**Montserrat Budget Aid Business Case**

**Summary Sheet**

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| **Title**: **Montserrat Budget Aid 2015/16** |
| **Project Purpose**: the project supports the provision of public services to meet the reasonable assistance needs of the population of Montserrat, including health, education and securing air and sea access. |
| **Programme Value**: £19.2 million |
| **Country/Region:** Montserrat: UK Overseas Territory. |
| **Project Code**: 204161 |
| **Start Date**: 1 April 2015. **End Date**: 31 March 2016 |
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**Intervention Summary**

**What support will the UK provide?**

1. The UK will provide a maximum of £19.2 million (EC$79.7 million at the current exchange rate) in budget aid to the Government of Montserrat (GoM) in 2015/16. This includes £1.0 million (EC$4.15 million) transferred over from the hospital project which has now ended.
2. Amounts ring-fenced within the 2015/16 budget include: EC$2.6 million for Short-Term Technical Cooperation; EC$6.1 million to subsidise air and sea access to the island; EC$2.5 million to finance the Contingency Fund; EC$1.8 million for the Small Capital Assets Fund, and the EC$4.15 million transferred from the the hospital project.

**What are the main programme activities?**

1. The budget aid programme for 2015/16 covers three specific funding areas. First, it funds the shortfall between GoM’s domestic revenue and the minimum spend GoM needs to maintain a range of reasonable public services. Second, it enables qualified regional or international staff to fill critical positions which cannot currently be filled locally. Third, it provides a subsidy to sea and air service providers to ensure that access needs are met. Support goes directly to the GoM who are responsible for implementation.

**Why is UK support required?**

1. The recurrent budget provides public services to meet the reasonable assistance needs of the population of Montserrat, including health, education, and air and sea access. Without UK support GoM faces a chronic budget deficit and would be unable to provide many essential services, leading to further emigration and undermining efforts to promote private sector development and broaden the tax base.

**What are the expected results?**

1. The planned outputs of the 2015/16 programme of budget support to Montserrat are:

* Reasonable assistance met through GoM’s delivery of key public services;
* Public sector capacity improved through the provision of technical assistance, including to strengthen GoM’s public financial management;
* Better access, which is a key component of economic development. Maintaining safe, reliable and regular sea and air access are also basic needs.

1. As has been the case in previous Montserrat budget aid settlements, this business case covers a one-year period, and logframe indicators focus on GoM performance to the end of March 2016[[1]](#footnote-2). GoM continues to use the Medium Term Expenditure Framework (MTEF) approach to planning and budgeting, although does not yet have sufficient technical capacity to fully operationalise the framework.
2. The Cabinet Secretariat is responsible for regular performance monitoring and reporting, enabling the Cabinet to fulfil its oversight responsibilities for the budget, public service capacity and delivery, and access to the island. Once approved, the budget is formalised through a Memorandum of Understanding. DFID will receive and review GoM budget progress reports prior to disbursement of budget aid tranches and plans to conduct a mid-year review (MYR) to further assess budget performance and related policy progress.
3. GoM has budgeted for greater spending in priority areas in 2015/16 partly through reprioritisation of existing resources and targeting higher tax revenue growth. The 2015/16 budget is based on, amongst other things: completion of a civil service organisational review; a more effective appraisal system; and stronger financial and procurement systems. The 2015/16 settlement includes higher funding in: maintenance of public assets; long-term technical assistance to support public financial management; child safeguarding and social welfare support; and training to upskill local Montserratians.

**How does the project fit with the country programme or department’s strategic objectives set out in the Operational Plan?**

1. Budget aid is a core part of delivering the Montserrat programme, as reflected in OTD’s strategic objectives and Operational Plan. As well as maintaining reasonable assistance needs, budget aid provides technical capacity support that also benefits delivery of the wider programme on Montserrat, and is a key component of GoM’s economic development strategy. The Operational Plan includes a number of specific targets on budget aid, including on health and education results and the overall share of DFID’s contribution to Montserrat’s budget

**What are the key risks to the success of the programme?**

1. The key risks are set out in detail in the Management Section, and will form part of the wider OTD risk register. These include: 1) weaker than expected standards of public financial management and procurement undermine value for money and/or resulting remedial measures slow project implementation; 2) lower revenue growth than assumed in the budget; and 3) planned improvements in technical capacity do not materialise due to higher emigration of skilled Montserratians and/or failure to attract international experts to Montserrat. The main external risks come from: a) natural disasters, principally hurricanes and volcanic ashing; b) higher imported inflation and/or weaker external demand, particularly in tourism slows economic activity; and c) large sterling depreciation relative to the EC$ reduces the resource available to GoM.

**Strategic Case**

**Overview**

1. The UK’s relationship with Overseas Territories is very different from that with independent developing countries. The International Development Act 2002 specifically exempts aid to the OTs from the poverty reduction criteria that apply to the rest of the DFID aid budget. With the exception of the EU (which provides around Euro 5 million per year) HMG is the only source of significant grant funding. As an aided Overseas Territory, GoM faces UKG restrictions on borrowing. The UK’s obligation to the OTs derives from the United Nations’ Charter: “to promote to the utmost, within the system of international peace and security established by the present Charter, the well-being of the inhabitants of these territories”.
2. The 2012 White Paper[[2]](#footnote-3) sets out a vision for Territories to be vibrant and flourishing, proudly retaining aspects of their British identity and generating wider opportunities for their people. The paper had three main strands: (1) to strengthen the engagement and interaction between the UK and the OTs; (2) to work with OTs to strengthen good governance arrangements, public financial management and economic planning; and (3) to improve the quality and range of support available.
3. The UK’s responsibilities to Montserrat, and to all the aided OTs, are

* To meet the reasonable assistance needs of OT citizens cost effectively;
* To accelerate aid-dependent OTs towards self-sufficiency(where possible);
* To manage the risk of contingent liability.

