Natural Resource Governance Institute

Precept 9: Public Spending

The government should use revenues as an opportunity to increase the efficiency of public spending at the national and subnational levels.

–Precept 9, Natural Resource Charter

Resource abundance provides an opportunity to fund a significant advance in infrastructure and public services. Unfortunately, countries often squander this opportunity. Even when the government follows the earlier precepts on managing savings and investment rates, public agencies still struggle to spend resource revenues in a way that results in economic development.

The impact of public investment depends critically on its efficiency. Comparing the value of public capital (input) and measures of infrastructure coverage and quality (output) across countries reveals average inefficiencies in public investment processes of around 30 percent (IMF 2015). The benefits of improving efficiency are stark–countries with the most efficient public investment had double the economic growth per investment dollar compared with the least efficient. A well-managed flow of revenues can fund improvements in public spending systems, resulting in more efficient spending and better public sector outcomes.

Efficient spending is particularly challenging for resource-dependent countries. A short boom time can leave little time for a government to reform its spending practices when revenues are high. During times of low revenue, a government not well protected by revenue management systems (precepts 7 and 8) needs to reduce spending, thereby disrupting services and projects or laying off public staff. When cuts are necessary, a public financial management system that works well will help governments prioritize projects and avoid major disruptions of services.

In order to assess spending practices, this precept considers allocative efficiency (the reflection of government priorities in the allocation and spending of public resources) (Q9.1), distribution of revenues (with a particular focus on the risks of off-budget spending) (Q9.2), budget execution or operational efficiency (the ability to manage budgeted public resources efficiently in delivering public services and value for money) (Q9.3) and how to ensure accountability in all of these processes (Q9.4). The questions in this precept closely follow the Public Expenditure and Accountability (PEFA) framework, with issues pertinent to resource-dependent countries given greater prominence.

PRIMARY QUESTIONS

9.1 | Public spending planning

Does public spending align with national plans?

9.2 | Revenue distribution

Does the government distribute revenues in an accountable and transparent manner, and avoid off-budget transfers and spending?

9.3 | Budget and project execution

Does the government spend public revenues as intended?

9.4 | Accounting, reporting and oversight of public spending

Does the government account for and report on revenues and public spending, and is there strong oversight of public expenditure?

9.1 | Public spending planning

Does public spending align with national plans?

The boom and bust cycle can be better managed if spending is directed by an overarching plan. An overarching plan means that clear priorities have been identified, that public resources are directed towards these priorities, and that different parts of government coordinate their actions in line with these priorities.

Secondary question	Guidance
9.1.1 **Planning and budgeting** Are national and sector plans formally integrated into the budgeting exercise?	Integrating government plans into the budget (or "policy-based budgeting") requires a budget formulation process that has: effective leadership; effective participation from other ministries, departments and agencies; and an orderly and timely process to ensure that the views of these organizations are taken into account. A multi-year perspective in budgeting and spending plans can help integrate a vision into the budget. This includes multi-year fiscal forecasts and allocations, and costed sector strategies with forward expenditures (showing future spending demands from recurrent expenditure). *Researchers should consider:* • Are sectoral planning documents used in practice to prepare the national budget? • Are budgets consistent and coherent across sectors and aligned with the national development goals and strategy? • Do government entities prepare multi-annual budget submissions based on future demands and expected change in available resources? (See Q7.1.1 on revenue forecasting.) Researchers may find it useful to refer to PEFA country report indicators PI-11 and PI-12.

9.1.2 **Project design and appraisal** Are public investment projects designed and appraised based on national and sector plans?	As with the budgeting process (see Q9.1.1), following national and sector plans can also help inform the selection and prioritization of the individual projects that should receive public funds. The government should have clear methods to appraise public project proposals made by government agencies. The methods should allow alignment of criteria used in project appraisals with national planning goals. *Researchers should consider:* • Are public investment plans integrated across tiers of government? • Do public investment plans provide certainty about funding from the central government? • Do public investment plans ensure sustainable levels of subnational borrowing? • Does an appraisal method exist that ensures projects are systematically vetted and selected based on transparent criteria, and clear and realistic priorities, cost estimates and objectives for each sector? • Are there ex ante independent reviews of appraisals? • Are recurrent costs of public investment projects (regardless of the funding channel) taken into account? • Does the budget provide transparency and predictability on investment spending, project-by-project, over the medium term? • Are all projects (even if donor funded) captured in budget documents? Another source of information are the country reports of the World Bank's Public Investment Management (PIM) framework, questions 1, 2, 3 and 4.

9.2 | Revenue distribution

Does the government distribute revenues in an accountable and transparent manner, and avoid off-budget transfers and spending?

