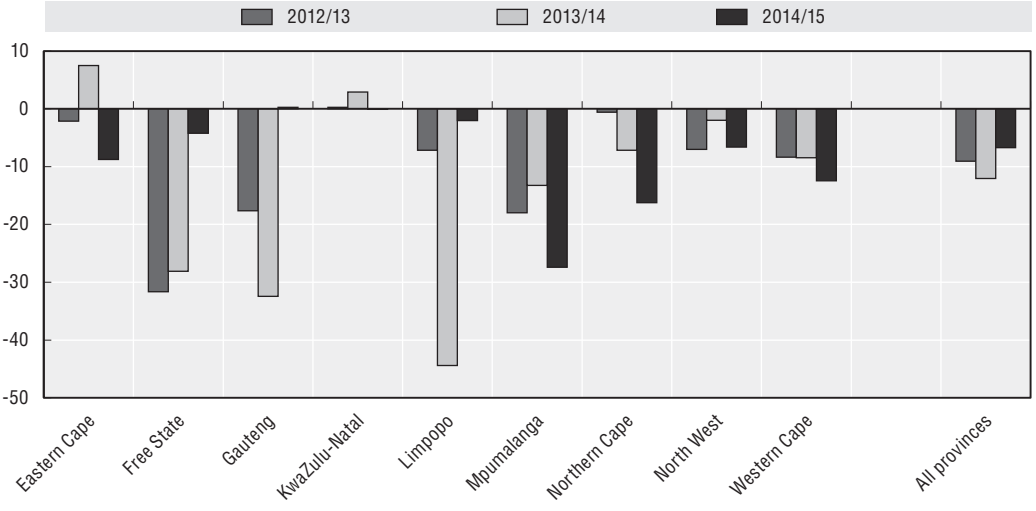
In addition to such processes between national and provincial treasuries, provincial treasuries have more frequent (monthly to quarterly) monitoring of spending by their health departments and other line ministries. These are in the form of financial monitoring committees, where programme managers will account for any expenditure variation from the budget, especially around staffing.

However, health facilities often still face delays in receiving funds, leading to under-spending

While such collaborations described above help ensure an effective budget execution at the provincial health department level and above, health facilities often still face practical challenges in receiving funds in a timely and flexible manner. This relates to the earlier discussion in Section 3.1 around delegations and the limited autonomy most healthcare facilities have on spending. Consequently, many health facilities face practical challenges to react to day-to-day needs (e.g. finding funds to fix leaks and other maintenance issues). This leads to under-spending as well as a lower quality of care.

Most notably, almost all provinces have underspent on the Health Facilities Management Programme in recent years (Figure 18). This programme encompasses infrastructure, refurbishment and maintenance of hospitals, primary healthcare facilities and community health centres. Across all provinces, spending on health facilities management was 6.7% below the adjusted budget in 2014/15, with greater under-spending in prior years (-12% in 2013/14, -9.1% in 2012/13). Under-spending on health facilities management has been particularly marked in the Free State, Gauteng, Limpopo and Mpumalanga provinces, with spending more than 10% below adjusted budgets on average in recent years, with under-spending sometimes reaching as much as 30% to 45%.

Figure 18. **Provincial expenditure on health facilities management, deviation from adjusted budget**



Note: Positive (negative) values indicate overruns (under-spending) relative to the main budget allocation.
Source: Based on data from National Treasury, Provincial Budgets.

Two main reasons have been given by South African policymakers to explain this under-spending. First is the limited autonomy many health facilities have in managing their budgets. In South Africa this is framed in terms of *delegations*, that is what decision-making powers are delegated to health facilities. District hospitals and above can have their own delegations for minor expenditures and also for hiring low-level staff, with legislation in place to support this (the District Health Services Policy). But they are not allowed to move funds between budget votes (e.g. from personnel to goods and services). Further, and critically, there is no standard set of delegations: it depends on provincial health

departments. Primary healthcare facilities have even more limited delegations, with all budgeting decisions requiring approval of their district health offices or even provincial DOH.

Second, *public procurement policies* can hinder implementation – large contracts must go to tender, which is a time-consuming process with multiple approval procedures. That being said, recent reforms to the provincial infrastructure grant system have been put in place to try and reduce under-spending on health infrastructure (constituting a major share of the Health Facilities Management Programme). In 2013/14, the health facility revitalisation grant was created through a merger of three previous infrastructure-related grants including the health infrastructure grant, the hospital revitalisation grant and the nursing college and schools grant. The new health facility revitalisation grant aims to give provinces greater flexibility to shift funds between infrastructure projects during the year in order to avoid under-spending (or over-spending) on the grant as a whole. Further, provinces now have to bid for infrastructure allocations two years in advance. In addition, a portion of the grant is allocated to provinces only if they meet certain planning criteria (for example, the submission of an asset management plan, an infrastructure programme management plan and a supporting construction procurement strategy) to access the health facility revitalisation grant. A financial incentive component is built into the grant allocation to reward provinces that implement best practices. Additionally, the national health insurance indirect grant was introduced in 2013/14. This is spent by the Department of Health on behalf of provinces and includes a component to support infrastructure projects (National Treasury, 2014b).

Comments and recommendations

South Africa has a well-developed system aimed at ensuring that health spending remains within the allocated budget and creating incentives to avoid high levels of budget under execution. Up-to-date data reporting systems, strict enforcement of fiscal rules, and well developed monitoring processes are good budgetary practices that can inspire other countries in the region. However, despite good aggregate spending levels, there is great disparity in the way provinces execute their budget. The National Treasury could play a more active role in ensuring that good practices and tools developed at the provincial level can be shared with other provinces to improve spending levels.

In order to tackle some of the main reasons identified as drivers for under-spending, the country could benefit from affording health facilities greater decision-making power, and clarifying and simplifying the delegation framework. This could help health facilities to increase their responsiveness to changing needs during the fiscal year – and consequently ensure better budget execution. Crucially, this requires lines of accountability to also be shifted, so that health facilities with increased delegated powers are held responsible (rather than provincial health departments), with facility managers losing their jobs if they misappropriate funds. There is also a capacity challenge: not all facilities have sufficient management skills to handle increased delegations; and facilities need to have access to the Treasury's Basic Accounting System (BAS) to ensure timely information on budget execution.

3.3. Performance monitoring

Monitoring of budgets and health outputs are well established, but performance monitoring that links financials to non-financial indicators are more limited

While national and provincial treasuries are primarily responsible for monitoring of health budgets to verify that funds are being spent on time and as indicated in the budget,

the national and provincial departments of health are the main actors responsible for monitoring health system performance.

In terms of health-related outputs, the NDOH has established *"outcome agreements"* with provincial health departments that detail health-based commitments. These include quantitative targets for health outputs such as reduced infant and maternal mortality rates, or service outputs such as increased coverage of antiretroviral treatments. Targets are set nationally and then cascaded down by province, with *annual performance plans* detailing how these health-related targets can be met through various health activities. These targets are non-binding. But provincial health departments use results from such non-financial monitoring when negotiating with provincial treasuries, to justify specific areas that require more funds.

However, monitoring that more specifically links financials to actual performance remains limited. The NDOH has recently instigated a range of measures to try and address this. Chief among these is the tracking of *spending on "non-negotiables"* by health facilities. Non-negotiables refer to 18 essential non-personnel recurrent activities that are required to ensure an effective minimum standard of health service provision. These items, linked to the standard chart of accounts for ease of monitoring, are as follows:

- Infection control services; medicines and medical supply; cleaning materials and laundry services; essential equipment and maintenance; laboratory services; blood supply and services; food services and relevant supplies; security services; infrastructure maintenance; vaccines; HIV and AIDS; tuberculosis; child health services; maternal and reproductive health services; school health (quintile 1 and 2 schools); district specialist teams; registrars posts filled; primary health care and family care full complement (of teams).

Monitoring spending on these items began because provincial health departments have often not been able to protect such recurrent expenditures, particularly in light of wages taking up increasing shares of budgets in recent years. Results from this monitoring exercise, though, are purely informational – that is, provincial health departments may be advised to protect such spending but are not legally required to do so.

District health expenditure reviews provide additional performance monitoring. These have recently linked financials to non-financial health indicators. A simple online tool filled by districts details spending by inputs and programmes. This spending is then linked to two key performance indicators – immunisation rates and antenatal visits – that are closely linked to district spending.

Another important district-level initiative is the *District Health Barometer*. This publication evaluates the health system at the district level, tracking performance over time. It benchmarks key indicators on quality, access and financing of health care, pinpointing where serious gaps or performance issues prevail.

Results from tracking of non-negotiables spending and district health expenditure reviews are discussed with provincial health departments. Alongside bilateral meetings between NDOH and specific provincial health departments, a forum of the 9 provincial health chief financial officers (CFOs) meets with the NDOH CFO to discuss these results and specific budgetary challenges. Participation in such forums is voluntary and designed to find policy consensus, with any agreed decisions on a non-enforced basis.

That is, monitoring efforts by the NDOH offers provinces useful performance information, but there is limited accountability on the actual results of these efforts. This reflects the

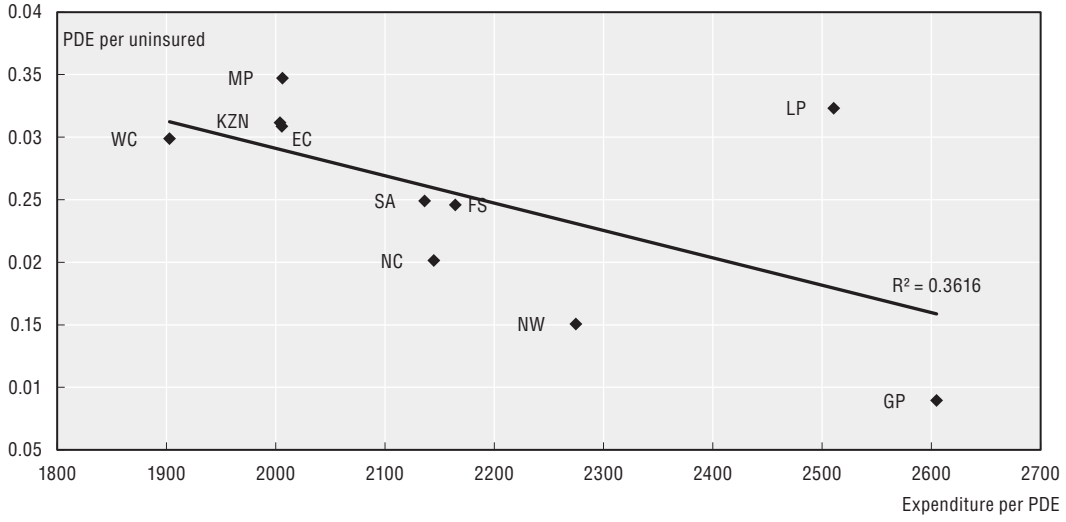
overall public governance structure and specifically that responsibility for local health services is devolved to provincial health departments.

A simple analysis of expenditure and utilisation data shows the potential for efficiency gains

Alongside these analyses by the NDOH, a simple analysis linking spending and utilisation shows the potential for efficiency gains in certain provinces. In particular, provinces with lower utilisation rates have a higher expenditure per patient day and visit. This negative association is suggestive of under-utilised capacity in some provinces, and is consistent with evidence elsewhere (see Adam et al 2008 for further discussion on patient caseload and cost curves).

Figure 19 plots public spending versus utilisation for inpatient care (per patient-day equivalent); Figure 20 illustrates the equivalent for primary health care. They both show a negative association between expenditure per person (uninsured) and utilisation rates. For example, Gauteng province has the highest expenditure per patient-day equivalent and primary health care visit, and the lowest corresponding utilisation rates.

Figure 19. **Public expenditure per PDE vs utilisation of district hospitals, 2014/15**

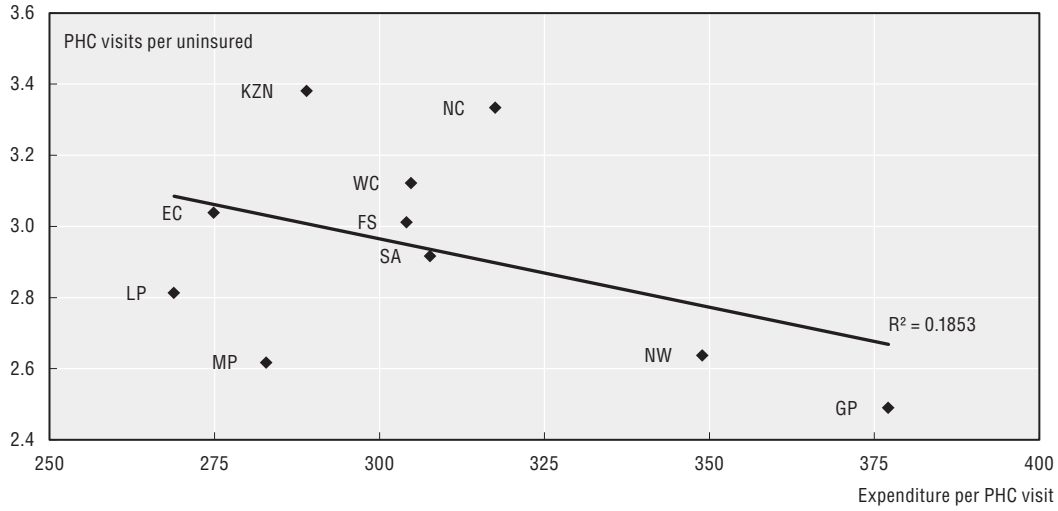


Other government institutions provide further performance monitoring efforts, limited predominantly to compliance

Alongside national and provincial treasuries and health departments, a number of other government institutions are engaged in performance monitoring for health. In particular:

- Independent audits by the office of the *Auditor-General* are useful in ensuring compliance to set indicators at the end of the financial year. But these indicators are more on processes – such as correct data accuracy, reporting procedures and meeting structures – with limited to no links to outputs. It is worth noting that provincial treasuries can place provincial departments of health under administration for consistently poor performance, largely based on the auditor-general's reporting.
- The *Department of Planning, Monitoring and Evaluation (DPME)* was set up in 2014 to monitor and evaluate performance across sectors. Summary indicators are provided for each of

Figure 20. **Public expenditure per PHC visit vs utilisation of PHC, 2014/15**



Notes: SA = South Africa; EC = Eastern Cape; FS = Free State; GP = Gauteng; KZN = KwaZulu-Natal; LP = Limpopo; MP = Mpumalanga; NC = Northern Cape; NW = North West; WC = Western Cape.
Source: Based on data from Health Systems Trust, District Health Barometer 2014/15.

the 14 major outcomes detailed in the overall National Development Plan 2030 (one of which is health). While this offers a broad overview of performance, it is a much aggregated analysis, with only country-wide indicators for health. Further, there is no clear link with the financial monitoring activities undertaken by Treasury.

- The *Office of Health Standards Compliance* was set up to specifically inspect the quality and safety of health facilities. Whilst this offers effective checks on whether facilities are meeting minimum quality standards set down in regulations, health policymakers from both NDOH and academic institutions believe that these standards could be set higher to encourage better quality care. However, for such a policy to be effective, it would require more powerful health information systems, comparable patient-level data and related analytical capacity to analyse these data. The NDOH has recently started this with the implementation of the health patient registration system.

Comments and recommendations

Through the national and provincial treasuries, South Africa has well-established monitoring processes in place that support the execution of health budgets and help to avoid excessive overor underspending at the aggregate level. At the same time, national and provincial departments of health set and monitor targets related to health outputs and health system performance.

However, performance monitoring that links the two perspectives remains limited and could be strengthened. Recent efforts at the district level (District Health Expenditure Reviews, District Health Barometers) linking health spending with non-financial health indicators provide a good example. Such monitoring efforts provide useful information on inter-district and inter-province variations that allow assessing whether the allocated resources are used effectively and efficiently. Exploring possibilities to more closely align the existing performance monitoring efforts by Treasury, DPME, the Department of Health and other government institutions might further improve the information base.

4. Conclusions

South Africa has made considerable progress in developing its healthcare system since 1994, with reform efforts and investments into the health system contributing to significant improvements in health outcomes. Nevertheless, important challenges remain today. From an overall health system perspective, a core issue is the continued two-tier nature of South Africa's healthcare system, reflected in both the financing and delivery of health services. Bringing parallel public and private systems closer together is critical to a more equitable healthcare system. In this regard, the National Health Insurance (NHI) reform agenda has significant potential. Successful NHI implementation, though, requires careful consideration of institutional implications, particularly the impact on the roles of provincial departments of health and the private medical schemes. It also requires capacity-building to ensure the requisite capacity to effectively manage and purchase health services at the district level.

Focusing in on public financial management and budgeting practices for health, it is clear that the South African system has many strengths. Key among these is a well-articulated budget formulation process that provides good predictability and transparency, and an effective budget execution that limits overand under-spending. These offer valuable lessons for other countries. However, other budget practices could be improved, notably in terms of greater involvement of health service providers in the budgeting process, greater autonomy of district offices and health providers paired with capacity-building efforts, and in a better linking of financial and non-financial performance monitoring efforts.

