

# Program and Performance Budgeting Experiences from South East Europe: Their Role in the Fiscal Consolidation Process

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# The role of performance budgeting in fiscal consolidation



- **Performance budgeting—defined as the procedures that strengthen the links between the funds provided to public entities and their outcomes or outputs—can have a positive impact on fiscal consolidations in three main ways:**
  - First, any expenditure-driven fiscal consolidation entails politically difficult decisions about public priorities, and performance information can help to mobilize the necessary support for such decisions.
  - Second, maintaining public support for a consolidation program also depends on the government’s ability to target non-priority sectors and protect socially sensitive areas. A prioritization that proceeds program-by-program—rather than by economic line item-by-line item—has a better prospect of achieving this.

# The role of performance budgeting in fiscal consolidation



- Finally, ambitious consolidation measures have to be absorbed by the administration without unacceptable consequences for the delivery of public services.
  - Accountability for results, rather than the detailed expenditure composition, allows for a devolution of managerial flexibility, facilitating an adaptation to tighter overall budget constraints.
  - The European Commission found performance budgeting to be associated with successful consolidation.
  - Reddick (2003) and Crain and O’Roark (2004) find a positive impact of performance budgeting on aggregate fiscal performance, but, as pointed out by Robinson and Brumby (2005) the causality is unclear in these studies.
  - Perotti (1998) and Wagschal and Wenzelburger (2008) underline the importance of protecting socially sensitive expenditure to sustaining consolidation effort.
- However, as pointed out by the OECD in 2007, enhancing the control over results has not been accompanied by delegation of managerial flexibility in all countries.

# Why is a program classification important?



- **A comprehensive program classification of the government sector, with clear program objectives and targets, facilitates a discussion on how the budget contributes to the government's overall policies and the impact of various consolidation measures.**
- **Budgets should therefore be classified, and ideally appropriated, on a program basis.**
- **By defining and systematically monitoring a set of objectives and targets for each major expenditure program, nonfinancial effects of proposed consolidations measures can be brought into the discussion.**

# Why is a program classification important?



- **Simply generating performance information is rarely sufficient to ensure that it influences budget decisions.**
- **But systematic performance reviews can provide an important input into the formulation of a well-targeted consolidation program.**
- **Although it is rarely possible to establish a direct link between performance and funding, performance information should feed into the budget process.**
- **Comprehensive reviews which evaluate the effectiveness of major government spending programs can help to provide a strong evidence base for expenditure rationalization.**

