Chapter 3

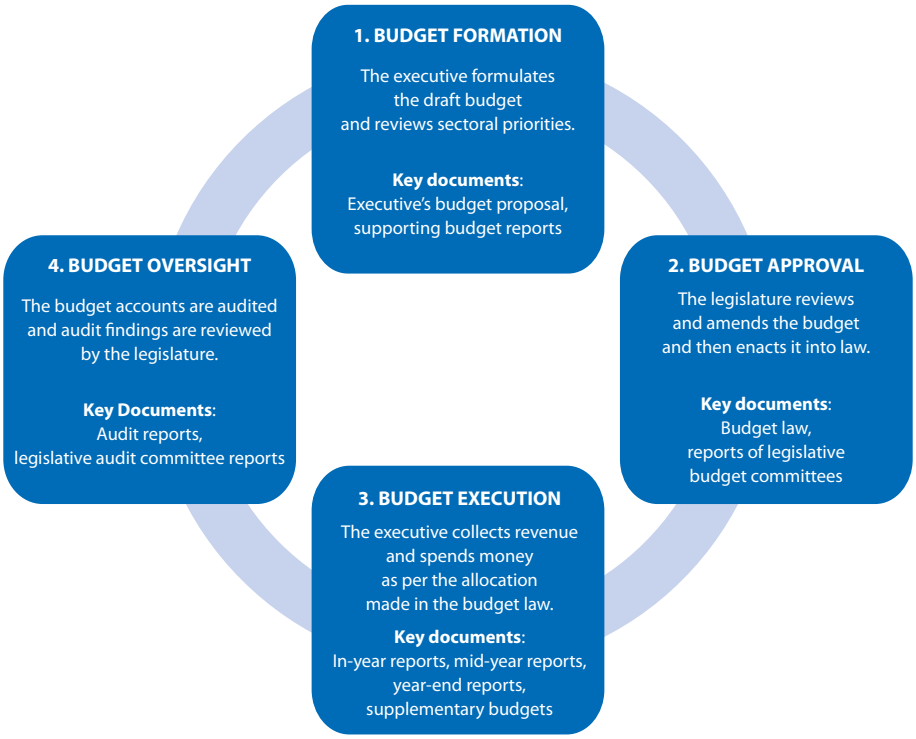
Greening national budget processes

This chapter outlines the linkages between the national budget process and a country's environmental performance and identifies capacity needs for greening national budgets. Among these are good fiscal knowledge, appropriate engagement of key actors, training and human resource development, targeting weaknesses and exploiting synergies and cross-sectoral links. Based on the framework introduced in Chapter 1, this chapter provides guidance on how to develop the required capacities, using case studies to illustrate how capacity development can be supported in various country contexts.

What is the national budget process?

The national budget process is essentially the way a country decides how to raise financial resources (the revenue side) and where to allocate those resources (the expenditure side). It is also referred to as a country's public financial management (PFM) system, and is generally understood to include the entire budget cycle from strategic planning to oversight (Figure 3.1; OECD, 2009). Upstream components of the budget process include strategic planning, preparation of a medium-term expenditure framework, and annual budgeting. Downstream components include revenue management, procurement, accounting, reporting, monitoring and evaluation, audit and oversight.

Figure 3.1. **National budget cycle**



Source: Adapted from Ramkumar, V. (2008), *Our money, our responsibility: A citizen's guide to monitoring government expenditures*, IBP, Washington, DC.

The budget formulation stage includes a review of sectoral priorities. Sector ministries are required to review their performance in order to inform the budget proposal for the next period. The review involves the collection and analysis of data on the development and recurrent expenditures for each ministry. It also includes budget hearings where sector expenditure plans are proposed and scrutinised by the ministry of finance (Buhl-Nielsen and Bird, 2010). Ideally, considerations of costs and benefits are also part of the review process.

Budget allocations should reflect policy priorities. In reality, however, planning and budget processes are often disconnected. Planning processes focus on achieving sector targets over multiple years while budgets are generally annual. Furthermore, since most budgets are structured along departmental lines rather than programmatic lines, it is

difficult to establish direct linkages between policy objectives and the level of funding needed to deliver services that support those objectives (Third International Round Table – Managing for Development Results, 2007).