Notes

1. See NDOH (2015b) for an in-depth analysis of the national health insurance reform process.
2. The HIV/AIDS 90/90/90 targets, developed by UNAIDS, have the aim of 90% of all people living with HIV being diagnosed, 90% of those diagnosed being on ART, and 90% of those on ART being virally suppressed.
3. South Africa are currently implementing the System of Health Accounts (SHA) 2011 methodology, which will result in some slight revisions to health expenditure figures.
4. Estimates of OOP spending are currently being revised, and preliminary results suggest OOP make up a slightly higher share of overall spending.
5. Description of grants taken from DORB 2016 (pp. 86-87).
6. In South Africa the financial year runs from 1 April to 31 March.

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Long-term budgeting: A cautionary tale from U.S. experience

by
Joseph White Ph.D.*

There is a growing tendency, among central budget-makers and commentators, to argue budgets should be made for the long-term, rather than the traditional annual budget. This tendency is especially strong in the United States, where it has become virtually a conventional wisdom. This article explains, first, why that approach fits very poorly with most of the goals of budgeting. It then evaluates U.S. experience with approximations of long-term budgeting of three types: i) medium-term limits on discretionary spending, ii) the Social Security programme, and the iii) Medicare programme. That experience illustrates the reasons why long-term budgeting would not be a positive reform. They include the fantastical nature of many long-term forecasts, strong incentives for both deception and self-deception about the effects of planned budget totals, and ignoring the basic task of budgeting, which is to reconcile preferences about policy details to preferences about budget totals in a way that considers each.

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He has benefited over the years from the wisdom of many other scholars, none of whom bear any responsibility for any controversial assertions herein. But Dr. White especially appreciates the encouragement and support from Paul Posner for the work that became this article, and dedicates it to Dr. Posner's memory.

1. Introduction

What is the appropriate time frame for a government budget? Budget processes normally have stated plans for the collection and allocation of resources over a period of one or occasionally two years (Caiden, 1982; Wildavsky, 1978). Recently, however, many budget-makers have promoted much longer-term perspectives.[1]

A long-term perspective could mean considering projections of possible long-term trends as part of the information used to make annual budgets. The OECD network of Senior Budget Officials endorsed a version of this view in OECD's 2015 *Recommendation of the Council on Budgetary Governance* (OECD, 2015a; White, 2015a). The ninth of ten principles is to "Identify, assess and manage prudently longer-term sustainability and other fiscal risks." This includes "publishing a report on long-term sustainability of the public finances, regularly enough to make an effective contribution to public and political discussion on this subject, with the presentation and consideration of its policy messages – both near-term and longer-term – in the budgetary context" (OECD, 2015a: 10).

In the United States, long-term projections have been common since they were created by GAO and taken up by CBO in the 1990s (GAO, 1992; CBO, 1997a). They were and are used to heighten policy-makers' concerns about deficit control. When budget conditions looked particularly good, long-term forecasts were used to call for restraint based on possible deficits decades in the future (GAO, 2001).

Many of the leading figures in debate over the U.S. federal budget process, however, recommend going further. They maintain that instead of being judged by the prospective deficit in the next year, the federal budget should be judged by the deficits or debt it is estimated to produce decades into the future. In short, allocation decisions should be driven by long-term goals for totals, and policy details designed and judged based on their estimated effects on budget goals 20, 30, or more years into the future.

Thus GAO has proclaimed that, "Long-Term Focus is Critical" (GAO, 2004) and that any delay in addressing those concerns would be "destabilising" and unwise (GAO, 2011: 2). It has called for "enforcement mechanisms" to encourage better deficit control for longer periods of time (GAO, 2011: 3). In 2008 a group of budget commentators including three former Directors of the Congressional Budget Office proposed thirty-year budget caps for Social Security, Medicare, and Medicaid, enforced by "automatic adjustments in benefits, premiums, provider payments, or other revenues" in order to save the nation's "fiscal future" (Antos et al., 2008: 2). Eleven members of the National Commission on Fiscal Responsibility and Reform ("Bowles-Simpson Commission") in 2010 endorsed a plan that defined the goal of budgeting as to, among other things, reduce federal debt as a share of GDP in 2035 to 40% (National Commission, 2010). They clearly believed that budgets should be judged by whether they would (purportedly) hit that target.

In March of 2011, ten former chairs of the President's Council of Economic Advisers declared that, "repeated battles over the 2011 budget are taking attention from a more dire problem – the long-run budget deficit." They called this deficit – which was a projection

decades into the future – "a severe threat that calls for serious and prompt attention." They asserted that, even though "the actual deficit is likely to shrink over the next few years," immediate action was needed because, "at some point, bond markets are likely to turn on the United States – leading to a crisis that could dwarf 2008" (10 Ex-Chairs, 2011). That was a remarkable claim considering that 2008 was the worst financial crisis in nearly eight decades. The battles over the 2011 budget to which the former CEA chairs referred included the possibility that the federal government would be unable to raise its debt ceiling, and therefore have to default on federal securities in August – an event which might be expected to have a more immediate and dire effect on the bond market. Nevertheless these economists were joined by the Committee for a Responsible Federal Budget[2] in arguing that the long-term prospects were a similar crisis. In a June, 2011 statement, the CRFB declared that "we need to see" both "a debt ceiling increase as soon as possible" and "a companion debt deal that (a) Calls for at least USD 4 to USD 5 trillion in total deficit reduction" including "steps toward reforming unsustainable entitlement programmes." "Failing to raise the debt ceiling," CRFB declared, "would likely lead to a fiscal and financial crisis, but failing to address the debt would eventually do the same." The statement acknowledged that entitlement "reforms" could not be drafted immediately, but called for a "credible process" including some set of binding automatic consequences if those reforms were not adopted (Committee for a Responsible Federal Budget, 2011a: 1, 3, 4).

Former CBO and OMB Director Alice Rivlin and former Senate Budget Committee Chair Pete Domenici (2015: 13) urged reforming the federal budget process so that Congress would "enact explicit long-term budgets for Medicare, Medicaid, and Social Security as well as other mandatory programmes" with "limits on automatic spending growth" that would be enforced by "re-establishing and simplifying pay-as-you-go rules for these mandatory spending programmes."[3] The National Budgeting Roundtable has now generated two analyses calling for enforceable long-term totals for either all or most of the federal budget. Phil Joyce (2016: 4) calls for establishing a statutory fiscal rule to determine long-term totals. Stuart Butler (2016: 3) called for "a 25-year budget for long-term mandatory programmes, together with a funding plan." Each proposal says that Congress could make changes to the long-term plan. Each also, however, provides for automatic procedures, to make programme or revenue details fit the targets, as a default. In Butler's (2016: 4) testimony, "(i) f spending or revenues for these programmes exceeded or fell short of the corridor established in the original statute, automatic provisions would be triggered to maintain the original long-term budget." In Joyce's version (2016: 5), deviations from the agreed budget path would be countered with sequestration applied to "all spending and revenue changes, including tax expenditures."

Advocates for such proposals may argue they are not really long-term "budgets" because they do not intend for the "enforcement" provisions to go into effect.[4] In this view, setting caps is not really budgeting; a budget must include decisions about budget details. The principle is correct: deciding about totals without considering what that means for details is an irresponsible and often dishonest way to budget. Yet *enforcement provisions are details*. They are the policy unless different laws are passed instead – just like any other budget law. As a default, the enforcement has all the power of the *status quo* in a political system in which legislating can be exceedingly difficult. Moreover, if Congress and the president could agree to waive the details of the enforcement, they also could agree to waive the totals – that is, to have higher deficits than planned. Therefore, proposals which combine long-term decisions about totals with enforcement procedures either should be

viewed as long-term allocation decisions to reconcile details and totals – that is, budgets – or should not be viewed as providing serious caps. Advocates who propose "enforcement" that they do not mean to occur are misleading the public, themselves, or both.

In these cases and many others, budget experts in the United States appear to believe that decisions should be based on forecasts of results far in the future. A long-term baseline would be estimated and then policies chosen because they are projected to reach some more desirable target. In this view, policies that do not move in a major way from the projected baseline to the target are irresponsible. So responsible budgeting must mean budgeting to meet long-term targets.

In international practice, long-term analyses have been encouraged but, "not used for allocation" (Schick, 2009: 17).[5] Nevertheless, versions of the American budget community's belief in long-term budgeting, as opposed to long-term projections, appear to be attracting interest within the international budgeting community. In these pages Marc Robinson recently wrote that the "long-term fiscal projections and analysis which are now produced by most OECD governments (and by the European Union)… need to be more closely linked to budgeting" (Robinson, 2016: 45). Allen Schick has suggested that the future of budgeting might include both transforming Medium Term Frameworks into more binding budgets, and adapting the current "analytical tools" of long-term analysis into fiscal rules that "require or prohibit certain actions" (Schick, 2016: 28-31).

In this paper I will argue that American experience provides ample evidence about why the American emphasis on long-term budgeting should be rejected in other countries and scaled back in the United States. In the name of alleged "fiscal responsibility" it threatens many of the key purposes of budget processes.

The problems begin with the fact that long-term forecasts call for decisions based on information that is distinctly less credible than the information used for traditional budgeting – flawed as the latter can be. This is especially problematic for health care, a large part of any modern state's expenditure. Moreover, many of the standard purposes of budgeting – including support for representative government, accountability, transparency, macroeconomic management, and efficiency – are threatened by how long-term tactics work. Long-term approaches also favour particular policy views over others, rather than providing a neutral framework for informed and representative choice. Even the view that it would favour – one that prioritises "economy" in the form of lower spending over all other values – might be favoured mainly in a fraudulent way, with fake decisions.

The first section of this paper looks at these goals and purposes of budgeting, and considers how long-term budgeting might be expected to fit with those purposes. The next three sections evaluate U.S. national government experience with approximations to long-term budgeting. These include five- and ten-year ostensibly binding totals for discretionary spending (spending by bureaus that receive annual allocations for some purpose, as opposed to more open-ended mandatory or entitlement programmes); decision-making for the Old Age, Survivors and Disability Insurance (OASDI) pension programmes, known in the U.S. as "Social Security"; and budgeting for the Medicare programme that provides health insurance for the elderly and disabled. The final section of this article will summarise conclusions about the limited ways in which long-term budgeting might be useful, and the reasons why it is not a direction that budget reformers should follow.

2. Annual Budgeting, Long-Term Budgeting, and the Goals of Budgeting

"Budgeting is supposed to contribute to continuity (for planning), to change (for policy evaluation), to flexibility (for the economy), and to provide rigidity (for limiting spending)… Obviously, no process can simultaneously provide continuity and change, rigidity and flexibility. And no one should be surprised that those who concentrate on one purpose or the other should find budgeting unsatisfactory." (Wildavsky, 1978: 501)

2.1. Goals for budget processes

As Aaron Wildavsky reminded us, the goals of any budget process are multiple and potentially conflicting. These themes go beyond what Robinson (2016: 30) calls "the main objectives of budgeting." He emphasises "aggregate fiscal discipline", "allocative efficiency", and "effectiveness and efficiency of expenditure" or, in the more recent jargon, "value for money". The OECD Recommendations and other literature (Axelrod, 1988; Lewis and Hildreth, 2013; Rubin, 1997) provide a much broader view of budgetary values that should be familiar to most readers.

2.1.1. Budgeting and representation

One well-known goal is to enhance **accountability:** of the government to the citizens and the executive to the legislature. Publishing plans and promises and then auditing performance provide ways for the citizens and their representatives to direct and/or oversee the government. Accountability thus is served by the norm of **transparency:** decisions are made in some visible way, with accurate reporting of how revenues are gathered and money spent. Both are major themes of the OECD Recommendations.[6] Budget processes also are intended to help the legislature or political executive **control** the executive agencies, including to ensure that they spend in the way intended and no more than the amount intended. In Wildavsky's (1978: 501) words, "Control over public money and accountability to public authority were among the earliest purposes of budgeting."

Representation in the form of responsiveness to political leadership is also the principle behind OECD's (2015a: 6) recommendation that processes "closely align budgets with the medium-term strategic priorities of government." It addresses a concern that budgets tend to be frozen into set patterns, so not responsive enough to election of new governments. This function can be overstated as a presumption that each year's budget should "**set priorities**." In practice there are good reasons why budgeting is usually incremental, with modest changes in the priority of most policies (Schick, 2009; White, 1994). Shift points (Dempster and Wildavsky, 1979) are punctuations in normally stable equilibria (Baumgartner and Jones, 1993). Nevertheless, a budget process that could not accommodate changed preferences because of events (such as 9/11 or the collapse of the Soviet Union) or elections that change the governing coalition would violate the basic goals of representative government.[7]

The budgetary literature tends not to emphasise as much another aspect of representation, but that may be because it is taken for granted. A democratically accountable budget process is one that will not systematically distort budgeting to favour any specific group or interest in society at the expense of others. Budget processes should be **procedurally fair** – or, at least as fair as the rest of the political system. As part of this fairness, budget theorists have argued that budgetary staff must provide **neutral competence** in budgeting.

2.1.2. Economy and efficiency

Although frequently conflated, economy and efficiency are not the same (Simon, 1997; Wildavsky, 1966). Economy means, simply, limiting spending. It is the dominant goal for many participants in budget processes, especially participants who represent wealthier voters who are likely to pay more of the taxes that finance spending. Budget process reforms frequently are adopted as part of an economy campaign. But efficiency is a more fundamental goal, in part because economy can be, from a value-for-money perspective, wrong-headed. Economy could be served by eliminating highly useful programmes, or cutting programme spending in a way that reduces their output even more, thereby giving citizens a worse deal than they received before. A focus on efficiency requires no ideology, and making efficient decisions is, in principle, the most neutral of competences.[8]

Efficiency itself has multiple meanings. The most significant distinction for budgeting is between seeking efficiency in the operations of individual programmes (as in traditional budgeting, which Wildavsky called "pure efficiency") or to make the most "efficient" choice about the package of programmes financed (in Robinson's terms, "allocative efficiency"). "Performance Budgeting" in its many forms promises to create efficient choices among programmes. In practice, pure efficiency at the programme level is much, much easier to pursue than any version of efficiency that includes the choices among programmes (White, 2012a).[9] The pursuit of efficiency at the programme level, however, is one of the core tasks of traditional budgeting – checking on agency proposals by "scrubbing the estimates." If efficiency can be increased by improving agency management, enabling that improvement is also a goal of budget processes. Making management more difficult would be a failure.[10]

2.1.3. Budget totals, the macroeconomy, and "balance."

The most visible set of goals involves **totals for revenue, spending, and their difference** (the "balance"). The relative priorities of spending, revenue, or balance values varies among policy-makers. In general, limiting deficits is a more consensual norm than limiting either spending or revenues. This need not mean a "balanced budget." Instead, **balance** as a goal means choosing a difference between taxes and spending that is viewed as reasonable within that political unit (Rubin, 1997), such as the Maastricht standards for the European Union. The OECD (2015a: 6) calls for "clear, credible and predictable limits for fiscal policy," rather than the narrower "balanced budget."

Some participants in politics view balance from a distrust of debt by analogy to household debt (White, 1998a) or of the freedom given politicians if they are able to borrow (Savage, 1988). Most policy-analytic arguments about the proper budget totals, however, at least claim to be based on beliefs about **economic or fiscal policy**. Different perspectives then have very different implications for budget totals.

The *demand management* approach, derived from Keynesian economics, says that the right balance is the level of deficit or surplus that will have the proper effect on aggregate demand – stimulus to increase employment, or contraction to slow inflation. It therefore focuses on the balance and assumes that should change with economic conditions. An alternative approach, particularly prominent among American economists, asserts that budgets should be used to increase *national savings*, so de-emphasises response to macroeconomic fluctuations (White and Wildavsky, 1991) and promotes budget surpluses (White, 2003). The savings argument, unlike demand management, sets no standard for totals in any given year: more savings is always better.

A third view at least purports to establish *financial market confidence* as the core standard for the use of the budget to shape the economy. It claims the markets will punish the nation for whatever budget totals the advocates for this approach do not like. The argument could in principle be used for any policy: the deficit-increasing mix of Reagan administration initiatives in 1981, the deficit-reducing initiatives of the Clinton administration in 1993, or the Trump administration tax cuts. Nevertheless, the usual claim is that deficits must be lowered because, otherwise, high real interest rates will torpedo the economy (White and Wildavsky, 1991; Woodward, 1994). Since participants in financial markets are assumed to be forward-looking, expected future deficits could be as damaging as current ones. The argument persists in spite of substantial contrary evidence.[11] Last but in the U.S. at present not least come arguments that *the government is too big*, and that size itself – both taxes and spending – harms the economy. A telling example was the George W. Bush administration's argument that taxes should not be raised to pay for new "homeland security" spending "because of the economic distortions introduced by the tax system" (Office of Homeland Security, 2002: 65).[12] This view is the core fiscal policy of the current Republican party, in which claims about the need to cut entitlements due to their long-term budgetary effects are common but a massive tax cut which increased projected deficits by USD 1.8 trillion over ten years is just fine (CBO, 2018; Stein, 2017). The most obvious budget process reform based on this view is proposals to set fixed limits on spending or taxes as a share of the economy.

