CABRI sector dialogue on value for money in agriculture spending

Key issues in budgeting for agriculture

Keynote paper

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Contents

Acronyms and abbreviations

GDP	gross domestic product
NGO	non-governmental organisation
ODA	official development assistance
R&D	research and development

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1. Introduction

Releasing the powers of agriculture and rural development will greatly contribute to the achievement of the Millennium Development Goals and beyond... and as we become aware of the contributions that agriculture and rural development can make to poverty reduction, they will take a central role in national and international development programs (World Bank 2007).

For many developing countries, agriculture is the most important sector in terms of its share in GDP and employment. Most of the world's poor live in rural areas and depend on agriculture for their livelihoods. Agriculture is a vital sector for both economic development and poverty reduction.

It follows that, in developing countries, agriculture is one of the most important government instruments for promoting economic growth and reducing poverty in rural areas (Fan & Saurkar 2006). Indeed, agriculture is widely supported by the public sector through institutional backing, extension services, the marketing of commodities, input supply and legislation on land use. Both theory and practice show that the formal and informal institutional systems have a decisive influence on fiscal performance, including on the following three levels:

- aggregate fiscal discipline;
- the allocation of resources according to strategic priorities; and
- the effective use of resources for strategic priorities.

The private sector participates in the financing of direct investment and local or foreign portfolios, as well as sponsoring research and capacity building in agricultural issues at universities. Governmental and non-governmental organisations also contribute through support in the form of funding, input supply and technical capacity building.

Yet, in most developing countries, public expenditure on agriculture has stagnated or declined. In Africa, agriculture has not only been neglected in the past, but has been penalised. Poor economic policy choices have created an unfavourable macroeconomic environment, exports have been taxed heavily and the level of investment by the government and donors in the agricultural sector has been very low. Aid to agriculture has declined in relative terms, as has public investment in African countries in this sector. Countries whose economies are based on agriculture, in general, and African countries, in particular, spend too little on agriculture, and research and development (R&D), and the quality of the expenditure is often poor. Agricultural GDP in economies based on agriculture accounts for about 30 per cent of total GDP, while public expenditure in this area averages only 4 per cent of agricultural GDP. R&D expenditure in agriculture is generally less than 1 per cent of agricultural GDP (Fan, Yu & Saurkar 2008). In recent years, these patterns seem to have been reversed. In this context, the quality of public expenditure budgeting is also a critical factor for agricultural and rural development.

The problems associated with projects funded by states or donors include lack of durability, lack of monitoring and evaluation, lack of effective co-ordination with other projects or national development programmes, and lack of alignment with national priorities (Govereh *et al.* 2006). Access to detailed agricultural expenditure data is also problematic. Data on budget allocations are more readily available than information on actual expenditures, and there are often great differences. There is also a problem with the way agriculture is defined: what is included and what is not, the diversity of spending agencies involved, the degree of concentration or decentralisation of activities in the sector, and so on.

Thus, given the importance of agriculture in development strategies, it would be interesting to know explicitly the factors that inhibit or promote efficient and effective budgeting in agriculture and how they manifest themselves. This report aims to shed some light on the challenges of public financial management in agriculture. More specifically, it addresses the following topics:

- failure to link budgets with strategies and policies;
- spending patterns that are not pro-growth or pro-poor;
- a high degree of centralisation despite decentralisation plans;
- low execution capacity;
- lack of integration of donor funding;
- lack of effective tracking and monitoring systems; and
- poor data quality and availability.

The report is structured as follows: Section 2 is devoted to the analysis of budget system failures in developing countries by way of an assessment of budget implementation and the link between a sector approach (involving donors in agricultural financing) and the budget process. The third section analyses the links between budgeting in agriculture and the impacts of climate change. The fourth section is devoted to fiscal reforms, and the principles of sound financial management, necessary institutional arrangements and fiscal reforms to be implemented for a more effective agricultural budget are discussed. The report closes with some concluding observations.

2. Failures of budget systems in developing countries

2.1 Assessing budget design methods

The weakness of many budget systems is due to poor co-ordination of the various functions of the budget process. The key elements outlined below create an unfavourable environment for the proper management of the agricultural sector.

