Policy, Planning, and Research

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World Development Report

Office of the Vice President
Development Economics
The World Bank
January 1989
WPS 46

Background Paper for the 1988 World Development Report

The Management of Public Expenditures:

An Evolving Bank Approach

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The key to better management of public spending, including investment programming, lies in the **process** by which programs are identified, prepared, approved, and implemented. Strengthening this process should lead to expenditure programs that are a more appropriate size and are more attuned to overall development goals.

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The Bank is paying increasing, though still unsystematic, attention to the institutional dimension of public expenditure management. This implies analysis of the processes and procedures by which programs are put together with an assessment of the strengths and weaknesses of the institutions involved and the links between them. Advising governments on these aspects requires more expertise than most Bank staff members possess. The Bank should develop staff skills in this area through:

• Better coordination in the Bank of public expenditure reform issues.

• More intensive, systematic staff training, and more contact with academics and other outside experts through such vehicles as seminars.

• Closer collaboration and more systematic exchange of views between operational staff and the Policy, Planning, and Research complex, including incorporation of feedback from the seminars held by the Economic Development Institute.

• A closer working relationship with the IMF, especially the Fiscal Affairs Department.

• Development of a well-designed program of operationally oriented, detailed case studies of specific country experiences (successes and failures) from which to draw lessons for future operations and country and economic sector work.

Addressing these issues may also have implications for the type of lending instrument the Bank uses. Reforms of public spending are usually dealt with through structural adjustment loans, backed up by technical assistance operations — but these may not always be suitable. If major policy decisions are required to bring about important long-term structural changes, a broader, more flexible lending instrument may be more appropriate.

One approach being explored is to finance a time slice of the country's public investment program (either on a sector-by-sector or aggregate basis, depending on the scope of the reforms to be introduced) to support not only more appropriate programs but also institutional and procedural reforms of the ways in which public expenditures are prepared and implemented. This approach could combine quick-disbursing balance of payments support with the longer-term approach needed to encourage institutional reform.

This is a background paper for the 1988 World Development Report. Copies are available free from the World Bank, 1818 H Street NW, Washington DC, 20433. Please contact Lupita Matthiesen, room S13-067, extension 33757.

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(i) Effective public expenditure management has become vital to developing countries in the context of the severe fiscal adjustments of the 1980s. Unfortunately, however, neither the conceptual tools nor the administrative instruments at their immediate disposal have been adequate in equipping governments to meet these challenges. First, on the conceptual plane, financial shortages and a changed view of the role of government have combined with a much more uncertain environment, externally and internally, to undermine the perceived usefulness of long term, comprehensive planning as a development tool. However, this has not yet been replaced by an alternative paradigm. Consequently, in their understandable preoccupation with the short term, policy makers in developing countries may frequently be unaware of the trade-offs between different expenditure patterns within and between sectors. Second, administratively, the increased size and complexity of the public sector had clearly overstretched the management capabilities of many governments even before the crisis of the 1980s. Fiscal constraints have accentuated the management problem through their devastating effect on real wages for many public servants at managerial level. The consequent drainage of talent and damaged morale of those who remain has made it still more difficult for governments to cope with the competing claims made on limited fiscal resources.

(ii) Effective public expenditure management makes heavy demands on government institutions. Each of its sub-activities -- the formulation of the macroeconomic framework, project preparation and investment programming, the link between planning and budgeting, the coverage, preparation and classification of the budget, and budget implementation and expenditure control -- has an institutional and political, as well as a technical or economic, dimension. A review of the experience of many countries trying to address these issues reveals an awesome array of problems which are at least as likely to have institutional roots as technical ones. Economic analysis and forecasting, even in the relatively short term, is often so deficient that it leaves the authorities unprepared for major deviations from the program necessitated, for example, by a substantial external shock. Unable to cope with the uncertainties inherent in the planning and budgetary processes, governments are forced to react with damaging, ill-thought-out, across the board cuts. Frequently, it will be found that the linkages between the macroeconomic framework and the investment program, and between both and the budget process, are fragile or non-existent. Many governments encounter considerable difficulty in formulating an investment program that is more than an aggregation of wish-lists drawn up by the different spending agencies. Control over the external borrowings of government agencies is frequently less than desirable, and even where this exists, donor pressure can at times undermine attempts to exclude significant but economically unjustifiable capital expenditures from the investment program. Phasing of capital spending is often inadequate or non-existent, while the recurrent cost implications of public investments are rarely taken into account. Classification of budgetary items may not facilitate a policy or objectives oriented approach to public expenditure planning. Budgetary coverage, both in terms of institutions and major categories of expenditure, may be partial, impeding the ability of the core ministries to exercise effective control. On the other hand, the organization of the spending agencies, their technical capabilities for financial and economic analysis, and their linkages with core ministries may be such that an integrated and coordinated approach to revenues and expenditures is, at best, severely impeded. Accounting and financial information systems, which used to work reasonably well, have deteriorated in many countries, and in some cases have disintegrated to the point where they ha[illegible]come inoperable. Their restoration is a prerequisite, though far fro[illegible]fficient condition, for strengthened public expenditure management.

(iii) Government responses to these immense difficulties have been, perhaps inevitably, piecemeal. Most of them have concentrated on expenditure control with an inevitably short term perspective. Others, however, have attempted major organizational reforms, combined, in some cases, with wholesale changes to the planning and budgetary systems. Success has been decidedly mixed.

(iv) While tightening expenditure control at the center may be a necessary and valid response, at least in the short term, it is far from synonymous with good public expenditure management. Even when it is accompanied by strengthening of core institutions, care should be taken not to neglect the sectoral ministries and line agencies where institutional improvements are equally vital. There are, moreover, important questions of accountability and autonomy at stake. Strengthened central control carries the danger of overdetailed intervention by core ministries. Long term institutional reform should concentrate on improving the capacities of both core and line agencies to manage expenditures in accordance with the objectives of economic policy. This, in turn, means developing measurable objectives and evaluation systems linked to appropriate rewards and penalties.

(v) In an effort to improve the links between the planning and budgetary processes, the Bank has frequently become involved in recommending or supporting organizational changes with a view to integrating the functions of budgeting and investment planning. These efforts have had mixed success and may, in many cases, be a red herring. While organizational changes are important, they can sometimes be an unsatisfactory substitute for deeper procedural and policy reforms. It is essential not to confuse the two.

(vi) Dissatisfaction with many aspects of public expenditure management has led several governments, sometimes with active support from the Bank and other external agencies, to attempt wholesale reform of the entire budgetary or planning process. Some governments have endeavored to introduce techniques such as program or performance budgeting. While these contain many useful lessons, they should, from an institutional and political viewpoint, be approached with caution. Following a few simple (but frequently ignored) rules will greatly enhance the chances of success for reforms, be they partial or general. They should make the greatest possible use of existing institutions: the grafting of new ones onto traditional structures often serves merely to increase confusion. Reform should proceed gradually and should involve all the principal actors from the outset. The effort needs to be guided by a centrally placed agency responsible for coordinating training and the dissemination of information. New processes and procedures should be tried out in suitable pilot ministries and agencies and gradually extended to the rest of the administration. Moreover, reform efforts need to be carefully planned. They are often costly in terms of the human and financial resources needed to carry them out. Failure to provide for this will undermine the reform effort itself and the credibility of its goals.

(vii) To stand a reasonable chance of addressing the complex institutional and technical issues involved in public expenditure management, governments require an analytical framework which would enable them to forecast and program spending over a three to five year period (updated annually), taking account of both likely resource constraints and the link with the economy at large. Such a framework -- which can be described in summary as Medium Term Expenditure Planning or MTEP -- carries many of the virtues of the comprehensive planning approach to public finance, an area singularly apt to benefit from them, while attempting to avoid the drawbacks. It would contain a macroeconomic framework, linking public expenditures and revenues to other economic variables; projections of the major items of current expenditure; a multi-year, phased public investment program distinguishing between high and lower priority projects; and projections of revenues from tax and non-tax sources as well as borrowing needs. It should also be formulated in such a way as to help policy makers cope with uncertainty by preparing alternative expenditure policy strategies corresponding with different economic and financial scenarios. It would thus help to achieve consistency between expenditures and macroeconomic assumptions as well as placing due emphasis on public expenditure as a policy instrument.

(viii) Although a full MTEP exercise may be beyond the immediate capacity of many governments, it nonetheless provides a consistent analytical framework for expenditure management and a relevant goal towards which to strive. Many of its features have been successfully adopted by a number of countries.

Implications for the Bank

(ix) The importance of the institutional dimension of public expenditure management has become increasingly recognized in the Bank in recent years. The number of structural adjustment and technical assistance operations which address these issues is increasing, especially though not exclusively in Sub-Saharan Africa. More attention is also being paid to them in economic and sector work (CESW). Although it is still possible to encounter major public investment reviews which concentrate almost entirely on the size and composition of the public investment program, with scant regard for overall expenditure management problems, these are now rare. However, Bank work in this area still needs to be more systematic; at the moment, in both reviews and lending operations, there is substantial variation in the scope and depth of coverage given to institutional issues. This may not necessarily be in response to any corresponding variation in the extent of institutional problems in the particular country, but may rather reflect the professional knowledge and interests of the Bank staff members concerned. A more systematic approach to the political and institutional aspects of public expenditure management needs to be routinely built into Bank reviews and operational work. The high institutional content of some recent reviews is an encouraging tendency which should be developed further through training, both "on the job" and otherwise, and through the judicious use of outside expertise.

(x) The institutional dimension of public expenditure management is a highly complex and sensitive area. The multiplicity and diversity of public agencies, interest groups and individuals with a vital stake in the process means that the political dimension is of primary importance. The role of the Bank is thus a particularly delicate one. Governments understandably resent outside interference in such a political area as the allocation of public expenditures. In this context, it is noteworthy that the Bank often finds itself with a more problematic role to play than the Fund. The latter is concerned with the "bottom line" of total revenues and expenditures and the consequent fiscal gap, whereas the Bank analyses not only the size but the composition of public investment and, increasingly, expenditure programs. Experience indicates, however, that the key element to better investment programming in particular, and public expenditure management in general, lies in the process by which programs are identified, prepared, approved and implemented; if the process can be strengthened then this should lead to better programs of a more appropriate size.

(xi) To advise governments on the institutional dimensions of this process requires greater expertise in the practicalities of public expenditure management than most Bank staff currently possess. In the short term this can be partially alleviated by outside expertise. In the long run, a more conscious effort should be made to develop staff skills in this area through:

- more intensive and systematic staff training;
- better internal Bank coordination of public expenditure reform issues staff working on a particular country are often not fully aware of similar efforts in the same region let alone elsewhere in the Bank. The potential offered by the reorganized structure for taking more systematic advantage of work carried out at a sector or spending agency level by "project" staff should be more fully exploited. The minimal coordination provided by occasional public expenditure reviews should be replaced by more frequent and regular instruments;
- the development of a stronger methodology, guidelines, and a checklist of questions for the use of operational staff;
- more coordination and collaboration between operational staff and EDI; not only do the courses on public expenditure management offered by the Institute contain valuable material for Bank staff, but they could also be a useful vehicle for obtaining feedback from government participants who are the daily practitioners in this area;
- more extended and intensified collaboration between the Bank and the Fund (especially the Fiscal Affairs Department). The work of both institutions could greatly benefit from more frequent and systematic exchanges of views, regular exchange of documents, participation in missions, etc.
- greater contact with academic and other experts outside the Bretton Woods institutions, as well as participation in seminars, conferences etc.; and
- a well-designed program of operationally-oriented, detailed case studies of specific country experiences (successes and failures) from which to draw lessons for future operations and CESW.

(xii) The lending instrument so far most closely associated with public expenditure reforms has been the SAL, frequently backed up by technical assistance loans of varying effectiveness. It is questionable whether these are always the most suitable instruments. The long-term nature of the issues to be tackled, and the variation in country experience, calls for flexibility in operational approach and style. If major policy decisions are required to bring about important structural changes, then policy-based lending may be the best way to support this; however, it may be more productive, especially from the point of view of sustainability, to use a longer term, broader, and more flexible instrument than the traditional SAL or sector loan. An interesting approach, which is already being explored in some parts of the Bank would be to finance a time-slice of the country's public investment program (on a sector-by-sector, but preferably on an aggregate basis) to support not only a more appropriate size and composition of the program itself, but also institutional and procedural reforms in the process by which public expenditures are prepared and implemented. This could, if carefully designed, combine the appeal (from the Government's standpoint) of quick disbursing balance of payments support with the longer term approach required to encourage and support institutional reforms.

THE MANAGEMENT OF PUBLIC EXPENDITURES: AN EVOLVING BANK APPROACH

Introduction

1. World Bank lending and advice to support institutional and policy reform of public expenditure management is of recent origin and of limited, but rapidly expanding, scope. The area where this concern has been most sharply focussed is on the management of public investment programs. Such programs are frequently a drag on public sector activities and hence in need of attention. However, in seeking to improve the decision-making process with a view, for example, to curbing inappropriate or excessive investment, or ensuring a more economic use of public resources, the Bank has inevitably been led away from exclusive concentration on the investment program *per se* and towards wider expenditure issues. At the most superficial level, this can be seen in the accelerating substitution of public expenditure reviews at the expense of public investment reviews. More significantly, it reflects an increasing awareness that the difficulties of investment programing cannot be dealt with in isolation from the more general problems of public expenditure management, including the budgetary process, the institutional capacity of both core and line agencies, relations between core and line agencies, and the political economy of budgetary reform. This intensifying focus on institutional issues arises from the well-founded belief that reforms are unlikely to be durable unless the related institutional capacity is strengthened. This type of change is often difficult to effect given characteristic shortages of skilled manpower in most developing countries. It therefore requires both a longer time period for implementation than most Bank-supported activities and presents a new challenge in terms of devising appropriate lending instruments. It is leading the Bank into areas of increasing institutional complexity and political and technical controversy where there are no easy guidelines or precise solutions.

2. This paper attempts to address some of these issues in the light of recent Bank experience. Despite the fact that that experience is short, the paper attempts to develop some guidelines for the future direction of the Bank's work in this area. However, the conclusions should be taken as indicative, not only because prescriptions should be tailored to fit each country's circumstances, but also because institutional reform by its nature does not lend itself to strict models or blueprint approaches.

3. The paper begins with a brief overview of the Bank's recent work on public expenditures both in the context of country economic and sector work (CESW) and lending operations. Itis based primarily on the projects and documents listed in Annex I. This analysis indicates the lack of a consistent or systematic approach to the institutional and procedural aspects of public expenditure management. As background to an attempt to develop more consistency, the paper goes on to discuss the Bank's changing approach towards public expenditures, starting with the concepts of economic

planning and public investment programs It describes how the Bank's concerns have pushed beyond the confines of investment programing into the wider area of the planning and management of public expenditure and from there to the reform of budgetary processes and procedures. This covers not only the link between the expenditure program and the budget, which is the principal administrative instrument for program implementation, but also the budgetary process itself. The paper then discusses some of the difficulties and issues involved in this process, particularly from the political, institutional and procedural standpoints. This is followed by an analysis of alternative approaches to budgetary reform which are evolving outside as well as inside the Bank and which aim to improve the budget's utility as an effective instrument of economic policy. It attempts to offer some tentative operational guidelines based partly on recent experience, and partly on the "state of the art" in some industrialized and developing countries. These are summarized in Annexes II and III, while Annex IV distils some of the main sequential features of the budgetary decision-making process.

Overview of the Bank's Recent Experience

4. The Bank has traditionally approached public expenditure management issues through three closely interrelated activities: structural adjustment lending operations (SALs),[1] technical assistance, and country economic and sector work (CESW). All structural adjustment loans support, *inter alia*, a rationalized public investment program, the size and composition of which is discussed with the Bank and included in the loan documentation. In addition, in nearly all cases, the country has entered into a Standby Arrangement or Extended Fund Facility (EFF) agreement with the IMF which normally supports a number of measures to reduce or rationalize public current expenditures with a view to increasing public savings. By the very nature of the agreements concerned, these programs tend to be focussed on the short term. The Fund also automatically requests Bank endorsement of the public investment program for an EFF and, increasingly, for Standby Arrangements also.

5. The extent to which the Bank has gone beyond these "traditional" concerns (size and composition of the investment program plus short-term financial stabilization normally with parallel support from the Fund) varies considerably between SALs. Thirty-six such loans and credits, approved between November 1981 and June 1986, featured rationalization of public investment programs, and most incorporated IMF-supported budget deficit reduction measures. However, few explicitly included institutional or procedural reforms to back them up. The lack of sufficient institutional underpinning carries the danger that programs will not be sustained beyond the short term. Although there have been improvements in public investment programing in most countries undertaking strcutural adjustment programs, the

1/ No specific public expenditure reform loan or credit has yet been submitted to the Board, though some potential operations are in early stages of preparation.

administrative and institutional support frameworks are still fragile. Permanent improvement will require continuing vigilance on all aspects of institutional structure, including retention of capable staff, use of economic criteria for project selection and evaluation in operating agencies, and inter-ministerial planning and budget coordination. In some of the more recent Bank-supported adjustment programs, total public sector expenditures, including both current and investment expenditures, are considered appropriate targets for policy reform.

6. The second principal lending instrument used to approach public expenditure management issues has been technical assistance lending. Unlike the SALs, these loans and credits focus more on long-term, institutional problems which they seek to overcome normally through the financing of temporary expatriate assistance and through training. Typically, they would include strengthening key functions in the core agencies (finance and planning ministries, plus in some cases the central bank or office of the comptroller and accountant general) such as macroeconomic strategy formulation, investment programming, budget preparation and expenditure control, and the establishment of central accounting and monitoring systems. Line agencies are covered more rarely since sectoral management capabilities are frequently the focus of Bank project work. In most cases, the TA projects are too recent to permit judgements concerning success or failure.[2] However, several of them have taken considerably longer to get off the ground than was anticipated at appraisal, reflecting to some extent administrative delays (in finding and appointing expatriate experts, for instance, or completing complicated formalities for the contracting of consultants), but also lack of government interest. This, in turn, reflects some resistance among governments (notably in Latin America) to "studies for their own sake" especially in politically sensitive areas such as budgetary procedures. For those operations more focussed on implementation than on study, it is perhaps unrealistic to expect most governments to undertake deep-seated and politically difficult actions in the absence of more powerful financial incentives than those provided by most technical assistance operations.

7. The third instrument used by the Bank is country economic and sector work (CESW), notably public investment and expenditure reviews, a considerable number of which are performed each year. These activities are evolving in a way which, on balance, shows an increasing concern for institutional issues and a widening of interest from investment to problems of current expenditure management. An analysis of the more recent reviews, prepared by the Bank's Country Econbomics Department (CECEM), shows that several of them address issues such as: (i) the ability to plan and appraise projects; (ii) the decision-making process concerning which projects are included in the investment program; (iii) the ability to monitor and evaluate projects; and (iv) budgetary procedure. However, the coverage and depth accorded to such subjects varies considerably among the reviews: a

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2/ See, however, Annex III for a partial discussion of the Administrative Reform Project in Jamaica.

few deal with none of them, while the attention given to item (i) and to a lesser extent item (ii) generally exceeds that afforded to items (iii) and (iv). It is clear that there is no consistent or systematic approach to these issues. Some staff question whether the Bank has the expertise necessary to make recommendations in this area and the credibility to follow them up with appropriate lending instruments. Such self questioning is to be expected and is characteristic of most new or rapidly evolving activities which the Bank undertakes.

8. In addition to public expenditure reviews, the Bank sometimes uses its regular reports on the economies of borrowing countries, or similar vehicles, to discuss public expenditure management issues. Again, the coverage given to institutional and procedural problems varies greatly and does not follow any consistent or systematic format.

9. Exceptionally, CESW is used as a tool for detailed Bank collaboration with Government in implementing improved investment programing and budgetary systems and procedures. A leading example is that of Zambia where the CESW approach had the great advantage of direct involvement by Bank staff who had been engaged for some time in an intense policy dialogue with the authorities. However, this is very expensive in use of staff time,[3] and does not, unlike a lending operation, involve the Government in implementation deadlines. Although it may be appropriate to commence with such a <u>process</u> rather than <u>policy</u> oriented approach, in order to build long-term sustainability of the reform effort, this does not, as Zambia's subsequent experience has shown, eliminate the necessity of deep-seated policy level commitment to change.

