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Angajament, Parteneriat, Acțiune

Child Care System Reform
Commitment, Partnership, Action

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Budgeting in the context of child care reform in CEE/CIS

**Background paper prepared by Mr. Yuriy Dzhygyr, Director FISCO, Ukraine and Ms. Kateryna
Maynzyuk, Development Director, FISCO, Ukraine**

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Acronyms and Abbreviations

ADB	Asian Development Bank
CEE/CIS	Central Eastern Europe/Commonwealth of Independent States
CFAA	Country Financial Accountability Assessments
CONTACT	Country Assessment in Accountability and Transparency
CPAR	Country Procurement Assessment Reviews
DFID	UK Department for International Development
DSAA	Diagnostic Studies of Accounting and Auditing
ENP	European Neighbourhood Policy
EU	European Union
HIPC	Heavily Indebted Poor Countries
IMF	International Monetary Fund
IEG	Independent Evaluation Group
MFBF	Macro - Fiscal Budgeting Framework
MTEF	Medium Term Expenditure Framework
NGO	Non - Governmental Organisation
ODA	Official Development Assistance
OECD	Organisation for Economic Co-operation and Development
PEFA	Public Expenditure and Financial Accountability
PEIR	Public Expenditure and Institutional Reviews
PER	Public Expenditure Review
PETS	Public Expenditure Tracking Surveys
PFR	Public Finance Review
QALY	Quality Adjusted Live Years
QSDS	Quantitative Service Delivery Surveys
ROSC	Report on the Observance of Standards and Codes
SIGMA	Support for Improvement in Governance and Management
UNDP	United Nations Development Programme
USIF	Ukrainian Social Investment Fund
WB	World Bank

Content

PREFACE	4
1. BACKGROUND	5
2. RECENT REFORMS TOWARDS POLICY-BASED BUDGETING FOR CHILDREN IN ENP REGION	5
2.1. WHY IS POLICY-BASED BUDGETING IMPORTANT FOR EFFECTIVE REFORMS IN SERVICES FOR CHILDREN?	5
2.2. WHAT IS THE ESSENCE OF POLICY-BASED BUDGETING	6
2.3. TWO DEFINING FEATURES OF POLICY-BASED BUDGETING REFORMS IN CEE/CIS: DISAPPOINTMENT WITH PLANNED ECONOMY AND EXTERNAL ODA FLOWS	10
2.4. SPECIFICS OF “STANDARDISED TOOLKIT” FOR POLICY BUDGETING – AND THE SPECIAL CASE OF THE ENP REGION	12
2.5. SUMMARY OF LESSONS: HOW TO USE NEW POLICY-BASED BUDGETING TOOLS FOR CHILDREN MOST EFFECTIVELY?	15
3. MECHANISMS FOR CHANGING INPUT-BASED BUDGETING APPROACHES IN CHILD CARE	16
3.1. WHAT IS INPUT-BASED FINANCING, HOW IT RELATES TO “MONEY FOLLOWS THE PROVIDER” PRINCIPLE, AND WHY IT IS BAD FOR CHILDREN?	16
3.2. WHAT IS THE ESSENCE OF THE ALTERNATIVE FUNDING MECHANISM, WHERE “MONEY FOLLOWS THE CLIENT”?	16
3.3. WHAT IS THE ESSENCE OF REFORMS TO INTRODUCE A NEW FUNDING MECHANISM SO THAT RESOURCES COULD FOLLOW THE NEEDS OF THE CHILD, NOT RESIDENTIAL PROVIDERS?	17
3.4. WHAT ARE PRACTICAL STAGES FOR INTRODUCING A NEW APPROACH?	17
3.5. ALTERNATIVE FORMS OF CARE AS COMMUNICATING VESSELS (AND WHY FLEXIBILITY OF CHOICE IS THE KEY TOOL IN RESULTS-BASED BUDGETING FOR CHILDREN)	18
4. COMPLEXITIES OF POLICY-BASED BUDGETING FOR CHILD CARE REFORM IN MULTI-TIER GOVERNMENT SYSTEMS	19
4.1. WHY COUNTRIES CHOSE TO DECENTRALISE CHILD CARE?	19
4.2. CAUTION: WHAT DO POLICY MAKERS MEAN BY DECENTRALISATION?	20
4.3. HOW DECENTRALISED IS CURRENT PROVISION OF CHILD CARE IN ENP REGION?	20
4.4. CAUTION: RISKS OF A MISMATCH BETWEEN FISCAL AND ADMINISTRATIVE DECENTRALISATION (THE CASE OF UKRAINE)	21
4.5. INCENTIVES TO RESIDENTIAL CHILD CARE CREATED BY INPUT-BASED INTERGOVERNMENTAL FISCAL ARRANGEMENTS	24
4.6. CHALLENGES OF DECENTRALISATION IN THE REGION: WHY IS IT SO DIFFICULT FOR MOST COUNTRIES TO DELEGATE SOCIAL POLICY FUNCTIONS TO SUB-NATIONAL GOVERNMENTS? WHY IS POLITICAL ECONOMY CRITICAL TO DESIGN REFORMS?	25
4.7. CONCLUSIONS	26
5. TECHNICAL ASSESSMENT TOOLS FOR CHILD CARE POLICY MAKING	27
5.1. WHAT TECHNICAL ASSESSMENT TOOLS GOVERNMENTS MIGHT NEED TO DESIGN AND IMPLEMENT POLICIES FOR CHILDREN?	27
5.2. WHAT PRÊT-A-PORTER ASSESSMENT TOOLS ARE AVAILABLE IN INTERNATIONAL DEVELOPMENT?	29
5.3. DETAILED OVERVIEW AND PRACTICAL RECOMMENDATIONS ON USING SOME DIAGNOSTIC ASSESSMENTS TO SUPPORT CHILD CARE REFORMS	31
<i>Public Expenditure Reviews (PERs) and Public Finance Reviews (PFRs)</i>	31
OVERVIEW	31
PRACTICAL TIPS AND BASIC STRUCTURE	32
<i>Public Expenditure Tracking Surveys (PETS) and Quantitative Service Delivery Surveys (QSDS)</i>	33
OVERVIEW	33
PRACTICAL TIPS AND BASIC STRUCTURE	35
<i>Policy costing and analysis of unit costs of various types of services</i>	36
CURRENT CONTROVERSY	36
OVERVIEW OF TOOLS	37
CONCLUSIONS AND RECOMMENDATIONS	39
REFERENCES	40

Preface

This report was prepared by the FISCO Inform (www.fisco-inform.com.ua) team comprising Kateryna Maynzyuk and Yuriy Dzhygyr.

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1. Background

Despite the shared commitment of all CEE/CIS country governments to overcome the dominance of residential services for children, alternative family/community-based services have so far failed to become a mainstream possibility for the vulnerable children living in these countries. Most governments recognise that one systemic obstacle to such change is related to the current budgeting approaches which financially benefit – and encourage – large residential providers and create entry barriers to alternative services. This paper attempts to summarise the main issues in public financial management which have prevented resource re-allocation between residential and alternative services for children in these countries, as well as the tools and reform experience which could be used to address these issues throughout the region.

2. Recent reforms towards policy-based budgeting for children in ENP region

2.1. Why is policy-based budgeting important for effective reforms in services for children?

Policy-based budgeting helps governments to use their budgets as means for achieving policies: that is, to implement strategic goals in an efficient and financially realistic way. Implementation of complex, multi-year and cross-cutting government policies requires any government to inter-relate a large number of financial and institutional constraints. Achieving this requires a special approach to management of public funds, which should be, at one and the same time, strategic, efficient, and realistic. Policy-based budgeting integrates a number of budgeting tools, which allow to link together indicators of policy costs, benefits, and macro-fiscal sustainability in the medium-term. It unites budgeting techniques which start at the level of long-term macroeconomic constraints and cover all levels of resource allocation all the way down to provision of individual services. Combined, these tools ensure that government activities are affordable (stay within collected revenues), correspond to agreed policy priorities, and achieve highest value at a minimum cost to taxpayers.

In other words, this budgeting approach is intrinsic to strategic policy making, which, as will be discussed in great detail in further sections, is still lacking in most CEE/CIS countries. Respectively, as these further sections will also describe, budgeting tradition in this region is often a direct opposite to policy-based approach: resources allocated without consideration of hard budget constraints (including macro-fiscal, inter-sectoral or intergovernmental constraints), based on already existing ways of spending (rather than based on strategic goals), and without considering achieved value for money spent.

Fiscally responsible, results-oriented budgeting is, by definition, a compulsory requirement for efficient delivery of public services in any sector, including for implementing reforms in delivery of services for children. Any efficient programme of public service delivery – including programmes of change in the ways services are delivered – requires a result-oriented budgeting platform¹:

- A fiscal commitment (resource envelope), sustainable in a mid-term perspective (resources secured for sufficient amount of time);
- A defined strategic goal formulated as an agreed policy for this sector / programme / reform (including measurable and verifiable indicators of success); and
- An approach to maximise value delivered for the money spent (including ways to detect public preferences, to compare benefits to costs, and to select most efficient policy scenarios).

Changing child care in the way which would make it serve the genuine interests of children, in the best available and affordable way, is impossible without allocating resources based on the logic described above. Without policy-based logic behind the budget, any change will be either inert and path-dependant (spending on existing services rather than anything new) or failing to react to child's interest (ignoring assessment of value), or inefficient (choosing wrong value-for-money option), or unaffordable, or a combination of the above. Further sections describe in particular details how input-based budgeting leads to all these failures.

¹ Joshua, L., Dzhygyr, Y. (2006).

Moreover, it is usually critical to extend the policy-based budgeting platform to cover more than just one year, especially if policies imply significant expenditure reforms, because of²:

- Time lags. Implementing policy decisions usually takes time. Multi-year expenditure projections help to detect processes which require intervention on early stages and design policy changes in time.
- Delayed effects. Multi-year expenditure forecasting helps to predict and analyse deferred effects of policy decisions, e.g. fiscal impact of long-term investment programmes or changes in social benefits (which have long-term behavioral effects and also depend on longer-term changes in sizes of entitled categories).
- Time scope for reallocation of funds. Announcing plans for reallocation of expenditures early on could support difficult reforms. Multi-year forecast is usually a more flexible policy instrument than annual budget, which makes it easier to introduce change which affects allocation of public funds.

Policies and reforms which are sector-wide or cross-sectoral (such as policies for children) are especially dependent on strategic budgeting tools. Introducing change to public policies which cut across responsibilities of individual spending units or even across central ministries is the most demanding institutional and budgeting task. It is by definition impossible to succeed in a cross-sector task without specifying what exact results of activities of individual spending units would be required for a joint overarching policy objective. If, on top of effectiveness, these policies should be cost-efficient and long-term, they also require routine mechanisms for public value delivery and respect of medium-term fiscal framework.

Child care reform is an example of a widely cross-sector public expenditure policy. Administrative, financial and regulatory responsibilities for social services to children are usually dispersed through a number of authorities, representing various traditional public sectors. These sectors usually include, at the very least: education, healthcare, social protection and welfare, justice, family and youth affairs. In CEE/CIS countries this problem is often especially pronounced; with providers of services belonging to fragmented vertical accountability lines and fragmented funding flows. Table 3 in Section 4.4 demonstrates how these services are allocated across sectors in the case of Ukraine. In view of this problem, tools for sector-wide policy making are especially important for reforming and implementing policies in this difficult sector.

2.2. What is the essence of policy-based budgeting

Neither policy budgeting, nor any of its individual tools, have strict, universally accepted definitions or methodologies: they represent a system of broad principles which help to link policies to budgets. Countries all over the world, including OECD countries, name these instruments differently and implement them according to their political, institutional and administrative context. What matters in policy budgeting is the essential idea of a political consensus and commitment to choices of how to reconcile strategic goals with limited funding opportunities³.

At the heart of this exercise is medium-term expenditure framework – MTEF. Figure 1 below illustrates the traditional logic of how policy budgeting usually works. In essence, the MTEF represents a dialogue between all stakeholders, which should lead to agreement on how, based on current macro-fiscal forecast (potentially available funds) and current government policies (jointly for the economy and for individual sectors), the limited resources should be allocated across individual spending programmes. Ideally, this agreement – the MTEF, reviewed annually within annual budget laws – creates a platform for classifying – and then implementing and monitoring – further spending based on individual results-oriented programmes.

The MTEF is a macro-level tool which creates a platform for negotiating sector spending ceilings based on already existing (previously designed) sector-level policies. The primary function of the MTEF is to coordinate resource requests of various sectors competing for funds within a limited macro-fiscal envelope. Policy-based budgeting – and MTEF in particular – originates from advanced OECD economies (pioneered in UK, but also other Commonwealth countries, notably Australia and New Zealand), who have invented them as a way to eliminate growing fiscal deficits in late 1980s – early 1990s⁴. At the time, one of the key issues which these instruments had to address was irresponsible expenditure bids routinely submitted by individual sectors in the process of budget negotiations. The new policy-budgeting philosophy increased the extent of top-down budgeting in the process of these negotiations: the ministries of finance started to impose harder top-down expenditure constraints (consistent with macroeconomic projections) on levels of sector spending, leaving it to the individual ministries to prioritise within

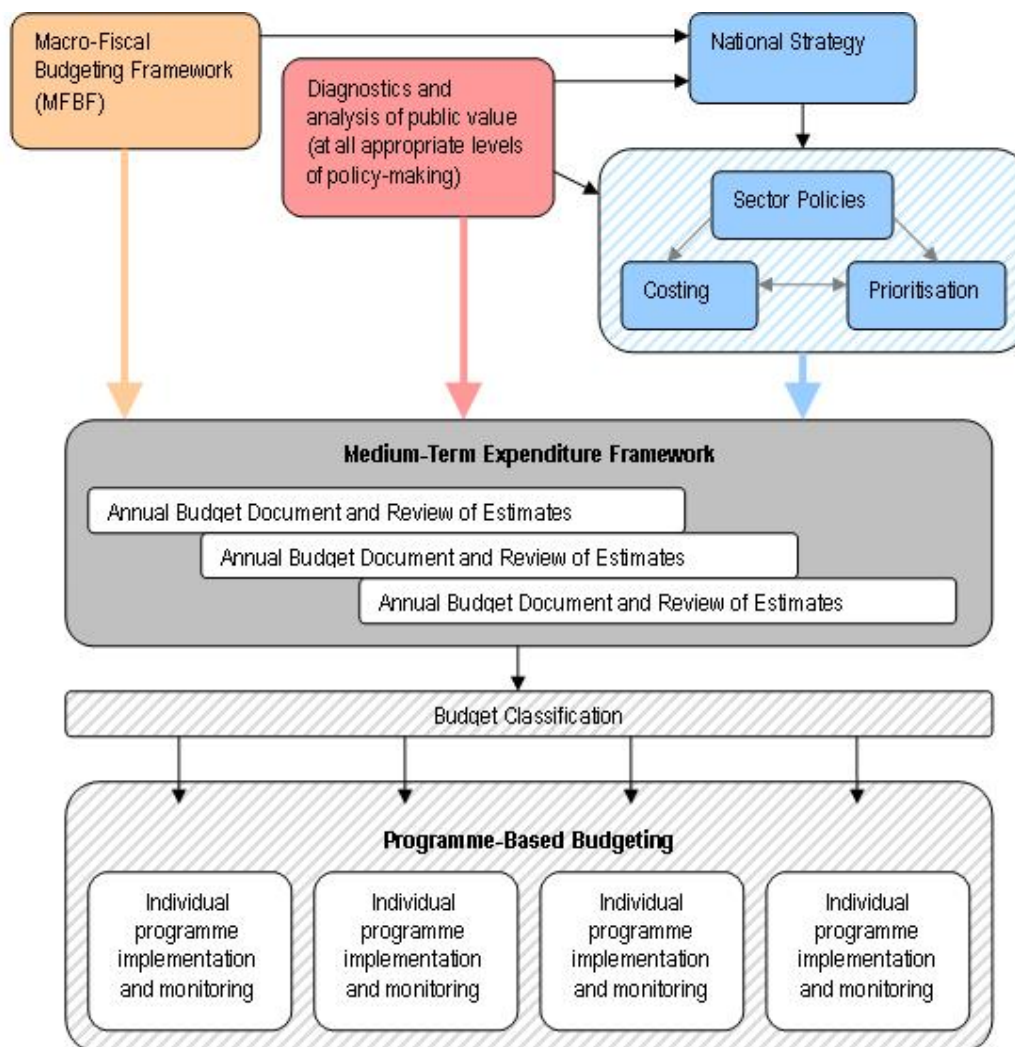
² General description in Ljungman, G. (2007)

³ Petkova, N. (2009).