1. Volcanic eruptions and ashing since 1995 have resulted in major economic and social challenges as the capital was deserted and the southern half of the island has become uninhabitable. Agriculture and tourism, the main contributors to the economy before 1995, declined dramatically and are only now starting to recover. Between 1995 and 2011 the resident population on Montserrat declined from 12,000 to 4,922[[3]](#footnote-4) and 14% of the population is now 65 or over. This has led to a shrinking of private sector activity with around half of the labour force now working in the public sector. The island’s small population inflates the costs of providing a range of basic public services through diseconomies of scale.
2. To address this, the GoM seeks to grow the population back to pre-crisis levels and improve the demographic balance in favour of skilled, working age people. GoM aims for its Strategic Growth Plan (SGP) investments to drive a virtuous circle of social and economic development providing a catalyst for wider economic growth and increasing the domestic revenue base. New developments of this type will also draw more people to the island; tourists, seasonal inhabitants, and returning Montserratians. It should also provide a stronger incentive for young Montserratians to stay in the Territory.
3. Without external assistance, the GoM would not be able to afford the provision of basic services to meet the island’s reasonable needs. Due to the small population, there are technical capacity gaps in critical areas, which calls for recruitment of international professionals at the same time as up-skilling local Montserratians to fill such posts over time.

**Summary of Budget Aid Settlement**

1. DFID funding for the 2015/16 recurrent budget is up to the lower of £19.2 million and EC$79.7 million[[4]](#footnote-5). Of this, £1.0 million (EC$4.15 million) has been transferred into the recurrent budget following the closure of the Montserrat hospital project this month. The £1.0 million therefore represents a reallocation of existing OTD resource. 75% of this health sector funding is CDEL (Capital Departmental Expenditure Limit), principally for the purchase of equipment in Glendon hospital, and 25% is RDEL (Recurrent Departmental Expenditure Limit) for health service provision. Within the budget aid project, DFID will ring-fence the overall £1.0 million and also ring-fence the respective captial and recurrent components of it.
2. Excluding the transfer of OTD funds from the health project, DFID’s 2015/16 budget aid contribution is EC$75.5 million, which as a share of the budget is unchanged from 2014/15. This has been achieved through a combination of general public sector spending restraint, and higher tax revenue targets in 2015/16. Total domestic revenues (principally from tax) are assumed to grow by approximately 6% next year. The 2015/16 budget accommodates higher spending in the following priority areas:
3. A 10% increase in recurrent maintenance as part of ongoing DFID efforts to address inadequate GoM routine maintenance of public assets;
4. Long-Term Technical Capacity (LTTC) support to bring in international expertise has increased by 80%, to EC$0.9 million. This includes filling gaps in public financial management, audit, procurement and commercial development, economics and statistics, a chief magistrate and a senior crown counsel. These are urgently required to help better manage fiduciary and governance risks.
5. Funding for long-term skills development through the Annual Country Training Scheme has gone up by 14%.
6. The 2015/16 budget includes EC$0.4 million to finance new social welfare and protection measures, including foster care support and an “incentives to work” scheme. In addition, the budget sets aside EC$1.0 million of Contingency Funds to take forward any proposals arising from the Lucy Faithful Child Safeguarding Report produced last week. This is based on a preliminary estimate of *potential* costs of resulting GoM measures that could not be addressed through DFID’s existing ‘Safeguarding Children in the Overseas Territories’ programme.
7. The budget provides EC$0.3 million to implement non-discretionary changes in UKG passport regulations.
8. The overall settlement also accommodates higher general inflation in the Montserrat economy since the 2014/15 budget.
9. The settlement includes a number of ring-fenced elements set out in paragraph 47). These include the Access Subsidy (of EC$6.1m) and Short-Term Technical Cooperation (EC$2.6m) which reflect the core budget objectives of “maintaining safe, reliable and regular sea access” and “improving public sector capacity through provision of technical assistance”. In addition, there is a Small Capital Assets Fund (EC$1.8m) for the purchase of small capital items of a recurrent nature. This was ring-fenced in 2013/14 in response to a perceived failure by GoM to adequately provision to replace small captial assets as they came to the end of their useful life[[5]](#footnote-6). A ring-fenced Contingency Fund (of EC$2.5m) was also set up in 2013/14 following a series of in-year calls on additional DFID funds by GoM to meet unexpected, unbudgeted liabilities (such as from legal payouts). Use of the Contingency Fund is governed by a protocol which requires pre-approval by DFID, before draw-down takes place. The transfer of funds from the hospital project is also ring-fenced to ensure both their use for that purpose and that the funding split between RDEL and CDEL within this is clearly enforced.
10. As part of the Medium Term Expenditure (MTEF) framework, three-year forecasts of GoM revenues and expenditure have been produced. At present, however there are considerable uncertainties around the revenue and expenditure forecasts for 2016/17 and 2017/18, including from the outlook on investment, tourism and the future of the economic development agency (MDC). In addition, GoM currently lacks the technical capacity to fully operationalise the MTEF framework, and is in the process of recruiting a Chief Economist and Chief Statistican to support more robust budget forecasting and planning. As a result, this business case covers 2015/16 only. DFID plans to have further discussions with GoM on the potential to move to a three year DFID budget settlement once these constraints ease.