<u>The Planning Concept</u>

10. The planning experience[4] is immensely varied among developing countries, where more than 300 plans have been formulated during the past 30 years. At the risk of over-simplifying, countries may be divided into four broad categories: (i) those where comprehensive, central medium-term planning has been practiced with the full backing of the political authorities (Eastern Europe plus some countries in South Asia, especially India, and North Africa) and seeks to directly influence private as well as public spending; (ii) those where planning is seen as a means of controlling and directing public expenditure and of setting a framework of active

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3/ In fiscal year 1985 alone, 51 staff weeks were used in Zambia with a further 28 planned for the next two fiscal years. This does not include the substantial amount of time devoted to these issues in the context of economic missions, preparation of Consultative Group meetings, and the broader policy and sector dialogue.

4/ The discussion in this section draws upon work carried out by Ramgopal Agarwala in preparation of the 1983 World Development Report and subsequently. Much of this is also summarized in his "Planning in Developing Countries: Lessons of Experience" Staff Working Paper No. 576.

cooperation with a strong private sector including foreign investment; here, flexibility and adaptability to changing circumstances are the hallmarks (Korea, Taiwan, Singapore, Malaysia); (iii) those where central plans were formulated but where comprehensive planning was only nominally adhered to by the political authorities often to assist in mobilizing external[5] aid (most of Sub-Saharan Africa); and (iv) those where there is little or no emphasis on central planning and where private investments are guided essentially by price signals arising from a relatively free functioning market (Hong Kong, Thailand, Colombia).

11. Since the 1950s and 1960s, a major change has taken place in the attitude of developing countries towards centralized comprehensive planning, and correspondingly in that of the Bank. In many of the category (i) countries, most notably India, planning, though by no means abandoned, has lost some of its emphasis and unquestioned political support; even in East European countries and the People's Republic of China, there is a tendency towards greater reliance on market forces and individual incentives. Most category (iii) countries have dropped any pretence at taking central planning exercises seriously; Ministries of Planning or their equivalent are still scattered through Sub-Saharan Africa but they are more and more dedicated to the vetting of investment projects and programs rather than the elaboration of self-contained documents providing a blueprint for development. Where such exercises still continue, they are frequently little more than academic with no real political backing. Indicative planning continues in many of the category (ii) countries, especially in East Asia, reflecting the special relationship between the Government and the private sector. However, these plans, although at times technically sophisticated, are not characterized by strict adherence to targets, but by consultation and flexibility.

12. There are a number of reasons for these changes, some of them due to trends in the economics profession itself, and others to the different circumstances and challenges which developing country governments have to face. First, within the profession, the rise of planning coincided with a view[6] that developing countries are characterized by accumulated cultural, social and institutional rigidities, which inhibit or prevent change. Consequently, in economic terms, agents cannot respond readily to price signals and the supply of most goods and services tends to be price inelastic. Hence "getting the prices right" (even if possible) can only be expected to have a limited impact at best, while only determined government action to change the structure of production and trade and to reallocate resources within the economy can bring about modernization and development. Hence the need for governments not only to closely direct economic actions, but to establish and control a wide range of prices of goods and services. Governments responded readily to these economic paradigms since they had the

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5/ Where, however, several other instruments of a dirigiste approach, e.g. price controls, are applied in a largely ad hoc fashion.

6/ Encapsulated in what came to be called the "structuralist" view of development.

effect, inter alia, of increasing still further the relative status and self-importance of officials already well established in many countries by the bureaucratic mores inherited from the colonial powers.

13. This view of the development process has, in recent years, changed considerably: most economists, within and outside government, now believe that, in developed and developing countries alike, quantities are in fact more flexible and resources more mobile than previously assumed, economic agents do respond to price signals, and markets, despite recognized imperfections and partial failures, tend in many cases to be better allocators of resources than governments. This change in attitude is, to some extent, the child of disillusion. The experience of detailed and comprehensive planning, as a logical corollary of the structuralist approach, was generally a severe disappointment. Even where some targets were achieved this was at the price of stunted growth and feeble institutional development outside the public sector itself. Overambitious planning spawned large public projects, some of which remain a costly burden. Similarly, the growth of a vast array of state institutions to achieve central government objectives encouraged the formation of interest groups which in many cases represent a financial burden on the State and can hinder the execution of development policy. [7] Detailed planning failed to respond to changes in the international economic environment. Even in those developing countries endowed with highly sophisticated economic expertise (e.g. India), analytical techniques and the administrative apparatus proved incapable of coping with the complexity of economic change. In most countries, the institutional framework could not begin to confront the requirements of a serious economic planning effort. Consequent heavy reliance on expatriate expertise further alienated the plans from the national reality.

14. Second, the role of central planning, with all its institutional connotations, received a major blow with the onset of the financial and economic crises which afflicted much of the developing world following the oil shocks of the 1970's. Projections, based principally on the notion that the future would be a slightly modified extrapolation of the past, lost their practical meaning. Moreover, sheer financial survival became the order of the day, and there was, therefore, little scope or desire to see beyond the short term. This affected not merely the concept of medium or long-term national planning but also investment programing and the management of public expenditure in general which now tends to assume an intensely short-term and highly selective focus.

15. While few would question the severe limits to the usefulness of detailed, comprehensive planning, there is a distinct danger that the crisis may make many governments lose sight of its virtues. Partly through ideological change, but mainly through the force of circumstances, the

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7/ Public enterprises in most of Sub-Saharan Africa are a case in point. See J. Nellis: "Public Enterprises in Sub-Saharan Africa", World Bank Discussion Papers No. 1, 1986.

authorities of many developing countries have de facto resorted to reliance on traditional budgetary methods for allocating resources. Under this approach, it is inevitable that short-term considerations will dominate. Ministries of Finance frequently impose control through the establishment of overall ceilings on government expenditure. If resources are less than anticipated, then the problem is resolved by across-the-board cuts. This implies scant regard for the quality of expenditure composition: since some categories are considered untouchable (e.g. personnel), then it is inevitable that budgetary ceilings, unaccompanied by planning, will lead to a progressive deterioration in the structure of expenditures, in the budget as an instrument of economic policy, and in the quality of government services. This is the pattern which has become depressingly familiar in recent years, especially though far from exclusively, in Sub-Saharan Africa.

16. The approach increasingly favored by the Bank in its dialogue with governments places greater emphasis on programing public, as opposed to total, expenditures within an overall framework of greater reliance on market prices and private sector decision-making. This implies shifting the focus away from some concepts of planning, which were earlier in vogue, and which conjure up a vision of government intervention in private decision-making. It should not, however, suggest a wholesale rejection of the concept and usefulness of planning. On the contrary, it explicitly recognizes that public expenditure programing cannot take place in a vacuum, and that some sort of systematic forecasting framework is a sine qua non for effective public expenditure management. In fact it is the public sector which should attempt to plan its own activities better without, however, trying to plan those of the private sector.

17. While choices in the short run may be severely limited by constraints, both exogenous and endogenous, to the public sector and the economy as a whole, over a longer period choice may become dramatically expanded. Options may emerge concerning not only the composition and size of the public expenditure program, but also between different totals and allocations of current and capital expenditures (some of them functions of the investment choices made), as well as their phasing. Political decision-makers and their technical advisers are frequently unaware of the trade-offs between different expenditure patterns even within, let alone between, sectors. Comprehensive awareness and consideration of these issues entails the coordination of macroeconomic analysis with public expenditure planning and budgeting over, say, a three-to-five year horizon. This coordination process may also be described as medium-term expenditure planning (MTEP), which, in essence, carries many of the virtues of the comprehensive planning approach to the area of public finances, an area which is singularly apt to benefit from them, while attempting to avoid the drawbacks.

18. In outline, the characteristics of an MTEP would be built from the following components:

(a) macroeconomic analysis linking the growth of national income, savings, investment and balance of payments to public expenditures and revenues;

(b) a rolling, multi-year public investment program with phased outlays reviewed annually;

(c) a fiscal plan, including:

(i) revenue forecasts at existing rates of taxation consistent with the macroeconomic assumptions;

(ii) forecast of non-tax revenues (surplus of public enterprises, fees, user charges, etc.) based on macroeconomic projections but without any changes in policy;

(iii) estimation of additional revenues which may be mobilized by, for example, higher tax rates, a different tax structure, or institutional and administrative reforms in tax collection;

(iv) estimation of additional income resulting from changes in the policy framework for public enterprises, public sector pricing policy, charges in the social sectors, etc.;

(v) estimates of resources available from domestic and external borrowing and grants; and

(vi) projections of current expenditure including debt-servicing, defense, administration and recurrent expenditure on development (sub-divided between committed and anticipated discretionary expenditures).

19. Consistency may be insured by establishing balances, year by year, for the plan period, between the sum of domestically generated resources and net inflow of external resources on the one hand, and total public expenditure (including public capital spending and net transfers to autonomous public entities) on the other. Given the inherent uncertainties in forecasting exercises, the trade offs to be considered, and the iterations that would be required to achieve consistency, it would in most countries be more feasible to formulate the MTEP over a three rather than a five-year period. Ideally, it should be a rolling program, updated annually.

20. Clearly, the MTEP exercise is fraught with difficulties. Export volumes and prices, interest rates, and the availability of foreign capital can all vary due to changes in external conditions. Also, governments change, and with them perceptions as to the principal objectives of economic policy. Moreover, in most developing countries, the exercise is "unrealistic" in the sense that if governments were able to formulate, and subsequently adhere to, a multi-year rolling MTEP this would in and of itself be a clear indication that they had their public sector finance problems under control, at least from an institutional and managerial standpoint. It is, nevertheless, useful in providing an analytical framework for public sector expenditure planning, which ensures consistency with macroeconomic assumptions and is itself a benchmark against which existing systems of planning and budgeting may be judged. Moreover, it

greatly facilitates the view of public expenditure as a policy instrument rather than merely stressing the "good housekeeping" aspect of budgeting. Once a government has formulated a policy framework in the context, for example, of a structural adjustment program, this can then be broken down into constituent parts, some of which will likely involve the establishment of targets and the enactment of reforms in the public sector. An MTEP exercise can illuminate the revenue and expenditure implications of achieving these targets, thereby enabling a sharper focus on the extent and depth of the specific reform measures required. It also facilitates analysis of the projected impact of the policy measures on the rest of the economy through the systematic linkage between the public sector variables and the macroeconomic model.

21. The institutional problems encountered in the establishment and successful operation of such a system of reformed public expenditure planning are formidable. For the Bank to be of greater assistance to developing country governments in overcoming them, it is necessary for staff to be fully aware of the issues involved and how they might be tackled. While not neglecting the traditional concerns such as the composition and size of the public investment program, and whether or not major projects are subjected to cost benefit analysis, this does involve going considerably beyond them into areas which are fraught with political as well as institutional difficulties.

22. Each separate sub-activity of public expenditure planning -- the formulation of the macroeconomic framework, project preparation and investment programming, the link between planning and budgeting, the coverage, preparation and classification of the budget, and budget implementation and expenditure control -- has an institutional and political, as well as a technical or economic, dimension. This dimension raises a number of key questions which need to be answered if the potential obstacles to reform are to be more fully understood. The detail with which each issue needs to be addressed will inevitably vary in accordance with each country's circumstances. Frequently, however, it will be found that the linkages between the macroeconomic framework and the investment program, and between both and the budget process, are fragile or non-existent. The demise of comprehensive economic planning is in danger of bringing in its wake a withering of all planning capabilities in many developing countries to the detriment of effective expenditure management. Many governments encounter considerable difficulty in formulating an investment program that is more than an aggregation of wish-lists drawn up by the different spending agencies. Macroeconomic analysis and forecasting, even in the relatively short term, is often so deficient that it leaves the authorities unprepared for major deviations from the program necessitated, for example, by a substantial external shock. Classification of budgetary items does not facilitate a policy or objectives oriented approach to public expenditure planning. Control over the external borrowings of different government agencies is frequently less than desirable, and even where this exists, donor pressure can at times undermine attempts to exclude significant but economically unjustifiable capital expenditures from the investment program. Phasing of capital spending is often inadequate or non-existent, while the recurrent cost implications of public investments are rarely taken into

account. The organization of the spending agencies, their technical capabilities for financial and economic analysis, and their linkages with core ministries are such that an integrated and coordinated approach to revenues and expenditures is, at best, severely impeded.

23. The rest of this paper attempts to analyze these and other difficulties, from the standpoint of identifying the institutional reforms which may be necessary if public expenditure planning is to become an effective policy instrument.

The Macroeconomic Framework

24. When the Bank undertakes a public expenditure review, it normally includes an assessment and projection of the macroeconomic framework for a period of three to five years ahead. This provides not only background and a context for public expenditures, but is also the basis for revenue forecasts. However, it is often unclear from the reviews whether the authorities themselves are capable of carrying out a similar exercise or, if so, whether this is consistent with that of the Bank. To be sure, the review is normally discussed with the government, but this discussion frequently focusses on the results of the projections rather than how they were produced. Moreover, the time lag between the initial review mission and the discussion with the government is sometimes of such duration that the Bank's assumptions may have lost much of their relevance.

25. Institutionally and technically, the Bank should assess: (i) what capabilities exist for macroeconomic analysis in the country concerned; (ii) what agencies are responsible for it; (iii) in what format the projections are produced (e.g. in a medium-term plan, through a forecasting model, through an annual economic report); (iv) whether the model or methodology used is sufficiently flexible to permit consideration of alternative scenarios; and (v) whether it permits the analysis of the impact of alternative expenditure strategies on economic variables. Even where such capabilities exist, institutional factors may impede their usefulness or practical application. Where, for example, are they located within the administrative machine? How effectively do they communicate and coordinate with other parts of the administration? How seriously are they taken by the highest political authorities and by those responsible, in both the core and line ministries, for the preparation of plans and budget estimates? Is there adequate coordination of the efforts of different agencies with consequent consistency of assumptions and results? If the answers to these questions reduce the relevance and effectiveness of plans and budget estimate, what measures are required to correct the situation?

26. A related set of questions concerns the quality of background material and guidance provided to those responsible for planning expenditures. Those Bank reviews which have addressed this issue usually find this of low quality or altogether absent. Again this is by no means confined to the least developed countries: a recent report on a major Latin American country found that no norms were provided to parastatals or spending ministries concerning macroeconomic variables such as the expected

rate of inflation, exchange rate movements, etc. Each agency thus produces its own with resultant inconsistencies which must be resolved, if at all, at a later stage of the expenditure cycle.

27. Finally, what kind of feedback is provided by macroeconomic analysis into the budget execution and monitoring process? Are contingency review meetings attended by forecasters? Are strategic choices analyzed when resources are less than anticipated? If so, by whom? Do the institutions involved have the capacity and the authority to carry their task out adequately? Are governments provided with the necessary information and guidance to react in any way other than simple across-the-board cuts? Again, the answer to these questions is frequently in the negative.

Investment Programing and Project Preparation

28. The institutional arrangements which exist for the preparation of medium-term plans and investment programs vary enormously from country to country, but in only rare cases could they be described as acceptably satisfactory according to the criteria normally applied by the Bank. This is perhaps less than encouraging in view of the immense effort which the Bank has put in over the years to improving public investment programing. This is not to say that these efforts have resulted in unmitigated failure. Some improvements have taken place, especially within the framework of a general economic reform program whether or not directly supported by Bank structural or sectoral adjustment lending. In a considerable number of countries, thanks to financial pressures, public investment expenditures have been substantially reduced to levels more consistent with overall resource availability. To a lesser extent, the composition of programs has also been improved especially where Bank financial assistance has been directly provided. Nevertheless, among the difficulties which remain in many countries are:

(a) Considerable and deliberate overprograming, reflecting an unwillingness or inability to make hard decisions as to priorities. This leads not only to the formulation of programs way out of line with domestic or foreign resource availability, but also to too many projects being started at the same time, excessive dispersion of available skills, slowdowns in project implementation and lower returns from investment.

(b) The lack of criteria for choosing which projects should or should not be included in the program. This has been addressed, with varying degrees of success, through Bank and other technical assistance to both planning ministries and spending agencies. Bank reports contain many recommendations for improved project appraisal capability. Over the years, thousands of officials from developing countries have been trained in analytical methods, through EDI courses and other means. Nevertheless, although no systematic survey or assessment of country practices has been undertaken, it is clear from references in expenditure reviews and other documents that a permanent institutional capacity is being built up only gradually and in a limited number of countries. In some parts of Latin America,[8] a high level of project appraisal capability has become established in public sector utilities and other implementing agencies to which the Bank has lent; in other countries of the region, the picture is less encouraging. In Sub-Saharan Africa, there have been many attempts to develop project appraisal techniques in core ministries. Despite all this effort, relatively few countries have systematically established procedures or institutional capacity for economic project appraisal at either sectoral or core ministry level. Even in Turkey, a recipient of five structural adjustment loans, a 1985 public expenditure review found "important deficiencies in project preparation and selection even in the case of agencies with high technical competence." Political considerations seems to dominate in project choice. There is still a widespread ignorance and/or mistrust of cost benefit techniques, well justified in many sectors. Such techniques are, perhaps, most widely accepted in transport where they are more refined, and where there is reasonably good knowledge of recurrent cost implications and of trade-offs between capital and recurrent expenditures. In other areas (especially agriculture and the social sectors), such knowledge is less developed and hard data is often difficult to come by. This is not to argue against the use of cost benefit techniques with the appropriate institutional backing; at best, they can lead to vast improvements in public investment programming, and at worst they can be conducive towards a more rational political debate on project choice. Perhaps that partially explains the slow progress in promoting their use. In poorer countries, with a high proportion of donor-financed projects, there may perhaps be more projects subject to economic analysis, though donor pressures to proceed are also strong. In any event, few projects financed by other donors seem to meet Bank standards of analysis.

(c) The lack of priorities and ranking of projects. Governments, together with the Bank, have tried to address this through the formulation of "core" investment programs. An agreement is reached that the government abandon a policy of partially funding all or most projects, and distinguishes between "core" projects which should receive funds under all circumstances and standby projects which are funded only when additional resources are available. It is important to emphasize here that "funding" includes not merely capital, but all current resources required to complete and operate a priority project. "Core" programs should also be concentrated on strategic projects and should exclude white elephants even where funding is assured. However, such programs need to be formulated against the background of consistent overall macroeconomic objectives and should take account of the constraints faced by the public sector and by the economy at large through the balance of payments, etc. Their

8/ For example, in Chile and, at least until recently, Panama.

preparation therefore frequently runs up against the same institutional and manpower constraints facing the formulation of macroeconomic strategies. In Sub-Saharan Africa, it is far from unknown for the core program to be hastily prepared by Bank staff, in advance of a Consultative Group meeting, with marginal participation on behalf of nationals.

(d) Lack of coordination among donors and donor pressure for unjustified projects. Theoretically, "core" programs should provide a framework within which donors can agree to concentrate their efforts. However, difficulties can and do arise when a donor's pet project, perhaps already underway, finds itself excluded from the "core" program. Despite much rhetoric to the contrary, there is incomplete recognition of Bank leadership and coordination of donor support for investment programs even when this is institutionalized through Bank-organized Consultative Group (CG) meetings. Examples of successful resistance to donor pressure for economically unjustified projects are not unknown (e.g. in Panama and Chile), though they are still exceeded by failures. Reluctance to accept a Bank leadership role stems from both donor and recipient governments for fairly obvious political reasons. It can only be gradually overcome through increases in the scope and depth of Bank CESW and policy-based dialogue with governments.

(e) Poor coordination between macro-analysis and expenditure planning can also lead to a lack of appreciation of the impact of the general policy framework on the success of a public investment program. In some countries, the opportunity provided by a Bank-supported structural adjustment program has been taken to increase government awareness of inappropriate policies which impose a heavy fiscal burden and devour resources that would otherwise be available for investment. Chief among these are: (i) pricing policies leading to large subsidies which are not only a direct strain on the budget but may also discourage production and hence reduce resources; (ii) substantial and unproductive overemployment in the public service; (iii) inadequate control over the expenditures of local authorities and autonomous agencies; (iv) public ownership of inefficient and loss-making enterprises, established with the intention of remedying market failures or achieving social objectives, but in practice doing neither; and (v) the general incentive and policy framework. If there is, in broad terms, a failure to encourage efficiency through economic incentives, then this will, of course, affect the quality of both public and private investment. Poor private investment decisions can in turn feed back on the public sector through not only fewer resources but also a sense that the public sector "must do everything."

(f) Poor implementation and operation of projects, often due to general underfunding, lack of prior analysis, including identification of interlinkages between projects, and failure to foresee current expenditure implications for operation and maintenance.

29. As a result of the factors listed above, the public investment portfolios of many borrowing countries are less than satisfactory, containing poor quality projects and rates of return well below expectations. Bank dialogue has responded to this by stressing the need to improve the productivity of existing investments, particularly in view of the scarcity of resources for new projects. In some countries, governments have thus been stimulated into placing greater emphasis on maintenance, rehabilitation and changing inappropriate pricing policies, an emphasis made easier by direct Bank support through project or sector lending.

