Item 13 of the provisional agenda

PRELIMINARY PROPOSALS BY THE DIRECTOR-GENERAL ON THE PREPARATION OF THE BUDGET FOR THE BIENNIUM (38 C/5)

SUMMARY

The document presents the preliminary proposal by the Director-General for the preparation of the budget for the biennium 2016-2017 (38 C/5) and the determination of the budget envelope. One scenario would be to determine the budget envelope under conditions of zero-nominal growth (ZNG). A second scenario would be a zero-growth (ZRG) budget which would maintain the same purchasing power as that for the biennium 2014-2015 (37 C/5 Approved), which itself had been built on zero nominal growth budget. A third scenario would be to consider an envelope pegged in between ZNG and ZRG (ZNG+). For the purpose of assessing these three scenarios, the document presents a preliminary and theoretical estimate of the budgetary requirements, taking into account increases arising from statutory and inflationary factors and technical adjustments. The document indicates also the implications of the future budget envelope for the Implementation Plan, adopted for the 37 C/5 if the situation with the withholding of Member State contributions should continue.

The document further presents, in accordance with 192 EX/Decision 5 Part III.C, the measures which are envisaged for the preparation of the Draft 38 C/5 document in terms of results-based budgeting (RBB). Reference is also made to the situation with regard to the constant euro/dollar operational exchange rate for the 38 C/5.

Action expected of the Executive Board: decision in paragraph 32.
I. INTRODUCTION

1. When the General Conference first decided in 2011 to adopt a four-year C/5 programme of work for the Organization, it also decided that the future budgets of the Organization would not be quadrennial but that they would remain biennial, and that they would be subject to a decision by the mid-term General Conference – the first time in 2015. Many reasons led to this decision. A large number of Member States felt that adopting a four-year budget would have raised considerable and sometimes insuperable technical and fiscal difficulties at the national level. Many also felt that a budget cycle of two years might allow the General Conference to better adjust the original budget to evolving circumstances, as the General Conference also retained the power to amend as necessary the original programme.

2. The exact parameters of this mid-point budget discussion were not extensively discussed, although it was felt by many Member States that the original budget choices may not necessarily be relevant for the second biennium. The progress achieved or the evolution of the external environment could render necessary an increase or a decrease of the original budget envelopes, as well as a possible adjustment of the performance indicators and benchmarks, if not of the expected results of the programme.

3. In light of this background, it was felt that the current preliminary proposals, while remaining faithful to the programme adopted by the 37th session of the General Conference, should not limit themselves to the technical exercise of budget adjustment based solely on a detailed recosting, but that it should also provide indications and guidance concerning the desirability and possible consequences of different budget choices, outlining both the relative advantages and the likely risks of such choices.

4. In this spirit, three major considerations have been foremost on the Director-General’s mind in preparing the present document:

   (a) The first is to enable UNESCO to face an extremely challenging budget situation, following on three years of a sharply reduced budget, as well as over a decade of nearly continuous Zero Nominal Growth.

   (b) The second is the need to ensure that UNESCO continues to deliver on its programme and is ready to deliver on the ambitious post-2015 agenda across its fields of competence.

   (c) The third is to pursue the reform process of the Organization, and to continue focusing on programmes.

5. Three possible budget levels will be discussed and weighed against the above imperatives:

   (a) Zero-nominal growth (ZNG):

   (b) Zero-real growth (ZRG):

   (c) Zero-nominal growth + (ZNG +).

6. At the time when the Executive Board examined the Director-General’s preliminary proposals concerning the Draft 37 C/5 (2014-2015), particularly on the technical estimates of the Zero Real Growth (ZRG) requirements and on the proposals for changing some of the practices in an effort to move towards a results-based budgeting (RBB) approach (190 EX/19 Part II), the Executive Board took the following decision (190 EX/Decision 19 Part II):

   "The Executive Board,

   …….."
4. Approves the following changes and improvements to the budgeting techniques and processes that are needed in order to apply results-based budgeting, inter alia:

(a) elimination of the presentation of zero real growth (ZRG) estimates based on inflation and statutory increase analyses in future preliminary proposal documents.

7. This decision was based on the understanding that focus should be placed on the results to be achieved instead of on the inputs to be used, and thus that there should be a move away from an inflation-based approach to a results-based approach in determining the future budget.

