



WORLD BANK GROUP

MACROECONOMICS AND FISCAL MANAGEMENT

International experience of the World Bank in evaluating public policies

Fernando Blanco
Lead Economist
October 2015

What is an Expenditure Review?

- Expenditure Review is essentially a tool for **Analyzing Expenditure Allocation and Efficiency**
- It looks at the value of public expenditures – assessing allocative and technical efficiency of public spending, and identifying bottlenecks to improving the effectiveness of spending. ERs make recommendations for improving:
 - 1) Budget management
 - 2) Allocation of spending between sectors
 - 3) Efficiency of spending within sectors
- Policy recommendations of expenditure reviews shed light on a country's strategic development and spending choices

Framework of Expenditure Review

Medium-term fiscal sustainability and revenue analysis

Strategic allocation of resources

Efficiency and effectiveness of spending

Incidence and equity

Institutions

Issues Typically Covered in ERs

1. Macrofiscal Issues: Fiscal Space and Medium-Terms Budget Strategy

- Issues of fiscal sustainability and fiscal space especially important for emerging economies
- Medium-term fiscal scenarios prepared under various conditions to provide policy makers with choices for prioritization in expenditure policy
- Analysis of the tax system – scope for enhancing revenues

Issues Typically Covered in ERs

2. Institutional Issues

- **Institutional responsibilities for central budget management:** Differences across countries in ministries for planning, budgeting and finance
 - Reviewing legal framework for budget and expenditure management
- **Annual Budget Processes of Central Government**
 - Budget formulation should reflect sector-specifics strategies as well as economy-wide government policy objectives
 - Annual budget formation – common problem of late start to the budget cycle
 - Dual budgeting – when current and capital expenditure decisions are made separately
- **Local Government Budget and Spending Responsibilities**
 - Appropriate level of sub-national governments in budget responsibilities and financial management is a political issue

Issues Typically Covered in ERs:

Spending Efficiency, Effectiveness and Equity

- Central to expenditure reviews is analysis of the efficiency, effectiveness or equity of public spending

Allocative Efficiency:
strategic prioritization of expenditure
across policies, programs and projects

Operational or technical efficiency:
achievement of outputs at lowest
possible cost

- Difficulty of comparing efficiency of spending across sectors
- Expenditure reviews often focus on efficiency in social sectors – occupies a large component of total government spending
- Data Envelopment Analysis (DEA) used for calculating technical efficiency
 - Estimate the efficiency frontier and the distance from the frontier to each unit (e.g. schools, hospitals)
 - Convert a unit's inputs and outputs to a single measure of efficiency

Expenditure Prioritization and Allocative Efficiency

- Budget preparation and approval – diagnostic considerations
 - Share of expenditures allocated by central versus subnational governments
 - Constitutional responsibility of subnational governments in allocating budgetary expenditures (e.g. primary education, health clinics)
 - Relative influence of ministries in deciding on board priorities and expenditure composition
 - Percent deviation between composition of approved expenditures and actual allocation at the end of the year budget
- Evaluate spending efficiency by benchmarking expenditures against best practice norms
 - Establish how much it would take to get a country's infrastructure per capita, per unit cost of GDP, and per square kilometer to the level of other countries
 - Econometric analysis of differences in efficiency by region, country

Technical or Operational Efficiency

- Assessed by measuring:
 - A) *Cost Efficiency* – the optimal amount of inputs used to obtain a given level of output
 - B) *Internal Efficiency* – the optimal combination of inputs allocated to produce outputs or outcomes within a sector, given input prices and marginal productivities
- Autonomy
 - Percentage and type of expenditure items over which line agencies have flexibility in allocating budgetary resources during budget preparation
 - How much of budgeted allocations are automatically released to line agencies
- Accountability
 - Specification of what body (ministry, department) is producing the output
 - Accountability mechanisms – linking performance indicators to compensation of persons responsible for programs
 - Punitive actions for delays, discrepancies
 - Audits – with what regularity and are results published

Data and Tools for Expenditure Analysis

- Focus on allocation of total government spending by broad aggregates
- Spending shares compared to other countries to identify anomalies
- Disaggregated data needed at the sector, subsector or program level to identify

Inefficiencies

Overstaffing
of the civil
service

Underfunding
of nonwage
spending

Ineffective
public
investments

- Disaggregated spending data are often incomplete or unavailable, posing a major challenge to expenditure reviews

Brazil: use of DEA in municipal education

- Main output indicator: pass rate of municipal schools
- Three inputs: administrative expenses, teachers' expenses, and capital spending per pupil
- Conducted for five population categories, ranging from municipalities to large cities
- Findings:
 - Administrative expenses and student pass rates are strongly correlated in municipalities
 - Municipalities in very similar contexts show a wide variety in efficiency of public spending on education
 - Efficiency is not necessarily higher among richer municipalities