Under the Paris Declaration (Box 1.1), developing countries are committed to strengthening their PFM systems, while developments support providers are committed to using those systems as much as they can. Developing countries, with strong support from development support providers, have introduced a number of technical instruments for improving the integration of planning and budget processes. These include *i)* the enforcement of pro-poor spending priorities; *ii)* the introduction of medium-term expenditure frameworks (MTEFs), and *iii)* results-oriented programme budgeting (Wilhelm and Krause, 2008). These reforms are at different stages in different countries, reflecting the importance of specific contexts and capacities at the country level.

How can national budget processes contribute to greening development?

Fiscal policies can have important environmental implications. On the revenue side, environmental levies such as taxes and charges can encourage economic activities to become environmentally sustainable and can raise revenues to fund further sustainable development actions. On the expenditure side, budget allocations to sector ministries and agencies can be used to improve the environmental management of sectoral programmes. Budget allocations to environment agencies can also help ensure that core environmental management functions, such as environmental monitoring or enforcement of environmental regulations, are carried out (Table 3.1).

Table 3.1. **Environmental implications of fiscal policies**

Fiscal policy	Policy instruments	Potential environmental impacts
Environmental levies	Traditional taxes	• All taxes (on goods, services, incomes and assets) influence people's decisions about the goods they produce, how they spend their income and what assets they hold
	Environmental fiscal reform (*e.g.* environment-related taxes, charges for environmental services and royalties for natural resources)	• Environment-related taxes can encourage lower levels of pollution and sustainable resource use by changing relative prices • Service charges can ensure the provision of environmental services by contributing to their financial sustainability
Expenditure policy	Direct provision of services and infrastructure	• Investment in natural resource management and ecosystem services can contribute to meeting sector development outcomes • Environmental infrastructure and service delivery (*e.g.* waste management services) should have net positive development impacts
	Financial transfers to economic agents (subsidies)	• Input subsidies can encourage over-use of natural resources and excessive pollution • Product subsidies can encourage over production of goods that damage the environment • Subsidies can encourage the production/use of products or technologies that are environmentally desirable but may not be competitive in the market in the infancy stage (however certain subsidies are environmental harmful and may cause over exploitation of natural resources)
	Expenditure on environmental management functions	• Research, development and diffusion of environmentally sound products and technologies • Implementation of environmental protection/restoration programmes • Provision of incentives to improve environmental performance • Promotion of behavioural change through information, education and awareness raising

Environmental taxes and charges: can they work in developing countries?

The revenue side of the budget offers important opportunities for improving the environmental performance of developing countries, as well as reducing poverty. One approach is through environmental fiscal reform. Environmental fiscal reform includes a range of taxation and pricing measures that can further environmental goals while raising fiscal revenues. It complements and strengthens regulatory measures and other approaches to fiscal and environmental management. Such fiscal reform can help address environmental problems that particularly affect the poor, such as water contamination and air pollution. It can also help indirectly by strengthening sector activities that contribute to better livelihoods and well-being, such as sustainable agriculture (OECD, 2005).

Environment-related taxes and charges are not widely used by developing countries. This is also broadly true in OECD countries, despite some examples of significant environmental fiscal reforms. Moreover, their environmental effectiveness and economic efficiency are often undermined by weaknesses in implementation. Common issues include the existence of multiple tax exemptions, a weak link between actual tax rates and estimated external costs and benefits (externalities), overlaps and inconsistencies with other environmental policy instruments, and complexity (variety of tax rates and special provisions). Furthermore, high taxes on the formal sectors, combined with weak control systems and poor quality of public service delivery, can result in both legal and illegal forms of tax avoidance. Finally, the high proportion of informal sectors in developing countries creates an additional challenge to the application of such environmental taxes.

