WORKSHOP ON MEDIUM-TERM EXPENDITURE PLANNING FOR NATIONAL SUSTAINABLE DEVELOPMENT

2-6 NOVEMBER 2015, NADI, FIJI

SUMMARY OF DISCUSSIONS

The Pacific Financial Technical Assistance Centre (PFTAC) and United Nations Economic and Social Commission for Asia and the Pacific, Pacific Office (UNESCAP) organised a Workshop on Medium-Term Expenditure Planning for National Sustainable Development, from 2-6 November 2015, in Nadi, Fiji.

The workshop brought together analysts from the budget and planning offices of the ministries of finance/ planning from seven countries—Cook Islands, Marshall Islands, Federated States of Micronesia, Nauru, Niue, Palau, and Samoa. Representatives from the Asian Development Bank (ADB) and the Secretariat of the Pacific Community (SPC) also participated.

The objectives of the Workshop were to discuss processes, tools and strategies for improving medium-term expenditure planning to achieve national sustainable development. In particular, the workshop focused on four main questions:

- How to implement medium-term budgeting to better link with medium-term national development plans?
- How to improve the quality of government spending?
- What are the fiscal risks and how should they be managed?
- How to improve medium-term expenditure planning?

Participants actively discussed issues through presentations and group exercises, which led to information sharing and highlighting good practices.

The key messages and outcomes from the workshop are set out below.

Setting the Scene

Public expenditure is an essential tool governments have to achieve sustainable development. Sustainable development requires the integration and balancing of economic, social and environmental considerations to serve overall public interest through social equity and maintenance of capital. Moreover, the UN Rio+20 outcome document 'The Future We Want', the 2014 Small Islands Developing States outcome document 'SAMOA Pathway' and the United Nations' 2030 Agenda for Sustainable Development clearly recognised the need for balanced and integrated policy making based on a strengthened evidence base. Inadequate linkages between the national planning and budgetary processes constrain the ability to achieve national development goals and priorities in the medium to long term.

Country Presentations

Country participants delivered presentations and shared experiences on their countries' planning and budgeting processes for sustainable development. A number of recurring issues relating to 'challenges and constraints', 'critical success factors' and 'strategies / policies' were highlighted in each of the country presentations. These included:

- Closer integration between planning and budgeting in an annually updated budget with a medium-term framework strengthens the discipline of showing taxpayers, donors and citizens how a country's own source money is going to be used for its development priorities. Medium-term planning and budgeting is needed to ensure multi-year programs/ projects are adequately funded given governments' competing spending pressures and commitments, for better implementation results.
- While countries face similar challenges and can learn from each other, there is not one off-the-shelf solution. A tailored approach is needed to take into account countries' sector comparative strengths, demographics, risks, country specific vulnerabilities and capacities that shape opportunity costs and trade-offs of budgetary allocations.
- Robust consultation, analysis of proposals, national agreement on priorities, and follow-up on progress are important to enhance outcomes.
- Regular and clear communications and quality policy analyses can support improved decision making and obtaining political will.
- Strong leadership, role models and champions at various layers of the decision making process are important to getting buy-in and support.
- Costing of planned priorities is essential before policy or spending commitments are made. Budgets should contain updated forward estimates including decisions made by cabinet between budgets.
- Monitoring of allocations and connecting with planned priorities are needed to achieve desired outcomes.
- Institutional arrangements can support necessary consultation and analytical preparation for stronger links between the budget and planning processes.
- The budget is a key document for creating accountability and transparency for both spending decisions and implementing policy reforms.
- Since government is an important contributor to economic activity in Pacific Island Countries (PICs) critical attention to the quality of government spending is particularly important.

National Planning, Government Expenditure and Sustainable Development

A presentation by UNESCAP covered commitments countries have made at the global level on sustainable development and discussed the links between these commitments to national planning and budgeting processes in the Pacific. While global commitments have to a large extent been incorporated into national development plans, implementation performance in the region has been mixed.

Reasons for uneven and mixed results include: limited linkages between planned priorities and budgets; limited capacity to coordinate and monitor plan implementation; plans are not always available or where available they are often not updated and hence are ignored. Plans have also been found to be too complex to implement; to be oriented largely to donor needs and to lack sufficient local ownership.