Readers must have their own opinions of the merits of these views. Each is based on ideologies or distributional preferences. Therefore standards for evaluating budget totals are one of the most important political inputs to budgeting, and designing the budget process to favour a particular economic approach must be controversial at best and economically damaging at worst.

2.1.4. Honesty and conflict management

Two other standards are crucial for evaluating any budget process, even though they may be taken for granted and not stated as explicit goals. The first is that **budgets should be honest and accurate**. Budgets built from fake estimates or on deceiving the public about what is included duck accountability, are not transparent, ignore or fake efficiency, do not reveal the actual economic policy, and misrepresent priorities. The OECD therefore made providing for the "integrity and quality" of budget decisions its tenth recommendation, mentioning measures such as independent audit and forecasting institutions.[13] Annual budget processes are repeated games in which the victims of lies can respond the next year, and that might encourage honesty. Nevertheless, there can still be rewards for deceptions that are clever enough to not get caught, sometimes the deceiver has allies who can protect it, and sometimes honesty is in hardly anyone's immediate interest.[14]

As the last caveat suggests, in practice, the goal of honesty may be violated because of another goal: **budgeting must enable decisions without overwhelming the system with conflict**. Making a budget might sound like an optimisation problem on many variables, but that would ignore the fact that different people would optimise, or satisfice, in different ways. The potential for conflict is maximised by peculiarities of budgeting as a social choice problem. The core conflict within budgeting involves mismatches between **preferences about details and preferences about totals**. Preferences about details for spending and revenue tend strongly to sum to deficits that are larger than preferences for deficit totals.

The traditional political theory of budgeting (Wildavsky, 1964) frames this conflict as between budgetary "claimants" and "guardians." In this view selfish "special interests" in

programmes or avoiding taxes oppose and sometimes block pursuit of the "general interest" in lower deficits. Budget-makers see themselves as the guardians of the general or public interest in more controllable, sustainable, responsible (choose your adjective) totals.

A less common theory, however, may be more accurate, especially under current conditions. The guardian/claimant distinction, and the guardian role, may apply better in situations where the totals are generally acceptable, so the challenge only is to prevent deviation, then when totals are already unpopular. In that situation, an inconsistent social choice problem, identified most clearly by Anthony Downs (1960), appears more fundamental.

In Downs' words, the package of government programmes always includes "at least one act which any given voter opposes" – in fact it surely includes many more. Because different people or groups want to cut different programmes, however, significant packages of spending cuts or tax increases that would be accepted by majorities are much more difficult to identify. Hence consistent individual preferences (each person could balance the budget) sum to inconsistent social preferences (no majority for any specific way to do so).[15]

From the guardians vs. claimants perspective, totals can be reconciled with details by simply declaring the totals and forcing the details to fit. Advocates for details are seen as selfish special interests so should be subordinated to the disinterested guardianship about totals. The OECD, accordingly, strongly endorses "top-down budgetary management" (2015a: 6). But this does nothing to ensure that there is any set of details that can fit the total and win majority support. Opponents of any measure do not have to feel like hypocrites because they do support alternatives that would fit the totals. So the total for the top does not produce moral suasion for compromise. A set of totals that looks reasonable without considering the details might be viewed as damaging by majorities once the details are filled in.[16] So in normal budgeting consideration of all the consequences leads to adjusting preferences about details and totals to each other in an iterative process – rather than simply setting a total.[17]

2.2. Annual vs. long-term budgeting, in principle

Although the traditional budget *process* or *schedule* in both the United States and other countries has been annual (Wildavsky, 1978), that has never meant that all *decisions* were made for only the following year (Caiden, 1982). Just as families will make long-term commitments such as mortgages, buying cars, and committing to pay a child's college tuition, governments engage in some activities for which they make commitments for multiple years: such as buying an aircraft carrier (they take a while to build), or committing to pay pensions (such as government employee pensions, or Social Security), or promising to pay back loans (much like a home mortgage). Yet almost all governments have had annual budget processes in the sense that each year they reviewed and tried to project what the spending and revenue totals would be if they kept doing what they did before, and considered whether to make changes in budget details in order to achieve different totals.

2.2.1. Annual budgets and the purposes of budgeting

Annual budgets fit with representative government for a series of reasons. One is that they serve the goal of controlling agencies, by setting and enforcing targets for their spending. Annual decisions also involve a time frame that voters and legislators can understand and assess, comparable to the standards used to evaluate performance in any other organisation (imagine if investors were expected to rely on five-year rather than annual reports!).

In annual budget processes, Central Budget Agencies and the legislature can review agency plans to search for *ex ante* efficiencies. Annual decision-making fits best with this pursuit of efficiency, because many of the factors in agency production of goods and services, such as prices of fuel or wages, change frequently. Demand factors for some programmes change with events in the economy. Plans for longer than a year can easily be superseded by events.

The theory of economic management which emphasises aggregate demand also fits best with annual budget decisions. Changes in the extent to which government spending and taxes add or subtract money from the private economy will influence short-term inflation, unemployment, and interest rates. Annual budget decisions are not as effective a tool for fiscal policy as was assumed when Keynesian demand management was first implemented by governments. Legislative responses to economic change are slow and often poorly timed (e.g. the spending occurs when the slump has ended). Therefore the best response to economic cycles is "automatic stabilisers": programmes such as the graduated income tax and unemployment benefits that are countercyclical. Nevertheless, the annual budget serves fiscal policy goals by forcing a review of trends and a statement of the government's approach. Legislated fiscal changes also are highly justified in extreme circumstances such as the shock created by the global financial crisis.

As discussed above, the repeated interactions within annual budget processes on balance also can encourage relative honesty. For these and other reasons, the traditional annual budget process has persisted in spite of many criticisms. We turn now to those criticisms, and to whether long-term budgeting is likely to be an improvement.

2.2.2. The flawed claims for long-term budgeting

Advocates for long-term approaches may claim that they make government more transparent by highlighting consequences that would otherwise be ignored. Information can only improve transparency, however, if it is true. The United States represents the international state of the art for long-term forecasts, both in terms of the sophistication of methods and having multiple, competing sources.[18] Nevertheless these forecasts are highly unreliable guides to budget totals far in the future. As Rudolf Penner has written, if the purpose is simply to call attention to long-term issues, "the huge inaccuracies do little harm." But one should be very cautious about assuming any budget forecast is good information because, as he wrote, "it has been shown that forecasts become rapidly less reliable as the forecast period is extended" (Penner, 2001: 14, 12).

A further argument asserts that long-term budgeting improves representation by bringing in the concerns of future generations. In Eugene Steuerle's version of the argument, both entitlements to pensions and health care and Republican tax cuts, by shaping future spending and revenues, mean that "dead men" rule. "Yesterday's policymakers have robbed their successors of their fiscal freedom" (Steuerle, 2014: 11). Any programme, such as pensions, that makes long-term promises is suspect because it is "set in law and, in the real world of policymaking, changing the law to break past promises to voters is easier said than done" (Steuerle, 2014: 9). He therefore calls for immediate long-term measures to reduce entitlements for the elderly.

Yet the power of the status quo applies to any status quo: for example, privatizing Social Security would make it very hard to restore the current system. Any automatic Medicare spending cuts would have the same advantage whether or not they look like good policy

when the time comes. If enforcement procedures are protected by supermajority provisions, as is commonly proposed, they would have a further advantage. Either way, decisions made in 2018 will influence results in 2048, so why is trying to force cuts now more democratic than trying to enforce promises about benefits? The long-term approach is particularly suspect when its advocates, as in the Bowles-Simpson plan, set rules about the "size of government." If one wants to avoid foreclosing choices for future voters, legislating automatic mechanisms that would be backed by the power of the status quo and target pain on particular future voters does not seem an obvious approach.

In practice, some public policies, especially pensions, make very little sense if they cannot include long-term and fairly binding commitments.[19] In the United States, the big federal entitlement programmes also have been extremely popular for a long time. The political pattern that campaigners to reduce entitlements want to "fix" reveals the point: proposals to cut benefits (as opposed to payments to medical providers) very rarely pass. Over fifty years of experience with Medicare and eighty with Social Security show that support for those programmes has persisted across "generations." The whole framing in terms of generations should be challenged, because aging is part of the life cycle. Any day's taxpayers are the future's beneficiaries, and making their health and income when they become elderly less secure may not seem like helping them.

Budget analysts and policy-makers can reasonably disagree about what form of "binding the future" is better policy (Rubin, 2009; White, 2009a). Yet claims that capping entitlements would make budgeting more representative *in principle* are highly questionable. They may be attractive from some public finance perspectives – Steuerle's "fiscal freedom" may look similar to the IMF's and OECD's advocacy for "fiscal space" (Heller, 2005; Marcel, 2015; Schick, 2009; Vallmalle et al., 2014). Social insurance advocates' arguments that programmes can and should have dedicated funding (showing the public is willing to pay for them) is opposed by public finance specialists' dislike for dedicated revenues. Nobody should imagine, however, that these disciplinary perspectives are representative.

Advocates for longer time frames frequently argue that this will increase honesty and accountability by reducing budgetary gamesmanship (GAO, 2011: 3). U.S. experience shows that they change the repertoire but not prevalence of budgetary evasions and deceptions. The 2001 tax cuts, for example, were kept within ten-year budget control rules through having them all expire 9 months early – creating a massive and automatic tax increase that reasonable people (and the law's sponsors) could expect would not be allowed to occur (Horney and Kogan, 2007). A ten year budget horizon has allowed budget-makers to increase the deficit in the near future but promise to "offset" those increases in the ninth or tenth year – a process that can be repeated year after year.[20] My account of specific policy areas below will show many examples of the ways long-term "plans" get gamed.

Under the right circumstances, keeping score of budget results for more than one year serves the goal of economy by making it easier to pass deficit-reducing legislation. Once the U.S. deficit became embarrassingly large in the 1980s, it was easier to get credit for making a dent in it by spreading action over a number of years. The 1990 deficit reduction package, for example, was described as a USD 482 billion five-year package – which sounds much better than the USD 33 billion deficit reduction in the first year. Unfortunately, long-term budgeting can also lead to claiming credit for big savings that may not occur because the details have not been specified.

Long-term budgeting also has logical implications for other budgetary values. From the standpoint of efficiency, its advocates may assume that, by simply capping the spending for some agency and telling its managers to live within the allocation, they will "incent" the managers to operate in the most efficient way. But that simply assumes away the work of discovering and validating efficiencies. Normally, strict budget constraints encourage short-term coping such as starving investment. The only exception to this concern would occur if short-term investments are needed to achieve long-term savings. Then a long-term focus may counter budgetary shortsightedness. Unfortunately, arguments about long-term savings are often wrong, and sometimes intentionally deceptive, even if attractive; so long-term budgeting could increase short-term costs without helping in the long run. This problem will be discussed further in the section on health care costs.

The campaign for long-term budgeting is associated with beliefs that the primary goal for budget totals should be either to reduce deficits or to limit both spending and taxes, as in the Bowles-Simpson plan. It therefore is biased against the demand management view of economic policy. In principle, demand management can operate from any baseline balance, e.g. as variations around some norm associated with savings targets. In practice, any provisions to leave room for such responses to economic distress are suspected of being a way to bust the necessary fiscal constraints. The Peterson-Pew Commission, although a fervent supporter of long-term "fiscal rules" (2011a, c), explained the problem nicely (2011b: 19):

> *There are questions about how to formulate this long-term rule in a way that is both transparent and sufficiently flexible. The former is necessary… to ensure public pressure is brought to bear when the rule is violated. The latter is necessary to accommodate inevitable short-term shocks that will require deficits and thereby sustain support for the rule over time. However, experience with cyclically adjusted balanced budget rules is insufficient to judge whether they are sustainable both economically and politically.*

In general, by raising the level of concern about totals, and the probability that totals could be deemed unacceptable, long-term budgeting should increase budgetary conflict and make settling it more difficult. This is a rewording and reframing of the perspective of budget hawks who believe that politicians are avoiding the tough (read: conflictual and difficult) choices and so they need to be forced to confront them through either information or procedures that create greater pressure to cut spending (or less commonly, raise taxes).[21] *More challenging goals for the totals should make it more difficult to reconcile preferences about details and totals.*

2.3. Summary

Compared to traditional annual budgeting, efforts to seriously budget for the long-term might make budgeting less honest and accountable, rather than more. They can make pursuit of efficiency more difficult, require that decisions be made based on less reliable information, and increase conflict. The possible effects discussed above are summarised in Appendix 1. The sections of this article which follow provide more evidence for those descriptions.

The discussion to this point, however, has excluded perhaps the most basic question: whether long-term budgeting is even possible. The following sections of this article address a series of difficulties that are illustrated by U.S. experience. The arguments made in the following sections apply to other nations as well, but in a few cases are especially relevant to the United States.

We will see that multiyear caps on discretionary spending separate decisions about details from decisions about totals in ways that are hard to sustain because of the consequences for details. The U.S. Social Security programme is the best case for long-term budget planning, but it is very difficult to forge agreement about how to do that. Both underlying ideological disagreements about the programme and disagreements about scorekeeping within the budget community create problems. In the case of U.S. Medicare, there is simply no good way to make long-term budget allocations. Health care spending control is a short-term problem; the best way to control spending in the long-term is to control spending each year. Decisions made in one year may be superseded long before the future years in which they were supposed to shape budget results. In short, ostensible long-term decisions may be "unsustainable," in part because they do not satisfy many of the goals of budgeting.

3. Caps, Enforcement, and Discretionary Spending

Many U.S. proposals to reduce deficits over the long run through some sort of enforcement procedure target enforcement on entitlement programmes. Some recommend backup tax increases. To date, however, legislation that actually passed has targeted enforcement on discretionary spending: bureau programmes that are annually appropriated, such as the Army, Environmental Protection Agency, and National Institutes of Health. Congress and the president have agreed on five laws with such provisions: the Gramm-Rudman-Hollings Act of 1985 (GRH); the Omnibus Budget Reconciliation Act of 1990 (OBRA-1990; and in particular the Budget Enforcement Act, or BEA, that was Title XIII); the Deficit Reduction Act of 1993 (also known as OBRA-1993); the Balanced Budget Act of 1997 (BBA-1997); and the Budget Control Act of 2011 (BCA).

The idea of multiyear caps developed in part from increased time frames for the Congressional Budget Resolution. This Resolution, a set of targets and constraints first created in the Congressional Budget Act of 1974, at first only provided figures for the following budget year: so the resolution adopted in 1978 set figures for fiscal year 1979. Beginning in 1980, in part to limit some games and in part to make deficit reductions seem larger, the period was expanded to three years. So the resolution adopted in 1983, for example, went through FY 1986. The time horizon for both budget resolutions and real budget decisions was expanded to five years in 1990; the deficit reduction package negotiated by President Bush with Congress covered a five-year period and the first step was to enact a (previously long-delayed) budget resolution outlining the plan. For a few years around the turn of the millennium the time frame for budget resolutions was increased to ten years; it has since varied between ten and five, if Congress can agree to pass a resolution at all (Heniff, 2015). But both the expansion to five-year resolutions and the development of discretionary spending caps were in part reactions to Gramm-Rudman-Hollings.

3.1. Gramm-Rudman-Hollings

In 1985, a coalition of senators took legislation to raise the debt ceiling hostage, threatening default on existing debt unless Congress passed legislation to force a balanced budget.[22] Since there was no majority for any particular way to do that, they demanded a process with phased deficit reductions (ultimately five increments of USD 36 billion each, to balance the budget at the end of five years) that would be enforced by automatic cuts ("sequesters") to discretionary spending programmes. We see here the origin of multi-year deficit reduction through "enforcement" provisions. When House Democratic leadership

decided that desire to "do something" about the deficit meant they would lose conservative southerners so had to adopt some version of GRH, they worked to make it as noxious as possible to Republicans. Nobody claimed that the discretionary cuts were desirable, and almost everyone involved rationalized them as so terrible that, rather than letting them go into effect, the other side would have to give in and do something else.

The political theory of GRH was flawed because all sides had already showed that they cared more about entitlements and tax policy than about discretionary programmes, by excluding the first two from the sequester in the first place. It was easier to threaten cuts in discretionary programmes in general because they did not have to be specified in advance, so the voters would not know what to protest against. But in order to make sequesters as threatening as possible, the law was written in a way that made it as arbitrary and irrational as possible.

The result should have been predictable. Hardly anyone was willing to give up their priorities in order to avoid sequestration, because they thought the sequester terms were so obviously horrible that the other side would have to give in. Since the threat did not create agreement, when the crunch hit each year the only response on which majorities could agree was to combine a small amount of real deficit reduction with a larger amount of flim-flam. In the three years prior to passing GRH, Congress and the President passed a major deficit reduction package in 1982, a modest but real one in 1984, and a Social Security refinancing package in 1983 that included significant policy changes (especially in Medicare) that would reduce the unified budget deficit. Between GRH and OBRA-1990, they did much less.