# Program budgeting and overall strength of fiscal institutions in South East Europe

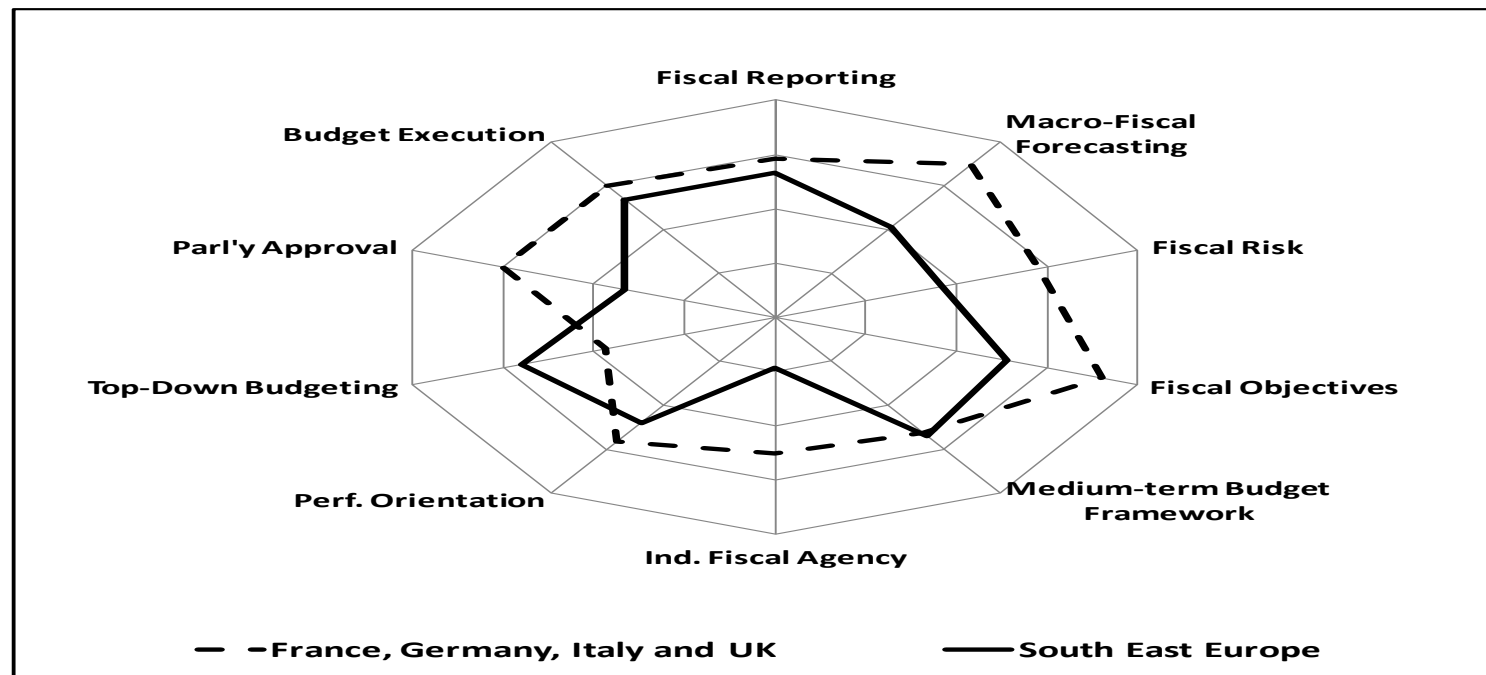


- **Recent survey by Fiscal Affairs Department (2011) examined strength of fiscal institutions in SEE. The following budget institutions were measured:**
  - **Understanding the Scale and Scope of the Fiscal Challenge**
    1. Fiscal Reporting
    2. Macroeconomic and Fiscal Forecasting
    3. Fiscal Risk Disclosure and Management
  - **Developing a Credible Fiscal Consolidation Strategy**
    4. Medium-term Fiscal Objectives
    5. Medium-term Budget Frameworks
    6. Independent Fiscal Agencies
    7. Performance Orientation
  - **Implementing the Consolidation Strategy**
    8. Top-down Budgeting
    9. Parliamentary Budget Approval
    10. Budget Execution

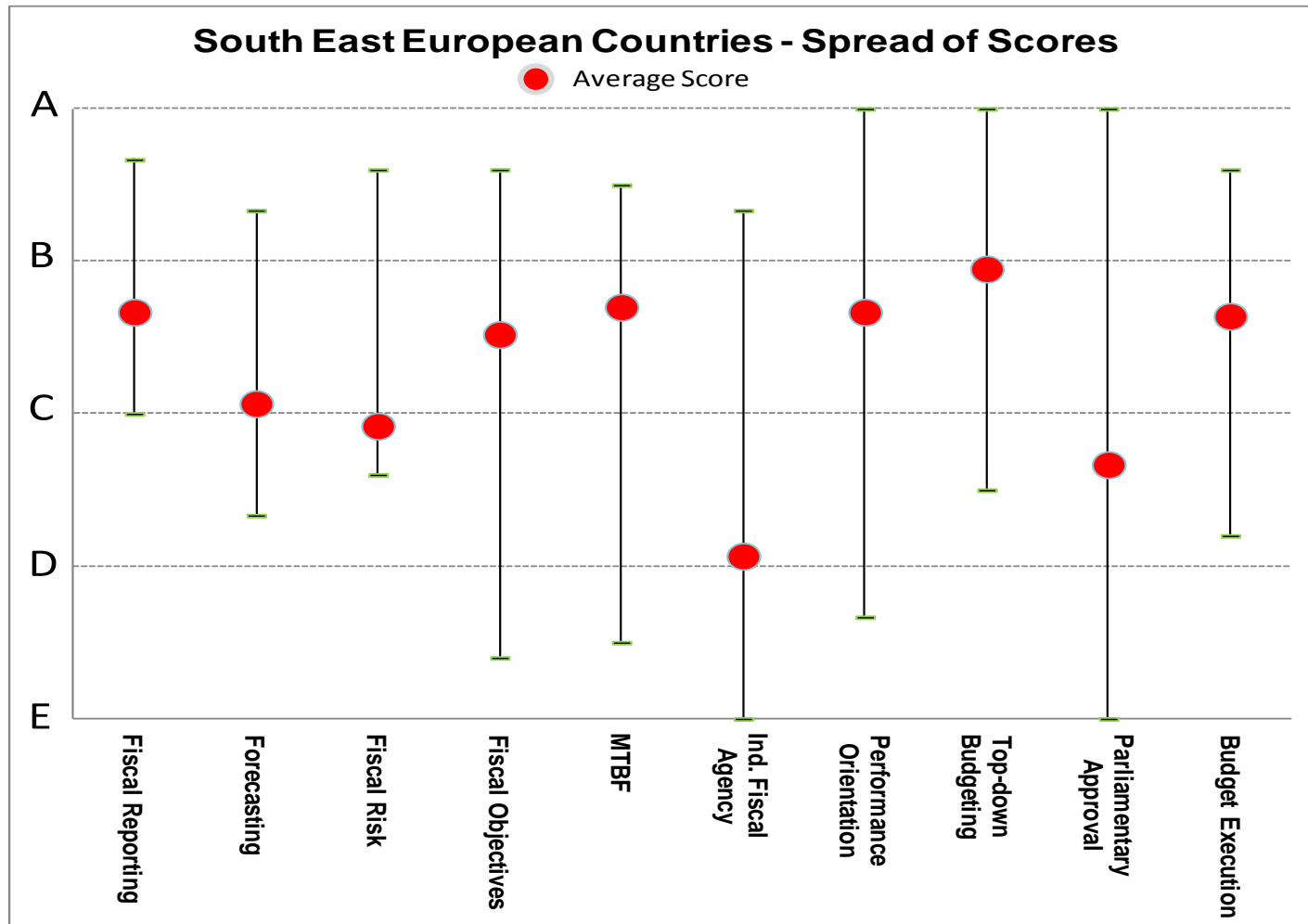
# Program budgeting and overall strength of fiscal institutions in South East Europe