**Gender Equality**

1. Direct budget aid will enable GoM to fulfil its essential public administration function, providing access to public services to the benefit of all people, in line with its Strategic Development Plan.  There is a good level of gender equality in education results in Montserrat, with very high literacy and completion rates for both girls and boys. The Island does not share many of the problems of high maternal mortality rates found in the LDCs.  Sex disaggregated education outcomes are tracked through the budget aid log-frame, though generally, statistical and socio-economic data is poor, precluding a more in-depth gender analysis. The 2015/16 budget contribution includes a key Director of Statistics post which should facilitate a review of GoM’s statistical capacity, including of equality and diversity data.
2. Social welfare provision has been a priority policy area of the Premier of Montserrat since his election in September. GoM aims to improve policy and programming on child safeguarding, social welfare and domestic violence. A child safeguarding review for Monserrat has recently been completed, and lists a number of recommendations for improving service provision and protection for girls and boys.  Budget aid for 2015/16 will also support initial reforms of social welfare targeted towards the elderly and disabled which will likely benefit women more, due to their longer average life expectancy[[6]](#footnote-7). Montserrat is not yet a member of CEDAW, but has completed a compliance exercise and is working with the FCO on extension of CEDAW to the Island.

## Appraisal Case

**Overview**

1. Budget aid is designed to: meet reaonsable assistance needs through the delivery of public services; strengthen GoM technical capacity; and support access to the island. Supporting economic development and growing Montserrat’s tax revenues are key to delivering these objectives efficiently over time and to delivering wider OTD strategic objectives. There is close engagement with GoM throughout the financial year with a view to maximising GoM domestic revenues and delivering cost effective public services. This process includes a number of visits by OTD advisors, a mid-year budget policy review, a full budget mission and regular monitoring and discussion of progress against the agreed budget.
2. Four feasible options for delivering budget aid support have been considered. These assess both the mechanism for deliving the project (for example general budget support versus a “projectised” approach), and the size of DFID funds (for example option 4 considers the impacts of a lower DFID settlement).

**Appraisal options**

1. Do nothing – no recurrent budget support
2. Projectised approach: delivering aid through a series of projects
3. General budget aid to the GoM as set out in this business case
4. Lower settlement – providing general budget support to the GoM but of a lower amount

**Option 1: Do nothing**

1. DFID has funded more than half of GoM’s recurrent budget for a number of years. Removing this support would leave GoM with an unmanageable budget deficit and trigger a sharp fall in public expenditure. There are UKG restrictions on GoM borrowing and limited scope for GoM to drive very large increases in tax revenues (given the small private sector). Stopping recurrent budget support would likely lead to further emigration of Montserratians, in most cases to the UK, US and neighbouring islands. Those that remain would face major declines in the quality of public services including education and health. This option would not meet the reasonable assistance needs of the island.

**Option 2: Projectised approach**

1. In this option a series of individual projects are set up to deliver services, funded and managed by the UK. The main benefit of this approach is that it increases the scope for direct DFID control over specific areas of budget spending and delivery.
2. Such an approach would be a clear departure from the process adopted to date of working through GoM’s systems and would require a parallel system of planning, budgeting and service delivery. It would entail a significant reduction in the current level of devolution from HMG to GoM, and could also skew accountability away from domestic constituents and potentially damage DFID’s relationship with GoM.
3. This option would be significantly more expensive, particularly as DFID’s budget support covers the full range of public services in Montserrat. Delivering projects remotely in this way would increase transactions costs, including DFID staffing costs. There is a further risk that OTD is stretched too thinly by such an approach, less able to focus on the priority areas of the Montserrat recurrent budget and wider programme, and less able to perform appropriate due diligence and robust programme management. And it could also hinder the longer-term technical capacity development within Montserrat’s public sector.
4. Overall, these costs are judged to clearly outweigh benefits from securing more direct control over specific areas of the budget.

**Option 3: General budget aid support - as set out in this business case**

1. This option is a continuation of the existing arrangement set out in the business case whereby DFID provides aid through GoM’s consolidated fund which is then allocated through GoM’s planning, budgeting and disbursement processes. Budget aid payments are released by DFID once GoM has evidenced spending need and satisfied the conditions of the MoU budget agreement. This approach allows money to be ring-fenced for specific activities if required, and does not preclude the use of additional resources for targeted projects if deemed necessary.
2. Such an approach reduces transaction costs through local delivery and minimises duplication of planning and delivery systems. It strengthens GoM’s ownership, empowering GoM to improve its policies, budgets and service delivery systems and encourages longer-term technical capacity development and public accountability.
3. The main cost of this approach is the converse of Option 2 above, in that it reduces direct DFID control of specific spending and delivery in Montserrat (relative to option 2).

