Budgeting to achieve the MDGs: Medium Term Expenditure Frameworks, Annual Budgets and Performance-based Budgeting

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I. Introduction

1. Development planning tends to result in a wish-list of policy measures that are not clearly prioritised and too often there is no link between the list and available financial resources in the budget. So, how should we go about setting priorities and finding budget resources?

2. This paper describes some of the tools for improving budgeting and what has to be done to find "space" in the budget to fund new policies. The techniques are generally referred to under the title of a Medium Term Expenditure Framework (MTEF). Introducing a MTEF requires a different approach to planning and budgeting. The paper starts by identifying common weaknesses in Government budgeting. After a discussion of the differences between forecasting and budgeting, the objectives of a MTEF are described along with its typical features. Discussion of Performance-based budgeting and how this helps by linking the budgets for activities to development goals and performance measures is included as an Appendix.

3. The process for moving to a MTEF is set out together with practical hints for aspects especially important for Pacific Islands countries – "making space" in the budget for new policies and improving the integration of donor funded projects into the MTEF. Some lessons from experience in other countries is drawn upon to provide a list of problems to avoid and suggestions to increase the probability of success.

II. Common weaknesses in Government budgeting

4. Government budget systems generally reflect the historical reason for a Government Budget – Appropriation to provide legal authority to Cabinet and department chief executives[1] for raising funds and making payments. Now, public sector management has become much more complex as it has evolved to include formal strategy documents (often 5-year development plans), sector strategies, corporate plans for individual departments and programs for particular types of expenditure (e.g. capital items or projects funded by donors). These have been a response to scarcity of resources and a desire to identify what should be done to improve economic and social development. The budget systems have not always changed to match the demands of the new approaches to planning.

5. Some of the major weaknesses in traditional budgeting are:

- Five Year Development Plans and three year Public Sector Investment Programs (PSIP), which set out national and sector objectives, policies and specific projects, were not linked to the availability of resources through a macroeconomic framework.

[1] In this paper the terms Parliament, Cabinet and Chief Executive will be used, though it is recognised that other titles are used such as Congress/Senate, President, Council of Ministers, Permanent Head, Permanent Secretary, Director-General, etc.

Some projects in the PSIP therefore were not funded, and the link between policy implementation and the Budget was not established.

- The budget preparation process did not link the achievement of objectives and meeting of targets with the funds required: there was greater emphasis on control of inputs and less on improving performance of the sector through meeting its objectives and targets.

- The recurrent budget was prepared on an incremental basis (adding a percentage to last year's estimates) without reviewing whether the activities being funded should be continued.

- Activities continued from year to year while resources were declining, therefore some activities which were critical were under funded.

- The classification of the budget did not show programs or activities (e.g. provision of extension services) but only types of expenditure (e.g. fuel).

- Even where the budget format had moved to programs and activities, the structure often reflected the existing organisational structure and was not closely linked to performance management or to the national or sector planning documents.

- Chief executives and budget managers did not have much autonomy to utilise funds for better performance, rather proper accounting was emphasised.

- Where the budget had moved to programs and activities, this may have limited discretion even more as the budget was now in even smaller "parcels" with budget control over each item within an activity budget.

- The investment budget (PSIP) was itself often an unprioritised wish-list of project requests to donors.

- The investment budget was prepared separately from the recurrent budget, therefore the recurrent costs arising from the investment programs were often not provided for once project funds (often from donors) had been spent.

6. Development of a MTEF has been a response to these problems. It has itself been an evolutionary process and there may be differences in approach in what has been described as a MTEF. This paper sets out what seems to be commonly agreed as the features of a MTEF. However, what works in one country may not suit another country so there will need to be adaptation to meet local requirements.

III. Planning, budgeting and forecasting

7. Strategic planning has become a very formal, structured process. It starts with statements of **Mission** and **Vision**, then sets out **Objectives** and **Targets** with **Strategies** for how each objective or target is to be achieved. From these strategies, **Action Plans** need to be developed

that set out the **Activities** that need to be undertaken.