Governments must make decisions about how to distribute the resource revenues from the collection agency (or agencies) to various spending agencies. In order to ensure the best use of funds, governments must have systems to track revenues. This can be a risky process as money can be misappropriated or lost. Off-budget distributions are spending and transfers that are not recorded in the government's budget, often activities undertaken by parties contracted by the government such as state-owned companies and sovereign wealth funds. These transfers provide more spending autonomy and discretion, but avoid checks and balances and risk undermining accountability, weaken coordination efforts and increase leakages.

Resource-rich governments face extra risk because of the large sums and different institutions involved in managing resource revenues. Resource specific government agencies, such as national oil companies or sovereign wealth funds, can complicate revenue distribution and spending as they may be involved in the collection, transfer or spending of resource revenues outside of the regular budget process. In addition, some resource-rich countries have large resource revenue sharing programs with subnational governments. Revenue sharing programs may be conducted on the basis of resource produced in each region, rather than on local spending responsibilities–this creates a risk of low oversight, low capacity, inefficiency and waste.

Secondary question	Guidance
9.2.1 **Resource revenues and the budget** Is all government spending from resource revenues appropriated through the national budget?	The Natural Resource Charter suggests that all government revenues be managed through a central government account—a treasury single account—brought directly into the national budget, and integrated in a medium-term budget framework. Some countries separate resource revenues in a resource revenue account. If such accounts are used, it is important that the resource revenue account is integrated into the regular budget process. Integration is best achieved if it is only a government account, rather than a separate institution, and that the account has no authority to spend. While accounts should be integrated, it is still important to report on resource and non-resource revenues separately, as resource revenues require different management tactics. (See precept 7.) *Researchers should consider:* • How much of revenues are spent through the budget process (via a treasury account) compared with revenues bypassing the budget process and being received and spent directly by other government entities? • Are resource and non-resource revenues reported separately in the national budget?
9.2.2 **Off-budget distribution** If state-owned enterprises, savings funds or development banks receive revenues off-budget, is there sufficient justification for such arrangements, and are the revenues managed in a transparent, accountable and efficient manner?	While it is typically best for resource revenues to be managed through a central government account (see Q9.2.1), it is common in resource-rich countries for some resource revenues to be distributed to entities outside of the standard national budget process. The Natural Resource Charter views such off-budget spending as unfavorable because it avoids scrutiny, checks and balances built into the national budget process, thereby reducing accountability. Given these risks, the decision to give entities the license to spend revenues off-budget requires a clear and reasonable justification. It is also important that such off-budget entities have their own checks and balances. (See precept 6 on the funding of petroleum or mining state-owned enterprises and Q7.4 on sovereign wealth funds.) *Researchers should consider:* • What percentage of government spending is through off-budget mechanisms? • What percentage of the entity's spending is related to non-core activities (e.g., an oil company building schools)? • Is the off-budget spending coordinated with sector plans? • Is there auditing, reporting, and oversight for the off-budget spending?

9.2.3 **Distribution to subnational authorities** If the government allocates revenues to subnational governments, are the transfers based on a well-articulated set of objectives, and are the transfers correct and timely?	Some resource-rich countries operate systems in which resource revenues are distributed to subnational authorities. These revenue sharing systems often use a formula or some other provision that determines distributions according to the amount of oil, gas or mineral produced in a subnational region or on other indicators such as population size. Whether a government decides to operate a revenue sharing system is primarily a political issue. Revenue sharing systems are not advisable for every country and have been associated with significant wasteful spending by subnational authorities. However, if a government does have such a system, there are eight principles they can follow: 1 Clarify objectives of revenue sharing. Objectives can be unclear. Clarification can help guide the design of rules governing the practice. 2 Achieve national consensus on the formula. Revenue sharing is often used to appease various regional concerns in a country. Consensus helps ensure legitimacy and stability of the system. 3 Codify the formula in law. Once consensus is achieved, codifying any formula used helps provide clarity, can link the system to any objectives set and provides some predictability. 4 Balance revenue and expenditure assignments. This is a basic principle of inter-government fiscal transfers, as it helps to ensure effective spending by subnational authorities. However, if resource revenues are distributed according to measures such as resource production, this can be an almost impossible principle to follow. 5 Promote fiscal responsibility. The disbursement of large resource revenue payments can easily result in wasteful spending. This can be avoided by earmarking of revenues, controls on debt and other practices. 6 Smooth fiscal expenditures and make spending predictable. Resource revenues can be large in comparison to subnational authority budgets, so the challenges of volatility described in precept 8 are also relevant here. 7 Simplicity and enforceability. Rules concerning revenue sharing should be simple and enforceable. Researchers should check whether there is a verification mechanism at the national and subnational level to ensure that subnational governments are receiving their fiscal entitlements. 8 Make revenue sharing transparent and verify amounts. Researchers should consider: • Are reports on transfers publicly available on an easy-to-access webpage on a quarterly or annual basis? • Audits on transfers • Is information disaggregated by revenue stream (e.g., royalties, corporate income tax); by commodity (e.g., petroleum, minerals); and by recipient (e.g., ministry, department)? Researchers should check how many of these principles are followed. (see Bauer et al. 2016 and see Resource Governance Index 2013 5.3.1.063 to 5.3.1.063.)