**Option 4: General budget aid support - but of a lower amount**

1. Under Option 4, DFID provides a lower settlement than that recommended in this Business Case. This has the (short-term) benefit to DFID of freeing up recurrent resources to be used for other projects.
2. As described earlier in this business case, the amount and composition of DFID’s contribution has been arrived at following close engagement with GoM over the course of the year including during the budget aid mission and subsequent discussions. The recommended 2015/16 budget is tight and substantially lower than the original draft budget presented by GoM. Significant cuts to this settlement could negatively impact on GoM’s ability to meet reasonable assistance needs. By way of example, reducing DFID’s overall contribution to the budget by between 5-10% could have the following impacts:

* A substantial cut to the access subsidy could result in a reduction in the frequency of the ferry service. The decision to move a 5-day service was based on a cost-benefit analsyis of growing tourism through a more frequent and reliable service which could be undermined by unplanned changes to the schedule.
* 2015/16 budget aid could no longer be sufficient to support the Internal Audit Unit, the Office of the Auditor General (External Audit) and the Head of Procurement. Support for recruitment of TA into these key posts is intended to ensure DFID money is well spent and fiduciary risks appropriately managed (as highlighted by DFID’s Internal Audit Department Report last year). Improving Montserrat’s governance is also an important part of achieving greater self sufficiency over time.
* There could be a reduction in TC funding which includes posts that are critical to delivering reasonable assistance needs (e.g. a Chief Medical Officer, and Child Safeguarding Specialist). Any cuts to the TC budget could have a large impact on core delivery of the budget aid programme.
* Reducing DFID support for the Annual Country Training Scheme could impair the ability of Montserrat to become more self sufficient over time and increase the medium-term cost of providing necessary technical expertise.
* Less budget aid may also lead to under-provisioning for regional commitments (e.g. to the Caribbean Development Bank, ECCB and University of West Indies) and/or legal liabilities, resulting in a build-up of arrears with associated interest payments. DFID has placed a strong emphasis in recent budget missions on Montserrat remaining current on its commitments.
* Cuts to the recurrent budget could push costs directly over to DFID’s capital budget, for example inadequate routine maintance could result in the inefficient degradation of capital assets, ultimately at a higher overall cost to DFID.

1. Any one of these options could impact one or more of OTD’s core budget objectives (for example meeting reasonable assistance needs), the medium-term cost of service provision, economic development, and standards of public financial management.
2. **Option 3, general budget aid support, as set out in the business case, is the best Value-for-Money option to deliver across budget aid and OTD’s strategic plan objectives.**

Quality of evidence

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| ***Option*** |  | ***Evidence rating*** |
| **1.** | **“Do nothing”** | Strong: through our close ongoing budget engagement OTD can assess the impact of completely withdrawing support. |
| **2.** | **“Projectised approach”** (meeting reasonable assistance needs through a series of individual projects) | Medium: OTD does not have experience of providing budget aid support in this way; but has experience from our *capital* projects. |
| **3.** | **“General budget aid support: of the amount set out in the BC”** | Strong: OTD has delivered similar budget aid programmes for a number of years. |
| **4.** | **“General budget aid support: of a lower amount”** | Strong: OTD has extensive experience of delivering budget aid programmes in this way, and of varying sectoral/budget line amounts. |

**Theory of change for preferred option**

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1. Whilst UK aid to Montserrat is non-discretionary under the provisions of the 2002 International Development Act, there are nevertheless a set of **key assumptions** and evidence underlying a theory of change for budget aid support. These underline the choice of Option 3 and may be summarised as follows:

* *DFID funding allows Montserrat to balance its recurrent budget, enabling GoM to maintain essential public services and access to the island (evidence: strong/medium).* Before and during the mission, the DFID budget aid team assesses a range of evidence provided by GoM including national and departmental accounts and estimates, MTEF strategies and planning documents, and information on budgetary and public service delivery processes. Following the recent PEFA evaluation (Public Expenditure and Financial Accountability) (December 2014) and FRA (Fiduciary Risk Assessment) (February 2015) DFID OTD is also working with the GoM on developing a PFM (Public Financial Management) Action Plan.
* *The development of a Medium-Term Expenditure Framework (MTEF) enables GoM to improve budget management overall (evidence: medium/low).*Specifically, it helps GoM to manage its total budget in line with best practice to maximise revenue and minimise expenditures, effectively allocating the budget in line with the GoM Sustainable Development Plan (SDP) to promote economic and social development. The DFID team and GoM review performance on expenditure and revenue raising mechanisms during the Budget Aid Mission, including how performance and planning links to service delivery outputs and outcomes. Whilst this business case only commits DFID to a one-year settlement, the MTEF process provides the framework for planning of budget allocation and service sector performance over a three year period.
* *Provision of technical co-operation (TC) enables improved financial management and delivery of services, and is intended to support local skills development and staff retention (evidence: medium).* In addition to TC in key service delivery areas (such as the Chief Medical Officer) the budget settlement includes support for a Chief Economist and Director of Statistics to improve the GoM’s macroeconomic and social analytical capacity. Once in place, these roles will improve financial and public service planning and delivery. A range of TC is being provided to support other public sector and economic development areas including providing long term capacity development and training of Montserratians through the ACTS programme. Evidence of impact will be provided through annual assessment of logframe indicators together with the SDP and MTEF key performance indicators.
* *DFID support helps to create an enabling environment for economic and social development on the island and this will reduce dependency on UKG (evidence: medium to low).*Montserrat’s economic progress depends on adequate access to island and an educated and healthy population. DFID’s support for health and education services and together with air and sea access help ensures the necessary conditions for economic progress are met. The recurrent budget supports public sector capacity and service delivery which, together with infrastructure projects in the Strategic Growth plan (restored fibreoptic cable connection, a new ferry and geothermal electricity), promote wider economic development.