30. Although important partial improvements have been attained in a minority of borrower countries, it is recognized within the Bank that a great deal remains to be done in achieving lasting improvements to public investment planning and programing. Much of this can be summed up under the heading: "the institutional dimension of reform." To begin to address this dimension, Bank staff need to go beyond the programs' size and composition and consider a number of key institutional questions, [9] the answers to which could at least initiate measures aimed at a solution.

31. First, is the planning function adequately coordinated or is it fragmented over a number of institutions? In Egypt, for example, it was found that the Ministry of Planning prepares five-year and annual plans and coordinates and channels foreign aid. The National Investment Bank finances approved projects and monitors physical progress. The Ministry of Finance mobilizes domestic resources for project finance. The Ministry of Economy is responsible for channelling foreign expertise and grants and transfers. Second, if there is fragmentation, why does it exist? Is it because of historical factors, the addition of new functions which overlap with existing ones, or the result of a deliberate decision to split judicial power so that the real authority rests elsewhere? Third, what would be necessary, in the context of each individual country, to achieve greater effective coordination? Could this be accomplished by simple merger or combination of the efforts of existing institutions, or, more typically, is the lack of coordination the result of deeper factors? Fourth, to what extent is each phase of the planning function related to different sets of interest groups with varying political priorities, and how far does this account for what may appear from the outside to be institutional fragmentation?

32. Fifth, it is important to plot the <u>process</u> by which the investment program is actually put together. The first step would be to examine existing laws and regulations; monitoring what occurs in practice is, however, more difficult. Perhaps the best way to do this, which would also answer some of the questions raised in the previous paragraph, would be to track typical investment decisions from their inception to their inclusion in the investment program. This is by no means an easy task and involves understanding and penetration of the governmental decision-making process.

9/ Some already address a number of these issues. However, as stated earlier, there is considerable variation in Bank treatment of them and a notable lack of a systematic approach.

Recommendations at a technical level (e.g. improving project evaluation techniques) would, however, be of little use outside the political context in which they will be applied. It is important to distinguish clearly between the political and technical phases in the decision-making process, so that it becomes as transparent as possible. This will enhance the chances of effective resistance to abuses.

33. Typically, though not exclusively, a project will originate in a sector ministry or autonomous executing agency (e.g. a public enterprise). Are these agencies capable of generating sensible capital expenditure proposals? Are coherent sector strategies developed or is there, rather, a "bottom up" approach to project selection influenced by the availability of donor finance and the political power and administrative skills of a particular minister in getting a project approved by Cabinet before it is properly vetted? What are the capabilities in a sector ministry or executing agency for developing a medium term strategy and for project evaluation, including the practical application of cost benefit techniques? In some cases, there may be no clearly delineated responsibility for such activities. In others there may be a proliferation of such agencies with duplication and overlapping functions impeding the development of a coherent sector strategy. For example, in Zaire's transport sector, planning units were established in each of the major public enterprises responsible for the bulk of the sector's public investments, and in the sectoral ministry. There is, moreover, a transport unit in the Ministry of Planning. The role of each is not clearly defined and differentiated. The resulting overlap in responsibilities results in poor communication, repetition, waste of resources, and an inability to clearly identify and resolve critical issues.

34. A related set of issues concerns the links and division of responsibilities between core and sector ministries. Often there is a tension between them which is far from creative. Some of this is inevitable: sector ministries are driven by technical considerations while core agencies are driven by financial ones. The core/line agency relationship is complex and varies greatly from country to country. Much depends on the financial links -- whether, for example, the line agencies funding comes from the central budget or from its own or independent sources. In many countries, a large proportion of public expenditure is administered by public enterprises, the efficiency of which depends on a greater autonomy and accountability than they are frequently granted. In Turkey, the Government has expanded the use of extra-budgetary funds over which the sector ministries have a greater degree of independent control. The issue, however, becomes problematic when overall expenditure control mechanisms are weak, technical capacity, at both central and sectoral levels, questionable, and political intervention pervasive. This situation often leads core ministries, themselves overstretched, to intervene at a level of detail inevitably incompatible with their knowledge of the sectors and institutions concerned. Factors such as these not only lead to poor management, but defies the principle of autonomy and accountability required at the level of those responsible for implementing and operating projects.

35. Sixth, to what extent do existing institutional mechanisms and incentives impede the translation of broad priorities into coherent expenditure programs? All too frequently government bureaucracies place a high premium on following established procedures even when these conflict with declared objectives, and encourage centralized decision-making while discouraging initiative. There may be a myriad of checks and regulations to prevent improper, wasteful or unauthorized expenditures, which at times can contradict the aim of investing in economically justified development projects. Accountability is often diffuse and there appears to be little concern, even at the highest levels, as to whether targets are met or not. Indeed, a greater premium is sometimes placed on failure to spend alloted sums. This is partly because spending targets are regarded as ends in themselves rather than the means to achieving an objective. This in turn reflects the difficulties involved in establishing measures of output and performance in much of the public sector, and getting all parties to agree to them. Ex post evaluation is sometimes carried out, rather perfunctorily to meet donor requirements, but usually little attempt is made to draw lessons from it to streamline procedures or improve agency performance.

36. In summary, efforts to improve institutional investment planning capabilities should concentrate on:

(a) the coordination of the planning effort among the core agencies;

(b) improvements to the process of investment planning and budgeting, including the ability of implementing agencies to generate and evaluate projects and of line ministries to review them within the context of coherent sector strategies;

(c) improving the link between investment planning and financial allocation through, for example, the establishment of rolling plans to decide on expenditure priorities and the sensible phasing of expenditures; and

(d) strengthening control and scrutiny by the central planning authority to which a project appraisal unit should be attached.

The Link Between Planning and Budgeting

37. One notable trend in most recent Bank reviews as well as in policy-based and technical assistance operations has been a widening of concern to encompass not only investment but public expenditure in general. This explicitly recognizes the importance of the institutional dimension and of an integrated approach and represents a marked departure from the traditional separation of Bank and Fund concerns, with the former focusing on "planning" issues and the latter on "budgeting." This blurring of demarcation lines was inevitable in the context of policy-based lending where it quickly became apparent that the Bank had little option but to become involved in issues pertaining to the whole of public financial management.

38. "Government budgets are the principal administrative instruments through which public investment (or expenditure) programs are transformed into tangible achievements." [10] Unfortunately, few countries, perhaps only one in ten, have a system of multi-year budgeting which would facilitate the integration of multi-year programs with annual budgets. It is also discouragingly true that after great effort has been devoted to formulating an investment plan, the budget, even for the first year following the plan's adoption may bear little or no relation to it. In Sierra Leone, for example, a 1985 review found that "there is no evidence that the overall goals of the plan, sectoral objectives or inter-industry relations are taken into account in preparing the yearly development expenditure budget and in selecting the projects for the sectoral investment programs. Sometimes, a project is included for political reasons in disregard of considerations such as total costs, availability of funds and long run development objectives. In other cases, the availability of funds becomes the determining factor, regardless of the project's repercussions on other sectors, on the balance of payments and on the Government budget." Similarly, in Kenya, it was found that the manner in which new projects have been planned, appraised, approved and included in the budget differs significantly from the pattern stipulated in Treasury circulars and the guidelines for the preparation, appraisal and approval of new public investment projects, despite the existence of a system of forward budgeting designed precisely to provide a link between the development plan and the annual budget.

39. Common reasons for the failure to provide an adequate link are:

(a) "Crosswalk" documents [11] and systems such as forward budgets do not, unlike the regular annual budget, have the force of law. Consequently, less attention is inevitably paid to them by both legislators and civil servants.

(b) Forward budgets are frequently overambitious and try to tranrfer to the planning and forecasting framework the full complexity of budgetary classification and line items.

10/ Chapter on Public Investment Programs in "Investing in Development: Lessons of World Bank Experience" by Warren C. Baum and Stokes M. Tolbert, O.U.P. 1985.

11/ A "crosswalk document" provides cross references between, for example, two budgets which use different systems of classification. The most common form consists of a matrix which helps the reader to determine where an item (or the portion of an item to be financed during the year in question) in the multi-year planning budget may be found in the annual budget presented to the legislature.

(c) On the other hand, the development plans which should form the strategic basis for budgetary formulation, though specifying general sectoral ceilings, frequently do not contain a consistent and comprehensive list of projects and programs.

(d) The institutional mechanism for interministerial discussions based on project submissions by the sector ministries, and involving both the planning and finance ministries, frequently break down in practice.

(e) For both legal and practical reasons, those responsible for preparing the development plan and (if it exists) the forward budget frequently have less prestige than those who prepare the annual budget which actually determines the allocation of financial resources. Less attention is therefore paid to their work by major actors at all stages of the process.

(f) Those responsible for preparing and executing the annual budget are often subject to overall budgetary ceilings which may have to be suddenly and arbitrarily lowered in response to a drop in resource availability. This inevitably affects the credibility of the planning exercise.

(g) The time available for completing the budget cycle is often barely sufficient and does not make allowance for the more complex requirements of negotiating and incorporating plan targets.

40. In an effort to improve the links between the planning and budgetary processes, the Bank has frequently become involved in recommending or supporting organizational changes with a view to integrating the functions of budgeting and investment planning. These efforts have had mixed success and may, in many cases, be a red herring. While organizational changes are important, they can sometimes be an unsatisfactory substitute for deeper procedural and policy reforms. It is essential not to confuse the two.

41. The approaches taken towards the changes are basically of three types: (i) the planning agency takes over the budget function (Brazil, Korea, Panama); (ii) the budgeting office of the ministry of finance takes over the planning function (Bahamas, Bahrain, Haiti, Mauritania, Kenya, Tanzania and Zambia); and (iii) establishment of budget offices, on the US model, which are organizationally independent of both the finance and planning ministries (Thailand, Philippines, Nigeria). Most of the organizational mergers under (i) and (ii) faced varying degrees of difficulty due mainly to the fact that each agency had developed its own separate identity which it did not lose when integrated with others. Several countries, consequently, reverted to separate budget and planning agencies, while others have gone through a cyclical process, with the separation of functions followed by integration and eventually by reversion to separate agencies again. It is important to recognize that there is a political as well as a technical dimension to this question. The addition or subtraction of ministries and departments from a government bureaucracy sometimes reflects shifts in the political wind and can make reform efforts more difficult rather than easier to sustain.

42. Even in the light of this mixed experience, it remains true that, ceteris paribus, combining planning and budgeting offices under one ministry is likely to improve coordination of expenditure programs. It is not, however, either a necessary nor a sufficient condition. At the political level, moreover, combining finance and planning functions into one ministry may create too powerful a core agency. Much more important than the issue of location are a proper decision-making authority, sufficient trained staff, and an adequate flow of information for the formulation of consolidated public sector budgets. Moreover, a separate planning authority can provide important checks and balances which could be absent if all key core functions were concentrated in one ministry. Chile, which is one of the leading examples of better budgetary administration among developing countries, shows how integration of plans and budgets can be tackled through procedural measures rather than organization mergers: any projects not appraised according to methods approved by the planning agency, and reviewed by that agency, cannot be included in the budget. India and Thailand have also developed successfully operating "crosswalk" procedures. These and other examples should be studied in more depth with a view to applying the lessons learnt to other countries.

43. In summary, both successes and failures seem to point to the following general recommendations. First, the prestige and importance of the planning process should be given full legal recognition. Whichever body is in charge of overall investment programing should have the effective power of veto over which projects are included in the annual budget. Second, if this body is separate from the finance ministry, then there must be very close coordination and cooperation between them. The planners must be sensitive to, and fully cognizant of, the resource constraints facing the government. It is not infrequent that lack of such coordination leads to the preparation of excessively large investment programs which subsequently undermine the credibility of the planning process. Third, the procedures linking the plan to the budget should be kept as administratively simple as possible to avoid overtaxing the institutional and technical capacities available to most governments. Fourth, the process should be organized to allow ample time for full discussion by all interested parties. It may well be that in the final analysis the finance minister or head of government will have to act as arbiter; but if the system is to succeed it is essential that all interested parties fully participate in the preparatory process. Fifth, the ministry or department responsible for the plan should be closely linked, and in close alliance, with that responsible for the annual budget. If this is not the case, then it is inevitable that the exigencies and time pressures of the annual budgeting exercise will take precedence and the exercise will be perceived as a Finance Ministry preserve.

Other Aspects of Budgetary Organization

44. As well as the link between planning and budgeting, and the ability of the planning agency and sectoral ministries to perform their tasks, it is important to focus on the organization of the finance ministry itself to determine whether it aids or impedes the use of the budget as an effective policy instrument. It is of little use recommending, for example, a greater emphasis on objectives to be achieved through budgetary allocations if there is no office in the ministry of finance which is

familiar with analyzing government operations along these lines. At times, the finance ministry may be unaware of the number of civil servants in each of the spending ministries, let alone the activities which they are supposed to be accomplishing (indeed, the spending ministries themselves are themselves unaware of this in a number of countries). Similar ignorance may exist on the price/ volume relationships between items of non-wage current expenditures. Until such basic data gaps are filled, the finance ministry will be unable to do more than crudely negotiate global expenditure ceilings with line ministries. The only information it will have at its disposal will be the previous years' expenditures (perhaps even that may be out-dated), and overall ceilings often based on optimistic estimates of future revenues.

45. A useful start can always be made by carrying out an organizational diagnostic of the finance ministry from the viewpoint of objectives-oriented budgeting. This will swiftly identify both the institutional and information gaps. Frequently, the latter can be partly filled through the installation of electronic data processing systems in both core and line ministries. Many countries have greatly improved public sector financial management through the automation of the wage bill and method of payment (though see paragraphs 64-66 for a discussion of the prerequisites for the successful introduction of automated systems). Institutional deficiencies are rather more difficult to tackle. Even here, however, they may be elements in the existing organizational structure that can be built upon relatively quickly. Most finance ministries include, for example, some sort of inspectorate of finances which is supposed to fulfill internal auditing functions and therefore focus on the operations of spending agencies. Such inspectorates could be strengthened into a new office that examines the desirability and efficiency of government activities in a more integrated fashion.

46. Another problem area which could be initially addressed through an organizational audit of the finance ministry would be that of superimposition of overlapping functions, particularly those of treasury, budget directorate and audit. As with investment decisions, it would be useful to track current expenditure allocations through the system from their initiation to their inclusion in the annual budget. This would likely highlight a considerable number of methodological, procedural and information difficulties.

47. Other institutional factors which affect the efficiency of budget preparation, and which need to be taken into account when proposing reforms are:

(a) The system's "heritage." Procedures and institutional relationships differ according to whether the country's budgetary system is influenced by the traditions of Britain (which tends to emphasize expenditures rather than revenues in the budgetary process as a result of which expenditures can sometimes be presented to the legislatures unaccompanied by revenue estimates); France (strong financial control and a central treasury which is not merely a cashier but also a banker); other European countries (in the Netherlands and Germany greater reliance on commercial principles of budgeting including depreciation allowances and accrual accounting, in Portugal and Italy a more legal approach with annual specification of budgetary allotments by law); the US (a general budget and numerous trust funds that are not subject to legislative approach); and hybrid systems such as those in Latin America that reflect the Spanish tradition combined with later US influence and the results of individual country experiences. [12]

(b) The budget calendar. As noted above, one of the problems frequently encountered when introducing reforms is insufficient time for the necessary preparation and negotiations. Budgeting is an activity which tends to "bunch" as critical dates (e.g. the submission of estimates to Cabinet or the legislature) approach. [13] The extent to which this can be avoided by stretching the process out is limited, first, by the annual framework and, second, by the fact that data and estimates can swiftly become outdated. Moreover, flexibility is important since estimates are subject to change at each stage of the political hierarchy. Producing a rational policy instrument from this complex exercise presents many difficulties, often compounded by exogenous factors such as a high inflation rate and uncertain trade-based revenues.

(c) The appropriateness of the fiscal year which should take account of factors such as the crop cycle, the annual business cycle, etc.

(d) Adequacy of budgetary circulars and guidelines which are the main instruments available to the core agencies for ensuring that estimates are in accordance with, as a minimum, expected revenue constraints, and, at best, with policy guidelines. Despite their importance, budget circulars can all too easily become routine documents which become notorious for what they do not cover rather than for what they explain.

12/ For a fuller treatment of the implications of different budgetary traditions, see A. Premchand: "Government Budgeting and Expenditure Control," IMF publication, 1983.

13/ As a minimum, the preparation of a budget will involve nine separate processes, each involving substantial demands on institutional and human resources: (i) preparation of budget estimate forms and guidelines by core ministries; (ii) preparation of revenue and expenditure estimates by line ministries and agencies; (iii) review of consolidation of agency proposals by responsible ministries; (iv) transmission of ministry requests to core agencies; (v) negotiations between core agencies and line ministries; (vi) preparation of draft budget; (vii) Cabinet approval of draft budget; (viii) transmission of Cabinet revisions; and (ix) preparation of final budget and its presentation to the legislature (see Annex IV for a fuller discussion).

The Comprehensiveness of the Budget

48. Few developing countries currently prepare a consolidated public sector budget. This failure not only places severe limitations on investment programing and its full integration with the budget, it also reduces the possibility of using fiscal policies for stabilization purposes. A 1980 study of Costa Rica's economic administration noted that some 550 autonomous institutions enjoyed legal financial independence and operated outside the control of the central authorities. Moreover, even within the Central Government, about 10 percent of expenditures took place outside the budget. Some specialized ministries had their own independent budgets while about half of total tax collections were earmarked for specific purposes. In 1979, a major step forward was taken with the setting up of a National Budgetary Authority; prior to that the responsibility for what little central budget preparation and control existed was split between the Ministries of Finance and Planning. Drastic reduction of earmarking, and progress in centralizing and consolidating the budgetary process were major components in Costa Rica's structural adjustment program supported by a policy-based lending operation in 1984.

49. Other examples abound. In Ecuador, the national budget was found to cover only 62 percent of public revenues and 43 percent of expenditures, with the rest accounted for by special funds and autonomous agencies and public enterprises. In Brazil, the growth of autonomous federal agencies and powerful public enterprises progressively weakened the once strong hold which the Federal Treasury had on central government receipts and expenditures. In the Ivory Coast in the late 1970's, the budget was split between the Treasury and two other agencies, while a multitude of extra-budgetary accounts were maintained. In Egypt,[14] a 1980 budgetary reform brought a number of special funds and separate accounts into the central budget, and the current budget was thus unified.[15] However, responsibility for financing public investments was transferred to a newly established National Investment Bank so that there were in effect two central budgeting agencies.

50. Frequently, the budget coverage reflects definitional problems resolved more by custom than by economic considerations. Defining the concept of "public investment" is not, for example, without its difficulties. Should it cover only investment by central government agencies? Should it include only those projects financed wholly or partially through the budget? What about investment by public enterprises?

14/ "Public Finance in Egypt" by S. Ahmed, Staff Working Paper, 1984.

15/ This should not necessarily be regarded as salutory since it may limit the autonomy and accountability of enterprise management.

Or by joint ventures? Should it cover all capital expenditures (as defined by the IMF which excludes only defense[16] but includes office furniture and equipment, as well as police stations, courts and prisons) or only that which is expected to lead to "development"? Even in a narrow "development" context, should investment be defined to include only expenditure on the creation of physical assets, or also other "development" expenditure, e.g. on raising the level of health services or expanding education? Development or investment expenditure often includes some recurrent and operating costs during construction which can easily lead to some current costs continually being hidden under the investment umbrella. Current Bank practice favors defining a public investment program which includes the investments of wholly owned state enterprises but excludes joint ventures except in individual cases where the government share is so dominant that the company is treated de facto as a 100 percent public enterprise. All projects funded by external aid or borrowing tend to be included (except defense), whether or not the resources are channelled through the government budget. In addition, the program usually covers the government's entire capital budget irrespective of any evaluation of its developmental impact. This at least has the operational advantage of consistency with IMF definitions. Current expenditures on "developmental" items such as health and education, or on the supply of agricultural inputs, are usually excluded from the investment program except where the country has a medium-term development plan; in such cases, all expenditure included in the plan as developmental is admitted into the investment program. This latter point is yet another reason why the Bank's interest has evolved beyond the purely investment concept to a wider concern with public expenditure as a whole.[17]

51. On the institutional level, the achievement of full budget coverage is far from easy. In the case of state enterprises, government marketing boards, or officially sponsored but financially autonomous development agencies, it is first necessary to define, as precisely as possible, the financial relationship between these entities and the State. This definition must include not only direct flows of funds but implicit subsidies or charges brought about by government policy as well as an updated and economically accurate picture of the entity's balance sheet and current financial operations. This is frequently a difficult technical exercise which taxes the quality of available data to the hilt. In many lesser-developed countries this data is largely unavailable to government despite the existence of elaborate rules and regulations "obliging" entities to provide the information on a systematic basis. In Zaire, for example, the government is only provided with the accounts, frequently unaudited and inaccurate, of the largest and most important public enterprises some 18

16/ Defense "capital" spending is essentially consumption and should therefore be placed above the line.