⁴ Ibid

their sectors to make sure the constraints are met. In other words, these tools primarily represented a way to enhance fiscal discipline and to share the sense of responsibility for affordability of spending with the sector representatives. It moves the hardness of the budget constraint some way down, away from the central financial authorities – on the shoulders of sector policy makers.

Figure 1. The logic of policy-based budgeting



All OECD countries use some form of multi-year policy-based budgeting frameworks, which are the same in principle, although vary significantly in legal and methodological details. To understand what represents the essence of policy-based budgeting, it is helpful to look at the differences between various forms of advanced multi-year fiscal frameworks and analyse why these varying features are insignificant to the philosophy of the MTEF. Understanding these differences should also help countries which start implementing MTEF to avoid selecting any of these non-essential technical aspects as the key target for their MTEF reforms – and to focus on the essence instead.

- **Legal enforcement and link to approved budget documents.** The core function of the multi-year fiscal frameworks is to improve the quality of annual budgeting. How the governments ensure that their multi-year fiscal projections influence annual budgets varies among countries. Only in very few countries, multi-year estimates are actually approved by parliaments; in most cases they are attached to approved annual budgets and revised on annual basis. In most cases, even where submission of such estimates is required by law, the actual incorporation of this information is a result of policy-making tradition, rather than formalistic legal feature. For example, in Sweden, the budget approved by the Parliament is still annual, and a multi-year forecasting framework is used to strengthen annual budgets: each appropriation has attached an explanation

of its purpose and expected results, but also an additional set of information showing how it is likely to develop in the next two years⁵. On the other hand, as will be discussed later, many (developing and transition) countries which require an MTEF by law, find that it has very weak relevance to actual budget process and to real resource allocations in any year. It is also noteworthy that multi-year frameworking is sometimes named as a “Commonwealth approach to budgeting”, indicating the especially advanced level of using these instruments in these countries. The noteworthy part is that most of these countries belong to legal traditions of common law, which is more conducive to policy-making based on consensus and dialogue rather than law enforcement.

- **Match point between top-down and bottom-up budgeting.** As already discussed, the central task of an MTEF is to agree on conflicted budget ceilings and to fix agreed ceilings in mid-term perspective. It is up to a country to define where in the chain of vertical expenditure administration the hard budget constraint of an agreed ceiling would be located, and what flexibility this level of administration would have in later re-allocation of resources within their agreed envelope. Usually for OECD countries, these ceilings are defined for individual sectors, represented by respective major spending units – usually sector ministries. However, the key point is the division of responsibility, the fixation of hard budget constraints at a certain level.

It is not difficult for any spending unit to estimate their expenditures for any number of years forward; the difficult part is to persevere in commitment. Many MTEFs of transition countries are generous in numbers, containing estimates at sector as well as intra-sector level, and were criticised for trading substance (consensus) for numbers. Although they make mid-term estimates, these estimates tend to change very quickly (in Ukraine, usually already at the point of first submission of annual budget for Parliamentary consideration)⁶. Box 1 below provides an example of the MTEF of the Kyrgyz Republic. It illustrates this problem: on the one hand, expenditure estimates are defined at the level of sectors (in this case, education), but on the other hand it also has plenty of detail on the intra-sector level. Talking specifically about, e.g. services for children without parental care, the key idea of the MTEF is to select an administrative level – e.g. a relevant ministry – for example a ministry of education – which would be responsible for keeping its spending within the ceiling agreed with the higher level, including through taking responsibility for reallocating resources within its domain, if necessary (e.g. cutting some providers and expanding funds to others). Too much detail further than this level in an MTEF (e.g. exactly how much would be spent on each type of provider) could be, in some cases, excessive, because it discriminates this commitment (the spending agent has to remain free to reallocate between providers so that it stays within its agreed resource envelope).

- **Coverage of decentralised expenditure programmes.** It is typically difficult for a complex tool like MTEF to cover decentralised aspects of public service provision. In most cases, MTEFs are limited to central level budgets (sometimes they could cover transfer allocations to sub-national budgets). Some of the MTEF champion countries are federal countries, which allows them to have autonomous sub-national MTEFs at the level of states (like in Australia). Only one exception to this rule is South Africa, whose MTEF covers all levels of budgets (central, regional and local)⁷. This current limitation of the MTEFs is critical for child care reform, since it is usual for public programmes for children to be funded through decentralised expenditure programmes. Moreover, as we discuss in Section 4, there are various modalities of decentralisation in child care, which means that central budgets can capture decentralised spending in very different ways: starting from earmarked transfers on concrete services (when local autonomy is weak) and going to block equalisation transfers which cover several large sectors (when local autonomy is stronger). Therefore, the role of central MTEFs for child care services can be very different, depending on the type of decentralisation arrangement in any given country. One example to illustrate this could be Ukraine, where responsibilities for child care are fragmented between all levels of governments. In such case, a multi-year budget framework at the central level would still be very useful for providing a picture of what will be spent by central ministries and what would be available to sub-national governments in the form of block grants. However, a *comprehensive* multi-year planning for child care – e.g. with the view of designing reforms – would require a complex co-operation arrangement between central and sub-national governments – something beyond an MTEF-kind document – where they could agree on future plans, and which is currently absent. The first attempt for such long-term coordination in Ukraine is visible in the area of regional development, where the Ministry of Economy starts to sign regional contracts with certain regions, based on agreed strategies of action at all levels, and agreed flows of funding for these activities.

⁵ Ljungman, G. (2007)

⁶ Ukraine's MoF Green Paper (2006)

⁷ Petkova, N. (2009).

- Time coverage and revision cycles. Multi-year expenditure frameworks can cover 2 to 5 years (typically, three) and could be either rolling or periodical. Rolling frameworks mean that every cycle overlaps with the previous and subsequent cycle by one or two years; while periodical frameworks do not overlap. However, both types of MTEFs can be revised in the middle of their lifetime. In other words, it does not matter how many years exactly does an MTEF cover in terms of child care expenditures and how often a government chooses to revise it. What matters is the decision to agree on spending priorities in a multi-year framework and to keep these estimates updated on a periodic basis.

Box 1. Example of Expenditures for Education in 2008-2010 MTEF of Kyrgyz Republic:

The 2008-2010 MTEF of the Kyrgyz Republic is focused on defining and explaining expenditure ceilings at the level of key sectors, based on the priorities identified in the country's Development Strategy:

"In [the MTEF table], cumulative expenditures of the state budget of the Kyrgyz Republic by sectors for 2008-2010 are broken down by basic sections of the state expenditures within the priorities defined in the Country Development Strategy. [...] The arguments of sectoral strategies for financing of priority programs were regarded in the process of defining the mid-term sectoral ceilings. It is necessary to strengthen work in sectors on further prioritising of programs with a view of more exact planning and increasing the efficiency of budgetary expenditures. [...]"

One of such strategic priorities is Education, which this Box discusses as an example:

MTBF 2008-2010 keeps strategic priorities of the Government of the Kyrgyz Republic:

- *Increase share of expenditures for education to GDP so that to ensure availability and equal opportunities to all categories of the population in receiving quality education. At the same time, to improve education efficiency for the purpose of budgetary funds savings.*

The MTEF further explains that its (increased) ceiling for Education assumes that this funds would be spent according to a sector strategy, and will achieve several strategic objectives through administration of eight vertical budget programmes. This box proposes a table which summarises this part of the original MTEF. The document itself explains the nature of each programme and whether it would represent a relative priority for funding in future years. However, these expectations remain secondary within the aggregate ceiling for Education, which remains the key focus of the MTEF.

Development programs laid at the basis of sectoral strategy of education financing for 2008-2010 are build within the basic regulations of Midterm Strategy of Financing the Education in the Kyrgyz Republic approved by the Governmental Decree of the Kyrgyz Republic of December 28, 2006.

Vertical budget programmes Strategies within sector	Pre-school	Primary and Secondary	Extra-curriculum	Vocational	Higher	Methodology and support services	Management and admin	Other (vulnerable categories)
<i>Overall level of priority for funding</i>	<i>Not a priority (expect support from off-budget sources)</i>	<i>Priority for funding</i>	<i>Not a priority for funding; try to save here and redirect funds to rural schools.</i>	<i>Reduction in funding based on new funding methods</i>	<i>Economy of funds expected to fund larger grant schemes for vulnerable students – overall size maintained</i>	<i>Funding level to be maintained</i>	<i>Funding level to be maintained</i>	<i>Funding level to be maintained</i>
Accessibility and quality		X		X	X			
Preservation and development of institutions network	X	X					X	X
New funding tools (capitation, min. standards).	X	X	X	X	X		X	
Technical improvement (more efficient methodologies, curricula, programmes)	X	X				X	X	

Effective multi-year expenditure framework requires effective policy costing. To enable these negotiations, the MTEF requires all participating sectors to prepare comprehensive sector level analysis of their policy priorities, which should also be comprehensively costed. These estimates allow the wider government to agree on overall prioritisation of expenditures, as well as on ways to address cross-sector policies and issues. The outcome of MTEF is a set of expenditure ceilings for all sectors for a multiple number of years, with a possibility of annual revision in the future.

Performance budgeting – and programme-budgeting in particular – help to ensure that policies are effective and efficient. As described above, paying for results in public service delivery – or results-oriented budgeting – is a system-wide philosophy of policy-making at all levels. It combines macro-level tools (like ceilings for costed policies in the MTEF) with micro-level tools for actual delivery of those policies. In particular, breaking policies down into individual, efficiently managed programmes is known as programme-budgeting. In other words, programme-budgeting is an element of performance budgeting which allows to implement sector-level and cross-sector policies through a tangible number of strategic and efficient programmes.

“Performance budgeting” is different from “line-item budgeting” because it transforms the notion of an “item” in the budget classification from automatic dispersal of funds against approved lines to a “programme” which is managed strategically and efficiently.

Programme-budgeting is a dimension of the MTEF since it is a vehicle which ensures that policy priorities agreed at the macro level are formulated as service results and that they would be achieved at lowest possible cost. It makes it easier to understand what should be done within each programme, how it could be measured, and provides programme managers with stronger administrative tools to deliver results.

OECD countries have different ways of structuring budgets through programmes. For example, in Netherlands, the budgets of individual sector ministries are broken down into “policy articles”⁸.

Although MTEFs and related budgeting tools are common to OECD countries, and are actively promoted in other parts of the world, even advanced economies have had a mixed success in their implementation. Policy-based, multi-year budgeting remains at the forefront of PFM development in all countries, including more advanced Western democracies. OECD countries assess their own success in implementing these tools as mixed⁹. The reasons why multi-year results-oriented budgeting is difficult for advanced countries, as well as for countries in transition, include:

- High vertical and horizontal complexity of individual sectors, and multiple cross-linkages between sectors, which makes it difficult to accurately predict, negotiate and coordinate sector-wide ceilings;
- Tendencies to over-optimistic macroeconomic assumptions;
- Tendencies of individual sector agencies to prepare their budgets “bottom up”, which conflicts with agreed MTEF ceilings;

2.3. Two defining features of policy-based budgeting reforms in CEE/CIS: disappointment with planned economy and external ODA flows

International development organisations recommended most developing countries, including those in CEE/CIS, to reform their PFM systems along a standardised policy budgeting framework, with a strong emphasis on MFBF, MTEF and a set of programme-budgeting techniques. The key function of this toolkit is to transform PFM to make it more realistic, strategic and efficient. Respectively, it included, for most aid-recipient countries, eight broad recommendations borrowed from the OECD own PFM experience¹⁰:

- Achieving budget savings through more robust central controls or by providing greater flexibility to managers and organizations in reallocating funds within budget line items to reflect changing conditions and priorities;

⁸ Ibid

⁹ IEG WB PSR evaluation (2008)

¹⁰ Ibid

- Restructuring budgets to include expenditures for all government activities, global budgetary targets, hard budget constraints, and program allocations to facilitate results monitoring and evaluation;
- A multiyear budget linked to a realistic fiscal policy and revenue estimates;
- Regular use of performance information in monitoring against targets to facilitate accountability and manage performance;
- Shifting from cost accounting toward accrual accounting;
- Shifting from compliance auditing toward performance auditing;
- Computerized information systems providing timely financial and related information to all parties in the budget process;
- Greater use of devolved budget management and market-based mechanisms, such as user and capital charges, market testing, outsourcing, and performance agreements.

Propensity to consume these reform recommendations, and degree to which they were accepted by the transition countries, was influenced by two key factors: the failing PFM of planned economy tradition combined with fiscal and political importance of foreign aid.

- **Demand for change from a planned system.** Policy-based budgeting approaches jointly represented a direct opposite to the PFM tradition previously dominating in post-soviet economies. Post-soviet government budgets were constructed on a basis of supply-driven hierarchical allocation of funds across individual lines (activities) (“to achieve education for children we shall spend the available 100 currency units on x number of schools”). Spending objectives were dictated by rights-centred declarative constitutions which claimed to guarantee rights without considering what resources this would require; as a result the systems were permeated by unfunded mandates and soft budget constraints (when spending units could expect a bail-out if they violated agreed budget ceilings). The resulting inefficiency and inability of the public services systems to support achievement of sustainable results was at the centre of disappointment with the planned economy which had to be transformed. Respectively, performance-based mid-term budgeting symbolised public financial management which united three key and new principles: fiscal discipline, strategic objectives in spending, and maximisation of public value for the money spent. These ideas were among the first ones promoted for implementation, especially within the numerous international development programmes launched in the post-soviet transition economies.
- **Conditionality attached to foreign aid.** Most assessments of the progress of PFM reforms in developing and transition countries openly admit that one of the key drivers for accepting this reform agenda for recipient countries was often the attached possibility of access to aid funds¹¹. This circumstance has had a crucial affect on the way policy-budget developed in the region.