Communications from ministries of finance on the preparation of the budget do not always inform line ministries about the financial framework. The lack of a budget framework letter in some contexts poses problems in three respects:

- line ministries do not have enough information about the overall budgetary framework and, as a result, their budget proposals lack realism and induce difficult budgetary negotiations;
- despite discussions between line ministries and the finance ministry during the budgetary meetings, no substantive exchanges take place on annual expenditures; and
- as a result, line ministries are limited in their input to the budgeting exercise, which they consider to be external to their actions.

The unpredictability of funding from one year to another and within the fiscal year is one of many factors contributing to the poor performance of the agricultural sector. In Burkina Faso, for instance, there is a preponderance of foreign aid in the financing of projects. On average, 88 per cent of project funding came from foreign funds over the period 1991–2006. The erratic nature of this support reflects a total lack of control of this source of financing, and uncertainty in the development of Burkina Faso's agriculture.

Another factor related to the budget is the inability to direct resources to policy priorities, largely because budgeting is treated as an annual financial exercise, and not on the basis of policy and development.

The lack of political linkage between planning and budgeting can be the most important factor contributing to poor budgeting outcomes on the macro, strategic and operational levels in developing countries. In many countries, systems are fragmented. Policy development, planning and budgeting in agriculture occur independently of each other. Planning is often limited to investment activities, which in many developing countries refer to a series of projects funded by donors. Capital expenditures are already well represented in the planning process, and much of the recurrent expenditure is predetermined in payroll. For this reason, the annual budget is confined to the allocation of donor resources, nationally funded investment projects and the non-wage portion of the operating budget.

Another weakness is the focus of the expenditure system on inputs only. Performance is considered good if actual expenditures correspond with those approved. In such an approach, short-term imperatives dominate budget decisions. This perspective makes it difficult to consider longer-term costs; and it distorts the choice of instruments for policy implementation between investment and operating costs, and between spending action, direct intervention or regulation.

Cammack (2006) points out that other weaknesses remain in many countries' budgeting. These include multi-year planning unrelated to the annual budget, unrealistic annual estimates, frequent additional budgets and non-transparent budgets.

Budget preparation is often done from the bottom up. Even if the macroeconomic framework of fiscal policy is sound, 'games' engaged in by managers or operational services in charge of the economic and financial framework (ministry of finance, planning, services attached to the head of government, etc.) generate high transaction costs and end up accommodating ministerial complaints superficially and unrealistically.

Budgets are defined at constant prices. The consequence of this approach, when there is inflation, is either strong pressure to increase overall spending (often endorsed by additional appropriations) or an arbitrary reduction of credit during the year, jeopardising the effectiveness of operational services.

The cabinet is concerned primarily with allocating budget savings between various proposals for new spending. The ministry of agriculture does not properly consider spending by setting priorities among competing activities with respect to sector objectives and assessing the impact of such spending. This calls into question the significant increase in public funding for agriculture in the absence of better management and efficiency.

General spending cuts are imposed abruptly, even during the financial year. Arbitrary decisions and sudden credit cuts create uncertainty about the funding of programmes. One of the key aspects of this is the attitude of budget managers, constantly in search of unexpected savings they seek to identify and capture. The system encourages services to spend their annual appropriations from the beginning of the year. Indeed, poor expense management leads managers to use their appropriations as soon as possible because there is no guarantee that funds will be available at a later date. In addition, current expenditures are the sole basis of budget haggling for the following year.

Budget debates are centred on programme financing at the expense of a critical examination of public policy decisions. In this context, appropriations for a given fiscal year are derived from the previous year's figures, adjusted by uniform coefficients. This results in a lack of coherence between policies and resources on both central and operational levels. This inconsistency has many drawbacks: it makes it difficult to clearly define goals and tasks, and, consequently, to produce adequate data on the outcomes and costs of policies, programmes and services.

A related problem is the fact that the administrative services combine the advisory, regulatory, financing and provision of management functions, and are hostile to the recovery of costs from users.

Weaknesses in the implementation of the budget include poor quality recording and monitoring of expenditures and commitments, the accumulation of arrears, the proliferation of bank accounts, unreliable financial reporting and financial statements, and inadequacies in the internal audit and the production of statistics.

