

Chapter 2. THE BUDGET AND ITS COVERAGE

Government policy objectives include quantitative aims, such as raising the literacy rate by a specified amount, or qualitative goals, such as improving market competitiveness (see chapter 15 for a discussion of performance monitoring and budget efficiency indicators). They can be achieved through a variety of instruments: direct government spending, indirect spending (tax expenditures, contingent liabilities, loans, etc.), tax policy, regulations, and direct commands. Government policy goals can also be achieved through financial transactions undertaken by the Central Bank or the state-owned banking sector (“quasi-fiscal expenditures”) or through state guarantees and insurance. However, direct government spending is the most important instrument, and the government budget is the financial mirror of most government policies.

A. BASIC DEFINITIONS

1. What is the “budget”?

The word “budget” comes from *budget*, a Middle English word for the king's bag containing the money necessary for public expenditure.¹ Budgets evolved in two directions. At first, Parliaments fought to take control of the budget and make governments accountable for the use of resources. In democratic societies, for instance, approval of the budget (the “power of the purse”) is the main form of parliamentary control of the executive. The budget authorizes to the executive to spend and collect revenues. In later years, the scope of government activities expanded considerably, and the role of the government budget became more complex. Today, government expenditure is aimed at a variety of objectives, including economic development, and social goals, or redistribution objectives. Hence, governments need sound fiscal policies, i.e., policies concerning government revenues, expenditures, and borrowing to achieve macroeconomic stability and other government objectives. The budget is the most potent instrument of the government in carrying out its policies. In countries with representative governance systems, the budget is the financial mirror of society's choices. Public money should be spent only under the law.

The scope of the budget depends on the field of activities of the government, but must also be in a form to allow government policies to be appropriately scrutinized by the legislature and the public. As noted, *this book does not cover the revenue side*. However, it is important to note that, from the macroeconomic point of view, it is crucial to review revenues and expenditures together. In a number of countries, bills on the budget and revenues are presented to Parliament and scrutinized separately (e.g., Nepal). This presents inconveniences with respect to scrutiny. Assessing the soundness and the realism of tax forecasts should be the preliminary step in analyzing a budget. Since fiscal stabilization, distribution, or allocational objectives can be achieved either through tax policy or through public expenditure policy, common issues need to be reviewed together, especially those concerning policy goals that can be achieved either through direct spending or through tax expenditures, or both. Accordingly, it is necessary during the budget formulation process to coordinate the preparation of the expenditure and revenue portions of the budget and consolidate them into a single document at the time of presentation to Parliament. In this volume, we focus on the expenditure side.

The budget period is in almost all countries twelve months (“the fiscal year”). In most countries, the fiscal year coincides with the calendar year. In several others, it starts on July 1, and in a few cases, it covers a different period (e.g., October 1-September 30 in the U.S.). Because many other relevant statistics (e.g. international trade) are reformed and published on a calendar year basis, a January 1-December 31 fiscal year is more convenient for analytical and reporting purposes.

2. What is the “government”?

The government consists of public authorities and their instrumentalities. The combination of all government units is the *general government*, which consists of the following entities. ²

- *Central government*. The central government includes all governmental departments offices, establishments, and other bodies that are agencies or

instruments of the central authority of a country, departmental enterprises attached thereto, relevant nonprofit institutions, and the geographical extensions of central government authority that operate at the regional or local level without the attributes necessary for existence as separate government units. Departmental enterprises are industrial or commercial units that are noncorporate, closely integrated with the rest of a government department or agency, and likely to hold small working balances (for example, the office responsible for printing and selling the official gazette).

- *Local government.* Local government consists of governmental units exercising independent competence in the various urban and/or rural jurisdictions of a country's territory. Local government units may include counties, cities, towns, townships, school districts, water or sanitation districts, combinations of contiguous local government organized for various purpose, etc. In some countries, the boundaries between the local governments and central government are not clearly defined. For example, when a province is under military control, the level of government is not distinct from the central government. By definition, an entity is treated as local government only if it is entitled to own assets, and raise funds, has some discretion in its spending, and is able to appoint its own officers, independently of external administration.³ This is the key difference between decentralization, which includes *devolution* of policy authority, and *deconcentration*, by which the authority of the center is exercised more effectively through local entities acting as agents of the central government.
- *State governments* are an intermediate subnational entity in federal countries (e.g., India, Australia). State government has substantial authority of its own, including budgetary. In some countries, e.g., Canada, state governments are named provincial governments. In other countries, e.g., Sri Lanka, provincial governments have less extensive powers than state governments do in federalist countries.
- *Social security and social assistance funds.* Depending on their size and on

the way they are managed, social security funds are either classified as a separate subsector of the general government or included into the level of government at which they are operating.

Concerning decentralized or autonomous agencies, the nature of their function and the source of their authority constitute the proper criteria for assessing the level of government at which they should be incorporated (e.g., a hospital managed by the Ministry of Health, wherever it is located, is part of the central government).