17/ One useful distinction is that between discretionary and non-discretionary expenditures. The former would include not only capital spending per se, but also recurrent items other than, say, debt servicing obligations and (at least in the short run) the civil service wage bill.

months after the event; for the lesser enterprises there are often no accounts at all. The usual result is that the full implications of the government-public enterprise relationship are not appreciated by the core ministries until a financial crisis occurs. Then governments find their ability to restrain the budget deficit hampered not only by commitments to subsidies and public enterprise pricing policies, but also by non-payment of debts between public entities, declining working capital (which must be supplemented by the Treasury), cumulative losses, non-payment of interest, and finally effective default on loans necessitating central government intervention to assume the debt service burden.[18]

52. Nevertheless, extending budgetary coverage to autonomous agencies, and especially to public enterprises, should be undertaken with great care. The full unification of public enterprise budgets with that of the central government is both unnecessary and undesirable since it violates the principle of operational autonomy without which greater efficiency is difficult if not impossible to achieve. Coordination consistent with the proper degree of autonomy could be improved through the following measures:[19]

(a) ensuring the adoption of a uniform budget year (with the possible exception of those entities whose revenues rely heavily on crop cycles, e.g. marketing boards);

(b) preparation of entity budgets in advance of the central budget, and in consultation with the Treasury;

(c) effective central government control over external and domestic borrowing by autonomous entities, except for those competitive enough to obtain funds without a government guarantee;

(d) inclusion of major autonomous agency investments in the public investment program;

(e) explicit provision in both central and entity budgets for all receipts and payments anticipated between the government and public entities; and

(f) a system of cash flow monitoring and forecasting permitting the revision of budgetary estimates of transfers at least on a six monthly basis.

18/ See A. Premchand: op.cit. for a fuller treatment of these issues.

19/ Most of these elements have been suggested by the Bank in its dialogue with governments concerning reforms to the institutional mechanisms for monitoring and evaluating state enterprise performance. See especially M. Shirley: "Managing State-Owned Enterprises," Staff Working Paper No. 577, 1983.

53. Clearly most countries have as yet been unable to institute most of these measures, though important partial successes have been achieved. In Zaire, for example, Bank technical assistance has been instrumental in establishing a debt control agency which has vastly improved central government's ability to control and monitor public enterprise external borrowing. Similarly, in Thailand, Bank advice was an important element in establishing better monitoring of public entity borrowing. In some Latin American countries, most notably Chile and (until recently) Panama, core ministries are able to exercise effective budgetary and administrative control over all public sector expenditure.[20] In these countries, fully integrated and consolidated public sector accounts are produced annually, cash flow information is generated, and the state of public finances may be easily monitored on a quarterly if not a monthly basis. In Sub-Saharan Africa, Botswana was found to have "a well ordered and effective system for the formulation, preparation and execution of its annual budget .... The crucial relationship between (the recurrent and development) sectors of the budget are appreciated in Botswana and this was a major factor in the remerging of the planning function with finance in 1970."[21] Moreover, the government exercises effective control "over a small, manageable number of parastatals." In each of these "success stories" Bank and Fund technical assistance and/or financial support were important contributory elements.

Classification of Budget Items

54. Irrespective of organizational structure and the role of the different tiers in the planning and budgeting process, Bank experience shows that reclassification of traditional budget categories is necessary if the budget is to become an effective tool of development policy. These traditional categories, which still have a surprisingly tenacious hold in a wide range of developing and industrialized countries, were established primarily as a basis for legislative oversight and a source of information about the end uses of each unit's expenditure. The classification is usually into items like salaries, equipment, supplies and services, etc., and shows what each organization is authorized to spend under each heading. They yield almost no informaton on the objectives of spending such as, for example, raising the level of literacy in a certain area or providing another with irrigation.

55. One of the most common devices used to address this issue has been to divide the budget into a recurrent and a capital or development budget. The former would include all "consumption" items while the other would ideally include not merely investments in infrastructure but all expenditures which might contribute to development. As noted earlier in

20/ Though whether this power is appropriately utilized is another question.

21/ Nimrod Raphaeli, Jacques Roumani and A.C. MacKellar: "Public Sector Management in Botswana: Lessons in Pragmatism," Staff Working Paper No. 709, 1984.

connection with the question of budget coverage, conceptual and definitional difficulties have sparked a good deal of controversy concerning such a separation of the budget. Supporters of the dual budget claim that it enables a clearer identification of the uses of borrowed funds and also a stronger focus on the importance of generating current account savings as a policy goal. Opponents argue that it places too much emphasis on infrastructure investments as the basis for development. There is, moreover, increasing concern within the Bank about frequent government failure to provide sufficient domestic resources to projects and other purposes deemed essential for development. This refers not only to matching capital funds but also to recurrent funds for the successful operation and maintenance of completed projects.[22] However, this failure would seem to argue in favor of rather than against the separate accounting and budgeting of capital and current expenditures. Although controversies abound on the merits of different classifications and measures of capital outlays, a separation would certainly facilitate a systematic approach to both the "local currency" problem of matching capital allocation and the "recurrent cost" problem. It also makes it easier to avoid the "camel's nose" syndrome: the allocation of a certain manageable sum to a project in the first year, the phasing of which involves far larger expenditures in years 2, 3, etc. when the girth of the camel makes itself felt. This can only be avoided through a system of multi-year budgeting and the use of a common system of classification for the investment program and the capital and budgets. Bank efforts should focus more on assisting governments to classify their budgets in such a way that the public investment program and other development spending can be tracked through line items of appropriation and expenditures.[23]

56. In practice, the choice of whether or not to consolidate capital and current budgets has important institutional as well as accounting implications. These concern, above all, the respective roles of the finance and planning ministries as discussed in paragraphs 40-42 above. In Zambia, for example, control of not only the investment program, but also of the capital budget, was vested in the Planning Commission, while the Ministry of Finance controlled the recurrent budget only. This provided the Planning Commission with the authority to promote its own vision of capital-led development, while relegating the Ministry of Finance to a less important

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22/ This "recurrent cost" problem has been examined in depth by Peter Heller in "The Problem of Recurring Costs in the Budgetary and Planning Process" (1982). He proposes a proforma for project summaries which would be used to extrapolate associated current cost requirements or, alternatively, the calculation of sectoral ratios based on historical data. There have been several cursory, and a few detailed, checks of such ratios by Bank missions which have found them on balance unstable. However, the Bank could usefully carry out much more detailed research in this area.

23/ This is seldom achieved in practice though some countries such as India, and more recently Thailand, have devised "crosswalk" documents between program and budget items.

accounting function. Under the guise of moving towards budgetary consolidation, de facto control of capital expenditures was transferred to the Ministry of Finance, while the Planning Commission was given the largely theoretical authority to plan the allocation of the complete budget. This was an essential first step towards the eventual goal (still to be achieved) of unifying the closely linked functions of planning, budgeting expenditure control and evaluation.

57. As with so much else connected with budgetary reform, reclassification is clear and simple on the conceptual plane, but complex when it comes to implementation. Within each ministry, when the classifications that civil servants have become accustomed to change, disruption and some resentment are inevitable. Also, politicians and senior functionaries may feel threatened by the greater transparency and "orientation towards objectives" implied by a reclassification exercise. This will occur even when current classification is properly coded in a manner which permits automation. In many countries, however, this is not the case. Not only is the classification and coding system inadequate from a functional standpoint, it is sometimes so haphazard that it cannot be automated. In Morocco, for example, the codes attached to ministries and line items change each year. Any modification in a ministry's or department's political status involves a change in its coding. There, as in many other countries, reclassification along development-oriented lines will be a major exercise which will have to be preceded by detailed work at individual ministry level to bring the current system into order. Once this is done, electronic data processing can be introduced. This is essential to allow flexibility in adjusting and updating budgetary classifications to reflect changing policies and circumstances.

Budget Implementation and Control of Expenditures

58. So far the discussion has focussed on the concepts, procedures and structures for the formulation of investment programs and budgets. Of equal or greater importance, however, are the problems of budget execution and program implementation. Bank approaches to this have been from the standpoint of two objectives: first, the timeliness and adequacy of the flow of budgeted funds to executing agencies and, second, the effectiveness of treasury control over public expenditures and enforcement of spending limits. There is, of course, a tension between these two objectives which manifests itself particularly strongly during periods of financial crisis.

59. The first approach is exemplified by experiences in the agricultural sectors of Zaire, Kenya and Madagascar which illustrate in useful detail the process of authorization, disbursement and monitoring of public expenditure. In all three countries, delays in the release of funds were found to be a major factor affecting project implementation, resulting in under-spending of budgeted amounts. Systematic monitoring of expenditure was rare and budgets were seldom revised during the course of the year.

This is not always due to the treasury's delayed release of budgeted funds as an instrument in dealing with financial crises. Sometimes, budgets themselves are unrealistically formulated in terms of real resource availability. In Morocco, a recent review of public expenditure found that of the investment expenditures voted by the legislative authority, just over half were incorporated into the spending plans of executing agencies authorized by the Treasury, and that of these latter amounts slightly less than half (i.e. about a quarter of the original appropriations) were actually spent.

60. In the absence of carefully implemented institutional and procedural reforms, severe financial constraints will always militate against orderly project implementation. Tightly controlled release of budget funds becomes inescapable when IMF conditionality imposes quarterly (or even in some cases monthly) spending ceilings. Of course, in principle, once budget allocations are properly approved and made, the responsibility for implementing the budget, along with the requisite freedom to do so, should rest with the spending agency. However, for this to be compatible with stringent and strictly applied spending limits, it would be necessary for these agencies to be equipped with adequate financial management capability. This is an issue on which substantially greater Bank attention should be focussed. Few would dispute that, except in the short term, tight central control is counterproductive because it is impossible for central agencies to comprehend the full spectrum and detail of government operations. However, greater freedom for spending agencies would have to be matched by a degree of accountability, not merely for executing and monitoring of spending but for the achievement of results, which few at present would be capable of assuming. Bank assistance needs to be directed towards building up sectoral financial management capability to estimate and monitor costs, to fulfill program tasks within specific cost ceilings, and to help governments devise measures to ensure accountability.

61. Ensuring a timely flow of funds for specific program and project implementation is, however, cnly one of the aspects of expenditure control. An equally important requirement is the reinforcement of the core ministries' ability to exercise control over public expenditures as a whole; indeed, in the short run, given the severe financial constraints under which most borrowers operate, the greater attention must be focussed on the core agencies. In order to minimize the damage to development objectives caused by revenue shortfalls and general financial austerity, it is important that the capacity for control of expenditures be extended beyond the ability to enforce global spending limits to that of influencing the <u>composition</u> of expenditures in accordance with development priorities.

62. In many countries it is nonetheless necessary to recognize that even the first of these abilities is sorely absent. It would be no exaggeration to say that the issue of expenditure control is usually the

most important and difficult problem area in the budget cycle. Whereas budgeting procedures *per se* can be at least marginally improved without encountering formidable political obstacles, it nearly always requires considerable political determination, administrative skill and time to institute solid control procedures for all major outlays. To assist governments in this difficult task, it is necessary to become familiar with current procedures and the "rules of the game," both theoretical and practical, which regulate them. Key questions which should be addressed include:

(a) How many categories of expenditure are there which require separate procedures for making commitments and issuing payment orders, and how many different agencies are involved? In Zaire, for instance, there are at least eight different expenditure tranches (four of them involving different categories of remuneration), the control of which (commitments and payments) is the responsibility of 12 different institutions.

(b) What percentage of total *commitments* does the finance ministry control? Again, in Zaire, the ministry controlled only about 30 percent, essentially those for the operating expenditures of the line ministries and the small proportion of total capital expenditures financed out of the central government budget. Wage and salary commitments of the Presidency, the military and government-financed political institutions escape the ministry's remit entirely.

(c) How many separate budgets are there? In several countries, commitments are made by semi-autonomous institutions without any participation on the part of the Finance Ministry. Nevertheless, the operating expenses of these institutions are frequently financed by government, often through an annex to the main budget or in a separate budget document altogether. Sometimes, indeed, there is no prior documentation at all and the treasury finds itself with payment obligations for which no allowance has been made.

(d) What is the system for ordering and controlling actual payments? In some countries, sector ministries have complete autonomy in the receipt and spending of earmarked funds and even of donor finance. This often takes place in the absence of guidelines or of a system of *ex post* accountability.

(e) Even when all, or most, payments are issued through the finance ministry this may not imply control over, or even awareness of, the amount or composition of outlays. Sometimes the payment orders may simply serve to transfer alloted sums (perhaps a fixed proportion of annual commitments) to the spending agency which determines both how much is spent and on what. This may be partially modified by the requirement of a finance ministry endorsement on all departmental checks issued. However, this does not solve the basic problem: control over payment orders, while important, is usually too late because a liability has already been incurred on which the government cannot renege.

(f) To what extent are existing rules and procedures, even if adequate in theory, bypassed in practice? It is inevitable that, from time to time, political pressures will be put on a finance minister to circumvent normal procedures to speed up a payment or to authorize a payment not included in either the normal or supplementary budget. The important question, however, is whether this occurs frequently and with regularity.

(g) It is also important to guard against the opposite tendency: because the institutional framework is often so weak, and in particular because the finance ministry's ex ante control over commitments is so partial, the only way in which the ministry can control the total level of spending is through delaying tactics. Requests for payment orders or endorsements are bogged down within the ministry's bureaucratic system, checks are issued but not sent, etc., etc. While an understandable last resort, this is an extremely inefficient way of controlling public expenditures which has very damaging consequences for the country's development effort. It involves delays in the execution of development projects and programs which can dramatically reduce their rate of return; it distorts the structure of spending in favor of wages and salaries since these cannot be delayed (except in extremis); it undermines the real accountability of the implementing agency; and it is highly vulnerable to political pressure (a powerful minister can appeal over the finance minister's head to finance favorite activities to the further detriment of development projects).

63. To address these problems over the medium term, it is necessary to recognize the political dimension of the issue. First, studies and Bank staff reports should make it clear to the authorities that budgetary control is weak either because of the inadequacy of existing rules and regulations or because, though adequate, they are regularly and frequently circumvented. In the latter case, it should be clearly pointed out that this is an ominous precedent which may evolve into a tendency throughout the administration to ignore or to interpret loosely the laws, rules and regulations. Although budget formulation is as much, or perhaps more, a political process of negotiation than a technical one, governments should be encouraged to recognize that once the budget has been decided upon and formally approved, its aim is defeated if at any time the agreed allocation of resources can be altered or spending limits ignored. Clearly, there must be flexibility and sensitivity to changing needs, but the mechanisms and procedures for review and response to changing circumstances should be clearly spelled out and adhered to.

More Effective Financial Management Information Systems

64. Once governments accept the above principles as a starting point, then the next step would be to install procedures to improve central expenditure control. At the heart of such procedures, and the prerequisite to more deep-seated reform, is a public accounting system which provides the timely, regular, detailed and accurate information necessary for expenditure monitoring and evaluation. This would nearly always require the installation of electronic data processing methods, since a manual operation would be unlikely to cope with the size and complexity of a modern government accounting system. The installation of electronic data processing should not, however, be regarded as a substitute for the institutional and procedural reforms which are necessary to permit any accounting system, whatever its technical sophistication, to work as intended. Among the preconditions for success are: (a) the existence of detailed budgets for all government departments, institutions and agencies (including the military and the presidency); (b) the existence of up-to-date files on existing personnel and detailed organigrams for each agency;[24] (c) an adequate system of reporting and review for monitoring the expenditures of all government agencies which depend upon the central budget; (d) proper procedures for ensuring adequate scrutiny of payments; (e) clearly delineated responsibilities among departments and their personnel; (f) a classification of the major items of revenue and expenditure consistent with a streamlined accounting structure; and (g) an adequately trained staff with sufficient incentives to remain in government service.[25]

65. A few other simple rules which will enhance the chances of successful installation of improved management information systems are:[26] (a) keep the system as simple as possible; (b) all the key players, in both core and line agencies, must understand the system and have an effective input in designing and improving it; (c) identify at an early stage what can be done given the short term staffing constraints and order the equipment accordingly; (d) apply the system as flexibly as possible since it is difficult, if not impossible, to be precise in advance concerning where new systems are likely to be most useful (elaborate feasibility studies are thus

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24/ See B. Nunberg: "Public Sector Pay and Employment Policy Issues in Bank Lending: An Interim Review of Experience." PPR Working Paper (forthcoming) for an analysis of the difficulties involved in public sector manpower planning

25/ In Kenya it was found recently that nearly all statistical surveys processed by the Government's Computing Center could have been done faster manually. The root cause of this was unfilled vacancies for programmers and systems analysts because of better job prospects in the private sector. (See Clay G. Wescott: "Building Information Management Systems for Developing Countries," paper presented at a conference on Policy Aspects of Microcomputers in Developing Countries, National Research Council, Washington DC, January, 1988.

26/ Wescott: op. cit.

likely to be a waste of time and money, at least until several pilot projects have been completed); (e) train and retrain more people than seem to be needed to cope with the likely losses to the private sector; (f) focus training on substance, not on technology; (g) share the benefits of the new system, particularly the increased volume of (hopefully) relevant information, as widely as possible, and certainly with all key actors whose work performance could be improved by possessing it; and (h) start with the core ministries (especially finance): sector ministries often have their own sources of donor financing which can complicate later attempts at achieving consistency between sub-systems.

66. It is really only when a reasonably well functioning system of central control has been established that it becomes meaningful to consider wider planning and budgeting principles such as objective-oriented spending or greater autonomy and accountability of line agencies. A well-functioning expenditure control system should permit: (a) greater flexibility on the part of spending ministries in reallocating resources to sustain core activities and support key objectives;[27] (b) concentration of scarce resources on delivering key services which are essential for economic recovery and the development of human resources.

Coping With Uncertainty

67. Perhaps the greatest challenge facing governments who wish to improve their public expenditure management is dealing with the uncertainties inherent in all budgeting and planning exercises. Budgeting techniques have not been well designed to cope with uncertainty; indeed, they may be said to thrive on stability. As Naomi Caiden so aptly puts it,[28] "budgeting works best where year-to-year adjustments are marginal, where it is possible to make firm commitments in advance of expenditures, where the recent past is a good guide to the immediate future, and where results may be easily and promptly evaluated." This is a far cry from the reality facing policy makers in most developing countries, particularly those where fiscal revenues rely to a significant extent on commodity export taxes, and where the public investment program depends on uncertain external financing. Even in less externally-dependent economies, the vicissitudes of an increasingly unstable environment render forecasting hazardous. Resource availability estimates and budget allocations may require frequent readjustment during the course of the fiscal year. To maintain a rational resource allocation under such circumstances is an immensely difficult task, which is demanding not only upon the individuals concerned with policy making at a high level, but also in terms of the flexibility of the institutions and procedures involved.

27/ One of the consequences and features of inadequate control systems is that expenditure realignments, especially in or out of personnel costs, can only be carried out by the core agencies; this reduces flexibility and impedes implementation.

28/ Naomi Caiden: "Public Budgeting amidst Uncertainty and Instability," in "Public Budgeting and Finance," Washington DC, Spring, 1980.

68. Uncertain revenues are, however, only one of the causes of unpredictablility in budgeting. The growth of the public sector, both in size and complexity, has made it much more difficult to predict levels and allocations of expenditure. Institutional and managerial capacities have not kept pace with this growth. Even within the short range perspective of the fiscal year, the cost of programs are underestimated, they run out of money and require supplementary appropriations.[29] Since resources are finite, this means less is available for other programmed activities. Such difficulties are even more acute for the growing proportion of activities which require to be programmed on a multi-year rather than on an annual basis. Such programs often do not get the stable long term commitments of funds which they require. In an atmosphere of semi-permanent fiscal crisis, core ministries tighten and centralise control procedures, and are reluctant to commit funds for more than the shortest legally permitted time. The authorities managing longer-term programs cannot, therefore, plan ahead in the knowledge that the end of each budget year will not bring about harmful reductions or even a cut- off in funding. Alternatively, administrations faced with uncertainty attempt to do too much too quickly. Appropriations are not spent and large balances accumulate towards the end of the fiscal year. This can lead to "panic spending" as agencies fear that the balances will lead to reduced allocations in the next budget round.