8. Typically, the list of strategies and activities is substantial and these need to be prioritised along with a timetable for implementation as it is not possible to do everything immediately nor will there be adequate resources to do everything. Other sessions have discussed costing new activities, so this will not be covered in this paper.

9. Strategic planning starts with the "current state", describes the desired "future state" with how to get there. This can be summarised as:

10. Strategic plans typically cover 3-5 year periods but Government Budgets have mostly been for a single year. The need for a MTEF arose from trying to integrate strategic plans with Government Budgets and also from the need for greater certainty over the availability of resources to fund multi-year programs without causing economic problems for the country.

11. The first response is often to prepare forecasts for the future years. Forecasts are educated guesses. Adding two years forecast results to the current year's budget is not adequate as a MTEF, but is often the first step. Rather a MTEF is about getting to a statement of a deliberately planned future. It has to link planning, policy and budgeting into an overall framework. This requires realistic, honest thinking about the future.

IV. Features of a MTEF

12. There is now general agreement that a MTEF has the following key features:

- It operates within a medium term (typically 3 year) **fiscal policy framework**, i.e. within macroeconomic policy objectives, such as moving towards a balanced recurrent budget.
- It operates within a medium term **planning framework** for strategies and policies, often with sector and sub-sector priorities for future spending.
- It covers **all resources available to Government –** both domestic and donor-funded, recurrent budget and development fund budget.
- It seeks to move away from a traditional incremental budgeting approach, by measuring the **future costs of goods and services** needed to deliver **existing** policies as well as **new** policies and uses these to make decisions restructuring Government spending so that **high priority areas receive adequate funding**.

13. These objectives are achieved through a fundamental change in the budget processes involving:

- A more **strategic approach to the allocation of resources** linked to ministries' objectives.
- Greater **emphasis on the performance and achievement** of objectives in sectors.

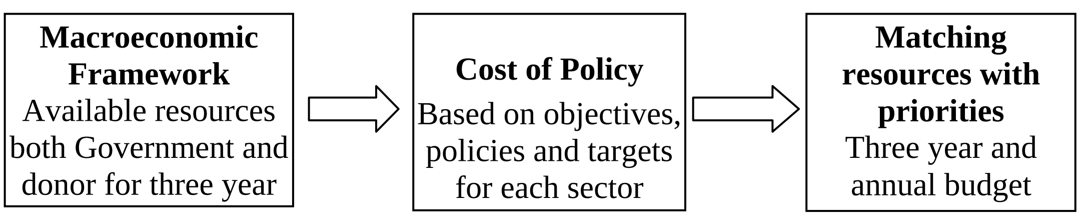
- Using the activities to be implemented as the basis for estimating both the Recurrent and Development Budgets, thus moving to an **activity based budget** approach. (This is also referred to as a **performance-based budget**.) If budgets still emphasise inputs, then improvements to the budget classification will be required so that the types of activities being funded can be more clearly seen in the budget documents.
- Building strong links between all stages in the public **financial management cycle**: budget preparation, implementation, monitoring and evaluation.

This usually involves:

- A **top-down** resource envelope (i.e. budget limits by sector) based upon broad macroeconomic policy priorities.
- A **bottom-up** estimate of the cost of current and medium term existing programs and activities.
- **Costing** of proposed new policies and activities, supported by targets for the benefits each will achieve.
- An **iterative** process of **decision-making** matching costs and new policy ideas with available resources over a rolling 3 year period.