Despite these challenges, there is growing interest in developing countries in the use of environmental levies (see Box 3.1). This is largely driven by the prospect of raising revenues and keeping them within the sector agency. Given the low budgetary allocations that the environment and natural resource sector tend to receive in the national budget process, internally generated funds are seen by the sector agencies as a way to ensure organisational survival. However, the earmarking of revenues generated by levies for environmental programmes goes against the principles of sound public finance and can generate strong opposition from the ministry of finance. There are also important environmental management and governance risks associated with the use of internally generated revenues in environment agencies. Potential risks include (Lawson and Bird, 2008):

- *Core functions can be left underfunded*. For example, in Ghana, the self-financing model for the environment agencies has become effectively institutionalised with their designation as "sub-vented agencies". This may be a workable model for game parks but not for core environmental management functions such as environmental monitoring or environmental enforcement.
- *Conflicts of interest can arise***.** For example, in Mozambique, "Simple Licences" give Mozambican nationals the right to cut a specific amount of wood within a defined area for a yearly fee without having to provide a full resource inventory and implementation plan. This approach to forest management has encouraged unsustainably high forest exploitation rates because it allows for higher income flows to the forestry department.
- *Major revenue amounts can go missing*. For example, it has been estimated that in Tanzania, 97% of forest revenue is "lost", amounting to USD 40 million annually. This is mainly due to the nature of the large and informal economic sector that make it particularly challenging to collect environmental taxes and charges.

Box 3.1. **India: Building green accounting capacity for using forest levies**

The Indian state of Himachal Pradesh has paved the way in sustainable resource management by developing its capacity to carry out a full economic valuation of its forests and the many environmental services they provide. This valuation has allowed the state to apply levies on activities that damage forest ecosystems and offer financial incentives to rural communities to preserve them. The study of the economic value of the state's forests revealed that they can potentially contribute a staggering USD 26.7 billion a year to the country's GDP. Most of this –USD 18.5 billion – is in the form of watershed benefits such as flood control, soil conservation and the regulation of water supply. Yet the state receives just USD 10 million a year in revenue from its forests and from the sale of timber and other forest products. In order to ensure that the true value of the forests in Himachal Pradesh is properly recognised, the state now applies a levy on anyone using forests in a way that diminishes the services they provide. This is meant to compensate for the loss of their economic and ecological value. The levy also offers incentives to communities to preserve their forests. This capacity development in using a "green accounting" methodology has been taken up by several other states in India and by the National Forestry Commission.

Source: www.lead.org.

Environmental funds have been set up in many countries with the purpose of managing revenues raised by environmental levies and contributions from development support providers to environmental programmes. They have several advantages as a way to deliver an alternative to project funding supported by assistance providers. They are well suited to mobilise national resources and support local capacity building. They can also provide a mechanism for pooling resources from a variety of sources, as well as a framework and mechanism for financing small-scale projects without direct involvement of development support providers (Lovei, 1995).

Expenditure policy: how can the environment be brought into the picture?

Public environmental expenditures are expenditures by public institutions on activities for preventing and reducing pollution and environmental degradation resulting from human activity (Swanson and Lundethors, 2003). These expenditures are therefore not confined to expenditures by environmental authorities and agencies. In fact, other sector budgets offer many opportunities for environmental integration in support of key development goals.

In most developing countries, there is no single "sector budget" for public spending on the environment and natural resources. The environment and natural resources sector consists of a collection of sub-sectors that make use of natural resources for productive uses (such as fisheries, forestry or mining) or deliver environmental services (such as waste management or wastewater treatment). The sector therefore includes a cross-cutting dimension that aims to achieve an appropriate level of investment to manage and enhance environmental assets or services related to productive sectors such as agriculture, energy or health. This cross-cutting component involves functions that are often marginalised in government processes.

In traditional budgeting processes, there is little room for ministries of planning or finance to improve the integration of environmental expenditures into sector budgets since resource limits often are based on historical expenditures. Greening public expenditures in sector ministries such as agriculture or energy requires a strategic policy dialogue and a set

of capacities at the sector level. Co-ordination between the budgeting and planning process is required to provide enough resources to enable sectoral policy objectives to contribute to national environmental outcomes.

MTEFs provide opportunities to green national budgets by linking policy, planning and budget processes. The MTEF combines top-down and bottom-up approaches to public financial management and creates the institutional basis that supports its implementation. However, to be effective, the MTEF approach requires significant and appropriate capacity in data collection and management skills, the knowledge and ability to set priorities, and acceptance of the ministry of finance in a co-ordinating role with other sector ministries. A review of the experience of nine African countries has shown that many MTEFs were not part of the annual budget process due to limited political engagement and the fact that budget behaviour is difficult to change (Le Houerou and Taliercio, 2002).