The quality of the design of sector projects and programmes, and the monitoring and evaluation of their impacts is dependent on the reliability of statistical series. The formulation of agricultural policies and strategies has often been confronted with the unavailability of reliable statistics. Difficulty in collecting and processing statistical information of good quality is a major handicap that statistics, and monitoring and evaluation systems must overcome to be operational. The agricultural statistical system is characterised by a persistent laxity, with shortcomings in the organisation of data production, as well as the coverage of essential data. This inhibits capacity to really cope with a growing and pressing demand for statistical information.

2.2 Challenges in budget sources for the agricultural sector

To effectively exploit national resources and achieve development goals in agriculture, policy-makers need a complete picture of all available resources, including external resources. In the absence of full information and co-ordination among stakeholders, there is a risk of duplication of efforts and lack of synergies between sectors and programmes.

Many developing countries are highly dependent on aid to finance investment activities in agriculture. Such assistance can take three forms:

- In sector budget support, which involves a transfer of funds to the national treasury of the partner country in support of the sector programme, funds become part of the national budget and, therefore, are managed through the management system of the country's public finances.
- Mutual funds or 'common funds' are systems designed to meet expenditure in a sector programme. The mutual fund collects contributions from donors in one 'basket' or common fund, from which disbursements are made in accordance with procedures established for this purpose. The main purpose of the common fund is the harmonisation of donor procedures to reduce aid transaction costs. Mutual funds may take several forms. In principle, they imply the existence of a bank account in which donor contributions are 'pooled' and from which eligible activities are funded. Sometimes, these activities constitute the entire programme in the industry, but more often, mutual funds finance subsets of activities in accordance with prior agreements between the government and donors involved.
- Much of this external assistance is provided 'off-budget' or outside the system of budgeting and government planning. 'Off-budget' aid is often channelled directly to NGOs or line ministries, and is not reflected in the national budget process. Because of failures in the system of forecasting, budget support to sector programmes is not predictable over the medium and long-term and, therefore, is not aligned with the cycles of the budget. In addition, resources often do not match the priorities of the sector (despite this being a key objective of the sector approach). Potential conflicts of interest also exist. Indeed, there is a genuine risk in developing large agricultural and rural development programmes that try to involve all stakeholders. Such 'mega-programmes' are likely to suffer from a lack of coherence, divergence of interests and institutional impasses.

Co-ordination gaps between the government and donors can also contribute to inconsistent and incomplete information on aid flows. In many countries, the public financial management system alone is not an adequate tool for planning and evaluation of the use of resources, as it captures only a fraction of development aid.

A budget framework, integrating all resources with a single nomenclature, must be implemented. Donors should not intervene outside of the agricultural sector programmes being developed. Ideally, they should adapt their procedures and intervention strategies to facilitate and enhance their alignment with partner country choices. They also need to link their support with interventions already funded and special initiatives in respect of national programmes and priorities under development. The harmonisation of practices and procedures with other donors should be pursued to minimise the costs associated with aid, to avoid duplication of services, while ensuring a diversity of approaches. For projects, it is important to use government rates and procedures, including systems of domestic procurement, and to support the process of decentralisation by empowering decentralised entities in programming, monitoring and evaluation, and management of project funds, where possible.

2.3 Dealing with low execution capacity

In some African countries, there is a very low level of budget execution due to weaknesses in the budgeting process and the mobilisation of resources for the agricultural sector, delays in procurement processes and in the start of some projects/programmes, and lack of control of donor procedures by project managers when it comes to external financing. This is the case in Mali, where the rate of budget execution reached 90 per cent in 1996/97 and fell sharply to around 60 per cent between 1999 and 2004, and then increased to 80 per cent between 2009 and 2012.

In Benin, foreign agencies' commitments are usually very significant, but the disbursed amounts are small. Between 1990 and 2012, an average of 15.2 per cent of the commitments of official development assistance (ODA) for agriculture in Benin were actually disbursed per year and only 12.2 per cent of the aggregate commitments were disbursed during this period. Thus, the low level of funding of the agricultural sector can be explained not by a lack of available funds, but by the low level of actual disbursements of foreign loans and, thus, the low capacity of Benin's administration to use the resources available.