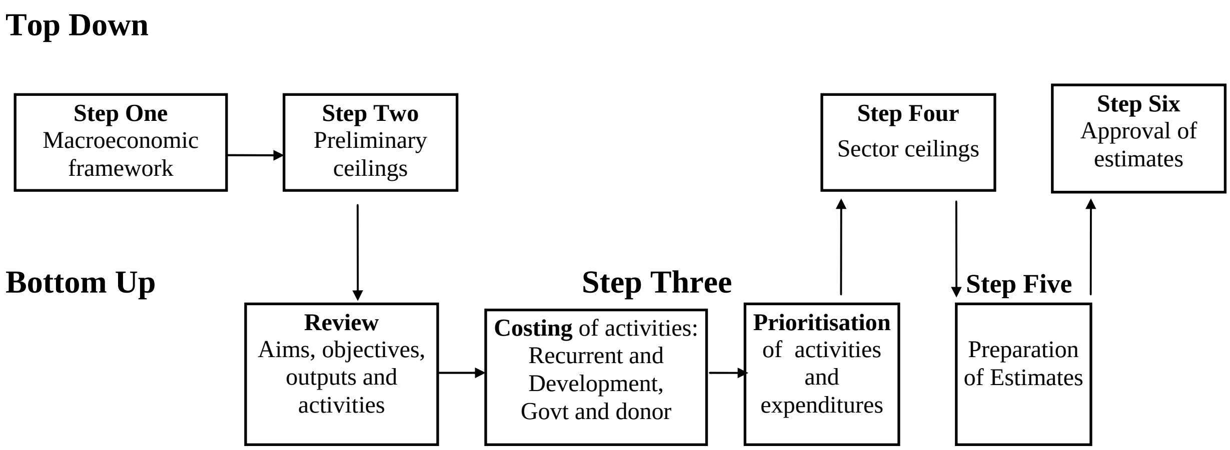
14. ***A MTEF provides a framework for allocating resources within which explicit policy choices and trade-offs are made depending on resource availability***. The MTEF can be a catalyst for building better basic budget conditions, i.e. improved fiscal stability and expenditure control. It needs to cover the whole of government – recognising that sectors develop at different speeds. Integration with the budget cycle is an indication of maturity and success of a MTEF. There needs to be a clear budget timetable and time for a strategic planning phase and for preparation of budget estimates.

15. The process can be shown by the diagram:



The Stages in the Process

16. The MTEF process is a top down process of determining resource availability and allocating these resources between sectors, and a bottom up process of estimating the actual requirements of implementing policies in each sector. The steps involved in developing an MTEF are the means to bring these processes together, and are demonstrated in the diagram.



17. Each of these steps needs to fit within the annual budget timetable. With more steps and greater use of analysis/review than traditional budgeting, more time is needed, so the process has to start earlier. Each of the "Top Down" stages involves decisions by Cabinet while the "Bottom Up" work mainly involves ministries.

V. Making this work in practice

18. This section sets out some practical suggestions on how to go about building a MTEF. There is a logical sequence in these steps.

Set overall targets/policy

19. This stage is very important as it sets the framework and constraints on the level of spending that can be built into planning. It is essential that there is agreement with Government Ministers on the overall aims and priorities for development as well as the fiscal aims. This is often achieved through formal planning documents that are developed with wide consultation and broad support.

20. There may be a Strategic Development Plan, though such plans are often at a high level, may not include the detailed strategies and typically have more proposals than can be funded. Often, there is not adequate prioritising of the aims and targets. The MTEF process can help with more realistic prioritising.

21. There also needs to be an approved Government policy statement on fiscal aims. For example, policy may be for there to be a "balanced" budget for operational expenditure with capital expenditure funded by donors or an agreed (limited) level of new borrowing. If there is to be borrowing, then there should be a study to ensure there is capacity to fund future repayments. The MTEF can also help demonstrate this – but only for the immediate (3 year) future while the impact of borrowing is long term.

22. Without political support for constraints on Budget expenditure, the MTEF process cannot work properly. For example, if Cabinet always exceeds the target levels of expenditure, the fiscal aims will never be achieved.

Analysis of the past as a guide to the future

23. A MTEF requires realistic projections of the future costs of existing policies. This is a measure of what is likely to happen if government continues doing what it is currently doing.