First, it affected the degree and the speed with which individual countries engaged in respective reforms. Although establishing any correlations in these matters would require a much more complex analysis, some observations could be made from basic facts of the MTEF history in the ENP region. Table 1 helps to track the level of fiscal significance of international aid among ENP countries and the way they have designed and implemented reforms in the area of multi-year budgeting. Countries with relatively higher dependency on aid were also the ones who introduced more standardised versions of MTEFs.

Secondly, the origin in “transfer conditionality” affected the nature of the recommendations themselves, providing it with certain biases such as selective attention to certain policies, lack of attention to local context, and excessive simplification of certain aspects of policy-based budgeting toolkit (in comparison to more advanced economies) which, as will be shown later in text, ultimately became the central obstacle to their progress.

¹¹ IEG WB PSR evaluation (2008)

Table 1. Official Development Assistance (all donors) as % of GDP

	ODA as % of GDP					Key features of adopted multi-year budgeting framework		
	2003	2004	2005	2006	2007	Reforms Started	Government Strategy	Multi-year forecasting framework
Belarus	0,2%	0,2%	0,2%	2007	Programme for Soc.& Ec. Development of RB (5 years) (2006-2010)	MT Financial Programme of RB
Ukraine	0,5%	0,4%	0,3%	2001	Programme for Soc.&Ec. Development of Ukraine (11 years), (2004-15, "On the Way to European Integration"), Government's Action Programme ("Towards the People")	MT forecast att. to annual bdt estimates; MT estimates for all spending units Green Paper on Multi-Year Bdtng
Georgia	5,7%	6,1%	4,6%	4,6%	3,8%	2005	PRSP (Econ.Dev.&PRP)	BDD and MTEF
Armenia	8,9%	7,1%	3,5%	3,3%	3,8%	2000	PRSP	MTEF
Moldova	6,0%	4,6%	5,7%	6,6%	6,1%	2002	PRSP (Econ.Growth&PRSP)	MTEF

Source: <http://www.worldbank.org>, <http://stats.oecd.org/qwids/>

2.4. Specifics of “standardised toolkit” for policy budgeting – and the special case of the ENP region

Using MTEFs well requires understanding their frequent weaknesses and limitations. This section explains the key specific features of policy-based budgeting reforms pursued in the developing and transition countries on the basis of internationally promoted toolkit. Understanding these special features should help the reform stakeholders in these countries to clarify expectations for these budgeting tools and to improve the way they are currently used for reforms in public policies, including policies for children.

- Issues with strategies (including policy strategies) on which the budgeting package is based. The backbone of this resource allocation process is the government’s central programmatic document(s), which establish(es) social and economic development priorities for the country in general.
 - > Level of complexity. The nature of central programmatic platforms across countries differs depending on their political systems and administrative capacity. Respectively, these platforms have different degrees of complexity. More advanced democracies tend to have more complex development strategies, normally represented by entire systems of various policies developed through political consultations. An example of one such policy is the UK policy for reduction of child poverty¹². Countries which transit towards policy budgeting from planned economy tend to have weak strategising capacities. Most MTEFs in transition countries tend to have anchors in generalistic programmatic documents which rarely capture political, administrative and institutional complexity of their proposed reforms.
 - > Local political ownership. The central idea of an MTEF – and policy-based budgeting overall – is committed political consensus. This is also the most difficult task for any country, especially young democracies in economic and social transition. In most transition MTEFs, even where these documents were required by approved national legislation (e.g. budget codes etc), the MTEFs as such tend to at least start off as parallel documents to real parliamentary debates on political and expenditure priorities, which sidelines the role of national legislature in resource allocation process.

¹² Minoff, E. (2006), Tomlinson, M., Walker, R. (2009).

- > **Supranational commitments.** For any country, a government's central programmatic document, or strategy, is usually a combination of various factors, and often acknowledges supranational drivers of change and government's international commitments. One example of supra-national commitments with fiscal implications from the experience of more advanced EU countries is their commitment to the *Stability and Growth Pact*, which requires all members to keep their annual budget deficits below 3% of GDPs, and their debt to GDP ratio below 60%. However, this external influence has been especially strong within the strategies accepted as "anchors" for MTEF-centered policy-budgeting toolkits in transition countries. Possible reasons for this were weak national systems for setting strategic goals, combined with financial leverage attached to aid flows from development organisations. As a result, most government strategies which lie behind transition MTEFs are usually strongly influenced by international development agenda such as Millennium Development Goals and Poverty Reduction.
- **Focus on central budget (typical especially for MTEF), with risks to overlook key issues for social services.** As already discussed, the MTEF is a highly technically demanding tool, which makes it difficult to apply for more than one level of government – even in advanced OECD countries. In most transition countries – notably countries of the ENP region – social expenditures, including programmes for child care – tend to be administered through complex multi-layer intergovernmental systems, usually through delegation or deconcentration of related allocations to sub-national budgets. Therefore, planning instruments which focus on the central budget either entirely overlook an overwhelming portion of these expenditures or treat them in overly simplistic way which nullifies the value of the exercise (e.g. without ensuring commitment of all stakeholders, realistic policy costing etc).
- **Lack of attention (or entire omission) of the analysis of public value.** Figure 1 shows that one of the three pillars of policy-based budgeting is maximisation of public value: making sure that policies are not only realistic and strategic, but also directed at what taxpayers – or clients – would value most at respective costs.

This part of policy-making is easy to confuse with setting strategic policy goals, especially for the post-soviet mindset. After all, at least in theory, governments are supposed to represent people and chose strategic goals in people's interest. However, any policy is usually facing a number of trade-offs, and selecting the optimal option is a matter of public choice. In expenditure management, understanding this choice usually requires more frequent (actually, constant) technical analysis of public value than just a periodic vote for a given government's platform. In other words, at all levels of service provision, respective stakeholders have to use appropriate tools for mapping the preferences of clients, identifying marginal costs of these preferences, and designing a menu of service options which satisfies these preferences at lowest cost. Sections 3 and 4 explain what are the challenges of sharing responsibilities for regular analysis of this kind, and Section 5 describes in detail some of the concrete tools which could be used on a regular basis for such analysis (like comparative analysis of unit costs and benefits of services and policies, micro-surveys at the level of service providers, etc.).

The simplified policy-budgeting toolkits promoted in the transition countries typically suffer from very weak attention to this element of policy-making. Analysis of public value is primarily an internal political task; while budgeting reforms often originated from international development agencies, who were focused on their respective strategic agendas rather than internal political processes in countries. Understanding complexities of public choice in recipient countries was therefore smaller priority compared to designing budgeting systems which best served strategic values of these international agendas.

- **Excessive standardisation – therefore bound to be too simplistic and less attentive to country context.** As often happens with prêt-a-porter reform packages, MTEFs often fell a victim to implementation at a cost of acknowledging local contexts.
- **(Low) degree of integration into national budget cycles.** Although most countries introduced MTEFs as legal requirements in their budget legislation, and although it is normal for MTEFs to be analytical rather than legally binding tool, in many transition countries this instrument is still excessively detached from real processes for resources allocation. According to the 2008 IEG evaluation of WB's public sector and public financial management reforms¹³, in majority of development countries MTEF and programme budgeting systems are parallel to domestic budget cycles:

¹³ IEG WB PSR evaluation (2008)

Program budgeting is still considered separately from the real budget preparation, however; there is little time devoted to substance; performance indicators focus on outputs rather than outcomes; and program managers are not accountable for results. In addition, budget execution does not take place on a programmatic basis, which reinforces the view that the program budget is not the real budget. Even where MTEFs are proving useful, a less-detailed and more strategic planning exercise might serve the purpose better.

- Frequent focus on budget commitment of donors rather than domestic stakeholders. According to WB assessment, MTEFs in developing countries often served, to a large extent, to coordinate financial commitments of international donors. This observation underlines the difficulty of using some of the existing MTEFs as credible tools for ensuring political and fiscal commitment of spending units to their spending and policy targets.

ENP countries have a unique opportunity for overcoming the weaknesses of the standardised policy-budgeting reforms. The 2008 evaluation of WB's support to PFM reforms¹⁴ notes that in Europe and Central Asia the Bank observes progress in PFM reforms among some non-borrowing countries which is unprecedented for non-borrowers anywhere across the world: the rate of improvement among non-borrowers there was 90%, which is the highest rate and equals that of borrowing countries. The report concludes: "clearly something else is going on: EU accession". Even countries who do not have immediate prospect of acceding, have taken a very strong impetus from the Europeanisation agenda. Countries of the ENP region are equally prone to all the above listed complications, but they also share access to a number of advantages which could help them to use policy-budgeting tools effectively and in line with their OECD success benchmarks. These advantages include:

- **Stronger policy ownership.** Most Government Strategies and policies in ENP region are significantly affected by action plans for co-operation with the EU, which are usually much stronger integrated into local political agenda compared to global development targets. In other words, the benefit of subscribing to some of the supranational commitments in these countries is political no less than fiscal.
- **Weaker dependency on foreign aid.** Notwithstanding the recent economic downturn, the ENP countries have steadily moved towards middle-income development levels. In many of these countries foreign aid has almost completely lost its fiscal significance, giving space to domestic financing of most reforms (e.g. Ukraine and Belarus). This should help to take sufficient time and institutional effort to use policy-budgeting in a country-specific, appropriate way to achieve best outcomes for public service clients, including children.
- **Better diagnostics and value analysis.** ENP countries have both internal and external factors encouraging them to use more complex and adequate value analysis tools. The governments of these countries would benefit from capitalising on these factors and opportunities, in order to integrate value diagnostics as strongly as possible into their policy-budgeting cycles.
 - > **Political democratisation.** Policy debates in young democracies of ENP region are not always pronounced, well-grounded or even civil, but they promote attitudes and stimulate political platforms which understand and acknowledge public choices, including public choices of social policies and services.
 - > **Community and civil society development.** Compared to many other developing countries, ENP region has a relatively strong non-state sector. Engaging NGOs and communities into joint analysis of priorities and tradeoffs is an important asset of taking policy-budgeting systems to their appropriate, advanced shape.
 - > **New analytical tools encouraged by Europeanisation.** Even without the immediate prospect of EU accession, the ENP country can benefit from integration to advanced OECD policy-budgeting instruments. An especially important opportunity of SIGMA benchmarking assessment is described later in Section 5.

¹⁴ Ibid

2.5. Summary of lessons: how to use new policy-based budgeting tools for children most effectively?

The recent experience of reforms in policy-based budgeting in ENP region suggests several lessons on how to use these budgeting tools in social policy most productively.

- **Without proper integration of budgeting tools into local institutional context, no policy for children will ever bring tangible results.** Progress of ENP countries in introducing policy-based budgeting was weak where new instruments were introduced without sufficient analysis of, and integration into, local institutional systems. Standardised MTEF package is intrinsically weak in capturing the complexity of these systems, and at the same time, this context in ENP region is too complex for any simplified budgeting approach to work well.
- **Effective policy-based budgeting for reforms in child-care should be linked to the country's system of intergovernmental relations.** It is impossible to design a successful child care reform without understanding – and acknowledging – the way expenditure and policy responsibilities are divided across levels of government. Since child care responsibilities in ENP countries are usually to some extent decentralised, child care reforms should contain a significant component of understanding existing decentralisation arrangements and, ideally, reforming them to achieve necessary policy change.
- **Using policy-based budgeting for children (including MTEF) in a locally integrated way requires investment into institutional diagnostics and analysis of public value trade-offs.** Despite temptations, setting strategic policy goals should be combined with constant diagnostic analysis of what is best for the children. These choices might not always be as straightforward as they seem. A policy maker might have certain overall strategic goals (e.g. making sure that, all other things equal, children have an opportunity to access care which is closer to family setting). However, no policy maker can ever know what is the concrete mix of needs of children in every community, what is the share of children requiring specific professional or medical assistance, specific legal support etc. Such specific needs and levels of dependency on additional social support vary across population, across various categories of vulnerable children, across communities, regions, countries, and cultures. Sections 3 and 4 of this report describe concrete tools which could be applied to best satisfy these choices in a decentralised PFM system, such as various forms of social commissioning (when a state purchaser represents the interests of the child, assess the child's needs and commissions appropriate services on competitive basis) and the "Balance of Service Provision" model (described in Box 2), when a policy-maker at any given tier of government allocates its resource envelope across a balanced menu of services, depending on a composition of needs among the children in respective community, and on marginal costs and benefits of these services.
- **Institutional obstacles to re-allocation of resources during reforms are deeper than traditional inter-ministerial rivalry.** Shifting approaches in child care (e.g. introducing innovative services on top of residential options) can lead to difficult but unavoidable managerial decisions about shifting responsibilities and funds between ministries. Reallocating funds between spending units, and cutting some of them thin, is never easy. But the bad news for children does not stop there. As this section illustrated, spending public funds to get results, not reports, is such a dramatic change in the ways policies are made in the CEE/CIS region that it requires a principle change in most roles and relations: those of international donors and recipient governments, executives and legislators, financial and sector authorities, state and non-state actors. Changing these roles is sometimes even more difficult to achieve – and more difficult to admit – than the task of cutting a budget line for a ministry or a residential home. Perhaps this is one reason why these other institutional challenges are so often neglected.

3. Mechanisms for changing input-based budgeting approaches in child care

3.1. What is input-based financing, how it relates to “money follows the provider” principle, and why it is bad for children?

In many countries of the region, the defining principle which drives allocation of resources for child care at all stages of this process (including, as we will see later, during allocation of resources across the tiers of government), is known as a principle of “money follows service provider”¹⁵. The essence of this terminological label is that the state agency, which acts simultaneously as a purchaser of services for the child and as a representative of the system of service provision, allocates available funds among already existing providers. In that sense, money is “following” these providers: allocation is based on already existing providers or already existing types of services. In other words, it is also “input-based”, since the government allocates funds between already known set of possible “inputs”. This approach to funding public services is simple and convenient, and was used in Western countries for a long time.¹⁶

However, despite its simplicity and convenience, this approach also has a number of considerable downsides for the children:

- When money follows providers, it does not leave an incentive for those who provide services to accurately evaluate current needs for services, and to search for the most effective and efficient way of providing them and of satisfying these needs. For any provider – not only residential – this approach does not create incentives to care for children better and more efficiently.
- When budgeting is based on inputs in relations between a funding agency and a service providing facility (for example, a residential care institution), it usually allocates resources based on expenditure norms for one client. This approach stimulates organisations to extend their client base or stops them from helping children to leave residential care for more flexible types of care.