The GRH experience led a sufficient number of centrist policy-makers to draw some useful conclusions. The first was that holding discretionary spending hostage to force action on entitlements and taxes didn't work. Second, if policy-makers want to cut entitlement spending or raise taxes they should do that directly. Third, attaching enforcement to specific deficit targets is a bad idea because outside events can require much larger cuts than expected in order to meet the targets. Fourth, targets for total discretionary spending should bear some plausible relationship to acceptable details.

3.2. The Budget Enforcement Act and 1990s extensions.

The Omnibus Budget Reconciliation Act of 1990, and especially its Budget Enforcement Act (BEA) section, reflected all these conclusions.[23] The BEA created discretionary spending caps as part of a broader deficit-reduction package that also included, among other provisions, Medicare savings and tax increases. The caps were defined as specific numbers for each of the following five years, but the law allowed for automatic adjustments in response to some economic factors (CBO, 1990: 5). BEA kept a sequester process, but sequesters would only be triggered if Congress acted to increase the deficit beyond what OBRA-1990 would have produced under the actual economic circumstances. So the sequester was to protect the law's provisions, not to force future legislation. A series of points-of-order were designed to further constrain Congress to offset any new spending or revenue reductions. Both the points of order and sequester process were called "PAYGO" (pay-as-you-go) rules.

This basic approach was continued in the 1993 Deficit Reduction Act and the 1997 Balanced Budget Act. BBA-97, however, differed from the first two laws in two significant ways. Because it was passed in conjunction with the Tax Relief Act of 1997, it made no

contribution to the balanced budget that emerged (to general amazement) by the end of 1997.[24] In addition, while the discretionary spending caps in the 1990 and 1993 laws were pretty much enforced, the 1997 caps were spectacularly overshot (CBO, 2003; GAO, 2002). The reasons for this difference in enforcement are instructive.

For the first few years, the details matched the totals because of a fortunate budgetary event, the collapse of the Soviet Union, and in 1990 a deal about the details between congressional Democrats, especially Senate Appropriations Committee Chair Robert C. Byrd (D-WV), and President Bush's OMB Director, Richard Darman.[25] The former allowed defense outlays to be cut by about USD 30 billion between FY 1990 and FY 1998, declining from 5.1% of GDP to 3.0% of GDP. Meanwhile, the 1990 caps allowed an *increase* in nondefense discretionary spending from 3.4% of GDP in FY 1990 to 3.6% in FY 1992.

The BEA targets for fiscal years 1994-1995 were also enforced, and actually lowered in the 1993 legislation, because of a powerful anti-spending mood in Congress after Ross Perot's 1992 presidential campaign. Conservative Democrats demanded a spending "freeze" early in 1993, and helped kill President Clinton's proposal for a short-term budgetary stimulus. Supplemental appropriations that under the BEA would normally have been allowed as an emergency were largely offset (Hager, 1993a, b, c; Towell, 1993). The Republican victories in the 1994 election put control of Congress, and especially the House, in the hands of a majority that made cutting domestic spending its highest priority. Although they could not enact their "revolution" (Drew, 1997; Joyce and Meyers, 2001), some discretionary spending cuts should have been expected even if there had been no caps.

To summarise, the caps for the first three years were based on expectations of defense constraint that was enabled by events and included a temporary *increase* in nondefense discretionary spending. After 1993 the caps were enforced partly by the reduced need for defense spending and partly by a strong anti-spending mood, driven by the 1992 and 1994 elections. Neither set of caps forced spending restraint that was not likely to have happened anyway.

The caps enacted in 1997 then were exceeded by large margins for two basic reasons. First, they were not needed to balance the budget – as CBO (2003: 114) later noted, "the surplus eliminated the essential purpose of the [caps] – to combat and control deficits." Second, after years of constraint legislators in both parties wanted to spend more on some specific programmes. Republicans, for example, wanted to spend more for transportation projects and biomedical research.[26] Republican leaders thought they had lost the veto battles with President Clinton in 1995 and were worried about maintaining their majorities. Republican leaders of the appropriations committees didn't think they could pass bills with the required constraint on the details.[27]

Therefore policy-makers avoided the caps through procedural moves that were available before but now had majority support. These included advance appropriations, payment delays, and defining more spending as "emergencies" so not subject to the cap. After the surpluses appeared, emergency designations grew to over USD 30 billion per year from FY 1998 on.[28] Beginning in 2000 those measures were not large enough, so the caps were simply raised within some convenient piece of legislation. Sequesters were prevented by legislatively eliminating balances from the PAYGO scorecards (CBO, 2003, 116; also GAO, 2002, 11-12). By fiscal year 2001, outlays exceeded the caps by 15%, nearly USD 85 billion.[29] In short, neither the immediate budget situation nor actual preferences about details supported enforcement of the caps adopted in 1997, so they were violated.

3.3. Return of the caps: 2011 to the present

The story of the current round of caps is incomplete, but fits with scepticism about both the honesty and reliability of the approach.

The 2011 Budget Control Act combined Gramm-Rudman with the cap approach from the 1990s, only for ten years instead of five. It first created a set of discretionary spending caps for fiscal years 2012-2021. Relative to CBO's baseline, this involved cutting budget authority by 4% in FY 2012, rising to nearly 9% by FY 2021.[30] In this sense it was similar to the 1990, 1993, or 1997 plans. But it also called for a Joint Committee process that was supposed to yield another USD 1.2 trillion of deficit reduction over the same ten years. If the Joint Committee failed, a backup sequester, as with GRH, would go into effect. The size of this sequester, however, was defined in advance: it would cut spending by a further USD 984 billion from FY 2013 through FY 2021.[31] Half of the savings would come from defense and half from domestic spending. A portion (just below 35%) of the domestic sequester would be applied to entitlements (mainly Medicare payments to providers), but about 83% of the total sequester would come from discretionary spending.[32]

It should have been no surprise that a political system that could not agree on different deficit reductions in July of 2011 could not agree on them a few months later. Therefore the Joint Committee process failed, and the sequester occurred in 2013. The law then automatically lowered the caps for subsequent years. The overall effect of the BCA, therefore was to create budget authority limits that were about 14% lower than the CBO baseline for FY 2013, and 15% lower for FY 2021.[33] In policy terms, these cuts were much more drastic than they sound, because the CBO baseline only assumed that spending would increase at the inflation rate from year to year. It thereby did not allow for economic and population growth, and this effect would compound over time. As a result, the baseline already assumed spending would decline from 9.1% of GDP in FY 2011 to 6.7% in FY 2021 (CBO, 2011c: 15). The largest effect of the BCA, then, was to turn the baseline from an estimate into the law; the sequester and other cuts then reduced legally allowed spending in FY 2021 further, to about 5.7% of GDP. Over the long run the expected cuts, therefore, were much more severe than in the 1990s, especially considering that the U.S. military is much more active now than then.

What have been the effects of the BCA, and to what extent has it been enforced? Actual spending figures are not straightforward evidence for two reasons. First, for the first couple of years there were still extra domestic outlays from earlier anti-recession appropriations. Second, substantial defense spending was excluded from the targets as "Overseas Contingency Operations" that in principle would rise or fall with the course of the "war on terror." Its trend, however, was subject to contradictory impulses: the Obama Administration's efforts to decrease those operations, and the temptation to reclassify regular defense spending as "contingency" so as to protect it (CBO, 2016a; Davidson and Booking, 2015; Tucker, 2015).[34] On balance, certainly by 2015 and 2016, the OCO designation was being used to exceed the caps (CBO, 2016a).

OCO manoeuvers aside, by my calculations appropriations for Fiscal Year 2016 were 10.1% below the original CBO 2011 baseline, compared to the 14.3% that would have been expected from the BCA's enforcement.[35] This was largely because of laws moderating the caps, ostensibly in the short term. The 2013 sequester was delayed and modestly reduced as part of the American Tax Relief Act (ATRA), otherwise known as the end-of-2012 "fiscal cliff" deal. The caps were modestly raised again in both the Bipartisan Budget Act of 2013

and the Bipartisan Budget Act of 2015. In each case Congress and the President raised the caps for two years and then claimed that spending would return to the previous capped levels afterwards.[36]

As part of BBA-2015, an extra USD 32 billion was provided for OCO spending, equally divided between defense and nondefense categories (CQ, 2015a). It seems fair to project that OCO appropriations are not likely to decline as much as OCO activities, thereby providing a bit more wriggle room for defense and some international affairs spending under (or out from under) the caps (Reich, 2016).

At the beginning of 2018, President Trump and Congress passed a short-term continuing resolution, providing temporary appropriations for the federal government that included substantial further legislation including the latest "Bipartisan Budget Act." BBA-18 raised the caps dramatically, by about USD 60 billion a year for two years for domestic discretionary spending and USD 80 billion a year for defense spending (Parlapiano, 2018). This time Congress and the President did not pretend to offset much of the increases. Projected domestic discretionary spending for Fiscal Year 2019 remains below the inflation-adjusted pre-BCA figures (Reich, 2018a), and the law still requires that it plummet after two years. There is some reason also to expect Republicans to try to spend less than the domestic caps – as is proposed in President Trump's budget (Davis, 2018) and seen in a variety of technical manoeuvers (Reich, 2018b). So the most recent events both show the weakness of caps based on ignoring details, and that in any given year spending will be driven by the political dynamics of that year.

When offsets were provided in laws that raised the caps, they heavily relied on timing games. ATRA's offsets were mainly back-loaded or, in the long run, cost more than they saved (Driessen and Labonte, 2015; PGPF, 2013a).[37] The offsets for BBA-2013 also were heavily back-loaded (PGPF, 2013b). The offsets for BBA-2015 included some more plausible payment reductions for Medicare, some one-term benefits from selling government assets, and again were heavily back-loaded (Driessen and Labonte, 2015; PGPF, 2015; "Winners and Losers" 2015).[38]

3.4. Lessons of a sort

U.S. experience with 5 to 10-year caps shows, first, why they are attractive short-term political manoeuvers. Agreement is possible because a) the public cannot see who will be hurt – unlike, for example, cuts in Social Security, for which any plan must include specific changes in benefit rules; and b) *the politicians cannot see who will be hurt, either* – because opposing negotiators guess differently about what will be cut in a few years – for example, defense vs. domestic spending. Following the logic explained by Downs, each voter may assume that other peoples' programmes will be cut. The problems arise later, when policy-makers have to fill in the details, and can be blamed for them.

Except in 1990, the totals do not appear to have been based on any coherent understanding of the details or even a plausible rule of thumb. It is especially hard to project long-term figures when over half of the spending is for a category, the military, that is heavily influenced by world events. The "government is too big," "increase national savings" and "satisfy the financial markets" approaches all are used to argue for lower spending, but do not set any specific bounds. Moreover, the totals are subject to perceptual distortions – such as confusing nominal dollars with spending power. Such errors have limited effects when budgeting is for one year, but their distortions compound over longer

terms. In 2011 totals were defined as targets for savings from a baseline, and since the inflation-adjusted baseline was itself, in the long run, quite strict, the long-term result could be much more stringent than the public would understand.[39]

Experience also supports serious concerns about how effectively caps constrain spending. They certainly create procedural difficulties. Yet when Congress and the President wanted to, they have easily exceeded the caps, with no political consequences. When legislation has offset cap increases, it has usually claimed savings years in the future, so that the long-term focus enabled higher deficits in the short term. In general, setting caps without explaining the details involved, and then offsetting some of the effects with what Robert L. Bixby and others call "gimmicks" (CQ, 2015b), does not seem to serve honesty, transparency, and accountability. Whether caps have been met or exceeded has depended largely on the political conditions at the time: public moods about deficits, elite pressures, and the partisan division within the government. Those are also the factors that normally determine annual budget action. So, while long-term caps may have had some impact on spending and deficits, much of the results in the cases reviewed here would have happened anyway. Caps have been input into later decisions but not actual long-term commitments.

Last but not least, at some points discretionary spending caps have been associated with spectacularly broken budget processes. Nevertheless, it would be unfair to conclude that the caps in the United States have caused process collapse. It makes more sense to conclude that both the caps and the collapses have been produced by the combination of intense budgetary pressure and disagreement about how to respond to that pressure.

4. "Social Security" in the United States[40]

In the U.S., the term "Social Security" refers to a social insurance package of age-based and disability-based pensions: Old Age, Survivors and Disability Insurance (OASDI). The old-age portion, OASI, was enacted in 1935 and first paid benefits in 1940. Disability Insurance, DI, was enacted in 1956, with first benefits paid in 1957. In 2016 OASDI accounted for 5% of GDP and about 24% of federal government spending (CBO, 2016a: 64).

The programmes in OASDI are funded mainly by a payroll tax, with contributions creating the entitlement to benefits. The contribution rate reached 6.2% of cash wages from both employee and employer (so 12.4% total) in 1990, having been raised many times before. The contributions apply up to a threshold, which in 2018 is USD 128 400. The trust funds also receive income from income tax on benefits and from interest credited on the funds' balances. Therefore benefits are essentially paid from three streams of income: current payroll taxes; current taxes on benefits (which could also be seen as just a reduction in benefits); and the interest created by previous surpluses of taxes over benefits.

Considered in isolation, Social Security has always been budgeted for the long-term. The first Advisory Council on Social Security (1938), whose report set the stage for the important 1939 Amendments, declared that,

> *"V. The planning of the old-age insurance programme must take full account of the fact that, while disbursements for benefits are relatively small in the early years of the programme, far larger total disbursements are inevitable in the future. No benefits should be promised or implied which cannot be safely financed not only in the early years of the programme but when workers now young will be old.*

"VI. Sound presentation of the government's financial position requires full recognition of the obligations implied in the entire old age security programme and treasury reports should annually estimate the load of future benefits and the probable product of the associated tax programme."

As one example of such looking ahead, the original 1935 Report of the Committee on Economic Security estimated, quite accurately, the proportion of aged persons in 1960 and 1975.[41] From its beginning, the programme's financing plans included scheduled increases in the payroll tax to meet expected cost increases.

Contributions to both OASI and DI are paid into trust funds, governed by trustees who report each year on the funds' prospects for the next 75 years. In 1983, the combined funds were expected to have less money than would be required to pay full benefits by around 1 July. In response, Congress and the President agreed to the 1983 Social Security amendments. While getting through the immediate problem was the highest priority, policy-makers also sought to enact changes that would eliminate the long-term actuarial shortfall (difference between projected costs and revenues over 75 years) (Light, 1985; see also Goss, 2010; Kingson, 1984; White and Wildavsky, 1991).

The rationale for this forecasting is that people contribute to Social Security based on the promise of future benefits, so need to know that promise is secure. Benefits are related by formula to enrollees' contributions. So, unlike most programmes, there is a very specific promise and claim to that promise. The claim is not quite equivalent to a contract, because Congress is sovereign and (with the President's support) can break its promises by changing the law. Moreover, the trust fund process establishes that beneficiaries only have a claim to the extent funds are available (see Goss 2010 for discussion). But major reduction in the promise was intended to be difficult: President Roosevelt famously explained that the payroll contributions were "there so as to give the contributors a legal, moral, and political right to collect their pensions…".[42]

The 1938 Advisory Council's statement clearly did not, however, view the programme entirely in isolation, separate from the rest of the federal budget. The quote above emphasises "the government's financial position" as a whole, not simply the programme's.[43] So one of the basic questions about Social Security is the relationship between Social Security's financing and the overall federal budget, which is not as straightforward as even many "experts" believe. The second is to what extent it is really practical to plan for the programme many years in the future.

DI has 75-year projections because it is attached to OASI's financing, and was viewed as a form of retirement protection like OASI (Social Security Administration, 1986). As a result, "most analysis of the actuarial status of the Social Security programme is done on a theoretical basis where the two trust funds are considered on a combined basis" (Goss, 2010: 116). The two funds are treated as interchangeable, to the extent that under current law, the payroll contribution will have been divided six different ways between 1990 and 2019.[44] Nevertheless, the logical time frame for DI budgeting is much shorter than for OASI.

4.1. The trust funds and Social Security within the federal budget.[45]

If spending is likely to grow over time, how can policy-makers plan to meet future costs of benefits? One approach would be to schedule, in the law, future contribution increases to match the spending increases, or spending cuts to match the contributions, or some of both to bring the two into balance. A second would be pre-funding: to build up

surpluses in the trust fund(s) that could be used to pay for some of the future costs – either through interest earnings on the trust funds or interest plus spending down the principal.

