



Review of Programme Budgeting Reform 2006:

Assessment of the 1st year achievements of Programme Budgeting in Serbia and improvements ahead

**Technical Assistance to the State Budget Preparation Process of the Republic of Serbia
(EAR funded project)**

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Executive Summary

During 2005 the Government of Serbia has started a major budget reform. One of its main directions is introduction of a programme classification to the budget structure. In this has been done in five pilot ministries, which earlier have had experience with yearly operational planning or the GOP instrument. The objective is to ensure that there is a better alignment between Government's policy aspirations and spending.

No doubt, 2006 has been a time of valuable experience and learning as well as the beginning of a unique Serbian version of policy led or programme budgeting. Already now, most of the ministries involved in this exercise recognize a shift in paradigm through which they think about policy, budget and work planning. Most importantly, there is support for improving the informative quality of the budget and linking funding and government objectives better.

The process of preparing 2007 budget in pilot ministries has been highly challenging not only for the pilot ministries but also for the Ministry of Finance. There is also an understanding that this experience presents with an opportunity for reflection, learning and further budgeting improvements along with programme budgeting discipline expansion across the government during the next few years. In this report we have highlighted those aspects of programme budgeting experience, which, in our view, require further discussions and streamlining. They should not be seen as criticisms, but rather as agenda for discussion to achieve the best budgeting model for Serbia.

Based on our analysis we have arrived at a number of conclusions and recommendation which cover programme budgeting concept or methodology as well as broader budget policy issues. As to the programme budgeting methodology, we have identified several main conclusions, which are outlined in more detail in the main body of the report along with other smaller comments and conclusions.

1. Information produced as a result of GOP and programme budgeting processes provides with better picture of what the pilot ministries do with the funds appropriated to them. It is a first step in re-focusing from just inputs-based budget planning to linking input information to objectives, government priorities and planning of activities.
2. However, at the moment it is not fully clear whether in the medium to long term the intention is to apply programmatic classification to all government expenditure or only to some areas of Government activity. Both models are possible and valid however in terms of methodology the consequences are different. Before any GOP and programme budgeting methodology adjustments are made, the overall model needs to be agreed by all stakeholders. In this report we have recommended the full coverage model, which is not the case at the moment.

3. So far only part of Government's spending in different policy areas has been subject to programme budgeting. Our analysis in the report suggests that programme budgeting framework "in real terms" has been applied only to half or in some cases even less than half of total expenditure. There are three major areas of Government expenditure which, in our view, have been left out from the programme budgeting discipline.
 - a. The first one relates to the nature of so called General Affairs Main Programme and the treatment of "business as usual" or ongoing functions of the line ministries. The programme budget preparation instructions required ministries to include all salary and related ongoing expenditure under one General Affairs Main Programme, which can include five programmes. As a result, in the case of larger ministries with diverse policy portfolio such as Health or the Trade, Tourism and Services expenditure for number of core services has been "detached" from these services and included under this General Affairs Main Programme. It has led to a misleading picture as to costs of those services, but the General Affairs Main Programme itself has become just a collection of inputs, although it's called programme. In other words, this programme is no different from the traditional inputs based budgeting. The instructions have also excluded day to day functions, services and related outputs of ministries from programmes. As a result, important areas of Government's work are not covered at all. The case of the Ministry of Trade, Tourism and Services is a good example of this. Approximately 600 staff of the Ministry works in the trade inspections area representing more than 70 per cent of the total staff of the Ministry. However, there is almost no mention of their services in the programmes of ministry, and only 2 per cent of ministry's budget relate to inspections. In our view, the current approach of using General Affairs Main Programme significantly distorts the logic of programme budgeting. It misses the link between funds and performance at the whole of ministry level as well as excludes major areas of ministry work from performance scrutiny. It also restricts the frontier of options for re-allocation of resources to support priorities.
 - b. The second is about the way the National Investment plan (NIP) has been brought into budget process. For 2007 budget NIP has been one of the major expenditure items accounting for some 30-50% of budget in some pilot ministries. However, the preparation process and presentation of NIP in pilot ministry budgets has been effectively separate from the programme budgeting and even GOP processes. Only the Ministry of Economy has structured NIP by programme logic, which in our report we mention as an example of good approach on which further improvements could be built.
 - c. The third area where programme budgeting has not been sufficiently applied is the level of policy implementing agencies. Effectively they are excluded from the annual budget law and programme budgeting on the grounds that they are funded through own source revenue. Ministry implementing agencies are mentioned only in cases when they receive funds from the State Budget. For example, in the case of Ministry of Economy only four out of eight policy implementation agencies are mentioned in

the draft Budget Law for 2007 – but only as much as they relate to funding they receive from the State Budget. In our view, the fact that these agencies are funded through own revenues (fees etc.) does not make them any different from other policy implementation “arms” of the government. The only difference is the source of funding, which still remains public even if it is labelled “own revenue”. Existence of each of those agencies means that the Government has considered the need to have specific policy intervention and for that it has created agency given to it the right to recover its service costs through fees. As such, these policy interventions should also be expressed as budget programmes or instruments available to the Minister and the Government to deliver Government’s policy objectives. This issue, in fact, relates not only to programme budgeting methodology, but also to general budget policy.

4. The overall number of programmes per ministry (between 8-22) is feasible for efficient programme management. If this would be the final level of allocation in the Budget Law, the new programme classification could be considered as an efficient framework for policy implementation management. However, if one counts all allocations below the programme level (projects (including also NIP projects), then the range of final allocations or „cost units” range between 70-140 per ministry. In addition to that large number of programmes – 63 per cent are between 1-5 percent from total ministry expenditure (41 per cent being less than 1 percent). This represents with a rather fragmented programme structure which focuses on projects and activities (and in several cases – just inputs) and less so on objectives, services and their outputs, it should be in programmes. The more fragmented programme structure is the less meaningful and useful the programmes become. In the light of this it is also important to debate the model of classification that is desired – programme or project. Again – both are valid but different in terms of methodology.
5. If programme model is chosen, we believe that there is a need for significant capacity building in ministries to help them to create better programme information including – re-focusing from inputs and activities to outputs, introducing outcome measures, organizing programmes into larger units based on related outputs that contribute to the same outcome, streamlining objectives so that they support outcomes and priorities, and last but not least – strengthening programme logic. Although the current information requirements for programmes are quite demanding (programme with one activity and one project has some 30 information entry fields), at the moment the quality of non-financial performance information included in most of the programmes is not sufficient for good programme analysis. At the same time we recognize that the first step for improving non-financial programme performance information lies in improving of the programme structure (the point above).
6. Another feature of programme budgeting instructions is a rather complex multi layer classification. There are four levels of planning (strategic area, main programme, programme and project or activity). However, in our view the value added in terms of improved information of the first two levels is limited. We believe that at this stage of development of programme budgeting it is more important to focus on creating good programme structure and information quality rather than attempt to accommodate complex classification.

7. Piloting of programme budgeting in 2006 has been very demanding in terms of effort and resources in both – the pilot ministries and in the Ministry of Finance. At the same time all ministries involved in the pilot exercise emphasized that in order to make the new budgeting approach successful in the future there is a need for more guidance, training and assistance from the centre, particularly, the Ministry of Finance.

In relation to broader budget policy we have arrived at the following main conclusions:

1. The Budget System Law provides that ministry spending ceilings (for budget funds) shall be determined by the end of May. The same law also provides that 1st of August of the same year is the deadline for ministries to submit the draft budget. For a number of reasons both ceilings setting and submitting of the draft budget were delayed in this last budget round. If the deadlines set in the law are met, it leaves three month for programme preparation. This is feasible, however, such ceilings need to be final and credible. Credibility is the concern, however. As our analysis suggests, in the case of pilot ministries the variance between ceilings and final allocation ranges from 0 per cent in the Ministry of Economy to 49 percent increase in the case of Ministry of Health and approximately 35 per cent increase in the case of two other pilots – Ministry of Trade, Tourism and Services and Ministry of Public Administration and Local Government [\(including NIP funds\)](#).
2. Budget Memorandum, which ideally should be the key budget decision making document, suffers from a number of weaknesses.
 - a. It spells out overall guidelines for further budget policies including overall macroeconomic framework as well as indicative spending trends by government function, i.e. health, defence etc. These are expressed as trends in the share of GDP for each particular function, for example, the health function in 2007 has 5.8 percent of GDP. These numbers apparently bear no linkage to actual ministry ceilings set in July of 2007;
 - b. Budget Memorandum also contains references to many aspects of various reforms and Government initiatives, but most are just statements that are not quantified in terms of financial implications;
 - c. There is no information on the cost of continuing (without policy change) the current Government policies and programmes. Having such baseline information is essential for establishing credible ceilings in a transparent manner. Clarifying this information, in fact, should be one of the first steps in each budget round;
 - d. There is no indication of how much new money is available to accommodate new initiatives that respond to the Government priorities. Equally, there is no estimate on the cost implications of legislation adopted throughout the year;
 - e. There is no information as to expenditure ceilings for individual budget beneficiaries;
 - f. Revenue data included in the Budget Memorandum excludes own revenues.

3. According to information made available to us, there is no collective strategic planning or deliberations stage at the political level where ministers could decide on allocation for new priorities, re-allocation from items of less significance to priorities, and setting of final ceilings for the budget beneficiaries. Having said this, we also note that the new structure and process of Budget Memorandum was in preparation at the time of finalizing this report.
4. Finally, our analysis suggests that there is not complete system of costing new policy commitments of the Government and using that information in the budget process at strategic decision making stage. There still can be legal acts and policy documents that get adopted without properly assessing their cost implications.

Considering the above mentioned conclusions we have identified several recommendations for both – improvements to programme budgeting methodology and general budget policy. We start with those which have direct relevance to programme budgeting methodology and then move on to items of general budget policy:

1. We recommend to adopt the model of programme based budgeting as opposed to project and activity based budgeting. As to the project level within programmes, we have proposed to use it only in specific cases – a) large investment projects; b) big capacity building initiatives; c) high priority items for Government that need to be “highlighted” for political or other reasons; and d) in some special circumstances – for example – upon request of donors. It is important that programmes represent all major service areas of all institutions in Government’s policy sectors. In the main body of the report and in the Annex II we have spelled out the new programme concept in detail. If this approach is adopted, the Government of Serbia will obtain fuller picture of what is being achieved by the totality of funds used. It will also achieve better capacity for more strategic resource allocation.
2. However, implementing this new programme concept will require addressing of the issue of the General Affairs Main Programme. Programme management requires capacity to manage all costs of outputs included in programme. This includes also salary and related costs. Therefore we have proposed that General Affairs main programme in the case of larger ministries, which include policy implementation functions such as inspections, eventually should be split in several programmes. For example, the Ministry of Health instead of having one General Affairs Main Programme could have at least two programmes – one dealing with sector policy advice and monitoring while the other with inspection services.
3. We also recommend that in future years NIP has to be planned and presented according to programme logic and structure (also in the case if the size of NIP significantly diminishes). It should be subject to the same budget procedure as other expenditure items. This does not mean that sectors cannot have their investment strategies. This integrated approach has implications for a number of aspects of budget process, but particularly for ceilings setting. As part of ceilings setting process the total funds available for NIP should be identified and include figures for both continuing started projects and starting new projects. Budget and NIP planning cycles should be identical and based on the same priorities of the Government. There is also a need to have a system for identifying the ongoing costs of investment projects and including those costs in baseline budgets of budget beneficiaries where appropriate.

4. At the ministry level there should be much better integration of different planning streams – GOP, programme budget and NIP. There is a need for all interested parties to meet, discuss and agree how to achieve this. At the same time, the central capacity for assisting and guiding the line ministries should be substantially increased.
5. We propose also to streamline decision making process at the budget preparation front-end by improving the informative quality and staging preparation process of the Budget Memorandum. This can be achieved through introducing one or several *collective strategic deliberations or planning stages* – formal and/or informal collective (not just bilateral) meetings of ministers where key budget decisions on priority policies and spending for the next planning period are debated and adopted. But to make such events successful a concerted and focused team effort Government’s centre including the Ministry of Finance is needed.
6. The Budget Memorandum should become a useful document for decision making. We propose the use of several drafts of Budget Memorandum. The purpose of the first draft would be to set out the overall planning parameters such as a) the current macro economic and fiscal policies and resulting overall resource constraints; b) adjustments to the current macro economic and fiscal policies and its impact on overall resource constraints; c) the cost of continuing current policies and programmes under a “no policy change scenario” what is often known as the baseline or stand-still budget (“soft” ceilings; d) Government’s overall priorities; e) Government’s budget policy; and last but not least f) total envelope for new spending and rules for ministries to bid for resources from this envelope. The second draft would follow transparent and structured bidding process and another strategic deliberations stage resulting in providing budget beneficiaries with final or “hard” ceilings.
7. Once such “hard” ceilings are adopted (which should be no later than mid May) every player in the system has to stick to them. This also means abstaining from budget rebalances (excluding technical adjustments) during ongoing budget year.
8. One of the important requirements in achieving aggregate fiscal discipline and allocative efficiency is to ensure that all public funds are subject to the same discipline, i.e. overall resource constraints and policy choices (including resource re-allocation) made within those resource constraints. The practical implication of this is that over time, all extra budgetary funds, separate budgets and policy implementing agencies (except Government’s commercial entities) will have to be revisited according to programme principles. However, we recognize that this could be Government’s longer term aim. In the main body of the report we have suggested some initial steps in this regard;
9. Last but not least, a highly crucial objective of programme based budgeting is a gradual release of the centralised control of inputs, giving more planning freedom and financial flexibility to line ministries and focusing more on performance information (outputs / targets/ outcomes) and cost effectiveness analysis. At the same time such a release of control needs to be transparent and managed. It is best achieved by the Ministry of Finance setting criteria that ministries need to meet in order to be granted greater flexibility.

We conclude that Serbia has embarked on a challenging and ambitious reform programme which, if implemented properly, can bring about not only technical improvements to the budget process but also wider and more strategic positive impacts on the way public funds are used to achieve



Governments policy objectives. However, for this to happen, a concerted effort of all players – domestic and donors is needed. Therefore we also have proposed a matrix of reform measures that could lay the basis for preparing, discussing and adopting a comprehensive public financial management strategy, which is needed to plan and coordinate programme budgeting introduction with other reforms in the area of public financial management.

Introduction

1. This report provides an assessment of programme budgeting experience in Serbia. It builds on analysis of the five case studies of programme budget piloting in ministries of Health, Economy, Religion, Public Administration and Local Government as well as Trade, Tourism and Services. As part of deriving conclusions and recommendations for this report, the budget submissions (both initial and final) of the five ministries were analyzed along with assessment of the draft 2007 Budget Law as adopted by the Government of Serbia (November 2006). On the basis of that analysis as well as research into development process and contents of yearly operational plans (GOP) of the pilot ministries, interviews with all pilot five ministry nominated representatives (involved in GOP and budget planning) were held. In addition to that we also met with officials from the Ministry of Capital Investment, which is responsible for major expenditure item of the budget, e.g. the National Investment Plan (NIP) and which also has started the GOP process. In those meetings our initial conclusions based on budget submission and GOP analyses were discussed in-depth and validated.

2. In the first part of this report we present our main conclusions covering four broad themes that are derived from the main principles of programme budgeting. These principles have been selected from international practice and are spelled out in the Annex 2. The themes are:
 - balanced structure of the budget;
 - comprehensiveness of budget;
 - programme design and performance information quality;
 - programming process.

3. We conclude this part by providing overall recommendations which are derived from our conclusions. In the second part we also suggest concrete proposals for aspects of programme budgeting on which agreement is needed before the start of 2008 budget process¹. These support our general recommendations. In the third part we set out the main longer term objectives of introducing programme budgeting and propose a framework for discussing a roadmap for introduction of programme budgeting in Serbia. This framework sets out the main stages of programme budget development. In addition to that, the Annex 1 provides with an initial proposal for concrete measures to be included in such a roadmap. Annex 2 sets out the main principles of programme design. We have derived these principles from recent OECD and transition country experience in programme budgeting.

¹ Before budget planning cycle 2008-2010 has been started.

Part I: Main conclusions and recommendations

4. This chapter sets out the main conclusions that are derived from analysis and discussion of the findings included in the last chapter of this report. On the basis of international practice of programmatic budgeting and internationally accepted principles in this area we have synthesized four core themes for the review process. We fully understand that there will be a unique programmatic budgeting model developing in Serbia, i.e. a “made in Serbia model”, and that no one particular country model is fully applicable to circumstances of Serbia. However, there is also no reason why Serbia in developing its unique programmatic budgeting approach should not use the experience that is increasingly available internationally including transition economies. The four themes are:
- Balanced programme structure;
 - Budget comprehensiveness;
 - Programme information quality;
 - Programming process.