69. The state of the art on budgeting and expenditure planning offers little to governments trying to cope with uncertainty. Refuge is often taken behind sweeping global reform proposals (see the next section) whereas a more modest, partial approach may be of greater practical relevance. Even here, however, there are few short term palliatives. Over the longer run, governments can be better equipped to deal with budgetary uncertainty through:

(a) judicious use of sensitivity analysis and alternative revenue and expenditure scenarios;

(b) drawing on comparative analysis and experiences of other governments and the private sector;

(c) the adoption of differential time spans reflecting the varying nature of programs;

29/ Supplementary budgets are themselves a common source of abuse of the system. In Zambia, for instance, this combines with diffuse expenditure authority in a highly detrimental manner. The Central Bank maintains a "revaluation account" under which payments are automatically made, irrespective of whether authorization was given in the budget. In effect, this allows spending ministries to overdraw their accounts and initiate new projects without approval from the Ministry of Finance, with retroactive authority provided through the suplementary budget. The results are as might be predicted: in 1986, the supplementary budget was almost as large as the original operating budget, yielding a very large overall deficit.

(d) placing much more emphasis on the implementation stage of the budgetary process (most analysis and reform proposals concentrate on the preparation stage) in terms of planning budget implementation processes, reviewing how officials work with budgets during the year, making adequate arrangements to ensure cash flow at critical periods, establishing self-pacing disbursement schedules, and initiating an incentive system for compliance with budgetary mandates;

(e) making fuller use of new accounting and electronic data processing techniques to compare, track, and assess expenditures with a view to achieving greater decentralization and more effective accountability at line agency level; and

(f) greater reliance on medium term financial programming with appropriate contingencies for shortfalls in anticipated resources and a closer link between revenues and expenditure planning.

70. Botswana presents an interesting example of how to cope with revenue uncertainties. The Government is highly dependent on trade and commodity-related income with customs duties and mineral royalties accounting for almost three-quarters of total revenues (excluding development grants). Accordingly, the country's sixth National Development Plan (NDP) contains four budget scenarios. The base case is the most optimistic both in terms of expenditure (it assumes an end to the then current drought) and revenues (increased mineral exports and drawing of foreign borrowing above historical levels). [30] The other three scenarios were designed to test whether policy actions (either new revenue measures, or reductions and reallocations of expenditures) would be needed under less favorable conditions. They assumed, respectively, higher drought relief expenditure, lower diamond export receipts, and less external aid funding. The model used could also predict the effects of all three phenomena occurring at once, though this "disaster" scenario was not published in the NDP. The approach adopted by the Government was highly useful, not only in terms of predicting the macroeconomic impact of deteriorating revenues, but also in preparing the authorities for the eventualities and having well-thought-out policy responses ready for them.

71. Before, however, attempting to apply this methodology elsewhere, it is important to note that in Botswana it forms part of a well-functioning planning and budgeting system with institutions and procedures that should be the envy of some developed, let alone developing, economies. Among its principal attributes are: (a) well-prepared macroeconomic projections to underpin the Plan, using a model adopted to the country's needs and characteristics; (b) a thorough preparation process for both the NDP and the annual budget, involving each ministry and spending agency at each stage o

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30/ Though it is interesting to note, <u>en passant</u>, that the Bank report considered the revenue projections even in the base case to be somewhat conservative, due mainly to different exchange rate suppositions.

the process; (c) a manpower planning system and population growth projections designed to guide expenditures in the social sectors as well as civil service size and salaries; (d) a carefully designed public investment program, using (where appropriate) project evaluation techniques, and choosing projects on the basis of national development priorities; and (e) recurrent cost implications for capital expenditures that are explicitly calculated and taken into account. In brief, the system possesses many of the attributes of the medium term financial planning "model" discussed in paragraph 18 of this paper. The so-called weaknesses described in the Bank report, and the recommendations for addressing them, could almost be described as fine-tuning. Unless these fundamental characteristics are in place, at least to a significant degree, the application of modelling techniques to deal with fiscal uncertainty will be of little use.

Comprehensive Budgetary Reform

72. The pervasive nature of the deficiencies throughout the budgetary system have persuaded some governments and observers that traditional procedures show little promise of enabling budgets to fulfill their role as instruments of economic policy in the wider sense. This has led to attempts in both industrialized and developing countries to introduce wholesale reforms to the budgetary process which seek a clearer definition of the objectives and outputs expected from budgetary allocations, a multi-year framework showing costs and expected results and a system of evaluation for feedback into subsequent budgeting. These objectives are common to a number of new methods which have been introduced in recent decades including Planning, Programing Budgeting System (PPBS), Rationalization of Budgetary Choice (RBC), and Zero Based Budgeting (ZBB).

73. PPBS is a refinement of the concept of performance budgeting which was partially introduced in the United States as early as 1912. Performance budgeting, as well as introducing the concept of objectives, embodied classification of expenditures by program and activity. The proponents of PPBS want to carry this further by adding the notions of need and efficiency with the aim of quantifying as far as possible the extent to which the chosen objectives have been met with the means used. In addition, PPBS has a multi-annual dimension which should facilitate the linkage between the planning and budgetary process.

74. The schemata of a typical PPBS process is summarized in Chart 1.[31] There are three basic phases following the name of the method: planning, programing and budgeting. The planning phase seeks through study to identify present and future requirements (objectives) and to evaluate

31/ For a fuller treatment, see A. Premchand: "Restructuring Budgeting Systems in Developing Countries: Relevance of the PPBS System" (1977) and L. Garamfalvi: "La Reforme Budgetaire: Quelques Experiences Recentes" paper presented at an IMF Budget and Expenditure Control seminar in 1984.

different possible solutions with a view to selecting the optimum one. It is in this phase that system analysis techniques come into their own. The programing phase takes the proposals of the planning phase and integrates them into programs. These should not only be internally coherent and consistent among themselves but should form a hierarchy of priorities. This would be pyramid-shaped with the top priority category of programs and sub-programs at the summit. Decisions concerning categories, programs and actions would be taken at different levels of the political hierarchy. The setting of broad priorities (program categories) concerning health policy, agricultural policy, etc., would be a cabinet level responsibility, while the optimization of individual programs would be the task of sector ministries. Each would be multi-year and would indicate the total cost and timetable. Every year, each program would be revised and updated in the light of experience and reprojected forward. The third phase, that of budgeting, is the translation of each multi-year program into a set of specific annual actions, and determines who does what and with what resources. Inevitably, this is the most difficult stage of the process. The organic structure of the budget administration is different from that implied by a programing approach and cannot be easily altered. Moreover, problems such as the apportionment between programs of expenditures which are not directly imputable (like wages, for example) must be solved at this stage. Finally, the system provides the means for control and post hoc evaluation of results which should then be fed back into the planning and programing phases.

75. RCB, introduced in France, is very similar to PPBS, to which it owes its inspiration. Differences between the French and US experiences, although important, reflect implementation rather than substance. Both experiments were initially attempted in a context of expanding resources and rapid economic growth. The third variant, ZBB, uses essentially the same techniques but adapts them to a more austere environment of unstable and even diminishing real revenues. As its title indicates, this method starts from the basic assumption that the fact that a given activity has had resources devoted to it previously does not automatically entitle it to a continued renewal of those resources. All activities, except in some cases of those forming part of a continuing, already-approved program, should start from the assumption that they have to be fully planned and justified from scratch.

76. System-wide budgetary reforms have generated a great deal of controversy. In particular, installation and operation of a complete PPBS has not fully succeeded even in the sophisticated administrations of some industrialized countries. They have proved to be lengthy and administratively complex undertakings requiring extensive revisions of traditional accounting systems and institutional habits. In some cases, for example in the United States, insufficient attention was paid to making them compatible with the political process and too much emphasis was placed on technical considerations. Nevertheless, they are far from being wasted efforts, and the experiments of both industrialized and developing countries are rich in lessons for those developing countries considering embarking upon a similar exercise. Annex III contains a more detailed discussion of

the pitfalls encountered in the United States and Belgium with the introduction of PPBS; of the slow but not wholly discouraging installation of RBC in France; and of the Dutch experience which has relied on a more gradualistic, decentralized approach. To complement the discussion, two recent examples of budgetary reform in developing countries are described: the forward budget in Kenya, refined by the introduction in 1985 of the Budget Rationalization Program; and the National Public Expenditure Plan of Papua New Guinea introduced in 1979.

77. In general terms, there would appear to be two groups of reasons for the failure of reform efforts, even in the most successful countries, to live up to their initial expectations. First, the inherent complexity involved in the new methods was not made fully explicit at the outset. This prevented adequate preparation of the planning mechanism and procedures, the accounting system and the requirements for electronic data processing. The muddling through and improvisation that followed both slowed down the new system's installation and reduced its credibility in the bureaucracy. Second, as indicated above, the technical aspects were overemphasised at the expense of the political dimension.

78. Since the budgetary process is, in essence, one of political bargaining, then it should be obvious that the political implications of a major reform should be fully and explicitly taken into account. Yet this is seldom, if ever, the case. The very nature of the political debate surrounding the budget changes profoundly as a result of the introduction of programing methods. The approval of a traditional budget presented under the usual form of votes and line items is very different from that of a program budget with quantified objectives. In order for politicians to feel secure in the rejection or approval of a budgetary item, it is important for them to have access to the same information as those who have prepared the program. This is difficult to achieve in the case of sophisticated and complex programs. For example, few ministers or legislators in France have the time or inclination to read and absorb the extensive and detailed material made available to them in the program budget annexes. Moreover, politicians are aware that the probable consequences of their decisions to approve or refuse an expenditure application will be much more transparent if costs and objectives are clearly identified and quantified than otherwise. This is by no means necessarily desirable for them.[32]

79. In nearly all countries, the budget is strictly regulated by a complex set of laws which govern not only its structure but the means of presentation, approval and execution. The introduction of new methods ignores this at its peril. The kind of reforms discussed here require

32/ At one extreme, "traditional" budgetary allocation can be viewed wholly as a political process, resulting from negotiations between interested parties, the results of which reflect the relative power of each. At this extreme, not only is there no market mechanism in the economic sense, and hence no "prices" attached to inputs and outputs, but the introduction of such "prices" might be viewed by politicians as, at best, unnecessary and, at worst, threatening.

fundamental changes in budgetary legislation. For example, in most cases the law enshrines the principle of annual budgeting; program budgets, by contrast, imply a multi-annual framework. The outcome of this dichotomy is that in none of the cases examined does the program budget have the force of law. This inevitably reinforces the tendency to regard it as a supplementary exercise somewhat removed from where the "real" decisions are made.

80. Institutionally, it is almost certain that a reformed budgetary system will collide with an administrative structure and mores largely incompatible with it. Either the institutions must adapt to the new method or the new method will be forceably adapted to the institutional structure to become eventually "neutralized" or even rejected. The experiences described in Annex I suggests that the latter is far more common than the former. To prevent or at least mitigate this requires considerable effort, forethought and expenditure which should be explicitly recognized at the outset. First, there is a need to build up support for the change at a "grass roots" level within the administration. The imposition of change from the top by executive order is nearly always fatal. The new methods should be introduced gradually on a pilot basis in carefully selected ministries which are willing to be used as guinea pigs. The fullest possible amount of information on the new system and its broad objectives should be widely disseminated among those potentially affected. In particular, the role of "outsiders" (experts and analysts) should be explained to reduce sensations of insecurity and irritation. Second, it should be recognized that this will be an expensive, though productive, process. At least three new cost categories will have to be met: information, training and equipment. The depth and scope of data required for program budgeting is greatly in excess of that for a normal budgetary exercise. Allowance should be made for the human and financial resources that this implies. Similarly, training should not be regarded as simply a "classroom" exercise of instructing the operatives of the new method. Rather, the government should tap all sources of expertise, both national and international, organize seminars, publish articles, and conduct experimental workshops in which participants should be made to feel pioneers in a new process. Training should be regarded as a continuous process of "learning by doing." It should also be recognized that program budgeting is impossible without full access by both core and sector ministries to electronic data processing. The full costs of equiping and training the administration should again be gauged on a pilot basis.

81. Third, while avoiding the pitfalls of dictation from the core ministries, it is important to establish a thoroughly professional unit, probably located in the ministry of finance, which is responsible for coordinating and guiding the reform effort. This unit should have the full backing of the higher political authorities, should be responsible for the dissemination of information, manuals, etc., and should advise ministries on the acquisition of appropriate external support. However, the decision of whether or not to hire outside expertise and to allocate resources to the reform effort should remain the responsibility of the executing ministry.

82. Fourth, it should be recognized that the process of reform, to be successful, must be gradual. It should be extended beyond the pilot ministries only as others become thoroughly prepared. Partial reforms, such as the use of cost benefit techniques and the preparation of sector strategies, could precede the full reform effort. It is noteworthy in this connection that Holland, which has perhaps the most encouraging experiences in wholesale budgetary reform, has been discussing and debating new methods since 1950; by 1986 program budgeting had been extended to about 40 percent of expenditures.

83. Fifth, procedures should be kept as simple as possible and should be consistent with the availability of qualified human resources. For example, an attempt to subject all detailed line items to a forward budgeting procedure or the full range of official activities to a programing approach will be impractical in most countries whether industrialized or developing. As the experience of Kenya shows, failure to be selective can swiftly damage the reform effort. On the other hand, while being selective, developing countries should avoid the error of Papua New Guinea where the new method was confined only to activities which could be regarded as marginal. A good start might be to introduce cost-benefit techniques, forward budgeting and performance budgeting to those ministries which account for the lion's share of the core investment program, concentrating initially on those expenditures, both capital and current, which are linked to the core program.

84. Finally, overambition is highly counterproductive in this field, and it is important to avoid trying to swiftly replace the traditional system in its entirety by a totally new approach. This will inevitably cause resistance at all levels of public institutions, and will eventually result in disillusion. Rather, developing countries should remember that there are many features of a programing budgeting approach which are useful, indeed vital, if a proper link between planning and budgeting is to be achieved and if the budget is to become an effective policy instrument. There is, for example, the basic principle that government objectives should be clearly specified, in as quantifiable a manner as possible, and that budgetary categories are reclassified so as to be able to track more easily the attainment of these objectives. There is also the tenet that major investment decisions, together with their current expenditure implications, should be objectively scrutinized and subject to cost benefit analysis. While recognizing, therefore, that the experiences described in Annex III illustrate the limits of, and constraints to, budgetary reform, and that few would argue for the wholesale import and installation of new sytems in developing countries, it is nonetheless important to avoid an unthinking rejection of the program budget approach. Carefully and selectively applied, it has much to offer developing country governments anxious to improve the allocation of public resources.

MANAGEMENT OF PUBLIC EXPENDITURES: CHECKLIST OF INSTITUTIONAL QUESTIONS TO BE ADDRESSED?/1

1. Macroeconomic Framework

1.1 Are analysis and projection of macroeconomic variables which have an impact on public expenditure planning carried out systematically and if so, do they appear to be taken seriously at a high political level?

1.2 Which institutions are responsible for producing assessments and forecasts? What are their staffing and data problems?

1.3 How frequently is the assessment carried out? What is the procedure for updating it?

1.4 In what format are the assessments produced (e.g. in a medium-term plan, through a forecasting model, through an annual economic report)?

1.5 What is the link, formally and in practice, between these assessments and the preparation of investment programs and budgets?

1.6 What is the extent and quality of background material provided to those responsible for planning and managing expenditures (growth rates by sector, investment and savings requirements, expected rate of inflation, exchange rate movements, etc.)?

1.7 Does each agency produce its own macroeconomic assumptions with consequent inconsistencies?

1.8 What is the degree of feedback between expenditure planning and economic assessments? Are there regular review meetings? Are these attended by forecasters? How reliable has their advice been in the past? Are governments provided with the necessary information to react rationally to shocks?

2. Investment Programing and Project Preparation

2.1 To what extent can the problems associated with the investment program be traced to institutional deficiencies?

1/ This Annex draws heavily not only on reports and conversations within the Bank, but also on the work of the staff of the IMF Fiscal Affairs Department. Messrs. A. Premchand, P. Heller, L. Garamfalvi, A. Tazi and H.R. de Zoysa have been especially generous with their time and advice. Like that of the Bank, the Fund's work in this area is constantly evolving as can be seen from the Fiscal Affairs Department's periodic country studies as well as their methodological papers.

2.2 Is there a planning function? Is it adequately coordinated or fragmented over a number of institutions?

2.3 Why does fragmentation exist (historical factors, the grafting of "modern" institutions onto traditional structures, deliberate decisions to divide power, etc.)?

2.4 What would be required to achieve greater coordination? Would a simple merger be enough or are deeper seated difficulties more significant?

2.5 What is the process by which the investment program is actually put together?

2.6 What is the capacity of line ministries and spending agencies for generating and evaluating investment projects?

2.7 Are coherent sector strategies developed in the line ministries?

2.8 Are there clearly delineated responsibilities for each stage of the project cycle or, rather, overlapping functions causing confusion and a breakdown of coordination?

2.9 What is the relationship between line and core ministries? Are the latter forced to intervene at too detailed a level because of lack of capacity in the former?

2.10 Does an adequate mechanism exist to enable core agencies to make strategic choices between investment alternatives, or are the line ministry submissions more like shopping lists?

2.11 What is the influence of current rules and regulations governing the formulation of the investment program? Does the system of checks and balances and incentives contradict the aim of investing in economically justified development projects?

2.12 What is the degree of accountability for the success/failure of development projects? Is there concern whether targets are met or not? Are there adequate formal arrangements for *ex post* reviews and a feedback into investment programing?

2.13 Has there been a tendency to solve institutional weakness and address lack of technical capacity by the grafting of new institutions onto a traditional administrative structure? Has this blurred responsibilities still further? What have been the consequences in terms of "widening the technical gap" between core and line ministries?

3. The Link Between Planning and Annual Budgeting

3.1 Is there a rolling annual investment budget linked to a multi-year program?

3.2 Are there forward budgets and/or "crosswalk" documents linking investment programs with annual expenditure allocations?

3.3 What is the coverage and degree of complexity of forward budgets? Can the administration cope with them?

3.4 What is the degree of participation of planning agencies (both core and line) in the annual budget preparation process?

3.5 Are development plans and investment specified in the right amount of detail and consistency for use in the budget process?

3.6 What are the institutional mechanisms for interministerial discussion of line ministry submissions?

3.7 Does the forward budget/investment program have the force of law? If not, what impact does lack of legal force have?

3.8 What are the factors which may have damaged the credibility of the programing exericse?

3.9 Is the time available for completing the budget cycle sufficient for the complex requirements of negotiating and incorporating plan targets?

3.10 What is the attitude of those responsible for budget preparation towards those who prepare the investment program/development plan?

3.11 What is the institutional division of responsibilities? Would coordination benefit significantly from having planning and budgeting in the same ministry? If not, then what can be done to improve matters?

3.12 Does the central planning authority have legal power of veto over which projects/programs are included in the annual budget? If so, does it have the institutional and technical capacity to make this effective?

4. Budget Preparation

4.1 What is the organization of the ministry of finance? Who within it is responsible for budget preparation? Is there an office concerned with analyzing government operations in terms of their objectives?

4.2 How are expenditure estimates prepared? Is the process essentially incremental?

4.3 What information is available to the finance ministry on the number of civil servants in each establishment, on their activities, and on the price/volume relationship for wage expenditures?

4.4 Are there overlapping functions in the finance ministry or functions that should be fulfilled but are not? Does the ministry have its own project evaluation capability? If so, how does it relate with that in planning?

4.5 What sort of budgetary system is in operation (e.g. French tradition, US tradition)? How amenable would it be to new procedures from a different tradition?

4.6 What is the budgetary cycle? Are there problems of "bunching" of budgetary decisions which affect the quality of the outcome?

4.7 How flexible is the system in terms of accommodating changes at each stage of the cycle?

4.8 How appropriate is the fiscal year?

4.9 Does the ministry of finance issue circulars and guidelines to the line ministries? If so, are these routine documents or are they used to disseminate substantive policy guidelines?

5. Budget Coverage

5.1 How much of total revenue and expenditure does the budget cover? Which institutions are excluded and why? What are the arrangements for the channeling of donor finance?

5.2 What is the extent of earmarking? What would be the institutional and economic implications of curbing it? Is earmarking authorized in the constitution or in laws and decrees that may be difficult to change?

5.3 How many special funds and separate or supplementary budgets are there and who benefits from them?

5.4 Are state enterprise investments included in the capital budget?

5.5 What measures could be taken to improve the coordination of autonomous agency investment without full incorporation into the central government budget?

6. Classification of Budget Items

6.1 How useful is the current classification for development policy purposes?

6.2 What is the definition of capital expenditures? How are recurrent costs during construction treated?

6.3 Are "development" expenditures separately dealt with? Do they include recurrent as well as capital costs? If not, is there an attempt to calculate and forecast recurrent cost implications? Are the results incorporated in the annual and forward budgets?

