

A Basic Primer for Costing Poverty Reduction Strategies



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Introduction

The implementation of poverty reduction strategies (PRSs) depends on the ability of governments to develop prioritized sector programs and interventions, funded by the national budget and implemented with the help of a functioning public financial management system. Successful implementation of PRSs therefore requires good linkages between policy, planning and budgeting processes.

Countries have attempted to strengthen the link between policy, planning and budgeting over a multi-year horizon with the help of medium-term expenditure frameworks (MTEFs). An MTEF requires a top-down resource envelope and a bottom-up estimation of the cost of policies, typically over a three year period. The annual budget process entails reconciling these costs with available resources. The exercise is then rolled over into the following year, adjusting for policy changes.

Costing is therefore a crucial part of the MTEF and an essential step in the operationalization of PRSs. By quantifying the human and financial resources required to meet specific development targets, it helps to link long-term development goals to realistic medium-term targets and enables the prioritization and sequencing of PRS objectives. It is also a vital step in the implementation of results-based public financial management systems.

This note describes the basic elements of costing PRS interventions, focusing on a simple, bottom-up approach. Intended as a knowledge sharing tool for public sector officials in central and line ministries, as well as development practitioners, it is divided into three main sections: first, it discusses the role of costing in promoting development effectiveness; second, it describes top-down and bottom-up approaches to costing, with a focus on the latter; finally, it suggests good practice ingredients for effective costing. The note summarizes a more detailed version of a “Basic Primer

on Costing PRS Interventions” that can be found at: <http://go.worldbank.org/BJTKSM63R0>.

Promoting Development Effectiveness

Costing exercises can reinforce the PRS processes, strengthen public financial management, and prompt policies to address absorptive capacity constraints.

Reinforcing PRS processes. Costing can help decision makers to make choices based on rational cost-benefit analysis. It can also provide transparent criteria for prioritization of PRS objectives. Prioritization is both a technical and political process, and while it would be unrealistic to suggest that costing leads to purely technical prioritization, it can highlight trade-offs between policy objectives and promote the sequencing of interventions. A number of examples of costing of sector strategies can be found at <http://go.worldbank.org/5R8AN4F6Z0> under *Costing in Education* and *Costing in Health*.

Strengthening public financial management. Country experience demonstrates that costing can enhance the efficiency and transparency of public financial management by providing sectoral staff with tools to negotiate budget increases and arming parliamentarians with criteria by which to assess budget allocations. For example, detailed costing of programs to reduce child and maternal mortality in Mauritania contributed to a significant increase in budgetary allocations to the health sector in recent years.

When integrated into the domestic budget, costed PRSs can form a basis for credible financing strategies. The difference between current and projected PRS costs and resources can be calculated so as to estimate a financing gap. In Sudan, the costing exercise paved the way for a financing strategy, finalized in the country’s Joint Assessment Mission. Financing strategies provide opportunities to review the efficiency of existing expenditures and domestic resource mobilization. In Sudan’s case, a thorough analysis of domestic resource

mobilization capacity took place before donors were approached for additional external financing.

Overcoming capacity constraints. Most costing exercises address two key questions regarding absorptive capacity, namely: are interventions realistic given current absorptive capacity; and are capacity-building initiatives required to alleviate constraints? In Tanzania, the costing of health interventions highlighted capacity constraints among administrative and skilled personnel and prompted the introduction of training programs and salary incentives.

Costing Methods

Approaches used to cost PRS targets will vary according to sector specifics, available data and the degree of sophistication of the analysis. Different methods can be complementary, since top-down econometric models usually provide estimates of total investment costs, which can be used as checks against bottom-up estimates. Bottom-up costing helps to translate PRS targets into a list of specific interventions necessary for their achievement. Two approaches will be described here: the Maquette for MDG Simulation (MAMS) model, and bottom-up costing, with a particular focus on the latter.¹

Top-down macro approaches often build on the Harrod-Domar model used for calculating the investments that will be needed in order to reach a target growth rate. One extension of this is MAMS, a dynamic Compatible General Equilibrium model that enables analysis of alternative development strategies in terms of their cost, macroeconomic implications, and the distribution of investment, while taking into account intersectoral linkages and absorptive capacity constraints.²