Below the main conclusions for each theme are described. The conclusions are based on findings in each pilot ministry. These are represented in Annex 3.

Balanced programme structure

Concept

5. Programme structure is about how many programmes a ministry has and what is the proportion (in financial terms) of each programme in the total set of programmes. This basically a) reflects how well-balanced ministry policies are, b) how manageable they are (in terms of financial flexibility and use of administrative resources²) and c) are they in fact of a programme nature. The idea is that programmes should be of sufficient scope so that, on the one hand, they would coincide with a natural units of planning, management, control and accountability in ministries while, on the other hand, the non-financial performance information could be meaningful, i.e. cover outputs and outcomes both unique to each particular programme³. This implies that each output should be attributed to only one programme, and that costs of producing that output shall be within that programme. In a more practical sense this implies that there should be no programme level

² E.g. administration of lots of small programmes would require more administrative costs (more accounting work, more detailed management at ministry level, etc.).

³ There also can be outcomes that cut across several programmes; however, those usually would be at the higher level and longer term in their nature. However, each programme has to have one or several outcomes to which the specific programme outputs are directly attributable.

appropriations that are exceptionally large or small in comparison to other such units. As a rule of thumb, exceptionally small programmes would be below the level of 1 per cent of total expenditure while exceptionally large ones – above or at the level of 50 per cent of total expenditure for an institution in question. Such small allocations, in fact, more resemble project and activity rather than programme level.

6. Disproportionately small programmes might have some negative aspects:

- They make ministry budgets quite fragmented and more input than policy driven;
- They, in many cases, suggest that what is called a programme, in fact, is a project or even an activity but often even a one off activity;
- More fragmentation requires more administration (accounting, controls, etc.), i.e. transaction costs, which in many cases have little to do with cost effectiveness and effective control of resource usage;
- Fragmentation and rigid re-allocation rules restrict financial and management flexibility, i.e. reduce the possibility of reallocating resources within and between policy areas when the need arises;
- Finally, it is almost impossible to apply good non-financial performance information (outputs, outcomes and the link between them) to very small appropriations. Usually, at this scale only output information can be meaningfully used.

7. On the other hand, disproportionately large programmes may suggest that policies behind this expenditure have not been thought through, i.e. policies are more input than policy driven. For example, programmes that include all investment funds are less policy, but more particular expenditure classification driven, which is against the programme budgeting logic. Also at such high level of aggregation of resources it is hard to establish attribution between outputs and outcomes. When attribution is lost, programme budgeting becomes activity budgeting.

Findings

8. The table below presents with a summary of the main findings from the five pilot ministries regarding structure of their programme budget. This table is based on the draft 2007 Budget Law approved by the Government of Serbia in November 2006 and submitted to the Assembly (due to upcoming elections to be adopted no sooner than March 2007).

Table 1: Comparison of number of programmes and final policy appropriations

Ministry	Number of programmes	Number of programmes below 1 per cent	Number of programmes below 5 per cent	Number of final policy allocations
MoE	22	9	18	69 / 140*
MoH	14	7	8	59 / 78
MoTTS	21	11	14	29 / 76
MoPLG	8	2	3	14 / 14

MoR	8	1	3	17 / 17
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Total	73 (100%**)	30 (41%)	46 (63%)	188 / 325
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*The first number shows total number of programmes, projects and activities whereas the second takes into account also NIP allocations (no revenue cost implications of NIP projects included), which currently in the draft Budget Law are not classified as 'projects' or 'activities', but which, in fact, also are *projects* by nature

**Percentages in first three columns show how large proportion of budget programmes is below 1 and 5 per cent

9. The data in the table above suggest that almost half (41 per cent) of total number of programmes in five pilot ministries are below 1 percent while more than half (63 per cent) are below the 5 per cent threshold. In the bigger ministries (Economy, Health, and Trade, Tourism and Services) half of the programmes are below 1 per cent of the total expenditure of the Ministry.
10. There are two key contributors to this high amount of small programmes in pilot ministry budgets⁴. The first is the NIP, which has added a substantial amount of funds to four out of five pilot ministry budgets, and to which programme logic has not been applied (except partially the case of the Ministry of Economy, where NIP projects are grouped in different programmes according to purpose). The second is the nature of general affairs main programme and the programmes below it. As to the latter, in the section of this chapter dealing with programme information quality we argue that programmes within the general affairs main programme are not programmes but just a collection of inputs for which there is no programme logic.
11. The data in the Table 1 also suggests that in the bigger ministries in many cases programmes represent only a "formal information layer" on top of other programming, management, monitoring and accountability units or, as we have called them – final policy appropriations. They include a) activities; b) projects; c) programmes without projects and/or activities (there are only a few such examples); and d) NIP projects which have been classified as neither programmes or projects in the Budget Law. The final policy appropriations include all appropriations in the Budget Law excluding functional and economic classification level. In a way, policy appropriations are budget basic cost centres or management units. For example, the Ministry of Economy has 22 programmes, but the real number of management units in the Budget Law is 140 (that includes also 92 investment projects). It should also be remarked that financial plans, according to programme budget instructions, should include six-digit level classification of planned expenditure, which fragments and complicates the budget management even more. The data in the table above also allows observing that programme level accounts only for 22 per cent or approximately one fifth in the total number of final policy allocations.
12. Another feature of the new system is a rather complex multi layer classification – even on top of already numerous projects and activities and programmes. Programme budgeting instructions introduce four levels of planning in the line ministries. There

⁴ It should also be noticed that not all public spending areas are subject to ministry budgets, for example, implementing agency own revenues in many cases are not included. This complicates the picture even more.

are two inter-ministerial levels (strategic area level and main programme level) and two ministerial planning levels (programme level and project and activity level). In practice, there can be another level, too. In the case of NIP, some ministries show several investment projects under one programme or project.

Conclusions

13. Overall the current budget structure and information represents a significant step towards achieving more policy driven budgeting. Compared to 2006 Budget the new budget has become richer in terms of information and in many areas there is a clearer link between resources and what is being done with those resources.
14. In our view, the four level classifications (strategic areas, main programmes, programmes, projects and activities) is an unnecessary complicated system in which some layers like strategic areas and main programmes add little or almost no value in terms of improving informative quality of the budget. Although the level of strategic areas and especially the main programmes might have their strong theoretical grounding⁵, it is important that ministries first get the programmes right and then see how groups of programmes contribute to cross cutting policy objectives. To start with this cross cutting high level angle of planning means ending up with a formal structure of classification, which does not support real decision making.
15. Overall, the number of budget programmes in the pilot ministries is satisfactory – they range from eight to 22 programmes. If the programme level was the level of final policy allocations (the level of financial plans) this would be a sufficiently flexible framework meeting also the criteria for financial flexibility⁶.
16. The findings above suggest that the focus of the current system is on the project and activity level and less on the programme level⁷. Most of the non-financial performance information is found at that level. Often, there is a one to one relationship between programmes and projects or activities, i.e. they are the same. This suggests that the current version of budgeting is more of an activity and project based approach rather than programme budgeting.
17. The programme structure financially is relatively fragmented. In the implementation stage that will significantly affect the scope for flexibility, without which effective programme management is impossible. According to the Budget System's Law,

⁵ Some countries use it to ensure that programmes of ministries focus also on cross cutting issues, for example, crime, environment control, families etc.

⁶ We discuss the issue of flexibility under the section of this chapter that deals with budget and programme manageability.

⁷ This conclusion is also supported by findings under the section of this chapter that deal with informative quality of the programmes.

however, it is possible to reallocate a maximum up to 15 per cent of appropriation⁸ without amendments in the annual Budget Law⁹. At the same time, in cases of exceptionally small allocations (less than 1-5per cent) this would not represent much financial flexibility. For example, in the case of programmes with budget of less than 1 per cent from the total ministry expenditure and with several projects and activities under those programmes real re-allocation scope would be insignificant.

Overall recommendations

18. We propose to focus the current classification system on both in the GOPs and in the Budget. In the next five years we also do not recommend using any classification levels above the programmes (i.e. strategic area and main programme) as there will be little or no value added to the budget planning from such information.
19. Within the programmes we recommend to focus on outputs (sometimes output groups) but not so much on activities and projects. Internationally there is an emerging consensus that programmes should be built around groups of similar outputs (goods and services), as in reality the government cannot “purchase” outcomes such as public health, but only outputs, i.e. health services of certain volume, quality and price. However, the programmes should include some outcome information, too, as they have meaning only if they support achievement of some specific outcomes. Designing programmes around outputs can be more effective than around activities because outputs represent the final products (goods and services) of a set of government activities. The government is interested in those outputs, but not so much in the processes (activities and projects) through which they are produced. The citizens are interested in outcomes (i.e. poverty reduction, increased access to quality education and health services etc.) and service quality, but not projects and activities. This level is of internal interest to the line ministries, i.e. the operational level. If this approach is taken, there is little value in maintaining project and activity descriptions within programmes.
20. For reasons explained above we recommend maintaining the project level within programmes only in exceptional cases, i.e. in situations when there is a specific set of activates that are not permanent and that are required for improving programme and / or institutional capacity. For example, major investment (NIP) projects could be earmarked for specific purpose under the programmes. Another example – significant capacity building initiatives that should be earmarked specially in the Budget Law.
21. The number of programmes with value lower that one per cent from total expenditure should be reduced and planned only in exceptional cases. Small programmes, which often happen to be just one project or activity could be reassessed and possibly combined or included as outputs in GOP. Detailed activities and small projects should not necessarily be budgeted in the Budget Law – this should be controlled

⁸ Up to 5% reallocation between economic classification categories, 10% between *projects/activities* within one programme and up to 15% between the budget *programmes*

⁹ By approval of the Minister of Finance

through output / target information and reporting on GOP. The GOP instrument (document) could be more detailed than the Budget Law and become the key management / reporting instrument (along its budget information function).

22. One of the reasons for such a detailed budget structure is the fact that both NIP and general affairs have not been subject to programme budgeting. It has prevented the creation of broader and more meaningful programmes. Therefore addressing the issue of budget coverage will also assist in reducing the excessive number of programmes. We address these issues in more detail in the next sections of this chapter.

Comprehensiveness of the budget or programme budget coverage

Concept

23. By definition and international standards budget should be comprehensive covering all major sources of revenue and expenditure of the government in a wider sense. This usually includes all revenue sources including own-revenues and expenditures of ministries and other institutions as well as policy implementing bodies¹⁰.
24. Expenditure of government institutions (ministries and policy implementation bodies such as agencies) should also be presented at the sufficient detail. It should clearly demonstrate all current costs including staff costs, capital expenditure and investment, transfers and other payments to third parties. The same logic applies for the revenue side, which should clearly reflect budget funds, own revenues, donations from international organizations, credits, and other special sources.
25. The comprehensiveness principle should apply also to the ceilings that the Ministry of Finance provides to the line ministries and other bodies during the budget preparation process. These should include all sources of revenues, even if some sources are indicative.
26. It is also important that all expenditures are integrated logically in the programme structure. Programmes should enable coherent presentation of related types of expenditure, for example, it should show the link between transfers to local government or to other entities and the management costs of those transfers. Another example – if there is investment project in some area, for instance, implementing new IT system to administer payments to farmers, this project should be linked to the

¹⁰ Even financial performance of publicly owned enterprises should be monitored within the budget scope, too, as many of those enterprises may fulfill functions in relation to public goods in which the government has a direct interest. If those goods are not being delivered because of the financial situation of a particular enterprise (for example bankruptcy) the state will have to take action to continue to provide those goods. That might have a direct budget impact. For this reason many OECD countries have sections in their Ministries of Finance dealing with the monitoring of financial performance of the state owned enterprises.

programme that includes services of administration of those payments. At the same time it is important that different types of expenditure (current, investment, transfers) are not mixed up, i.e. they are clearly identifiable in the programme structure¹¹.

27. Finally, when medium term focus to the expenditure side of the budget (at programme level) is introduced, the outer year budget information should reflect the commitments made and demonstrate the costs of continuing the programmes in the medium term.

Findings

28. Presentation of both revenues and expenditures are at a sufficient level from the perspective of programme budgeting. Both, financial plans and the annual budget law allow identifying different sources of revenues and expenditures. However, there are two outstanding issues that need to be mentioned. The first is about separation between capital and investment expenditure. As we were told on numerous occasions in the pilot ministry interviews, there are no clear criteria for deciding why some expenditure should go into usual ministry capital expenditure and why some is proposed for funding by NIP. In fact, in the draft NIP projects such as buying personal computers or even memory sticks have been included.
29. The second issue related to budget coverage is about planning and reflection in the budget of different types of *own-source revenues*. For example, when the Ministry of Finance issues institutional ceilings (with budget planning instructions) these does not cover own source revenues¹². In cases where ministries themselves do not have an indicative planning figure early enough this complicates smooth, integrated and timely budget planning. Moreover in the final Budget Law only own-source revenues of the ministry are reflected but not those of all the implementing agencies (institutions)¹³ of the ministry. Ministry implementing agencies are included in the budget only in those cases when they receive transfers or have programmes from the budget funds. For example in the Ministry of Economy case only four out of eight agencies are included in the Budget Law¹⁴ and only partially (only in those parts where they have programmes / transfers from the budget funds). However most of the current implementing bodies are actually of the implementing agency type since they mostly execute public (not commercial) functions, their work contributes to GOP and programme objectives, and many of them are in monopoly situation, use

¹¹ Some International budget scholars would argue that funding like transfers, investment etc, should be in separate programmes or sub-programmes.

¹² However included in the later stages.

¹³ Referred here as implementing agencies since they in fact implement ministry policies – however in practice these institutions have different legal status and therefore also varied governance frameworks.

¹⁴ MOE has 8 subordinate institutions - Privatization Agency, Share Fund, Agency for Development of SMEs, Agency for Licensing of Receivers in Bankruptcy, Agency for Commercial Registers, Development Fund, and Institute for Measures and Precious metals and only four first of them are partly included in the Budget Law.

state assets etc. – therefore in most of the cases in the medium term they should be controlled as Government agencies and gradually integrated more fully in the budget¹⁵.

30. The table below represents expenditure of the line ministries by economic classification and shows how much of the total expenditure in each ministry is allocated through the programme budgeting approach (last column). Although all expenditure of the five pilot ministries has been formally allocated through programmes, our analysis of ministry financial plans (programmes) and our review of budget preparation process in those ministries allowed us to conclude that NIP and the main programme of general affairs (which includes five types of programmes) can be hardly regarded as programmes in real sense. Both are just economic classifications of expenditure and lack most programme attributes (See Annex 2) both in terms of content and the process of development. According to the current draft Budget Law NIP planning approach has been different in various pilot ministries. In the Ministry of Health, for example, there is one NIP programme combining all the NIP projects in it (19 projects). This represents very much an input based rather than programme approach. In the Ministry of Economy, on the other hand, NIP allocations are integrated under several budget programmes according to their purpose.

Table 2: proportion of ministry expenditure subject to programme budgeting discipline for 2007 Budget

Ministry*	NIP as % of total	General affairs as % from total	General affairs + NIP as % from total	Own sources as % from total	Donor funds and credits as % from total	% of funds subject to programme budgeting in 2007
MoE	35,91	4,21	40,12	0,00	1,24	59,88
MoH	46,42	3,05	49,47	0,65	9,64	50,53
MoTTS	45,27	33,90	79,17	0,00	0,00	20,83
MoPLG	0,00	68,97	68,97	10,19	20,83	31,03
MoR	37,58	2,53	40,11	0,00	0,00	59,89

* The data in the table does not include special funds for ministries, such as funding for the Red Cross of Serbia (the Ministry of Health) or material reserves (the Ministry of Trade, Tourism and Services).

** In the brackets we show the % from total if the NIP was removed.

31. According to the Table 2, programme budgeting framework has been applied only to half or in some cases even less than half of expenditure. In some cases, like the

¹⁵ Usually only those state enterprises / institutions could be left outside budget that are implementing clearly commercial functions e.g. state owned electricity, telecommunications companies etc. However it is acknowledged that this is a wider Public Administration reform and includes also devolution of implementing functions from the central ministries and establishment of effective public agencies system.

Ministry of Trade, Tourism and Services, this observation remains valid even if NIP, considering its special planning process and status, is removed.