6.4 What would be the institutional and manpower implications of reforming classification? Is the coding system capable of data automation?

7. Budget Implementation and Control of Expenditure

7.1 What is the institutional capacity of the spending agencies and line ministries to exercise greater responsibility for budget execution and the control of expenditures?

7.2 At core ministry level, what are the arrangements for expenditure control? How many expenditure categories are there? How many institutions are involved?

7.3 What degree of control does the finance ministry exercise over commitments? Who is exempt from this control and why?

7.4 What are the procedures for ordering and controlling actual payments? What degree of autonomy do line ministries and spending agencies have in the expenditure of earmarked funds?

7.5 To what extent are existing rules and procedures, even if adequate in theory, frequently and significantly by-passed in practice? Why is this done?

7.6 To what extent does the finance ministry have to resort to delaying tactics to control global spending limits?

7.7 Does the finance ministry have the necessary information to control the composition as well as the total level of spending? What institutional, procedural and manpower changes are required to make such control effective? Is it politically feasible?

7.8 If control mechanisms are adequate, what is the scope for allowing greater flexibility on the part of spending ministries to reallocate resources to sustain core activities and deliver key services?

7.9 What instruments are available to achieve flexibility in expenditures? How are supplementary estimates processed? Are guidelines? Are they applied? Why are supplementary estimates necessary--initial underestimation, unforeseen factors, lack of flexibility in the reallocation of resources, etc.?

BUDGETARY REFORM: SOME COUNTRY EXPERIENCES

A. Introduction

This Annex describes the experience of four industrialized and three developing countries in the implementation of improved budgetary procedures and systems. All six experiments have in common the objectives of making the budget a more effective instrument of economic policy, and of improving links between planning and budgeting and between policy inputs and outputs. Accordingly, they aim to improve the allocation of increasingly scarce resources and to facilitate the preparation of expenditure programs consistent with economic policy. The experiments with reform provide a number of important lessons for developing countries which are discussed in the main text. None of them has been fully successful; they range from almost total failure (the introduction of PPBS in the United States) to gradual improvement with some hope for future practical improvements. All of them, however, amply illustrate the political, institutional and technical difficulties associated with reform in this complex area.

B. United States

The pioneer experiments in program budgeting took place in the United States. Their early history stemmed from the need to coordinate, in wartime, the availability of strategic metals with the requirements of the military for finished equipment. This resulted in the preparation of Production Requirements or Controlled Materials Plans which linked together the production of armaments with the necessary means (metals, labor, etc.). This Plan was thus the first program budget prepared under official auspices. After the Second World War, the methodology was developed and extended, principally by the Rand Corporation working with the Department of Defense. Techniques of cost benefit analysis, systems analysis and multi-criteria analysis were refined and adapted to the needs of military production and strategy. In 1953, the preparation of the Air Force budget under PPBS techniques was proposed. Although this was not elevated beyond the academic stage, the Rand Corporation continued to develop PPBS and the method was introduced into the Defense Department in 1961 by Secretary McNamara.[1] In 1965, President Johnson ordered the extension of the system to the entire Federal Administration.

After six years of effort and very discouraging results, the experiment was terminated. Without expressly mentioning PPBS, a June 1971 circular from the Budget Office informed Departments that applications for budgetary allocations from Federal agencies should no longer be accompanied by multi-year programs or by analytical studies. A number of reasons can be cited for this unhappy experience. First, a method which was developed exclusively in one Department (Defense) was imposed by Executive Order on all others without considering whether they had the means with which to comply. The Budget Office issued circulars based entirely on the Defense

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1/ L. Garamfalvi: "La Reforme Budgetaire: Quelque Experiences Recentes," IMF mimeograph, 1986.

Department's experiences without any attempt to adapt them to the requirements of other Departments. Nor were these latter given any assistance from the Budget Office in terms of either methodology or coordination. Some Departments tried to install the system using only their own manpower resources; others asked for assistance from the Defense Department; yet others hired consultants from the universities or even from abroad. Whatever the quality of their academic achievements, these individuals were usually less than familiar with the complexities of the U.S. Federal Government system.

Second, the introduction of program budgeting was not preceded by any serious analysis of the suitability of the Federal structure for it, nor of the administrative, political and technical aspects of it. The imposition of the system from above without any preparation or taking account of the manpower and other requirements condemned the experiment to failure before it began.

Third, the encouraging experiences in the Defense Department proved elusive elsewhere. Quantifiable objectives, the vital raw material of PPBS, were considerably more difficult to identify. There was, moreover, an inevitable clash between the concept of quantifiable objectives in the program budgeting sense and the implicit objective function of the Federal Administration as expressed in its mores and administrative structure. This always occurs to some extent, and it is unrealistic to hope to adapt a complex political structure to programing ideas except very gradually and, even then, incompletely. However, it is necessary to try to insure a minimum of conformity to the ideals of the new system by having, within the Administration, at least one body dedicated to its management and dissemination. This was missing in the United States.

Fourth, the introduction of PPBS encountered a subtle but nonetheless formidable opposition from administration functionaries. As it was not instead of, but rather in addition to, the traditional budgetary procedures, it increased the volume of work substantially. Officials were charged with the preparation of the "normal" budget, plus the programs budget and a crosswalk document (matrix) linking the two. Officials also resented what they saw as the intrusion of analysts and other technicians, charged with the planning functions, into their domain. Frequently the analysts displayed lack of knowledge or appreciation of the difficulties involved in the practical application of their theories. Resentment of overworked officials was also reinforced by the knowledge that the complex and controversial programs could be seen to have little or no influence over the actual allocation of resources.

C. Belgium

The approach adopted in Belgium from the late 1960s onwards, differs in several important respects from that of the United States.[2] Instead of starting from a global or centralized planning concept, the Belgians attempted to identify and systematize the actions followed and the

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2/ Garamfalvi op cit.

objectives pursued by individual ministries. This approach had the advantage of identifying, at an early stage, the contradictions between declared objectives and objectives actually pursued in accordance with actions taken. The exercise was developed into the elaboration of programs at a ministry-by-ministry level, and then converted into program budgets with financial values attached to the expected inputs and outputs. Two ministries, Agriculture and Health, were chosen for the pilot experiments, and between 1969 and 1971 the operation was extended to five more entities (the Ministries of Labor and Employment, and of Social Security, the Post Office, Scientific Establishments, and, at its own request, the National Savings Bank). After 1971, the budgetary requests at ministerial level could be made in wholly program form for the two most advanced ministries (Agriculture and Labor and Employment). Unfortunately, this was the high point of the Belgian experiment. The extension to other ministries, and the integration of the programing approach into traditional budgetary procedures and allocations never took place. The decision to "formalize" the system was not taken and it accordingly fell into disuse. After 1973, the method was progressively abandoned by those ministries which had adopted it and the central team established to coordinate and assist program budgeting was dismantled.

Four main reasons may be identified for the failure of the Belgian experiment. First, not only the parallel continuance of traditional budgetary procedures, but also the failure of the political authorities to give any weight to program budgeting meant that the latter never lost its aura of being no more than a rather academic experiment. Second, close involvement and understanding of the new method was confined to relatively few senior officials and little attempt was made to train or encourage a sympathetic attitude among the civil servants responsible for preparing ministerial budgets. Third, the core institutions in the budgetary process (for example, the Finance Inspectorate and Budget Directorate of the Finance Ministry, the Parliament and the Office of the Accountant General) were not involved in the pioneering of the system[3] and never displayed more than a qualified enthusiasm for it. Fourth, those who tried to apply the system swiftly found that it was impractical in the absence of a fully computerized management information system. At the time few, if any, Belgian ministries possessed such systems.

D. <u>France</u>

France is, perhaps, the country which has gone the furthest in the practical application of program budgeting. More than in most industrialized, non-Socialist societies, economic planning enjoyed considerable prestige in France, at least until the 1970s, both as an authoritative forecast of the French economy and as a statement of proposed government policies.[4] Nevertheless, even in France the economic

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3/ The pioneer work was done by scholars and civil servants from the chosen ministries and was located in the Institut Administration-Universite, an independent body which carries out research work in public administration in Belgium in collaboration with the Civil Service Ministry.

4/ See "French Planning Reforms 1981-84" by Martin Cave, Brunel University, 1986.

vicissitudes of the 1970s, combined with an increasingly "free market" orientation of economic policy to push planning into disrepute. Top be sure, plans continued to be produced; but the sixth plan (1971-75) was disrupted by the recession following the first oil shock, while the expansionary seventh plan collided with the austerity program of Prime Minister Raymond Barre in the late 1970s. It was only after the election of a Socialist Administration in May 1981, that planning began to be taken seriously again at a high political level.

It is important to bear this background in mind when considering the French experience with program budgeting: this was, in essence, the application of planning principles to the annual budgeting exercise and a means of linking the latter to the planning process. As program budgeting was effectively launched in France only in 1970, its early years were inevitably tainted by what was seen as the increasing irrelevance of planning.

Moreover, several other industrial countries attempted to introduce program budgeting broadly along the lines first developed in the United States. Their mixed experiences have also had an impact on the French experiment. The French, however, persisted and it would appear that the concept is gaining ground, albeit slowly. Even in France there is a long way to go before program budgeting is fully accepted or integrated into regular procedures but the French avoided some of the mistakes of the U.S. and Belgian experiments, and their experience provides a number of important lessons.

Program budgeting in France attempts to capture the concept of performance evaluation by results introduced in the original American PPBS idea.[5] However, in France it was launched in a more flexible form; no directive or general instructions were issued by the core ministries and coordination was entrusted to an Interministerial Commission established in September 1970. This Commission is expected to "monitor and coordinate the development of the (program budgeting) tasks undertaken in each ministry and to propose to the Government the setting up of procedures to assure a periodic control of the results attained from this work."

Perhaps because of this relatively flexible approach, program budgeting increased its coverage of public expenditure activities in France, often at the initiative of individual ministries and agencies. By 1974, fifty analytical studies had been completed or were underway and five ministries had prepared program budgets which were annexed to the finance (budget) law of 1975. By the mid 1980s, program budgets present a rich and systematic source of information about the great bulk of public sector activities. The 1984 budget, prepared in 1983, contained annexed programs in 91 general areas and 395 separate sub-groupings representing a total expenditure of 850 billion francs (over 90 percent of all state

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5/ The following paragraphs draw upon an excellent evaluation of the French program budgeting experience in Robert Poinsard: "Les Budgets de Programmes, Quinze Ans Apres" in "Economie et Prevision" published by the Finance Ministry, Year 1985/5, Number 71.

expenditures foreseen under the budget apart from debt servicing and some special account). As a result of this expansion, certain "good habits" have become inculcated and in some cases have become legal requirements. The carrying out of cost benefit analysis, for example, is obligatory and the absence of such analysis or of a positive rate of return has led to administrative decisions being reversed at ministerial or cabinet level.

Despite these important advances, program budgeting, even in France, has not become fully integrated into the budgetary decision-making process. During the 1970s, the budgetary annexes prepared under program form, while expanding in number, did not provide the basis for actual expenditures voted into the budgetary law. As noted above, this coincided with the increasing disrepute of the planning process per se. Gradually, the initial ambition of full integration into the budgetary system has been de facto abandoned. Even the revival of planning under the Socialist Administration has not reversed this trend. Instead, new and potentially productive uses are being found for program budgeting. Its beginnings in France coincided with a period of growth and increasing resources. It was intended both to complement and to draw upon a centralized system of indicative planning aimed at maximizing the rational use of these growing resources. As the external environment worsened, these ambitions seemingly dimmed into irrelevance. However, the persistence of the French civil service apparatus with program budgeting, despite its alienation from the final decision-making process, meant that not only the administrative machinery, but also the necessary technical and intellectual capabilities, were still available to put the instrument to other uses. These latter were more compatible with an environment of scarcity and future uncertainty than of abundance. Thus, after 1980, program budgeting has been marked by greater emphasis on increasing the productivity of the administration and on reinforcing the coordination and compatibility of cost benefit and other studies aimed at enlightening the choice between alternative expenditures.

The failure to realize the original ambition of full integration of the program approach into the budgetary decision-making is not entirely due to external factors. Internal elements are also at work from which important lessons can be drawn for developing countries. First, conceptually, the programs frequently fail to specify their final objective and its time frame with the same degree of precision as the administrative, financial and physical means that are to be used. Consequently, impact indicators tend to be relegated to a more modest role and are sometimes absent altogether. The program budgets thus falls far short of the "production function" ideal which aims to show the effect on "output" of certain combinations of "input".

Second, the efforts suffer from lack of basic data, and from disputes about interpretation of the information that was available. For example, for some civil servants the cost of an activity means only those juridically and financially linked to it; for others, it has a wider, more economic connotation with externalities fully taken into account. Often the former won the day if only because those elaborating the program are forced to resort to inadequate global data available from the national accounts.

Third, considerable difficulty is encountered in establishing and maintaining the forward character of the program budgets. The overwhelming institutional, political and legal concentration remains on the annual budget. The program budgets are forward budgets of three years. The crosswalk between the rolling three-year budget and the annual exercise leading to the finance law was never properly constructed.[6] The program budgets have no legal force whatsoever. Inevitable forecasting problems and consequent weakened credibility compound this problem.

Fourth, the linkage between broad planning objectives and those of the forward budget is also weak, on both the institutional and technical planes. The plans consist of vague and general goals which are far from easy to narrow down to quantifiable objectives, the impact of which can be measured. These difficulties can only be compounded when the quantification is done by sector ministries and executing agencies without adequate participation by those who prepare the plan.

Fifth, the relative lack of importance accorded to program budgeting by decision-makers has inevitably had its toll on the morale and quality of work of those responsible for it. In some cases, the program budgeting office in a ministry has been closed and its work taken over by the general budgeting office which is also responsible for a large number of other tasks. Technical and executing agencies have become reluctant to elaborate complicated sets of information for an activity which they see as supplementary. The skills and techniques used to prepare the programs have become somewhat stunted in their development due to lack of adequate training and professional stimulus. The administrative mechanics and procedures for producing the documents are consequently showing signs of wear and tear and an increasing tendency to jam up. This, of course, contributes to the aforementioned delays, thereby creating something of a vicious circle. The continued devotion of enthusiastic disciples of the approach is insufficient to arrest this gradual decay. Similarly, on the demand side, a certain loss of vigor could be noted by the end of the 1970s. Many legislators encountered difficulty in absorbing the lengthy and dense material associated with the program budgets and their desire to try waned as they observed the alienation of the technique from decision making. In 1979, seven ministries[7] which regularly prepare program budgets were asked if these played a significant role in their negotiations with other parts of the administration for the obtaining of funds. All replied in the negative. Rather, they were held in reserve to be used only if the course of the budgetary dialogue so dictated and only if the necessary documents and information could be made available in a timely manner.

6/ This problem is worsened by the poorly coordinated timing of the preparation of program budgets and that of the annual finance law. Each program document, although extremely lengthy and detailed, is only available to legislators a few days, at best, before the definitive voting on the allocations under the annual finance law.

7/ Agriculture, Economy and Budget, Education, Industry, Environment, Health, Labor and Transport.

It would nevertheless be a mistake to conclude from the above that program budgeting in France is a dead letter. The revival of planning and the adoption of Rational Budgetary Choice to a more austere environment have given it a new lease of life. Techniques learned and developed since 1970 are being applied in the preparation of Priority Action Plans--"core" expenditures in times of fiscal shortage.[8] As noted earlier, the programs approach is being used to study ways of increasing the administration's productivity. Equally important, at a technical level, have been the efforts made to reconcile the nomenclatures of the programs and the regular budgets. This has worked in favor of the programs approach through, first, the annexation of program tables to legal budget documents and, second, through the increasing adaptation of traditional nomenclature to a programing structure. These developments encourage the belief that at least key elements in the program approach will not only become more integrated into the budgetary process and but also extended to assess past performance and improve budgetary control mechanisms.

E. <u>Holland</u>

As in France, program budgeting in Holland developed in the 1970s in response to experiments conducted elsewhere. In 1971, the Minister of Finance established an Interdepartmental Commission, chaired by the Director General of the Budget, to develop methodologies and techniques for <u>ex</u> <u>ante</u> evaluation. The efforts of the Commission were extended to perform a comprehensive analysis of the objectives of all the ministries in a manner characteristic of the centralized approach of the time. Politicians and civil servants, however, felt the exercise to be not only cumbersome but threatening. Few studies were completed and the commission had to admit failure in its evaluation report.

In 1982, the Dutch authorities decided on a new approach. The Commission was abolished, and ministries themselves were made responsible for their own policy analysis studies. A new department for policy analysis was created in the Ministry of Finance to provide guidance. Training facilities were expanded, the development of techniques became more focussed on the operational problems faced by sector ministries, and agencies were given enlarged possibilities for engaging outside consultants. In 1984, a permanent mechanism was established to permit the formal exchange of views and experiences of the new approach on a national and regional level. Workshops and seminars followed, by no means confined to civil servants or even to Dutch nationals.

What has emerged from this process is an interesting hybrid of the rational or program approach to policy-making and expenditure management, and the traditional method of "muddling through."[9] Politically,

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8/ Although, again, the relationship between Priority Action Plans and program budgets prepared by the same agency is not always clear.

9/ See "Some Important Experiences with Policy Analysis and Performance Budgeting in the Dutch Central Government" by A. Sorber and J. Schild, in "International Review of Administrative Sciences", September 1986.

the latter has much to be said for it: it takes full account of the need to negotiate and to recognize that the end is often a function of the means chosen to attain it. The introduction of program techniques has been gradual and by and large voluntary. The only legal requirement is that of the Government Accounts Act of 1976 which stipulates that "to each relevant chapter of the expenditure estimates there shall be attached an annex giving information, in relation to those expenditures for which this is possible and appropriate (my italics), on the results attained in consequence of the activities for which the expenditures are incurred and on the resources associated with those results." The decision on what is "possible" or "appropriate" is taken by each ministry.

Although program budgeting is still far from fully integrated into the Dutch budgetary process, considerable advances have been made which bear witness to the success of a gradual, decentralized approach. Cost benefit analysis is nearly always used to evaluate infrastructure projects. Not only this, but policy analysis techniques (development of sectoral strategies with quantifiable goals and cost inputs and the application of cost benefit techniques to guide expenditure choices) have been expanded into areas such as health, the labor market and crime prevention. Between late 1984 and mid 1986, methodological advice on techniques of project and program evaluation was provided by Finance Ministry and private consultancies to ministries as diverse as Home Affairs, Foreign Affairs, Economic Affairs, Social Affairs and Employment, Education and Science, Housing, Physical Planning and Environment, and Health. The training "infrastructure" and the supply of expertise has been kept flexible and methodologies are constantly being revised and updated in accordance with the lessons of experience.

Another interesting feature of the Dutch experience is the length of time taken for decisions to evolve and for systems to change correspondingly. The formal introduction of program budgeting in 1976 had been preceded by decades of discussion and experimentation: the idea had first been put forward by two Finance Ministry officials following a visit to the United States in 1950. In keeping with the tradition of consultation and decentralized decision-making, the core ministries gradually allowed a consensus to build up rather than imposing systems from the center. As noted earlier, even the rather toothless interministerial commission was dissolved in 1982.

Similarly, there has been no attempt to replace traditional methods of budgetary allocation even in those areas where program techniques are fully applied. Rather, the emphasis has been on improving and complementing traditional methods. At one extreme, traditional budgetary allocation can be viewed as a wholly political process resulting from negotiations between interested parties. At this extreme, not only is there no market mechanism and hence no "prices" attached to the inputs and outputs of government services, there is no need for such a mechanism. Agreements are reached on expenditure allocations by "input" (e.g. staffing, equipment), without regard to output. This process is frequently dominated at a technical level by incrementalism, while at a political level both the physical magnitudes and the policy objectives behind the sums of money are all too often lost. In practice this is, at least in most industrialized countries as well as the more sophisticated developing countries, tempered by the application of some objective evaluation techniques. In Holland, the introduction of program budgeting is aimed to increase this tempering by gradual steps. The integration or annexation of information on costs and outputs is, moreover, being done in the least threatening and "system friendly" way possible. This means use of existing information and institutional structures wherever suitable and ensuring that any changes are fully compatible with the existing budget mechanism and political process of negotiation. By 1986, about 40 percent of Dutch central government expenditures were covered by program budgets as against 90 percent in France. It appears, however, that the new techniques are better entrenched and more widely accepted.