24. The suggested approach is to project both revenue and expenditure, recurrent and capital expenditure, as well as debt servicing and to take account of expected inflation and changes in exchange rates. The reason for including inflation and exchange rates is that different aspects will be affected in quite different ways. For example, debt servicing. Domestic debt will be in local currency while foreign debt (especially multilateral debt) will be in "hard" currency such as SDRs, US dollars or Euros. If the local exchange rate is falling, then the cost of debt servicing of foreign debt will rise in terms of local currency (which means that a concessional loan may be more expensive than it appears).[2]

25. When costing existing expenditure programs, it is important to build in current policies and take account of expected growth in volume, e.g. from population growth. For example, for education spending the projection needs to reflect the expected number of students and the approved policy for Pupil/Teacher ratios. If there are currently fewer girls than boys at school, then achieving the MDG for eliminating gender disparity in education will require more resources as education spending will need to grow at a faster rate than the youth population as a whole, so there are teachers for the extra girls.

Cost new activities/policies

26. Proposed new activities and policies also need to be costed. Some general points to consider:

- Have all possible costs been included? Develop a checklist of things to consider.
- For capital or development projects, has provision been made for the recurrent operating costs.
- Consider whether a range of prices or values should be used, rather than a single figure.
- Consider making a provision for contingencies.
- What are the key assumptions, e.g. exchange rates, and what happens if they change?

27. For capital projects, consider:

- What accommodation is needed for either capital items or staff?
- Are there installation costs that need to be provided for?
- Training costs should be considered as should the availability of staff with skills.
- Ongoing support may be an issue, especially in rural areas. What happens after the project is completed?
- Who will own the assets?
- What about intellectual property?
- Can costs be expressed in terms of other measures, e.g. unit costs, costs per person, costs per beneficiary? This may help with evaluation.
- Operating costs and availability of necessary items such as consumables (e.g. fuel, printer paper and print cartridges).

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[2] This may not be an issue for countries that use a "hard" currency such as US dollars as their local currency. It becomes and issue if the country borrows from agencies such as the ADB whose loans are in SDRs,

- Physical facilities needed for initial set up, e.g. building, protection from weather.
- Suitability of items for operation in the tropics.
- Economic life, maintenance, capability.
- Price versus capability – comparing like with like.

Build a financial model

28. Once work has been completed on projecting future revenues, the future cost of existing policies as well as the possible new ones, this all needs to be built into a financial model. A spreadsheet will often be adequate, with linked worksheets. A financial model can start out as a simple one and be made more sophisticated as experience is gained.

29. The purpose of having a model is that it allows "what if" questions to be answered through creating different scenarios. Typically, the first attempts at MTEF projections will show that there are many more bids for expenditure programs or projects than can be funded. By changing assumptions, new scenarios can be quickly calculated until an acceptable result is obtained. This process of trial and error is called doing "**iterations**" (trying different things). It also typically involves identifying which policies or assumptions make the greatest difference to revenue or costs, e.g. population growth, exchange rates, inflation, interest rates.

Making space

30. With limited funds available for expenditure and pressure for new programs, activities and projects, there will almost certainly need to be cutbacks on existing areas of expenditure. The best approach is to identify low priority areas of expenditure and stop a complete activity. The worst approach is to implement "across the board" cuts to budgets or to make arbitrary cuts.

31. Staff costs are typically a high proportion of government expenditure programs. If a budget is cut, it is difficult to reduce staff numbers as this may mean forced redundancy, which is costly and disruptive. Typically, managers cut the discretionary areas such as maintenance, training and purchases of supplies. This can lead to absurd situations, such as having staff who are unable to do their job because the budget for some essential item has been cut, e.g. if agricultural advisors had their fuel budget cut so they cannot make visits to farmers. Another example might be approving additional medical staff to target HIV/Aids but not providing funds for drugs for treatment.