It is important to note that input-based budgeting maintains its benefits and downsides at any stage of resource allocation. In other words, input-based budgeting happens just as well when central government allocates funds for child care across local budgeting based on existing infrastructure for service provision as when a state agency pays an orphanage in proportion to the number of “beds”, “buildings” or “staff of defined categories”.

3.2. What is the essence of the alternative funding mechanism, where “money follows the client”?

An opposite approach to the currently prevalent input-based budgeting through arrangement where “money follows providers” is a funding mechanism where “money follows the client”, or, in a narrower case, the child. Again, the fundamental difference between the two systems is in the sequence of decision making and in the roles played in the relations between the participants of the market for social service provision; that is, in the scenarios against which these relations unfold (described by the label of “routes” which money “follow”).

The essence of funding principle where money follows the client is in dividing the two key roles – the role of a purchaser and the role of the provider, leaving the role of “purchaser” to a government (funding) authority, and fully transferring the role of service provision to other organisations, which should compete with each other to receive a contract for service provision. Such scheme creates a clear link of market relations between purchaser and provider. Moreover, the state authority, as a “purchaser”, acts fully in the interest of the client (the child), and not in the interest of any provider. This state “purchaser” evaluates the needs of the child, investigates the best service options (e.g. care options) and purchases them on the market. This is why this mechanism is known as “money following the client”, or, because of the clear distinction between the two roles, as a more commonly known “purchaser-provider” or “social commissioning” model.

¹⁵ Alternatively, this model is sometimes called “money follows the supplier” (see Fox, L., Göttestam, R (2003)).

¹⁶ Dzhygyr, Y. (2006), (2007).

In other words, a purchaser-provider institutional arrangement is one of the dimensions of the transition to results-based financing; it is the institutional essence of how, practically, it could be possible to allocate resources based on expected outputs (not inputs). A purchaser-provider setting helps to allocate resources to providers (or, indeed, to entire government tiers) not based on automatic financing of their declared needs (within limited budget envelopes), but based on agreed performance and results indicators. Such agreements (or contracts) can go into details about concrete line items of future expenses only in case, and only in size, in which this helps to achieve and control the result. Rigid line-item budgeting gives space to flexibility of using funds towards best results – at any level.

This division gives space to resolving the problem of excessive residential care provision, which is to a large extent motivated by financial incentives to such providers to keep children in residential care. When state representative acts as a care purchaser on behalf of the children, it opens possibilities for providing funds to residential institutions in sizes defined by entirely new principles. In the interest of the client, the state purchaser can set financing volumes for each provider not so much based on the arguments of what funds are needed to maintain this institution (including calculations based on the number of children served). Rather, such ceilings could be determined by the expected results for these children and the effectiveness of care of each provider.¹⁷

3.3. What is the essence of reforms to introduce a new funding mechanism so that resources could follow the needs of the child, not residential providers?

The essence of reforms which aim to achieve sustainable – not short-term and cosmetic – change in the provision of child care is to create an institutional setting which gives the state authority a role of service purchaser and which clearly distinguishes this role from the role of service provision. In other words, introducing a funding mechanism where “money follows the child” implies primarily a structural change in the role of existing agents – rather than one-off reallocation of funds. Such structural changes should include, among other things, creating legal and operational basis for the existing authorities to take new roles, including clear statement of powers and responsibilities, clear instructions and help to engage in the new type of relations.

Simply paying for some new family-based services does not bring sustainable change, or reform, for children, and could be very much input-based and systemically inefficient. The fact that the input-based “money follows providers” model is usually oriented towards state-owned residential institutions does not at all exclude the fact, that the same model is often used to fund (rather automatically and inefficiently) some alternative care services, including private providers such as foster families or family-type orphanages. This means that creation or support of family-type care providers – or any other alternative non-residential providers – as such – does not yet imply a change from input-based towards result-based budgeting, and introducing a model where “money” genuinely follows the child, and not care providers.

On the other hand, purchaser-provider, or output-based budgeting, when the state pays for results, not infrastructure, helps to make all kinds of services more efficient, including residential. Very often, especially at the initial stages of such reforms, state-owned residential providers continue, for some time, to dominate on the “market” of care services for children. However, in the “purchaser-provider” setting, they do not receive their financing directly and automatically. Instead, they are forced to compete for funds, and, respectively, to “sell” their services to the state “purchaser”, who in turn can choose the best and most efficient service for the client within the available funds.

3.4. What are practical stages for introducing a new approach?

Introducing service commissioning requires the government to solve four major tasks:

- To design and introduce appropriate arrangements (legal, institutional, informational) for the state authorities to act as service purchasers (including clearly defined responsibility and incentives to defend interests of the children, not care providers). These arrangements – and the role of a “service purchaser” should include sufficient flexibility to choose between different options of care, and capacity to assess and compare their costs and benefits.
- To design and introduce funding tools and budget procedures for service commissioning at all levels;

¹⁷ Dzhygyr, Y. (2006), (2007).

- To design and introduce other necessary tools for the authority and providers to engage in “purchaser-provider” relations (contracts, pricing, tender procedures etc);
- To reform existing providers and to create conditions for new providers (including non-state) of non-residential care to enter the market.

3.5. Alternative forms of care as communicating vessels (and why flexibility of choice is the key tool in results-based budgeting for children).

The key aspect of acting as service purchaser is to be able to analyse relative benefits and costs of every type of care for the children (with varying needs!), and use this information as key guidance in decisions on how much to spend on every type of care. Respectively, to engage in such role, the purchasing agency should not only be able to conduct such analysis, but also to be flexible in using alternative forms of care as communicating vessels: being capable to influence the sizes of all types of care, reducing or extending their shares through respective commissioning decisions, as needed.

In the practice of more advanced European systems of care provision, this flexibility is known as a “balance of service provision” model and has remained a leading concept in social care reforms in recent decades. The idea of this concept is to help the agency responsible for service provision to qualitatively define a balanced and most efficient composition of various services which should be available to clients, depending on what are the needs of these clients (what sub-groups with what vulnerabilities are present among those who need care). Detailed description of this concept, taken from earlier materials prepared by a UK Public Finance expert Mr. Laurie Joshua¹⁸, is provided in the Box 2.

Box 2. “Balance of Service Provision” Model for Child Care

A balance of service provision is a menu of alternative forms of care for every vulnerable categories of children. The financing agency defines the share of every form of care based on specific analysis of the current needs of children matched to the comparative costs of needed forms of care to the budget.

Obviously, for any kind of vulnerability – including absence of parental care – children greatly differ in terms of the level of their dependency on social care. Although the benefits of growing up in a family are well known, some of the children, for example, might require more professional or additional care (e.g. medical assistance related to certain health-related problems), which could be more conveniently or effectively provided in a residential setting.

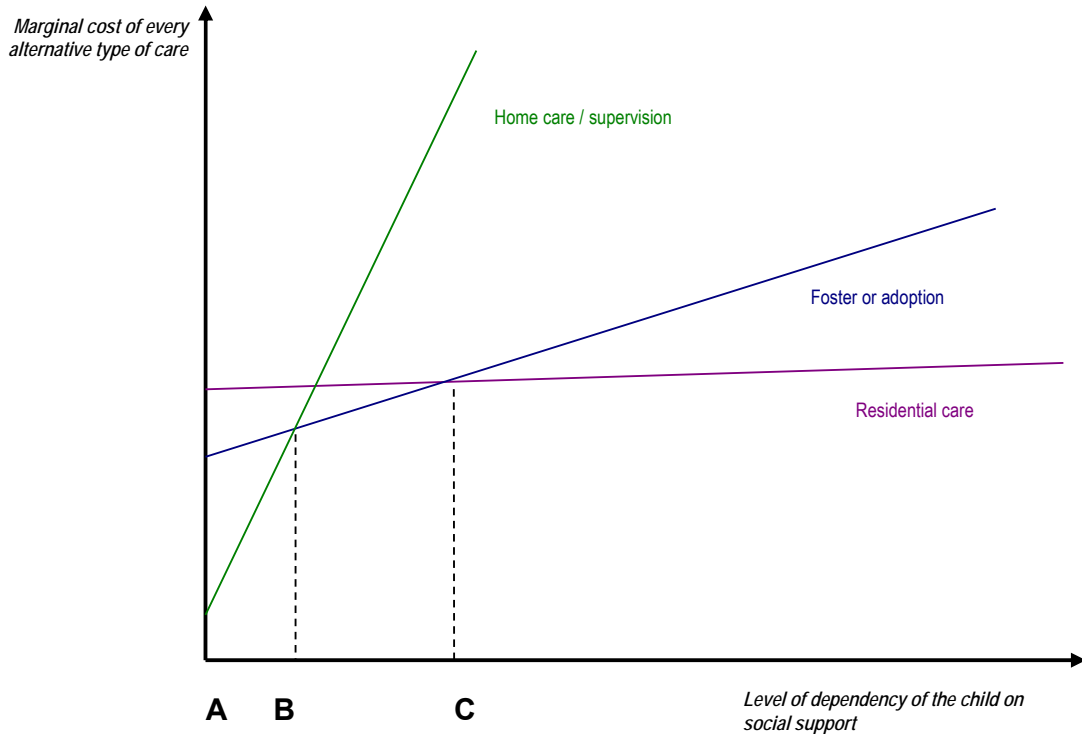
On the other hand, there could be a whole range of alternative forms of care with varying depth of proposed support, including elements of residential support. Respectively, services differ in their cost. The task of the government as purchaser is to define which groups of vulnerable children it has to support, and to find for each of these groups a form of care which represents the best combination of a needed amount of services and their cost.

This box explains the principle of such analysis and calculations, for an example of social services for children without parental care.

- Horizontal axis measures the level of dependency of a child (or group of children) on additional help: this dependency can be measured in various units reflecting the amount of additional help needed (from periodic consultations to continuous professional or medical support).
- Vertical axis measures marginal unit costs of each form of services: how much does it cost to the budget to provide needed level of support using this particular form of care? For example, providing additional medical help to a child with a disability is more expensive when provided at home compared to the same level of medical support in a residential home or specialised boarding school.
- After defining these indicators, the agency which defines the policy and financing decisions for the given category of vulnerable children on a given territory can select, for any of sub-categories of such children, a type of care which would bring those children biggest benefits at the lowest cost (for each value of X this means selecting a service represented by the lowest curve). For example, for children who need support at the level in the interval AB (quite low) it is preferable to provide services at home, etc. Further on, depending on the composition of sub-groups, the policy-maker can identify and finance an optimal overall balance of service provision.

¹⁸ Joshua, L., Dzhygyr, Y. (2006)

An example of defining optimal forms of services for children
Based on the "Balance of service provision" model



4. Complexities of policy-based budgeting for child care reform in multi-tier government systems

4.1. Why countries chose to decentralise child care?

Child care as a sector in public policy is highly sensitive to individual needs of its clients, which could be very diverse. In particular, this sensitivity is reflected in the need to choose the menu of services available to children most effectively. And although some basic principles of children's needs could be visible at central level, it is very difficult to make a decision at the central level on the precise choice of such service menu, which would take into account individual needs of children living in various regions and various communities.

The case of child care services is a bright case for applying a principle of subsidiarity, accepted by intergovernmental finance systems of all ENP countries. According to this principle, public functions should be decentralised to a the lowest level of government which would be still capable to effectively administer these functions.

Subsidiarity principle becomes especially important for child care services when governments intend to diversify the menu of available standard services – typically, residential services – for children in order to support a wider and more complex range of vulnerabilities among children (to provide services which would be more individualised and respective of individual needs of children compared to wide-scale residential institutions). The primary idea of such reforms is always to incorporate individual needs of every child. Therefore, any diversified menu of services always benefits when it is administered and funded by a level of government which is closest to the child – therefore, when this function is, to a maximum extent, decentralised.

Certainly, subsidiarity should also match the need for the financing authority to be flexible in incorporating the local context of the child with the capacity of this authority to effectively provide respective services. In particular, this level of government should have sufficient capacity to develop local policies for child care on its territory, to analyse the needs of children and to represent their interest, to engage in the needed tender procedures etc. Very often, local (or any sub-national) authorities lack such capacities, especially in transition countries. However, engaging in long-term strategic reforms in this sector requires policy makers to understand clearly, which of the levels of government should be responsible for provision of such services (at least in the long term perspective), and incorporate steps for gradual decentralisation into the reform agenda.

4.2. Caution: what do policy makers mean by decentralisation?

Decentralisation is a vague term which could mean different things. In terms of decentralisation of public functions, a principal difference is often in the question of which aspects of service provision (or which public powers) have been decentralised: financing, administering, regulating, or any combination of the above. Combined, the answers to this question define the degree of decentralisation.

Traditionally, the degree of decentralisation is ranked by subdefining it into three sub-types.

- The most powerful level of decentralisation – *devolution* – is when all decisions on the implementation of the corresponding function are made locally (that is, all three powers – financial, administrative and regulatory are transferred to the lower level).
- The moderate degree of decentralisation – *delegation* – is when the local level is empowered to make decisions which are to some degree controlled by the centre (in other words, the lower level receives full administrative and shares financial and regulatory responsibility with the center).
- The weakest degree of decentralisation – *deconcentration* – is when local level only implements certain tasks of the central government (in this case, the local level receives only administrative powers, but full financial and regulatory responsibility remains at the center).

As we will discuss soon in this text, many ENP countries experience considerable difficulties in clearly choosing an optimal type of decentralisation for social functions, and for child care policy in particular. This uncertainty and confusion brings serious conflicts into their systems of intergovernmental fiscal relations, making it essentially impossible to build an effective system of services for children (as well as for any other population group).

4.3. How decentralised is current provision of child care in ENP region?

Accurately identifying ways in which countries divide responsibilities for child care is challenging because of fragmentation of these responsibilities across sectors/spending units. This report is based on preliminary analysis of intergovernmental relations in funding services for children. Unfortunately, up-to-date statistical information on division of expenditure programmes between levels of government in ENP countries, in comparable format, has not been readily available, and was collected for different years and from different sources. A particular difficulty in this analysis is drawing a complete picture of expenditures on care for vulnerable children which are traditionally fragmented between education, healthcare and social protection authorities – and are not immediately reflected in more generalistic classifications. Table 3 provides an overview of how these expenditures are fragmented in the case of Ukraine.

A substantial share of social services for children in ENP region is funded by sub-national budgets. Table 2 shows that although expenditures on social protection in all five countries is highly centralised, other functions which include services for children (education, health, and, most importantly, social services) are often funded by sub-national governments. Even in Armenia and Georgia – whose public sectors are relatively smaller (as % of GDP) and significantly more centralised, a still palpable portion of these expenditures is spent sub-nationally. In Moldova, significant decentralisation was already implemented for education services. In Ukraine and Belarus most social expenditures are sub-national. This means that even in countries where fiscal decentralisation is only starting, a portion of social services for children (even if a small one) is already provided through a decentralised arrangement, and therefore deserves respective analysis.

