



Twinning Project MK11 IB FI 01

"Strengthening the medium term budgeting for effective public financial management"

Summary of the Report:

Analysis of some existing key strategic and legal documents with recommendations to develop program budget classification

Component 1

Activity 1.1



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## Summary of the Report: Analysis of some existing key strategic and legal documents with recommendations to develop program budget classification

Analysis of current practices in budget planning, strategic planning, existing legislation and performance orientation

There is a need to make improvements into Macedonian program budgeting. At the moment the annual budget includes government programs which are related with the strategic priorities of the Government, development programs with indicative 3-year budget and budget programs. New budget programs are often introduced, which makes classification and time series unclear. There is not much performance orientation visible at the moment in the budget planning although some elements can be found in the strategic and budgetary documents.

According to the Budget Law, Government Strategic Priorities should be approved by mid-April and 3-year Fiscal Strategy by end of May. Budget circular letter with expenditure ceilings is sent to budget users by mid-June. Budget requests by budget users are sent to Ministry of Finance (MoF) in September at the latest.

The Unit for Strategic Planning of the Government General Secretariat is responsible for coordinating the process of strategic planning. Government determines during spring the Strategic Priorities for the next year operationalizing the Government's Program. Each budget user drafts 3-year Strategic Plan which should contribute to Government's strategic priorities. These plans are sent to MoF in connection to budget request. Strategic Plans are used as supporting documents in the budget process, but they are not approved by the Government. There is obligation that the budget users' Strategic Plans need to be in line with the budget expenditure ceilings, however, in practice this is not always the case. In addition, budget programs (to be found in the Budget Book) can be different than strategic programs (to be found in Strategic Plans).

While making the program budget reform, it may be considered to adjust the annual processes and timetables and to do the strategic planning already in winter-spring before/together with the medium-term budgeting (Fiscal Strategy)<sup>1</sup>.

It would be important to create new program budget classification and procedures for it in a way that strategic planning would be better linked to budget planning and vice versa. Both should be based on the same program budget structure, objectives and indicators. This would mean that the Unit for Strategic Planning should make adjustments and changes to their methodology as well.

Programs should be multi-annual and clearly defined. There should also be well-structured coding system, descriptive text explaining the programs and indicator time series. This would provide support

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<sup>1</sup>Within the Twinning Project Component 2, recommendations will be given concerning the contents, timetable and process of Fiscal Strategy. E.g. it is suggested that the process of Fiscal Strategy should be moved to earlier spring time.

for more effective budgetary decision making and provide more clear and transparent information on how central government finances are used, and what are the objectives related to the use of money.

Good connection of strategic planning, budget requests and program classification is needed to connect the program budgeting also to medium term expenditure framework. Important thing is that the program structure should remain the same from the spring time strategic and medium term planning to the annual budget planning. The program budget structure should not change much from year to year (with the exception of major changes e.g. in political key areas), so that time series can be drafted. Also performance information (objectives, indicators) should be on quite a strategic level and remain stable also when budget figures change. There is a need to highlight the quality of performance indicators – e.g. not to focus only on direct output indicators (e.g. km of new road), but also on outcomes (e.g. faster mobility of goods and people).

### Program budget classification for policy areas

The main idea behind program budgeting is to improve expenditure prioritization and effectiveness and efficiency of existing services. It should not be just one more way to classify and report the budget expenditure. Programs should be used for the planning and control of expenditure. Programs need to be to maximum possible extent result-based. This means grouping together activities (and outputs) with a common intended outcome. Program budgeting structure should be kept as simple as possible – too many hierarchy levels and too small programs should be avoided. Programs should be defined only for the level which is of importance for the Government / Parliament / top level of ministry management in determining centrally total resourcing.

In the work to redefine the classification for MK, it is vital that both Budget and Funds Department and budget users are very engaged in designing the programs, classifications and indicators. Copying another country's system is not an option – solutions should be chosen to suit the local context. This is important to keep in mind while this part of the Twinning Project relies strongly into the Slovenian expertise of program budget reform.

It is highly political issue, what kind of approach is taken in program budgeting. There can be more technical / organization based approach. This would mean to work more on development of direct impacts and outputs of programs. More developed pure program budget approach focus more on the higher level outcomes and societal effects of policy areas. In this approach outcomes should be connected to Government main strategic objectives and organizational classification should not restrict the definition of programs – many budget users can contribute to same program.