9.3 | Budget and project execution

Does the government spend public revenues as intended?

A budget or project executed as planned builds credibility, ensuring that public and private sector actors can rely on the government. A government can focus on three areas to maximize the efficiency of public spending: spending controls, procedures to ensure projects are implemented on time and on budget, and procedures to govern public procurement.

Secondary question	Guidance
9.3.1 **Spending controls** Are there spending controls and commitment plans in place, and do these result in public spending in line with the approved budget?	Differences between actual and intended spending may be the result of inaccurate forecasts of revenues (difficult for countries dependent on volatile resource revenues, see precept 4 on tax and precept 8 on managing volatile revenues), poor planning, bottlenecks in managing spending programs or corruption. *Researchers should consider:* • What is the difference between budgeted aggregate spending and actual aggregate spending? • How much of this difference between budgeted aggregate spending and actual aggregate spending is explained by a difference in forecasted and actual resource revenue collection? • What explains differences between the composition of spending in the budget and actual spending composition? • Does the government have effective tools in place to keep in-year spending under control (e.g., spending and commitment controls, cash-flow planning)? • Is there an orderly and transparent way to amend the budget when necessary? • Is there a mechanism to manage the orderly amendment of the budget? For instance, a mid-year review of budget execution that takes into account a shortfall in resources or an increase in expenditures beyond the authorities' control. • Are in-year adjustments to the budget frequent and transparent? If a PEFA exists in the country, refer to PI-1 (aggregate expenditure out-turn compared to original approved budget), PI-2 (composition of expenditure out-turn compared to original approved budget), PI-10 (public access to key fiscal information), PI-16 (predictability in the availability of funds for commitment of expenditures) and PI-20 (effectiveness of internal controls for non-salary expenditure). See also the Open Budget Survey, question 24.
9.3.2 **Project implementation** Are public investment projects implemented as planned?	*Researchers should consider:* • Are most public projects completed on time and on budget? • Has any major recurrent cost arisen that was not envisaged at appraisal stage? • Are medium-term project plans and budgets used and kept up to date? • Are public investment projects adjusted to reflect any changes in government policy? • Are investments protected so that project appropriations are sufficient to cover total project costs and cannot be diverted at the discretion of the executive? • Is funding reliable throughout the project? *See also:* • Another source of information are the country reports of the World Bank's PIM framework (question 14), which provides average percentage of cost over-run in inflation adjusted terms for selected countries. • The IMF's Public Investment Management Assessment (PIMA) framework also measures project implementation. • Implementation of public investment projects is measured by the Public Investment Management Index (PIMI) for 2010 only. (See Dabla-Noris 2010.)

9.3.3 **Public procurement** Is public procurement predictable and subject to a process of open and competitive tendering?	Public procurement can be an opportunity to ensure that the private sector delivers the goods and services that public organizations are not able to provide efficiently. Public procurement can be wasteful if public-private relationships are not well managed or if they are undertaken without appropriate checks and balances. *Researchers should consider:* • What proportion of contracts are subject to open and competitive tendering? • Does procurement of major projects differ from plans and does this seriously affect the predictability of the budget during budget execution? • Are the contracts awarded with values above a certain value (e.g., USD 100,000 equivalent) published at least quarterly? Other sources of information include the PEFA report PI-19 (competition, value for money and controls in procurement), and the PIM country reports (question 11).

9.4 | Accounting, reporting and oversight of public spending

Does the government account for and report on revenues and public spending, and is there strong oversight of public expenditure?

Good accounting and reporting of public spending allows government officials and oversight actors to scrutinize spending and check whether it is in line with national priorities. It also enables assessment of whether spending allocations are fair and equitable. This question considers two important aspects of public financial management: accounting of revenues and spending, and oversight of public financial management. General transparency and oversight processes, including audits and evaluations, are extensively covered in precept 2. The secondary questions here cover two types of spending: recurrent spending (Q9.4.1 and 9.4.2) and capital spending (Q9.4.3 and Q9.4.4).