As enacted in 1935, Social Security included some moderate pre-funding, but that was pared back for many reasons in the 1939 amendments – one argument being that collecting taxes without paying benefits had helped put the economy back into recession in 1937 (for a further explanation that provides a good introduction to the programme, see Corson, 1940). But, since all covered workers (which then did not include the self-employed and agricultural workers) were paying in, and pay-outs were low for a long time because few workers had made many contributions, the OASI trust fund still far exceeded benefits into the 1950s.[46] From about 1960 on, however, spending and tax revenue had become fairly similar, and as both grew, the trust fund balance shifted to about 100% of annual spending – a prudential margin to cover short-term bad news. At that point the programme could be described as basically pay-as-you go, with some tax increases still scheduled to cover projected spending increases, and a trust fund cushion against bad economic news.

During the 1970s a combination of policy decisions and unexpectedly bad economic news threw the programme out of financial balance. Financing reforms enacted in 1977 failed largely because of miserable economic performance over the following five years, and the actuarial projections then showed the trust fund balance falling to zero, so inability to pay full benefits, by July 1 of 1983. This led to the Social Security Amendments of 1983 and a policy change to more of a pre-funding approach (for accounts see Svahn and Ross, 1983 and Light, 1985).

The 1983 law accelerated scheduled payroll tax increases, but did not change the projected rate of 12.4% combined (for OASDI) in 1990. Nor did it schedule further tax increases in the future. It included one significant benefit cut in the future, an increase in the Normal Retirement Age from 65 to 67, which would be implemented in two stages over the years from 2000 to 2022. Its major other provisions were a mix of more immediate modest benefit cuts or tax increases, with the lynchpin being one measure, taxing benefits for higher-income beneficiaries, that each political side could count as a "win" (Democrats as a tax, Republicans as a cut). These measures were projected to build up surpluses to help finance costs through the baby boom generation's retirement.[47] In essence, the baby-boom "generation" would pay higher taxes than needed to pay for its predecessors' retirement, in order to help finance its own. Current estimates say it didn't quite work: the trust fund balance is expected to hit zero in 2034, when the oldest baby boomers will be 88 and the youngest will be 70. Still, starting at near-zero and ending up with a positive balance for the next fifty years is pretty good, though not quite as good as it looks.[48]

In 2015 the Social Security Trustees projected that costs in 2089 would be 17.97% of taxable payroll, and income 13.32%, so the difference 4.65% of taxable payroll. By trust fund logic, however, the actuarial deficit – the change in 2015 that would finance the programme in 2089 – was 2.68% of taxable payroll. The reason is that the immediate change would create surpluses that would build up over time, and then could finance later spending by being used up (Board of Trustees OASDI, 2015: 4).[49] Thus, the Trustees and others have long argued, acting sooner will enable less drastic change (Board of Trustees OASDI, 2015; CRFB, 2015).

4.1.1. *Are the trust funds "real"?*

Many budget experts and economic commentators, however, would agree (in more gentle words) with Allan Sloan's (2010) description of the trust fund logic as, "ridiculous

accounting." The problem is the nature of the assets in the trust funds. It is not just a technical dispute because it puts in question most of the arguments for planning ahead.

In some countries, such as Canada and Sweden, national pension funds are allowed to invest surpluses in private instruments such as bonds and equities (OECD, 2016; Severinson and Stewart, 2012; Tedesco and Shecter, 2016). In the United States, however, the Treasury is forbidden to invest surpluses in the private economy because that looks like Socialism. So it holds the surpluses as federal debt instruments. The critics' point is that when Social Security spends interest or spends down the principal, Treasury has to get the money somewhere, which means from taxes or borrowing. But if there were no trust funds, it would do the same – so the trust funds would seem to be irrelevant.

The 2001 President's Commission to Strengthen Social Security was able to quote many authorities to this effect. It cited President Clinton's OMB ("(t)he existence of large Trust Fund balances… does not, by itself, have any impact on the Government's ability to pay benefits") the Social Security public trustees, CBO, GAO, and the Congressional Research Service to the same effect (President's Commission, 2001: 17-19). This view has also become conventional wisdom for many journalists (e.g. Jackson, 2011; Montgomery, 2011).

Yet *if the trust fund is useless, then what is the benefit of the early action demanded by advocates of long-term budgeting?* There are two arguments, both typified in GAO's (2017: 22) statement that, "acting soon would allow any adjustments to be smaller and spread across more generations of participants and be phased in so that affected individuals could have time to adjust their retirement planning." The first presumes that earlier action will make it easier to pay benefits in 2034, but if trust fund balances don't count, that isn't true. As for the second, if the benefit cut in 2034 will be the same either way, then phasing it in ahead of time hurts anyone who retires before 2034, but it doesn't help anyone who retires then and after. If the cut will be the same either way, they are better off waiting and seeing if it happens – after all, it might not. Moreover, a rational retiree in 2025, if told that the government would cut their benefits each year leading up to 2034 so as to help "phase in" the pain of the cut, would say, "no thanks, let me have the full benefit up to 2034, and if I want to I'll save the difference each year." Having the government give her less earlier surely won't help her cope.

Aside from the fact that it doesn't support the policy its advocates promote, scepticism about the trust funds is also a highly dubious financial and political analysis. The 1938 Advisory Council explained why:

> *"The United States Treasury uses the money realized from the issuance of these special securities by the old-age reserve account in the same manner as it does moneys realized from the sale of other Government securities. As long as the budget is not balanced, the net result is to reduce the amounts which the Government has to borrow from banks, insurance companies, and other private parties. When the budget is balanced, these balances will be available for the reduction of the national debt held by the public.*
>
> *"Members of the Advisory Council are in agreement that the fulfillment of the promises made to the wage-earners included in the old-age insurance system depends upon, more than anything else, the financial integrity of the Government. The members of the Council, regardless of differing views on other aspects of the financing of old-age insurance, are of the opinion that the present provisions regarding the investment of the moneys in the old-age reserve account do not involve any misuse of these moneys or endanger the safety of these funds."*

Past surpluses reduced federal borrowing from, so debt owed to, the public. Less debt (interest rates being equal) means lower interest spending in the future. Lower spending on interest means more money available to pay for other government activities.

The situation is analogous to a person preparing for retirement. She could invest any extra cash so that future unearned income could replace earned income.[50] But she could also pay off her mortgage, reducing future housing expenses. Nobody would say that reducing future costs by paying off the mortgage is "useless" as a way to prepare for retirement. Reducing future government interest costs is exactly the same principle. In 2018, the trust fund interest earnings account for what the government does not have to pay to outsiders because of the previous surpluses.

In short, the balance sheet effects of accumulating surpluses are not at all "ridiculous." But those who want to call trust fund surpluses fake also make a further, political, argument. They claim Social Security's surpluses made the deficit look smaller than it really was, so Congress and the President simply spent extra money (or cut taxes more) in the rest of the budget (CRFB, 2011b; Munnell, 2005; Spivak, 2010). In a separate paper (White, 2012b: 13-25) I give extensive reasons to doubt that claim. The economic modelling (Smetters, 2003, 2004) cited to support the argument has major technical flaws (Hungerford, 2009) and is based on a strange construction of budget process and history. The historical record provides no evident examples of the supposed fiscal illusions from Social Security surpluses reducing budget responsibility. One cannot even make a case that the 2001 tax cuts were enabled by Social Security surpluses, as CBO's forecast at the time still showed an on-budget surplus after the revenue losses. There is much better reason to agree with Alicia Munnell (2005: 3), who judged that, "neither administrations nor Congress pushed less hard to restore balance on the non-Social Security side because of the surpluses in the trust funds." Therefore the surpluses are highly likely to have reduced federal borrowing.

In the United States, the history of budget-making as I interpret it suggests that the trust funds are real, and some portion of future costs can be pre-funded by building them up. This is an argument for long-term financial planning for Social Security. The next questions are whether costs and revenues can be forecast accurately, and how likely it is that policy-makers could agree on long-term plans.

4.2. Accuracy and acting on projections

How accurate, then, are long-term projections of Social Security costs and revenues? Clearly there is some uncertainty, which is why the actuaries create high-, low-, and intermediate cost forecasts.[51] Estimates depend on assumptions about dozens of factors. Just a few include birth rates, death rates, immigration rates, the ages of immigrants, trends in disability, growth in national income, how that growth is distributed between labour and capital, what portion of the labour share is above and below the maximum for OASDI contributions, interest rates and labour force participation.

Part of the future is relatively predictable. Spending should rise substantially relative to payroll tax revenues and GDP because the number of beneficiaries will rise relative to the number of workers paying taxes. The effect of other factors, however, is much less predictable, and that has been visible from changes over time in the projections of long-term actuarial balance.

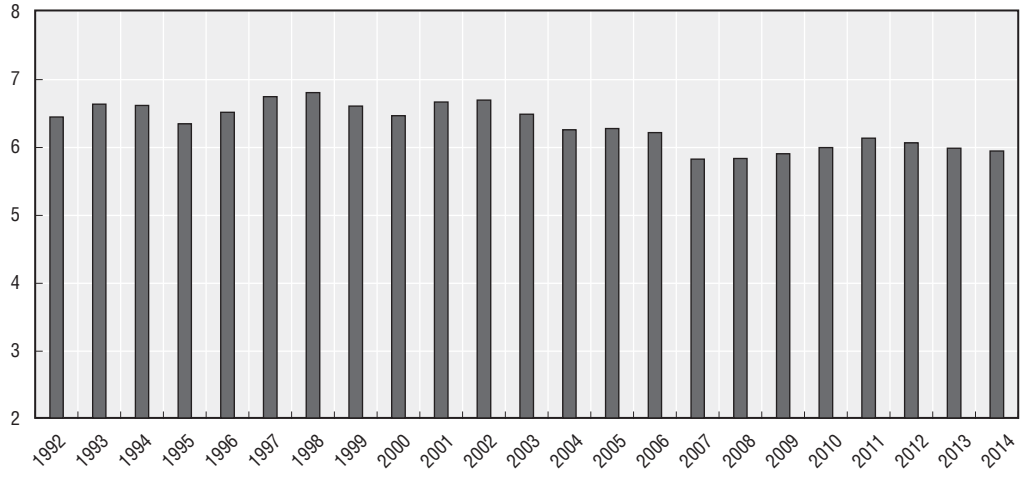
The 1983 legislation projected actuarial balance over 75 years at 0.02% of taxable payroll (so, barely). By 1985 the estimate declined to (-0.41). By 1994, the projected trust fund balance

was down to (-2.13), with the reserve estimated to be depleted by 2029. But in 2008 the projection of the actuarial balance had improved to (-1.70), and depletion of the reserves was not expected until 2041. Then the projections worsened again, so that by 2014 the projected long-term shortfall was (-2.88), and the reserve was estimated to run out in 2033.

Some of the decline in projected actuarial balance over most of this period is simply due to time. Each year's projection is for 75 years; each successive estimate includes one less year when the large baby boom cohort is contributing much more than it is collecting. Yet the variation from year to year has been much larger than can be explained by timing alone. The deterioration in the forecast long-range balance in the six years between 1988 and 1994 was 1.55 percentage points – close to as large as the 1.84 point improvement from the 1983 legislation (Board of Trustees OASDI 2015, Table VI.B1). The trustees' explanations (Board of Trustees OASDI, 2015: 165-167) show how the wide variety of factors involved in estimates allow for this kind of change.

We can get another view of variation in forecasts by looking at spending projections as a share of GDP. Figures 1 and 2 give two views of how forecasts have changed over time. The 2050 forecast, highlighted in Figure 1, may look fairly stable – but the estimate made in 2008, at 5.81% of GDP, was almost a full point lower than the 1999 projection of 6.79%. Figure 2 shows projections for a series of other years, and how they have changed over time. If we were to look at the numbers behind the chart we would see, for example, that the current predicted shortfall in 2035 is 1.24% of GDP, but projected spending in that year was 6.96% of GDP in 1999 but only 6.02% today.

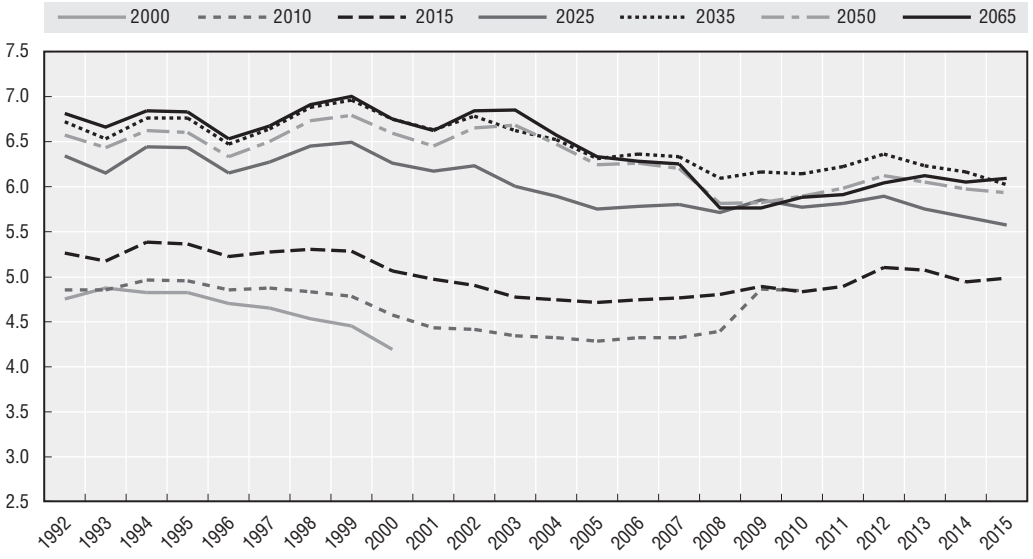
Figure 1. **Projected OASDI Spending in 2050 as percentage of GDP, by year of Forecast**



Hence the future burden of Social Security on the economy is not so easy to predict, and no one should imagine long-term budgets for Social Security can be made with the same kind of confidence as annual budgets for agencies. These overall figures, moreover, hide the greater volatility of the Disability Insurance programme.

DI is subject to some of the same long-range demographic dynamics as OASI, because older people are more likely to become disabled. The effect shows up in the numbers about fifteen years earlier both in the U.S. (CBO, 2010; Fritze, 2015) and other countries (OECD, 2010). Yet DI eligibility is much more complex. Administrative discretion matters more, and

Figure 2. **Projected OASDI Spending as share of GDP for various years, by year of trustee report**



there are many more arguments about supposed fraud and abuse (people getting benefits who should not) or inequity (people not getting benefits who should).[52] There are two levels of choice, which vary less systematically than demographics: people have to choose to apply, but the disability determination process also must decide they are eligible. Both are influenced in part by economic conditions (Merline, 2012), for legitimate reasons.[53] DI spending therefore has fluctuated not only with underlying economic conditions, which influence applications, but with the administrative process, which varies with legislative changes, budgetary resources, administrations' priorities, and among states.[54] States manage the application process in different ways and so with different initial results.

The number of applications and awards for DI therefore varies substantially more than for OASI.[55] Increases and decreases in both have been related to policy changes, especially a crackdown on both applicants and current beneficiaries that was legislated in 1980 and implemented with perhaps unexpected zeal by the Reagan Administration (Derthick, 1990; Pear, 1982; Social Security Administration, 1986). That crackdown included an increase in Continuing Disability Reviews, designed to identify persons who had been awarded benefits but whose medical condition had improved and so no longer needed them. This programme, as administered, was widely accused of going too far, and a backlash resulted in legislation in 1984 that changed some of the terms of the 1980 Disability Amendments (Derthick, 1980; Social Security Administration, 1986). Discretionary funding for administration also affects the programme's financing. The amount of Continuing Disability Reviews has varied substantially over the years even though CDRs on average lower total federal spending (CBO, 2010).

To summarise, DI is an entitlement but involves administrative discretion that means it does not operate remotely as automatically as OASI. It involves a much less certain risk, and most people will not end up collecting. Nobody who is paying into DI expects to collect even 50 years later – they're supposed to be retired and on OASI by then. The promise is that DI will protect you if you get disabled soon, or at least sooner than your expected retirement age. If a change in eligibility rules is defensible, then it normally should be

implemented quickly. If current rules reward people they should not, or prevent aid to people who should get it, that should be fixed sooner rather than later. These differences between DI and OASI are likely to also distinguish disability pensions from old-age pensions in any country. For example, the issues regarding disability benefits, entitlement and administration have been far more complex and conflictual than old-age pensions in the Netherlands.[56]

4.3. The weaknesses of the best case

OASI is the best case for long-term budgeting. Individual voters have reason to look ahead and – if they're not told the trust funds are fake, and trust politicians to treat the assets as real – perhaps agree to pay for benefits in the future with earlier contributions. Because discretion is limited, administration is not so strongly related to spending, as long as it is not badly underfunded. Any efforts to change long-term outcomes also require specific decisions about those rules, so conscious and visible connection of details to totals. Estimates are uncertain enough that policy-makers should not respond often to changed projections. There can even be honest mistakes.[57] But over many decades the Social Security Actuaries have earned a reputation for integrity. Building up a trust fund is a policy choice to lean in a more fiscally contractionary direction, but only modestly so and should not be viewed as especially biased.