F. Forward Budgeting in Kenya[10]

The Kenyan budget system consists of three instruments: the forward budget, the annual draft estimates, and the supplementary revised estimates. The forward budget is a planning tool which should determine annual government expenditures for the next three years. It was first introduced in 1973 as part of an effort to relate the five year development plans with the annual development and recurrent budgets. Use of the forward budget as a planning tool was somewhat haphazard until the mid 1980s when severe fiscal constraints forced the Authorities to plan the use of resources more carefully. In theory, the forward budget is meant to : (i) review the implementation of ongoing programs in the development plan to ensure that their execution remains consistent with national priorities; (ii) provide revised financial ceilings for the current fiscal year and tentative budget ceilings for the next two years; and (iii) integrate planning and budgeting on a continuous basis.

A pilot experiment in the Ministry of Agriculture has been successful in implementing many of the features of a forward budget including: (i) a better link between planning and budgeting (ii) establishing more specific criteria for determination of priorities; (iii) strengthening project evaluation and monitoring; (iv) better intergration of parastatals in the planning and budgetary processess; (v) paying more attention to planning of current expenditures and identifying the current expenditure implications of capital projects; and (vi) changing the internal structure of the ministry to conform to the requirements of the new budgetary system. Inevitably, extending the reform to the rest of the Central Government has been more problematic. The institutional difficulties inherent in major

10/ This section draws on a number of Bank and other documents, the following of which are publicly available: Emery M. Roe: "The Ceiling as Base: National Budgeting in Kenya," in "Public Budgeting and Finance," Summer, 1986; and Glenn Lehmann: "Kenya's Experience With a Forward Budget," EDI Training Materials, July 1986.

changes of this nature continue to manifest themselves. However, the Government has in recent years made a determined effort to tackle them. In February 1985, it announced its intention to implement a government-wide budget rationalization program (BRP) of which the forward budget would be the principal instrument. The BRP has four broad aims:

(a) to ensure a more productive use of scarce resources;

(b) to facilitate the seeking of donor support in a manner consistent with (a) above;

(c) to increase domestic resource mobilization mainly through higher user changes and other non-tax revenues; and

(d) to improve the planning and budgeting processes in both core and sectoral agencies.

Considerable progress has been made in recent years in achieving these aims, although much remains to be done. Kenya is helped by having a reasonably well-working basic accounting system and an ability to exercise overall control of expenditures in the central government agencies. It has also successfully installed a computerized financial information and management sytem in the Ministry of Finance as well as in the Ministry of Agriculture as part of the pilot experiment mentioned above. Improvements are gradually being made in the process by which the forward budget is prepared and in the seriousness with which it is taken by core and line agencies. Nevertheless, the BRP is still a long way from achieving its objectives. Expenditure cuts continue to be made in response to resource shortages without clear priorities or concern for the quality of the remaining project portfolio. The wage component of current expenditure is still increasing disproportionately; as a consequence, not only capital spending but maintenance and operating expenses suffer. Many projects are not been fully funded. The link between the plan and the budget sometimes remains unclear. This is a familiar litany of problems which forward budgeting was intended to solve.

Its difficulty in doing so to date may be attributed to a number of factors which have important implications for other countries attempting similar reforms. First, a series of major expenditure retrenchments have made it difficult to achieve lasting improvements in the composition of expenditure. As the experience of industrialized countries has shown, it is somewhat easier to introduce budgetary system reforms against the background of abundance than in times of austerity. Second, Kenya, although less, perhaps, than most African countries, faces acute shortages of the human skill resources required to make improved budgetary systems work. Particularly at sector ministry level, there are few qualified staff to fill planning officer posts. As a consequence, these officers have not been fully involved in the preparation of forward budgets which have hence come to be regarded as a Treasury preserve. Although the rules stipulate that Sector Planning Groups, chaired by Planning Ministry officers, should provide a forum for the discussion of line ministry submissions to ensure their consistency with overall planning objectives, these groups in practice rarely meet. Moreover, the time available for discussions and negotiations is often too short to permit binding agreements to be reached. Even within the Ministry of Finance itself, there is a difference in status between planning officers and Treasury supply officers with the latter playing by far the most important role in forward budget and annual estimate preparations.

Third, little attempt is made to simplify classifications or concentrate on priority expenditures when formulating the forward budgets. Consequently, they become three-year projections of the annual budget items, with a huge number of votes, sub-votes, heads and sub-heads with several line items under each one. The turgid and unwieldy process would tax the patience and resources of a highly sophisticated and fully automated adminsitration.

Fourth, there is little or no flexibility allowed to ministries in shifting resources between budget items, particularly between the capital and current budgets. Moreover, although the Government is aware of the need to rectify the imbalance in favor of wage expenditures, the forard budget mechanism is not used to serve this end. This is because personnel expenditure is a "protected" category which ministries do not have the discretion to increase or decrease. Moreover, large salary increases have recently been granted, the number of civil servants is projected to rise (especially in health, education and agriculture), and public agencies are obliged to hire certain school leavers unable to find work in the private sector. In these circumstances it would be meaningless to attempt to use the forward budget to set targets for relative personnel expenditures.

Fifth, the forward budgeting exercise has, until recently, been mostly confined to the Central Government administration: the activities of parastatals and other "autonomous" agencies hardly featured in the planning or budgeting process, though they inevitably had a major impact on budget execution through, for example, their subsidy and capital transfer requirements. The Government has expressed its intention to correct this situation and to involve both parastatals and local authorities in the preparation of the forward budget: the Treasury has been instructed to issue appropriate guidelines.

Sixth, the major preoccupation of the Treasury has been to keep global expenditure below ceilings which are calculated on the basis of revenue projections, deficit/GDP ratio assumptions and historical expenditure patterns. By contrast, relatively little attention is paid to the analytical work (project evaluation, economic categorization, etc.) which is supposed to be carried out by the Special Planning Groups. As noted earlier, these groups, which are chaired by planning officers from the Planning Ministry, rarely meet and are not equipped to carry out this analytical work.

Seventh, the Development Phase itself, which is supposed to provide the basis for forward budget projections, does not contain a systematically formulated list of sector projects. Rather, overall ceilings are set for sector ministry development expenditures with little attention paid to content. Links betwen the Finance and Planning Ministries are, moreover, weak with the latter participating to only a limited degree in budget execution.

Finally, the forward budget has no legal status, unlike the annual budget which forms the basis for the finance law. Even though, as part of the new BRP, the Authorities have issued greatly improved and more comprehensive guidelines on how to prepare the forward budget and review investment programs, sector ministries will inevitably continue to pay more attention to the annual budget which has a much more direct impact on the resources actually made available to them. Moreover, these comprehensive circulars need to be complemented by a widespread training program, at both core and sector ministry level, or both the aims and techniques of forward budgeting.

The difficulties associated with Kenya's forward budgeting experiments should not be construed as a condemnation of the system itself, any more than those encountered by industrialized countries imply the wholesale rejection of program budget techniques. Indeed, there is no question that the forward budget has been a useful instrument in helping the Government to think more systematically in terms of expenditure priorities. Recent progress in overcoming some of the difficulties discussed above is, moreover, encouraging. Nevertheless, the Kenya example provides at least four valuable institutional lessons which can be of great use to countries trying to improve budgetary processes. First, the regulation of the system should be kept as simple as possible so as not to overtax the limited administrative and technical capacity available to most governments. Second, the process should be organized to allow ample time for full discussion by all interested parties. It may well be that in the final analysis the Finance Minister or Head of Government will have to act as arbiter; but if the system is to succeed it is essential that all interested parties fully participate in the preparatory process. Third, the ministry or department responsible for the plan should be closely linked, and in close alliance, with that responsible for the annual budget. If this is not the case, then it is inevitable that the exigencies and time pressures of the annual budgeting exercise will take precedent (it is, after all, the Treasury which signs the checks!) and the exercise will be perceived as a Finance Ministry preserve. Fourth, it is essential that the budgeting process be as integrated as possible, covering all public sector entities which have a significant impact on public finances. These considerations lead on to two vitally important aspects of the budget as a developmental instrument: its coverage and its organization.

G. National Public Expenditure Planning in Papua New Guinea (PNG)

The National Public Expenditure Plan (NPEP) in Papua New Guinea, which was applied during the late 1970s and early 1980s, was conceived as a method of resource allocation distinct from both conventional and theoretical program budgeting, though sharing some of their characteristics. While there was considerable dissatisfaction with traditional methods of resource allocation, experience had shown that most developing countries had neither the data nor the trained manpower needed for the kind of detailed planning involved in the program approaches and that this was particularly true of PNG. The country was especially poorly equipped to select projects on the basis of social returns. Since program budgeting involved the prior reclassification of all expenditure as well as a cost-benefit approach to allocations; it was likely to prove complex and difficult to implement.

The NPEP aimed therefore to allocate public expenditure through the budget on the basis of policy-determined priorities. An overall ceiling on public spending would be derived from macroeconomic considerations, including growth of revenues, expected capital inflows, etc. Aggregate public expenditure would then be divided into a number of sub-budgets, each directed towards a specific goal such as food production and nutrition, other economic production, social welfare, development of relatively backward regions, urban management, environmental protection and so on. Priorities would be laid down by the Government between these "strategic objectives" and translated by the planners into allocations of funds. The intention was that all public spending should be covered, bringing general administration and security into the strategic allocation framework. No distinction was to be made between current and capital expenditures, to avoid the danger of associating development only with the rolling exercise. In essence NPEP was an adaptation of the UK Public Expenditure Survey Process, simplified to suit conditions in PNG.

NPEP has been an effective instrument of macroeconomic policy, curbing the growth of government expenditure in a period of severe resource constraint. It has enforced a system of priorities and strengthened internal controls on new items of public spending. The concept of forward budgeting has also taken root. Despite these important advances, the system as applied has a number of shortcomings:

(a) At the start of NPEP the idea of comprehensive expenditure planning was given up as an immediate aim, largely for political reasons, and the methodology was applied only to new activities, leaving prior expenditures to be budgeted as before. The anticipation that the non-NPEP part of public expenditure would decline in relative size and importance was not realized, and the "NPEP wedge" accounts for less than a quarter of all expenditure.

(b) Whereas NPEP became the exclusive concern of the newly created National Planning Office (NPO), the non-NPEP budget remained with the Finance Department, creating inevitable institutional conflict.

(c) Since NPEP covers both capital and current costs associated with new activity levels, recurrent expenditure in such fields as education, health and rural development are divided in the PNG budget into NPEP and non-NPEP components, leading to confusion and overlapping.

(d) The "strategic objectives" defined to serve as the basis for PNG's national development strategy have not proved to be particularly helpful for budgetary decision-making. They cut across both departmental responsibilities and the functional classification of expenditure. Ex ante the development agencies do not have ceilings to work against, or expenditure targets by objectives, though ex post the expenditure is cross-classified by agency and project.

(e) The "strategic objective" approach, coupled with the "project" basis for the allocation of NPEP funds, makes sectoral planning difficult.

(f) Although NPEP is a four-year rolling plan in concept, in practice it has tended to be largely a year-to-year budgetary exercise. The forward budget format has little operational content; very few projects are initiated in the later years.

(g) Altogether NPEP procedures for approval, funding and modification of new activities are too elaborate and rigid. They are uniform for both large and complex projects and for minor schemes, even for small staffing additions in existing organizations. As a result, the NPO is involved in detailed budgeting and expenditure control that it has little time for the more important tasks of policy analysis, establishment of investment priorities and inter-sectoral coordination.

H. The Administrative Reform Program in Jamaica

The fundamental objective of Jamaica's Administrative Reform Program (ARP), supported by a World Bank technical assistance loan approved in May, 1984, was to strengthen the line ministries, particularly those critical to structural adjustment and long term economic development. However, it was determined that before improved management structures could produce results in the line ministries, the "administrative environment" primarily set by the three core agencies -- Finance and Public Service Ministries, and the Public Service Commission -- would have to be profoundly changed. With regard to the Ministry of Finance, the ARP aimed to: (i) restore its institutional capacity by rationalizing its organizational structure, upgrading staff and physical facilities, and creating or revising procedures and systems in the areas of budgeting, financial administration, and public enterprise control; (ii) strengthen the staff support for the senior civil servant (Financial Secretary) to enable him to devote more time to planning and policy work rather than crisis management; and (iii) install, over a five year period, a performance budgeting and review system throughout the Government, including the creation of the necessary institutional capacity in both the Finance Ministry and line agencies.

A review which took place some three years after the loan was approved concluded that notable progress had been made in presenting the budget on a performance basis. Virtually the entire budget would be using the PBS format by 1989; even more significant was the conclusion that the new method had "already led to a better definition in some ministries of lines of responsibility and has helped pinpoint financial, management, staff, and contracting problems impeding the timely attainment of stated objectives. The quarterly review system has reportedly proven to be especially useful in bringing about a better interaction between managers and operating staff." The initial project brief, moreover, concluded that "a real improvement in the financial management and control of the Central Administration" could be observed in recent years. The Government had carried out two SALs and Stand-bys "successfully" while achieving considerable progress in financial management: revenues had increased, expenditures fallen and the fiscal deficit reduced from nearly 25 percent of GDP in 1984 to about 7 percent in 1987. Politicians and senior civil servants considered that the ARP had played an important role in these achievements and wished it to continue.

Despite these important successes, the installation of the budgetary reform itself was proving problematic. In late 1987, a mission suggested that fresh thought be given to the implementation of certain features of the proposed performance budgeting system, taking account the limitations of the Jamaican administrative system. In particular:

(a) the government-wide installation of a <u>working</u> system looks unlikely to be accomplished by the target date of mid 1989, in the light of progress made to date;

(b) the government has not yet established a satisfactory link between the planning and budgetary processes essential to a performance budgeting system;

(c) the respective roles of the Budget Division of the Finance Ministry and the Planning Institute have not been clearly defined, and the integration of the Planning Project Staff with the Budget Division has not yet been successfully accomplished;

(d) as a consequence of (b) and (c) above, there are still two separate budgets for capital and recurrent expenditures for all ministries and departments, even the Ministry of Construction Works which was chosen as a pilot for the installation of the performance budgeting process;

(e) organizational units in the line ministries and agencies have not been realigned to match the new budgetary process;

(f) consequently, cost centers, which should produce measurable outputs or services with identifiable cost figures for each ministry and department, and take into account all relevant constitutional, institutional, and organizational aspects, have not yet been successfully established;

(g) there is a serious lack of qualified technical and accounting staff; many of those trained under the project have moved to other positions or have left the Government;

(h) consequently, there is no adequate cost accounting, even in the technical ministries; the current, essentially cash-based accounting model continues to be used; it is not designed to yield the information and analysis necessary for performance budgeting;

(i) evaluation of results is rendered difficult by the lack of capacity to check work in progress except in cash disbursement terms; and

(j) the leadership role assigned to the Budget Division of the Finance Ministry (essential for the successful installation of any new budgeting model) has not materialized in practice; there seems, indeed, to be a lack of close cooperation between the Division and those responsible for implementing the ARP. As a consequence, the momentum and enthusiasm manifest in the early stages of the project, has been lost.

As a result of these difficulties, the budgetary reform has largely stopped at the format preparation stage, and performance budgeting concepts have not yet been introduced as a working management tool even in the selected pilot ministries. Care should, however, be taken not to interpret these results as a wholesale condemnation of the system and all it is designed to achieve. Three years is a very short time for the successful introduction of reformed budgetary systems even in industrialized countries. Many of the problems encountered in Jamaica were familiar in France three years after RCB began to be introduced there. As shown above, by persisting with the improvements, the French now have a budgetary system which, although a long way removed from the total conversion to RCB originally envisaged, is able to draw on the concepts and intellectual discipline involved in the preparation of RCB to benefit the financial management system as a whole and to improve the budget as an economic policy tool. It would be a pity if the Jamaican Authorities were to become so disillusioned by the early setbacks that they abandon the attempt at budgetary reform. Many of the concepts embodied in performance budgeting are sound. If there is a major lesson to be drawn from Jamaica's experience of the ARP (other than the normal ones concerning the institutional, procedural and political prerequisites for successful reform which are discussed in the main text), it is that outside agencies like the Bank should be careful not to raise expectations too high. Five years was always too short for such a major reform effort in a politically sensitive area. It is useful in this and similar endeavors to obtain some sound successes which can help to maintain momentum. High initial expectations, when unfulfilled, yield disappointment and disillusion.

THE BUDGETARY DECISION-MAKING PROCESS

A. Introduction

This annex serves the double purpose of summarizing a number of the concepts and issues dealt with in the text while at the same time focussing on those areas of the decision-making process to which Bank staff could fruitfully pay particular attention. Clearly, this process varies substantially from country to country so that the discussion inevitably suffers from a degree of generalization and abstraction. Nevertheless, it aims to highlight the main defects frequently found in the process and hence point the way towards improvements in procedures and institutions required to make public expenditure a more effective development instrument.

The annex first describes the framework for a typical budgetary process, and then goes on to discuss how, in practice, each stage presents a number of institutional and procedural difficulties which lead to deviations from the idealized schemata. It concludes by considering some of the more common responses by both central and line agencies to defects in the budgetary process. These responses frequently have damaging consequences of their own for the effective conduct of fiscal policy and of economic policy in the wider sense.

B. The Budgetary Process: A Schemata

A typical budgetary decision-making process is summarised in the following table. The table presents an essentially theoretical, even idealized framework, from which practice can deviate in a number of important respects. The first column refers to the steps which should normally be followed in a typical budgetary cycle, while the second outlines the most commonly observed methods by which each step may be carried out.

Budgetary Decision-Making Process: Typical Steps, Methods and Agencies Involved

Steps	Methods and Agencies Involved
(i) Determination of overall level of public spending within budget period.	(a) Estimate of global ceiling by the central authorities communicated to sector agencies.
	(b) Estimate of individual program costs by sector agencies communicated to central agencies for compilation and aggregation.
(ii) Initial allocation of estimated available resources between sector agencies and/or programs.	(a) Current budget: allocation usually by agency rather than program. Core agencies send sector agencies budget circular indicating economic prospects, broad policy objectives, and how the budget is expected to help attain them. On this basis, the circular should justify proposals for increases and reductions in agency allocations.
	(b) Budget circular restricted to general statement of resource availability and policy objectives, allowing the sector agencies to respond with their own proposals for allocation.
	(c) Capital expenditure: sector agencies present proposals for new projects based on criteria indicated by core agencies, including rate of return, availability of financing, implementation capability, and consistency with overall economic and social objectives. Time table, again prepared by sector agencies proposes annual breakdown of expenditures for inclusion in the budget.

(iii) Response of sector agencies to budget circular.	Negotiations between core and sector agencies usually at technical level, the Cabinet having already decided on broad aims and priorities. Approach often incremental, with scrutiny of previous expenditures rare, and focus almost exclusively on proposed increases. Negotiations may be conducted on the basis of programs, but most frequently on line items (salaries, materials etc.) which cut across programs. The success of requests for higher allocations based on political bargaining power of sector agencies concerned.
(iv) Preparation of draft budget document.	This is the responsibility of the core agencies. Since requests generally exceed resources, it is inevitable that core agency technical staff will have a major input through adjustment, integration and harmonization.
(v) Approval of draft budget.	This is at Cabinet level and can be a lengthy process. Due to alterations by core agency technical staff (see step iv), what spending ministers read may be significantly different from what they thought their officials had agreed to. A return of a draft budget for revision and modification may occur several times during the cycle.
(vi) Preparation of final budget for presentation to legislature.	This is the responsibility of core agencies. This can be a technically complex task, involving the preparation of a cogent summary and copious annexes.
(vii) Consideration by the legislature.	Depending on the country, this may be the most difficult part of the process. If the legislature takes its task seriously, the review can involve several sessions: (a) consideration of budget framework, including macroeconomic policies and assumptions behind revenue and expenditure forecasts; (b) examination of detailed proposals at budget committee and subcommittee level; and (c) final plenary session to pass budget into law.

(viii) Budget implementation: release of funds.	Core agency responsibilities include administering payments to sector agencies so as to ensure adequate control over the flow of expenditures. There are three basic methods: (a) immediate release of entire budgeted amount to sector agency accounts; (b) release of funds against payment vouchers or receipts showing that the sector agency has effected or is about to effect payment; (c) periodic release of funds to sector agencies (e.g. one-twelfth of the budgeted amount per month or one-fourth per quarter). Sector agency responsibilities include: (a) preparing forecasts of requirements over the year; (b) preparing commitments; and (c) acknowledgement of receipts of goods and services and certification of expenditures on them.
(ix) Budget implementation: capital expenditures.	Sector agencies are normally responsible for project implementation. This includes the preparation of forecast expenditures over the year, and the organization and administration of bidding and contracting procedures. Core agencies would be responsible for ensuring that laws and regulations had been complied with before releasing funds.
(x) Budget implementation: procurement	Core agencies should be responsible for establishing uniformity in contractual procedures to ensure as many competitive bids as possible. Sector agencies should administer the procurement process including advertising, detailed cost evaluation (for comparison with bid prices), evaluation of bids, negotiation with contractors, and review of contractors' performance. Contracts should only be awarded after budgetary allocation is assured.