Table 2. Shares of local expenditures in overall government expenditures by sectors

	Sub-national exp as % of national (consolidated)			
	Total	Education	Healthcare	Soc.Protection
Armenia ¹	7%	8%	0%	2%
Georgia ²	21%	17%	8%	9%
Moldova ³	25%	66%	4%	7%
Ukraine ⁴	45%	65%	78%	31%
Belarus ⁵	20%	81%	80%	8%

Sources: 1: 2007; <http://www.amstat.am/en>

2: Period not specified in source; PFM reforms in CEE/CIS – budget systems; CASE-Kyrgyzstan; Presentation at UNICEF CEE/CIS Regional Child Well-being Workshop Kyrgyzstan, Issyk-Kul, 21 April 2009

3: 2007; <http://www.mf.gov.md>

4: 2008; <http://budget.rada.gov.ua>

5: 2008; <http://www.minfin.gov.by>

At the same time, the degree of functional decentralisation considerably differs across the ENP countries. The two Caucasian countries and Moldova are in the initial stages of developing decentralised elements in their systems and their sub-national budgets remain rather small. Although these countries have accepted benefits of decentralisation, designed respective strategies, and sometimes even legislated for a possibility of local provision of social services, the key programmes for children remain under regulatory and budgetary domain of central ministries. At the same time, larger Eastern countries (Ukraine and Belarus) have traditionally stronger and more administratively capable sub-national authorities, which administer much larger social budgets. Therefore, experience of Ukraine related to challenges of decentralisation in social services could be of future value to other countries whose current sub-national shares in funding services for children are small and/or growing.

4.4. Caution: risks of a mismatch between fiscal and administrative decentralisation (the case of Ukraine)

The case of Ukraine provides a set of useful lessons on how reforms in child care are related to decentralised service provision. This Section describes lessons for effective reforms in child care in a decentralised service provision system received from recent decentralisation challenges in Ukraine. As already mentioned, Ukraine has relatively more decentralised public expenditures and is therefore a useful example for countries where similar reforms could progress in nearest future.

In Ukraine, child care expenditures are administered fully through sub-national budgets (including all types of care, residential and family-based). According Ukraine's Budget Code, sub-national budgets are responsible for the bulk of spending programmes in healthcare, education and social services to vulnerable population groups – each of which includes some services for children without parental care. Combined spending on these functions is around 85% of local budget expenditures. According to the WB PFR for Ukraine¹⁹, local spending on education accounted to 64.1 % of total consolidated education expenditures in 2006, and local budget on healthcare in that year was 79.3%. Respectively, child care is funded entirely from the sub-national budgets (local and regional).

The bulk of sub-national expenditures on child care is funded through a block grant allocated across territories based on relatively simplistic criteria. Child care services in Ukraine are still predominantly residential, despite numerous activities to introduce alternative care forms. A small portion of these alternative services (mostly, fostering) exist, essentially, as central programmes – administered as earmarked subventions to local budgets to fund specific amounts of existing foster families²⁰.

¹⁹ WB (2008), Ukraine Report.

²⁰ Related earmarked subventions also include small and narrowly targeted support to other services related to child care, such as, for example, "subvention for refurbishment of centers for children and youth".

At the same time, the major part of child care (which, as already mentioned, is mainly residential) is provided by sub-national administrations of various levels (municipalities, rayons and oblasts) – and should be financed from a block grant which these sub-national administrations receive to perform all delegated functions (healthcare, education, culture, sports etc) (See Table 3). Moreover, for most functions (education and healthcare), transfer allocation formula is anchored to variables of relative expenditure needs of communities compared to national average, rather than their absolute needs compared to national standards.

Such financing arrangement (block grant allocated based on indicators of relative rather than absolute need) is a rather advanced decentralisation feature, implying that expenditures in question are *delegated* - not just *deconcentrated* to subnational governments. The idea of such approach to transfer allocation is to use transfer mechanism to equalise *opportunities* between regions, leaving sufficient flexibility to the local authorities to take these opportunities forward.

Table 3. Fragmentation of responsibilities for expenditures on child care services in Ukraine (in part delegated to sub-national budgets, i.e. covered by equalisation formula)

Expenditures covered by equalisation formula (delegated to sub-national governments):	Level of sub-national budget:		
	Oblasts, the ARC and Cities of Special Status (Kiev and Sevastopol)	Rayons and Cities of oblast significance	Towns of rayon significance, settlements and villages
Education	orphanages specialised schools, e.g. boarding schools for children with special needs or disabilities	orphanages (if 70% of children come from the same rayon or city), family-type orphanages, foster families, assistance to children in custody	-
Healthcare	baby homes	-	-
Social Protection and Social Services	a mixture of specific programmes such as support to mentally disabled, post-institution support to disabled, etc.	shelters for minors	-

The key problem of this reform is that it concentrated on fiscal changes and strongly relied on assumption that political decentralisation would later complement the new fiscal arrangement, and that local authorities would receive sufficient regulatory responsibilities in social sectors – which never happened²¹. At the moment of reforms in Ukraine, unlike in Central and Eastern European countries, economic argument for decentralisation was much more convincing than political considerations. Deteriorating quality of public services, maintained by the post-soviet public finance, was a relatively safe political explanation to the need for new financial rules. As a result, the reform focused on clarifying the (previously almost entirely informal) rules for public financial management and on alleviating unfunded mandates at sub-oblast level. The latter was achieved (primarily) through clearer division of revenue and expenditure responsibilities between levels of government, and an introduction of a formula-based equalisation system for all rayons and cities of oblast significance directly at the central level, covering expenditures for major social programmes (health, education and social care). Because of political uncertainty around division of responsibilities among levels of government, the new equalisation scheme was introduced without actually defining expenditure responsibilities – either legally, or in terms of the necessary political and regulatory functions needed to administer these expenditures at the local level. Expenditure responsibilities were defined as the obligation to pay for respective budget lines.

Despite expectations, regulatory decentralisation in Ukraine has not happened till this time, which created a sharp mismatch between fiscal and administrative responsibilities in all social sectors – including child care. Until today, sub-national governments in Ukraine have very low discretion in allocating funds and administering respective programmes. Administrative decision-making (including facility-level budgeting) is subject to a rigid vertical structure of input norms, dictated by central line ministries.

²¹ Dzhygyr, Y., Manzyuk, K. (2008).

Negative consequences for effective child care resulting from this uncertainty include²²:

- **Significant unfunded mandates.** On the one hand, sub-national governments are subject to strong vertical (input-based) norms for spending, including vertically protected recurrent spending, including half of the total public wages. This makes child care (as well as other related programmes) “deconcentrated” functions – where local governments are not responsible for making regulatory decisions. On the other hand, the funding they receive is deeply “delegated” in nature – it is not allocated based on actual needs, and in this way the central government is sharing responsibility for financing these programmes with sub-national governments (without sharing responsibilities for respective policy decisions).
- **Uncertainty as a time bomb, creating impetus for retrograde change.** Since the 2001 reforms allowed an uncertainty in political definition of delegated functions, they left the area open for multiple interpretations and vulnerable to manipulation. The central post-reform debate and misunderstanding is on degree of decentralisation for core programmes in healthcare, education and social care. The current uncertain and contradictory system creates major and growing stress to all levels of government, pushing them to develop coping strategies.
 - > The central government is stressed by disproportionate increase of responsibility for accurate calculation of transfers, which resulted after the core programmes were shifted to the block grant financing but without regulatory release. This stress was multiplied by eliminating the intermediary role of oblasts in transfer allocation.
 - > The local governments are stressed by their inability to fund pre-defined services in pre-defined institutions with transfer funds which are, by definition, insufficient.

Moreover, all participants of intergovernmental relations are prone to coping strategies which drag the system rapidly back to, and below, the pre-reform point. Given the amount of areas left unregulated for proper delegation since 2001, pro-centralisation appeal has been strong from the beginning and increased exponentially because of multiplying stress factors associated with the unregulated environment. Coping strategies almost exclusively include actions which manipulate uncertainties in the system to establish pre-reform budgeting practices, such as:

- > Renaming institutions to match the existing division of responsibilities with expenditure responsibilities defined in the Budget Code;
 - > Token reallocation of clients between institutions to change their legal status (e.g. mixing clients from different rayons to assign an oblast coverage to the service provider);
 - > Using weaknesses in formula to match the results with existing practice of service provision on various territories;
 - > Lobbying for changes in formula, especially in the revenue side;
 - > Lobbying for the increasing share of targeted transfers.
- **Uncertainty in fiscal decentralisation as an obstacle to effective policy-making at all levels.** As we will discuss further, effective reforms and effective routine provision of child care services require government stakeholders to use policy-making instruments whose application critically depends on the nature of fiscal and administrative responsibilities allocated to a given level of authority – and ways in which these responsibilities relate to other levels. Such “decentralisation”-dependent instruments include: MTEF (which should deal with multi-year planning of decentralised programmes), development and implementation of a “balance of service provision” (discussed in Box 2 in Section 3.5), policy costing and various forms of expenditure audit. In Ukraine, none of these tools is working properly for child care reforms, at any level, because of continued confusion about the nature of delegated social responsibilities. In particular:
 - > National strategies which include child care components could not be properly costed;
 - > Stakeholders cannot agree what information on unit costs of services should (or should not) be included into the formula for transfer calculation, and where – if not in that formula – unit cost data should be applied;

²² Maynzyuk, K. (2008).

- > None of the existing public financial oversight institutions effectively engages into performance audit (given that it is impossible to identify an agent responsible for setting priorities and funding them). Official audit is limited to inspection of compliance and accuracy of financial statement, while conclusions on spending efficiency are used without clear methodologies and often in a politically manipulative way.
- **Additional obstacles to decentralisation of child care services at the level of institutions / service commissioning.** Recent pilot projects to introduce comprehensive and sustainable local practices of service commissioning (in social care for vulnerable) showed that it would be problematic to increase decentralisation at the level of facility budgeting without removal of central regulatory barriers to local policy development. In particular, in social services, wide-scale pluralisation of service menu will not be possible without removal of central level barriers such as lack of marginal revenue flexibility at local level (since local governments do not influence the rates of taxes which they receive, any innovative decisions have to be funded from someone else's pocket (central funds) and there is no possibility to take financial risks / raise local taxes to fund local initiatives).
- **Exacerbating intrinsic resistance to reform which already exists in key social sectors which cover services for children without parental care.** Excessive centralisation and excessive reliance on input-based bureaucratic administration in all sectors diminishes local accountability. Without local accountability, and without appropriate systems for quality control, sector governance breaks down into resilient administrative enclaves, which are in a position to seek economic rents from manipulation with quality of services they are providing (such as out-of-pocket payments in healthcare and education).

4.5. Incentives to residential child care created by input-based intergovernmental fiscal arrangements

Input-based budgeting can stimulate residential provision at the level of intergovernmental finance. As discussed in Section 3 on purchaser-provider financing and social commissioning, the principles on which funds are allocated to pay for service provision can have a dramatic effect on their efficiency. This logic holds for the principles of allocating funds between tiers of governments just as well as for allocating funds to certain providers. In particular, intergovernmental finance systems can create powerful incentives for specific forms of services and obstruct development of alternative possibilities if they are based on input-based budgeting philosophy.

The three major ways in which intergovernmental systems can stimulate residential services are²³:

- **Allocating responsibilities in terms of fixed types of providers (rather than functions)**
The way responsibilities are defined in legislation matters. It is usually very difficult for post-soviet societies to agree on definition of any responsibilities, including responsibilities which should be assigned to levels of governments. As described for the case of Ukraine, it may be tempting to postpone such politically difficult decisions until later stages of reforms. In the meantime, responsibilities could be defined in terms of commitments to finance traditional budget lines, which are usually input-based (such as certain kinds of care providers). As also quoted for Ukraine in Table 3, its child care function was allocated across government tiers as a set of responsibilities for “orphanages”, “baby homes”, “boarding homes for disabled”, etc. Such definitions promote continued allocation of funds through traditional providers and demotivate introduction of any new, alternative forms of care.
- **Allocating transfers based on infrastructure-based variables**
Some decisions on local approaches to service provision could be powerfully stimulated by incentives built in the transfer formula. Ukraine is also a good example of this problem. Although most variables in the formula are linked to demographic variables (e.g. in Healthcare or Education), some other variables – notably, in the part of formula which defines the size of transfers for social services - still allocate funding based on existing infrastructure of service providers. In particular, the formula allocates funds for social care based on the number of clients registered with particular residential institutions, reinforcing their domination.

²³ Dzhygyr, Y., Sheyko, R. (2007).

- Undeveloped systems for service quality control (standards; licensing; decentralised performance audit systems)²⁴.

Systems for quality control of social services (including design of appropriate standards) represent a separate large theme which is beyond the scope of this report. However, certain aspects of the quality control systems are closely linked with systems of service funding, including the system of fiscal relations between the tiers of governments. Some intergovernmental aspects of these systems can stimulate residential care or limit development of alternative services for children. These problematic aspects may include:

- > Soft budget constraints and weak fiscal discipline, in relations between tiers of government promotes unrealistic expectations about the quality of services;
- > Rigid standardisation systems. Even compared to education and health, social services – and especially child care – are very difficult kinds of services to standardise quality, since they are focused on a wide range of children’s needs and vulnerabilities, which is highly subjective, depends on various factors, and could be addressed in a variety of ways which are not easily comparable. Designing quality control systems which capture the nuances of children’s needs is possible only through building social services system around the client and his/her needs. Importantly, simply engaging respective NGOs to the process of designing standards is not sufficient to achieve this. The only way is to organise service provision so that the governmental purchaser (on any tier of government), which represents the interests of the child, has sufficient administrative and financial autonomy to select a form of care provision which best suits any individual case. However, this approach is by definition problematic for introducing unified service standards.
- > Rigid unified national standards. The closer care services become to the child (under the subsidiarity principle), the more difficult it becomes for any central government to ensure unified national standards of care provision. This is especially true for countries with some intrinsic heterogeneities, e.g. because of geographical, cultural, or demographic differences. At the same time, defending unified access of all children to quality care requires certain compromises and development of unified quality principles. An example of this problem is Great Britain, where debates on the topic are still on-going. One of the possible solutions are quality control systems based on inspection and general guidance, rather than compulsory quality standards (which allows inspecting authorities to be more flexible in taking account of the client’s situation and needs, and yet to have influence over the quality of received care).

4.6. Challenges of decentralisation in the region: why is it so difficult for most countries to delegate social policy functions to sub-national governments? Why is political economy critical to design reforms?

Decentralisation reforms seem to face systemic problems in at least some of the ENP countries. Recent studies have shown²⁵ that even in countries who have implemented decentralisation reforms relatively faster or more actively (like Ukraine), despite much work and active legislative developments, public administration continues to suffer from excessive centralisation, and attempts to decentralise it have systemically failed. Historical record also shows that all previous reforms and policies in this area have faced a set of similar, often identical, obstacles to change. This suggests that it would be difficult to expect progress in the future without addressing these root causes of failures in the policy process.