The OBS measures the transparency of budgetary process. Researchers may find the data in the OBS useful in answering this set of questions.

Secondary question	Guidance
9.4.1 **Budget accounting and reporting** Is public spending (including any off-budget spending of resource revenues) fully accounted for and reported?	In some resource-rich countries, a large proportion of government revenue may be spent outside the budget process. It is important that officials follow similar accounting and reporting practices for this off-budget expenditure. *Researchers should consider:* • Does the government have an accounting system that tracks budget execution? If a PEFA report is available, refer to PEFA Indicator PI-5 (classification of the budget). • Regarding the government's financial reporting, are in-year budget execution reports and financial statements routinely produced and made available to the public? If a PEFA report is available, refer to indicator PI-24 (quality and timeliness of in-year budget reports), PI-25 (quality and timeliness of annual financial statements) and PI-22 (timeliness and regularity of accounts reconciliation). • Is information published through appropriate means at least annually, or available upon request in at least two sectors (such as elementary schools or primary health care facilities)? If a PEFA report is available, refer to indicator PI-23 (availability of information on resources received by service delivery units) and the Open Budget Index (budget execution). See also precept 2 on other aspects of government oversight.

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<tr><td>9.4.2
Independent audit and oversight

Is budget and off-budget recurrent spending subject to independent audit and oversight?</td><td>Both independent and governmental bodies—whether civil society organizations, the legislature or the auditor general—may oversee the budget process if they have information via reports and accounts (see Q9.4.1), as well as the capacity to understand and analyze the information. Likewise, public participation in the budget process strengthens oversight. Independent think tanks, analysts and other civil society organizations act as important actors in monitoring government spending.

This question concerns recurrent spending. Questions 9.4.3 and 9.4.4 concern capital spending.

Researchers should consider:
• Does the audit process adhere to appropriate auditing standards, including independence of the external audit institution?
• Does the audit process address the reliability of financial statements, regularity of transactions and functioning of internal control and procurement systems?
• Are all reports on central government consolidated operations made available to the public through appropriate means within six months of the completed audit?
• Are financial statements made available to the public through appropriate means within six months of the completed audit?

Researchers should consider whether there is evaluation of the quality and impact of public expenditure in the country.
• Assess if any findings are used to improve the design of projects, programs and policies, resource allocations and operational bottlenecks.
• Are evaluations routinely used to enhance accountability, strengthen program management and support decision-making?

Researchers should also consider:
• Do non-governmental bodies publish analyses of the budget proposal or execution?
• Does the government respond to external analysis of the budget?
• Do legislative committees analyze the actual spending of the budget and make recommendations for subsequent budgets?
• Do civil society organizations participate in the budget process and actively monitor spending?

See also OBS Questions 97-102 and precept 2 on other aspects of government oversight.</td></tr>
<tr><td>9.4.3
Public investment project accounting and reporting

Are public investment projects fully accounted for and reported on?</td><td>Good accounting and reporting practices are critical for the effective delivery of capital spending such as public investment projects. Accurate and credible accounts also ensure that projects can be scrutinized by the public.

This question concerns capital spending. Question 9.4.2 concerns recurrent spending.

Researchers should consider:
• Are public investment projects and any related public assets fully accounted for, properly recorded and their depreciation recognized in financial statements? (See OBS question 6 and 7)
• Do specific reports exist for these projects or programs?
• When projects are externally funded, are they accounted for in the national budget and reported on in government reports?
• If they are off-budget, are the contracts procured are reported on elsewhere?

Other sources of information include the country reports of the World Bank’s PIM framework, questions 11 and 19.

See also precept 2 on other aspects of government oversight.</td></tr>
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9.4.4 **Public investment project audit and evaluation** Are there independent audits and evaluations of public investment projects?	An ex post evaluation of public investment helps the government learn from the past and avoid mistakes in the future. This can take the form of a comparison of budget costs to actual costs, done by the auditor general or the executive, and external audits from independent auditors. Audit results should be made public. This question concerns capital spending. Question 9.4.2 concerns recurrent spending. *Researchers should:* • Assess whether domestically funded projects are monitored, audited and evaluated and if information is routinely scrutinized by the public, central statistical offices and/or the legislature. • Consider whether external audits and ex post evaluations of major projects are produced on a regular and timely basis. *If a PEFA report is available, refer to PEFA indicators:* • PI-26 (scope, nature and follow-up of external audit) • PI-27 (legislative scrutiny of the annual budget law) • PI-28 (legislative scrutiny of external audit reports) *See also:* • Dabla-Norris et al. (2010) • Precept 2 on other aspects of government oversight

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