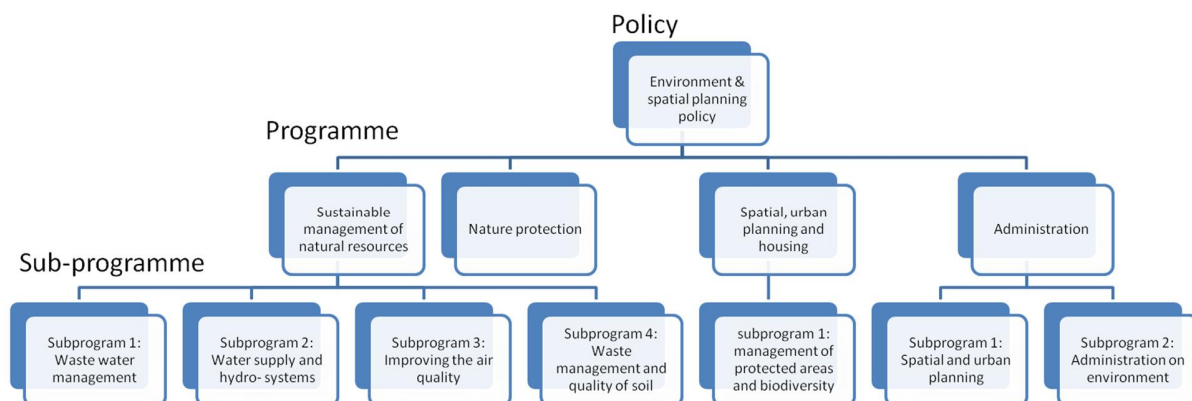
It was decided within the Twinning Project to combine as much as possible of the two approaches. Outcome indicators and policy area level can be used, although quite technical approach would be implemented so that at least on lower level of hierarchy with subprograms organizational structure will be taken into account. Internationally it has been quite typical that countries have settled for a hybrid classification that combines programs and organizational structure in a single structure instead of pure and real program budgeting system.

The approach chosen has been tested and adjusted during the Twinning Project through work with pilot sectors of transport, environment and physical & spatial planning, and agriculture and forestry. In the next phase the approach and working method will be expanded to more and more sectors, or by program budget terminology “policy areas”.

It needs to be highlighted that it is important that budget users and line ministries will understand the logic of the reform. Cooperation with budget users in the planning phase, effective training of budget users, and step by step approach is needed. It will be a big challenge to change the thinking from very detailed input-oriented budget planning into more holistic approach that focus into outputs and outcomes. At some point also Treasury Department of MoF needs to be very much involved as it is a crucial issue, how the program classification coding is done in e-budget and e-treasury systems so that also reporting and follow-up is possible and easy.

The assumption (or hypothesis) is that the new classification would consist of some 10 policy areas. As a starting point the policy areas have been drafted so that they are quite extensive and include in many cases areas of various ministries.

*Picture: Hierarchy of programs in pilot area of environment and spatial planning (Katja Lautar, MoF, Slovenia)*



Another thing to notice is that the program budget classification is designed for the Budget Book at this first stage. So it will not follow e.g. ESA2010 classification of public sector. In budget programs are only included programs, subprograms and activities that receive at least partial funding from the budget of the central government and funds.

In MK it can be assumed that in the first phase of program budget reform it would be so that program budgeting would be a way to classify the budget in a more informative way. In this first phase decision making could still be made on a more organizational basis starting from budget user ceilings (only in next phase decision making would be based on ceilings by policy areas). In any case, this would be an important first step in order to get familiar with the program budgeting method and better performance orientation, and to make the Budget Book more transparent.

Maybe in the future in a later phase program budgeting could also be in the core of strategic decision making. But one precondition to this is that the organizational classification needs to be revised and the amount of first line budget users should be step by step cut down. One major challenge in MK for program budgeting is the amount of first line budget users (close to 100) and the fact that there are no line ministries who would be in charge for the whole sector and institutions within that sector. So cooperation and coordination in between policy area budget users need to be reinforced, and at some stage also the coordinating role of the line ministers / ministries need to be emphasized.

Already at this point also the fact should be raised, that many countries have at least partly failed in performance-based budget reform. It can happen that e.g. linkage between performance information provided and expenditure level remains weak or non-existing. Or there might be only very limited or no discussions on Government or Parliament level concerning previous performance and ambitions for future. Some key issues have been identified to help successful change in program budget reform:

- High political commitment is needed to implement program oriented budget;
- Capacity building is important in the sense of changing the mind setting to the strategic program budget planning with connection to medium term framework, and it needs to be taken into account that the change of decision making culture takes time, so it is good to be realistic with expectations in the beginning;
- Crucial to strengthen the awareness that program is not institution;
- Good coordination and negotiation mechanism are needed in between different budget user organizations. Also needs to be decided, who is in charge and running the negotiations;
- Development of program oriented budget also in the connection to the public sector administration reform;
- Good coordination needed between strategic plans and budget planning;
- Harmonization of the definition of objectives and indicators;
- Distinguish the different use of the budget presentation (what is for program budgeting and planning, what is for accounting).

Monitoring and reporting is an issue that will be considered more in detail later during the Twinning Project, but already at this phase some core issues should be considered. Important questions are for example: where will the reporting take place (in Budget Book, in separate document or in possible policy area strategic plan, in connection to final accounts), what will be the coverage of performance reporting, what kind of time series will be reported and who will be in charge for the reporting.