8. Nevertheless the Director-General is fully cognisant of the Member States’ concern about the exceptional and severe financial constraints that are affecting the Organization since 2011. Therefore, notwithstanding 190 EX/Decision 19 Part II, the Director-General is presenting in this document a theoretical estimate of inflation and statutory requirements, from which arise three scenarios: zero-nominal growth (ZNG), zero-real growth (ZRG) and a scenario in-between ZNG and ZRG. A preliminary estimate of the Zero Real Growth (ZRG) requirement allows Member States to assess the overall budgetary impact (i.e., loss of purchasing power in theoretical terms) in the event that the same budget ceiling of $653 million as well as the ceiling of the Implementation Plan of $507 million were to be maintained also for the next biennium.

II. ESTIMATE OF INFLATION AND STATUTORY REQUIREMENTS FOR THE DRAFT 38 C/5 (2016-2017)

9. The Zero Real Growth (ZRG) requirements, i.e., the total of inflation and statutory increases occurring from one biennium to the next, are calculated in two stages: first by re-evaluating the budget base (Parts I-IV) of the current biennium to the price level of the beginning of the next biennium (recosting), and then by adding the Anticipated Costs Increases that would be incurred during the next biennium (Part V). Details of the methods used to determine the total requirements for the 38 C/5 are outlined below. Further, the ZRG requirement is presented not only for the 37 C/5 Approved budget of $653 million but also for the $507 million Implementation Plan.

Calculation of the Budget Base (Parts I-IV) – Recosting

10. The budget base (which excludes Part V, the Anticipated Cost Increases) for any particular biennium is the estimated costs based on the price level as at the beginning of that biennium. Therefore, the budget base Parts I-IV of the 37 C/5 Approved (2014-2015) was based on the salary and price level as at 1 January 2014. To estimate the ZRG level for the following biennium, the budget base of the 37 C/5 Approved needs to be recalculated to reflect the price level foreseen at the beginning of the next biennium (1 January 2016). This exercise of re-evaluating the budget base of the current biennium to take into account all statutory, inflationary and other cost increases that would occur in the present 2014-2015 biennium is referred to as recosting.

11. The recosting estimates are calculated for each item-of-expenditure and are based on an in-depth analysis of the increases in staff costs and in goods and services that have already occurred, and also based on the most precise information available concerning the evolution of salary and inflation indices for the remaining period of the current biennium. This recosting is done on the basis of the same programme and staff/organizational structure, as the purpose is to estimate the theoretical additional costs that the Organization would need in order to maintain the same purchasing power, i.e., on the assumption that the Organization undertakes the same programmes with the same staff structure. This, of course, does not mean that the actual future 38 C/5 budget contents shall have the same programme and staff structure.

12. In addition to the estimates of statutory and inflationary requirements, there are other elements in the approved budget which give rise to cost variances that are beyond the
Organization’s control. For such elements, the Secretariat analyses invoices received, expenditure trends and other concrete factors to determine the additional requirements. These items are presented as “technical adjustments”, which is consistent with the approach used in preparing the 37 C/5 Approved Budget.

13. Based on the above methods, the total ZRG requirements for the 38 C/5 budget base (staff, operational costs and technical adjustments combined) related to an approved full budget of $653 million are estimated at $24.9 million. For the Implementation Plan of $507 million, the total additional ZRG requirements are estimated at $20.7 million.

**Estimate of the Anticipated Cost Increases (Part V)**

14. As mentioned earlier, the recosted Budget Base (Parts I-IV) is calculated using the forecasted price level as at the beginning of January 2016. Anticipated cost increases expected to occur during 2016-2017 are not included in the budget base, but are pooled separately under Part V of the budget, for which the use of funds is subject to the prior approval by the Executive Board. In theoretical terms, the total Part V requirement is estimated at $16.9 million with regard to the future ZRG budget based on the Approved Budget of $653 million. For the Implementation Plan, the future Part V requirement is estimated at $13.7 million.

**Estimate of the total ZRG requirement**

15. Therefore, with regard to the Approved $653 million scenario, the total ZRG budget estimate for 2016-2017 (38 C/5) would amount to $681.8 million. With regard to the $507 million Implementation Plan, the total ZRG level would amount to $534.0 million.

16. It may be also important to take into consideration the actual status of the Organization’s current work plan level, whereby the total requirements for the biennium amount to $522.0 million despite the intense ongoing efforts to adapt to the $507 million Implementation Plan. Although the efforts for cost reduction will be continued throughout the remainder of the current biennium 2014-2015 for indicative purposes the ZRG level for the Implementation Plan based on the current actual work plan status is estimated at $549.8 million.