32. Although there is plenty of small programmes, there are only few exceptionally large budget programmes (close or above 50 per cent) in the pilot ministries, like in the Ministry of Public Administration and Local Governments (MoPALG) there is a programme Salaries and outflows for employees accounting for almost 63 per cent of the total ministry budget or the NIP programme in the case of the Ministry of Health accounting for 46 per cent.
33. When preparing the 2007 budget as well as when undertaking the 2006 budget rebalance, ministries were asked to plan beyond year 2007. Thus ministry ceilings for programme budgeting set in July included also planning figure for 2008 and 2009 (only budget funds), but the 2006 Budget re-balance included information for 2007 for NIP. Also the 2007 draft budget law includes indicative figure for NIP funding for 2008¹⁶. According to some ministries, NIP 2007 budget figures in the 2006 budget re-balance, which now has the status of law in force, do not match the figures in the draft 2007 Budget Law. For example, the Ministry of Economy in the draft Budget Law for 2007 has foreseen 212.500.000 DIN for programme of Credit Support to Business Startups while in the Law on 2006 Budget Re-balance the same item is shown as having 425.000.000 DIN.
34. Overall it is clear that NIP has become and will be a major budget source into the future. According to the draft budget law, NIP funding forms as much as 30-50% of the total budget expenditure in some pilot ministries. However, there is no evidence how binding and realistic the figure for 2008 is since detailed privatization receipts still have to be costed and the Government's decision is yet to be taken on the allocation of funds to NIP. There is also no evidence whether maintenance costs after implementation have been calculated and which budget source will fund this. This is critical – if there are such costs then NIP must be integrated in Standard Budget process.
35. Finally, some ministries expressed concerns about capacity to manage large investment expenditure items – particularly as regards outer year expenditure, i.e. commitments management. Obviously there is a lack of systems, processes and capacities to effectively record and manage commitments.

¹⁶ It is not entirely clear what principles and rules are used to determine that outer-year funding. As concerns NIP, several people interviewed were not able to say precisely, what 2008 figure for NIP in the draft Budget Law included. Most of them said that 2008 NIP data probably represented commitments (cost of continuing already started projects) while some ministries remarked that it is also new money.

Conclusions

36. The nature and preparation process for both NIP and general affairs main programme have created a situation where programme budgeting discipline is applied only to half of all expenditure and the remaining expenditure is rather fragmented, i.e. many small programmes or, in fact, projects. The latter is the result of an important part of expenditure for service delivery being already funded from general affairs thus leaving for programmes only some extra project types and one off expenditure. The general affairs main programme with its five programmes under it cannot be regarded as a real budget programme – these are just economic categories of input that serve no policy or programme purpose.
37. According to our assessment, revenues and expenditures are reasonably well reflected in the Budget Law. However, there are issues that could be addressed in short to medium term:
- a. Reflecting all public agencies funding in the Budget Law according to a programme structure (*realistically a medium term issue*). There is, in fact, no reason why agency budgets should be left outside the Budget Law and programme disciplines. On the contrary, applying programme structures to their budgets would only reinforce the link between government and ministerial priorities on the one hand and the implementing agency activities on the other hand. It would also make control more performance based and therefore more effective;
 - b. Reflecting own source revenues in the budget ceilings (*possibly longer term issue*). At the moment own revenue planning is left to ministries, but there is no evidence that the own revenue forecast figure is used in combination with budget resources to set the overall ceilings for ministry programme package at the start of programme planning process;
 - c. Planning of NIP according to programme logic (*this should be addressed already in the 2008 budget planning cycle*). In most of the pilot ministries interviewed, the NIP process has been separated from the GOP and programme budgeting. In some ministries this was separated even structurally when there were staff working on NIP and on GOP and on programme budgeting – all separately with little coordination¹⁷.
38. As to programme budgeting, its discipline in the pilot ministries has been effectively applied only to part of the expenditure - approximately to one half or in some cases even less than that. NIP has been one of the contributors to that, as its planning process in most of the cases has been rather spontaneous with little coordination with GOP and budget programmes. However, also the nature of the main programme of general affairs has contributed to that, too, particularly in ministries where a large part of the services are delivered by people working in the central ministry, for

¹⁷ In this review we did not address the issue of NIP planning in non-pilot ministries.

example, the ministry of Trade, Tourism and Services. In those ministries only a third of expenditure is left for programme budgeting¹⁸.

39. There is a need to clarify elaborate criteria for inclusion of some activities under the regular ministry capital (capital / investment) budget or NIP budget funds.
40. There is also room for clarifying the status and contents of the 2008 NIP figures and their potential implications for the 2008 year budget planning (e.g. the precise amount of privatisation receipts, other sources, and the general fiscal risks of these). At the same time, urgent work is needed to improve capacities in the area of commitments management, particularly, in such large sectors as health.

Overall recommendations

41. There are three major reasons why we consider that NIP should be coordinated more closely with overall budget planning and in the ideal case integrated into the programme budgeting framework, i.e. using the same basic methodological principles and relating particular investment project to programmes whose objectives they support. Firstly, NIP is a major budget item; secondly, some ministries have quite a considerable *capital-investment* budgets apart from NIP, and there is no sound argument why they should be separate; and finally, investment expenditure does not operate in isolation – it should be a core part of achieving ministry objectives as defined in the GOP and in other budget programmes.
42. In the short term, a number of remedies could be used to better integrate the NIP with other parts of the budget. Some of the options include:
 - a. NIP planning principles should be methodologically aligned with basic requirements for programme budgeting, i.e. planning according of programme logic (as the Ministry of Economy has already attempted to do for the 2007 Budget); and assigning performance information;
 - b. The NIP should also be closely linked with national cross-cutting priorities (e.g. PRSP, EU strategy) – the NIP bidding process should be based on ministry GOP objectives, which should support PRSP, EU Strategy, etc.
 - c. Within the ministries (in both pilot and non-pilot ministries) NIP planning should be coordinated with the GOP and programme budgeting in terms of a) timing including ceilings setting; b) structure – the same people should be involved; c) process and prioritization should be made on one set of criteria.

¹⁸ The Ministry of Public Administration and Local Government is a case study where this number could be even less, as two thirds (20.83%) of its programme budgeting expenditure (31,03%) are donor funds, which, in a way are already pre-determined.

43. At the central level – in the Government the budget and NIP planning cycles should be integrated so that budget priorities are discussed together rather than planning those two parts of budgets separately from each other and in different periods.
44. As to the *general affairs programme* we also recommend that it be subjected to programme budgeting logic and discipline (we discuss this in greater detail in the next section of this chapter).
45. One of the important requirements in achieving aggregate fiscal discipline and allocative efficiency (two key objectives of a well functioning public expenditure management system, the third being operational efficiency) is to ensure that all public funds are subject to the same discipline, i.e. overall resource constraints and policy choices (including resource re-allocation) made within those resource constraints. The practical implication of this is that over time, all extra budgetary funds, quasi fiscal activities, guarantees, separate budgets and expenditure lines will have to be revisited according to programme principles (some of them will remain separate such as health insurance fund or pension fund; however, even then some performance information will have to be applied to them). A key feature of comprehensiveness is that it increases capacity to reallocate resources and achieve the best mix of inputs, at both the centre and at the sector/ organisational level. Therefore in the long term – achieving such comprehensiveness should be one of the core objectives of the budget reform.
46. In the longer term all own-source revenues including own revenue of the agency-type public bodies should be included in the Budget Law (payment into the Single Treasury Account, planning through the budget – meaning that own-source earnings could not be earmarked and used just for the respective agency's needs but should be planned via the Budget Law and programme structure);
47. In the short term we propose that ministries need to indicatively forecast their own revenues and make this figure available to planners at the start of the budget process (as indicative planning figure), e.g. at the same time when Budget Memorandum sets the ceilings for budget resources. The Ministry of Finance should also start working on the plan how to improve e forecasting capacity of the ministries to make this information more reliable.
48. We also recommend paying immediate attention to capacities in ministries related to investment planning and management beyond the current year. In situations where the NIP forms such a large part of ministerial expenditure, systems and capacities need to be in place to record and manage commitments. Action in this regard should also include clarification of 2008 NIP planning figure status as well as setting clearer criteria for separating between capital and investment expenditure.

Programme design and information quality

Concept

49. First, it is important to clarify the meaning of ‘a programme’. Budget programmes are used to organize similar outputs into coherent policy interventions that contribute to specific policy outcomes. In this way government obtains a fuller picture of how expenditure used by its organization links to concrete outputs and how that helps to achieve policy outcomes and government priorities. In this context a **programme is defined as an aggregation of similar services and goods or outputs (policy interventions) produced by an organization and contributing to achievement of specific policy objective(s), i.e. outcomes.** Programmes are restricted by the amount of funds appropriated for them. Programmes reflect what government does and not what it wishes to be doing.
50. Although practices vary there is an emerging consensus that programmes should be built around groups of similar outputs (goods and services), as in reality the Government cannot “purchase” outcomes such as public health, but only outputs, i.e. health services of certain volume, quality and price. However, the programmes should include some outcome information, too, as they have meaning only if they support achievement of some specific outcomes. Also programmes should not diverge too much from the institutional structure in each sector.
51. We have outlined programme design principles in the Annex 2 to this report. However, in this section we would like to emphasize one important principle. Programmes, in essence, are policy interventions therefore they must reflect key policy / work areas of the organization. If programme budgeting principle is applied, then all major outputs (and activities / functions leading to them) should be covered, irrespective whether they are one-off or permanent. Also the costs of producing a particular output shall be fully reflected and included in one programme to be able to inform the Government, the Parliament, and society of the full costs of production.

Findings

52. The programmatic budget preparation guidelines issued in July 2006 identify information requirements for programmes, projects and activities. Closer analysis of that reveals that programmes have 11 data fields to be filled in; the projects have 13 data fields; but activities only 6. Thus, for example, a programme with one project and one activity might have 30 data fields to be filled in, some of them quite demanding in terms of information requirements such as indicators of achievement.
53. One of the key principles of the programme design for 2007 was exclusion of so called “business as usual” functions from programme discipline. In other words, ministries were not required to do planning of those functions and activities, which they regard to be ongoing functions of the ministry. For example, basic functions of

civil servants working in ministries or inspector functions as a rule are not included into programmes.

54. Only in those cases when there is some special event, project or activity, such as a conference or development of some significant legislation is it mentioned as an activity or project. As a result of this, there are large parts of government activity that are left outside of programme budgeting in terms of definition, monitoring an assessment of performance and use of budget funds.
55. The case of the Ministry of Trade, Tourism and Services is striking in this regard. Approximately 600 staff of the Ministry works in the trade inspections area, i.e. more than 70 per cent of the total staff of the Ministry. However, there is almost no mention of their services and any performance framework for them. At the same time, most of the programmes of the Ministry are about tourism. In the Ministry budget there are two programmes that refer to an inspections theme with a total value of only 2 per cent of the total budget. Similarly, in the Ministry of Health inspection services are hardly reflected at all.
56. The nature of the *general affairs main programme* creates this situation. The costs of inspectors, for example, are hidden under programmes within this main programme. However, such costs are hard or impossible to identify within the current budget, but more importantly most of the performance information regarding inspectors is lost. This might also create further problems such as the misleading representation of cost of outputs. For example, many programmes mention projects or activities dealing with the development of legislation or organizing different events like seminars, but the programmes reflect only partial costs of those outputs, as other costs are hidden under the general affairs main programme. There are plenty of similar examples, too.
57. There are many programmes which lack essential programme elements, i.e. policy interventions involving a set of related outputs linked to outcomes. Rather they are projects, activities or even just inputs with some non-financial information attached to them. For example, in the Ministry of Economy draft budget there is the programme (1015¹⁹) *Publishing of catalogue and organization of the craftwork exposition* (0.02% of MOE budget), the programme (1005) entitled *Programme on institutional arrangements and legal acts* (0.15%) – these are just activities or projects, but not real programmes.
58. In the Ministry of Trade, Tourism and Services the programme (0016) *Procurement of vehicles for tourist and market inspection* (0.52%) and (0017) *Procurement of IT Equipment and mobile phones for market and tourist inspection* (0.20%) – represent just inputs, there is no programme logic. In the same ministry the programme (0019) *Organization of national exhibition and monitoring of project Serbian trade house in Moscow* (0.30%) is more like a project within wider policy intervention related to promotion of export, while (0008) *Public Relations of the MOTTs* (0.47%) is more like a permanent function that for some reason has acquired programme status and is not treated as “business as usual”.

¹⁹ Budget programme code in the draft *Budget Law*

59. Most of the programmes as well as ministry staff involved in planning do not use output and outcome language, but rather talk about activities and projects. Equally, there is no clear distinction between various types of programme elements. Thus, for example, ministries often regard training activities as projects and programmes in it although it should rather be a capacity building for some other programme. For example, training of inspectors cannot be regarded as outputs of programmes but rather a capacity building measure to make sure that inspectors are better prepared to carry out their core services – inspections. In general, most of the ministry representatives remarked that they had considerable difficulties in identifying performance measures. They said that many aspects of defining objectives, projects and activities remained confusing and required further capacity building. Finally there are a considerable number of programmes that have only one project or activity.

60. As to the preparation of financial plans, which essentially are the programmes, ministries spend considerable time in planning inputs at a very detailed, i.e. 6 digit level. This takes away attention from the more valuable work of defining outputs, outcomes, their indicators of achievement and programme logic.

Conclusions

61. Programme design requirements are quite strict and detailed. This is reinforced by the use of special software, which, on the one hand, helps to structure the preparation process but, on the other hand, limits design flexibility. Such flexibility will become more and more essential, as ministries will improve their programming work and take innovative approaches. In some ministries the number of total policy allocations in the Budget Law will range as a maximum from 70 (the Ministry of Health – 78, the Ministry of Trade, Tourism and Services – 76) to 140 policy allocations (the Ministry of Economy). The total number of final policy allocations and programming and management units for all the pilot ministries reach over 300 if NIP allocations are counted. If programme information requirements and six-digit economic classification for financial plans is added, this becomes quite information intensive and hard to manage material. This level of detail has obviously been reflected in terms of programme quality.

62. Having a separate main programme for general affairs covering the ongoing costs of different policy interventions distorts the programme budgeting logic. It does not achieve the objective of demonstrating the link between funds and performance at the whole of ministry level. It also excludes major work areas of ministries from performance definition and scrutiny. It restricts the frontier of options for ministers as well as central institutions to influence re-allocation of resources to support priorities. There is also no place where the services of some important government work areas, such as inspection, are described and linked to costs. At the moment, if one uses the programme budget as an accountability document (which it should be), then they receive a rather distorted picture about the ministry. The case of the Ministry of Trade, Tourism and Services is the most striking example.

63. Most of the programmes require significant further development in terms of information quality (provided that the general affairs main programme issue is resolved). This is understandable, as programme budgeting experience has just begun. In particular, the following aspects can be mentioned: re-focusing information from inputs to outputs, introducing outcome indicators, streamlining objectives so that they support desired outcomes, strengthening programme logic (the link between outputs and outcomes), developing indicators of achievement, and introducing capability development measures and indicators.
64. NIP, as discussed already in the sections above, is another area where programme logic has not been sufficiently applied. As a result, quality of information for this programme, as a general rule, is in most pilots limited. In most of the programmes encapsulating NIP projects, there is a lack of broader policy objective framework. The closest to good practice is the case of the Ministry of Economy, where NIP has been broken into several thematic blocks.

Overall recommendations

65. As regards improvement of programme informative quality, our recommendation is to address the issue of the general affairs main programme. Whilst agreeing in principle that there is a need for good control over the wage bill and other current expenditures (which is the key purpose for having a separate general affairs main programme), we emphasize that salary costs are programme costs and should be attributed to programmes as soon as possible. Programme management requires capacity to manage all programme costs. If salaries are outside of programme costs and control of the line ministries, then it is hard to expect effective programme management and it is illusory for the government to think that it has costed its programmes. There are ways how the Ministry of Finance can still ensure control over the wage bill, but allowing wage cost allocation to programmes, for example, by “capping” the salaries in a special budget line under each programme.
66. We strongly believe that it should be subject to programme discipline, too. In other words, salaries and other expenditures should be allocated to policy areas or interventions to which they belong. It will allow make programmes more comprehensive, balanced and logically structured. It will also allow developing better performance information including outputs, outcomes, their indicators of achievement and capability measures. The same logic applies for NIP.
67. However, our proposal does not mean that the current costs of central ministries, now collected under one ‘main programme’ (and five ‘budget programmes’) should be split into many smaller programmes. For ministries (the central apparatus) we propose a model where there is generally one programme concerned with policy elaboration, monitoring and support to the minister. Thus for example, in the Ministry of Religion there could be one programme dealing policy advice and monitoring in the area of religion and several programmes (transfers) to non-governmental organizations.