### Step-by-step working method

Below is shortly explained different steps to define the program budget classification. Some steps can and do take place simultaneously. It is extremely important to have a good cooperation between the MoF and the budget users. There is a need to discuss the approach and idea of program budgeting, the suggested draft program classification and draft indicators. In all the policy areas the best knowledge and

expertise is in the budget user organizations. Cooperation is needed also to achieve the commitment of budget users to the whole project of redefining program budgeting with performance orientation.

- Step 1: Work with each policy area starts with assessment and review of all relevant strategies, plans, programs and legislation – their goals, results and resources. Attention should also be given, especially at later phase in EU accession, to also EU level strategies. Also the existing sectoral strategies by sector working groups (of Sector Policy Co-ordination Framework) need to be studied.

After analyzing the set of important documents, the aim is to identify the main objectives and activities, to be converted into the expected results and impacts, and to allocate resources. In other words, what kind of results we can expect to see and how these contribute to some strategic objectives.

- Step 2: Good way to start is to figure out some 2-3 general objectives and goals for the whole policy area. These should highlight the high level objectives of public spending. In the future with EU accession, special attention should also be addressed to Europe 2020 targets concerning the employment, R&D, climate change and energy sustainability, education and fighting poverty, and social exclusion.
- Step 3: Under the policy area is defined programs and their goals. One program should combine all activities that serve the same purpose and target for same objective. Also the programs are on quite general level. There might be e.g. 3-6 programs with specific objectives under one policy area depending on the size and structure of the policy area. One of them might be also for administration or technical support, if needed.
- Step 4: Under each program there are sub-programs and their expected results. These are more concrete and with very clear linkage to activities. At the very first phase there should not be too much focus into all the possible activities – it is enough to get the main idea, what kind of activities exists. This is because activities can change already before the new classification is implemented (projects end, new projects start). However, when implementation gets closer it is important to go through the activities with budget users. Only those activities should be included that have financing in the medium term budget planning (i.e. Fiscal Strategy). It is recommended that subprograms are defined so that they have clear ownership and clear budget per budget user.
- Step 5: For each level of policy/program/subprogram and their objectives, also indicators must be decided. It is important that indicators are chosen so that they reflect the objectives set.

Indicator must be easily accessible and transparent, and same data must be available and published annually or with other set timetable. For example statistical data published by the State Statistical Office can be used in indicators. Also annual data gathered by international organizations (EU, OECD, etc.) can be used. In some cases indicators mentioned and used in the current Strategic Plans can be used. Indicators should be such that they remain stable over the years and are not constantly changed.

For the policy area general objectives the indicators should be on quite general level. The impact indicator should reflect the long-term consequences on the level of overall policy, markets, companies, associated with the general objectives.

As comes to programs, outcome indicators must be chosen. These should reflect the effect (outcome) or long-term consequences of specific government measures / projects, which are expressed as the wider socio-economic consequences at the level of the program or policy. The achieved effects (outcomes) could influence other factors, not just a specific program; associated with specific or general purpose.

From subprograms are expected results, which are direct and immediate consequence of generation of direct effects leading to the realization of a goal (medium term result of government measures / projects). So indicators must be set according to this. The result can be expressed in physical or monetary units. Direct impacts (outputs) are immediate (short-term) consequences of measures / projects, for example goods produced or services performed. It is a means by which to achieve the desired results.

- Step 6: Together with the budget users must be checked that all the current government programs, development programs, budget programs and other activities can be found from the new structure. Nothing can be left out. The Budget and Funds Department has major coordinating role to understand and take into consideration linkages between the budget users. There are many policy areas and programs which are financed through activities of different ministries and budget users.
- Step 7: Next step is also to see, what kind of activities take place to support the objectives of subprograms, programs and policy areas. So what are the grass-root-level activities that have financing in the coming medium term planning period. Also the coding of activities will play a key role.

It is also important to see, how the current budget resources are allocated into the defined program classification of the policy area. This is highly important so that a clear link is developed. There is a need to draft reconciliation table from old program classification / organizational budget structure to the new one, and also to allocate funds according to new program classification. Again, clear coding system is needed to track change.

The assessment was written by: Jonna Berghäll (RTA), Katja Lautar (STE), Franci Kluzer (STE) and Monika Gepl (STE). It was produced as a result from activity 1.1 "Identifying the strategic programs, legal documents, and defining programs" within the Twinning project "Strengthening the medium term budgeting for effective public financial management".

The overall objective of the Twinning project is to ensure and maintain sustainable and sound public finances by improving public finance management. The activities of the project are aimed at improving the effectiveness of medium-term budget planning, program budgeting and budget classification, as well as fiscal reporting in line with ESA standards. The project was launched Dec 2015 and it will end Nov 2017 and the main beneficiary is the Ministry of Finance, Department of Budget and Funds.

Activity 1.1 is part of Component 1 which aims to improve the program budgeting in Macedonian Ministry of Finance. The recommendations produced with this report are given to the main beneficiary of the project, Ministry of Finance.

It should be pointed out that this assessment is based on limited studies of the Macedonian budget practices, legislation and processes, through expert missions done. It should therefore be regarded mainly as a base for further discussion.

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