The presentation noted that medium-term expenditure planning is an important tool for monitoring budget and plan progress and can help ensure that policies and plans are implemented.

Getting the Baseline Budget Right—Towards Medium-term Expenditure Planning

An introductory session by PFTAC on implementing medium-term budgeting and planning emphasised that for essential public services, like education and health services, any improvements in most countries will always be a multi-year endeavour. Ensuring the public that elected leaders' promises to improve these services will actually materialise, therefore, requires a disciplined process for multi-year fiscal planning.

Results from Public Expenditure and Financial Accountability (PEFA) assessments in the Pacific Island Countries, however, show very low ratings on the development and implementation of multi-year perspectives in fiscal planning, expenditure policy and budgeting. PIC practices contributing to these low ratings were highlighted and possible solutions were discussed. These are summarised in the table below.

Practices Diminishing Spending Quality	Solutions to Improve Spending Quality
Notions that planning and budgeting are separable	Integrate processes, documents and teams
Separation of recurrent and development budgets	Integrate processes, documents and teams
Undisciplined cabinet procedures: Approving policy changes throughout the year without fiscal reviews or prioritisation in the context of long-run priorities	Require ministry of finance 'fiscal reviews' of all proposed cabinet policy actions before adopted considering both: • Long-term costs of the proposal, and • Effect on the medium-term fiscal surplus/ deficit
Inadequate time for cabinet / parliament debate on budgets, underlying policy objectives, and long-term impacts	Start budget process earlier so that more attention can be given to longer-term objectives
Multi-year focus not taken seriously by cabinet / parliament	All decisions reviewed relative to longer-term consequences for priority national goals

Numerous supplemental budgets for non-emergency matters and consequent reallocations	Final action on all non-emergency proposals delayed until annual budget preparation so they can be properly weighed and prioritised in the context of: • Longer range plans to develop and maintain critical infrastructure and growth-enhancing public services • Other past adopted policies with "built-in" cost increases • All other newly proposed policies that have arisen during the year
Diversion of appropriations for other purposes than originally intended	Careful monitoring to limit reallocations that may jeopardise achieving longer-term goals
Lack of proper commitment controls forces reallocation during the year to cover costs incurred by violators	Greater use of the commitment control capabilities of financial management information systems (FMISs)
Procurement system failures and rent-seeking behaviours	Require start-of-year procurement plans with estimated prices for services made available to the public

Long-term Spending Pressures Arising from Demographic Changes

A PFTAC presentation discussed long-term fiscal pressures arising from demographic changes. A comparison of annual historical and forecast population estimates, which are available by age groups for all seven countries represented at the workshop, revealed some common trends and significant challenges for many PICs.

A common trend is net migration with the number of people leaving their country generally exceeding the inflow of new migrants or returning residents. Moreover, internal migration within countries from rural to urban areas and outer to main islands is an important factor. However, countries differed in terms of the age profile of their populations and population growth rates. Marshall Islands, Nauru and Samoa have a relatively young and rising population, while the proportion of people aged 60 years and older is largest in the Cook Islands, Niue and Palau. The Federated States of Micronesia also have a relatively young population but the number of children being born has been falling.

Changing demographics have fiscal implications. Population ageing is expected to increase health care expenditure. In addition the costs of social security or other old-age benefits will increase particularly if the eligibility age for state pensions is not increased to reflect today's increase in life expectancy. Also adding pressures on health care costs is a high prevalence of obesity in the region.

Changes in the number of school-age children and the migration of young families from rural to urban areas can also have significant impacts on the cost of providing basic education, though the magnitude of the cost changes is less clear. A small rural or outer island school requires a minimum critical mass of staff to operate, so migration of students from such schools may not translate into much cost savings, while the cost impact on the larger urban school to which a student migrates will depend on whether it is at, or under, capacity. If new schools or larger schools are needed, education expenditure will increase.

Government Spending to Achieve Sustainable Development

UNESCAP presented on the importance of targeted expenditure for effective delivery of services for achievement of national development priorities. Integration of national plans and budgetary processes can support the achievement of national development goals. Budgets can signal government commitment to areas of national priority, by allocating funding even if funding through national resources is only partial. Donor funding could attracted to areas where government resource commitments are clearer. Service delivery focused indicators may help create stronger integration between plans and budgets, and help achieve national development goals.