68. In the Ministry of Trade, Tourism and Services, where there is a large policy implementation function in the central apparatus, besides the programme on trade, services and tourism policy advice and monitoring programme, there could be a programme on consumer protection in the area of trade and a similar programme in the area of tourism. Finally there could be one or several programmes dealing with specific tourism support initiatives.
69. In the health area there could be at least three programmes, the first of which might be on policy development, monitoring and ministerial support in the area of health care with an objective of ensuring that the Minister of Health and the Government as a whole receives well informed, analysis based, forward looking and timely policy analysis. It would also be aimed at ensuring effective oversight of policy / legislation implementation. Such a programme could include services such as Policy papers, action programmes and plans, analysis, reports, opinions for other ministries, monitoring and monitoring reports, investment plans, oversight of health care institutions, etc. There also could be two further programmes, one on health services improvement (health care inspections) aiming to improve the quality of health care facilities and services according to standards predefined by health policies and normative acts, and including services such as inspections, accreditation services, complaints handling, compliance checking etc. The other programme could be in the area of sanitary inspections aiming to ensure food safety²⁰. In this way programmes also obtain a better match to organizational boundaries and natural ways of management and accountability within ministries.
70. We also recommend considering the use of more guidelines for formats and information requirements rather than strict forms in order to allow for innovation in programme design.
71. There seems to be room for discussing what information requirements are included in GOP and what in financial plans and how to integrate both better. The Government could develop detailed control mechanisms outside the Budget Law (financial plans) at which it would be possible to control performance / compliance at more detailed e.g. *project-type* levels. However it should be acknowledged that the very objective of programme budgeting is a shift away from very detailed centralised input (including financial) controls to performance monitoring. It is also understandable that this kind of reform could take time, however a meaningful balance should be found not to lose incentives for the ministries and making the reform formal.

²⁰ Having, for example, inspections programmes clearly identified in all ministries, could give to the Government a good opportunity and tools needed to think about improvements in this area across the government. Having good programme structure would also allow identifying real main programmes – i.e. areas where cross cutting work of government agencies is required.

Programming process

Concept

72. The key propositions regarding the programming process relate to several aspects of the budget cycle, but two in particular – the setting of budget policy and ceilings. As such, it is one of the key issues for the Budget Memorandum. These two have substantial impact on the time available for programming in the line ministries and impact on resource availability. Both are fundamental in terms of constraining budget bids and focusing on programme quality rather than on programme quantity. One of the objectives of programme budgeting is to encourage strategic re-allocation decisions within the line ministries. **This requires a conducive environment, which can only be created if ceilings and budget policy are set in a transparent manner early in the process (May or even earlier) and are credible and comprehensive, i.e. do not change substantially during the rest of the budget preparations.**
73. A central purpose of the budget preparation process is to ensure that resources are going to priorities and to reflect information on what is working and what is not. International research suggests that much of the uncertainty in the resource constraint and in the budget process is self-inflicted - by politicians unwilling to be constrained either by a hard budget constraint or by agreed priorities. Therefore providing space for a strategic deliberations phase in budget preparation and separating it from the detailed preparation and consideration of the budget is essential. This is done as part of preparing the Budget Memorandum, which should already reflect sectoral priorities along with overall resource constraints for sectors (and ministries)²¹.
74. Significant budget amendments during the budget execution period can have a negative impact on preparing the following year's budget, as it changes the budget "base" from which next year's planning takes place. Ideally, budget re-balances should be only technical without any major policy (funding) changes²². For example if the Government allocates large resources (through rebalance) to salaries in a particular sector in mid of the year this would have a consequence of double expenditure for these salaries next year - for the whole fiscal year this would be at least twice more than in the year of rebalance. Therefore this is not regarded a good fiscal discipline and is also not based in good planning practice (usually time for rebalance is quite limited and cannot undergo all the scrutiny of usual good budget planning process). It means that a well designed and enforced budget process must restrict political freedom to significantly amend the budget during the year – all major budget policy decisions need to be taken at the strategic deliberations phase.

²¹ Adopted from the Project's earlier discussion paper: „Comments on multi annual budgeting and programme budgeting”.

²² This, in fact, is one of the major budget policy issues that need to be addressed in the public finance reform strategy.

75. There should be integration of various planning processes within the context of budget decision-making. Ministry strategic and activity plans should be, on the one hand, based on last year's budget, but, on the other hand, influence the next year's budget. Once the budget is adopted, those plans need to be adjusted, too. The same applies to national and sectoral investment strategies. A unified planning system shall also be reflected in the ministerial internal structures dealing with planning, prioritization, monitoring, control and evaluation. There also should be substantial external assistance in programme design.
76. Another feature of a good programming process at the sector level is the ability of the ministry to exercise full control over all areas of policy interventions of that ministry.
77. Last but not least, a highly crucial objective of programme based performance budgeting is gradual release of the centralised control of inputs, giving more planning freedom and financial flexibility to the line ministries and focusing more on performance information (outputs / targets/ outcomes) and cost effectiveness analysis. At the same time such a release of control needs to be transparent and managed. It is best achieved by the Ministry of Finance setting criteria that ministries need to meet in order to be granted greater flexibility. Good programme design and proof of well functioning internal monitoring, control and accountability systems should be some of the key criteria.

Findings

78. The ceilings (budget funds only) for the year 2007 were provided to line ministries in July 2006. They were calculated using the amount of funds approved in the 2006 Budget Law which was used as a basis to which pre-determined parameters like inflation and other adjustments had been applied. Similar logic has been applied to the two outer years, i.e. 2008 and 2009 (indicative). The budget instructions for the line ministries have also made it clear that the total sum of the funds planned in the budget submissions must not exceed the total sum of ceilings provided by the Ministry of Finance to the budget beneficiary. However, this position was "softened" in the same document by referring to exceptional cases when extra funding requests might be considered and when ceilings could be over-stepped, i.e. due to the adoption of new legislation and/ or new services and/or programmes which had not existed in the previous year budgets. This "softening" is furthermore strengthened by the tables used to present the programmes (in software applications as well as in GOP Guidelines). There is section that asks for resources needed for the implementation of a specific project and/or activity. As to own revenue and other source revenue, the ceiling setting has been rather unclear.
79. The instructions for program budget preparation ask the line ministries to undertake prioritization of proposed programmes and projects/activities giving them low, medium or high priority status. They also provide that ministries with some exceptions must comply with the ceilings set by the Ministry of Finance. Decisions of whether and which ministries will get any extra funding on top of last year's budget are left for the Minister of Finance and his/her bilateral consultations with fellow ministers. One of the key criteria for including extra funding requests into the

draft budget is whether they have legal basis. But there is no further detailed procedure how different bids for extra money can be evaluated and how they could compete with each other to ensure that extra funds are appropriated to priorities and well prepared initiatives for implementation of those priorities.

80. There is also no strategic deliberations stage at the front end of the budget process. However, before issuing institutional spending ceilings, the Ministry of Finance issued the Budget Memorandum (May 2006). It spells out overall guidelines for further budget policies including overall macroeconomic framework as well as indicative spending trends by government function, i.e. health, defence etc. These are expressed as trends in the share of GDP for each particular function, for example, the health function in 2007 has 5.8 percent of GDP. These numbers apparently bear no linkage to actual ministry ceilings set in July. There is one more observation that requires noting in the context of the ceilings setting process and the Budget Memorandum document. To use the same health example, then Budget Memorandum contains references to many aspects of health care reform, new priorities in the area of health protection etc. Most of these are just statements that are not quantified in terms of financial implications.
81. Table 3 below indicates the difference between the ceilings provided initially (July 2006) and the final allocation from the budget (not total) as at November 2006 as approved by the Government. In almost all cases it shows significant differences – most ministries have received substantial increases in funds compared to the ceilings originally set. In particular, the Ministry of Health stands out. The key reason for that is that the ceilings set in July 2006 do not include funds for some of the legislation mandated, in particular the. Funding for the medical insurance of uninsured persons. The Ministry of Economy seems to be the most disciplined in planning within the ceilings.

Table 3: comparison of ceilings for budget funds and final appropriation*

Ministry	Initial ceilings as set in July 2006 (DIN)	Final allocation (DIN)	(+/- %)
Ministry of Economy	7.983.440.000	7.983.440.000	0
Ministry of Health	4.798.632.000	9.720.278.000	+ 49
Ministry of Trade, Tourism and Services	1.215.708.000	1.788.571.000	+ 32
Ministry of Public Administration and Local Government	139.509.000	218.577.000	+ 37
Ministry of Religion	619.495.000	638.509.000	+ 3

* This is final as in the draft Budget Law approved by the Government in November 2006, not the Assembly.

82. In the pilot ministries we also saw limited evidence of GOP, NIP and programme budgeting being integrated processes. In several cases these three processes were disjointed both in terms of human resources and the structures involved in the planning. Table 4 shows how the two processes (GOP and programmatic budgeting)

produced different numbers of programmes. All the pilots told us that these are now being adjusted in order for the GOP to reflect the Budget Law for 2007.

Table 4: comparison of the number of programmes in GOP and in programme budgeting

Ministry	Number of programmes	
	GOP	Programme budget
Ministry of Economy	20	22
Ministry of Health	18	13
Ministry of Trade, Tourism and Services	10	21
Ministry of Public Administration and Local Government	1	8
Ministry of Religion	Not involved	8

83. Finally, all ministries remarked that given the 2007 Budget experience, they are looking for considerably more support in programme design from the Ministry of Finance when preparing the 2008 budget.
84. In this section of the report we would also like to make a reference to the report prepared by other external experts who have researched the issues of ministerial ability to fully control funding within its policy intervention areas. The Draft Report by Keith Stanton (*EAR project on PIFCA / IA Phase 2 implemented by Ernst & Young and CIPFA*) has identified some issues that are of direct relevance to introducing programmes budgeting and these need to be further researched and discussed as the piloting of programme budgeting proceeds. It also touches the issue of control over expenditure and the relationship between the Ministry and Indirect Budget Beneficiaries (IBBs) in the area of health. In particular it notes the following:

“The lack of involvement in the salaries element of the budget is cause for concern as in effect the Ministry of Finance is the budget holder for this part of the Ministry of Health budget. This is clearly unacceptable from a budgetary decentralisation and internal control viewpoint. The IBBs receive the remainder of their funding from the Republican Health Fund for Insurance (RHFI) and the Ministry of Finance for salaries and salary expenses. The Ministry of Health has very little input with regard to health policy of the IBBs. This role appears to be weak and involves input from the Ministry of Finance, via the review and negotiation, of IBB financial plans and also the RHFI. There is no proper linkage between the health policy set by the government and the budgets of IBBs. The Ministry of Health should be the lead Ministry to ensure that the health policy of the government is targeted. However this is clearly not the case and is not helped by IBB funding being sourced from 3 areas: Ministry of Finance – salary and salary expenses, Ministry of Health - investments, and RFHI - current expenses, additional expenses and investments through their own sourced income.”

(EAR project on PIFCA / IA Phase 2 implemented by Ernst & Young and CIPFA)

Conclusions

85. 2007 ceiling setting has happened relatively late in the budget process and ideally should be brought forward during the next budgeting cycles. The Budget Memorandum was issued in May but the planning ceilings had to be provided for the line ministries by June 1st, according to the budget calendar set out in the Budget System Law. In reality ceilings setting for 2007 has been substantially delayed, i.e. programme budgeting ministries have received ceilings only in July. This is too late for the line ministries to prepare good programmes, particularly, if one considers the official deadline for submitting draft budgets to the Ministry of Finance, i.e. the 1st of August, according to Budget Systems Law.
86. Although the Budget Memorandum spells out a number of priority initiatives and promises that need to be delivered by the Government, and provides indicative spending levels by Government function (expenditure expressed as share of GDP), according to the information available to us there has been no whole of government collective decision making process at the front end of budget preparation during which the budget priorities could have been identified, agreed upon and reflected in the budget ceiling of the line ministries. On contrary, a more traditional approach has been used for 2007 ceilings setting, i.e. last year budget allocation plus/minus some adjustments such as inflation etc.
87. Ceilings have also lacked strong enforcement, as almost all ministries have managed to substantially increase their budget funds. The picture might have been different if NIP was not available.
88. At the moment there is no concept, plan and criteria how to move from inputs control oriented programme design and implementation to a more performance oriented system. Such a concept, plan and criteria obviously need to be developed, as ministries need to have incentives to become better planners.
89. Clearly, one of the main weaknesses of the current process has been the lack of proper coordination between GOP, programme budgeting and NIP. Although the NIP cycle was rather different from the rest of the budgeting process, there was scope for better coordination inside ministries.
90. One of the pre-requisites for effective programme budgeting is that the Ministry responsible for overall policy has effective control over this area, including its expenditure. In this way the ministry has incentives to make trade offs within its area and use programmes in the budget as a source of information for making such trade-offs. However, as the report by Keith Stanton highlights, this is not the case in the Ministry of Health at the moment. This is not an issue of a “quick fix” type. However, as the programme budgeting in Serbia progresses, institutional issues will have to be dealt with. Some countries working with programme budgeting have attempted to concentrate all policy functions in the central ministry and to delegate policy implementation to subordinate bodies (such as the Health Insurance Fund). This could be one model that the Government of Serbia could consider. In the short term, however, we believe it is important to include in the Budget Memorandum the

financial information of policy implementation bodies (subordinated institutions of ministries) that operate mostly on own revenue basis.

Overall recommendations

91. Overall the budget cycle should become more front-ended. The key budget decisions should be taken at the budget *strategic deliberations phase* (one or several government meetings where key budget decisions on priority spending for the next planning period are taken) possibly in May (for *hard ceilings*) and even earlier (for *soft ceilings*). Macro economic development and revenue forecasting systems should be gradually geared to support that.
92. The Budget Memorandum should become a useful document for decision making. In order for the Budget Memorandum to become such a document it needs to provide decision makers with the following strategic information:
 - The current macro economic and fiscal policies and overall resource constraints as a result of them (the overall spending envelope);
 - Adjustments to the current macro economic and fiscal policies and its impact on overall resource constraints (overall spending envelope);
 - The cost of continuing current policies and programmes under a “no policy change scenario” or initial ceilings²³;
 - Government’s overall priorities;
 - Government’s budget policy;
 - Room for new spending.
93. One option to be explored is that there can be several drafts of the Budget Memorandum and consequently budget ceilings for organizations – evolving during the budget process - following sequential stages of the decision making at political level. The purpose of the first draft would be to set out the overall planning parameters as identified in the point above. This would come early in the budget process (April) and could be built on the Budget Memorandum approved with the current year’s budget. In this first draft budget beneficiaries would see their baseline budget or we could call it “**soft**” ceilings plus they could see the total amount identified for new spending against which budget beneficiaries would be invited to bid (using the framework of overall government priorities as well as some other rules, for example – limiting the amount of one bid to no higher than 50% of total funds available for new priorities; ranking all ministry bids in priority order etc.). The second draft (around May) would follow *strategic deliberations phase* and provide ministries with final ceilings or “**hard**” ceilings;
94. The budget ceilings should be strongly enforced. Over time that will create a sense of discipline and improve efficiency through reducing efforts on ineffective bidding;

²³ Often known as baseline budget.

95. There should be better coordination of various planning processes inside ministries – GOP, NIP, programme budgeting. But equally, there needs to be more external support and guidance available to the line ministries during the programme design.
96. Finally, there is a need for an overall financial management strategy setting out a transition from inputs control oriented programme budgeting to performance focused programme budgeting. Such a strategy should also link into wider public administration reform and address the issues of funding relationships between sector ministries and policy implementation bodies and the degree of control each party has over funding.

Part II: recommendations for the year 2008 budget process

97. This chapter sets out the main recommendations for 2008 Budget process. These are based on our overall recommendations outlined in chapter one above and are part of our detailed suggestions for a reform matrix outlined in chapter three and included in Annex 1.
98. Year 2006 has been a good starting point for the initial introduction of programme budgeting in Serbia. This report has identified some of its positive impacts on the way ministries plan, prioritize and link funds to objectives. This report has also identified a series of issues that need to be discussed on the way to strengthening this good practice. In 2007, when preparing for the 2008 Budget, we propose the following improvements:
- **Planning process:** Better integration of GOP, NIP and budget process (including programme budgeting)²⁴;
 - **Programme structure and comprehensiveness:** simplify currently very detailed multilayer classification and achieve less fragmented programme structure while ensuring that programmes cover all areas of work of ministries and no major policy intervention area is left out even if it is a permanent function;
 - **Information quality:** Improve programme level information by definition of outputs and outcomes that are mutually linked.

Planning process

99. The 2007 Budget process has produced rather different results in each of the five pilot ministries. The 2008 Budget process should focus on unifying the approach, which will require substantially more guidance and capacity building from the Ministry of Finance.
100. The new planning process should accomplish several objectives at the same time. First, it should provide greater certainty to the pilot ministries regarding all the funds available. This shall be done as early as possible.
101. Secondly, it should distinguish between the funds available for continuation of ongoing but not yet completed programmes (mostly NIP) and funds available for new

²⁴ In year 2007 this shall be done within the current legal framework since legal changes should be carefully discussed and agreed. Legal amendments could be implemented for the consecutive planning cycle.

initiatives. As to the latter, it should provide a very transparent decision making process against competing bids from the line ministries.