Value for money

1. As set out Option 3 delivers the best Value for Money against our budget aid and wider OTD strategic priorities. Our approach to VfM is based on the **3Es:** **Economy, Efficiency and Effectiveness**. For example, to promote **economy** we will be tracking unit cost/prices as part of the logframe (including of essential drugs to treat diabetes, and the cost per child for primary and secondary school students). In addition, to increase local ownership and to incentivise efficient spending we have set logframe targets to increase GoM’s local revenue share as a proportion of Ministry of Health expenditure.
2. To ensure **efficiency** we will be tracking a range of output indicators such as the percentage of teachers with professional training and qualifications. We will also monitor primary and secondary school enrolment and completion rates as part of the logframe. To ensure **effectiveness** we will be tracking outcome indicators including the percentage of student age cohort gaining 5 CSECs (incl English and Maths) and the percentage of registered diabetics with blood glucose levels under control (measured by HbA1c <7.5). More broadly OTD seeks to ensure VfM by encouraging the GoM to allocate and spend resources efficiently through the budget and MTEF process and through Public Financial Mangement Reviews (e.g, the development of a PFM action plan, drawing on the recently completed PEFA and FRA).

Risks to VfM

1. There are clear risks to obtaining VfM for budget aid in Montserrat, in particular, the PEFA raised concerns regarding weak GoM internal controls, including internal audit and the lack of follow up on external audit findings. The FRA raised concerns regarding lack of oversight of statutory bodies, revenue forecasting and tax. OTD is working with the Ministry of Finance and Economic Planning and CARTAC to develop and implement a new PFM Action Plan that addresses these concerns. As noted above DFID budget aid also supports the Internal Audit Unit, the Office of the Auditor General (External Audit) and the Head of Procurement (through TC) to mitigiate these risks.

**Commercial Case**

**General**

1. The proposed mechanism is Budget Support Financial Aid to GoM. A Memorandum of Understanding between DFID and the GoM’s Ministry of Finance and Economic Management will be used for this intervention. The intervention is not expected to open up opportunities for further negotiation and cost savings.
2. DFID has a good understanding of GoM capability and capacity to deliver public services as budget aid has been provided in the way for many years, and there is close ongoing engagement with GoM on capacity building and public sector reform, including through a DFID Public Sector Reform project and direct TC support.

**Procurement**

1. The OTs are not bound by UK Government or European Union procurement directives although we fully expect OTs to follow best practice. Ordinarily, GoM has accountability for procurement of major goods, services and capital projects required for the island. However, a DFID audit on overall GoM procurement processes in 2014 recommended a number of actions to deal with concerns over the commercial practices in Montserrat. OTD, working with Procurement and Commercial Department (PCD) and the divisional Commercial Adviser, has put in place an Action Plan that provide assurance over procurement under Budget Aid:

(i) GoM has agreed to create a new line ministry post and to appoint an internationally recruited Head of Procurement (supported by TC support from DFID). This post will head up all commercial and  procurement processes in Montserrat[[7]](#footnote-8).

(ii) The DFID resident representative and/or Infrastructure Adviser on island will sit as observers of the Public Procurement Board;

(iii) DFID’s Commercial team undertakes a monthly quality assurance of GoM’s procurements; and

(iv) The ASCOT divisional commercial advisor for OTD has quality assured the revisions to GoM’s Procurement Standard Operating Procedures (SOPs) as revised by Crown Agents (funded through OTD TC in 2014). Training in the application of the Standard Operating Procedures (SOPs) for key GoM staff will be provided by the DFID commercial adviser in April 2015. GoM and arms-length bodies will be required to apply the agreed revised SOPs.

1. Specifically with regard to the £750,000 that can be used for purchasing health equipment, (75% of the £1.0 million brought over from the Health Project) there is already an established agreement and process for GoM to procure via the Crown Agents.
2. All assets procured using DFID funds will be owned by GoM. GoM will maintain an Assets Register and DFID will make regular spot checks on procurements during the course of the programme. The development and implementation of a preventive maintenance programme for buildings and equipment is an integral part of the project to ensure adequate care and optimal life span of fixed assets procured with project funds.