In addition, given the limited resources of governments and competing priorities, technical analysis on policy choices needs to inform key decisions, to minimise ad-hoc and politically driven agenda. Clear prioritisation allows targeting a few key expenditures to support full implementation and higher impact. Knowledge sharing, including learning from past mistakes and understanding future policy commitments can help with improved medium-term expenditure planning.

Case of Agriculture Planning and Expenditure

A presentation by the SPC representative highlighted the agricultural sector as a major employer and contributor to national output and economic growth, with further potential for reducing poverty in the Pacific. The presentation noted the need for public policy makers in the Pacific to systematically review their agriculture sector policies and budgets and to align them with policy priorities to maximise the impact of the agriculture budget.

The presentation highlighted key measures to improve the effectiveness of public expenditure on agriculture. These include:

- evaluating the relative merits of competing sectoral and national priorities;
- aligning budget allocations to priorities; and
- reviewing past performance.

An Agriculture Sector Public Expenditure Review (AgPER) can be used to analyse and improve public investments in agriculture. The Pacific Community (SPC) and the World Bank are assisting PICs to conduct AgPERs.

Importance of Context Appropriate Planning and Budgeting Processes

The ADB representative presented on experiences with designing context appropriate planning and budgeting processes, taking into consideration not only technical and legal requirements ('what one should do') but paying attention to the political economy ('what one wants to do') and capacity constraints ('what one can do'). All three factors interact and influence compliance with existing processes and should inform the design of reforms to overcome shortcomings.

In a political and capacity-constrained environment, planning and budgeting officers, together with their management, have a crucial role to play in (i) providing decision-makers with comprehensive and relevant information that allows technically and fiscally sound decisions and holding leaders accountable if they act otherwise; (ii) ensuring processes and reform solutions are context-appropriate; and (iii) assessing reform feasibility and establishing an environment conducive to change. Governments' lead in designing solutions and managing external assistance is essential to facilitate context appropriate processes and systems.

Quality of Government Expenditure

A PFTAC presentation discussed quality of government spending. Public expenditure is a significant contributor to economic activity in Pacific Island countries and an important tool that governments have to achieve economic and social objectives. But public expenditure is constrained by the financing governments can raise and by how many projects can feasibly be implemented. Given these limited resources, governments need to make decisions on what programs or projects to fund. The economic merit of spending programs can be evaluated by three criteria—their effect on (i) economic efficiency, (ii) equity and (iii) provision of safety nets.

Some forms of government expenditure can increase economic efficiency by raising the productive capacity of a country or the output a country can sustainably produce with given resources. Infrastructure spending, for example, can permanently increase a country's output and people's income, even after construction projects are completed given re-access to markets and services. Similarly, government expenditures on basic education and basic health care increase people's ability to earn higher incomes by producing more output more efficiently. In addition, they help achieve redistributional and equity objectives by equalising access to opportunity. Typically governments are also expected to provide some sort of social safety net or insurance to prevent people from falling into poverty because of personal conditions, e.g. ill health, or economic shocks, such as natural disasters. The quality of government expenditure can be evaluated by these three criteria.

Fiscal Pressures and Fiscal Risks

PFTAC delivered a presentation on the importance of disciplined preparation of 'fiscal notes' on all proposals before adoption by parliament or cabinet. A fiscal note estimates the fiscal impact—the potential costs, savings, revenue gain, or revenue loss resulting from the implementation of a proposed policy or project—regardless of funding source. It is a tool to help cabinet members and parliamentarians better understand how a proposal might impact the budget as a whole, the budgets of individual agencies, and in some instances, local governments.

Fiscal notes should be prepared for all proposed cabinet / parliament actions before decisions are taken. They should be a required part of all cabinet and parliament briefing materials on any proposal. Initial preparation should rest with the proposing ministry or agency on a form prescribed by the Ministry of Finance. Cost (or savings) estimates should cover at least a 3-4 year period or longer if a longer phase-in is needed for full implementation. Ministry of Finance review and comments on all fiscal notes should be a part of the cabinet and parliament submission. In addition to showing the costs (savings) associated with each specific proposal, the Ministry of Finance should present information showing updates of the overall fiscal surplus (deficit)—including all changes resulting from cabinet / parliament decisions since the last official budget.