102. Thirdly, in the five pilot ministries it shall ensure transition from one programme structure to another (if the recommendations of this report regarding programme design are approved) whereas in the new pilot ministries it shall lead to planning according to the new programme concept. Finally, it should ensure the integration of three planning streams into one – GOP, NIP and programme budgeting leading to programme discipline covering all expenditures of the pilot ministries.

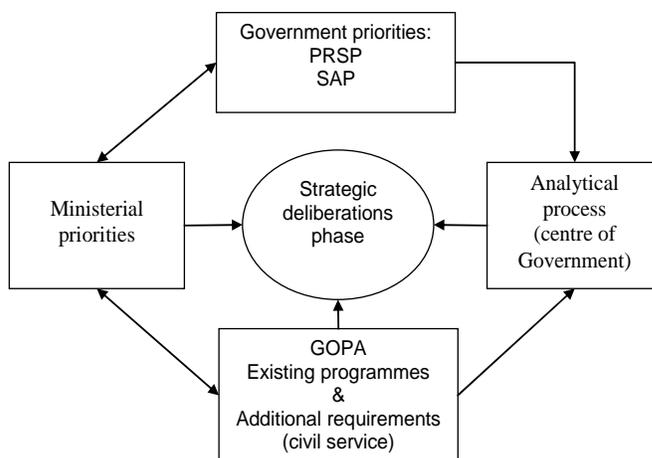
This could be completed according to following actions:

103. The planning process (as in the previous cycle) should be started with the preparation of GOP for the Programme Budgeting ministries (five plus new pilots). However, we strongly recommend that the process is bottom-up. In other words, the line ministries first shall determine their budget programmes (according to the mandate, main work areas and commitments from 2007) and only then proceed to wider SWOT analysis, stakeholder consultations etc. in order to determine whether any changes are required for the current programmes or new programmes and initiatives should be implemented. In this way, the GOP process would have two parts: part “A”, which would cover regular functions and continuation of started but not finished programmes (*base* in the budget terminology); and part “B”, which would identify new funding requirements. In case the ministry requests for new funding are not satisfied, ministries need to re-consider the base and possibly take reallocation decisions;
104. Both processes – A and B - should be financially constrained through the ceilings setting process. We propose to organize ceilings setting process in two parts along with two parts in the GOP planning. The first part (A) would focus on establishing initial, so-called *soft ceilings*. In the future, soft ceilings should be based on projections of ongoing programme continuation costs under “no policy change” conditions, i.e. continuation costs for programmes, which, according to Government’s policies should continue.
105. In the short term (for the 2008 budget), however, soft or initial ceilings should be determined by taking 2007 budget funds, removing any one-off items from them, undertaking necessary adjustments (such as inflation etc.), if any, as well as adding funds needed for continuation of projects still in progress but not yet completed. In this, base funding for new legal commitments (legislation that is adopted and in force) should also be included²⁵. As to the funds for projects still in progress, most such projects would be capital and / or investment initiatives whose continuation

²⁵ During our assessment work, we did not find much evidence (except in the Ministry of Health) where already made but not funded legal commitments represented a problem. Partially it might represent a true Picture (no problems exist) and partially such situation could be result of practice where not all implementation costs of new legislation are calculated and set out along with adoption of that legislation. This issue will have to be discussed in great detail under development of policy, legislation and programme costing system and methodology.

should be funded from budget revenues (mostly capital expenditure) and resources available to NIP. For this reason, one option would be to clearly earmark such funding. Once the cost of continuing NIP projects in progress is identified, the funds available for new projects could be determined. The first draft Budget Memorandum could provide such initial or “soft” organizational ceilings;

106. The Ministry of Finance should also encourage ministries to identify a planning figure for own source revenues. This estimate, together with funds from the budget (as explained above), would form the resource envelope available for programmes;
107. Ministries would then undertake programme identification, initial design and cost allocation to programmes (see next section). It is possible that one particular programme could be funded through various sources;
108. The second part (B) would focus on identifying initiatives that are not covered by ongoing programmes but that are essential for accomplishing Government’s priority objectives. Mostly, these will be NIP type of initiatives but could also be others, such as creating new programmes or enhancing the current ones (for example, more inspectors etc.). In order to avoid the production of too high a number of such new funding initiatives, it is essential that ministries receive policy guidance as to priorities at the national level. These shall be spelt out in the initial Budget Memorandum along with total resource envelope available for new initiatives (with possible earmarking for NIP and others), i.e. based on the growth of the economy, macroeconomic projections and country’s fiscal policy. The Ministry of Finance / Treasury could then calculate how much funding would be available for new ministry initiatives for the next period. The idea is that the Government would support only those new initiatives that advance Government’s priorities. The others need to be funded from re-allocating within the ministry base budget. In fact, when submitting ministry proposals for strategic deliberations (requesting additional funds), ministries should list them in priority order. Assistance to the Government in defining the initial budget priority framework could be given from the Deputy Prime minister’s Office (PRSP Office, Joint Project), Ministry of Finance and others. This process can be encapsulated in the following schema:

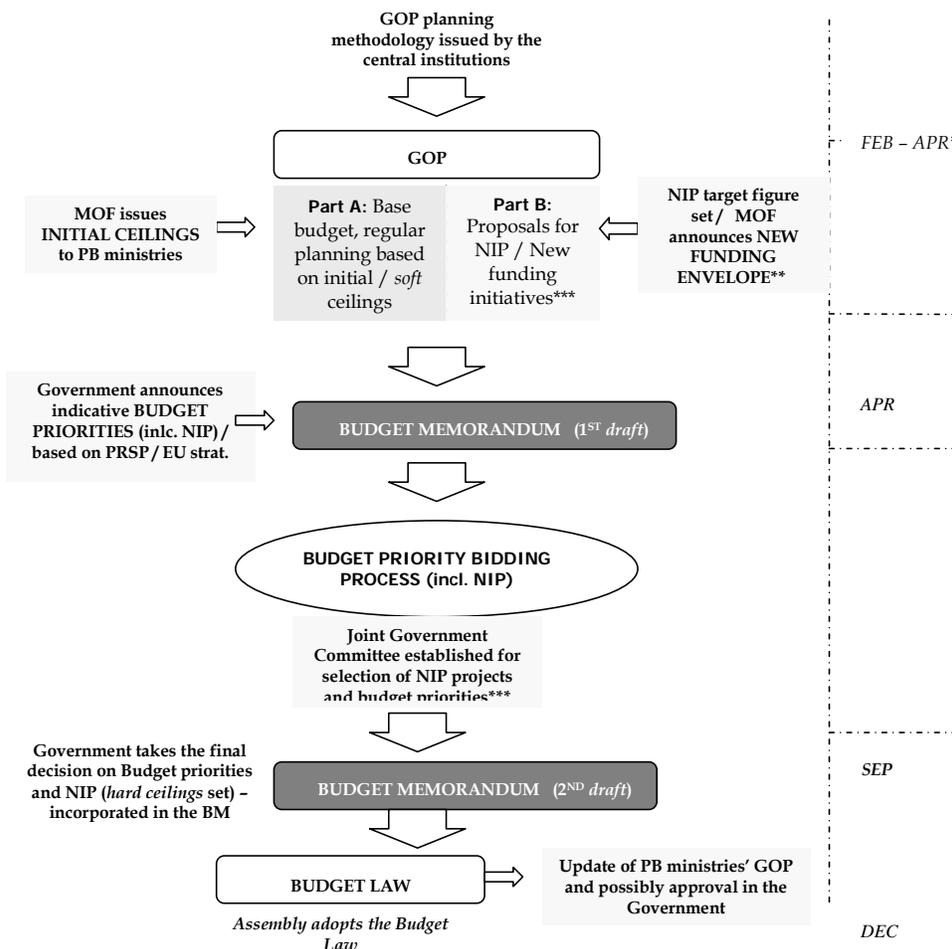


109. There is always the risk that such a strategic deliberation stage can be overburdened by bottom-up, often inflated, bids from the line ministries who are well capable of coming up with many ideas to justify new spending. Exactly for this reason, it is very important that the Government defines areas, i.e. strategic priorities, which it wants to support. Serbia already has two key documents that set out two such broad priority areas, i.e. EU (SAP) and poverty reduction (PRSP). If the line ministries want to have additional spending (introduce new programmes or increase existing ones based on an assessment carried out through GOPA / strategic planning process), they need to produce proposals that demonstrate direct relevance to either one or both of these priorities. Those, in turn, need to be carefully assessed by the centre of government providing advice to the government as a whole on which new initiatives need to be supported. Finally, based on that advice and following discussions at the political level, ministers need to take the final decision. However, it is very important that that decision is justified, transparent and collective, so that everyone in the process understands the rules.
110. Equally – the Budget Memorandum should encourage the line ministries to reassess their base budgets against the overall Government’s priorities. However, this is hard to achieve, as the incentives for the line ministries are geared to bidding for additional money instead of reassessing the base. Setting firm ceilings early in the budget process and making ministries to understand that all new initiatives need to be accommodated within these ceilings is one way to deal with those incentives. There are other mechanisms, too. For example, the Government of United Kingdom is using so called *public spending reviews* when ministry budget areas are reviewed from time to time. However, this is very information and effort intensive process, which we do not recommend for Serbia at the moment. Implementing proper programme budgeting system (thus getting better information on what the Government does with its spending) would significantly advance the prospects of quality spending reviews in the future. In fact, introducing programme budgeting is a kind of spending review in itself.
111. To evaluate ministry submissions for extra funding a Joint Government Committee on Budget Priorities could be set up²⁶ to advise the Government and Ministry of Finance on those ministry submissions which most clearly match Government priorities. Since investment projects may also need more expert / technical evaluation a separate NIP subcommittee could be established (or the current NIP selection bodies could be used although they should be more coordinated with the overall approach).
112. Based on the assessment process defined above *hard or final* organizational ceilings (initial ceilings plus allocation from new money) could be set and Budget Memorandum updated with approved (real) budget priorities.

²⁶ Could include relevant officials from cross-sector Government institutions (like Deputy Prime Minister’s Office, MOF) and other experts

113. This means that in each pilot ministry there should be one group of people working with the minister and dealing with all three planning streams – GOP, NIP, programme budgeting;
114. This also means that NIP projects should be allocated to ongoing programmes (in cases where those NIP projects are aimed at accomplishing programme objectives). Equally, there could be new programmes with a NIP element within them. Finally there should be some programmes consisting just of NIP type projects;
115. We also recommend that all planning figures (budget funds, NIP and other) are made available as early as possible;

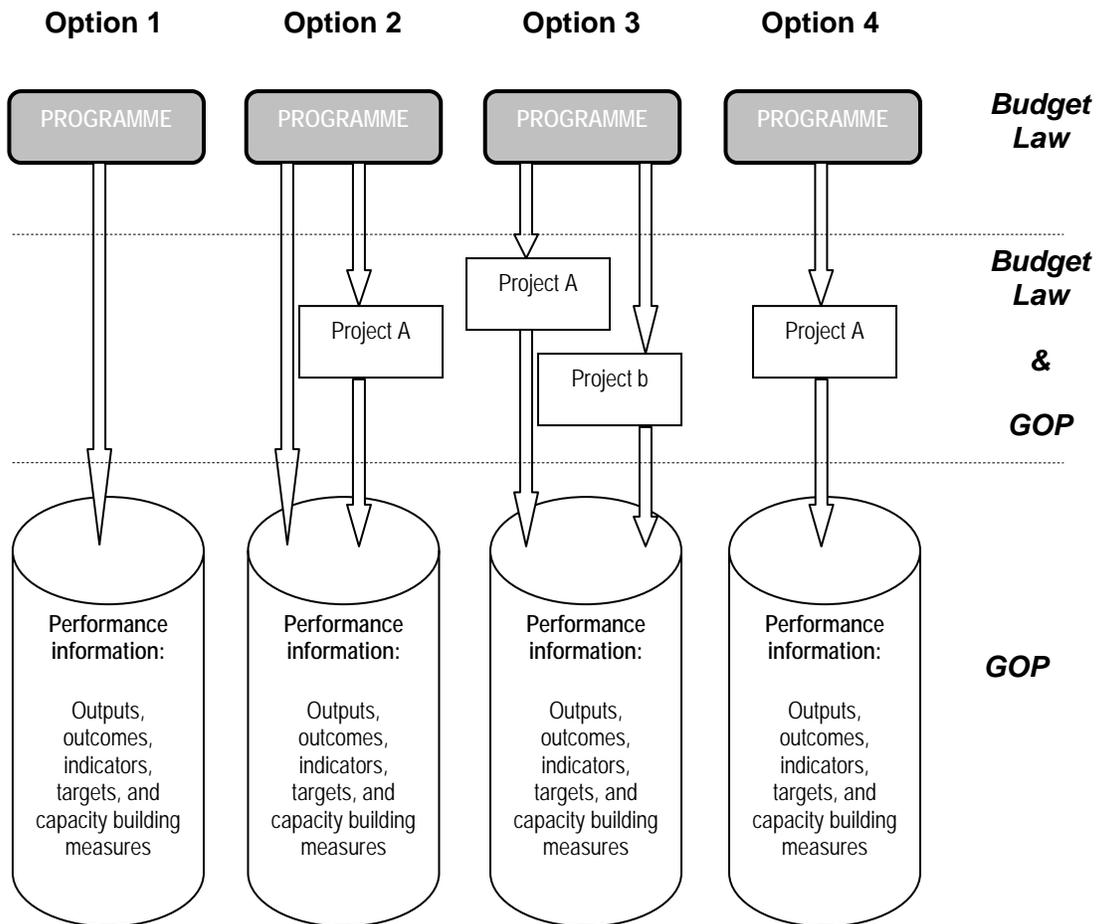
This all can be shown in the following scheme providing indicative proposal for the next planning cycle:



*Very indicative timing: dates should be discussed separately respecting the current legal framework if an overall approach supported.
 ** Based on growth of economy, macroeconomic projections and country's fiscal policy, Ministry of Finance / Treasury could calculate how much funding would be available for new ministry initiatives for the next period.
 ***New funding initiatives – priority policy issues that Ministry wishes to propose for new (extra) funding – however bidding process should be organised within realistic financial framework and based on Budget Priority Framework announced by the Government (possibly in the Budget Memorandum first draft).

Programme structure and comprehensiveness

116. Within the current methodological setting the main planning unit in the budget is actually the ‘project – activity’ level. We propose that the ‘programme’ level should become the main planning unit in the further implementation of programme budgeting. Key priorities for the next planning cycle from a programme design methodology point of view should be to improve the programme coverage to better reflect what government does, to reduce extreme fragmentation of ministry budgets and to improve programme quality by focusing on outputs definition and the outputs – outcomes link. To achieve these objectives the following changes to the current programme budgeting approach are proposed for the next cycle.
117. First, we propose that all expenditures of ministries are subject to proper programme budgeting logic (output based and specific outcome focused). It means that programmes need to reflect all key policy interventions of each ministry. In this way programmes could be built around the main service areas of ministries – by putting similar services (outputs) together. Programmes would then strongly reflect organizational planning and accountability lines. Usually each ministry would have one programme incorporating policy development and monitoring services and several specific programmes. Thus, all “business as usual” functions would be reflected in programmes, too. As a result, ministries will have between five to twenty programmes, but in smaller ministries, like the Ministry of Public Administration and Local Government even less than that – two or three;
118. We also propose to include in the budget subordinated institutions and apply programme logic to them, too;
119. To avoid very detailed planning and budget fragmentation programme budgeting methodology does not require budgeting at the level of projects and activities, which instead of the programme level is the real budgeting level in the 2007 Budget. For this reason the ‘activity’ level should not be budgeted in the Budget Law but reflected as programme output information included under a programme description in the GOP instrument which, apart from budget planning, should also become the major management and reporting tool for the ministries. If needed, financial plans can copy that information;
120. ‘Project’ level in the Budget Law could be planned only in exceptional cases – this should be predominately left for the NIP projects, large capacity building initiatives and in some other cases for earmarking some politically important expenditure.
121. In this way there could be three basic options how to organize programmes and projects. These are presented in the scheme below. In this model, activities are transformed into outputs and are not budgeted in the Budget Law. Projects, on the other hand, could be included under programmes in the Budget Law, but only in very exceptional cases, like NIP type projects, large capacity building initiatives, cross cutting projects.