Brazil: use of PETS in Unified Health System

- Public expenditure tracking surveys (PETS) developed to track the flow of public funds from the central government to front-line service providers
- Brazil PETS study examined service delivery and quality of health expenditure
 - Tracking the financial flows between levels of governments; identify leakages
 - Evaluating how resources were used in health units
 - Comparing resources used with the results achieved
- Data collected at four levels: Ministry of Health, state health secretariats, municipal health secretariats, and health units
- Main recommendations include: establish robust monitoring and evaluation systems; develop organizational arrangement that give health units more management autonomy; make budget geared towards performance

Incidence analysis and equity of public spending

- Equity: distribution of benefits of public spending
 - Progressive versus regressive
- Expenditure reviews may identify income groups that benefit from public spending policies
 - E.g. Poland Education PER (2009) found that higher education subsidies disproportionately benefited the wealthy
- Benefit incidence analysis (BIA) – tool used in some PERs to examine spending equity issues
 - Examines share of benefits from a spending program that different groups receive
- Example: BIAs show that public expenditure on primary education and on preventive health care is pro-poor

Peru Macrofiscal PER 2012

- **Objective** to contribute to the policy discussions on public expenditure issues
 - A) Developments in public expenditure and revenues during the last decade
 - B) Impact of decentralization and shift to results-based budgeting
 - C) Extent to which public expenditures are allocatively and technically efficient
- **Analysis**
 - Macrofiscal focus,
 - Examined trends in GDP, total revenue, total spending and their main components; international comparisons made
 - Analysis of tax system and other revenues, expenditure allocation, efficiency and equity

Russia PER 2012

- **Objective** to assist the Ministry of Finance in identifying opportunities for savings and efficiency gains in 2 large spending categories: transport infrastructure and public sector employment
- **Analysis**
- Benchmarking – relevant international comparisons in terms of overall spending and as unit costs
 - Annual spending on roads in the 1990s was 3.5 of GDP in China, compared to Russia's 2.8 percent in 2000 and 1.5 percent in 2009
- Analysis of road and rail maintenance planning, scope for increasing user fees and financing of road and rail infrastructure
- Identified financing gap for road maintenance
- Analyzed Government's Transport Strategy

Russia PER 2012

- **Findings**

- Chronic underfunding result in deterioration of road infrastructure – only one-third of roads considered in good or fair condition
- Sizable financing gap for road maintenance and reconstruction
- Financing for Russian Rail (RZD) determined largely by tariff structure, annual tariff indexation and government financial support

- **Policy recommendations to improve efficiency**

- Increase road user charges
- Gradually increase spending on road maintenance, rehabilitation, and reconstruction
- Introduce a second-generation road maintenance fund
- Establish a multiyear financing framework
- Introduce performance-based road maintenance contracts
- Adjust freight rates to ensure cost recovery
- Review process for indexation of freight tariffs

Mexico PER 2015

- At the request of the Secretary of Finance and Public Credit (SHCP), the World Bank is preparing a Public Expenditure Review (PER) for Mexico. Initially, efficiency and equity aspects of public spending were the focus of this study. The fiscal retrenchment triggered by the recent fall in oil prices has generated strong interest on the potential impacts of the proposed policy options raised by the PER.

Public Financial Systems

The Macro-Fiscal Profile

The Medium-Term Fiscal Framework

Subnational Public Finance

The Public Budget Process and Role of Congress

The Public Evaluation System

Human Resources in the Public Sector

Selected Sectors

Public Health

Education

Social Protection

Other Subsidies and Transfers

Water and Sanitation Infrastructure

Public Security

Potential Short-Term Efficiency Gains in a Context of Rising Expenditure Pressures

- **Potential efficiency gains and their projected fiscal impact**

- Locking-in the excise tax on gasoline and diesel by fixing tax rates at their 2015 levels (1.0% of GDP)
- Increasing subnational tax collection (0.2% of GDP)
- Reducing administration expenditures to below 10% of the public health budget (0.15% of GDP)
- Eliminating social protection spending leakages in the top two quintiles, which represent 10% of total social protection spending (0.1% of GDP)
- Auditing the teacher payroll financed by FONE (0.08% of GDP)
- Uniform protocols in health units and Consolidation of pharmaceutical procurement (0.04% of GDP)

- **Rising expenditure pressures and their projected fiscal impact**

- Projected increase in pensions payments (+0.05% of GDP)
- Projected increase in health expenditures (+0.05% of GDP)
- Projected increase in education expenditures (+0.02 of GDP)
- The efficiency gains described above represent one-time savings, while the expenditure pressures are continuous and will compound over time.

Lessons from PER Experiences

High-quality and timely data are important

Specific techniques are needed for expenditure analysis

PERs require strong analytical skills and sector expertise

International comparisons in PERs are most useful

Client ownership is crucial

Collaboration with multilateral organizations avoids inconsistent policy advice

Other development institutions may have useful recommendations