Budget department officials should maintain a database on all fiscal notes for use in preparing future budgets or budget updates. Ministry of Finance officials with responsibility for budget preparation should be informed by the cabinet of actions on all cabinet decisions with fiscal consequences. This information should be added to their information base for preparing forward budget estimates.

The presentation stressed that fiscal notes and cabinet approval should be required for all of the following proposals:

- creating a new program, activity, or project by using funding from another program, activity, or project. While such actions may be appropriate it is important to determine and certify that the transfer will not harm the program and there is no intent to ask for restoration in future years of funds to the program, activity, or project from which the funds were removed;
- all new policies or projects for which the government will be responsible. Examples:
    - phase in requirement for all public school teachers to have BA degrees by a specified date; and
    - compulsory secondary education by a specified date.
- all expansions of current government policies;
- all new donor-funded capital or other development projects. Examples:
    - donor funds initial construction of a capital project. Country responsible for operation and maintenance, asset repair / replacement; and
    - donor funds initial operation of a new public service for x years, then country is expected to finance operation after x years.
- all proposals for new borrowing; and
- all proposals to provide guarantees or establish public-private partnerships.

Cook Islands Loan Repayment Fund—An Example of a Tool to Manage Fiscal Risks

The Cook Islands presented on the Cook Islands Loan Repayment Fund (LRF), a risk management initiative. In February 2014, the parliament of the Cook Islands passed the Cook Islands Loan Repayment Fund Act 2014 formally creating an LRF. The aim of the LRF is to quarantine funds previously accumulated for loan repayments and to prevent them from being utilised for anything outside of debt servicing requirements.

The LRF Act also ensures a framework for the prudential management of all sovereign public debt and the timely allocation of money from the Budget for debt servicing. Another core aim is to monitor and manage exchange rates fluctuations of foreign currency denominated debt and debt servicing payments.

Estimating Annual Set-Asides for Asset Repair and Replacement

Most PICs are not setting aside adequate resources for asset repair or replacement. PFTAC presented a simple approach to estimate the minimum annual set-asides for this purpose. It relies first on developing a comprehensive asset register for all fixed and movable assets (regardless of whether the asset was purchased by own source or donor funds). The cost of replacing the asset is then determined as well as its estimated useful life. Once these basic pieces of information are obtained, the estimated annual set aside for repair and replacement can be determined by simply dividing the replacement cost by the estimated useful life. The annual set-aside should be maintained in a centrally managed ministry of finance account specifically for asset repair and replacement. Any end year balances should carry forward. This approach should insure that funds are available when needed, without requiring special appropriations when assets need to be replaced or need significant repairs.

Maintaining and repairing assets during their useful life will require adequately trained local technicians and workers.

Supplemental Budgets

ESCAP presented on challenges created by supplemental budgets, which often lead to public funds being diverted from use towards meeting longer-term national development priorities. Some major problems with supplemental budgets are that they:

- promote a ‘soft budget constraint’;
- lower incentives for strong commitment controls;
- lower incentives for estimating forward budget envelopes accurately because of knowledge of potential in-year top-up; and
- create room for ad-hoc politically driven expenditure which may not be focused on development priorities.

Country participants discussed experiences with supplemental budgets, noting the common challenges and practices. Stronger linkages of plans and budgets, robust monitoring and regular consultations, stronger budget discipline including through fiscal notes and better revenue and expenditure forecasts, can help minimise the need for in-year supplemental budgets.

Managing the Fiscal Risks of Natural Disasters

A presentation by PFTAC discussed natural disasters. Mainly cyclones, floods, earthquakes, and tsunamis have had major fiscal impacts throughout much of the region causing damages every year on average of almost 2% of countries' gross domestic product (GDP). Fiscal planning can enhance economic resilience to natural disasters by building more natural disaster resistant public infrastructure and by having in place post-disaster budgetary procedures to support emergency relief, economic recovery, and reconstruction without sacrificing debt sustainability.