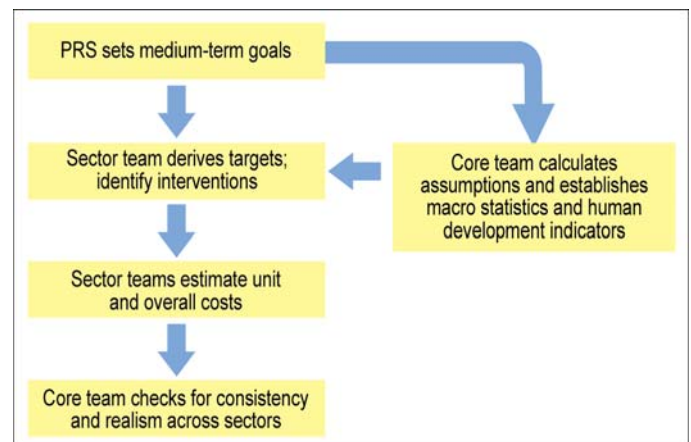
Cost estimates generated by MAMS, and the analysis of trade-offs between alternative uses of funds, can facilitate prioritization and sequencing of interventions. On the downside, MAMS models are highly data and capacity intensive. MAMS have been used in a number of countries in Africa and Latin America, mainly to develop scaling up scenarios for stronger growth and MDG achievement. In the case of Ghana, for example, MAMS estimates the additional resources needed for achieving primary school completion and access to safe

water and sanitation at \$350-400 million annually from 2007 to 2015; the full MDG scenario calls for \$750 million additional funds annually between 2007 and 2011, rising to \$1.7 billion annually between 2012 and 2015.

Bottom-up costing exercises have a number of benefits. First, simple approaches to bottom-up costing can be introduced early into the PRS process and support prioritization at the sector level. Second, basic bottom-up costing exercises will allow line ministries to gradually build up capacity and pass on the skills acquired by costing teams when there are turnovers in personnel. The models can be updated regularly to reflect changes in baselines, assumptions, or policy goals. Third, building up government capacity in this area can help to stimulate demand for more technically demanding costing processes, which may be required to ensure a precise assessment of synergies, trade-offs, and absorptive constraints.

Common steps for a bottom-up approach. A basic costing model is generally based on a few key elements (see Figure 1).

Figure 1: The Basic Elements of a Bottom-Up Approach to Costing



PRS sets medium-term goals. The PRS (or an equivalent national development strategy) is the starting point for the costing exercise, as it sets out overarching goals, from which teams will derive targets and interventions. It may also provide realistic forecasts of population and economic growth, among other statistics that are necessary for calculating baselines and assumptions.

Sector teams derive targets; identify interventions. From the PRS, sector teams, where they exist, derive medium-term and annual targets and identify the

¹ A more comprehensive presentation of costing methods is available at <http://go.worldbank.org/5R8AN4F6Z0> under *Websites with Excel-based Models Used for Costing Programs or Projects*.

² World Bank. 2007. p.49.

interventions which will be necessary to meet these targets. In the case of basic education, for instance, the target set by the PRS may be 90% completion of primary education by 2011. The sector team will identify annual target completion rates, and the interventions which are necessary to reach these targets – such as lowered pupil-to-teacher ratios, improved classroom facilities, and free school meals. Since limited capacity is often a major factor, sector teams will need to ensure that the planned interventions are in-line with human-resource and infrastructure constraints in their country.

Core team calculates assumptions and base-line statistics. It is useful to have a core team of budget and planning experts from a central ministries to ensure consistency in costing exercises across sectors. They will have established the baseline statistics (including macro and human development indicators) and assumptions regarding economic and population growth rates. Sector teams will use these baselines as starting points for targeted development goals, and ensure that objectives are feasible, given the assumptions.

Sector teams estimate unit costs. From the list of interventions, sector teams will calculate both capital and recurrent expenditures. Information on unit costs is often available in national planning documents and tenders, national expenditure reviews, consumer price data, and salary scales for the public and private sectors. But where local unit costs are not available, sector teams may have to use unit costs that have been collected for similar interventions (for example the cost of delivering immunizations can be used to estimate the cost of delivering medicines) or from the same intervention in a similar country.