An exceptionally difficult issue for national consensus is often the role of regional / middle government tier, accompanied by fears over risks to state integrity. From the first years of decentralisation reforms across CEE/CIS, the role of middle government tier remained one of the most difficult and was even called “a focal point of reform”²⁶. In post-soviet public administration systems, regional governments were initially seen as a symbol of the “matryoshka”-type (quasi-feudal) public administration, with the risk that the central government would not be able (or willing) to preserve interests of local-self government and hold regional authorities to account in how they exercise the delegated functions. Another factor is anxiety of growing political regionalisation and the risks to state unity. At the same time, already in 1998 observers noted that when regional responsibilities were considerably reduced, this created another type of risks: of excessive fragmentation at the local level, on an example of Hungary. These

²⁴ Dzhygyr, Y., Maynzyuk, K., (2009).

²⁵ WB (2008), Ukraine report; Dzhygyr, Y., Maynzyuk, K., (2008).

²⁶ Dunn, J., Wetzel, D. (1998).

concerns were supported by later experience in Ukraine – where reduced role of oblasts created a number of fiscal problems both for sub-oblast tiers and for the central government. Similar concerns were raised during administrative-territorial reforms in other, smaller countries – with regard to rayon equivalent of regional tiers (e.g. in Georgia).

Social services, and child care in particular, are an example which can be among the first public services to suffer from these problems, given that regional tiers often prove to be most effective providers of this function.

Strong and capable central authorities are vital for successful decentralisation. Some observers suggest that meaningful decentralisation always implies policy consultations around basic principles of the society's national compact – which is difficult for countries with weak tradition of policy consultations and with weak capacity of central governments to engage into public communications.

4.7. Conclusions

Initial experience of decentralising social services in a post-soviet setting of public administration offers the following practical lessons:

- **Build alliances through joint analysis.** Countries engaging in any degree of decentralisation of social services (i.e. most transition countries) should actively stimulate joint work (e.g. through working groups, task force co-operation etc). of all government ministries affected or influencing such policies. Notably these partnerships should include ministries of finance, sector ministries and ministries responsible for development of political decentralisation arrangements. Such partnerships should jointly commission and consult around deep diagnostic studies of how intergovernmental fiscal relations affect service provision and children in particular, identifying areas for change.
- **Focus on assigning responsibilities.** The tasks related to policy-based budgeting should be assigned to government levels appropriate to the given country's intergovernmental framework and appropriately co-ordinated with all other levels which effect policy-making. The tools for such policy-based budgeting should usually be more diverse than just an MTEF document.
- **Central government should start by eliminating wrong incentives.** The key task for the central government is to eliminate wrong incentives existing at the national level, which obstruct development of social commissioning and stimulate inefficiencies like excessive residential care.
- **The second task for the center: equip sub-national policy process with enough tools and freedoms.** The other key task for the central government is to equip an appropriate, jointly chosen (usually sub-national) tier of government with sufficient tools, freedoms and autonomies to engage in flexible policy-based budgeting and social commissioning;
- **Consider pilots.** Central government might consider designing specific central programmes to pilot social commissioning models at sub-national levels. Ideas for such pilots were considered in Ukraine, with WB and DFID support.
- **Always keep in mind political economy.** All work on decentralising social expenditures should be aware of political economy issues, drivers and limitations – such as, e.g., opposition to political decentralisation, fears of risks to state integrity etc. – since these seemingly unrelated factors could have strong effect on the success of reforms in social policy.

5. Technical assessment tools for child care policy making

5.1. What technical assessment tools governments might need to design and implement policies for children?

Designing reforms and then efficiently implementing child care policies could be highly technical. In particular, there are two types of tasks which require specific evidence-based analysis:

- **Technical assessments for designing and implementing structural institutional reforms.** The key message of previous sections was that effectiveness and sustainability of reforms in public service delivery tends to strongly depend on how well these reforms are tailored to the nuances of the country's institutional and fiscal architecture (or, rather, its institutional and fiscal anatomy²⁷, physiology²⁸ and biochemistry²⁹). Therefore, successful reforms start with specific diagnostic analysis of this institutional and fiscal setting, with the view of understanding its problematic areas and making sure that any new tools or approaches would match the existing structures, capacities and limitations. In the case of reforming child care, the technical analysis is needed for the following changes:
 - > To identify elements of the current fiscal and institutional anatomy which are best entry points to start re-directing resources away from inefficient (sometimes detrimental) forms of care towards alternatives services which help children best and at lowest cost. In other words, analysis should show, which building blocks of the system, which processes, and which micro-issues are the weakest in terms of providing best care for children, so that they are addressed as priorities. Moreover, analysis could show where change would be feasible and effective (e.g. in which reform tasks it is possible to expect institutional or political support). "Entry points" for reform would be tasks which combine these features, i.e. which represent biggest priorities and best opportunities for realistic change³⁰.
 - > To assess possibilities and limitations of trying to redirect resources towards most efficient care in a particular country through the existing tools such as MTEF, annual budgets, policy documents, etc. As only one example already mentioned earlier, analysis of the country's decentralisation arrangement can show that using MTEF could be problematic and insufficient – however analysis could also show similar issues with other tools.
 - > To design new tools, and to improve existing ones (including MTEF), changing some parts of the fiscal and institutional anatomy itself, in order to find new ways to manage public finance in children's best interests. Examples of this could be sustainable capacities for costing policies, commissioning child care services through open competition, auditing performance and value for money, etc. Design these new approaches so that they would be feasible to implement and sustainable in the long run.
- **On-going technical analysis in the process of implementing child care policies.** Routine policy process for children should also engage technical assessments at various stages, including the following tasks:
 - > To periodically assess comparative costs and benefits of alternative policies and services, making sure that the menu of options available to children suits their interest best;

²⁷ Anatomy (from the Greek *ἀνατομία anatomia*, from *ἀνατέμνειν ana: separate, apart from, and temnein, to cut up, cut open*) is a consideration of the structure of living things.

²⁸ Physiology (from Greek φύσις, *physis*, "nature, origin"; and -λογία, *-logia*, "study of") is the science of the functioning of living systems.

²⁹ Biochemistry is the study of the processes in living things, dealing with the structure and function of their cellular components.

³⁰ Examples of such possible "reform entry points" differ greatly across countries. For instance, as further sections demonstrate in detail, in Ukraine, an analysis of entry points led to a range rather unexpected options and unexpected choices. The menu of options included such diverse directions for reform as: political relations at the central level (priority but difficult to address); political definition and clearer intergovernmental division of delegated expenditure responsibilities (key priority but difficult to address in the short run); capacity building for strategic policy-making in social service provision at sub-national level (moderate priority and moderate challenge). However, the menu also included options such as removal of incentives to residential care in the equalisation formula which were both priority and easy to address. The first steps of reform concentrated on this issue and helped to both make steps away from residential provision and gradually build platform and knowledge for further reform activities.

- > To understand public value and demand regarding various types of care; enabling policy dialogue on policy trade-offs.
- > To audit service performance, efficiency, value for money; and control their quality;
- > To raise hard and convincing evidence on service delivery to enable public communications (e.g. to help the government convincingly communicate its strategic priorities to the public or to help sector ministries explain their standing during MTEF negotiations).

Breaking down tasks for technical assessment in this way helps to make one overarching observation. While major structural reforms might do with ad-hoc assessments (to identify entry-points or specific problems), routine implementation of policy-making for children in longer term requires the government to engage in relevant assessment on a permanent basis through capacities which are sufficiently integrated into its own locally funded structures. Again, examples of such permanent functions are policy costing, cost-benefit analysis, or performance surveys. As we discuss next, international development tools may provide useful ideas on how to build these permanent capacities (e.g. provide examples of how to calculate certain indicators or how to make appropriate samples for performance analysis surveys). But these instruments still remain what they have been from the start: examples of how some things may be done or one-off support tools to answer specific reform questions.

**Box 3. The dangers of confusing one-off studies with sustainable capacity building:
the case of a unit cost study of social services in Ukraine**

In 2006-2008, WB Ukraine considered funding a study which would analyse unit costs of alternative forms of social services for vulnerable population groups, including children. The study was conceived as a response to a request from the Ministry of Finance at the background of growing debate in Ukrainian social policy arena on the problem of calculation of unit costs for social services and on using this information to reform their funding and to transfer away from residential provision.

Despite some influencing from DFID, the WB's approach to the design of the study was strongly focused on the idea of a one-off pilot exercise to define comparative costs of several alternative forms of services to generate hard evidence on the relative attractiveness of community-based care and to estimate potential costs of change. However, the government expected this study to help them understand the nature of unit-cost analysis and to apply this tool permanently in their practice. By that time, the government had already fully accepted the need to pluralise the menu of social services and to add alternative forms of care to the residential option, but was struggling to practically achieve this goal.

The actual difficulty with unit costs of services in the case of Ukraine was that the country had a variety of opinions on how to use unit cost data in the policy process, and the choice of approach would actually, de facto, affect the model of decentralisation (= division of responsibilities) between the levels of government – so it was also political and highly controversial. Needless to say, the government's actual needs in this area went far beyond a simplistic one-off assessment considered by the World Bank.

This WB's approach was reinforced by the decision to administer the study through a Ukraine's Social Investment Fund (USIF) – a WB project designed around a quasi-governmental agency (USIF) which had cut in the way of development of the domestic policy function in the Ministry of Labour and Social Protection. A technically and administratively weak structure, USIF perpetuated a simplistic attitude to the study, opposed meaningful engagement of the Ministry of Finance, and essentially counteracted the process, leading to eventual decision to abandon this activity.

To summarise, the government of a reforming country should chose technical studies which are appropriate to answer the following questions in the following stages of reforms:

- What is the current institutional and fiscal context (anatomy, physiology and biochemistry) – in order to design reforms best tailored to the context and such which would actually work;
- Where and what are any malfunctions and failures in this organism (which represent obstacles to reform and healthy policy-making, and should therefore be treated or removed);
- How well is the whole system functioning (a variety of assessments for routine check-up in the process of policy implementation).

5.2. What prêt-a-porter assessment tools are available in international development?

International experience is an obvious source of lessons on how to crunch evidence for social policy-making. However, here, as well as with reform tools, recipient governments should use international models with very clear understanding of their origin and purpose, so that they apply it most effectively at home.

In the particular case of assessments of fiscal frameworks, the danger zone is that most quick international recipes for such studies originate from a specific concern of the donor community – over the effectiveness of utilisation of aid funds by the recipient country. These risks are called fiduciary – based on the legal concept of “fiduciary duty”, which describes “legal or ethical relationship of confidence or trust between parties, most commonly – a trustee and a beneficiary, where one party has to act on behalf and in the interest of another, which, in turn, is protected only by the expectation of agreed loyalty. For aid organisations – especially those who help countries through direct support of their budgets – the critical question is whether the recipient government would have the loyalty and capacity to use these funds well, which represents a “fiduciary risk” to aid effectiveness.

Because of these major fiduciary anxieties, international organisations have devised a significant body of models for technical assessment of PFM systems of less developed countries. True, all of these fiduciary studies always serve a double-purpose, bringing information on the issues in the PFM systems which could also be of high value to the national governments. But very often – with varying expression – these assessments are still focused on issues which concern donors more than national governments. Moreover, when “fiduciary” elements of such studies are disguised, they could sometimes be even more detrimental since they make it difficult for recipient countries to use such studies well or use them at all. In particular, one big risk is that “fiduciary” anxieties often motivate donors to stimulate studies or analysis in parallel to incipient analytical efforts already developing in the recipient countries, and parallel systems (especially when they are unsolicited) are always the surest way to kill such authentic reforms at their birth.

Standard international models for PFM assessment tools can be presented in three broad groups:

- **International benchmarking.** These studies help to define certain aspects of PFM systems which make them internationally comparable.

One example are HIPC assessments – tracking of indicators of how well Heavily Indebted Poor Countries are using resources they receive as debt relief (and therefore developing respective debt relief policies and eligibility criteria). Another related example is a PEFA (Public Expenditure and Financial Accountability) initiative – a broad partnership of major international organisations³¹ created to harmonise their approaches to reform in PFM. A core part of the PEFA initiative are PEFA assessments along a set of standardised indicators which help to track how reforms are progressing in various countries.

Importantly, international PFM benchmarking are sometimes much less “fiduciary” and aid-related, and can serve other purposes in the area of international relations. A key example for the ENP region is the SIGMA (Support for Improvement in Governance and Management) initiative of the OECD and the European Union. This initiative was launched in 1992 to help potential members of the EU to reform their public government systems before accession, and initially supported only immediate candidate-countries. However, with time, it gradually developed co-operation with less immediate candidates and, from 2008, started to work officially with European Neighbours and Partners.

SIGMA assessments of country’s public finance help the political purpose of understanding the progress of each country in aligning its PFM with EU practices. Consequently, they cover a much wider range of PFM issues compared to more simplistic international studies, including: design and implementation of PFM reforms, external audit, financial control, legal frameworks, policy-making and coordination, public expenditure management, public integrity systems, public procurement and regulatory policy.

Such political factors behind some of the international benchmarking assessments of PFM can make them relatively more useful to recipient governments compared to, e.g., some of the more clearly fiduciary tools, since they may focus on more context-specific issues and raise more advanced challenges. The countries of the ENP region are therefore in a fortunate position given their access to instruments such as SIGMA, which should be utilised to a maximum extent.

³¹ The World Bank, the European Commission, the UK’s Department for International Development, the Swiss State Secretariat for Economic Affairs, the French Ministry of Foreign Affairs, the Royal Norwegian Ministry of Foreign Affairs, and the International Monetary Fund

**Box 4. How countries can use SIGMA assessments for social policy reforms?
Lessons from Ukraine**

Ukraine is a ENP country and not an EU member-candidate. This means that until SIGMA activities were officially extended to cover the ENP region in 2008, Ukraine was not eligible to SIGMA assessments (in other words, the EC was not ready to pay for an analysis of Ukraine's public administration and finance given that there was no plan for political integration of Ukraine into the EU in foreseeable future).

However, in 2005, Ukrainian government has volunteered to go through such assessment for its own benefit, and international donors (SIDA and DFID) agreed to sponsor this work. As a result, OECD SIGMA has conducted two partial SIGMA assessments for Ukraine in 2006 and 2007, available in Ukrainian at <http://www.sigmaweb.org/dataoecd/47/1/37127338.pdf>. This means that at the moment of this report, Ukraine is the only ENP country which already has the experience, and can share it with other ENP governments who can now benefit from this option at the cost of the ENP programme.

Ukraine SIGMA assessment has focused on most key areas of PFM. However, its findings were most striking and most systemic in the areas related to political economy, institutional frameworks and policy processes. In fact, that study appeared capable of raising such fundamental obstacles to reforms in PFM and in all social sectors that no previous assessment was either technically capable or politically well-positioned.