In Togo, it is rather the payment arrears *vis-à-vis* multilateral agencies like the World Bank, the African Development Bank and the International Fund for Agricultural Development that have led these institutions frequently to suspend disbursements on projects in progress, which ultimately impacts negatively on the disbursement rate. In addition, the portion of government funding committed to projects is seldom disbursed because of budget constraints on the government. Consequently, the investment gap is due to a crisis in public finances and the difficulties experienced by the state in mobilising internal resources.

3. Mainstreaming climate change in budgeting for agriculture

The debate on climate change is no longer restricted to the environment but now takes a broader view, which closely binds environmental objectives with economic and social development. Tackling climate change has become a key national and international policy issue, given the recognised negative effect climate can have on agriculture. For agriculture, the disturbance of rainfall regimes is already noticeable in several developing regions, and could severely affect areas already subject to substantial developmental constraints. An increase in the number of 'bad years' will affect the grain market, with severe consequences for food-dependent countries. The global food system is vulnerable, and extreme weather events generate additional economic costs, which weigh heavily on the budget situation of affected countries.

Governments have made an effort to increase the budget allocated to the environment. However, climate finance (public and private) and the monitoring of climate-related expenditure through clear budget lines in national accounts are yet to be achieved. Taking into consideration climate change objectives during the budget process, and in the design and implementation stages, is still hypothetical. In addition, codes of budget lines on projects related to climate change barely exist. Thus, it is difficult, if not impossible, to ensure the traceability of climate-related expenditure in the environment sub-sector. The integration of climate change objectives in the planning process of public policies, along with the inclusion of national budgeting tools and innovative financing mechanisms, is not yet effective.

Very often, measures taken respond to short-term needs and do not allow countries to meet the challenges of climate change in the agricultural sector, in rural and urban areas, better. They also fail to strengthen the dialogue between the private sector, the public sector and civil society on issues of climate change.

Most countries suffer from insufficient scientific and technological capabilities. This is due to several factors: lack of direct links between research and national development priorities, and inadequate public and private funding allocated to research (investment in R&D is less than 1 per cent of GDP in most countries). This hinders the development of new crop varieties better adapted to climate change. Although countries are forced to respond to these environmental challenges, they have been slow to address them seriously, given the complex scientific nature of climate change and the uncertainty that accompanies it.

Efforts against climate change face barriers mainly related to:

- limited financial resources;
- weak institutional capacity and limited co-ordination;
- inadequate technical and scientific expertise;
- lack of integration of R&D;
- a regulatory framework barely implemented and requiring further adaptations;
- low involvement of the private sector; and
- limited regional co-operation.

Lack of funding is a key barrier, and mitigation and adaptation policies involve investment, technology and binding measures to manage natural resources with high costs not included in the budget. ODA and concessional loans directly allocated to adaptation to climate change remain limited.

Given the weakness of agricultural and trade policies undertaken so far (modest technological progress, limited use of drought management instruments, insufficient irrigation capacities, unsuitable management of land policy, free trade policy and European trade requirements), climate change could have drastic consequences on agricultural productivity and trade, leading to adverse effects on the macroeconomic situation (deficit in the balance of payments, inflation, etc.), as well as on the social front (job losses, declining incomes, food and nutrition insecurity, increased rural-urban migration, conflict, etc.).

Thus, the following are imperative:

- funding for adaptation must be provided in a predictable manner, in line with a strategy or plan for adaptation driven by the country concerned;
- facilitation of country leadership and ownership, and international funding for adaptation to climate change must be planned in terms of the priorities for adaptation directed by the country itself (in addition, such funding must be integrated into the national budget);
- effective leadership of the government must be established for adaptation planning and funding, which must be managed by a clearly identified department or agency;
- an effective co-ordination process should be established to develop and oversee a national adaptation strategy; and
- coping strategies and the use of funds in respect thereof must be developed and implemented by countries with the full participation of vulnerable communities and civil society, and must be transparent and accountable to them.