32. Having to reduce a budget is never easy. So, what are some more sensible ways to go about making budget savings? Here are some suggestions:

a. Form a task force or working group. This may be for the whole of government or an individual ministry. Members from different ministries or parts of the ministry will provide varied knowledge and points of view.
b. Start by considering the overall budget target set by Cabinet and the net saving that is required. If there are new, high priority activities or items for a sector that already has a substantial budget, then suggest that savings to fund this expenditure should be found from other areas within the sector. Set a target for savings. For ministries with several programs, consider allocating a savings target for each program, based upon overall priorities.

c. Request the manager of each budget program to review their own budget. A good starting point is an estimate of the likely outturn for the current year (i.e. what is expenditure for this program expected to be, based upon spending and commitments to date as well as current and expected staffing levels for the balance of the year – for example, there may be unfilled staffing positions which are frozen). The estimated outturn is probably a better start point than the original budget for working out what will be required.
d. The ideal way to build a budget is not to look at last year's budget and make a few changes. The best way is to start afresh – what is sometimes called zero-based budgeting – as this requires each manager to work out what is required in future, not what was used in the past. Naturally, a good place to start is the number of staff and their salaries and allowances.
e. Look through the current budget for items which were "one time" expenditures, that is will involve spending only in that year and will not need to be included in future budgets.
f. It is better to stop an entire activity than to take a small amount out of all budgets. What is the lowest priority activity? Can it be dropped entirely without having a significant impact on your purpose or public policy reasons for existence or on your customers.
g. Staff costs typically make up around 40-50% of overall government spending, but may be 60-80% of some activities. Saving in staff numbers has a greater impact than most other savings, especially as you normally also save on other overhead costs. How can an organisation become more efficient and save on staff numbers? If someone leaves, do they need to be replaced?
h. Other than staff, what are the largest items of expenditure? Consider each of these in turn. Why do we spend funds on this item. Is there an alternative way of achieving the same result?
i. Ask staff for ideas on savings as they often have good ideas.
j. If a ministry has revenue as well as expenditure, consider whether revenue can be raised. For example, consider prices charged as these may not have been increased recently. If you can increase revenue, you may be able to justify more expenditure if the net cost remains the same.
k. Include "tax expenditures" in the reviews. Often these are hidden expenditures that are not recorded as they are items such as concessions or exemptions from a tax, e.g. import duty, income tax holidays. These may account for a substantial sum.

> "One of the great gaps in PEM [Public Expenditure Management] has been failure to focus attention on the relevance and effectiveness of ongoing programs. The result is that new spending is treated as additional, and spread thinly over too many programs and activities, rather than prioritised on the basis of the effectiveness of existing policies and their impact on poverty reduction."
> *ODI Briefing Papers June 2005*

Setting priorities

33. Setting priorities needs to be based upon the overall Strategic Development Plan for the country. Ultimately, Cabinet needs to determine its priorities as part of their overall political program. Civil servants and budget advisors can assist by providing clear information on the choices and the implications of each option. Clearly, the Millennium Development Goals should feature as being high on the priority ranking, and these should be a major part of what goes into the overall Strategic Development Plan.

34. The relevant Millennium Development Goals should also be used by each sector, such as education and health, in determining their priorities. The MDG targets should feature in the aims for each sector and there should be an emphasis on developing new proposals (projects or program activities) that will lead to their achievement.

35. The most important aspect, and frequently given inadequate attention, is measures of what each program or activity has achieved, or is expected to achieve, if approved. The more clearly the benefits and beneficiary groups can be defined, the more rational the decisions are likely to be. Where accurate statistics do not exist to measure whether key goals (such as the MDG), then part of new activities may be systems that record and measure the relevant data.

36. While sophisticated techniques such as Cost/Benefit Analysis can be used, in many cases this level of analysis is justified for large, complex programs. For many programs or proposed new projects, a simple comparison between benefits and costs may be adequate. Clearly, options with the highest ratio of benefits to costs should be preferred over those with lower pay-off ratios.

Sector strategies and priorities

37. If sectors have their own clear sector strategies, delegation of prioritisation becomes a practical option. Certainly, many of the MDG goals are focussed on particular sectors. However, decentralisation will work well only if this greater freedom and flexibility of ongoing funding means better planning and higher quality spending. That is, delegation is practical to sectors that have a clear performance focus that in turn means they need good measurement systems for benefits not just target setting.