17. All these figures are summarized in the following table:

<table>
<thead>
<tr>
<th></th>
<th>Based on Approved $653M</th>
<th>Based on Expenditure Plan $507M</th>
<th>Based on actual work plan level $520M</th>
</tr>
</thead>
<tbody>
<tr>
<td>37 C/5 Approved Budget (Parts I-IV)</td>
<td>653.0</td>
<td>507.0</td>
<td>522.0</td>
</tr>
<tr>
<td>Less Part V</td>
<td>(13.0)</td>
<td>(7.5)</td>
<td>(7.5)</td>
</tr>
<tr>
<td><strong>37 C/5 Approved Budget (Parts I-IV)</strong></td>
<td>640.0</td>
<td>499.5</td>
<td>514.5</td>
</tr>
<tr>
<td>Recosting of the Budget Base (Parts I-IV)</td>
<td>24.9</td>
<td>20.7</td>
<td>21.1</td>
</tr>
<tr>
<td><strong>Total Budget Base for 38 C/5 (Parts I-IV)</strong></td>
<td><strong>664.9</strong></td>
<td><strong>520.2</strong></td>
<td><strong>535.6</strong></td>
</tr>
<tr>
<td>plus Anticipated Cost Increases (Part V)</td>
<td>16.9</td>
<td>13.7</td>
<td>14.2</td>
</tr>
<tr>
<td><strong>ZRG Budget Estimate for the 38 C/5</strong> (Parts I–V)</td>
<td><strong>681.8</strong></td>
<td><strong>534.0</strong></td>
<td><strong>549.8</strong></td>
</tr>
<tr>
<td><strong>Total ZRG requirement</strong></td>
<td>28.8</td>
<td>27.0</td>
<td>27.8</td>
</tr>
</tbody>
</table>
18. It should be noted that the ZRG requirements for the draft 38 C/5 turn out to be significantly lower than the ZRG requirement for the last biennium (estimated at $55.8 million). This is mainly due to lower statutory staff cost increases expected to occur in the current biennium than in the previous biennium 2012-2013. This is particularly due to the post adjustment for Paris and the base salary for the General Service category.


19. Throughout the past biennia UNESCO has been going through intensive austerity measures in order to manage under conditions of a Zero Nominal Growth (ZNG) budget, aggravated during the last and current biennia wherein the actually available funds had been drastically reduced due to the withholding of a significant contribution since 2011. This has resulted in a drastic reduction in cost for non-programme area and the restructuring of the entire Organization just completed. The now prevailing structure allows to implement the reduced activity level by Programme Sectors – as prioritized by Member States – and to provide the minimum administrative support to the programmes.

20. As mentioned earlier, the Director-General is examining three scenarios for the budget ceiling for the 38 C/5: zero-nominal growth (ZNG), zero-real growth (ZRG) and a scenario in-between ZNG and ZRG.

(a) **ZNG**: If it would be the decision of Member States to continue applying the ZNG scenario for the preparation of the 38 C/5 (2016-2017), i.e., $653 million for the approved budget and $507 million for the “Implementation Plan” (in case the withholding of contributions continues), the impact would be very severe. As shown above, the estimate of costs that would need to be absorbed under such a scenario would be $28.8 million with regard to a $653 million budget, and – even more detrimental – $27.8 million for the $507 million Implementation Plan. Considering that the present work-plan level of $522 million exceeds the level of the Implementation Plan by some $15 million, the total amount to be absorbed for the delivery of the same programme as at present would be in the order of $43 million. This would be nothing short of emaciating the capacities of the Organization, while bearing in mind that already in 2006 a ZNG approach had been labelled to produce a “bare bones” budget by the then Director-General. $12-14 million of the ZRG requirements would be for statutory increases under the staff costs. Under a ZNG scenario, these staff cost increases would need to be absorbed within the staff costs if the operational budget were to be maintained at least at the same – low – level as in the current biennium. Such an absorption would effectively translate into a no-recruitment policy for the future and the need for the abolition of existing posts. A detailed examination of all cost elements, a review of the organizational structure and of working methods would be required in order to find possibilities for the absorption of any significant amount. As the Organization has just undergone a major restructuring, the Director-General believes that further drastic reductions in staff and consequently in the structure of the Organization are neither recommendable nor feasible. This will then require that Member States conduct a further programme prioritization exercise, which will also lead to the termination or abolition of certain programmes.