Yet even in the case of U.S. Social Security, the conventional approach to long-term planning is excessive. 75-year forecasts even for OASI are not especially credible, and DI does not belong in those forecasts. Its spending is driven too much by short-term economic developments and how the programme is administered. Medical understandings change, and so decisions about disability change, in ways that cannot be anticipated. Administration is especially important for the value of efficiency, as *both* accepting applicants who perhaps should not get benefits and turning down people who perhaps should can reduce the net benefit of the programme. So it would make a lot more sense to view DI in a much shorter time frame. A third problem applies to current arguments that entitlements as a whole should be subjected to caps over a 20-year or 30-year or longer time period. Ironically, a long-term plan that separates entitlements out from the rest of the budget and sets a cap on entitlement spending would ignore how extra trust fund revenue can reduce spending in the rest of the budget.

The most severe problem with proposals to focus on long-term financing of Social Security, however, is that adding some sort of larger set of long-term budget controls or solvency rules to what already exists within Social Security will not solve the problem of how to get agreement among U.S. policy-makers about the means. There might be situations in which a long-term focus enables political leaders to compromise with each other, because very long-term measures would not excite their constituents. The 1983 legislation's provision to raise the retirement age over forty years seems like an example. But in order for that kind of buffering from voters to work, the sides have to want to compromise. In 1983 a majority of the House and Senate thought raising the retirement age was a reasonable policy.[58] Under present circumstances, looking at the long-term does nothing to reduce conflict. If anything, the choice between accelerating and delaying action is just a matter of tactics.

DI would have gone into deficit in 2016, and substantive response was postponed by changing the fund allocation between OASI and DI, rather than addressing DI on its own. The Trustees have argued for many years that the trust funds were not in long-term actuarial balance, and since 2013 have projected exhaustion within 20 years. From this

perspective, long-term budgeting for OASI is possible but is not being done; and the time for long-range budgeting of DI is past.

So why has there been no action on OASI or DI in recent years? It is not because DI beneficiaries are powerful "claimants." They are poor, disabled people – which may be why U.S. policies to help the disabled are among the least adequate among all OECD nations (OECD, 2010: 85-87).[59] Instead, policy leaders in the two parties disagree intensely about how to respond to DI's financing issues. Republicans believe the programme is rife with abuse and encourages people who aren't really disabled not to work. Democrats believe these claims grossly misrepresent benefit levels, the difficulty of claiming benefits, and the medical status of beneficiaries (Fritze, 2015; Kessler, 2015; Ruffing, 2015). Democrats believed they could not convince a Republican-controlled Congress, so sought to postpone the issue by reallocating funds from OASI; House Republicans tried to forbid re-allocation through a House rule (Romig, 2015; Ruffing, 2015). Eventually they backed down, and the Bipartisan Budget Act of 2015 included a three-year reallocation from OASI to DI, which was projected to build up the DI fund enough to pay full benefits into 2022. The reallocation was immediately condemned by the Heritage Foundation as robbing USD 150 billion from Social Security (Greszler, 2015). Not much room for agreement there.

The OASI story is much the same. Virtually the entire Republican party insists that only spending cuts are acceptable. More and more Democrats have concluded that a steady decline in other sources of retirement income means Social Security benefits should be increased, not cut (Altman and Kingson, 2015; Hiltzik, 2016). Even without advocating expansion, Democrats have emphasised raising payroll taxes and especially the cap on taxable payroll. Republicans, if they are willing to be specific at all, favour privatisation and forbid tax increases. Self-described centrists propose approaches that hardly anyone likes – in the Bowles-Simpson case, also relying heavily on benefit cuts (Blahous, 2010; Ruffing, 2011). The current OASI conflict is precisely the kind of situation in which attention to totals does not cause action because of disagreement about the details, for there is no majority to meet solvency targets in any specific way.

In this situation, any attempt to force immediate action is fundamentally partisan. To put this another way, time is more on the Democrats' side. They can reasonably project that OASI's funding is far more likely to be improved by tax increases in the future than it is today. In the early 2030s the prospect of major benefit cuts will seem much more real, and the elderly will be a much larger portion of voters – particularly in midterm elections (such as 2030 and 2034). Under these circumstances, raising taxes – including even taxing "unearned income," or raising the threshold so high earners pay on more of their earnings – seem much more likely than they are today (Arnold, 2015).

What, then, could any efforts to further enforce long-term budgeting for Social Security accomplish? A plan might include some sort of automatic policy changes triggered by changes in projections. Yet the fight over such a plan will look just like the fight over more straightforward policy changes, and there will be no more reason to expect compromise. Or, the plan could include some sort of commission to submit proposals in response to projected shortfalls. Yet there is no reason to expect that approach to be any more successful than the 2011 commission – or various other efforts over the years. If policy-makers do not have some underlying basis for agreement, then addressing issues that do not have to be dealt with yet (because they are long-term) can only increase conflict, giving more to fight about. Postponing will be much more attractive. And so it has been.

5. American Medicare

Within long-term projections of the federal budget, Medicare is the major cause of future spending increases. For instance, the 2015 forecasts (Board of Trustees OASDI Table V.B3) showed OASDI growing from 4.98% of GDP in 2015 to 6.03% in 2060, while Medicare was projected to grow twice as much, from 3.53% in 2015 to 5.7% in 2060. Indeed, health care spending is widely considered a key aspect of budgetary sustainability across all rich democracies (OECD, 2015b; White, 2014). If we combine Medicare with Medicaid and other federal health care programmes, it seems clear that the United States does not have a "deficit" or "entitlement" problem, but a health care cost problem (Aaron, 2007). Because it is the single most important factor in long-term projections of "unsustainable" budget deficits, whether long-term budgeting for Medicare is desirable or possible must be central to the case for long-term budgeting in the U.S. overall.

The Medicare programme is remarkably complicated. It involves separate insurance for hospital benefits (HI, Part A), medical benefits (SMI, Part B), and pharmaceutical benefits (Part D); payroll funding for Part A alone; enrollee premiums for Parts B and D; private insurance either as a supplement to the traditional package ("Medigap" plans) or as a replacement ("Medicare Advantage"), and shared responsibility with the state-based Medicaid programmes for costs of impoverished and disabled beneficiaries, the "dually eligible" (Cohen et al., 2015; Kaiser Family Foundation, 2015, 2016; Jacobson, Huang and Newman, 2014; Brown et al., 2014; Newhouse et al., 2015). This article cannot come close to identifying all the relevant budgetary twists that result from this complexity. Yet one thing is clear: long-term budgeting for Medicare is a truly terrible idea. Some of the reasons are unique to the U.S, but other difficulties will apply in any system.

5.1. American exceptionalism in health care finance.

Healthcare spending in the United States, as a share of GDP, far exceeds that in any other country. Even though government provides only about half of total U.S. healthcare spending, its share of GDP, at over 8%, is greater than in all but a few OECD countries.[60] Yet the U.S. covers its population less successfully than any other rich democracy, being the only one with no national guarantee of health care services.[61]

Higher U.S. total spending is not caused by more generous benefits (especially for the uninsured!). Nor is it caused by higher use of services (Angrisano et al., 2007; Farrell et al., 2008; Ginsburg, 2008; Papanicolas et al., 2018; Squires and Anderson, 2015). Nor is it caused by greater prevalence of disease or worse risk factors, as American disadvantages on factors such as obesity are offset by other factors, such as low tobacco use and a younger age distribution. Nor does it buy better outcomes. In fact, the proportion of Americans that dies from conditions that would be amenable to healthcare is higher than in at least 23 other countries, including all those that might be expected to have comparable economic capacity and political responsiveness (Gay et al., 2011; Nolte and McKee, 2012).

Although Medicare has controlled spending growth more effectively than have private insurers (MedPAC, 2015: 9),[62] the peculiar division between government and private finance in the United States makes population ageing seem like a much bigger budgetary problem in the U.S. than in other countries. The dynamics that will increase Social Security beneficiaries' share of the population have the same effect on the Medicare share. This enrolment growth is a major factor in projected Medicare cost increases. (e.g. CBO, 1998, Tables 4-2, 4-5). Yet OECD analyses do not show aging having comparable effects on public

spending for health care in other countries (de la Maisonneuve and Martins, 2013), and it's important to understand why.[63] One reason is that U.S. health care costs per person are so much higher than in any other country, so effects of aging compound on a much higher spending base. But the major reason is that aging in the United States shapes eligibility, while in other countries it only affects cost per person. In the United States, when a person turns 65 she may shift from private budgets to Medicare. Her entire cost is an increase in government spending. In other countries, the increase in spending when a person turns 65 is just the difference between her costs that year and the year before. Therefore, if all Americans were "entitled" to the same public or semi-public coverage, the effect of aging on the budget would be much lower!

Moreover, when projections show Medicare spending rising quickly over time, so being "unsustainable," then if the same assumptions about spending growth per capita were applied to the entire health care system, it too would be "unsustainable." For example, in 2001, when Medicare spending was expected to rise to about 8.5% of GDP by 2075, the same assumptions projected total national health care spending of 38% of GDP (Technical Review Panel, 2000: 39). This seems likely to be at least as much of a challenge to private budgets as the Medicare figure would be to the federal budget.

These facts help explain why focusing on long-term Medicare costs is a seriously flawed problem definition. Considering the overall failings of the U.S. approach to financing health care, and the relative success of Medicare compared to private insurance, treating Medicare as the problem is a bizarre policy analysis. There are strong arguments for reforming the U.S. health care system as a whole, rather than focusing on the Medicare budget (Aaron, 2007; Aaron et al., 2008).

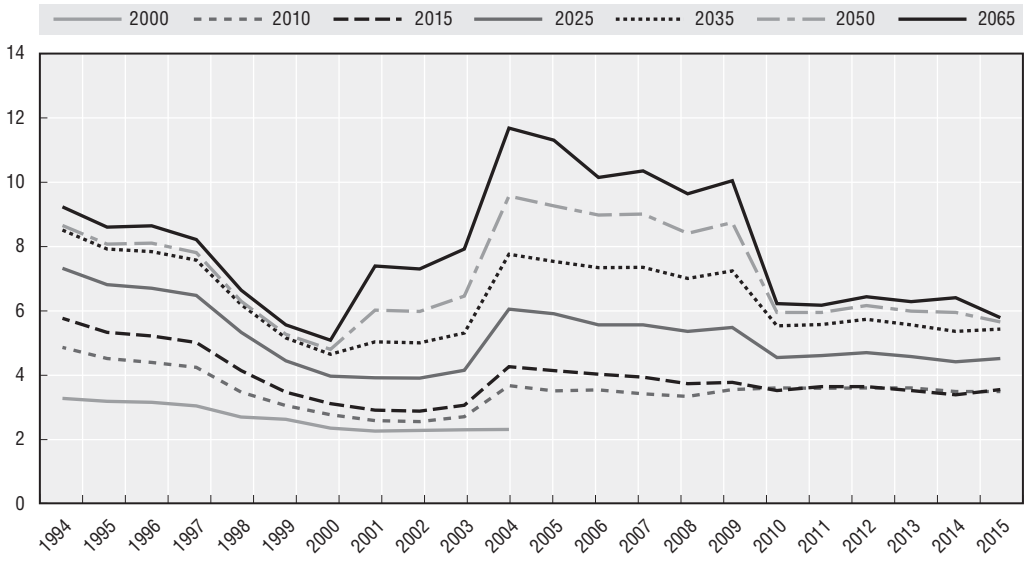
5.2. More general lessons from Medicare: the near-impossibility of long-term forecasts.

In spite of all the exceptional characteristics of American healthcare finance in general, and Medicare in particular, Medicare still offers general lessons about long-term budgeting for health care. The most fundamental involves spending forecasts. Former programme administrator Bruce Vladeck in 1998 described the whole enterprise of forecasting costs beyond a ten-year horizon as "an exercise in comparative fantasy," and with good reason (Pear, 1998).

Part of the problem is that short- to medium-term forecasting is also quite difficult. Policy can change outcomes, but they also depend on unpredictable behaviours within the health care system. The bottom line of Figure 3 shows projections for spending in 2000 that were made from 1994 on. The 1994 projections were more than 40% higher than actual spending (3.26% of GDP vs. 2.29%). In this case one major factor was the unexpected effectiveness of a campaign against fraud and abuse (Rosenblatt and Rubin, 2000).

Spending on the Part D drug benefit, enacted in 2003 and implemented in 2006, also illustrates the difficulty of forecasting. As CBO (2014: 5) reported, its estimate of spending for fiscal year 2013 was nearly twice the result (USD 99 billion vs. USD 50 billion). Total spending over the period from 2006-2013 was 36% less than the original estimate. Part of the difference is explained by lower enrollment than expected (CBO, 2014: 11), but more was due to unexpected trends within the pharmaceutical market, which affected spending by all payers (CBO, 2014; Hoadley, 2012). Not only did many brand-name drugs go off patent, allowing substitution by lower-priced generics, but, less predictably, "new brand-name drugs (which

Figure 3. **Projected Medicare Spending for Various Years, as Share of GDP, by Year of Trustees Report**



tend to be more expensive than older brand-name therapies) were introduced at a slower rate than in the late 1990s" (CBO, 2014: 2). The trend through 2013, however, could not be used to predict the future. In 2014 Part D payments jumped by 8.3%, with the Medicare trustees (2015: 106) projecting a 15.1% increase in 2015. What happened? Prescription drug spending in the entire system accelerated sharply in 2014, largely "caused by increased spending on new medicines (particularly for specialty drugs such as those used to treat Hepatitis C), a smaller impact from patent expirations than in previous years, and price increases for brand-name drugs." (Martin et al., 2016).

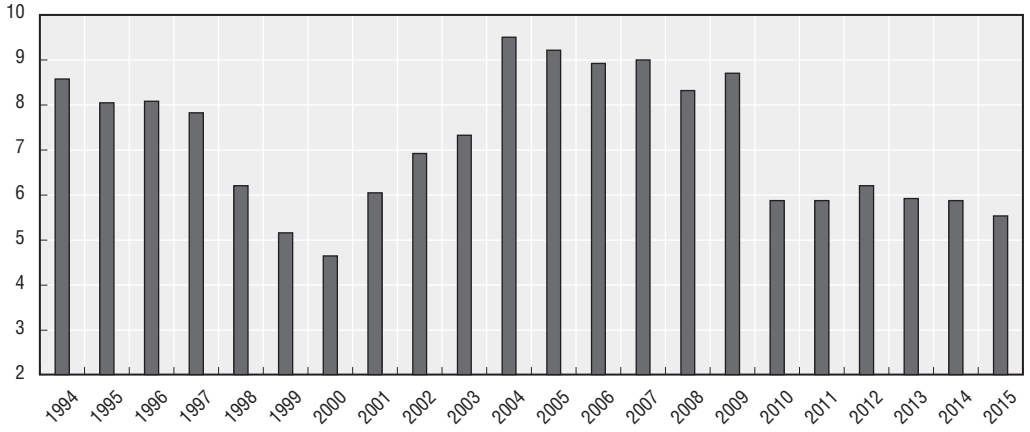
I do not want to suggest policy-makers could do nothing about such developments. They certainly could regulate prices for new drugs more strictly. Absent much stricter short-term cost control measures, however, Part D experience illustrates the difficulty of even short- and medium-term estimates.

Long-term forecasts are volatile from year to year for four reasons. First, short-term experience can change the baseline on which long-term estimates compound (Sommers, 2010). The immediate good news in the late 1990s, as the other lines in figure 3 show, drove down longer-term forecasts as well as the forecast for 2000. Second, short-term experience may cause estimators to re-think their judgments about underlying dynamics. Third, the assumptions used for longer-term projections are rather arbitrary, and may be changed because none of them are particularly compelling. Last, legislation can change policy and virtually mandate changes in the forecasts – whether that legislation is sustainable or not.

All four factors explain the dramatic variation shown in Figure 4, which gives the projections for Medicare spending as a share of GDP in 2050 made from the 1994 Trustees Report through the 2015 Report. Readers can see how Medicare's estimates depend on far more than demographics or basic economic trends by comparing Figure 4 to the Social Security forecasts in Figure 1.

The dramatic fall from projecting 2050 spending of 8.64% of GDP in the 1994 report to 4.79% in the 2000 report was largely due to the real life trends that lowered spending as of

Figure 4. **Medicare Spending Projections for 2050 as Share of GDP, by Year of Trustees Report**



2000. At that point, however, the Trustees changed an arbitrary assumption about long-term trends. Until then, the actuaries figured they had no basis for projecting spending after 25 years, so assumed spending per enrollee would decline to equal the growth rate of per capita GDP. The 2000 Technical Review Panel recommended raising the assumption to growth 1% higher than per capita GDP, and adopting that assumption raised the 2050 projection to 6.0% of GDP. The long-term nature of the changed assumption is reflected in the lines in Figure 3, in which projections for 2050 and beyond rose much more steeply in 2000 than projections for earlier years. As Figure 3 also shows, all projections increased substantially in 2004, due to the effect of a policy change: creation of the Part D benefit.