In particular, the assessment made the following key conclusions on the country's PFM:

- Any recommendations on PFM made in the assessment would be feasible only after Ukraine resolves fundamental issues of changing and clearly defining the roles and responsibilities of the key political players: the President, the Prime Minister / central government, and the Parliament. If key authorities in Ukraine would not be ready to resolve responsibility issues, approving any laws as such would not be of much help, and the risks of confusion and falling respect to legal authority will only grow.
- Most reforms which Ukraine has started look ambitious but are certain to not be implemented in practice, since they take policy beyond the possibilities of current institutions and attitudes. The study recommends Ukraine to accept a policy of "radical moderation", which means slowly diverging from the earlier declared strategy of big structural reforms and, at the same time, sticking to a new radical strategy of moderate changes (requiring a complete change of expectations of both reform champions and donors).
- Fundamental institutional changes which obstruct meaningful PFM change in Ukraine require considerable reforms. A leap-change of this kind could be possible only in case of either a social or economic crisis, or a significant external shock or massive public demand for clearly understood kind of change. The only way to support this is to work on gradual creation of a public nuclei / nurseries of demand for reforms.

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- **Fiduciary analysis and portfolio reviews.** As already discussed, some of the standard international PFM assessments are openly fiduciary focused, even if guidance for their delivery suggests ways to make them useful for the benefiting country and integrate into local policy-making. Such assessments include: WB Country Financial Accountability Assessments (CFAAs), WB Country Procurement Assessment Reviews (CPARs), WB Public Expenditure and Institutional Reviews (PEIRs), IMF Report on the Observance of Standards and Codes (ROSCs), ADBs DSAAAs (Diagnostic Studies of Accounting and Auditing), and UNDP CONTACTs (Country Assessment in Accountability and Transparency).
 - **More flexible diagnostic studies.** Some of the assessments of PFM effectiveness in aid-receiving countries were originally designed, in just the same way as the above tools, to strengthen donors' country strategies and to uncover fiduciary risks. However, this class of assessments has been more flexible and more focused on providing analytical support to national governments. Such tools include WB Public Finance Reviews (PFRs), WB Public Expenditure Reviews (PERs) and various kinds of Public Expenditure Management Assessments conducted by related international projects. The flexibility allowed by these tools, despite their origin, created analytical space for such assessments to pay attention and analyse more contextual and specific issues, compared to the standard simplistic assessments.

One variation of such diagnostic tools are Public Expenditure Tracking Surveys (PETS) and Quantitative Service Delivery Surveys (QSDS). These two inter-related tools were devised as tools for very primary diagnostics of key problems in a public financial management system. Both tools were designed for countries with very weakly developed public finance systems and government institutions (mostly, African), as the first step for the aid agencies to understand how budget allocations are transformed into actual results at the frontline of the service provision, what distortions and leakages happens as money flows down from the central government through its various sub-national tiers and structures, and where are the biggest possible

areas for reform. In other words, these tools help donors and governments to make a first check-up of what share of public spending actually brings results.

More flexible international assessments also include sector-specific studies and surveys, which donors commission for various purposes related to their country strategies. The study of unit costs of social service provision in Ukraine, described in Box 3, would have been an example of such work. When such surveys happen, they provide valuable opportunity to use advanced and labour-intensive methods for statistical analysis, policy costing etc, and to transmit some of this capacity for further utilisation in routine policy-making.

To summarise, despite the availability of various international models for technical assessment of PFM systems, governments should be closely aware of the origins, purpose and limitations of the tools they are using. For the purposes of *domestic* reforms and policy-making, the most suitable tools are always the most flexible diagnostic studies which also give space to sufficient level of complexity of the local context – and which should be used as frameworks rather than rigid guidelines. At the same time, international benchmarking – and especially ENP-related assessments like SIGMA – can also open strong drivers and technical support for reforms.

It is also useful to keep in mind, that standard assessments (like standard PFRs or PETS) and tools (like MTEF) promoted by development agencies are not the only frameworks which exist for analysis of public financial management. In particular, it could be useful to keep an eye on how similar tasks are taken by more advanced economies, borrowing individual elements and skills as needed. E.g. diagnostic PFM analysis to identify structural imbalances in the budgeting process in Western countries through a complex network of expertise, competing in quality and in political messages. Multiple related studies with various focuses are regularly produced by the NGO sector, thinktanks, watchdogs, on top of the government's own studies. Although development organisations recently noted that this variety of approaches to PFM analysis in Western countries did not leave scope for a single authoritative body like IMF or WB to effectively voice concern over some structural problems (which might have contributed to the development of the global financial crisis), no better feasible alternative than this democratic variety of information has yet been devised.

5.3. Detailed overview and practical recommendations on using some diagnostic assessments to support child care reforms

Public Expenditure Reviews (PERs) and Public Finance Reviews (PFRs)

OVERVIEW

Flexibility and relevant complexity of approach makes PFRs very useful instruments to focus reforms well. PERs/PFRs originate as WB standard assessments, and yet have a lot of useful diagnostic possibilities for the national government. Properly designed, context-respective PFR can raise significant problems which are specific to a particular assessed country. Table 4 shows how most recent PFRs in the ENP countries have taken on board specific country issues, on top of the usual building blocks dictated by the WB guidance.

Table 4. Overview of country-specific themes raised by recent WB PFRs/PERs for ENP countries

Country	Year of PFR/PER	Specific issues raised above standard PFR/PER blocks
Armenia	2003	Off-budget elements of the fiscal system
Belarus	2003	The institutions of the budget process
Georgia	2002	Budget management issues; Inter-governmental fiscal relations.
Moldova	2007	Civil service pay reform; Sustainability of the pension system; Maintenance of road network.
Ukraine	2006-2008	Broadening tax base (VAT administration, payroll taxation, simplified tax system); Reforms in the pension system; Capital budgeting; Out-of-pocket payments in healthcare and education.

Box 5. How public finance reviews helped to steer reforms in social services in Ukraine

In the case of Ukraine, two internationally sponsored reviews of public financial management, with specific focus on social services, have made a break-through in the understanding of fundamental obstacles to change and of directions for reform. The WB Public Finance Review (2006-2008) looked at the problems of decentralised provision of public services and cross-referenced this analysis to the review of fiscal space available for reforms. The study made the following conclusions on social services, rather shockingly to many observers and policy-makers:

- Ukraine's spending on health and education is already very high (in education – exceeding the EU-10 average) and continues to grow, while outcomes in these sectors are extremely poor and quickly deteriorate.
- Ukraine does not need to spend more on provision of key public services in social areas; current poor results in these areas are caused exclusively by the sector governance problems. Moreover, these sectoral fiscal envelopes cannot be increased without harming the economy with an added tax burden (e.g. through any forms of healthcare social insurance schemes).
- The level of informal unofficial payments for key services in social sectors (health and education) is one of the worst in Eastern Europe and is caused not so much by the low wage levels of teachers and doctors as with fundamental problems in the governance of these sectors.
- The key systemic obstacle to further reforms in public service provision is dysfunctional division of responsibilities between levels of government (a mismatch between fiscal and administrative mandates), which requires urgent change.

Another key study – Assessment of Public Expenditure Management for Reform in Social Services (sponsored by DFID) – made a similar set of revealing conclusions, some of which included the following practical tips for further reforms:

- Any sustainable reallocation of resources between forms of care is limited by dysfunctional policy process (including fragmentation of responsibilities, absence of policy consultations, etc).
 - Dysfunctional decentralisation arrangement obstructs change in the way social services are funded and creates incentives for residential care;
 - Long term policy for social service provision does not take into account long-term demographic trends;
 - There are considerable barriers to entry for non-state providers to the social service market (which would not disappear simply through reallocation of resources towards such services in the budget).
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PRACTICAL TIPS AND BASIC STRUCTURE

According to the WB basic guidance, there is a certain traditional logic for an appropriate structure of a public finance review. It should include the following broad elements:

- Analysis of an appropriate public-private mix of goods and service provision in the economy after the rationale for public intervention--market failure (efficiency) and redistribution (equity)--has been identified;
- The country is generating adequate revenue in a reasonably non-distortionary, equitable and sustainable manner, and fiscal deficits, if any, are sustainable and consistent with economic growth, inflation and other macro objectives;
- Evaluation of public expenditure priorities--across and within functions--given the resource constraint and distributional objectives;
- Examination of the link between expenditure inputs and outcomes (such an analysis does not necessarily have to be based on fancy statistical techniques; good anecdotes could work well as supplements in case data are poor and/or insufficient);
- Focus on the public sector institutional arrangements (including the political incentives) with suggestions to reform incentives and institutions that are needed to improve the efficacy of public spending.

This broad framework allows a PER to analyse the country's public financial system in a comprehensive way, and identifying issues in each area in the context of overall systemic limitations. This structure could be then develop to incorporate any specific issues relevant for the country in question. In the case of ENP countries, most of the recent WB reviews included the following blocks:

- Ways to create fiscal space for economic growth;
- Improved effectiveness of public investment;
- Increasing efficiency of services in healthcare, education, social protection and social care.

Comprehensive PFRs are time-, labour- and money- consuming exercises. According to the World Bank, the average cost of such report (estimated in 1992) implied 88 staff weeks which amounted to around USD 250 000.

Public Expenditure Tracking Surveys (PETS) and Quantitative Service Delivery Surveys (QSDS)

OVERVIEW

PETS and QSDS are basic diagnostic tools which try to understand why public spending does not result in better development outcomes³². PETS and QSDS are tools for very initial and basic diagnostics of public expenditure systems. They were developed in response to donor concerns that despite growing sizes of the budgets of developing countries (often thanks to raising aid flows), outcomes of public services they provided were often uncertain or poor. Although the goals and outcomes of desired policies were often clearly declared, both governments and donors realised that country's institutional and fiscal systems were blocking efficient implementation of such policies. Money were failing to reach the right categories of population, or even the frontline service providers; sometimes the systems created such perverse incentives for service provision that even where services were properly funded they were not provided or provided highly ineffectively (e.g. with high rates of absenteeism among frontline workers). Moreover, the existing systems did not ensure that the clients were using services most effectively (e.g. parents failing to seek help for their children in time). In other words, the link between inputs and outputs was clearly weak, with the secret laying somewhere inside the black box of the country's multi-tier fiscal system. PETS approach was pioneered in Uganda in 1996, and since that time these studies were mostly covering African countries.

In essence, PETS and QSDS are surveys which track, and quantify the flow of public resources across various administrative levels. On the one hand, it may seem that neither PETS nor QSDS is anything new. Both studies are, in essence, detailed micro-surveys at the level of frontline service provision (therefore, they utilise research methods which are rather well-known). However, the added value of these tools is in the way they use surveys to shed light on problems in public financial management. The idea of both studies is to conduct very detailed surveys at various levels of service provision to capture a variety of aspects of service outputs and of the process of service provision. The surveys question both sides of service provision: service providers (facilities, funding agencies) and service consumers (client or their representatives) on a whole range of possible output indicators relevant for the current sector: inputs, outputs, user-charges, quality etc. Combined, this information can reveal very deep and fine connections and problems in the ways public funds are used in the service provision system.

PETS/QSDS can be more sensitive and precise diagnostic tools compared to PFRs. Sociological surveys have a number of possibilities for detecting complex problems of interactions between agents which are not open to other instruments such as econometric or institutional analysis used by typical PFRs. In particular, the PETS/QSDS have the following comparative advantages:

- They can collect a very diverse range of data and indicators, and therefore are not limited to any already existing statistics and can open wider options for analysis;
- It is possible to design micro-surveys so that they include mechanisms for cross-checking and verification of responses (such as triangulation and cross-validation), which reduces the risks of inaccurate information, especially in the sensitive financial area. On the other hand, any already existing official statistics is often unreliable;
- Some of the possible problems in the operation of PFM systems are difficult to measure, or even predict. Micro-surveys could include variables which are more likely to capture those issues;

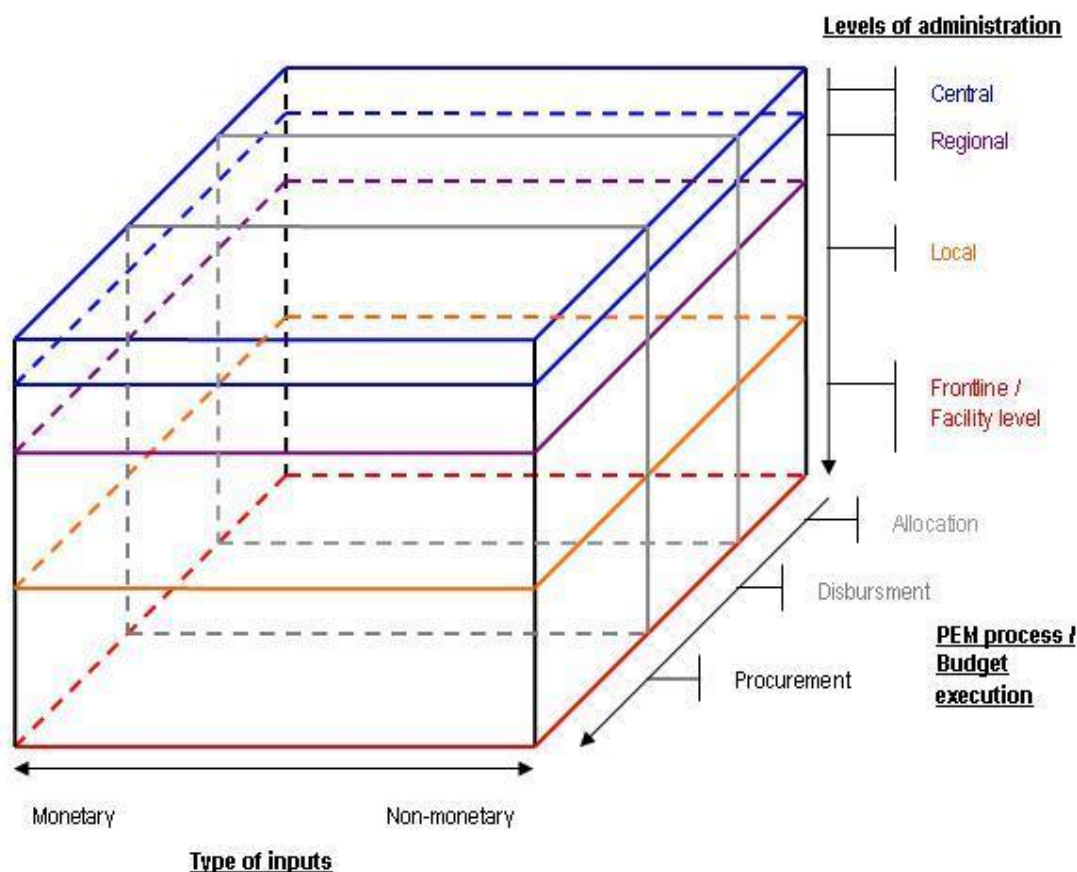
³² Sahgal, G. (period unspecified); Voorbraak, D., Kaiser, K. (2007).