- **Option 1: regular planning case** - to avoid unnecessary fragmentation of the ministry budgets, achieve greater financial flexibility, better programme quality and focus on outputs, it is suggested to have budget programmes as basic / regular planning case in the Budget Law. This does not mean that ministries could not have more detailed planning if necessary (e.g. within the GOP instrument);
- **Option 2: regular programmes with project(s)** – this would be when regular programme has one or several projects that directly support achievement of objectives of this programme. For example, the programme of trade inspectors might need to be enhanced by building a warehouse to store confiscated illegal products. Similarly, it could be some large capacity building initiative, like introducing large IT system;
- **Option 3: programme with several investment projects** – this would be the case, when government simply provides significant investment funds for some specific

users. For example, there is already a Ministry of Economy programme providing funds to different local governments to set up industrial parks. But even in this option, there should be performance type information applied;

- **Option 4:** in special cases there could be large projects such as the custom's IT modernization project. Such projects could be earmarked separately in the budget. However, in order to achieve a unified approach, they could be subject to programme structure, too. The alternative would be to allow such projects to be at the same level as programmes.
122. In case of budget programmes with one or several projects, the programme level should remain the unit of planning and accountability, i.e. financial plans and reporting against outputs should be done at this level. It also means that generally there should be no one-to-one relationship between programme and project (except option 4 above), i.e. the programme total budget will be bigger than that of project²⁷. For example, there could be a programme with total funding of 1 million CSD and related project with funding of 200 000 CSD or 2 projects with funding of 250 000 CSD and 150 000 CSD – these would be special cases where budget resources are earmarked within the programme but this should not necessarily cover all the programme;
123. In this way, all NIP projects are organized according to programme logic. There should be no more programmes called “NIP”;
124. Budget classification could be possibly simplified further by achieving less levels of classification – one option would be to reassess and possibly merge the ‘strategic area’ and ‘main programme’ or ideally - retain from using such classification at all. Currently the ‘main programme’ does not provide much added value and in most cases just represent grouping of functions (which is also available at functional classification level).

Information quality

125. This work area has already been largely covered under the points above. The key here is to emphasize outputs as the key planning unit within the programmes, and build the rest of programme information around them. In this way activities would be included only in ministry internal plans. Generally they should not be subject to external interest and accountability. In this way programmes could include:
- Code and organization
 - Title

²⁷ Currently in the pilot ministries usually the programme total value reflects project's total budget – in this way ‘projects/ activities’ become the real planning, management and accountability level and the sense of programmes gets lost.

- Legal base
- Objective
- Outcome measures – specific and general
- Outputs and volume indicators²⁸
- Projects (in special cases)
- Capacity building measures (if large in scale, could be also projects)
- New funding initiatives (for example, to increase programme scope, to carry out capacity building etc.)

²⁸ Later also quality, timeliness.

Part III: Medium term roadmap for programme budgeting

126. This chapter proposes a roadmap for the implementation of programme budgeting in the Republic of Serbia. Specific reform activities can be designed, agreed and implemented on the basis of this proposal. We start with the objectives of the reform and then set out five reform stages or steps through which these objectives could be achieved.

Objectives of reform

127. Programme budgeting attempts to integrate policy, planning, budgeting and accountability activities in one single process with a medium term perspective. Programme budget does not cover only priorities, but also a full set of government's activity, which can be modified to reflect government's priorities. It focuses on performance, which is the key word for ensuring integration of the above mentioned areas of Governmental activity. In a fully developed programme budgeting system the budget debates should focus not so much on input details but on reviewing the costing and effectiveness of policy proposals (programmes), and most importantly on discussions around possible implementation alternatives.
128. It is possible to adopt an approach where programme classification is just added on top of the existing line item classification in order to enhance the informative richness of the later. In such a model, programme classification is mostly used for ex ante control of spending and less for performance monitoring, ex-post control and evaluation of programme effectiveness (i.e. programme budgeting with low to medium value added). A medium to high value added "performance approach" on the other hand, requires well designed programmes and includes features such as the specification of services, link between outputs (services) and outcomes in a coherent programme logic, the specification of performance indicators, reflection of full programme costs, and a system of reporting and auditing / evaluation of performance. But it also entails a much higher degree of decision making decentralization and a far lesser degree of ex-ante control of inputs.
129. The analysis in the report above suggests that the current approach to programme budgeting in Serbia has started from an emphasis on ex ante control of inputs and centralized management of some major expenditure items like salaries or investment. At the same time there are also requirements for more non-financial performance information²⁹. As a matter of fact, in the current circumstances this approach can be justified considering that this is just the beginning of application of programme budget disciplines to government activity. Equally, one of the key objectives of

²⁹ Guidelines for 2007 programmatic budget for pilot ministries

current budget policy is to ensure fiscal discipline. In the longer term, however, greater flexibility with less ex-ante input control is a good incentive for ministries to improve their planning, budgeting, management, reporting and monitoring practices and skills. Therefore devolution of control and decentralization of decision making should be clearly built into a longer term plan for programme budgeting reform.

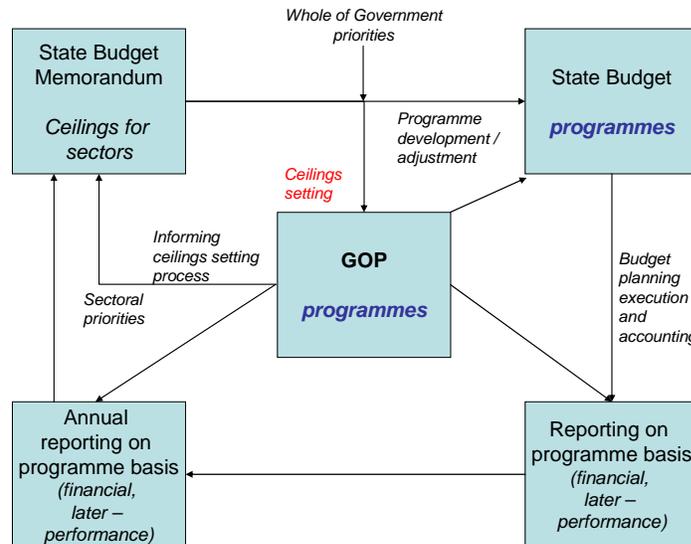
130. Introduction of programme budgeting should lead to better expenditure and cost effectiveness information being available to line ministries, Ministry of Finance, Government and Parliament, so that at each respective level they can allocate resources to strategic priorities better. It also should also facilitate better control as well as transparency and accountability of all public expenditure and the results of that expenditure. Finally it must create better incentives for ministries and other budget users to innovate, challenge policies and programmes, and to spend more efficiently and effectively.
131. However, the introduction of programme budgeting also needs to be linked to other aspects of financial management without which programme budgeting will have very limited effect. Therefore we would like to propose a wider set of objectives of budget reform with the introduction of programme budgeting at its heart. In our view, by the beginning of the next decade the Government of Serbia shall aim to have:
- Sound medium term macro economic and fiscal policy expressed in the Budget Memorandum providing a disciplined framework for examining overall budget aggregates and sector / line ministry programme aggregates in a multi-year perspective. The Budget Memorandum shall include information for decision makers concerning fiscal policy and aggregate fiscal targets, the total available resource envelope; overall cost of continuing government programs; key Government priorities and “free room” for new spending.
 - A comprehensive budget covering all revenues and expenditures³⁰. All budgets should be expressed through a programme structure;
 - Robust and reliable information on ministries’ baseline budget, i.e. the cost of carrying out already approved policies and programmes (no policy change scenario) in a multi year perspective;
 - The costing of new policy proposals (also in a multi year perspective), and a structured high level decision making process in the Cabinet at the very beginning of the budget process (strategic deliberations stage) to decide on allocations for additional spending, restructuring of spending or its reduction³¹, as well as linking spending to priorities. This should result in credible and

³⁰ Including budget beneficiary own revenues (except government’s commercial entities)

³¹ There is a need to develop a program and new initiatives costing methodology with multi annual focus, which takes account also of the cost drivers implicit in the underlying policy

comprehensive³² spending ceilings for sectors / ministries early in the budget process;

- Clear and agreed roles and responsibilities in this process regarding central agencies, particularly, the Prime Minister’s Office (e.g. General Secretariat), the Ministry of Finance, the Treasury;
- A well integrated planning cycle which can be represented as follows:



- Robust programme definitions and structure reflected in budget and strongly linked to management control and accountability. Programmes include outputs that are linked to outcomes. Robust performance indicators;
- National investment planning fully integrated into a programme budgeting system, i.e. investment projects clearly linked to policy and programme objectives;
- Strong commitments management capacity, particularly for investment projects;
- Robust planning, financial and performance measuring and reporting - accountability systems internally (in sectors) and externally;
- Only one budget a year, budget re-balance should involve only technical adjustments, no major policy and programme decisions;
- A practice and culture of challenging budgets at all levels – the Ministry of Finance challenging budgets of line ministries, but the line ministries acting as “finance ministries” for all of spending units in their policy area.

³² Including also forecasted own revenues of public institutions except government owned commercial entities

- Institutional separation between policy and policy implementation in each sector, i.e. sector ministries acting as “purchasers” of programme outputs from implementing agencies³³.

Reform steps

132. In the context of above mentioned objectives we propose a staged approach for introducing programmatic budgeting in Serbia. It starts from the current situation (baseline) and consists of four stages including the baseline. The stages can be modified depending on the speed of reform. However, its basic progression logic should be maintained. The importance of sequencing should not be underestimated. Unrealistic sequencing may create negative impact on behavioural incentives of ministries and cause unnecessary transaction costs without providing visible and significant benefits. But more importantly it can “kill the appetite” for this reform, which will make it much harder to implement programme budgeting in the future.
133. Below we describe in brief each stage and present its main outputs while Annex 1 to this report presents our proposals for a financial management reform work programme, which stakeholders can debate with a view to achieving consensus on a way forward.

Stage 1: introduction and adjustment of programme budgeting approach (2007)

134. By the end of 2006 the programme budgeting approach has been piloted in five ministries. It has proven to be a valuable exercise in improving the informative qualities of the budget and focusing ministerial attention on linking funding with objectives and activities. The objective at this first stage should be to learn from this experience and to identify areas where improvements to programme budgeting methodology are needed and agree with stakeholders on the necessary adjustments. Also this stage has to identify interlinkages with other aspects of budgeting reform such as macro-economic and fiscal forecasting, ceilings setting, financial management information systems and wider planning (for example GOP) and public administration reforms. This report can provide with the basis for the process. However, a careful account of practical management / budget execution experience in pilot ministries during 2007 should also be undertaken and, as far as possible, its lessons need to be integrated already in the process for preparing the 2008 Budget. We also recommend that during early 2007 a comprehensive budget reform strategy is prepared and submitted to Government for approval. This would form a good

³³ This could be a longer term reform

platform for planned and more coordinated implementation of different programme budgeting related initiatives during the next few years³⁴.

135. This stage would cover 2007 Budget execution and preparation for the 2008 Budget. Its main outputs would be:

- A comprehensive Public Expenditure Reform Strategy;
- Programme budgeting adjustments / improvements in the initial five pilot ministries. This involves also adjustments in programme budgeting methodology to be used for 2008 budget³⁵;
- As part of this adjustment, mechanisms for ensuring control of wage bill and other current expenditures under programme structure need to be identified;
- Expanding of the programme budgeting approach to new ministries (the Ministry of Education and Sport and the Ministry of Capital Investment);
- Agreeing on a new Budget Memorandum to ensure that it is used as the key decision making document in 2009 Budget cycle. However, the piloting of the new approach to the Budget Memorandum should already be in place for the 2008 Budget;
- Agreeing on a system for considering new funding initiatives in the context of the Budget Memorandum (the strategic deliberations stage of the budget) and having such a stage as part of the 2009 Budget preparation process. Pilot ministries should submit their bids for new funding (if the “room for new funding is made”) according to programme structure;
- Developing initial methodology for costing and forecasting programme level expenditure as well as policy (including legislation) implementation costs (final methodology for the former can be developed only after the programme concept stabilizes);
- Full integration of GOP and programmes;
- Organizing NIP 2008 according to programme structure with a view to integrating the NIP with programme budgeting fully for 2009 cycle;
- Learning lessons from the 2007 Budget implementation / execution in pilot ministries and integrating those lessons in programme budgeting guidelines for 2008 / 2009;
- Designing a new budget cycle to be used for 2009 Budget preparation;

³⁴ The steps included in this paper already form the basis for such strategy

³⁵ The work on methodology adjustments needs to be completed by the February – latest, in order to allow for starting preparations for 2008 as soon as 2007 budget is adopted

- This stage shall include also a number of reviews aimed to start discussion on other programme budgeting related but not urgent issues, such as classification issues, accounting policies etc.

It is very important that at this stage the following supporting mechanisms are put in place:

- Capacity increase (in terms of manpower) in the Sector for Budget Preparation of the Ministry of Finance, i.e. setting up and fully resourcing a unit dealing with programme budgeting ministries. However clear distinction of functions between units then should be marked excluding overlap – in the medium term after the roll-out of the programme budgeting to all ministries units dealing with various parts of budget planning (traditional and PB) should be merged in one³⁶
- Close and regular coordination between all technical assistance projects supporting budget reform (EAR, DFID, Norwegian Government, other donors);
- An inter-ministerial forum for programme budgeting development consisting of representatives from the pilot ministries, Ministry of Finance and Treasury to discuss all issues related to programme budgeting reform;
- Help-desk to support pilot ministries on a day to day basis.

Stage 2: strengthening of budget cycle and expanding programmatic budgeting to all ministries (2008)

136. By 2008 there will be at least seven ministries working under a discipline of programme budgeting (five ministries for the second year with two ministries for the first time). 2008 will therefore be a crucial year for reaching full consensus on the approach (methodology) to programme budgeting and preparing for a full roll out in the 2009 Budget. Depending on implementation progress in 2008, the full roll-out could be postponed for one or even two years (2009 or even 2009 Budget). In fact, this would be the approach we recommend.³⁷ This will also be the year for piloting a new budget cycle for 2009 Budget. During this year it will also be possible to test in practice some of the approaches and methodologies developed during 2007, for example, programme costing and forecasting, a new Budget Memorandum along with new funds initiatives consideration system (budget strategic deliberation stage). This should be the year when a new approach to budget cycle is fully implemented (more front-end budget leaving more time for proper programme preparation).

³⁶ In our view, such Unit should include 5-7 people initially (eventually one person per sector). If this unit is set up early in 2007, the EAR project could deliver to it a series of capacity building initiatives like study tours, training in programme design and programme analysis.

³⁷ The Annex 1 below proposes the full roll-out for 2009.

137. This stage would cover 2008 Budget execution and preparation for 2009 Budget. Its main outputs would be:

- Programme budgeting strengthened in 2008 Budget pilot ministries (including the Ministry of Education and Sport and the Ministry of Capital Investment);
- A programme budgeting approach rolled out to all other ministries with adjusted methodology;
- The Budget System's Law reviewed (re-drafted and discussed) to accommodate the lessons learned from programme budgeting implementation and to reflect other new aspects of budget management³⁸;
- Programme costing capacities strengthened through a) training; and b) piloting this approach in 5+2 ministries). Policy (including legislation) costing made mandatory in all ministries;
- There is one planning process for GOP, programme budgeting and NIP. The latter is prepared according to programme logic;
- More credible expenditure ceilings are set in the Budget Memorandum early in the budget process, ministries also have an indicative planning figure for own and other source revenues. The Budget memorandum is a useful decision-making document;
- The budget cycle (ceilings setting) includes so called strategic deliberations stage in the Cabinet where all new policy initiatives requiring additional finances are discussed and new funding initiatives are agreed upon;
- Implementation of a Budget information management system (BIMS)

Stage 3: embedding and developing further the new approach to budgeting (2009)

138. By 2009 most of the ministries will have had experience with programme budgeting. This should be seen as a stage where programme budgeting experience matures and becomes an integral part of the financial management process. In particular, the budget cycle becomes more stable with key decisions made early in the year (May or earlier), revenue information and expenditure ceilings are comprehensive and also cover own and other source revenue (initially set indicatively), programmes as well as policies have reliable medium term cost information, different planning processes – GOP, programme budgeting and NIP are fully integrated. By the end of 2009 there should also be evidence of internal planning, monitoring, control and evaluation as

³⁸ Possibly, this shall be output in the third stage (during 2009) when there be experience of one stable budget cycle.

well as external control and evaluation systems becoming fully engaged in programme budgeting. This is also the stage at which real capacity improvements should be witnessed at both levels – central (Ministry of Finance) and line ministries.