**Financial Case**

**Breakdown of budget aid components**

1. The total maximum DFID contribution to the 2015/16 Montserrat budget is £19.2 million (EC$79.7 million using an exchange rate of £1 = $EC.4.15). Ring-fenced components of the budget include:

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| **Access subsidy** | **Short-term Technical Cooperation** | **Contingency Fund** | **Small Capital Assets Fund** | **RDEL Transferred from hospital project (HHCIP)** | **CDEL**  **Transferred from the hospital project** |
| EC$6.1m | EC$2.6m | EC$2.5m | EC$1.8m | EC$1.0m | EC$3.1m |

**Financial Arragements and Process**

1. GoM (Ministry of Finance and Economic Management) is the only direct recipient of budget aid payments under the Memorandum of Understanding that sets out the conditions and process for delivering DFID budget support. Funds will be provided to GoM from DFID’s OTD programme for Montserrat for 2015/16 and will be made available to departments through GoM’s recurrent budget warrants to Accounting Officers.
2. There are no third party organisations that contribute support to the recurrent budget of GoM. The only other source of finance is from GoM’s own revenue streams.
3. There are no specific accounting considerations during the lifetime of this project with the exception that DFID and GoM funds are, in effect, pooled into the GoM recurrent budget/ This pooled funding mechanism means that forecasting, accounting or attribution of either DFID or GoM funds unique to the other’s funds is neither possible nor sensible. DFID does however ring-fence components of budget aid (for example access, STTC and the Contingency Fund) to ensure use of funds for the specified purpose.

**Assessment of Financial Risk and Fraud**

1. The PEFA report completed in December 2014 raised concerns regarding weak internal GoM controls, including internal audit and the lack of follow up on external audit findings. The subsequent Fiduciary Risk Assessment (FRA) of GoM’s financial systems raised concerns regarding lack of oversight of statutory bodies, procurement, revenue forecasting and tax. A number of measures are in train to address these issues:

* DFID is working with GoM’s Ministry of Finance and Economic Planning and with CARTAC to develop and implement a new PFM Action Plan that directly addresses the PEFA and FRA reports.
* Through TC, DFID budget aid supports the Internal Audit Unit, the Office of the Auditor General (External Audit) and the Head of Procurement.
* DFID is also working with the EU to help GoM access EDF funds that could potentially support key positions such as the Chief Economist or Director of Statistics – both vital to ensure financial integrity. This collaboration also reflects EDF conditions on macroeconomic stability and predictability of GoM budgets.
* The ongoing Public Sector Reform 2 programme will contribute to greater administrative efficiency within the public sector and support for a new PFM Action Plan. Notable achievements from the previous PFM Action Plan included: the establishment of the IAU (Internal Audit Unit) with a workplan; progress in the areas of budgeting with the implementation of the simple programme budget and linking the budget to the planning framework; line availability of budget reports; publication of contract awards; improved financial reports published within agreed timeframes, and; the introduction of a fiscal framework around the MTEF. The next PFM action plan will build on this progress and OTD will continue to monitor performance (alongside GoM) as part of implementing GoM’s PFM action plan and through formal Annual Statements of Progress against the FRA.

1. It is not possible to design budgetary aid to directly reduce fiduciary risk, and in particular the risk of leakage and fraud. Looking at the key areas of risk of leakage:

* Revenue collection: through fiscal pressure there is greater incentive to strengthen revenue operations (registration, assessment and collection) and these are already being pursued more vigorously in response to consecutive budget aid missions as well as the FRA recommendation;
* Procurement: A robust action plan to respond to the DFID’s Internal Audid Department Report has been put in place as set out in more detail in the Commercial case; and
* Oversight of statutory bodies: The new PFM action plan will include measures to ensure greater operational transparency e.g. to revise the Chart of Accounts to clearly show transfers to: a) individual statutory bodies; b) individual regional organisations; and c) individual NGOs, with inclusion of information in GoM budget estimates and in-year reporting, and budgets of all statutory bodies as memorandum items in budget documentation.

**Management Case**

**Governance and management arrangements**

1. GoM is fully accountable and responsible for the implementation of its strategic priorities and (through the Financial Secretary) for: the management of DFID’s financial contributions in support of this. Once the 2015/16 budget is approved, the GoM Cabinet (which includes the Premier and the Governor) lead on the legislative and implementation processes. The budget passes to the Legislative Assembly (which has elected representatives from the non-ruling party) and is then made public to citizens of Montserrat through a budget speech. This includes a forward look of planned activities and expenditure and a statement on how funds from the previous year were spent. To improve budget transparency GoM has committed to publishing greater budget information, and quarterly budget reports are published for the Legislative Assembly.
2. Montserrat’s Auditor General will produce an annual audit report covering GoM’s recurrent expenditures and revenues. After delays in recent years in producing audited accounts, GoM has improved performance and is now up to date against target. DFID will continue to monitor and support performance in this area.

**Donors**

1. DFID and the EU are the main donors supporting ongoing initiatives to improve the effectiveness Montserrat’s policy framework, budgeting and service delivery (with DFID providing approximately 90% of the total support provided). This support is designed to better align actual spend with the publicly declared policy priorities. EU support for Public Financial Management is formally linked to European Development Fund (EDF) funding. OTD is working more closely with the EU on the development of EDF 11 funding, including on the development of joint Key Peformance Indicators and on arrangements for DFID managing under a delegated agreement the TC components of EDF 11.

**Monitoring and evaluation of progress and results**

1. M&E activities will be guided by the OTD M&E framework put in place in February 2015. To monitor expenditure and delivery of budget aid, we focus on the aggregate budget and headline sectoral level budgets, interrogating Departmental strategies and spending plans. GoM is encouraged to improve both its national planning and budgeting systems together with sector policies and plans to improve operational efficiencies.
2. To monitor budget aid, the SRO, Deputy Programme Manager and other relevant advisers:
3. Review and discuss budget performance with GoM’s MOFEM on a monthly basis.