National budget reforms can change the relationship between finance and environment agencies. As planning and budgeting become an integrated process for allocating resources, budget preparation should change from negotiating numbers to identifying and prioritising options for achieving targets. In this process, environment agencies will need to demonstrate that environmental programmes are worth pursuing and that these programmes can effectively contribute to national development goals. Depending on the level of capacities within the ministry of finance, modernising the budget process can refocus the role of the ministry away from top-down control, to support to line ministries focused on assisting them in meeting their sectoral targets through more effective resource allocation. Such reform provides more flexibility in the management of the budget funds. This however, requires that budget officers have the capacity to develop good results-based management in environment agencies. Improved co-ordination on budgeting for environmental objectives across sectors is also needed in order to ensure consistency between national sustainability objectives and sector allocations.

Building the capacity for greening national budget processes: a five-step framework

Capacity development is a long-term proposition. As such, it is important to recognise that capacities must be developed over several budget cycles. Particular capacities should be developed for each step of the budget process. Given that the budget cycle is usually one year, while the planning cycle can cover five or ten years, a long-term programme for capacity development over several budget cycles is crucial.

Reforming the budget process is likely to be harder than that of the planning process – the stakes for entrenched actors are higher because national budget processes are the mechanisms through which national resources are appropriated and distributed. Capacity development for greening the national budget process must therefore be strategic, based on a sound understanding of the political economy of the budget process, the role and interests of the actors targeted, and the types of efforts that can be deployed. A capacity development framework for the budget process must be based on:

- good fiscal knowledge;
- engagement by a full spectrum of actors;
- training and human resource development;
- targeting key weaknesses;
- working with existing synergies;
- improving cross-sector linkages.

Table 3.2 outlines the challenges and priority actions specific to the budget process following the five-step approach.

Table 3.2. **Steps for building capacity for greening national budget processes**

Strategic priorities	Challenges	Actions to deliver capacity development for environmental issues
Step 1: Assess the political and institutional context		
• Budget process • Alignment with NDP process • Awareness of budget officials	• Budget cycle not widely understood by environment actors • Budget cycle is often not well linked to development planning processes and priorities • It may be hard to identify senior budget officials with a knowledge of environment – development issues	• Assess budget cycle process and institutional set-up • Identify potential link to relevant policy dialogue and key issues *e.g.* forest revenues • Enlist senior officials with experience of environment-development links engaged in budget process
Step 2: Identify the key actors and their capacity development needs		
• Finance/budget actors • Environment actors • CSOs/research bodies	• Given the diversity of stakeholders that contribute to the national budget processes, it is difficult to define capacity development needs for individual actors.	• Reach out to key actors and identify their capacity development needs. Actors include: - Environment agencies - finance/planning ministry - sector ministries - CSOs - "champions"
Step 3: Identify opportunities to shape organisational incentives		
• Incentives • Cross-agency working • Familiarity with the process	• Often environment actors are formally involved in budget process – many environment activities are "project-funded" • Budget staff may not have incentives to consider the role of the environment to sector budgets • Environment and budget staff often do not work together	• Enable formal participation of environment agency in budget cycle *e.g.* involvement in key working groups • Create incentives for budget staff to assess costs and benefits of environmental expenditure • Create working relationship between budget and environment staff
Step 4: Identify awareness/knowledge needs and existing analytical tools		
• Provide support/training • Knowledge products	• Environment staff often do not understand the budget process and fiscal policies • Budget staff are usually not aware of how environment contributes to sector outcomes	• Train environment staff on budget process and fiscal system • Raise awareness of budget staff on the economic and financial value of environmental expenditures • Provide knowledge products *e.g.* case studies and experience sharing
Step 5: Address options for policy influence		
• Revised budget allocations • Prioritised fiscal measures • Financial management	• Specific analysis are not always well suited to the needs of decision-making process in the budget cycle • Environment staff are not experienced at "making the case" • There is a need to encourage influence by CSOs	• Provide support on using results of technical analysis to fit decision-making process • Develop skills in communication and negotiation for environment staff • Engage CSOs with potential to influence the budget process

Step 1. The political and institutional context

This step involves understanding the political and institutional context that governs the budget process and the issues that determine the choice of priorities. In some countries, environmental issues have been successfully integrated into national development plans, such as poverty reduction strategies. But, to a large extent, the importance attributed to the environment in development plans has not been reflected in financial resource allocation

and implementation at the sector level. The annual allocation to environmental protection is often between 1% and 2.5% of public spending (Lawson and Bird, 2008). Such limited operational budgets prevent environment agencies from effectively carrying out their basic environmental management functions such as environmental monitoring or enforcement of environmental regulations. In addition, they have little capacity to engage with sector agencies and integrate environment issues into sector strategies.