4. Fiscal reforms in the agricultural sector

The budget for agriculture has multiple functions and objectives, including a breakdown of expenditure in accordance with strategic priorities and the effectiveness of management. As a result, budget reform is a complex task. The most important factor is not the choice of the instrument of fiscal reform, but the genuine commitment to the principles underlying the use of the instrument (Van Blarcom, Knudsen & Nash 1993). Budget reform involves the establishment of principles of sound budgetary and financial management, and the adaptation of institutional arrangements.

4.1 Principles of sound budgeting and financial management

According to Van Blarcom *et al.* (1993), comprehensiveness and discipline are the first two principles. Indeed, fiscal rules are the only mechanism to discipline the decision-making process. Comprehensiveness means that the diagnosis has to incorporate all factors and institutional barriers affecting performance; initiating a reform requires identifying the best 'entry point' and subsequent steps for expansion. The budget should include all of the government's financial transactions.

The principle of legitimacy entails that all policy choices within or outside of the budget process should involve all decision-makers, who may modify their choices during the implementation process. The principle of legitimacy also means that decisions made in terms of the budget framework are essentially public policy decisions. The principle of legitimacy has two corollaries: first, it is for the operational departments to decide on the optimal use of inputs; secondly, decisions must be made by the community and the private sector when they are best placed to make such decisions.

The principle of flexibility means that decisions must refer to the level where all necessary information is actually available. Business decisions must be taken by managers; programme choices should more often be delegated to ministers. Delegation of authority requires transparency and accountability; it also implies a rigorous definition of strategies. Too often, in agriculture, it is the execution that is rigorous, whereas the strategies are vague.

The principle of predictability is important for effective implementation of public policies and programmes. The public sector works best when macroeconomic policies and strategies are stable, and when programme funding is being provided. Such success is conditional on a balance between the short- and long-term. It is necessary that fiscal policies work in order to ensure sustainable financing of programmes and projects; and the evaluation of programmes is a necessary part of a medium-term perspective.

Predictability is a prerequisite for the opportunity to discuss and challenge public policy proposals and conditions regarding the provision of services. Thus, policies can be criticised and revised, and operational services are required to constantly improve their performance standards.

The principles of transparency and accountability mean that clear information should be provided to the community on decisions, their rationale, outcomes and costs. The principle of transparency means that all data and analyses should be available when policy-makers make decisions. In addition, policy-makers should be held accountable for actions taken in the performance of the duties entrusted to them. These are the counterparts of the principle of flexibility. All of these principles stimulate the demand for reliable data in a timely manner.

4.2 Institutional arrangements

Theory and practice show that the formal and informal institutional systems have a decisive influence on fiscal performance on the following three 'levels':

1. aggregate fiscal discipline;
2. allocating resources according to strategic priorities; and
3. the effective use of resources for strategic priorities.

The interdependence of these three levels is one of the most important practical and theoretical conclusions. Often, aggregate fiscal discipline is achieved at the expense of the level 2 and 3 objectives: arbitrary decisions undermine priorities and seriously affect the operational performance and quality of services. Similarly, lack of fiscal discipline and unrealistic strategic choices cause an imbalance between public policies and resources which compromises the financing of operations. Conversely, financial stability creates an environment conducive to good management on levels 2 and 3, which, in turn, is a factor of fiscal stability.

4.3 Fiscal reforms

Poor performance is often found in weak links between policy, planning and budgeting. On the one hand, policy and planning are constrained by medium-term measures. On the other hand, policy design and planning do not reveal enough about their budgetary implications and their likely impacts on the community.

The main objective of public spending in agriculture should be the improvement of the sector, revenue growth and productivity. Yet, income transfer is sometimes a major objective. If agricultural spending is used wisely and the private agricultural sector is efficient, productivity and poverty reduction will result. When the objectives of welfare are not clearly identified, expenses tend to absorb excessive levels of resources and create undesirable side-effects. Schick (1998) argues that for developing countries, the lesson of the most radical reforms was the necessity to 'clean up the basics of the system', which implies that the principles of discipline and flexibility must be reconciled. This balance also changes depending on the progress towards the achievement of fundamental objectives. In his thesis on the need to 'clean up the basics of the system', Schick observed that:

- we must create an environment that encourages and demands performance before introducing fiscal systems based on performance or results;
- one must check budget credits before controlling products;
- external controls should be submitted before internal controls;
- internal controls must precede the introduction of mechanisms that empower managers;
- we must have a reliable accounting system before implementing an integrated financial management system;
- the budget should plan for the work to be undertaken before setting the desired results;
- it is necessary to first ensure the proper execution of private contracts before introducing performance contracts in the public sector;
- it is necessary that financial audits are effective before considering performance audits; and
- we need the government to adopt and implement reliable and predictable budgets before requiring managers to effectively manage resources entrusted to them.