1. Review and discuss with GoM’s Human Resources Team on a monthly basis the TC components of the budget, including recruitment processes and support.
2. As part of the payment process for Budget Aid claims (which will be disbursed three times a year, most likely in May, August and November), OTD review and discuss with GoM each line of the draft claim, alongside key policy issues relating to the claim and overall budget performance[[8]](#footnote-9).
3. There will be full Budget Aid Mission by the OTD budget team, most likely in January 2016, which will further assess budget performance during 2015/16 as well as forming the basis of Ministerial advice by March 2016 on the 2016/17 budget settlement.
4. These measures will be supplemented by ongoing engagement between OTD advisors and programme staff and GoM.
5. OTD also monitors progress through the project logframe, which has been developed with GoM over the last two months. The new government is in the process of revising a number of policy objectives, which will also inform further development of logframe indicators. Within GoM, the Monitoring and Evaluation Officer has led on technical input to logframe indicators, which seek to reflect priority budget areas, such as public service delivery, access, technical capacity and overall budget management. At the outcome level we track indicators such as the “percentage of student age cohort gaining 5 CSECs (incl English and Maths).” At the output level we include measures of budget accuracy and performance based on the PEFA framework such as “aggregate expenditure out-turn compared to original approved budget.” A range of unit cost measures also inform performance against the logframe.
6. A Delivery Plan has been produced alongside development of the Business Case. lf the project suffered severe failure, DFID would introduce alternative measures for meeting the reasonable assistance needs of Montserratians. The Delivery Plan, Risk Register and Logframe will be updated as necessary throughout the year. An evaluation is not planned for this project.

**Ability to Deliver**

1. DFID has a good knowledge of GoM capability and capacity to deliver public services. There is close ongoing engagement with GoM on capacity building and public sector reform. As set out below, the core Monserrat Budget Aid team consists of OTD’s Senior Economist who is the SRO, a Deputy Programme Manager, the DFID Representative on Montserrat, as well a number of advisory inputs (Economics, Governance, Social Development and Health). The main points of contact within GoM for Budget Aid is the Ministry of Finance & Economic Management (MOFEM) via its Budget Director and the Financial Secretary.

**Expected Roles and Responsibilites**

|  |  |
| --- | --- |
| **Role** | **Responsibility** |
| **DFID** | |
| Senior Responsible Officer | Overseeing the overall design and implementation of the project. |
| Deputy Programme Manager | Lead on programme management compliance for the design and implementation of budget aid. |
| Economist/s | Lead on forecasting, monitoring and overall macroeconomic policy advice relating to budget design and performance. |
| DFID Representative on island | Lead on access subsidy budget line. |
| DFID Representative on island, alongside the Head of Procurement once this appointment is made[[9]](#footnote-10) | Lead on procurement under the budget aid project. In particular the DFID Representative on island shares (with the Montserrat OTD Infrastructure Advisor) an observer seat at the GOM Public Procurement Board. |
| Governance Adviser | Lead on Technical Cooperation budget line and general public financial management and public sector reform. |
| Senior Social Develoment Advisor | Lead on social development components of the budget, including DFID’s support to child safeguarding. |
| Health Adviser | Leads on health services components of the budget. |
| **Government of Montserrat** | |
| MOFEM Financial Secretary | Oversees the overall implementation of the project. |
| MOFEM Budget Director | Leads on the provision of supporting budget analysis and financial reporting. |
| Chief of Human Resources Office | Leads on the provision of Technical Cooperation recruitment and advice. |
| Director of Policy and Planning, and the Monitoring and Evaluation Officer | Leads on monitoring and evaluation, including logframe indicators. |
| Auditor General | Produces an annual audit report covering GoM’s recurrent expenditures and revenues. |

**Beneficiary engagement**

1. There will be two main vehicles for beneficiary engagement on the budget aid project:
2. Principally through GoM’s normal democratic process, including as outlined earlier the consultative and legislative process of approving a budget and reporting progress against it;
3. During the Budget Aid Mission, DFID will engage directly with community based organisations on a range of budget policy and performance issues with a view to better understanding wider beneficiary views on the project.

**Risks, tolerances and approaches to escalate problems**

1. This project will be guided by the OTD risk strategy and framework put in place in February 2015 to systematise OTD’s risk management procedures. A full risk register for *Montserrat as a whole* willbe finalised in the first quarter of 2015/16. Key budget-aid specific risks are outlined below, and OTD will regularly monitor risk and engage closely with GoM on additional mitigation required should risks escalate or new issues arise.