Typically, to ensure their survival and development, environment agencies have found it easier to focus their attention on attracting project funding from development support providers or to finance their activities from taxes and fees than to compete with other sectors for national budget funding (Lawson and Bird, 2008). Over the years, external funding has become a major source of finance for most environment agencies. The problem with this approach is that such funding is primarily intended for investment activities. Environment agencies seeking project funding therefore have to reorient their activities in order to meet the investment criteria. As a result, they have little experience in participating in the national budget process and often do not have the basic skills to develop credible budget submissions (Lawson and Bird, 2008).

The need is growing for environment agencies to engage in the national budget process to secure the necessary financial resources for the sector and to ensure that environmental sustainability objectives in national and sector plans are met. Development support providers are increasingly delivering assistance via general budget support and sector budget support instruments (Box 3.2). As a result, environment agencies will need the capacity to raise recurrent financing for public environmental functions from the national budget rather than from project financing from development support providers. Technically sound budget submissions by the agencies, possibly supported by budget guidelines produced by the ministry of finance, would help to secure public resources. Ultimately, however, in order to justify adequate budget allocation, such budget submissions need to show that investments in environmental integration deliver benefits larger than their costs.

Box 3.2. **Ghana: Capacity development for better use of sectoral budgets**

Ghana's natural resource sector is known for its successful integration of environmental considerations into the activities in the sector. The Natural Resources and Environment Governance Programme was developed by the Government of Ghana and a group of development support providers. Financial support was given to the sectoral budget, but the use of the fund was at the discretion of the Government of Ghana conditional on its activities contributing to the progress targets agreed upon. This relatively discrete support to the management of the sectoral budget was enabled by a range of capacity development activities developed for the Government of Ghana, including technical expertise in EIA, SEA and climate change adaptation. One result is that now all policies, plans and programmes instituted by the Natural Resources and Environment Governance Programme must undergo SEA.

Source: OECD (2011), *Strategic Environmental Assessment in Development Practice: A review of Recent Experience*, OECD, Paris.

Step 2. Key actors and their capacity development needs

Key actors

The national budget process is more government-centred than the planning process discussed in Chapter 2, involving mainly (but not exclusively) state actors. The executive branch and parliament tend to be more involved in the formulation of the budget than in national development planning. In contrast, CSOs and the public often have less opportunity for meaningful engagement in the budget preparation than in planning, although this differs across countries (Wilhelm and Krause, 2008). The main actors in the national budget process and their roles include (OECD, 2001):

- *Ministry of finance*: responsible for the custody and management of all public finance. If there is a separate ministry of economy or planning, it is usually responsible for identifying programmes to meet the environmental policy priorities.
- *Line ministries*: responsible for planning, managing and controlling their own budgets. They are accountable for defining and implementing government policies and sectoral budgets. They also have the technical capacities and information needed to make effective trade-offs among on-going programmes and appraise new policies and programmes.
- *Local authorities*: participate in the budget process as budget sector groups to develop more concrete programme proposals. Because of the capacity challenges encountered by budgetary staff, local authorities may play a more important role in the future as co-ordinators of budget proposals across sectors at the local level.
- *The legislature*: participates in the governance of the budget by approving budget allocations, overseeing budget execution, and controlling budget performance. Often, accountability suffers as a consequence of parliamentarians not having enough financial literacy to follow the budget agenda.
- *Supreme audit institutions*: audit government accounts to ensure that the government has implemented the budgets passed by the legislature.
- *Independent research institutes*: can play an important role by questioning whether parliaments have set the right priorities.

It is important to consider the capacity needs of non-environmental actors involved in the budget process or in developing fiscal policies. They need to understand the implications of their actions on the environment. For example, decisions made by the ministry of finance about a wide range of non-environmental taxes or subsidies may well encourage unsustainable use of natural resources. Similarly, environmental policies will have wider impacts on the economy, for example on employment. Environmental actors also need to understand the potential impact of efforts to increase environmental budgets or environmentally targeted taxes on the economy.