Donor funded projects and Investment Programs

38. Another area for potential improvement is integration of donor-funded projects into the MTEF. All too often, donor funding is not properly reflected in measurement and reporting of economic activity. Much donor spending is done directly by the donors and does not go through the government's accounting system. The projects where donors directly manage spending tend to be amongst the largest. Where donor funding does come within the government system, it is often handled though a "Development Fund" but this is often not considered along with expenditure funded through the Consolidated Account (or its equivalent).

39. Another aspect that is often not well handled, is identifying the implications for recurrent ongoing operational spending after the project funds have been spent. If ongoing funding is not provided, the benefits from the donor-funded project may cease or be less than was envisaged

when the proposal was approved.

40. In terms of setting priorities, co-ordination of donor-funded projects tends to be done separately from overall budget priorities. There is also often the attitude that donor funds are something “extra” and a “free” addition to the resources available to Government.

41. Most donors are themselves governmental organisations. They have budgets and priorities for allocation of funds to regions and countries, typically using MTEF approaches with 3-5 year programs. This means that the donor funds from each individual donor tend to be fixed in terms of the amount available to a particular country.

42. This means that the donor funds need to considered within the MTEF priority setting as each time a request is made to a donor for a particular project to be funded, this is effectively a statement of government priorities for spending and development. So, it is suggested that:

- Data on donor spending that is made directly by donors, should be gathered systematically and included in reports on overall resources used for development.
- Priority setting for donor-funded projects should be done as part of the overall MTEF process, i.e. considered at the same time as priorities for the recurrent budget.
- Proposals for donor-funded projects should clearly identify the future spending implications for the recurrent budget and adequate provision should be made for this expenditure, if the project is approved.

VI. Problems to avoid

43. A survey of reports on experience in developing countries with introducing a MTEF, has given the following list of problems, as suggestions of things to avoid:

- **Over optimistic predicted growth in revenue**
  If revenue predictions are over-optimistic, then the financial model will suggest that there is room for growth in government expenditure. If this does not occur, then there may need to be cutbacks in spending. Cutbacks are difficult to achieve and often cause inefficiency. Alternatively, if expenditure is not restrained, and there is a shortfall in revenue, then the overall Budget aims will not be achieved, e.g. there will be a deficit or a much higher deficit than planned.

- **Forecasts are seen as the entitlement**
  Where the future cost of existing policies is predicted, care must be taken to ensure that spending ministries do not assume that these predictions are their future budget entitlement. The purpose of the prediction is to identify areas where there is likely to need to be changes in priorities and some activities may have to be stopped to allow space for new high priority items.

- **Budget predictions ignore inflation (i.e. use nominal not real expenditure)**
  Revenue and cost elements may change at different rates of inflation than predicted, and at varying rates, e.g. fuel price rises. If budgets are expressed in real (inflation adjusted terms), then spending ministries will assume they will receive full compensation (in the sense of increases in budget) for any price rises. This can cause a Budget blow-out as spending ministries may not respond to price rises by

constraining spending.

- **New policy and projects not integrated**
  The whole point about a MTEF is to integrate new spending bids with the existing so that there is a trade-off with replacement of low priority spending by new higher priority activities. The risk of treating the new entirely separately is that the new gets added to the Budget, but nothing is stopped.

- **Donor-funded projects not integrated with recurrent spending**
  If donor-funded projects are kept separate, when the project funds are spent, there may be no funding to continue employing staff or to fund essential operating costs. The new activity may just stop for lack of funds leading to waste.

- **Creating uncertainty in non-priority areas**
  While setting priorities is essential, there will still be core aspects of government that need to continue. There is a risk that if too much attention is given to the highest priority areas, ongoing core areas will suffer. The risk is that cutbacks to non-priority areas go too far, leading to stop/start allocations for non-staff costs, especially maintenance. This may be the wrong thing to do as deferring maintenance may end up costing more in the long run.