However, estimating the potential fiscal costs for emergency relief and the losses and damages caused by natural disasters is difficult because of uncertainty about the frequency, magnitude, timing and specific location of natural disasters. Available data on natural disasters in small island economies, recorded in the International Disaster Database, suggests:

- average losses and damages of around 10% of GDP, but
- median[1] losses and damages stood at about 1%.

The median is substantially lower than the average because of a small number of extremely costly events. The costs of the top 10% most damaging natural disasters amounted to around 25% of GDP. Moreover, losses and damages vary widely across types of disaster with storms and earthquakes typically causing more damage than floods and droughts.

To meet the fiscal costs of natural disasters there are three main sources of finance available to governments. These are: (i) fiscal buffers, including contingency funds, cash reserves and public debt; (ii) risk transfer instruments, such as insurance and other hedging instruments; and (iii) support from donors and multilateral institutions, including the Asian Development Bank, International Monetary Fund (IMF) and the World Bank. Funds from donors and multilateral institutions typically are available following a major natural disaster, but they may not be available for moderate disasters or in some cases they may not be accessed immediately thus requiring some contingency for emergency relief.

Moreover, whether disaster related aid is in addition to planned aid or replaces planned aid is of crucial importance. Donor related funding is aimed to increase the productive capacity of countries and longer-term growth prospects. If disaster related aid simply replaces planned aid and only rebuilds destroyed or damaged physical capital without adding new productive capacity, countries will be worse off than the originally planned use expected before a natural disaster struck. Also the form of support whether it is provided as grants or loans has longer-term implications with loans adding to a country's indebtedness and possibly adversely affecting debt sustainability.

[1] A median is the point at which 50% of cases is above and 50% below.

Self-Assessment of Budget Documents

Budget documents can be a powerful tool for:

- explaining funding decisions;
- communicating information on the medium-term relationship between policies/ plans and funding;
- informing elected officials and the public of service improvement strategies; and
- establishing a basis for service delivery accountability.

Participants assessed the quality of their budget documents using the following criteria/ questions:

- Does the budget document provide medium-term estimates at the program/ activity level at least for important basic services (primary education, secondary education, tertiary education, technical vocational education, public health, clinic services, and hospital operations)?
- Of those estimates is it clear what funding changes are due to demographic changes, past decisions, inflation, or new policy proposals?
- Does the budget narrative clearly explain the changes at the program/ activity level?
- Is the layout of the budget document easy to understand by the lay public in terms of clearly connecting policy promises with funding decisions?

Country Priorities, Observations and Action Points

Country	Observations, Priorities and Action Points
Cook Islands	• While planning, policy and budgeting frameworks exist in theory, more can be done to strengthen processes, protocols, manuals, and capacity. • Building capacity begins with strong leadership, and developing analytical skills, critical evaluation, data/ statistical analysis, information literacy. • To support analysis, need to strengthen the National Statistical System (National Statistics Office, as well as Ministry/ Agency level administration data) and ability to collect, store, access, disseminate accurate/ reliable/ useful data in a timely manner. • From a practical perspective, Cook Islands can make improvements to the policy, planning, budgeting, and performance frameworks as identified below: o fiscal note template included within the cabinet manual; cabinet submissions could provide more details on fiscal impacts (medium term) through fiscal notes, instead of just having ‘costings’; o strengthen policy development toolkits and workshops; o improving templates, establishing good practice, providing

	training; o strengthen Heads of Ministries and Parliamentarians Induction Manual and Workshop to include elements of fiscal impact, quality government spending, budgets and forecasting, strengthen the links between budgeting, policy and planning; o budget book and NSDP – should include more meaningful narratives to improve decision making; o improve management of risk and assets; and o decentralisation of asset management (island governments dispersed over 12 inhabited islands) makes administration/ auditing costly.
Marshall Islands	• Current fiscal note format in a general form and does not specifically track expenditures of individual policy objectives and commitments. (Note: Cabinet can reprogram funds during each fiscal year for any priorities programs pursuant to the appropriation bill but needs to focus on more development orientated expenditure). • In the format/ procedures: Ministries/ Agencies must submit a 'cabinet paper' with all the following outlined; i. Proposal; ii. Background; iii. Financial Proposal (must put the fund amount); iv. Comments from Attorney General, Chief Secretary and Secretary for Finance; recommendation from the aspect requester. • In an effort to strengthen quality of spending, MOF has just recently got its standard operation procedure to handle and manage all the funds expenditures; and • RMI has not yet in place a "Medium-Term Expenditure" framework. Therefore, RMI will need assistance to implement this to link more strongly with national development plan priorities.
Federated States of Micronesia	Importance of accounting for demographic changes in expenditure forecasts. Some issues include: • accounting for the impact of outmigration; • importance of accounting for aging population is one of the main issues that would lead to higher payment of pension or social security in the FSM; • higher NCD's cases in FSM which translate into higher cost for health care services; • changes in health spending cost (age group) to understand the trends in comparison to the budget; • provide information on the movement of students withdrawing from class and leaving the country; • understanding population trends is important to predict the impact of these changes on budget forecasts;