Capacity needs

The goal should be to focus resources for capacity development on the areas where they will have the greatest impact. Clearly, the right conditions in the enabling environment must be in place to ensure sufficient political commitment to the integration of environmental issues into the budget process. Only then is it possible to assess what specific capacities are needed at the organisational and individual level and what can be achieved given the

current capacity and technical/political priorities. This can range from the capacity of non-environment actors (*e.g.* the ministry of finance) to understand the importance of environmental issues, the capacity to formulate and justify environmental programmes to the capacity to execute environmental expenditure programmes effectively, the capacity to keep relevant sector actors accountable, and the capacity to co-ordinate providers of development support that finance environment-related activities.

Table 3.3 identifies the priorities for capacity development at the enabling environment, organisational and individual levels. It includes the capacity needs of environment ministries and ministries of finance. A key priority is to ensure that the environment agency has the capacity to present evidence on how the environment achieves specific development outcomes in a language that can be understood by budget officials. This involves strengthening capacities within both the environment agency and the ministry of finance, as well as among other participants involved in the budget process.

Table 3.3. **Capacity needs for greening national budgets**

Goal	Enabling environment level	Organisational level	Individual level
Relevant stakeholders understand the importance of environmental issues	Environment stakeholders have access to the institutional process for preparing the national budget	Incentives and institutional mechanisms for the ministry of finance to assess the financial and economic value of environmental policies and programmes are in place	Staff in ministry of finance have awareness of economic valuation of environmental policies and programmes
Formal involvement of environment agencies in the national budget process	Agreement by ministry of finance on the role of environment agency in budget process	Finance and environment officials have joint understanding of how environment stakeholders will participate in the budget process	Environment staff have good understanding of how budget process works and how they can engage effectively
Analysis of the environment and development links – making the economic case	The budget process involves allocation of financial resources between spending ministries consistent with the national plan and its identified priorities	Ministry of finance staff have incentives to include environmental priorities and measures from the national plan in the budget formulation	Environment staff have skills in environmental expenditure reviews, economic valuation, programme costing and making the case for environmental expenditure to budget officials
Formulation of budget level environmental management measures and environmental fiscal reform	The budget process formally includes specific environmental management measures, use of environmental fiscal instruments, and reform of subsidies	Environment agency has an opportunity to participate effectively in developing budget proposals. The ministry of finance adopts guidance to ensure environmental integration	Environment staff have the analytical and presentational skills to communicate the benefits of budgeted environmental measures, economic instruments and subsidy reform
Use of environment-development indicators and monitoring mechanisms	A well functioning national audit system promotes good management of expenditures in all government agencies	Environment and relevant sector agencies have management systems in place to disburse funds efficiently according to policy priorities	Staff in environment agencies have good project screening, management and monitoring/ evaluation skills

It is clear that one must consider what capacities are required to address both the process and the technical aspects of greening national budgets. Sometimes the national budget process is characterised as a purely mechanical process where technical inputs automatically contribute to the outcome of the budget process in terms of budget allocations or other changes in fiscal policy. In practice, however, the outcomes depend upon the skills of the various actors engaged in the process. Strengthening the environment agency's ability to engage in this process should help to secure improved outcomes. When identifying capacity needs it is also important to keep in mind that different capacities are needed at the various stages (formulation, approval, execution and oversight) of the national budget process.

Step 3. Shaping organisational incentives

When undertaking initiatives to enhance capacity for greening the national budget process, important questions to ask include:

- How can capacity development for greening the budget process be designed as a specific programme consisting of a range of different elements and prioritised activities tailored to the particular process, entry points, timescale and resources required?
- What opportunities exist for addressing organisational capacity needs that will enable the environment agency to have a meaningful role in the budget process?

It is important that the main actors understand the importance of cross-sector co-ordination, and are aware of how these linkages can be identified and improved. Enhanced environmental sustainability in one sector can have a positive impact on other sectors. Often however, these linkages (such as the impact of soil erosion on electricity generation and hydro storage reservoirs) are insufficiently reflected in budget allocations. For example, to help overcome poor accountability due to the fragmentation of the environment and natural resources sector (multiple agencies, spending patterns and funding streams), shared reporting methodologies can be developed. Finance ministry staff can be engaged as resource persons for capacity development efforts targeted at environment agency staff. They can help to foster collaboration among the policy and administrative communities that have been largely ignoring one another (Box 3.3).