- Micro-surveys are useful to collecting convincing and hard-hitting evidence which could be used for multiple purposes (e.g. for public communication and policy dialogue).

The primary task of PETS/QSDS is to track bottlenecks and leakages on the way of money from allocation stage to actual consumers. Because of these methodological advantages, PETS/QSDS can be very helpful in detecting the following critical problems in the operation of the PFM systems:

- leakages (cash and in-kind, e.g. textbooks, drugs, or absenteeism)
- collusion and bribery
- delays and bottlenecks
- issues related to political economy (such as the effect of interest groups)
- governance issues

Figure 2. The logic of multi-layer expenditure tracking



However, these surveys allow research to watch for specific patterns which can point at systemic problems and directions for reform. While leakages and delays are usually symptoms, precise data collected through micro-surveys can also help to investigate some of the reasons behind these symptoms and shed light on linkages and incentives which give rise to these problems. In particular, the studies can detect problems related to:

- equity of access to services (and any systemic biases or discrimination)
- regional disparities
- transparency and adequacy of PFM systems

PRACTICAL TIPS AND BASIC STRUCTURE

What is the difference between PETS and QSDS, and why they are used jointly?

Both studies are micro-surveys, and they both represent tools to track how public money transforms to services delivered to clients. The difference is that:

- PETS (or, sometimes separately, TS – tracking surveys) are focused on how funds flow through the levels of administrative bureaucracy; and
- QSDS are more complex and time consuming surveys specifically at the frontline level – that is, at the level of facilities and other service providers – which look specifically on how services are delivered and what are their outputs.

The two surveys are often used jointly in order to receive a complete picture of the process of service delivery. PETS and QSDS can usefully complement each other and help to identify more complex patterns and processes.

What are the steps to design and implement PETS and QSDS?

1. **Secure relevant sociological expertise.** Since both types of assessments are, in essence, sociological surveys, the key idea is that their design and implementation requires respective expertise and knowledge, including relevant experts at all research stages.
2. **Consultations and scope of study.** To be most useful, the study should be designed in close consultations with key stakeholders, including government, donors and NGOs. These consultations are needed for the appropriate design of the survey, since they should not only help to fine-tune objectives, but also to build a basic picture of the resource flows which should be investigated, questions to be asked, and patterns to look for. The issues to investigate at this stage include:
 - What is the scope of the study; which sectors and services should be covered?
 - What are the key issues and problems?
 - What is the structure of resource flows, including all the layers for tracking?
 - What are the nuances of the institutional setting?
 - What data is available or could be gathered?
 - What survey tools would be appropriate?
3. **Rapid data assessment.** Expenditure tracking strongly depends on availability of respective records. To design the study well, the researchers need to be clear about what records are available or are not available at all surveyed layers.
4. **Design of questionnaires.**

PETS and QSDS usually require a number of separate questionnaire including:

- Questionnaires for facility managers (by types of ownership - government, private for-profit providers, and private not-for-profit, and by level – local, regional and central/national).
- Datasheets for analysis of facility records;
- Beneficiary surveys.

Questionnaires should contain six core blocks of questions, covering:

- Characteristics of the facility;
- Inputs valued/measured in monetary terms (at least the most important ones; which take largest share of service costs);
- Measurable outputs (preferably but not necessarily valued in monetary terms);
- Quality of services (maximum range of aspects);

- Financing (sources, amounts, types – kind or in-kind);
 - Institutional mechanisms and accountability.
5. Training, field testing and implementation (often ignored but critical for success).
 6. Data entry and verification (preferable throughout data collection process);
 7. Analysis, report and dissemination (communication of results should be planned strategically and in advance).

Note 1: some facility surveys can play a similar diagnostic role without being called PETS or QSDS.

Many donors and governments engage in facility surveys of varying complexity, which could also be used for similar policy purposes. For example, World Bank has sponsored several facility studies for health and education in Ukraine which were critical during the subsequent PFR analysis and in other sector-specific studies. It were, primarily, these facility studies which helped the Ukrainian PFR to raise and analyse such fundamental problems in service financing as out-of-pocket payments, equity of access to health and education, and regional diversity.

Note 2: beware of parallel systems.

As was already repeatedly stressed earlier, governments should not confuse one-off diagnostic studies with in-house capacity for performance audit and quality control in service delivery. Micro-surveys, at the level of providers and customers, are a critical tool for any government to conduct periodic routine assessment of the operational effectiveness of the service provision system. Developing an in-house capacity for such analysis is a critical task for child care reform. Access to opportunities of ad-hoc PETS/QSDS analysis should not replace that process, e.g. by creating a temporary parallel analytical system.

Note 3. use expenditure tracking micro-surveys in combination with other PFM assessment tools.

PETS/QSDS provide vital primary diagnostics but could not replace further analysis of fundamental systemic malfunctions which they uncover. As in the case of Ukraine quoted above, primary detection of problems such as dramatic sizes of out-of-pocket payments in education and health were only the first step for further PFR to question the sources of this problem and arriving at conclusions such as dysfunctions in intergovernmental fiscal relations. Moreover, as also demonstrated for the case of Ukraine, even PFR turned to be insufficient to detect even more fundamental political economy problems which only became visible with the SIGMA study, which had a political leverage to address these sensitive issues.

Policy costing and analysis of unit costs of various types of services

CURRENT CONTROVERSY

Overall interest in methodologies for policy costing has been growing across the CEE/CIS region, and this interest is usually focused on ways to calculate and apply information on unit costs of services. Over the recent years, reforms in social policy in the region focus increasingly on the importance of developing effective financing systems for service provision. In particular, numerous discussions look at ways to assess and apply unit cost of service delivery. The need in unit cost assessment is mentioned in connection with the following challenges: introducing social service commissioning and contracting, diversifying social services network, increasing the role of alternative and community-based services, and improving budgeting techniques at all levels.

Most materials available to the ENP governments on this issue stress importance of unit cost analysis and explain the various techniques for comparing costs and benefits. However, they rarely explain in practical terms at what stages of policy making this analysis should be applied. As a result, stakeholders typically lack common vision about how and when to use this tool.

In current discussions, opinions clash on a number of critical issues. Some issues regarding unit cost assessment for social services are not only open but have become stumbling blocks to further discussion. Namely, controversial questions include:

- Should unit costs data be included into calculations of intergovernmental transfers?
- Which agency should perform this analysis?
- How regularly?
- Should it be sampled or complete?

This section addresses this controversy and uncertainty by demonstrating that there is no universal recipe about when and how to use costing tools; it depends on how responsibilities for policy-making are divided among agents; and therefore each country has to use costing tools according to its individual institutional framework. Description of costing tools in this section will illustrate that they could be used in a variety of ways and situations. It should also provide a picture of how to use appropriate costing tools for every single setting or policy question, and how to do it well.

OVERVIEW OF TOOLS

The main purpose of unit cost indicators is to inform decision making in social policy. Information about how much it costs to provide a certain service can play a deciding role at various stages of decision-making by officials of all levels of government. However, it is clear that stakeholders should make the whole range of various decisions in the process of policy design and implementation. This variety is illustrated by the list of the following diverse decisions that should be considered:

- What are reform goals?
- What are long term challenges? (e.g. demographic change?)
- What should be the balance between different types of services?
- What obstacles will appear on the path of reform and how to overcome them?
- How spending on social services should compare on spending in other sectors?
- How to divide responsibilities for services between levels of government?
- How to define the size of transfers to local governments to fund social services?
- What is the realistic minimum of guaranteed services?
- What should be standards of their delivery?
- How to select the most effective providers of social services?
- How to control effectiveness of spending by the selected providers?

Reflecting the differences in the type of decisions, approaches to collection and analysis of data on unit costs to inform these decisions should also vary. Moreover, while unit costs play a decisive role in making some decisions, other processes may use such information only as secondary or additional.

For practical understanding on how costing could be applied best, it is convenient to define three broad kinds of decisions requiring unit cost analysis:

1. To assess a particular service.

This is the simplest of all situations, where the service provider or policy maker needs to understand how much it costs to provide one concrete service. Respectively, it represents a simple accounting task.

2. To assess and compare alternative services

This class of tasks requires comparative analysis of different types of services. There are several types of economic assessment of alternative ways of funds utilisation. All of them use information on costs associated with service delivery but compare this information with different indicators of achieved results:

- **Cost minimisation analysis.** This is the simplest type of economic assessment, which considers only cost indicators and does not take into consideration the indicators of the expected results of the funds utilisation. This analysis can serve the only purpose of identifying the cheapest alternative. Accordingly, its use is limited to the cases when the analyst is prepared to make an assumption that all alternatives in the analysis are equally effective. For example, a policy maker can use this analysis to identify what is the cheaper way of providing care for a child without parents: in a residential home or in a foster family.
- **Cost-effectiveness analysis.** Calculations measure benefits in so-called *natural units* - i.e. years of life gained, number of disability free days, depression level, etc. In case of social services the improvements in family relations, ability of elderly people to be self-sustainable or ability of disabled people to perform certain functions could be taken as units. Then, it is possible to define for each alternative project (i.e. Alternative types of services or providers) a measure of proposed costs per one *natural unit of outcome gained*. Priority is given to the projects with the lowest value of costs per unit of outcome. For example, a policy maker can use this analysis to identify which type of care for a child is most effective in ensuring some of the child's future life-time indicators (e.g. looking at expected additional years education achieved by each alternative type of care per dollar spent, or, in another way, how much does it cost with each type of care to ensure the same expected amount of education years for the child).
- **Cost utility analysis.** In essence, this is special case of cost-effectiveness analysis, which measures outcomes specifically as "utility" or improvement in quality of life. Quite often 'Quality Adjusted Live Years' or now commonly accepted abbreviation QALY are used as utility indicator. To estimate this indicator, life years are adjusted with a number of coefficients according to the impact of various health conditions on the quality of life. This analysis is more widely used in health care and not commonly used for social services. However, in principle, it could also be applied: for example, to compare types of childcare in terms of what comparative professional utility they bring in future life per dollar spent (i.e. not just years of education, but also professional achievements measured in some quantifiable way).
- **Cost consequence analysis.** As in the simple cost-effectiveness analysis, this approach estimates project costs per certain *natural unit*; however, it assumes that the same activities may simultaneously have several different effects. This analysis is based on the fact that for many services it is impossible to measure effectiveness with just a single unit. In the example we are using for child care, comparing residential care with family-based care is impossible with only one indicator like additional education. Usually, it is important to simultaneously analyse effectiveness of each type in terms of a range of indicators such as, for example, health and mental health outcomes, social outcomes, criminal vulnerabilities, etc.
- **Cost benefit analysis.** This approach measures project costs and outputs in monetary terms. Thereby it becomes possible to directly compare the cost and benefits of the proposed steps. Certainly it is difficult to use this method if it is hard to estimate the results of some events in monetary value. In such cases it is recommended to distinguish monetary and non-monetary dimensions on the output which in fact approximates this method to the cost-consequence analysis. So, the benefit for the child in our example would be a complex indicator of various results achieved by alternative care types, including educational, health, social, criminal and other dimensions.

3. To assess policy initiatives

This most difficult class of tasks implies much more complex decisions (policies), such as introducing or supporting innovations and new services, extending policies to cover new clients or priorities etc.

- Often applicable to make decisions in decentralisation, especially when services are delegated to local governments.
- Could include overall costing of a policy, or comparative analysis of various policies. In such case, it relies on sampled studies.
- Could be sequenced as "top-down" and "bottom-up" approaches. Top down – quick but less precise. Bottom up – more accurate and complete, but tends to overestimate the costs.

Conclusions and Recommendations

This report looked at the experience of introducing new policy-based budgeting tools across the five countries of the ENP region, trying to make observations about why PFM reforms for children are not progressing as fast as was hoped, why inefficient residential services continue to dominate in the area of child care, and what could be realistically done to make reforms work. These key observations and recommendations are listed below.

- It is impossible to treat pathologies in PFM systems without understanding their anatomy, physiology, and biochemistry, and without making sure that treatments and tools fit to the system's complexities and limitations. The key task of PFM reforms for children is to design any policy-budgeting tools so that they fit into the country's institutional and fiscal "anatomy, physiology, and biochemistry". Although this recommendation might sound vague, in reality - this one problem of budgeting tools imposed by donors which are either oversimplistic or overly ambitious for the country's institutional capacities and problems - was responsible for many delays in reforms, including delays caused by creation of parallel budgeting systems.
- The institutional essence of the transition from input- to output-based budgeting for children is purchaser-provider role model - not one-off reallocation of funds between any kinds of policies. A child care reform which introduces purchaser-provider setting helps to allocate resources to service providers (or, indeed, to entire government tiers) not based on automatic financing of their declared needs (within limited budget envelopes), but based on agreed performance and results indicators. Rigid line-item budgeting gives space to flexibility of using funds towards best results - at any level. In order to provide best results most efficiently for children, re-allocation of funds between programmes and policies as such is not sufficient. Instead, governments should focus to a maximum extent on these institutional changes, and making sure that the right policies for children would be selected and financed on sustainable basis in the long run.
- Effective policy-based budgeting for reforms in child-care should be linked to the country's system of intergovernmental relations, and should take into account numerous challenges of effective decentralisation. It is impossible to design a successful child care reform without understanding - and acknowledging - the way expenditure and policy responsibilities are divided across levels of government. On the other hand, decentralisation of social services, including services of child care, creates very significant political economy challenges related to division of responsibilities across levels of governments. Mistakes on this front, along with protracted uncertainty, can cause dramatic harm to effectiveness of child care.
- Institutional obstacles to re-allocation of resources during reforms in child care are deeper than traditional inter-ministerial rivalry. Reallocating funds between spending units, and cutting some of them thin, is never easy. But the bad news for children does not stop there. As this section illustrated, spending public funds to get results, not reports, is such a dramatic change in the ways policies are made in the CEE/CIS region that it requires a principle change in most roles and relations: those of international donors and recipient governments, executives and legislators, financial and sector authorities, state and non-state actors. Changing these roles is sometimes even more difficult to achieve - and more difficult to admit - than the task of cutting a budget line for a ministry or a residential home. Perhaps this is one reason why these other institutional challenges are so often neglected.
- Best technical assessment tools for reforming and implementing child policies are those which are most flexible and help to identify country-specific areas and entry points for reform. Governments should be aware of origins and nature of the available PFM assessment instruments, in order to choose those which best fit their own policy agenda and long-run interests. Usually, these tools are variations of Public Finance Reviews and Public Expenditure Tracking Surveys. The countries of the ENP region should also try to benefit to the maximum extent from the PFM reform support opportunities related to European integration, including access to benchmarking studies like SIGMA assessment (which can point at problems which no one else might be willing to raise) and offer lessons and tools applicable to the institutional setting of more advanced and complex countries (based on the EU experience), which could be more suitable to the ENP region compared to some more traditional and less sophisticated toolkits.

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