	• coordination of budget departments at national and state level needs to improve; • adopting fiscal notes to address the medium-term expenditure plan, at national and state levels; • more investment in FSM national trust fund; and • quality spending on state priority projects. In terms of contingency funds, FSM has an emergency fund management which needs to be streamlined for quicker access. Changing the state public projects to accommodate natural disaster is a current issue with the budget division.
Nauru	• Capacity building needed for officials, including decision makers on the budget process; • Awareness on the purpose and benefits on the NSDS to all levels and why it is important to be clearly linked to the budget; • More proactive approach is required to obtain political will, mostly because not much information is provided to justify and to understand the policy proposal. Currently politicians take the initiative in identifying areas of new policy and later seek information from officials to develop policies; • Critical assets are most vulnerable to deterioration and misuse, therefore forward repair and replacement planning is very crucial; • Clear budget process on implications of surplus budget and unspent contingency funds; • Better understanding on managing revolving funds, on how to access funds which are not realised; • Critical policies should be legislated so they can’t be changed by new decision makers; • Demographic process and information is very valuable to decision makers in developing new policy (e.g. Refugee Processing Centre, and externalities); • Safety net is crucial while heavily reliant on donor support; • Revamp the National Development Committee in order to assist decision makers, by screening submissions and making recommendations and most importantly updating the success and progress of the NSDS; • Strengthen relationship with potential donors by providing regular fiscal reporting; • Donor commitments clear and available prior to budget submission; • Building Trust Funds would give assurance and certainty for cash available in future endeavours; and • Allocating contingency/ trust funds to cater natural disaster response and other unforeseen expenditures.

Niue	• Need better integration between budget and planning divisions. • Better planning for capacity constraints needed. • Skills gaps—currently don't have a budget analyst position and need for more active involvement of policy advisor in budget process. • Need to resume preparing medium-term estimates when preparing annual budget estimates. • Propose setting up a Disaster Risk Fund.
Palau	• Improve on quality of spending. • Need to be realistic about our economic outlook and revenue forecast. We need to recognise future requirements for budget changes due to decisions already made in the past and funding changes driven by demographic flows. We also need to anticipate inflation. • Think about the right-size for various reserve accounts or buffers. • Need to be mindful of project policy changes not yet made but highly likely to take place. • Engage with public in the budget formulation process. • Improvements in our Medium Term Fund balance to include statements showing projects policies and demographic flows such as children and elderly. • Need to improve on our documentation – detailed policy focused on Medium Term Budget – ministries to combine recurrent and development at the program level: o MOF to provide guidance; o LM lead on policy/ strategy/ content; and o MOF enforcing fiscal reality, including out year estimates.
Samoa	Fiscal/ Budget Discipline: • Majority of areas covered are already practiced in Samoa but there is a lot of room for improvement. Variety of developments currently underway. • To budget limited amount of resources in a most effective and efficient way with discipline/ controls is so vital, in order to enhance transparency and accountability. • Strengthening of financial systems and processes is essential, and fiscal discipline must be taken into consideration. • Short and long-term effects caused by undisciplined systems limit development outcomes.

Follow-up Activities

Workshop participants will consult national stakeholders to confirm priority actions and where necessary liaise with partner agencies on implementation support required.

Guidelines on good practice for strengthening medium-term expenditure planning and better linking to national plans will provide a helpful resource for both national and development partner stakeholders. Workshop participants will assist with drafting of the proposed guidelines in partnership with organisers.

Version Dated 20 November 2015