Box 3.3. **Uganda: Better tools for greening the national budget process**

For several years, the Ugandan government has been developing its capacity to green national and local planning processes. Uganda's National Environment Management Authority has recently focused on improving its organisational and individual capacity to green the budget process in co-operation with the Ministry of Finance. To that end, it has prepared a users' manual: *Mainstreaming Environmental Issues into Budget Framework Papers*. This guidance follows the standard format of the budget framework papers that are used for submitting budget submissions. It is recognised that additional capacities are needed to target managers responsible for budget processes at national and local government levels. This includes ensuring that managers participate in the entire budgeting cycle. In moving forward, progress in four areas could prove critical: *i)* developing a common understanding among Ministry of Finance and environment and natural resource agencies on what "greening the budget" means, *ii)* developing simple tools and checklists to track progress, *iii)* developing lobbying tools and skills among key environment sector officials to link environmental priorities to political priorities, and *iv)* making use of the annual environment budget performance monitoring and expenditure review to identify areas of improvement.

Source: www.unpei.org.

Step 4. Knowledge and analytical tools

Good fiscal knowledge is essential for greening the budget process. This includes understanding the country's fiscal system (federal systems require a different approach than centralised systems), the decision points for the introduction and reform of taxes or allocation of expenditures, and the different demands on fiscal policy (such as achieving fiscal stability or helping to achieve food security). Such knowledge is particularly important in countries where tax collection and management are decentralised, and where the risk of corruption due to limited transparency is high.

Public environmental expenditure reviews (PEERs) are a useful process for assessing the adequacy and efficiency of environmental expenditures and pinpointing areas for improvement. Such reviews have also increased the dialogue on environmental budgets between ministries and generally raised awareness. PEERs generally address the following activities (Swanson and Lundethors, 2003):

- *Allocation of expenditures to environmental programmes*: cost of environmental policy priorities and comparison with the spending envelope made available; identification of the possible scope for increasing the spending envelope (due to an increase in internally generated resources, but without advocating earmarking); identification of possible policy inconsistencies in budget allocation by using international comparisons, analysing sub-national allocations, and examining trends over time.
- *Management of expenditures in environmental programmes*: rationale for programmes; integration of capital and recurrent expenditures; analysis of amount budgeted compared to amount spent; analysis of the effectiveness of environmental programmes; analysis of the efficiency and quality of environmental programmes (*e.g.* cost-effectiveness).

Essentially, PEERs offer a way of systematically assessing the equity, efficiency and effectiveness of public environmental spending. The data and insights they yield can be valuable for designing policy reforms and developing government budgets and investment projects. They examine whether government expenditures are effectively matched to environmental priorities and identify inconsistencies. If done well, PEERs frequently highlight the mismatch between (new) environmental policy and plans, and (historically) low levels of spending in those areas of government that are now linked to environmental priorities. In many cases, PEERs have helped to redistribute spending towards those institutions responsible for environmental priorities, towards long-term rather than short-term goals, and in some cases have helped to increase environmental budgets (Box 3.4).

Box 3.4. **Recommendations from the PEERs on greening budgets**

Madagascar: highlighted a financing gap for the protected area system and the fact that it was 50% dependent on development support. Furthermore, it showed that the protected area system could become a net source of government revenue through ecotourism fees.

Ukraine: recommended rationalising numerous separate environmental funds, thus reducing overall administrative costs.

Tanzania: demonstrated the value of environmental investment for livelihoods, and recommended increasing the environment authority's budget fivefold.

Colombia: compared current expenditures to the results of a stakeholder survey of upcoming priorities, thereby providing the justification for a major World Bank Sustainable Development Policy Loan.

Mozambique: demonstrated that environmental expenditures were only 0.9% of GDP and identified weak links between environmental policy and actual budgets, highlighting the lack of prioritisation in environmental policy.

Source: Markandya *et al.* (2006), "Geeting the Most for the Money – How Public Environmental Expenditure Reviews Can Help", *World Bank Environment Strategy Note*, No. 16, World Bank, Washington, DC.