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| **Risk** | **Category** | **Impact** | **Probability** | **Tolerance/Mitigating** |
| Natural disaster, particularly **hurricanes** and/or increasing **volcanic activity** leading to increased costs for response, recovery and re-building. | External | High  Impact (impact delivery and need for public services, and damages economic growth, and private sector confidence). | Medium (in terms of volcanic activity this rating relates to serious volcanic ashing rather than an eruption of the scale in 1995). | Montserrat benefits from regional Disaster Risk Reduction programmes which include early warning and disaster risk management. Monitoring by the MVO will continue where there is proactive management of hazard levels and access restrictions. Disaster response plans will be kept up to date and fully operational. New development and design should take into account hurricane risk and be located on the relatively safer northern half of the island. |
| Falls in the £ against EC$ means value of UK budget support in local currency falls below amount in estimates. | External | Medium | Medium | There is no currency hedging in place and DFID has no separate contingency amount set aside to increase the £ value of the 2015/16 Montserrat budget. GoM and OTD will therefore closely monitor the exchange rate and discuss throughout the year where additional savings within the agreed settlement could be made in the event of a significant fall in the £ against EC$. |
| Regional financial instability impacts Montserrat’s banking sector and wider economy. | External | Low to medium (the banking sector has much smaller international exposures than many other banks in the region) | Medium | As part of the Budget Aid Process, DFID reviews the performance and policy of the key financial institutions (including remaining liabilities following the wind-down of the Government Savings Bank).  The Governor has principal responsibility for financial services.  The Governor and Financial Services Commissioner monitor risks and report to Cabinet, and escalate to DFID any risks to the budget. |
| Higher inflation negatively impacts consumer and GoM finances. | External | Low to Medium | Low to Medium | GoM pursuing Social Welfare reform to improve targeting of support and ensuring reasonable needs are met.  Also, diversify Montserrat's energy production by getting renewable energy sources on line as soon as possible. |
| GoM fails to implement public financial management reforms required to address substantial fiduciary risk (e.g. as identified in PEFA and FRA reports). | Fiduciary | High | Medium | As set out in detail earlier in the Business Case, planned actions include implementation of a new PFM Action Plan as a co-ordinated GoM/donor response to risks identified in PEFA/FRA.  Further DFID assistance to strengthen GoM MoF and particularly the Treasury through advancing the public service reform programme and other technical assistance programmes. |
| Tax revenue growth is lower than expected due to lower than expected economic growth and/or weaker reform and implementation of tax policy. | External and governance | Medium | Low to Medium | OTD monitors tax performance as a core part of the budget aid process.  GoM has better expert technical leadership in place at MCRS. |
| Human resource capacity cannot be improved sufficiently to support planned public service delivery - compromising the quality and impact of services and overall value for money. | Operational | Medium to High | Medium | As set out in more detail earlier in the Business Case, DFID is providing finance via budget aid to allow GoM to source experts for critical areas, as well as wider recruitment support to GoM’s Human Resource Department.  Additional technical assistance support via Public Sector Reform programme and Short Term TC. |
| Risk that OTD is compelled to continue active management of procurement services and the GoM’s mechanisms do not improve sufficiently. | Operational | Medium | Medium | As set out more detail earlier in the Business Case, there is a Commercial Plan in place including:  i.Appointment of an internationally recruited Director of Procurement to head the Procurement Unit;  ii.The DFID representative on island will sit on the Public Procurement Board and  iii.DFID’s Commercial Team will have fortnightly Commercial Meetings with OTD and GoM to monitor progress against various actions of the plan. |
| Change in GoM policy commitment to key assumptions underpinning delivery and risk management of budget aid programme. | Delivery | Medium to High | Low to Medium | GoM has shown willingness to strengthen governance (PFM, procurement, project management, child safeguarding). Alongside the changes, GoM is seeking an increase in HMG/DFID investments. DFID will continue to promote and work alongside GoM in these key areas: through the Budget Aid project and wider programme engagement. |

**Other information to consider**

1. This project will not be delivered under a Partnership arrangement. There are however ongoing discussions across HMG and with GoM to agree a ‘New Deal’ for the wider governance and management of UK support for Montserrat. Linked to this, DFID is working with GoM to agree a strategic package of investments to stimulate the economy, including the following Strategic Growth Plan projects: (i) the introduction of a new ferry; (ii) a new fibre-optic cable connection and (iii) the development of geothermal energy. This is being complemented by a series of GoM public sector reform measures targeting investment and growth. Together these measures are consistent with the shared DFID and GoM objective of delivering a greater degree of self sufficiency for Montserrat over time.

1. For some of the indicators, there are agreed GoM targets for 2016/17 and 2017/18 which have been included in the Logframe. [↑](#footnote-ref-2)
2. FCO, 2012.The Overseas Territories: Security, Success and Sustainability. [↑](#footnote-ref-3)
3. Montserrat Census 2011 [↑](#footnote-ref-4)
4. An exchange rate of £1 = EC$4.15 has been used throughout [↑](#footnote-ref-5)
5. In this way, it ensures a minimum level of spend on replacing small capital assets. [↑](#footnote-ref-6)
6. Future reforms will be targeted on poor households with children which will benefit both sexes equally, though there are slightly more male headed households with children than female households (around 60:40 respectively).    [↑](#footnote-ref-7)
7. In the medium to long-term it is expected that this role will transfer to a suitably qualified and experienced local person, but we expect that this will be outside the period of this business case. [↑](#footnote-ref-8)
8. As an example, any payment of airline subsidies will be conditional on GoM demonstrating due diligence in terms of policy development. [↑](#footnote-ref-9)
9. Also, ASCOT’s regional commercial advisor leads on the Montserrat Procurement Action Plan and, as part of this, is responsible for spot checks in procurements under EC$100,000. [↑](#footnote-ref-10)