- Variation in institutional strength within countries was greater than that across countries.
- Suggests room for improvement in all countries.
- Performance orientation looks reasonable but looks can be deceiving.



# Average strength of fiscal institutions for South East European countries





# Strength of fiscal institutions by country

Budget Institutions	SEE Avg.	South East European Countries									
		Alb	BiH	Bul	Cro	Kos	Mac	Mol	Mon	Rom	Ser
<b>A. Understanding the Fiscal Challenge</b>	C	C	C	C	C	C	C	D	D	C	D
1 Fiscal Reporting	C	B	B	C	B	B	C	C	C	C	C
2 Macro-Fiscal Forecasting	C	C	D	C	C	C	D	C	C	B	C
3 Fiscal Risk Management	D	D	C	C	D	D	C	D	D	C	D
<b>B. Developing a Consolidation Plan</b>	C	C	D	C	B	C	D	C	D	C	C
4 Medium-term Fiscal Objectives	C	C	E	B	C	B	C	C	D	B	B
6 Medium-term Budget Framework	C	B	B	B	B	B	C	B	E	B	C
5 Independent Fiscal Agency	E	F	E	F	C	F	F	F	F	C	B
7 Performance Orientation	C	B	D	B	A	C	C	C	C	C	E
<b>C. Implementing the Strategy</b>	C	D	D	C	C	C	C	C	D	B	D
8 Top-Down Budgeting	C	C	B	B	A	C	C	B	D	B	C
9 Parliamentary Approval	D	D	F	C	D	E	B	D	D	A	D
10 Budget Execution	C	C	C	C	C	B	C	B	C	C	C
<b>OVERALL SCORE</b>	C	C	D	C	C	C	C	C	D	C	C

# So how does performance budgeting fit into this in SEE?



- **Most South East European countries have introduced some performance dimension into their budget processes, but only one of 10 surveyed has in place all the institutions needed to fully integrate performance information into budget decisions. Specifically:**
  - Four countries (Albania, Bulgaria, Croatia, and Kosovo) use programs as the legal basis for expenditure appropriations, while the remaining countries include a program classification of expenditure in their budget documentation;
  - Although all but one country (Serbia) fix performance objectives or targets for some portion of expenditure, only two countries (Croatia and Moldova) regularly conduct comprehensive reviews of program performance;
  - Only one country (Croatia) has a comprehensive performance budgeting system which combines all of the above elements.