In 2006, the OECD Council issued Recommendations on Good Practices for Public Environmental Expenditure Management, which included checklists to support environment agencies in complying with good practices for public environmental expenditure management. The recommendations advise OECD member countries to ensure that public environmental expenditure programmes are environmentally effective, economically efficient and managed in accordance with sound principles on public expenditure management. It further recommends that, in establishing and managing public environmental expenditure programmes, member countries should take the following steps:

- Define priority environmental objectives using evaluation methods such as risk assessment, cost benefit analysis, cost effectiveness analysis, and participatory political processes.
- Demonstrate that public expenditures are necessary to achieve these objectives.
- Define the sources of funds, the size of the budget, and the terms and conditions of the expenditure programme.
- Authorise the appropriate institutions to manage the expenditure programme.
- Continue, modify or terminate the expenditure programme in light of periodic reviews of the programme's performance to assess whether its objectives have been achieved and its continuation is necessary.

The Recommendations also include three checklists on the performance of public environmental expenditure in terms of *i)* environmental effectiveness, *ii)* sound budgetary practice, and *iii)* management efficiency. The checklists identify key principles and good practice. These are valuable tools that can be used by developing countries when greening their national budget process.

Step 5. Options for policy influence

Finance and line ministries often operate as rivals – finance ministries fight to lower and enforce spending ceilings and line ministries try to "build empires". This is less the case between finance and environment agencies, given the low burden of environment agencies' spending on the national budget. As long as the major revenue sources such as taxes on fossil fuels have remained under the control of the finance ministry, no major adversarial relationship has developed. This has resulted in an erosion of the environment agency's capacity to effectively participate in the budget formulation process.

The increasing importance of climate change financing has accentuated the need for greater collaboration between finance and environment ministries and agencies. With this increased interaction, existing capacity gaps have also become apparent – this applies to both finance and environment staff. Such gaps include the capacity to quantify financial needs required to address the impact of climate change (Box 3.5) and the capacity to channel these new sources of finance through existing public financial mechanisms. However, given the potential size of climate finance there is an incentive for all parties involved to enhance their capacity to effectively access and use them.

Box 3.5. **Costa Rica: Capacity development for financial analysis of climate investments**

UNDP has provided support to Costa Rica as part of a global programme on capacity development to address financial needs for climate change investments in key sectors. The programme aims to raise the awareness and technical skills needed by the government bodies involved – including finance and line ministries – to assess the investment needs for climate change adaptation in key sectors. The main focus has been on the water and biodiversity sectors. Specific capacity development activities include two inter-ministerial dialogues and a designated investment and financial flow workshop to identify adaptation priorities and actions and to develop costing methodologies for a better understanding of the specific financial requirements to carry out these activities. Lessons learned from the Costa Rica study are that *i)* measures must be carefully defined to be considered and included in a country's financial plan (they must include an accurate measure of costs and set priorities); *ii)* it is useful to distinguish investment costs from operation and maintenance costs (to adequately consider trade-offs between measures); and that *iii)* a cost assessment of various options is particularly challenging in sectors with greater uncertainty and less experience in public policy, such as biodiversity conservation.

Source: Adapted from *www.undpcc.org.*

The role of development support providers

In the new context of general budget support and heavy reliance on country systems, development support providers can focus on the following priorities when assisting developing countries in greening their national budget processes:

- *Agree on priorities and performance assessment.* Development support providers should agree with developing countries on how to integrate environmental issues into the budget process. They should be mindful of the traditional dependence of environment agencies in developing countries on off-budget support and ensure that these agencies are not marginalised in the shift to budget support. Development support providers should also help developing countries identify domestic and recurrent revenue sources that are aligned with the contribution of the environment to the economy.
- *Develop technical skills and sound environmental programmes.* Development support providers should focus technical assistance on the skills and tools needed by key actors in developing countries. For instance, skills for valuing the economic costs and benefits of environmental policies and preparing public environmental expenditure reviews for key economic sectors are crucial. Support can also be directed to the preparation of guidelines on how environmental programmes should be developed so that they align with the budgetary process and demonstrate their contribution to PRSPs.
- *Provide support through existing mechanisms.* Development support agencies should provide assistance through existing consultative mechanisms in developing countries rather than create parallel processes. While country experts should set the priorities, development support providers can play an active role by providing the resources needed. They can also help clarify the functions of the agencies involved in environmental management in order to reduce possible overlap of responsibilities.

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