VII. More Lessons

44. A case study of two African Developing countries (Malawi and Ghana) had a useful summary of lessons:

- There needs to be political commitment to the process from the start.
- All stakeholders should have involvement in design and implementation, rather than having new MTEF processes dictated from the central agencies.
- As the changes are difficult to introduce, pilot projects are recommended rather than a "big bang" approach that has a higher risk of failure.
- There is a need to manage expectations that a MTEF will provide more resources. It won't, but it will help a better approach to setting priorities so more funds are found for new activities.
- Change management is essential. This means taking time to include a careful communications plan so that stakeholders, such as senior staff of spending ministries are involved and well informed from the start.
- Link the MTEF closely to the budget implementation timetable.
- Ensure that the MTEF links closely with other reforms, e.g. changes to staffing.
- Ensure there is close involvement with donors.

VII. Benefits of a MTEF

45. What are the key benefits from moving to a MTEF? These can be considered in terms of the view of central agencies and line agencies.

Central agencies

46. For the centre, the MTEF becomes a contract for performance, in the sense of being an agreement with the Government (Cabinet) and with line agencies on the framework for planning and budgeting. This provides:

- More predictable funding
- More credible policy
- Transparent and predictable processes for allocating and reallocating resources
- Rules and practices that support and demand efficient resource use
- Ability to delegate to line managers and local governments power to manage

Line agencies

47. For line agencies (ministries and local government) a MTEF provides:

- Clear sector and local development strategies
- Incentives for using resources efficiently and effectively
- Improved reporting on resource use and results
- Greater emphasis on living within budgets

VIII. Summary – the purposes of a MTEF

48. In conclusion, it is worth summarising the main purposes of a MTEF. There are three key aspects for improved financial management – fiscal, resource allocation and efficiency.

Fiscal

49. The key is to improve the overall management of the government Budget (improved fiscal discipline) with clear:

- Medium term fiscal policy and targets
- Agreement on a policy of fiscal sustainability and
- Disciplined policy making aimed at keeping to the medium term policy

Resource Allocation

50. A MTEF aims to improve resource allocation, through a rigorous analysis and decision making process over Budget allocations. This is achieved through:

- Disciplined decision making and highlighting the need for action by showing:
  - the future costs of current policies
  - the future costs of new policies and investments
- A clearly communicated commitment to specific priorities through forward estimates, and
- Indicative medium term allocations to open up budget space to reallocate funds for new priorities

Efficient Resource Use

51. With greater predictability of funding for budget allocations to each sector and clear priorities for spending, operational managers within each sector can then concentrate on:

- Strategic planning, and
- Improving management and operational performance at sector level

52. Basically, if the resources available to a sector are more predictable, even with a fixed ceiling, there is greater incentive for budget managers to make better use of the funds available to them – cutting back on low priority items but also taking a longer term view on spending, such as undertaking preventative maintenance to avoid future higher costs.

Appendix

Performance-based budgeting

1. Performance-based budgeting, sometimes called activity-based budgeting, is an important part of moving from traditional budgets, based upon the costs of inputs to budgets which emphasise achievements, outputs and outcomes.

2. Public financial management systems have traditionally emphasised control of resources over achievement of outcome-oriented objectives. Resources have often been allocated to government agencies on a historical basis and without consideration of their goals or performance. At the same time, highly centralised decision making and control systems have made it difficult for public servants to take initiatives that improve the efficiency and effectiveness of government programs. While developing a performance culture and supporting management systems may require wide institutional reforms, a number of additional measures may be considered within the budget system to improve the link between resources and performance, without sacrificing the controls needed to ensure compliance. Developing appropriate measures of performance is a necessary first step in this process. Ideally, these should relate to indicators that reflect the goals identified in the development plan and can be related to resource use:

Performance Measures and Indicators

Key performance measures are shown by the examples presented below.