The sharp drop in spending estimates as of 2010 is due in part to the short-term measures in the Patient Protection and Affordable Care Act, as amended by the Health Care and Education Reconciliation Act (PPACA hereafter).[64] PPACA included provisions that immediately reduced spending, and raised revenues, in reasonably predictable ways. The big shift in the long-term projections as of 2010 however, resulted from language in the law about how payments to health care providers would be calculated "in 2011 and later" – that is, forever. The law said that instead of updating payments to each category of provider according to changes in the underlying "prices that providers must pay to purchase the goods and services they use to provide health care services," the Medicare programme would raise its providers' prices about 1.1% per year more slowly, on the theory that the productivity of Medicare services could improve at the same rate as productivity increases in the whole economy (Medicare Trustees, 2010: 2, 8). Thus the legislation essentially offset the actuaries' previous assumption that in the long-term spending per capita would rise by one percentage point over the trend of per capita GDP. The U.S. health care system could surely do a better job of capturing technological improvement in the form of greater value for payers rather than higher income for the medical industry.[65] Yet nobody should pretend to know if the productivity adjustment to prices can be enforced for ten years, never mind forever.

More recent forecasts provide an even better example of the arbitrary nature of long-term estimates. The 2015 Medicare Access and CHIP Reauthorization Act (MACRA) overturned projected major reductions in Medicare's payments to physicians, which had been part of baseline estimates even though they were not about to happen.[66] CBO (2015c)

projected the change in physician payment would raise (estimated) Medicare spending by USD 175 billion over ten years. Yet MACRA enacted some annual restraints on increases in physician fees, which were assumed to apply forever. As a result, the next Trustees report projected slightly smaller Part B spending beginning in 2059 (Medicare Trustees, 2015: 71, 98).[67] CBO, however, still makes its long-term projections by assuming that "excess cost growth per beneficiary" [over growth of per capita GDP] "will trend smoothly to a rate of 1.0 [percent] between 2027 and 2046" (CBO, 2016b: 16). In 2015 CBO stopped publishing projections of Medicare spending more than 30 years in the future, so is not officially disagreeing with the Medicare Actuaries about longer-term trends; but it is making a different, equally arbitrary, assumption. It is easier to see why both assumptions are wrong than why either would be right.

5.3. *Why health care cost control is a short-term problem*

The evident unlikelihood of credible long-term estimates is reason enough to reject long-term budgeting for Medicare. Yet developing credible long-term measures is equally difficult.

For Medicare and for any national health care programmes, spending depends on how the programme is administered. In the United States, that means an immense variety of choices about payment rates and rules for thousands and thousands of services. It also depends on decisions outside the government, especially the continual expansion of the medical realm in modern society. This is not so much "technology" as the medicalisation of problems. The medical industry seeks to expand spending not only through traditional political action, but by promoting new services and drawing attention to problems that were not previously viewed as medical, such as Attention Deficit Disorder (for further discussion see White, 2014).

Spending control is made more challenging by the fact that within the health policy world there is a plethora of arguments that long-term savings can be achieved from an agenda of delivery or payment reforms such as electronic health records, "paying for performance," and "integrating care" through "Accountable Care Organizations". Distinctly unimpressive results from such efforts (Goldsmith et al., 2015; Nichols et al., 2017) does not seem to reduce advocacy for such measures (as in Nichols, 2017). In one telling example, leading health economists criticised CBO's forecasters for insisting on "traditional evidence" that measures would succeed (Cutler, Davis and Stremeckis, 2009: 10). Ideas that have better records of success are not as attractive to analysts as these policy unicorns (Vladeck, 1999), and ideas that have records of success, such as price regulation, have bitter enemies (the people who lost incomes). Ideas that have not reduced spending meet less fervent opposition from providers, who may even nod solemnly and say those are really good ways to make health care "higher value" (White, 2013b).

The basic politics and economics of health care provide a further obstacle to long-term policies. Health care cost control is a continual war, a contest for territory (money) between powerful adversaries. On one side are the payers – governments, sickness funds, private insurers. On the other side are the providers, in the U.S. a sixth of the national economy. They are some of the smartest and most accomplished people in any country; they have massive resources; at least the physicians have some significant credibility among voters. That does not mean the medical industry cannot be beat in political battles. Even in the U.S. the relative cost-control success of Medicare shows that governments have power too. In many other countries, the payers are better-organised, more purposeful, and the

medical industry has less independent power. But it is a battle that has to be fought again and again. The providers will attempt to bust any spending control method, and eventually budget-makers will need to adjust their tactics in response.

None of this is to say there can be no merit to experimenting with unproven cost control methods in the hope that they will someday "bend the cost curve." Any policy analyst will have ideas for measures that cost more up-front but could be useful in the long run.[68] Some may be worth trying. Budgeting should not have such a short-term perspective that useful investments are crowded out.

Yet unless policy seeks budget savings simply by cutting benefits, there is no credible way to "save" in the long run. And cutting benefits based on claims about total spending decades in the future is not likely to be desired by voters, either now or in the future. It is not likely to be representative, will be based on highly questionable forecasts, is likely to involve measures designed to hide effects (such as vouchers), and so seeks to avoid relating details to totals. Measures that seek to control spending in other ways will have the same questionable forecasts and, if they include details such as long-term assumptions about payment rates, relate details to totals only in the sense that because the details are made-up, the totals are made-up too.

The history of Medicare spending projections shows that they should not be a guide for action. They are too volatile, too sensitive to unpredictable events, and too reliant on highly dubious assumptions. Reducing spending is in the short run however, can have dramatically favourable effects on long-term spending estimates, as occurred after 1997. Better yet, it saves money quickly and these effects – so long as policy-makers don't go out of their way to reverse them – seem more reliable than any assumptions about what will be done 10 or 20 years in the future. Sherry Glied and Abigail Zaylor (2015: 1), based on their own analysis of this history, draw the same conclusion. "The ability to make significant programmatic changes in the short-term," they write,"…and the difficulty of forecasting costs over the long-term suggest that policymaking can be most effective by addressing immediate needs."

6. Summary and conclusion: the search for budget responsibility

The campaign for long-term budgeting in the United States is promoted by highly prominent individuals and organisations within the budgeting community. They have asserted that binding decisions about programmes and revenues should be made with the intent of meeting some sort of targets for the totals 30 or more years in the future. Possible results that far or further away are described as crises that need to be addressed immediately. The advocacy is so broad that it nearly constitutes a conventional wisdom.

In this analysis I have sought to remind readers that good budget processes serve a wide range of goals. Long-term budgeting, based on the logic and evidence discussed in this article, is inimical to increasing efficiency, relating details to totals, transparency, accountability, the values of representative government more generally, accuracy and honesty. It is designed to serve its sponsors' economic theories and overall political priorities over others. Long-term budgeting might serve the goal of economy, but even that claim may often be false, because the policies involved are not themselves sustainable.

The operation of budget processes depends on how they solve budgeting's core decision-making quandary, which is how to match *social* preferences about totals to *social* preferences about details. Social preferences are inconsistent even when individual preferences are not. The most basic problem is not how "guardians" can protect the budget

against "claimants." It is how to resolve conflict between different views of how to fit totals and details together. Therefore common political arguments about how to budget are based on a misguided view of the problem. Advocacy for long-term budgeting is an example, because it is based in part on a belief that making the totals seem like more of a crisis will strengthen guardians. This does nothing to dampen conflict and enable compromise between competing views.

In the U.S., old age pensions (OASI), offer the strongest case for making long-term decisions within a broader budget process. Long-term commitments are part of the programme's promise, and so their financing should be part of its decision-making. Compared to either taxes or other spending programmes, OASI is designed in a way that allows the least inaccurate estimates, and poses fewer issues of transparency or efficiency.

Yet even the case for long-term decision-making about OASI, unfortunately, has been made in logically questionable ways. It requires giving credence to pre-funding through the trust funds, so is contradicted by common claims from many of those who claim to be budget guardians, that the trust funds are fake. Unfortunately also, if building up trust funds is agreed to be helpful, that still does not solve the problem of how to do so – from whom to collect extra money in advance (if anyone) and which benefits to reduce so as to allow greater accumulations. It was difficult enough to forge agreement in 1982-83; it seems impossible now. Any efforts to "reform" budgeting to create a doomsday mechanism to force earlier action will face the same problem, only redefined as how to agree on the mechanism.

Within American Social Security, Disability Insurance illustrates how policy dynamics should determine attitudes towards long-term projections. Nobody should imagine that DI can reasonably be budgeted far into the future. DI is more similar to Unemployment Insurance (UI) than to OASI. Although some of its spending demand is predictable in the long run, other factors, including economic cycles but also medical norms and administrative processes, are much more short-term and unpredictable. In the U.S., defining DI as a long-term problem, in tandem with OASI, has made it easier to *avoid* budgetary responsibility. If it were viewed as a freestanding short-term programme like UI, its financing would already have been addressed.

Long- or medium-term caps on discretionary spending are another form of long- or medium-term budgeting. American experience with these measures suggests a few lessons. They have become the default method of deficit reduction because it is possible to adopt caps without specifying details. Hence they privilege economy (in the short run at least) over transparency, accountability, and efficiency. As a way to manage the government they can only do harm, as the specific details of programme operations are given much less weight in budget decisions. When the time comes to make details fit the cap, this may lead to intense conflict that can only be resolved by either fraud or busting the caps. Enforcement has depended very much on each year's political conditions, rather than on the supposedly binding nature of the caps. None of these patterns suggest that long-term caps on discretionary spending meet the goals of budgeting as normally understood. All suggest that using discretionary caps as backup enforcement for long-term budget plans is a bad idea.

Long-term Medicare spending projections, combined with assumptions they will not be financed, explain much of projected increases in U.S. federal government deficits and debt. Indeed, any U.S. long-term budget problem is actually a health care cost control problem. Yet long-term budgeting for Medicare cannot be responsible.

This paper has shown the immense variation in Medicare spending projections. Both positive and negative shifts in the projections have often involved arbitrary assumptions about long-term spending trends – such as whether the long-term rate of increase in per-enrollee spending will be the same as or more than the growth of per capita GDP, or for how long the programme could enforce fee updates that are below the rate of general inflation. Trends in Medicare costs per enrollee depend partly on policy and partly on behaviour by patients and the medical industry. The medical industry is in the business of outflanking or overpowering spending control policies. In spite of these pressures, public policy can restrain growth in spending per capita. Experience in other countries has been far more successful than in the United States, and Medicare has been more successful than private insurers. There is no way, however, to make policies to resist the providers that can be expected to work for long periods of time. Therefore the most practical way to constrain Medicare costs in the long run, while attending to other budgetary values, is to adopt short-term measures that actually work, and so reduce the base on which future increases compound. Then do it again, again, and again.

Long-term risks are a reason to make both annual budgets and other policies with careful attention to these risks (remembering they are risks, not certainties). Like managers of any household, political authorities should try to anticipate serious problems down the road. Yet it is not at all obvious that the annual budget process is the place to address those challenges. In general, they are discreet challenges associated with specific policies. Some, such as the effect of global warming on nations with extensive coastlines, or possible needs for higher military spending, are barely being considered by budget experts at the moment. Others, like pension and health care costs, are major policy issues in their own right. In the case of health care, viewing the problem as long-term is misguided. It should be addressed year after year in annual budgeting. In the case of pensions the extreme importance of benefits to many voters, the ability to direct specific revenues towards those programmes, and the need for credible long-term promises all make the annual budget process a questionable place to address the policy. Budget reform is much less important than simply building the coalition to enact stand-alone legislation.

In the United States, the campaign for long-term budgeting is not only unwise but dangerous. Budgeting has always been hard. At the moment it is almost impossible. There is a political war, and the stakes are what kind of government the United States will have, for whom. In this context the call for long-term budgeting has two major flaws beyond its normal problems. First, it largely supports one side, by defining government as the problem. The December, 2016 budget process "reform" proposed by House Budget Committee Chair Price, his parting statement before his departure to serve (briefly) as Secretary of Health and Human Services, illustrates the link (Kogan and Reich, 2016). Second, it provides no reason for anyone to compromise. Rather than cooling the temperature of political debate, the campaign for long-term budgeting raises the temperature, by providing one more source of heat, one more "crisis."

Notes

1. The work for this analysis was originally commissioned by the National Budgeting Roundtable, sponsored by the William and Flora Hewlett Foundation, and a version that focuses more on potential reforms in the United States was produced as White (2016). I thank the Roundtable leadership for permission to use some of the same material in this article.

2. CRFB is an advocacy organisation with a board of directors that includes many formerly leading officials in U.S. budgeting. Six were CBO Director; six were OMB Director; three chaired the House or Senate Budget Committee and two were Comptroller General.
3. The term "pay-as-you-go" usually refers to provisions to inhibit legislative changes, but in the context of the sentence must mean provisions that would change spending trends if events were different than expected.
4. One can see versions of this view in some of the proposals mentioned above, and it was expressed in the National Budgeting Roundtable meeting that discussed the first version of this paper.
5. This view was supported in February of 2016 by Jon Blondal, Head of the Division of Budgeting and Public Expenditures in OECD's Directorate for Public Governance and Territorial Development, in a personal conversation. He suggested the closest equivalent would be Medium Term Expenditure Frameworks in a few countries, which to some extent allocate resources over the term of a government.
6. Thus principle 4 is, "Ensure that budget documents and data are open, transparent and accessible." Principle 5 is, "Provide for an inclusive, participative and realistic debate on budgetary choices." Principle 6 is, "Present a comprehensive, accurate and reliable account of the public finances," and Principle 10 is, "Promote the integrity and quality of budgetary forecasts, fiscal plans and budgetary implementation through rigorous quality assurance including independent audit." Principle 5 speaks to procedural fairness, mentioned just below.
7. This is the logic of the OECD's call for creating MTEFs, with the model being the Netherlands, in which budget priorities and expenditure targets, subject to various adjustments, are negotiated as part of the coalition agreements when a new government is formed (Bos, 2008). In the U.S. the governing coalition tends to change every two years, with each congressional election, so the equivalent approach would be to move Budget Resolutions to a biennial cycle (White, 2009a).
8. As one OMB official described neutral competence in an interview in the early 1990s, "that meant if it was a Republican administration trying to minimise cost; if it was a Democratic administration, trying to maximize value for the money we had."
9. These problems may help explain why OECD's Recommendations (2015a: 9) call for "routinely presenting performance information in a way that informs" budget decisions, but using that information to only a limited extent – what some call "performance-informed budgeting."
10. Thus both increased conflict which prevents timely allocations to agencies, and "sequester" processes that disrupt agency planning and administration, are bad budgeting on the management dimension.
11. Typical more recent examples include CRFB (2011a) and 10 Ex-Chairs (2011). Others include Democratic economists advocating for budget balance in 1980 (as described in White and Wildavsky, 1991), the rationale for the Reagan budget plans (Stein, 1984: 264, 266, 269; White and Wildavsky, 1991) and the pressures on President Clinton in 1993 (Woodward, 1994). Contrary experience both in the 1980s (with big deficits, modest growth but a long stock-market boom) and recent years (with historically low interest rates) has never shaken advocates of market expectations views.
12. Another good example of the right-wing view is Boccia (2014) – objecting to IMF (2014) because that document allowed for the possibility of revenue increases.
13. OECD 2015a, p. 10. Some of the other recommendations, such as comprehensive accounting (Recommendation 6) could also be considered part of the concern for honesty and accuracy.
14. The classic statement about repeated relationships generating trust is Wildavsky (1964). Roy Meyers (1994) provides an extensive but presumably not complete inventory of the deceptive tactics available even within the context of repeated interactions. White and Wildavsky (1991) provide numerous examples of deceptive budgeting being used to enable agreement.
15. The problem can be illustrated most easily with a smaller system, like a condo association. Imagine a condo association with ten units and monthly payments of USD 225, so annual revenue of USD 27 000. Imagine it has ten expenditures, each costing USD 3 000 per year: landscaping, cleaning public spaces, utilities for public spaces, heating and cleaning the pool, maintenance of the exercise room – whatever. So spending is USD 30 000, revenues are USD 27 000, and the deficit is USD 3 000. The simplest approach would be to raise the fees to USD 250 per month. But Mr. Simpson may say, "wait a minute, I don't swim, let's cut out spending for the pool." That is a consistent position – but the other nine owners like to swim. Mr. Bowles may say, "I'm allergic to grass, let's pave the yard and then we won't have to pay to maintain it." But the other nine think pavement is much uglier than grass. Mr. Cote thinks people can bring their own towels to the exercise room and shower in their condos, but the others think the showers and towels are worth

the money. In this scenario all ten owners object to raising the fee; all ten owners are intellectually consistent; none is a hypocrite; but 90% oppose any individual's solution. A good budget process might then involve carefully reviewing each expense; determining if any efficiencies are possible; some bargaining among the owners, and perhaps a package of specific changes adding up to USD 1 500 per year and an increase of the monthly payments to USD 237.50. The example can be extended to allow for borrowing. In short, the condo association would go through an iterative process in which preferences about the details and totals were adjusted. Traditional budgeting works in this iterative manner.