139. This stage would cover 2009 Budget execution and preparation for 2010 Budget. Its main outputs would be:

- Adoption of the new Budget System's Law;
- Budget programmes in all ministries include information on no policy change programme costs in the medium term;
- GOP, programme budgeting and NIP integrated in one planning document used as the key information document throughout the budget process;
- Increased capacity for working with the programme budgeting in the Ministry of Finance;
- Several external programme budgeting evaluation pilot projects are carried out focusing on both programme quality and internal planning, monitoring, control, reporting and evaluation systems;
- The Budget information management system is fully functional.

Stage 4: reviewing experience and further building of policy led budgeting (2010)

140. 2010 is the time by which there will be considerable programme budgeting experience. Therefore this is a time when it makes sense to step back and to assess the progress to date and to suggest areas where further improvements / development are needed. Therefore at this stage we recommend that a major review of the implementation of the financial management reform strategy, which we have suggested for adoption during the first stage, is carried out. However, even if such a strategy is not adopted, we recommend the review to take place thus focusing on programme budgeting experience. We also recommend that such a review is carried out by external, i.e. independent party to provide a more objective view. This is also the stage where links between financial management reforms and different institutional issues (public administration reform) will be clearly visible thus creating an opportunity for further development of programme budgeting through clarifying different roles and responsibilities and adjusting incentive structures.

141. This stage would cover 2010 Budget execution and preparation for the 2011 Budget. Its main outputs would be:

- External review of programme budgeting experience and implementation of the Financial management reform strategy;
- Updated Public Expenditure Management Reform strategy.

Annex 1: matrix of suggested measures for introducing programmatic budgeting in Serbia

INDICATIVE BENCHMARKS			
2007	2008	2009	2010
1. AREA: OVERALL BUDGET REPRM STRATEGY			
A comprehensive Public Expenditure Management (PEM) Reform Strategy drafted and approved by the Government of Serbia.	The first report on the Public Expenditure Management Reform Strategy prepared and submitted to the Government by Autumn 2008(if the necessary adjustments to the reform approved).	The second report on the Public Expenditure Management Reform Strategy prepared and submitted to the Government by Autumn 2009 (if the necessary adjustments to the reform are approved).	External evaluation of the Public Expenditure Management Reform Strategy is carried out; Strategy is updated on the basis of that evaluation.
	A review of the Budget System's Law is undertaken to build on experiences of programme budgeting implementation and to accommodate other requirements of Public Expenditure Management Reform Strategy. (issue of budget amendments throughout the year also addressed).	The new Budget System's Law with improved budget process and cycle adopted in Assembly.	
Unit to deal with programme budgeting set up in the Ministry of Finance (5-7 staff initially). Its three main functions would be: 1) Development of programme budgeting system (methodology / process); 2) Help desk to ministries; 3) Programme review and challenging during the budget process.	Capacity of the new Unit increased, its staff number is 10. Delimitation of competencies and coordination with work of other units o the Ministry of Finance is clear.	Capacity of the new Unit increased further, its staff number is sufficient to cover all ministries. The Unit takes active part in analysis and review of ministerial programmes from both perspectives: financial and policy.	
2. AREA: PROGRAMME BUDGETING METHODOLOGY			
Programme budgeting methodology is adjusted and consulted with a) other relevant institutions (Joint Project, PRSP office (General Secretariat)) and	Programme budgeting methodology is adjusted to take account of lessons learned from implementation of programme budget in initial 5 pilot ministries	Programme budgeting methodology is adjusted to take account of lessons learned from roll-out of programme budgeting and piloting of programme costing as well as the new budget cycle. It also incorporates new	<i>See above (external evaluation).</i>

INDICATIVE BENCHMARKS			
2007	2008	2009	2010
b) the PB pilot ministries.	as well as the new budget cycle.	positions of the revised Budget System's Law.	
Ways to ensure wage bill current expenditure control under programme structure identified.			
Lessons from programme budgeting implementation in 5 initial pilot ministries are recorded and fed into programme budgeting methodology for 2009 and, where possible, also for 2008.			
Policy (including legislation) and programme medium term costing methodology elaborated and agreed by the MoF and the Government (where necessary, the legal changes are made to make such costing mandatory). Institutional responsibility for compliance checking and performance in this area designated, i.e. <i>Budget Preparation Sector</i> of the Ministry of Finance.	Capacity building (training) in policy and programme costing is carried out.	Capacity building (training) in policy and programme costing is continued.	
	5 initial + new pilot ministries undertake programme costing while all ministries are required to undertake costing of new policies including legal acts.	All ministries undertake programme costing.	
Capacity building (training) package and plan for new methodologies developed. Plan covers such issues as programme identification and design, performance measurement, costing of programmes, costing of legislation and policies.			
GOP methodology is adjusted to include budget programme structure as the departure for			

INDICATIVE BENCHMARKS			
2007	2008	2009	2010
<p>GOP planning.</p>			
3. AREA: PROGRAMME BUDGETING IMPLEMENTATION			
<p>5 initial pilot ministries develop their 2008 Budget according to adjusted programme budgeting methodology.</p>	<p>Full roll-out of programme budgeting to all ministries.</p>	<p>Programme structure and contents improved in all ministries. Roll-out to other central Government institutions and agencies.</p>	<p><i>See above (external evaluation).</i></p>
<p>Programme budgeting is piloted in two ministries, e.g. the Ministry of Education and Sport and the Ministry of Capital Investment.</p>			
<p>Other ministries are welcomed to develop their GOPs according to programme budget structure, but this remains voluntary.</p>			
4. AREA: INTEGRATION OF PROGRAMME BUDGETING, NATIONAL INVESTMENT PLAN PREPARATION AND GOP PREPARATION			
<p>A joint action plan for development of GOP / PB / NIP in 5 + new ministries for 2008 is agreed between the Ministry of Finance, Deputy Prime Minister's Office, and the Ministry of Capital Investment (re: NIP) early in 2007. The objective would be to achieve as much integrated as possible planning process for all three areas in 5+new pilot ministries.</p>	<p>GOP, PB, NIP planned as part of the same process and in one document in all ministries. As a general rule NIP projects are clearly referenced to programmes and follow the PB basic methodology.</p>	<p>Integrated GOP, PB, and NIP document is used as the key budget information document for the strategic deliberations stage at the beginning of budget cycle.</p>	<p><i>See above (external evaluation).</i></p>
<p>In 5+2? pilot ministries, GOP, budget programmes and NIP are included in one document.</p>			
<p>NIP in 5+2? pilot ministries are structured according to programmes and PB general planning principles.</p>			

INDICATIVE BENCHMARKS			
2007	2008	2009	2010
NIP in other ministries is developed using the Programmatic Budgeting approach			
5. AREA: BUDGET CYCLE			
New - more front end budget cycle designed and agreed for 2009 (as part of PEM Reform Strategy).	New - more front end budget cycle is adopted in the Budget Systems Law and implemented for new planning cycle.	The 2010-2012 budget planning cycle is well implemented.	The budget planning cycle is stable, no major deviations from the agreed model, no major budget amendments (just technical) during budget execution.
Initial ceilings for Budget expenditure and NIP for 2008 Budget are set more early (e.g. in May). Pilot ministries provide also indicative planning figure for other sources of revenue.	Initial ceilings for Budget expenditure and NIP for 2008 Budget are set more early (e.g. in May). All ministries provide also indicative planning figure for other sources of revenue.	Ceilings for Budget expenditure and NIP for 2008 Budget are set in Budget Memorandum following strategic policy deliberations stage in the Cabinet. An indicative planning figure for other sources of revenue by ministry is also included in the Budget Memorandum.	Ceilings for Budget expenditure and NIP for 2008 Budget are set in Budget Memorandum following strategic policy deliberations stage in the Cabinet. A planning figure for other sources of revenue by ministry is also included in the Budget Memorandum.
Budget Memorandum is improved to include the basic information needed for decision making in the budget process. The new Budget Memorandum is practically used when preparing 2008 Budget especially in definition of the Budget Priorities (based on PRSP, EU strategy – includes NIP other new funding priorities)	The new Budget Memorandum is one of the key documents used for decision making as part of 2009 Budget process. It clearly indicates macro economic and fiscal policy objectives and overall priorities for spending and resource re-allocation, revenue and expenditure aggregates (Budget and NIP), cost of ongoing programmes and services as well as room for new initiatives (new funding initiatives).	Budget Memorandum clearly indicates macro economic and fiscal policy objectives and overall priorities for spending and resource re-allocation, revenue and expenditure aggregates (Budget and NIP), cost of ongoing programmes and services as well as room for new initiatives (new funding initiatives).	Budget Memorandum clearly indicates macro economic and fiscal policy objectives and overall priorities for spending and resource re-allocation, revenue and expenditure aggregates (Budget, NIP and others), cost of ongoing programmes and services as well as room for new initiatives (new funding initiatives).
A system for considering new funding initiatives is developed (also as part of PEM Reform Strategy) and agreed.	The new system for considering new funding initiatives is being piloted as part of the budget process. Appropriate systems are put in place to ensure collection of information regarding new	The new system for considering new funding initiatives is fully functional and provides with well structured information for decision making during the budget process.	

INDICATIVE BENCHMARKS			
2007	2008	2009	2010
	funding initiatives.		
6. AREA: INTERNAL PLANNING, MONITORING AND CONTROL AND EVALUATION SYSTEMS			
In the first 5 PB pilot ministries, effective systems are established to plan, monitor and evaluate implementation of GOP / PB.	Lessons learned from pilot experience. Planning, monitoring and evaluation systems are strengthened in pilot ministries. Guidance on setting up such processes and systems issued for other ministries.	Internal planning, monitoring and evaluation systems strengthened in all ministries.	External review of ministries' internal planning, monitoring and evaluation systems is carried out.
Review of current internal control and audit systems and capacities is undertaken. ³⁹	The Government adopts a policy paper where the role of internal and external control / auditing structures in the programme budgeting is analyzed and a system for future involvement in programme budgeting implementation is proposed. ⁴⁰		
	Ministerial internal control and audit units are trained in programme budgeting implementation control matters.		
7. AREA: EXTERNAL CONTROL SYSTEMS			
External audit mandate and capacity in the area of programme analysis and evaluation is assessed.	The Government adopts a policy paper where the role of internal and external control / auditing structures in the programme budgeting is analyzed and a system for future involvement in programme budgeting implementation is proposed.	The first external programme evaluation pilot projects are carried out.	A plan for external review of programmes is developed and being implemented.
	Designated external control structures are trained in programme analysis and		

³⁹ This shall be coordinated with EAR and other technical assistance projects in this area.

⁴⁰ This needs to be consulted with officials and technical assistance projects involved in this area. The policy paper we propose could be also broader covering the role of internal control and audit in general. If possible, this task should be completed during 2007.

INDICATIVE BENCHMARKS			
2007	2008	2009	2010
	evaluation methodology.		
8. AREA: CASH MANAGEMENT			
The current cash management practices, particularly quota system, are reviewed on the basis of adjusted programme budgeting methodology. Proposed action is included in the Financial Management Reform Strategy.	Recommendations of review are implemented according to pan.	Recommendations of review are continued to be implemented according to pan.	<i>See above (external evaluation).</i>
9. AREA: CLASSIFICATION ISSUES AND ACCOUNTING			
Revenue / expenditure classification in the budget law and in financial plans is discussed as part of programme budgeting methodology adjustment process. Appropriate action is taken to eliminate unnecessary planning and reporting details.	A review of current accounting practice in the context of programme budgeting is undertaken, strategy and plan for improvements suggested.	Recommendations of review are implemented according to pan. Financial plans include information to the detail that is actually used for decision making.	<i>See above (external evaluation).</i>
10. AREA: FINANCIAL MANAGEMENT INFORMATION			
New Budget Information Management System is designed and developed on the basis of adjusted methodology for programme budgeting. Integration with FMIS is ensured. The new system includes: 1) financial-performance information; 2) non-financial performance information; It also accommodates the information needs of both central institutions, such as Ministry of Finance and line ministries.	New Budget Information Management System is implemented and used in all ministries, which work on programme budget basis. BIMS is integrated with FMIS.	BMIS is adjusted to take into account any methodology adjustments.	<i>See above (external evaluation).</i>
11. AREA: INSTITUTIONAL AND ACCOUNTABILITY ISSUES			
A review of the current own and	All Public Administration	All revenues and expenditures of	<i>See above (external evaluation).</i>

INDICATIVE BENCHMARKS			
2007	2008	2009	2010
other source revenue forecasting systems and practices is undertaken and recommendations provided for improving the current forecasting systems.	institutions, except commercial bodies (e.g. state enterprises), are represented in the 2008 Budget.	all public sector institutions except state owned enterprises are represented in the budget.	
		Recommendations of review are implemented according to pan.	Recommendations of review are implemented according to pan. Ministry own and other source revenue forecasts are credible.
		Analysis of state owned enterprise governance framework in terms of a) implementation of programme objectives; and b) financial management issues (assets and liabilities) is undertaken.	Management of state owned enterprises is sound and does not possess any major financial risks.

Annex 2: programme design principles

This Annex highlights the main features of the programmatic budgeting approach that has been used during recent decades internationally. This will provide the Ministry of Finance with the necessary background information for further developing of a “made in Serbia” programmatic budgeting approach. These guidelines do not discuss in detail specific country examples but rather provide a generic analysis of the main principles and approaches used to programme design⁴¹.

Most of it is built on budgeting studies in the OECD countries⁴². However, we have also relied on examples of programmatic budgeting in some CEE countries, particularly Latvia and Lithuania, which at the moment represent the most advanced cases⁴³. None of these examples represent the “best practice” example for the GOS as each is tailored to specific circumstances of

⁴¹ Not in all countries are they called programmes, for example, in New Zealand, they are called output classes.

⁴² Mostly in preparing this note, the following OECD study has been used: “Specifying outputs in the Public Sector”, 2001, www.oecd.org.

⁴³ There has been a recent analysis of public management systems in the EU 8 countries (New EU Member States) carried out by the World Bank (unpublished, yet), i.e. Poverty Reduction and Economic Management Unit, Europe and Central Asia, World Bank: “EU-8 Administrative Capacity in the New Member States: The Limits of Innovation?”, September 2006. Using the Common Assessment Framework or CAF (www.eipa.nl/CAF) the authors of the report conclude that both Latvia and Lithuania are above the EU average in this regards where as other countries of the EU 8 below that.

a specific country. However, they can be a good source for identifying issues that need to be discussed as part of developing a GOS approach to programmatic budgeting.

This Annex starts with a summary of elements of programmatic budgeting in use in 27 OECD countries as well as in Latvia and Lithuania. It is followed with information on reasons why most of the OECD countries have used this approach. Programme definition is then provided followed by identification of the main principles of programme design. The note is concluded by a discussion of future budgeting and management implications of using programmatic budgeting approach. As part of this, the example of a Common Assessment Framework (CAF) is provided to demonstrate the full breath of financial and non-financial performance implications of the reform.

Examples of programmatic budgeting in OECD countries

Many OECD countries show performance targets (outputs and outcomes⁴⁴) as an accountability factor of public sector organizations as well as budgeting. Performance based budgeting is a term that is sometimes used instead of programme budgeting but can be taken as a broader concept. It is possible to have an approach to programme budgeting that is not well designed for enhancing performance, whereas performance based budgeting would usually be built on a foundation of well designed programmes and include features such as the specification of services and costs, the specification of performance indicators, and a system of reporting and auditing of performance⁴⁵.

- Outputs are distinguished from outcomes thus demonstrating clearer output – outcome link (5 countries in all organizations, 6 countries in most organizations, 13 countries in some organizations, 3 countries do not separate). In comparison, Latvia and Lithuania requires separation of outputs, immediate outcomes and outcomes for all organizations;
- Many OECD countries show performance targets in their budget documentation. 17 out of 27 countries include output information in the main budget documentation, but outcome information is incorporated in the main budget documentation 13 countries. Also in Latvia and Lithuania the budget process involves considering strategic plans which include programmes with performance targets;
- Many of those countries have specific reporting systems to report against specified targets. There are systematic reports on outputs for most programmes in 13 OECD countries and in 8 countries for outcomes. 7 OECD countries do output and outcome reporting for selected government programmes. Lithuania also provides an example of systematic government wide reporting while Latvia does it as part of updating sector strategic plans annually;
- 6 OECD countries have a very clear expenditure output link for all output targets while 12 countries do this just for selected targets. As to an expenditure–outcome link, some 14 countries do attempt to demonstrate that link. In Latvia and Lithuania the idea of specific programme related outcomes is being used. These outcomes are linked to outputs which are then fully linked to expenditure;
- Performance information appears to be used to support the allocation of financial resources in half the countries that responded. Fifty percent of the Senior Budget Officials were of the

⁴⁴ For definitions see section on programme design principles.