The allocation of public expenditures should be tied to the objectives of agricultural policy. Any public expenditure in agriculture should occur as part of a clearly defined and publicly discussed sector strategy. Project evaluation and selection criteria should be subject to independent review. Important initiatives should be discussed openly, with the participation of persons likely to be affected. The environmental review should be an integral part of the evaluation process. Economic criteria should guide investment planning. In addition, funding should be allocated to higher-priority projects, and the investment portfolio should include a manageable number of projects. The preparation of the budget should be transparent and predictable, with the information provided in a timely manner to the public. Donor funding should be integrated into the national system of public expenditure management, as dual budget systems rarely work well.

The budget process should include mechanisms to ensure accountability, including monitoring and evaluation. The design of the budget can be considered as a three-step process:

1. determination of available public resources;
2. distribution of resources among activities, functions or sectors; and
3. project evaluation within the funding constraints established for each sector.

In the first step, planning and budgeting organisations work together with authorities and independent bodies to determine the volume of available resources. In the second step, authorities follow the advice of planners in the allocation of resources, taking into account the importance of each sector, the desired development path, physical and economic constraints, and absorptive capacity. At some stage, political factors are considered, but these must be recognised as such and minimised to the extent possible. The process should be guided by a multi-year, medium-term plan that addresses the institutional, political, technical and economic issues, and which considers the effects of national and sector income, savings and investment, and the balance of payments of the economy on public spending. Multi-year expenditure planning is a powerful tool for the management of conflicting demands on resources.

Management of agricultural public spending can also be improved by establishing procedures to ensure the timely release of funds to government creditors, including farmers, by adopting measures aimed at simplifying and harmonising procurement procedures or amending the procurement code.

Finally, the need to integrate climate change adaptation into planning, programming, budgeting and the process of decision-making in the agricultural sector has become more evident with the general recognition of multiple bonds between the industry and climate change.

5. Conclusion

The purpose of this study was to review the budget process failures in the agricultural sector of developing countries. The lack of policy linkage between planning and budgeting can be the most important factor contributing to poor budgeting outcomes on macro, strategic and operational levels in developing countries. In many countries, the systems are fragmented. Policy design, planning and budgeting in agriculture occur independently of each other. Many of these countries are highly dependent on aid to finance investment activities in agriculture. Much of this external assistance is provided 'off-budget', or outside the system of government budgeting and planning. In addition, budgeting in agriculture has not adapted to climate change.

To remedy these shortcomings, it is necessary to reform the budgeting process. This reform involves the principles of sound fiscal management through the establishment of an adequate institutional framework and the application of the following guidelines:

- strengthening budget design and implementation procedures;
- building the capacity of the government in terms of management and monitoring of agricultural public expenditure;
- an adequate and transparent resource allocation system based on the comparison of different options;
- full integration of public expenditure reviews within the budget process, and the commitment of local managers to these mechanisms; and
- improved consultation with donors on the distribution, management and financing of public spending.

A system of public expenditure management must be developed that will:

- produce, implement and adjust a framework for the medium-term programme of public expenditures every year, in line with the macroeconomic reform programme, which will describe the key spending programmes and detail how the overall budget will be funded (this framework may include estimates based on different scenarios, and must take into account the debt service and the potential impact of a rescheduling or debt reduction);
- put in place adequate standards for the management of annual expenditure, built on the principle of accountability in a transparent framework for both the public and donors;
- prioritise spending, effectively mediate conflicts generated by resource allocation, and integrate government policy objectives;
- ensure that expenditures reflect actual budget priorities of the government and that their implementation is consistent with the fiscal rules; and
- cover the entire field of public expenditure, including donor-financed expenditure, and produce results that justify the expenses.

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