(b) **ZNG+**: a possible scenario might be to agree on an intermediate target, which would help fill in part the gap between ZNG and ZRG. It is recalled that this gap is in the order of $27-29 million. However, it is also recalled that: (a) $12-14 million of the ZRG requirement is dedicated to staff costs – and hence, any cut below that level would directly affect the level of staffing for the programmes and programme support, and would therefore require an explicit decision from Member States concerning the programme areas to be discontinued in the next biennium or given a low priority, also translating into effective staff reduction; (b) the current work plan deficit of
UNESCO stands at around $13 million, which means that any cut below that level effectively means that programme cuts will need to be made below today’s level of implementation.

(c) **ZRG**: the proposal to maintain the UNESCO budget at its current level adjusted for inflation and statutory increases would allow the Organization to maintain its staff base and to maintain the present level of operational activities.

21. On the assumption that absorption of the entirety of the ZRG requirement is impossible, the Director-General considers at this stage that it would be most appropriate to prepare the Draft 38 C/5 based on a budget ceiling which is in between the ZNG and ZRG levels (ZNG+).

**IV. IMPROVEMENTS IN RESULTS-BASED BUDGETING (RBB) FOR THE PREPARATION OF THE DRAFT 38 C/5 DOCUMENT**

22. As outlined previously in documents 191 EX/5 Add. and 192 EX/5 Part III.C, the introduction of a full RBB process involves the entire programme management cycle, including programme planning, budgeting, implementation, monitoring, reporting and evaluation, and thus the global calendar for a successful placement of RBB extends over several years. However, the preparation of the Draft 38 C/5 (2016-2017) is considered to be one of the key phases where a significant improvement can be introduced.

23. As the programme cycle is now quadrennial, the C/5 expected results in principle have been defined for the entire quadrennial cycle. Although a better mechanism for determining and formulating the expected results themselves may be required for a successful RBB, the programmatic objectives of the 38 C/5 would be more-or-less in line with 37 C/5 expected results. Nevertheless, some adjustments may need to be made in light of progress made during the current biennium. On the other hand, in terms of budget preparation, the Draft 38 C/5 is an opportunity for introducing a fundamental change in the Organization’s working method and process towards RBB.

24. In the past, the contents of the Draft C/5 regular budget documents have been constructed primarily through an exercise of breaking down the budget ceiling determined or recommended by the Executive Board. Budget envelopes were established by the Director-General for each programme sector and central service. The sectors/bureaux then examined how each of these envelopes could be best distributed among programme areas and geographical regions in order to achieve the expected results. Although this was undertaken with a great deal of planning and care, this approach had two major shortcomings in terms of RBB. Firstly, the approach of distributing budget envelopes led to a situation where a number of activities were not allocated sufficient funds to achieve expected results. Secondly, the examination of staff costs was rather detached from the examination of the programmes’ need for human resources. Although for the 37 C/5 the sectors were required to identify how their staff structure and staff costs would contribute to each expected result, the method of linking the staff resources and programme implementation need to be improved.

25. In this regard, the Secretariat aims at improving the working method for the preparation of the Draft 38 C/5. It is intended that the overall process be switched into a more bottom-up approach, with a budgeting process based on proper initial costing of each activity required to achieve the expected results. As envisaged in the overall RBB project plan, the Draft 38 C/5 budget structure shall be built based on advanced preliminary work plan proposals (or a review of current four-year work plans which already cover the 38 C/5 period too) to be elaborated by programme specialists at Headquarters and in the field. It is also important to ensure that each work plan be accompanied already at this stage with proper cost estimates, including for staff resources. Once preliminary work plans are prepared with cost estimates, the programme specialists, divisional directors, executive officers, heads/directors of field offices and ADGs/bureau
directors and other senior managers will be required to review the proposals with a view to streamlining or rationalizing them from a strategic perspective. The prioritization of work plans would be of particular importance because it would enable Programme Sectors to have a clearer idea which work plan could be realistically financed from the regular budget.

26. In order to support this new working method, an IT tool will be needed in order to assist the programme specialists in costing their work plans (including the costs of staff resources), and then to enable all staff involved to review and analyse all the work plans and to prioritize them. The development of this IT tool is in progress.

27. This new approach is expected to help establish a portfolio of prioritized activities with cost estimates, including staff resources, and with clear links to expected results. It will also provide a better tool for programme planning in accordance with available regular budget and extrabudgetary funding. The approach may also reveal opportunities for streamlining and eliminating certain activities.