(xi) Budget implementation: reporting.	Sector agencies should prepare periodic (monthly or quarterly) progress reports and accounts, which should be consolidated and annualized by the core agencies.
(xii) Monitoring and evaluation.	Responsibilities of the sector agencies include: (a) periodic review of actual expenditures; (b) analysis of variations with budget estimates; (c) analysis of budgetary lags; and (d) matching financial and physical progress. Core agencies should (a) conduct periodic overall progress reviews independently or jointly with the spending agencies; (b) revise policies and objectives where appropriate in the light of these reviews; and (c) reallocate funds where necessary. (NB. In many countries, monitoring is carried out by a central body. This may be necessary where the capacity does not exist in the line ministry or sectoral agency; however, it is desirable that this activity should be carried out by those in close contact with the project in question).
(xiii) Budget implementation: cash management.	Core agencies should prepare an overall plan for cash management to ensure that borrowing is within limits and interest on debt minimized. Sector agencies should rapidly surrender excess funds or process requests for additional funds in a timely manner.

C. The Budget Process in Practice

(a) Determination of Overall Spending Levels

At each point in the process, a number of factors can combine to divert reality from the theoretical process described above. In the first stage, the core agencies should, in principle, determine the overall level of public spending within the budgetary period consistent with resource availability and macroeconomic stability. In fact, total spending may simply result from the mere compilation and aggregation of the expenditure requirements of each individual program or agency. The power of the core agencies to carry out their task is often limited by a number of factors. First, the relative political power of some of the spending agencies may be such that they can, in effect, determine what they will spend by recourse to higher authority than the core (or central) agencies. Second, forecasts of fiscal receipts are plagued by uncertainties especially when there is significant reliance on commodity taxes. Third, in many countries, not all foreign aid or borrowing flows through the central ministries. In Mauritania, for example, the core agencies had, until recently, little knowledge, let alone de facto control, of direct arrangements between sector agencies and foreign providers of funds. Fourth, aggregation of agency proposals leads to very notional magnitudes which cannot possibly help informed decision-making on a multitude of individual programs. Fifth, central authorities are frequently hampered in their judgement of agency proposals by lack of basic information on matters such as number of staff, what activities are underway, what they cost etc. The information gap generally becomes wider as one moves away from the central government agencies and towards the local authorities and public enterprises.

(b) Initial Resource Allocation

Many of the decisions involved in the next step, the initial allocation of the estimated available resources between individual agencies and/or programs, may already have been subsumed in the previous stage. Again, this would depend upon the relative political power of the core and spending agencies. A number of other factors may also intervene to undermine the theoretical process. For instance, budget circulars may not be systematically prepared and distributed in a timely manner. They may contain no cogent indication of the government's goals or how these are to be met through the budget. The estimate of the resource envelope may be grossly inaccurate for reasons cited above. Core agencies sometimes resort to deliberately underestimating it in order to increase the degree of de facto central control over resource allocation. This in turn can lead to the proliferation of supplementary budgets which may increase the likelihood of hurried expenditure allocations for ill-thought out purposes.

It is at this stage of the process that the quality of the information available to the core agencies becomes a vital consideration. Indeed, it is often possible to identify the key decision points in the cycle, by tracing the flow of information or lack of it. Financial data, which is the basic raw material for effective budget formulation, may be scattered in various ministries and agencies. Accounts and accounting systems may not be uniform and may well be in conflict with each other. For example, the codification and accounting systems are often different for the current budget, prepared by budget office in the finance ministry, and the capital budget which is the responsibility of the the planning authority. Both of them may be inconsistent with the accounts in the treasury department of the finance ministry which is responsible for administering actual payments. These difficulties in the core ministries are often compounded by the fact that the sector agencies operate with their own sets of data which will again likely be different. Even when data are consistent, it is by no means unknown for the spending agencies to conceal the full cost of a project in an attempt to avoid an adverse decision. As a result, programs that have initially gained budget support on the basis of underestimation have subsequently ballooned (the "camel's nose" phenomenen). Again, some agencies operate with a different fiscal year to that of the central government which impedes attempts to achieve accounting consistency.[1] All this confusion not only involves officials in a duplication or triplication of data collection and processing, but is a major impediment to the use of the budget as a policy instrument. One of the most important improvements that can be made to a country's budgetary system is the construction and installation of a financial database which places all budgetary information,as well as the public investment program, on a common basis which can be shared by core and sector agencies alike. While this is a major undertaking, which can stretch over several years, the direct and indirect benefits are substantial. Among the latter are the fact that the construction and operation of a new information system will force different agencies to work together on solving budgetary problems and arriving at a common understanding of the issues involved in solving budgetary conflicts.

(c) Negotiations Between Sector and Core Agencies

The hardest bargaining normally takes place at the next stage, when sector agencies respond to the core agencies' initial proposals. One of the techniques most widely used in the subsequent negotiations is the incremental approach: rather than deliberating over the general desirability of continuing with an ongoing program or project, the authorities will simply focus on variations in outlays compared to the previous exercise, in practice concentrating almost exclusively on proposed increases. The implicit assumption is that no scrutiny of what was spent under previous budgets is warranted; complacency regarding existing policies becomes inbred; and the budgetary review process becomes one more impediment to the revitalisation of public expenditure management. Where incrementalism focusses not on programs but on line item categories such as salaries, materials, debt service payments etc, the effects can be even more

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1/ Although rare for ministries and other central government agencies, this is not infrequent for public enterprises and other decentralized entities.

pernicious. First, this involves yet a further departure from an objectives-oriented approach, and, second, by concentrating on the minutiae of line items, tends to lose sight of the broader policy issues. Nevertheless, these techniques are widely used and have stood the test of time in both developing and developed countries; these factors alone account for a large part of their appeal.[2] Although, in some countries, the influence of incrementalism has been diminished by changes in external circumstances[3] or through the introduction of medium term planning and improved budgetary techniques. In most cases, however, it remains deeply embedded in the decision-making process; reform efforts should be respectful of the hold it has over decision-makers and try to ensure that any suggested alternatives do not diminish still further the often fragile financial control over the spending agencies.

One of the consequences of incrementalism is that the budget process becomes almost exclusively concerned with the often small amounts available for additional spending. In a large number of countries, these are frequently below 10 percent of total foreseen outlays. As for the rest, the greater part of it is frequently "untouchable", either for political reasons (salaries) or because of financial agreements which the government must honor (debt servicing). In such circumstances, there is clearly little or no room for adjustments or adaptation to unforeseen changes in the economic environment. If the budgetary gap turns out in practice to be too large to finance, then recourse must be had to a number of potential palliatives. Debt servicing obligations may be reduced through rescheduling, or the inflow of new foreign resources may be increased through negotiation. Frequently, however, it is the capital budget, together with operation and maintenance expenditures, which bears the brunt of the cuts. In some countries, where there is a separate development budget, it is not unknown for current account line items to be shifted to this budget in order to secure financing, sometimes from donor-provided funds. This clearly impedes a government's ability to "deliver" the genuine development expenditures as programmed. Nor can it be expected that a more relaxed financial background will lead to a more rational structure of public spending. On the contrary, it often leads to a deterioration: salaries and fringe benefits are ususally increased, together with the numbers on the public payroll, while less attention is paid to quantitative selection procedures for new projects and programs.

(d) Cabinet Approval

Negotiations between core and sector agencies can be quitelengthy, and several modifications may be required when the draft budget is considered at Cabinet level. The time taken by the whole process causes

2/ See especially Aaron Wildavsky:"A Budget for All Seasons: Why the Traditional Budget Lasts" in G. Bruce Doern and Alan M. Maslove eds: "The Public Evaluation of Government Spending", Institute of Research on Public Policy, Ottawa, 1979.

3/ For example, the financial crisis may be sufficiently grave so as to pose challenges to traditional allocations of resources; this is, however, comparatively rare.

major problems in many countries, both developing and developed. This can become particularly acute if the cycle has to cope with significant changes to the technical draft as a result of Cabinet intervention. This may lead to revisions in expenditure ceilings which require changes throughout the budget. As the time between the draft and final budgets is nearly always short, spending agencies may find it difficult to make adjustments within the constraints of the budget calendar. The ad hoc budget that emerges from this may well be very different from the approved budget that reflects the full adjustments. The same thing may, of course, happen when the changes are effected by the legislature, or occur as a result of a higher than anticipated rate of inflation. Much needed manpower and skills that should be devoted to budget implementation are therefore required to change the budget.

(e) Consequences of Fragmented Responsibility

Added to the problems of time are those of fragmented and uncoordinated decision-making, often linked to blurred lines of authority and roles between agencies. Although these characterise most economies to a greater or lesser extent, attempts to reinforce decision-making capability at central level lead to a particularly acute dilemma for developing countries. On the one hand, economic and financial crises combine with weaknesses in the management capabilities of the spending agencies to render a stronger degree of central control over expenditures indispensable. On the other, the central authorities often lack the means, both in terms of manpower and information, to make central control effective. Expenditure management can thus get bogged down in lengthy procedures, subject to judgement by actors far removed from the consequences of their decisions.

These procedural and institutional difficulties are frequently reinforced by the structure of authority and role designation within an administration. This varies from country to country and is a reflection of the culture of the society. In some cases, executive authority as such may simply not be acknowledged; instead of decisons being deliberately taken, matters may simply evolve depending on the relative political strength of different parties at different times. Even where this is not the case, it is frequently observable that different roles are not clearly delineated and that authority is, consequently, fragmented, unclear and uncoordinated. Fragile political and administrative structures tend to become highly personalized so that the authority boundaries of an agency can expand and contract in accordance with its leadership and staff capability. Even within more established and sophisticated structures, lines of authority become blurred as a side effect of efforts to build consensus. For example, the preparation of the draft budget should be the responsibility of, say, the budget bureau or corresponding office in the finance ministry. The attempt to secure the agreement by participation of other agencies may lead to a dilution of the primary agency's responsibility.[4] Moreover, key agencies are often internally divided; this tends to be even more acute at a political level. Cabinet consensus may be difficult or impossible to attain. Then there is the role of the legislature. In new democracies, or countries recently restored to democracy, the legislature may insist on a much more active role in budget decision-making, and at a much earlier stage of the process than the executive is accustomed to. Even in established democracies, the legislature may have a heavy role to play in budget formulation which can contradict or supercede that of the executive (e.g. the United States).

In the short term, the state of the art on expenditure management offers little to governments wishing to solve these dilemmas. In the longer run, the development of adequate expenditure management capabilities in the spending agencies is an essential prerequisite to more effective decision-making. Once this is installed, it could be reinforced by the gradual introduction of a system of "control through incentives" somewhat parallel to the methods of monitoring and supervision of public enterprises frequently advocated by the Bank. In essence, this would mean the establishment of a system of target setting and performance monitoring linked to rewards and prnalties for the individuals involved in budgeting and executing the activities concerned. Such ideas are far from new. In the

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4/ Many administrations resort to the use of committees in an attempt to build consensus. However, considerable attention should be paid to their composition and terms of reference since otherwise they can easily have a number of nefarious consequences for the budgetary process. First, decision-making by committee generally takes longer. Second, the outcome of committee deliberations tends to be highly dependent on the characteristics and interelationships of the individuals involved; it is thus less predictable and more arbitrary. Third, committtee membership may well be short lived; accountability is thus undermined. Fourth, unless all affected parties are represented, they may well try to undermine committee decisions; on the other hand, insuring their representation may well make the committee unwieldly. Recourse to committees is often a substitute for more deep-seated reform of the core institutions; it is motivated by the powerful forces of consensus building and dilution of responsibility. Unless roles are clearly defined, and along with them areas of responsibility and accountability, it is to be expected that agencies and officials will take the safe route of committee formation. A more promising approach over the longer term would be to undertake a reorganization of the key agencies and their interrelationships. This would imply redefinition of job descriptions, assessments of manpower requirements and perhaps some modifications in the govenment's overall organization chart.

late 1960s, Schultze[5] suggested that incentives be included in the design and formulation of the budget and of individual budgetary programs. These should clearly not cover the whole gamut of government spending, but could be applied in areas which lend themselves more readily to the specification of output, costs and measures of performance. The practical application of such an approach is limited by the philosophy of public service which does not normally include direct performance incentives in the carreer path of state employees (at least in central and local government). However, selective application of this approach may be worthy of further exploration.

(f) Implementation Issues

These can conveniently be divided into problems of control and cash management. By control is meant not merely ensuring that expenditures are kept within limits imposed by resource availability (itself a difficult task), but also that they reflect the broad goals of policy. Most expenditure management systems in developing countries lack the means to achieve control in this broader sense. Specifically, they often do not have:[6]

- a well-defined work program for each of the spending agencies indicating forecasts of when financial and other key resources will be needed;

- a system of periodic reviews to replan and reschedule in the light of previously unforeseen obstacles and/or changes in costs;

- an established procedure of periodic releases of funds to spending agencies relating financial flows to the program of activities;

- a financial management information system providing an up-to-date and accurate account of commitments, expenditures and the status of funds allocated for a particular activity and/or to a particular agency;

- a well-functioning and adequately supervised procurement system for the acquisition of goods and services;

5/ See Charles L. Schultze: "The Politics and Economics of Public Spending", the Brookings Institution, Washington DC, 1968, and "The Role of Incentives, Penalties and Rewards in Attaining Effective Policy," Government Printing Office, Washington DC, 1969.

6/ For further details, see F. Khalid: "Budget Execution and Cash Management," in "Issues in Budgeting and Expenditure Control," IMF, 1982.

- a simple but functional reporting system for verification of work in progress, tailored according to the varying requirements of the levels of hierarchy involved in budgetary execution and subjected to an institutional review process (monthly, quarterly etc. depending on the importance and nature of the activity); or
- an evaluation and audit system, administered by an independent body (either within the government or answerable separately to parliament), capable not merely of financial audit but also of the extent to which a project or activity realized its wider goals.

Consequently, there is, at best, an overemphasis on financial control as an end in itself. This can reach the point where it seriously hampers the work of the spending agencies. Highly complex procedures for the release of funds are often combined with a confusion of the treasury function with that of expenditure control (i.e. funds will be held up at the point of release whether or not all steps have been properly carried out, since this is the only effective way of keeping within overall spending limits). This not only makes it nearly impossible for the spending agencies to plan their activities, but also rules out effective delegation of responsibility or the establishment of accountability in the use of public funds.

Good cash management (i.e. the meeting of the government's daily cash requirements at a minimum cost) can save governments substantial amounts, as well as supporting wider aims of monetary and fiscal policy.[7] Despite this, it is a neglected area of public expenditure management. There are three main reasons for this. First, spending departments rarely have incentives to manage their cash well, since the costs of poor management, in terms of interest charges, are usually borne by the budget, while the benefits accrue to the finance ministry and/or central bank. Second, budget execution focuses primarily on release of funds to line agencies, while the actual spending of the money is usually several stages further removed. Third, accounting information systems used most frequently by governments do not generate flow of funds data but concentrate rather on post hoc accountability for resources released to line agencies. The institutional prerequisites for effective cash management may also be missing. There is frequently no central authority responsible for this function. Because of defects in the budgetary system, or with a view to escaping surveillance as much as possible, line agencies often prefer to generate special funds over which they have control rather than return their surplus cash to a central pool. This can lead to a situation in which the core agencies are forced to borrow to meet the government's day-to-day cash requirements at a rate of interest higher than that earned on the line agencies' cash surpluses deposited with the commercial banks.

7/ For example, when the monetary authorities are trying to keep a tight hold on credit expansion, cash management procedures should not permit public agencies to build up large balances with commercial banks.

D. Typical Responses to Defects in the Budgetary System

The practical problems associated with the budgetary process have led both core and line agencies to adopt a number of ameliatory measures and methods to deal with conflicts and facilitate the allocation of funds to activities deemed politically important. The most common are extra-budgetary activity, earmarking of funds, and supplementary budgets. All these methods are, to a large extent, palliatives and substitutes for deeper, and hence politically difficult, institutional reforms. Moreover, their adoption can have damaging consequences for the government's ability to mange public expenditures effectively.

(a) Extra-Budgetary Activity

As a result of the defects in the traditional budgetary procedures, more and more activities tend to shift from the national budget to other sources or methods of financing. These are often less visible and hence less subject to public scrutiny. Numerous extra-budgetary funds are created, some of the them with donor encouragement and even active support, to ensure the establishment or continuation of agencies,programs and projects. Officials dislike the uncertainty and delays associated with normal budgetary allocations and much prefer effectively controlling their own finances. Donor influence is often a major factor; in some countries foreign funding does not pass through the national budgetary system. In Mauritania, for example, a recent study found that over 90 percent of investment expenditures are financed from foreign grants and loans and all are extra-budgetary. While useful in terms of operational flexibility and guaranteeing the continuation of some vital functions, extra-budgetary funds are frequently abused. In many countries it can be seen that funds are still directed to projects and activities that have outlived their usefulness; in some cases, they may even have ceased to exist, and the money is channelled to other, non-mandated uses. Moreover, they not only undermine practically all the principles of sound budgetary management,they can escape comparison with other uses of funds and hence the choices which should be involved in the budgetary decision process. It is of little use, however, to bewail their increasing prevalence while failing to address the deficiencies of the budgetary process itself, which are frequently their main cause.

(b) Earmarking

Earmarking is another technique widely used to circumvent the normal budgetary process. It can take the form either of a specific allocation of a percentage of revenues, or the direction of a particular category of revenue, to a particular agency. It is prevalent in Latin America and in East Asia. Although less conspicuous in systems inherited from the British or the French, it is increasingly practiced in Sub-Saharan Africa. At least in theory, it has a number of advantages. It can ensure funding for certain activities and reduces uncertainty. It can provide a direct link between the costs and benefits of a particular type of taxation.

It should ease performance measurement and the establishment of cost-cutting incentives. It can help the executive reduce the delays associated with legislative approval of the budget process. In practice, there are as many problems as benefits arising from these so-called advantages. The link between taxation costs and benefits is often obscure and not apparent to taxpayers. Administratively, the growth of earmarking undermines the authority of the central budgeting process and that of the legislature. It encourages an enclave mentality among those responsible for administering the funds. Agencies tend to become a law unto themselves and aggravate the complexity of the budget process. The resulting lack of fungibility of public resources often results in new expenditures being incremental rather than substituting for existing ones which are protected from cuts by their access to earmarked resources. Moreover, since most major new initiatives in public expenditure are financed externally, the end result is both an overall increase in public spending and an addition to the external debt burden. Access to nonfungible resources may also distort the sectoral pattern of investment, especially during fiscal austerity. Again, donors are often a major part of the problem: they encourage earmarking for similar reasons as extrabudgetary funds (which can also be financed from earmarked revenues). They often insist on the specific provision of counterpart funds for individual projects and programs, rather than allowing the government contribution to be financed from general budgetary allocations. This can lead to the accumulation of "slush funds" which the government may use for non-budgeted projects provided that they can persuade the donor to release the funds. In Zambia, for example, a large and ill-conceived expansion of the agricultural credit program was financed by PL480 funds from US food aid. In general terms, governments should be encouraged to phase out earmarking, though this should be gradual and accompanied by efforts to reform the budgetary process.

(c) Supplementary Budgets

Core agencies may resort to supplementary budgets in an effort to increase their *de facto* control over expenditures -- for example, by artificially depressing the total amount of resources in the initial budgetary envelope and then subsequently meeting requests through supplementary appropriations. Sometimes, the legal framework makes the use of such supplements unavoidable. In Colombia, for example, the constitution requires, first, that the budget be balanced in the formalistic sense that expenditures must not exceed legally confirmed resource availability, and, second, that estimated revenues not increase by more than 10 percent over the previous year's budget. This means in practice that the initial budget only partially covers expenditures during the year, so that a series of supplementary budgets are formulated as more resources become available. In recent years, there have been up to five supplements accounting for as much as 50 percent of the initial allocation. Inevitably, the additions are prepared in a hurry without an evaluation of their consistency with the original budget or the overall development strategy. Undesirable though such a system is, at least the core ministries maintain a degree of effective control over expenditure decisions. By contrast, in some Sub-Saharan African countries it is the spending ministries which can determine the size of the supplements. In Zambia, for instance, the Central Bank maintains a "revaluation account" under which government payments are automatically made, whether or not the expenditure was authorized in the budget. Spending ministries are allowed to overdraw their accounts with Ministry of Finance approval being provided only retrospectively through the supplementary budget. In 1986, the supplementary budget was almost as large as the original operational budget and was the major contributor to a very large deficit. Again, as with earmarking and extra-budgetary funds, the only cure in the long run is a reform and streamlining of the main budget process.

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