# Performance budgeting in SEE

## Role in consolidation efforts



Developing a Consolidation Plan	SEE Avg.	South East European Countries									
		Alb	BiH	Bul	Cro	Kos	Mac	Mol	Mon	Rom	Ser
<b>4. Medium-term Fiscal Objectives</b>	<b>C</b>	<b>C</b>	<b>E</b>	<b>B</b>	<b>C</b>	<b>B</b>	<b>C</b>	<b>C</b>	<b>D</b>	<b>B</b>	<b>B</b>
a. Objectives are precise & transparent	B	Fully	Not	Fully	Partly	Fully	Partly	Fully	Partly	Fully	Fully
b. Objectives are comprehensive	B	Fully	Not	Fully	Fully	Fully	Partly	Fully	Partly	Fully	Fully
c. Report performance against objectives	B	Fully	Partly	Fully	Fully	Fully	Fully	Fully	Partly	Fully	Fully
d. Permanent fiscal rule	D	Partly	Not	Fully	Not	Not	Not	Not	Not	Partly	Partly
e. Sub-nat'l rules & enforcement mechs	C	Not	Not	Not	Fully	Fully	Partly	Not	Partly	Fully	Fully
<b>5. Medium-term Budget Frameworks</b>	<b>C</b>	<b>B</b>	<b>B</b>	<b>B</b>	<b>B</b>	<b>B</b>	<b>C</b>	<b>B</b>	<b>E</b>	<b>B</b>	<b>C</b>
a. Multi-year spending & revenue estimates	B	Fully	Fully	Fully	Fully	Fully	Fully	Fully	Partly	Fully	Fully
b. Binding multi-year expenditure ceiling	C	Partly	Partly	Partly	Partly	Partly	Partly	Partly	Not	Fully	Partly
c. Clear statement of sectoral priorities	D	Partly	Partly	Partly	Partly	Fully	Partly	Partly	Not	Partly	Not
d. Covers majority of central government	B	Fully	Fully	Fully	Fully	Fully	Partly	Fully	Not	Fully	Partly
<b>6. Independent Fiscal Agencies</b>	<b>E</b>	<b>F</b>	<b>E</b>	<b>F</b>	<b>C</b>	<b>F</b>	<b>F</b>	<b>F</b>	<b>F</b>	<b>C</b>	<b>B</b>
a. Prepares macro & fiscal forecasts	E	Not	Partly	Not	Partly	Not	Not	Not	Not	Partly	Partly
b. Evaluates ex ante fiscal policy	D	Not	Not	Not	Fully	Not	Not	Not	Not	Fully	Fully
c. Evaluates ex post fiscal performance	E	Not	Not	Not	Partly	Not	Not	Not	Not	Partly	Fully
<b>7. Performance Orientation</b>	<b>C</b>	<b>B</b>	<b>D</b>	<b>B</b>	<b>A</b>	<b>C</b>	<b>C</b>	<b>C</b>	<b>C</b>	<b>C</b>	<b>E</b>
a. Program classification & appropriation	C	Fully	Partly	Fully	Fully	Fully	Partly	Partly	Partly	Partly	Partly
b. Regularly monitored targets/objectives	C	Fully	Partly	Fully	Fully	Partly	Partly	Partly	Partly	Partly	Not
c. Regular expenditure reviews	C	Partly	Not	Partly	Fully	Partly	Partly	Fully	Partly	Partly	Not

# How is performance budgeting contributing to fiscal consolidation efforts?



- **To contribute effectively performance information needs to be more effectively integrated into the budget process in most SEE countries.**
  - Some SEE countries now appropriate their budgets on a program basis.
  - Key performance indicators for major programs have been developed in a number of countries but these indicators are rarely used to inform the budget planning process.
  - Few countries undertake regular program monitoring and evaluation to ensure that program performance information is used to improve allocative and operational efficiency of expenditure.
- **Further efforts in this area are essential, although the benefits may only be evident in the longer term.**

# Strengthening all fiscal institutions as part of a wider fiscal management process



- Improving performance and program budgeting capacity is not enough.
- Other fiscal institutions have to be developed as part of a wider PFM reform process if fiscal consolidation is to be achieved.
  - Improvements in the breadth, depth, and timeliness of fiscal reporting and more systematic analysis of the risks surrounding fiscal forecasts contribute to better *understanding of the scale and scope of the fiscal challenges*.
  - Multi-year macroeconomic and fiscal forecasts are the norm but tend to be limited to a single scenario.
  - Although fiscal risks are increasingly being disclosed, quantification and control are typically limited to explicit guarantees and tend to ignore implicit guarantees and contingent liabilities.

# Strengthening all fiscal institutions as part of a wider fiscal management process



- *Consolidation planning* needs to be supported by more clearly articulated fiscal objectives, more comprehensive and binding medium-term budget frameworks, greater independent scrutiny, and a stronger focus on performance.
- While most South East European countries set medium-term objectives for fiscal policy, these are not often formulated and monitored in a manner which enables the public to hold the government to account for their realization.
- Medium-term budget frameworks are in place in nearly all countries but need to be expanded in coverage and impose more binding constraints on future budgets.

# Strengthening all fiscal institutions as part of a wider fiscal management process



- Independent fiscal agencies providing input into fiscal policy-making remain uncommon in South East Europe.
- While all South East European countries have introduced elements of performance budgeting, performance information needs to be more systematically integrated into budget decision-making processes in most countries.
- *Implementation of consolidation plans* would benefit from a more rigorous top-down approach to budgeting, stronger parliamentary endorsement of consolidation strategies, and more explicit contingency arrangements.

# Strengthening all fiscal institutions as part of a wider fiscal management process



- Budget preparation follows a top-down approach in most South East European countries to a degree, but budgetary rigidities and circumvention of the budget process diminish its disciplining impact.
- Parliamentary ownership of the government's fiscal strategy is limited by a traditional bottom-up, chapter-by-chapter approach to budget approval in most countries.
- While controls over budget execution are relatively strong, management of contingency reserves and controls on multi-year spending commitments need to be strengthened in order to keep consolidation plans on track.