28. However, challenges will persist. The essence of the new process needs to be understood widely by all involved staff of the Programme Sectors. Furthermore, the new accountability framework for the field network will have to be taken fully into consideration and applied. During the first phase, efforts will be needed to reconcile the bottom-up process and top-down control. The result of this new approach will be visible and explained in the RBB presentation of the Draft 38 C/5.

V. REVISING THE CONSTANT DOLLAR EXCHANGE RATE

29. The impact of revising the constant euro/dollar exchange rate will also need to be taken into account if such revision is to be effected for the 38 C/5. Based on the explanation on UNESCO’s constant dollar mechanism presented in documents 187 EX/6 Part XI and 190 EX/19 Part II, the Executive Board initially decided to revise the rate for the 37 C/5. During the discussion of the General Conference at its 37th session, however, it was agreed to postpone this and to consider its possibility for the 38 C/5.

30. The constant euro/dollar rate being used today is 0.869 euro per US $1, whereas the actual rate is 0.748 (as at August 2014). This represents a deviation of 14%, and means that all the regular budget figures corresponding to euro-based expenditures are underestimated in the current C/5 presentation due to the fact that UNESCO is using a stronger value for dollar than exists in reality. If applied with a realistic dollar value, the nominal budget amount would increase.

31. In order to accurately define what the budget amount would become in the case the constant rate is revised into one that corresponds to the actual realistic level (although the actual rate will always evolve), it is essential to identify the anticipated dollar/euro expenditure weight for each Sector/Bureau. More detailed explanations will be provided in document Draft 38 C/5 so as to enable Member States to take an informed decision on this matter.

Action expected of the Executive Board

32. The Executive Board may wish to adopt a draft decision along the following lines:

The Executive Board,

1. Having examined document 195 EX/13,

2. Takes note of the scenarios presented and in particular the estimate for the Zero Real Growth (ZRG) requirements, i.e. the additional budget amount required if the same purchasing power were to be maintained in the 38 C/5 (2016-2017) as that of the 37 C/5 Approved;
3. **Further notes** that the Director-General proposes to determine as budget envelope for the 38 C/5 an amount between ZNG and ZRG, i.e., ZNG+;

4. **Notes** that the preparation of the Draft 38 C/5 will be based on an improved RBB approach;

5. **Notes** that a revision in the constant Dollar rate is envisaged in the preparation of the 38 C/5 budget.
PRELIMINARY PROPOSALS BY THE DIRECTOR-GENERAL ON THE PREPARATION OF THE BUDGET FOR THE BIENNium (38 C/5)

CORRIGENDUM

1. The third sentence of the first paragraph of the introductory summary should read as follows:

A second scenario would be a zero-real growth (ZRG) budget which would maintain the same purchasing power as that for the biennium 2014-2015 (37 C/5 Approved), which itself had been built on a zero nominal growth budget.

2. Paragraphs 29, 30 and 31 under Section V should read as follows:

V. REVISING THE CONSTANT DOLLAR EXCHANGE RATE

29. The Organization uses a split-assessment system where Member States are invoiced partially in US dollars and euros for their contributions to the Budget. The split percentage for the two currencies is based on the Organization’s expected expenditure in each of those currencies during the budget period. A fixed exchange rate (referred to as the constant dollar rate) is used to present and report the budget in US dollars. A change to the constant rate would not impact Member States’ contributions in US dollars and euros. Based on the explanation of UNESCO’s constant dollar mechanism presented in documents 187 EX/6 Part XI and 190 EX/19 Part II, the Executive Board initially decided to revise the rate for the 37 C/5. During the discussion of the General Conference at its 37th session, however, it was agreed to postpone this and to consider its possibility for the 38 C/5.

30. The constant euro/US dollar rate being used today is 0.869 euro per US $1, whereas the actual rate is 0.748 (as at August 2014). This represents a deviation of 14%, and means that all the regular budget figures corresponding to euro-based expenditures are underestimated in the current C/5 presentation. If applied with a realistic dollar value, the nominal budget amount would increase but the contributions in US dollars and euros from Member States would not change.

31. In order to accurately define what the budget amount would become in the case the constant rate is revised into one that corresponds to the actual realistic level, it is essential to identify the anticipated US dollar/euro expenditure weight for each Sector/Bureau. More detailed explanations will be provided in document Draft 38 C/5 so as to enable Member States to take an informed decision on this matter.