- **Input** indicators measure the quantity and sometimes the quality of resources provided for project activities. The performance criteria corresponding to inputs are compliance, defined as adherence to budgetary limits, and economy, or minimizing the monetary cost of a given volume and quality of inputs.
- **Output** indicators measure the quantity and sometimes the quality of the goods and services created or provided through the use of inputs. The performance criterion corresponding to outputs is efficiency, that is, minimizing the total inputs per unit of output.
- **Outcome** indicators measure the quantity and sometimes the quality of the results achieved through the use of the project output. The performance criterion is effectiveness, that is, maximizing the outcomes in relation to the outputs produced.
- **Impact** indicators measure the ultimate change in the living conditions of beneficiaries resulting (wholly or partly) from a project or program.

Type of indicator			
Sector	**Intermediate**	**Final**	
	Input/output	**Outcome**	**Impact**
Education	Number of teachers; teacher absenteeism	Number of primary school graduates; retention rates in poor regions	Higher literacy rates among the poor
Health	Number of primary health staff; availability of drugs	Vaccination rates among children of poor households	Lower morbidity and mortality rates in poor families

3. Practical considerations - such as the availability, reliability, and cost of data - should play a part in selecting appropriate performance indicators. It will often prove more cost-effective to monitor indicators for which data are already collected on a routine basis - assuming they are relevant - than to develop new systems for collecting new indicators.

4. One of the challenges of performance management is linking the responsibilities of managers to appropriate performance indicators. The director of a village clinic may be held responsible for the number of vaccinations administered, for example, but cannot be held responsible for the overall health status of the population. In general, measures of output and outcome are more suitable for service delivery units, and measures of impact are more suitable for the policy level. Care should also be taken to ensure that linking responsibilities to performance indicators does not have unintended results such as organisations and individuals seeking to achieve performance targets regardless of their effect on poverty outcomes. A focus on exam pass rates, for instance, may encourage schools to exclude less able students. Given these risks, it is preferable to measure program performance against a range of indicators - ideally, with direct linkages to poverty reduction goals - and to monitor the impact of linking levels of personnel to performance indicators (the performance management system) as programs are introduced. Performance indicators can be linked to budgeting by requiring government agencies to present targets for key performance indicators as justification for their budget and medium-term expenditure proposals.

5. For performance targets to be effective, they must be attainable with the resources at the business unit's disposal. Ideally, they should be set after consulting with the appropriate managers rather than imposed from above. Feedback from users, through surveys or other instruments, can also provide critical information. Benchmarking can offer a useful starting point when setting targets for comparable service delivery units. It is also important to set output and outcome targets after assessing the availability of inputs. For example, an increase in the number of children attending school in a district by 500 pupils may require 25 new classrooms, 25 more teachers, 500 desks, and 500 sets of textbooks.

6. Attention should then turn to the feasibility of providing the necessary inputs within a given time period; if only 15 new teachers can be recruited and trained, the corresponding outcome targets can be scaled down accordingly. Only then should the manager consider costing the inputs required to achieve the revised targets.

7. Outcome and impact targets should have clear poverty reduction objectives. It is also important to link the targets to performance management systems for managers, so that formal performance appraisal supports the overall objective. Performance appraisals can stimulate improved performance when they allow peer comparisons and benchmarking. This system can work quite well at the service delivery level, enabling managers to compare and contrast their performance with other units and helping to build a spirit of emulation and healthy competition. Closer analysis of the characteristics of better-performing units will help identify how poor performers can improve.

8. Performance may also be improved by giving managers at all levels greater flexibility in resource use. Traditional budgeting systems consider compliance a higher virtue than efficiency

and effectiveness: spending on individual line items is minutely controlled, and the reassignment of appropriations to different expenditure categories is discouraged. Allowing discretion over line items may enable mangers to improve efficiency and gain greater outputs from the same level of budget. Letting go of traditional controls is often an important part of improving outcomes and impact.

Comment:
See the separate paper "Hints for planning a successful Project or New Program". The ideas in this paper can be applied to a "performance budget" a new program or a project. The basic concepts are the same: setting clear objectives and performance measures and building a budget that is realistic and reflects costs and benefits. This becomes the basis for both planning and measuring success by comparing actual results against the plan.