While costs naturally differ from country to country, costing team may refer to rule of thumb norms that can be found in sources like the UN Millennium Project Handbook, and WHO publications for the health sector (UN Millennium Project, 2005; WHO, 2001).³ Sector teams may also do their own surveys to find out unit costs, for example by collecting private sector wage data and by surveying markets and auctions to establish prices. As noted below, marginal unit costs should be employed where possible, since they tend to be more accurate.

Core team checks for consistency across sectors. Responsibility for the final stages of the PRS costing

process falls once again to the core costing team. The team will ensure that there has not been double counting of any intervention. It will also identify potential synergies or complementarities between interventions. This is a complicated task which countries often handle through close inter-sectoral coordination, guided by the core team. In Tanzania, when costing the road sub-sector, stakeholders from all sectors were invited for a two-day consultative workshop to identify inter-sectoral linkages. In Rwanda, the core costing team facilitated mapping exercises to identify links between sectors.

The core team should also aim to ensure that, when combined, interventions across sectors are consistent with the country's overall infrastructure and human capacity constraints. For instance, they will ensure that sectors' combined use of civil servants matches public employment projections for the same period. Core and sector teams may need to engage in a consultative process, resulting in the scaling back of targets and/or interventions if they are deemed to be unfeasible, given overall capacity constraints.

Translate cost estimates into budget classification. Consistent cost estimates should be linked to the budget so as to feed into a country's resource allocation process. To do this, cost estimates should be classified according to the domestic budget classification system or a simplified version of the Government Finance Statistics (GFS) framework (IMF, 2001). GFS classifications present many expenditures according to their functional purposes, helping to link them to targets set out in the PRS. As noted above, once integrated into the budget, costs can provide a basis for a credible financing strategy.

Good Practice Elements

Based on country experience to date, some good practice elements are emerging for effective costing exercises as described below.

Keep it simple: Initial cost estimates should be bottom-up, based on simple and practical models and unit costs. More advanced models or top-down econometric models can be used to complement the simple models at a later stage.

Ensure strong engagement of core teams and line ministries: A number of countries have relied on a small core costing team to provide guidance and training and ensure consistency between sectors. For instance, in Rwanda, a permanent team of four costing experts

³ For example, the WHO estimates that \$30-40 per capita in public health spending are required annually to guarantee full coverage basic health care (WHO, 2001).

works full-time to assist and train sector representatives. The accurate costing of policies and programs takes time to evolve and requires a full information base. Country experience shows that successful costing exercises require appropriate incentives for line ministries to become and remain engaged in the process.

Establish consistent baseline statistics: So as not to complicate the process down the line, agreement on a consistent set of baseline statistics and assumptions must be reached early on.

Use clear estimations of costs and targets: Cost estimations should include both capital expenditures and expected recurrent costs for project upkeep. Costing exercises are only meaningful if development targets are SMART (Specific, Measurable, Achievable, Realistic, and Time-bound), with institutional accountability (which organization is responsible for reaching the target) clearly defined.

Differentiate between average and marginal costs: While average costs are usually easier to estimate, marginal costs (the cost of producing one more unit) are more accurate for the purpose of scaling up. The

costing exercise should always indicate whether average or marginal costs are being used, and employ the latter where possible. If marginal costs prove too difficult to establish, another alternative is to disaggregate populations (e.g. urban/rural or gender) so that the average costs will differ depending on which group is being targeted.

Take capacity into account: Consideration of absorptive constraints must determine the timing and pace of disbursements and guide the planning of capacity building programs.

Adapt the basics according to country context: While the steps in Figure 1 are common to most bottom-up costing exercises, there is a need for flexibility in the face of country, region, or sector-specific circumstances. Developing countries face various limitations in terms of missing data and overstretched analytical capacity. Far from being reasons to not initiate costing exercises, these limitations provide compelling motivations to ensure that any strategy is crafted to be in-line with local constraints, with the potential to scale up efforts as capacity grows.

Resources on Costing

For more information consult “A Basic Primer for Costing PRS Interventions” <http://go.worldbank.org/BJTKSM63R0> and the PRS costing webpage <http://go.worldbank.org/5R8AN4F6Z0>

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