16. This point is made from a different perspective by Robinson (2016: 46). White and Wildavsky (1989) provided examples of how the policies to meet the goal of balancing the budget in 1993 could seem highly unacceptable on the policy merits.

17. The Dutch approach to setting a Medium Term Expenditure Framework begins with consideration of details in the form of "bottom-up calculated levels of expected public expenditure in constant prices" (Bos, 2008: 30). So targets are based on consideration of effects on details.

18. Readers may compare U.S. institutions to the OECD Recommendation (2015a).

19. See the discussion below and White (1998b).

20. One classic example involved the "Alternative Minimum Tax" (AMT). For an explanation and history through 2012, when it was finally "fixed," see *www.taxpolicycenter.org/briefing-book/what-amt*. For an analysis at one point during the saga, see CBO (2008).

21. The rhetoric of "tough choices" deserves a separate discussion. Briefly, budget hawks appear to believe "tough choices" to reduce deficits are substantively easy, since the costs of higher deficits are so severe, so only "tough" for cowards. If the policy costs of the details are taken seriously, "tough choices" are actually tough, so not obvious. For more discussion see White (2010).

22. The summary here is based on the much more extensive account in White and Wildavsky (1991), chapters 19 and 21. See also Leloup (2005).

23. There are many possible sources on OBRA-1990: I rely here on my own account in White and Wildavsky (1991). For a short summary of measures during the 1990s see Heniff (2001).

24. The combined effects of the two bills on deficits for Fiscal Years 1998 to 2000 would have been roughly zero – if the discretionary caps were enforced, and they were not. See Table 1 in CBO 1997b and the summary table in CBO 1997c. The 1997 BBA was not about deficit reduction, but was a short-lived truce in the budget war between congressional Republicans and the Clinton administration, possible because the deficit was going away anyway.

25. The story is discussed in the Postscript to White and Wildavsky (1991); as we put it (p. 583), "our sources report that [OMB Director] Darman told the appropriators that he would get them a domestic increase, but he would have to hide it in the baseline so Congressional Republicans wouldn't object."

26. Joyce and Meyers (2001) emphasise Bud Shuster and the Transportation Committee, but the doubling of NIH spending was initiated by House Appropriations Labor/HHS Subcommittee chair John Edward Porter (R-IL), with support from party leaders.

27. The problem, as staff and members explained in interviews I conducted at the time, was that colleagues who supported the caps in principle or when voting on budget resolutions would not want the blame for the cuts in actual appropriations, so would vote against them. The bitter pill of "more spending" was sweetened a bit by increasing the volume (and more modestly the spending total) of earmarks for which members could claim credit. Republicans preferred to get credit by passing tax cuts, but Clinton would veto that (see White, 2015b).

28. See GAO 2002 (p. 34) and CBO 2003 (pp. 114-16). For some reason CBO and GAO have very different figures for Fiscal Year 2000: GAO says USD 30.8 billion and CBO USD 44 billion.

29. Author's calculation from data in CBO 1997b, p. 90; CBO 2003, Table A-2.

30. Author's calculation from data in CBO 2011a.

31. Savings from these cuts were assumed to lead to further savings from borrowing less and paying less interest.

32. These were CBO's estimates from CBO 2011b, Table 2. For attempts to make sense of the BCA and its terms, see CBO, 2011a, c; Kogan, 2012, 2013; Austin, 2014; Driessen and Labonte, 2015.

33. Author's calculation from data in CBO 2011a,c.

34. To trace the use of the OCO designation as a share of defense spending over time, one can consult reports on the office of the Department of Defense Comptroller, at *http://comptroller.defense.gov/budgetmaterials/budget2016.aspx*.

35. I used data from Driessen and Labonte, 2015; CBO, 2011a; CBO, 2011b.

36. For an overview see Driessen and Labonte, 2015. These varied measures addressed more than discretionary spending (for ARRA the discretionary aspect was a small portion of the law) and each had its own peculiar politics. On the two Bipartisan Budget Acts see CBO, 2015a; Greenstein, 2015; House Committee on Rules, 2015; Krawzak, 2015; Parrott et al., 2013; Tucker, 2015; "Winners and Losers" 2015. The final decisions implementing some implications of the 2015 BBA are reported in Brown et al., 2015.

37. ATRA also included massive deficit increases relative to the baseline because of its revenue provisions, so in context whatever it did to the sequester was decimal dust. We should remember that the baseline was not politically credible. Some portion of the Bush tax cuts would have been continued; they certainly would not have all expired at once; and provisions like the A.M.T. had to be fixed. Nevertheless, ATRA certainly could have reduced revenues less than it did, so can hardly be seen as an example of budgetary responsibility.

38. There was also some controversy about a change in Social Security payment rules, which was viewed by most Social Security experts as correcting a minor loophole and didn't amount to enough money to be mentioned in offset summaries. See NCPSSM 2015.

39. I have not discussed here, but should at least note, the further complications involved in defining categories within the caps. This can lead to a lot of games at the boundaries, such as putting breast cancer research into the defense category, or redefining the nature of "security." Any efforts to separate "investment" will be especially subject to manipulation and conflict. Reischauer (1993) provides useful commentary on the problem.

40. There is a lot of controversy about Social Security, as well as an extensive literature. My own overview of the history and issues is White (2003). It does not seem to me that much has changed, in terms of the positions taken and their merits, since then; and much of the discussion that follows is based on that work.

41. The report estimated that the population aged 65 or over would be 9.3% in 1960 and 10.0% in 1975. The actual figures were 9.2% in 1960 and 10.5% in 1975. See Committee on Economic Security, 1935; United States Census Bureau, 1975. Common claims that Social Security was designed for the 1930s and is in that sense outdated are falsehoods. For critique of some more egregious examples, see Altman and Kingson, 2010.

42. The comment was reported in a memorandum written by Luther Gulick, which can be found at *www.ssa.gov/history/Gulick.html* Note that compulsory contributions were also intended to ensure that individuals took some responsibility for their own retirement, rather than rely entirely on others who were "more prudent" (Musgrave, 1986: 69-70; Penner, 1994: 4).

43. The Advisory Council also assumed that eventually some of the programme would be paid for from general revenues, on the grounds that it would help citizens other than the direct beneficiaries. For example, helping older people retire would help younger people find employment, and maintaining income for the elderly would help the economy.

44. Self-employed individuals pay both parts, but the equivalent of the employer contribution can be deducted from calculated income for income tax purposes. The history of payroll tax rates can be seen at *www.ssa.gov/oact/progdata/oasdiRates.html*.

45. The argument I make here views the trust funds with much less scepticism than I expressed in White and Wildavsky, 1991 (pp. 315-317). My excuse is that at that time I was focused on short-term budgeting, and had yet to investigate the history of Social Security financing. For a much more extensive analysis see White, 2012b. Readers interested in technical operations of the funds should see Pattison, 2015.

46. In 1949 the trust fund end-of-year balance was more than 16 times that year's expenditure; in 1954 it was more than five times as high; 1957 was the first year in which expenditures exceeded payroll tax contributions to OASI, so trust fund earnings became part of financing the costs. Calculations here and the data for descriptions that follow are from Social Security Administration 2015, Tables 4.A1 and 4.A3. The best account of policymaking through the 1977 legislation is Derthick (1979).

47. The trust fund ratio (end of year balance to year's expenditure) was projected to rise to 2.58 in 2000, 3.90 in 2005, 5.0 in 2010, and 5.44 in 2015 before declining slowly over the following 45 years.

48. The caveat is that some legislation since 1983 did improve the programme's financing. For instance, the 1990 Omnibus Budget Reconciliation Act increased revenues by adding new state and local employees to the programme. Projected trust fund ratios based on the 1983 Amendments are taken from 1984 Annual Report of the Board of Trustees of the Federal Old-Age and Survivors Insurance and Disability Insurance Trust Funds, Table 33, p. 78, and from the same table from the 1985 Annual Report. For how the figures changed over the years, see Table 4.A3 in Social Security Administration, 2015.

49. Actually they said that the imbalance was 2.68%, but a 2.62% change would, for various reasons, be sufficient. I've used the 2.68% estimate because it allows for a cushion equal to one year's spending in 2089. The Trustees (2015: 6, 12) also estimated that the programme could be put into 75-year actuarial balance by cutting benefits 16.4% immediately, while if benefits were cut on a pay-as-you-go basis, that would be a 21% cut in 2034, and 27% in 2089.

50. The same could have been done with Social Security surpluses, though it would have made only a modest difference. For discussions see Aaron and Reischauer (1998); Van de Water (2014); White (2003).

51. Also, CBO's estimates differ from the Trustees'. Compare CBO (2015b), Exhibit 2, to Board of Trustees OASDI (2015), Table VI.G4.

52. A good recent example is the controversy over Senator Rand Paul's claim (Kessler, 2015) that, "if you look like me and you hop out of your truck, you shouldn't be getting a disability check. Over half of the people on disability are either anxious or their back hurts – join the club. Who doesn't get a little anxious for work and their back hurts? Everybody over 40 has a back pain."

53. CBO (2010: 2) gives a good example. A deaf person might receive accommodations from some employers but not others. When the economy turns sour, his disability might mean he cannot work. The Americans With Disabilities Act may have led to more people becoming eligible for DI because they could find work for a while (Merline, 2012).

54. These kinds of behavioral and administrative uncertainties led the Social Security Board Actuaries in the 1930s to believe it was very difficult to produce reasonable cost estimates for a programme (Kearney, 2005/2006).

55. Data may be found in the Social Security Bulletin Annual Statistical Supplements, so Social Security Administration (2000) Table 6.C7 and (2015) Table 6.B5.

56. Readers of this journal can surely think of many citations about this issue; one for U.S. readers would be Fultz (2015).

57. CBO made a quite surprising error recently; see CBO (2015b) and the note at the bottom of page 16, "text and table corrected on February 10, 2016." The explanation is at *www.cbo.gov/publication/51232*. Arguably, this is an example of how having multiple analyses helps encourage accuracy. Then again, the SSA actuaries had not made the mistake to begin with.

58. As described in White and Wildavsky (1991: 323-325), some senior House Democrats supported the idea but did not say so publicly because they wanted to make House Rules Committee Chair Claude Pepper think he could defeat it, so he would allow a vote on the floor.

59. See also the comparison between average DI and OASI benefits at Social Security Administration (2016a, Table 2), and the discussion in CBO (2010).

60. By my calculations, from data at *www.oecd.org/els/health-systems/health-statistics.htm*, U.S. public spending was below Belgium, Denmark, France, Germany, Japan, the Netherlands, and Sweden. The U.S. might be above some of those countries if the figures counted capital investment, or the budgetary effects of the tax expenditure which encourage employers to offer health care benefits. In 2013 U.S. total spending as a share of GDP was 16.4%, compared to 11.1% for the next highest countries (OECD, 2015c: 165, 167).

61. Among OECD member nations, Greece and Poland also have sizeable portions of the population not covered, while the benefit package in Korea and Mexico is for a smaller portion of costs than is covered for the insured in the United States. See OECD (2015c), pp. 20, 25.

62. Medicare's better performance over time is due to its better ability to restrain prices. A recent study (Wallace and Song, 2016) provides evidence that per capita costs go down when people switch from private insurance to Medicare, for the same reason.

63. Conventional "wisdom" in general exaggerates the effects of aging, in spite of more recent disagreement from almost every major study. For summaries of the literature see sources cited in White (2007), the discussion in de la Maisonneuve and Martins (2013), and the discussion in OECD (2015b). This is not to say aging does not matter, especially if a country is at the far end of the aging distribution and has had strong cost control policies for the system as a whole, as is the case for Japan. The United States is the opposite case.

64. White (2013a) is an overview of the PPACA that attempts to put it in perspective for international readers.

65. Health care policy wonks debate such issues as whether health care is subject to "Baumol's Disease," or why technology might drive spending up. For one review of such issues see White (2014).

66. The issue here was the Sustainable Growth Rate Mechanism (SGR), and its technical failings. For explanations of the policy and its problems, see Farb (2015); Fontenot, Brandt and McClellan (2015); and Laugesen, Wada and Chen (2012). I would add only that such measures for volume-adjusted fee constraints can work much better if properly designed; see White (2013b).

67. These small effects are seen in Figure 4: the slight uptick in the 2025 line in 2015 and the slight downtick of the 2065 line.

68. Even a skeptic like myself. I would like the federal government to pay for medical education so physicians do not feel they need to make huge incomes to pay off their huge debts. Then I'd ratchet down fees over time to collect more savings than the cost of education.

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ANNEX 1

Likely differences between traditional and long-term budgeting for pursuing goals of budgeting

Democratic Accountability and Transparency

Traditional: Decisions are overseen by current voters and include budgets that affect them. Information can be better or worse, depending on institutional arrangements. Multiple effects, both totals and details, can receive comparable attention. Long-term commitments on some details might be made more credible with dedicated funding. Credibility based on funding may be seen as "binding" future decisions in a way that reduces democratic control by future voters. May reduce "fiscal space" so flexibility to respond to new needs in the future.

Long-term: Policies about totals, if "enforceable," presume decisions must be made in advance without consulting voters to whom they will apply. So policy-makers who make these decisions are not accountable to the voters who will be affected. Aggregated decisions (caps, targets) will involve less transparency about the details involved than in traditional budgeting. Decisions to reduce projected long-term spending by reducing commitments (e.g. privatisation) may create "fiscal space" in future but also will constrain future choices about those programmes – e.g. privatisation is not easily reversed. Policy is less transparent to the extent it is justified by less credible information.

Efficiency and Economy

Traditional: Allows detailed analysis of agency work plans. Information is relatively up-to-date. Some bias against capital investment that could achieve savings (e.g. favours leasing over purchase). But can focus on efficiency.

Long-Term: Information will be less accurate, and work plans make little sense; Could give credit for savings from investment – if the claims are accurate; Must emphasise economy much more than efficiency, since information to judge efficiency will not exist.

Economic Policies and Balance

Traditional: Could pursue multiple theories – household management, Keynesian demand management; targeting national savings rates, targeting "size of government," satisfying supposed demand by the financial markets. Some of these theories are more credible than others, but all are contested. Critics believe it is biased towards deficits and so excess stimulus, insufficient savings, larger government, and unhappy financial markets. All of these judgments are in some sense in the eye of the beholder.

Long-term: Difficult to pursue Keynesian demand management, as such flexibility requires exceptions to the targets, and provision for those exceptions will be viewed as evading controls. Intended by its advocates to reduce deficits, increase savings, limit government and calm financial markets – so enforce specific economic policies. Actual effects are uncertain, though bias to limit totals for taxes and spending appears most likely to succeed.

Setting Priorities

Traditional: The routines of annual budgeting are incremental. So change in priorities is an exception, rather than the rule. May be related to events or to changes in political control of the government, so in that sense representative. If there is a bias, it is in favour of the status quo.

Long-term: In principle, it requires that the government at one point in time be able to bind decisions of future governments, so can short-circuit representation. It is normally proposed in order to change priorities, generally against entitlement programmes. Yet in the United States, medium-term (5- or 10-year) policies have been biased against discretionary programmes. There are reasons to believe long-term approaches are biased against raising revenues. So in practice, long-term budgeting tends to be less neutral in terms of policy priorities.

Relating Details to Totals

Traditional: Totals and details are considered in relation to each other, in an iterative process. Some recent movement towards more of a medium-term top-down approach, but most versions begin with some assessment of the set of concerns about details. Measures to increase efficiency (e.g. "scrub the estimates") are designed to help resolve conflicting preferences.

Long-term: Strongly top-down, as long-term estimates for details make little sense. Exceptions require that spending or taxes be based to a great extent on relatively predictable factors such as demographics. Much of the traditional work of budgeting (e.g. search for management efficiencies, creating work plans) becomes irrelevant.

Managing Conflict

Traditional: Very difficult because of conflicting preferences, both among political forces and between details and totals. Might be dampened through incrementalism, but incrementalism may be more a result than cause of containing conflict. Occasionally can be reduced by obscuring consequences. Divided government makes it worse.

Long-term: In the United States, designed to increase conflict by making policy-makers confront "tough choices." This normally means making the deficit look bigger or more frightening, which in turn should make it harder to meet goals for totals with acceptable details. However, a long-term focus can backfire by giving opportunities to postpone choices to a promised future. This tends to be associated with deviations from the final value…

Honesty

Traditional: Depends on professional budget staff with norms of honesty, transparency in the sense of clear statements of plans, multiple checks on projections and subsequent auditing. Also encouraged by repeated interactions, so dishonesty that is discovered can be

sanctioned in the next year's decisions. Nevertheless there can be a wide range of gaming behaviours.

Long-term: Advocates claim it will be more honest because directs attention to concerns that would otherwise be ignored. But could be less honest because a) enables greater vagueness about details; b) projections involve greater uncertainty so multiple checks can create confusion more than control; c) auditing is irrelevant; d) errors or misrepresentations would be discovered much later, so the prospect of sanctions for misrepresentation is much less immediate, if it exists at all.

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