⁴⁵ Lynne McKenzie: “Performance Based Budgeting- Report for the Ministry of Finance and Economy for the DFID Medium Term Expenditure Framework Project in Armenia”.

view that there was evidence that performance data determines budget allocations whereas 40% did not see such evidence. Almost all of those officials who held the view that the performance information was used for allocation decisions reported that the information is used for allocation within programmes and agencies and within ministries, whereas only one in three was of the view that performance information is used for allocation between ministries and programmes. Also in Latvia and Lithuania it is believed that programmatic budgeting is mostly contributing to better design of programmes (policy interventions) and re-allocation within sectors (the same minister). It is much harder to use programme information to re-allocates between sectors (ministers).

Why programme budgeting?

In traditional input based budgets the focus is on the resources consumed (and control of those resources) and not on services and policy outcomes that the resources contribute to. Redesigning of budgets into programmes can provide the government with better information for allocating public expenditure and prioritizing government activities (within one sector or even between sectors), as it better demonstrates a link between inputs, services provided and goods produced and objectives what are achieved by that.

Most OECD member countries, as illustrated above, tend to include performance information for most programmes in their budgets. However, at the very the beginning of introducing a performance and programme dimension to budgeting it is important to realize the purpose of introducing them (these have been different in different countries), as programme concept, design, budget classification etc. will have to be adjusted to ensure that that purpose can be met. OECD countries, according to the study quoted above, have improved their specification of budget programmes for a variety of reasons:

- To better link spending to government priorities, i.e. to demonstrate that programme structure and contents takes account of government priorities;
- To make the budgeting and annual accounting documents more informative;
- To link organizational and programme planning and accountability through inclusion of performance targets in strategic plans for government entities (departments, ministries, agencies). These targets can reflect performance specifications for programmes in the budget;
- Whole-of-government performance reviews – general or in relation to specific priorities. These are easier to do when programmes are well specified;
- Performance appraisal of organisations and individuals, performance related pay and other forms of performance related staff management. Key performance requirements for staff should reflect the performance requirements on the organisation which can be captured in part in programme specifications;
- Giving increased managerial control to managers in exchange for enhanced accountability for results. Increased managerial control should be based on good specification of performance and well designed programmes can assist with this;
- Introducing contracts between entities delivering public services (i.e. agencies) and parent ministerial departments;
- Performance audit by supreme audit institutions. This requires the specification of performance in the ex ante accountability documents including the budget then ex ante reports on performance;

- Competition between public (and sometimes private) sector providers of services on the basis of output costing;

Programme concept definition

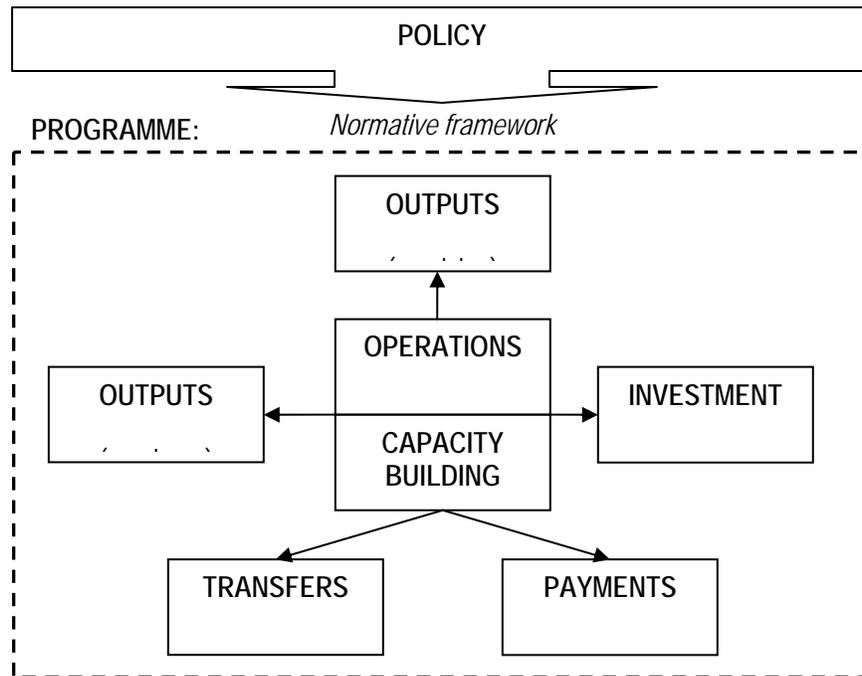
Government “purchases” outputs from organizations, i.e. goods and services of certain volume, quality and at certain cost but not outcomes. For example, government “purchases” a certain amount and quality of health services from hospitals, but not the state of health of the population. However, delivery of outputs (which in essence is policy intervention) should be oriented towards achievement of some specific policy outcomes, i.e. health services of hospitals need to contribute to improved public health. It is also important that outputs contribute to achievement of government priorities. The same applies for transfer of money from government to individuals or groups.

Broadly speaking, government carries out three basic functions (policy interventions): a) regulation (normative acts); b) provision of goods and services; c) the transfer of money to individuals or groups. However, the a) and c) functions also require services, i.e. normative acts need to be produced, monitored and enforced; and transfer of money requires administration. It also undertakes its own capacity building to be better at delivering above mentioned functions. Funding for all of those is organized according to both organizations and programmes. Responsibility for use of funding for the above mentioned functions is assigned to organizations, but use of funding for actual delivery of those functions is carried out through programmes⁴⁶.

Budget programmes are used to organize similar outputs into coherent policy interventions that contribute to specific policy outcomes. In this way government obtains a fuller picture of how expenditure used by its organization links to concrete outputs and how that helps to achieve policy outcomes and government priorities.

In this context a **programme is defined as an aggregation of similar services and goods or outputs (policy interventions) produced by an organization and contributing to the achievement of specific policy objective(s), i.e. outcomes.** The following schema can be used to demonstrate various programme elements. For each element indicators of achievement can be used.

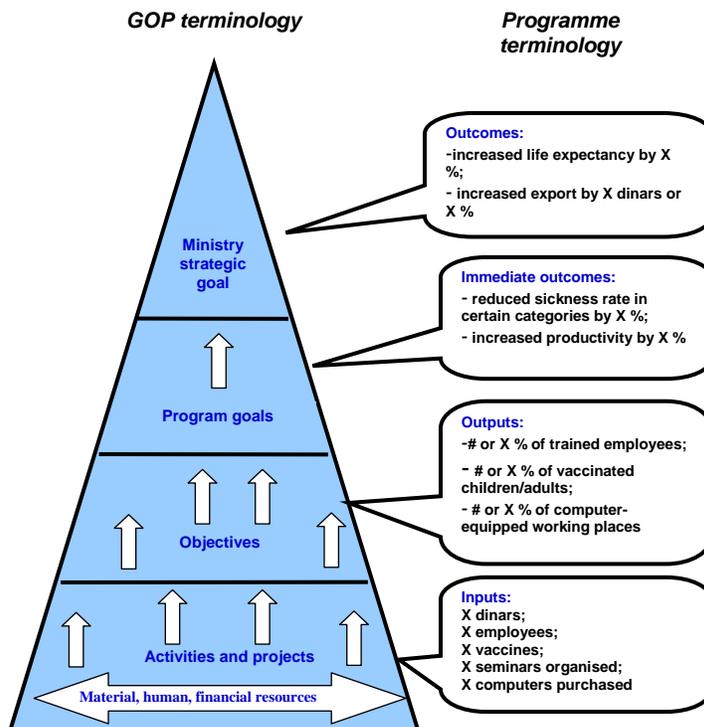
⁴⁶ There can be programmes across several organizations; however, these should be well motivated exceptions rather than a rule. See the section of programme design principles.



Programmes, in essence, are policy interventions therefore they must reflect key policy / work areas of the organization.

Once the credible output information is in place for each programme, the specific objectives and outcomes along with their indicators of achievement can be identified. However, identifying specific programme outcomes is very hard, as it requires demonstrating attribution between the outputs and specific outcomes. It is easier to define general outcomes with very loose attributions to actual policy intervention or outputs (which could be the first step), but real programme planning, monitoring and evaluation requires the establishment of more direct attribution (this could be the task for the second or third stage).

The scheme below presents an attempt to capture the nature of programmes:



Definitions⁴⁷

Outcomes are the changes in the general state of well being in the community that governments want to achieve, or at least pursue, through various policy actions. The overall purpose of government is to influence the achievement of desired outcomes, such as reducing the incidence of childhood deaths, reducing the level of criminal activity in the community, improving the average level of educational achievement, improving the health status of the population, increasing the standard of living and increasing the nation's economic performance. Outcomes are why governments are funding outputs.

Specific or Immediate Outcomes are the changes in the general state of well being in the community that is specifically attributable to a concrete programme. For example, the reduction of the general unemployment level (the outcome that government wants to achieve) can be influenced by a training programme for the unemployed. A specific outcome of that programme could be that people who have undergone the programme find jobs within six months of completion of the programme and stay in those jobs for at least another six months.

Outputs are the goods and services produced by organizations for use by consumers outside the organization (this includes services produced for the minister). Outputs are those final goods and services that are produced by one organization for use by another organization or individual. Goods and services can be tangible or non-tangible. For example, a typical output of the central ministry is production of normative

⁴⁷ Material on definitions and types of budgeting systems have been sourced from OECD, "Specifying outputs in the Public Sector", 2001, www.oecd.org.

acts or policy proposals in response to government priorities. Inspectors carry out the inspection service of enterprises, police investigates criminal cases etc.

Activities are processes which contribute to outputs. An example could be road safety (reduce the rate of accidents) which is an outcome target. Outputs contributing to this outcome can include an advertising campaign and the activities would include designing, printing and posting posters.

Inputs are the resources used by an agency to undertake activities and thereby produce outputs. Inputs are the labour (the range of skills, expertise and knowledge of employees), capital assets (including land and buildings, motor vehicles and computer networks), financial assets and intangible assets, such as intellectual property, which are used in delivering outputs. Input information identifies the nature, mix and value of the resources that an agency uses in the course of delivering its outputs. Input information provides little direct insight however, into the nature of those outputs.

Costs are the money spent or expenses incurred to finance the input.

Capacity building measures are initiatives that ministry or other government institution undertakes in order to enhance its programme delivery capacity, for example, introduction of some IT system, staff training etc.

Performance and results are terms referring interchangeably to outputs and/or outcomes.

Programme design principles

- **Output grouping principle.** Outputs (goods and services) of policy intervention should be similar in nature and geared towards certain policy objective and government priorities where appropriate; for example, different inspection services carried out by certain government organizations in the area of food safety;
- **Revenue / expenditure full coverage principle.** Programmes should capture all funding of an organization including transfers, as all of the activities of the Government contribute to certain policy objective(s). It means that all revenue / expenditure should be covered by programme structure and process, including such expenditure items as staff costs and investment. If programmes are developed just for some limited priorities, it does not allow a) the effective assessment of spending in other non-priority areas; b) that parts of a priority can be implemented through “business as usual”;
- **Separation of current expenditure, capital expenditure and transfers.** Programmes should be homogenous in their nature, i.e. they should either be an aggregation of goods and services or an aggregation of transfers but not a combination of both. Exceptions are possible, for example, in situations where a small service organization manages transfers (subsidies) to farmers administrative costs of that organization (services) can be included into the same programme as the transfer. However, clear separation must be made in the economic classification. A similar principle applies to capital spending;
- **Full coverage of the outputs principle.** Programmes shall also capture all outputs produced by an organization;
- **Cost efficiency / transaction cost principle.** However, programmes shall not be too detailed, i.e.: a) activity and project level information, as a general rule, should not be represented in the budget law or any other budget documentation / reporting system used by external users, i.e. the budget presentation does not need to be too fragmented; b) Within each programme, only major outputs supplied to external parties need to be presented. If needed, more detailed

information and sub-programme structure (projects and activities) can be represented in the internal planning documents and monitoring / reporting systems of ministries. Any level of aggregation / disaggregating of programmes should be subject to detailed transaction cost considerations. A good principles to use in defining programmes is:

- Programmes should be aggregated at a significant level of expenditure; or
- Be an item that needs to be disclosed to external parties to an organization (but again – this should be on the basis of MUST KNOW and not “nice to know”);
- In practice there could be no more than 3-4 budget programmes for smaller ministries and some 5 -12 programmes for the larger ministries with diverse policy responsibility. Also programme structure should be carefully balanced: it is not advisable to have some programmes with very low proportionate funding e.g. 0.5% of the overall budget and programmes with very high proportion (like close to or more than 50%) of the overall budget. Initially there should not be more than 5 to 7 outputs / targets per budget programme and one or two outcomes with indicators;
- **Principle of separating policy development and policy implementation.** As to the line ministries (central apparatus), it is recommended that these are kept as one programme covering provision of policy advice, monitoring and evaluation services to the minister and government. For this reason, where a service delivery functions, such as inspections, which are part of the central apparatus, the possibility of bringing them out of the ministerial structure needs to be considered. If that is impossible, funding of those services including staff and other costs need to be clearly ring-fenced, as this policy intervention area will have different policy outcomes. If, however, there are some shared costs, such as electricity and other running costs for one common building, these should be assigned to one of the programmes;
- **Non-double counting principle.** One output (and related inputs) should not be included in more than one programme;
- **Organizational accountability principle.** Programmes are the basis for appropriations to organizations. However, as public sector accountability will remain on an organizational and not a programme basis, one programme, as a general rule, should not combine more than one organization. Such multi-organization programmes should be exceptional and well motivated. If there is more than one organization assigned to the programme, careful attention needs to be paid to the following considerations:
 - The need to ring fence a portion of each organization within programme;
 - The possibility of tracking the revenue / expenditure of each organization within a programme, thus ensuring accountability at the level of each organization;
 - There should be concrete management responsibilities assigned to programme implementation.
- Linking programmes to organizations allows :
 - Clearly assigned managerial responsibility;
 - An identifiable cost centre;
 - It is easier to identify cost drivers;
 - FMIS can be used without substantial additional compliance costs.

Longer term issues related to introducing programmatic classification to budgeting

In different performance management regimes, there are different emphases on planning and accountability regarding costs, inputs, outputs, processes, and outcomes. The planning, measurement and accountability issues change according to the focus and there are tradeoffs in choosing one approach over another.

- A traditional input focus is easier but it does not, in itself, support efficiency and effectiveness. However, emphasis on inputs control works better in circumstances of low confidence and variable competence in the civil service. In practice however what commonly occurs is that some central administrative expenditure is tightly controlled while other expenditures escape the controls⁴⁸.
- An output focus is concerned with what managers are producing rather than on the inputs they use. Performance indicators relate to the goods or services produced. This approach facilitates efficiency and control of aggregate expenditure and lends itself to enhanced accountability. On the other hand it can result in information overload, there are measurement problems and it can be costly. Because of these challenges, some see it as a good approach when confidence is high and the basics are in place⁴⁹;
- An outcome focus facilitates re-allocation, supports policy formulation and co-ordination and can enhance the long-term perspective of public sector activities. On the other hand it suffers the same problems as the output approach in regard to measurement, costs and information overload and in addition this approach has problems in regard to accountability since outcomes are not always controllable or even attributable to specific public sector actors. The outcome focus can generally be seen as good for situations equal to situations where an output focus is viable but where politicians in addition are dedicated to driving the management regime to achieve outcomes. It should rest on a solid output based budgeting approach and not be treated as an alternative to this. It is an enhancement to output based budgeting. It is important to note that, while some countries use a mixture of output and outcome performance measures, no country has a pure “outcome accountability” model⁵⁰.

There could be three key stages of development in input – output – outcome mix:

- Inputs based planning and control. Often rather detailed, based on economic classification, and with rather tight central control over a number of items of expenditure, such as current expenditures. Little managerial autonomy and responsibility;
- Outputs and outcomes mix based planning and accountability. The focus is on results. There can be also detailed financial reporting but not so much detailed financial inputs planning and approval. Substantial managerial autonomy, decentralization of decision making but also a substantial delegation of responsibility;

⁴⁸ According to the OECD study quoted above.

⁴⁹ Ibid.

⁵⁰ Ibid.

- A mixed model where there is a lighter form of centralized inputs planning and control, for example, controlling of salary totals and not positions, and greater focus on outputs and some outcomes.

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International experience suggests that the introduction of more performance or outputs and outcomes focused approach requires a clear central strategy in relation to the transition from inputs based planning and control to outputs and outcomes (mixed or pure) based planning and accountability. If ministries and other government agencies are required to focus on performance, eventually they need to obtain more freedom to determine on their own the inputs mix for producing outputs and achieving objectives set by the minister and government. Often it involves Ministries of Finance setting clear criteria that ministries and other government agencies must meet in order to obtain more freedom.