Each level of the government should have its own budget to cover its own sphere of activity and responsibility. Most countries generally share such arrangements in place. However, in some transition economies, the organization of the budget system and the mode of negotiation of tax-sharing arrangements, based on political bargaining, do not ensure a clear assignment of responsibilities in budgeting. In these cases, one of the first steps in public expenditure reform should be to clarify the distribution of responsibilities among the different levels of the government, and to put in place stable and transparent arrangements for organizing the relationships among these levels.

3. What is the “public sector”?

In addition to the government itself, the public sector includes entities owned or controlled by the government, such as state-owned enterprises or financial institutions. In market economies, public enterprises should be commercially oriented and aim at profitability. For this purpose, they must have autonomy in management and be corporatized. Thus, their expenditures and revenues cannot be submitted to the same scrutiny and approval mechanisms as the government budget and the government budget, which should cover only their financial transactions with the government and not their transactions with the rest of the economy.⁴

However, a financial approach must also be developed for the public sector as a whole. Thus, the budget can show in an analytical table, presented for information only, the consolidated account of the public sector (sometimes called “consolidated budget,”

although it does not have the legal status of the government budget).

For accountability and transparency, the government should report on the performance and the financial situation of entities that it controls. Chapter 11 defines a government reporting entity which should consist of all entities controlled by the government. In practice, the definition of the government reporting entity varies from one jurisdiction to another.

B. GENERAL PRINCIPLES

In general, as noted, the budget is the financial mirror of government policy. Thus, to be an effective instrument, the budget should be as comprehensive as possible. Two major issues are involved here: First, if the budget excludes major expenditures, there can be no assurance that scarce resources are allocated to priority programs and that legal control and public accountability are properly enforced. Second, the amount of expenditures not included in the budget is itself often uncertain and opaque. In turn, this makes macroeconomic programming more difficult and increases the risk of corruption and waste. Budget comprehensiveness does not mean that all expenditures should be managed according to the same set of procedures. For efficiency, specific arrangements for administer some programs may be established, provided that they do not lead to a fragmented approach to budgeting and expenditure policy formulation.

In many countries a significant share of government expenditures is managed through special procedures. These special arrangements include: revolving funds to provide more flexibility in government spending, notably to overcome the annual rule; trading funds for departmental enterprises and other commercial services rendered by the government; emergency funds; special funds for specific expenditure purposes (such as road funds, health funds) managed at the sector level; expenditures financed by external loans; counterpart funds; budgets of autonomous/decentralized agencies, notably in the higher-education and health sectors; and special accounts managed by the Ministry of Finance or its Treasury Department. In a number of countries, expenditures managed through such arrangements are not shown in the budget and

managed through “extrabudgetary funds.”

Box 3 Extrabudgetary Funds in Thailand

In Thailand, a serious cause for concern is the tendency to have a large segment of public expenditure outside the discipline of the budget and the jurisdiction of the legislature. The executive exercises control over the three types of nonbudgetary funds: extrabudgetary funds, revolving funds, and special funds. A high proportion of government expenditure remains outside Parliament, giving powers to the executive and within it to the Ministry of Finance which controls these funds.

Extrabudgetary funds include the following:

- Reserve fund for emergency spending;
- Advance spending by the government authorized by law;
- Treasury reserves for special purposes;
- Temporary deposits of government agencies at the Ministry of Finance;
- Donations to government agencies;
- Foreign grants and loans;
- Receipts of public-service institutions such as hospitals, schools, and other welfare institutions;
- Compensation for loss or damage to government properties.

Revolving funds are set aside from the regular budget and operated by the agencies that initiated them. The purpose is to provide flexibility in the use of funds by the executive which is missing or restricted within the normal budgetary management system. There is no specified time frame within which the funds must be spent. At present, there are more than 80 revolving funds in active circulation, amounting to more than 3 billion baht at the end of 1987.

Special funds are the Oil Fund to regulate the retail price of oil products in the market, the Farmers' Aid Fund, the Rural Development Fund, the Land Reform Fund, and the Rubber Farming Assistance Fund.

Source: "The control and management of government expenditure: issues and experience in Asian countries, ESCAP-UNDP Development Paper No. 13, 1993.

Box 4
The Growth of Extrabudgetary Funds in the People's Republic of China

The narrowing of the scale of central government activities has brought about a decline in budgetary expenditures from 31 percent of GNP in 1978 to 20 percent in 1991. The deepest cuts have been in capital expenditures, from 12.6 percent of GNP in 1978 to 3.9 percent in 1991, as reforms transferred the bulk of investment responsibilities to state-owned enterprises. Further sharp cuts took place over those same years in budgetary defense spending, from 4.7 percent of GNP to 1.8 percent. Against the general trend, non-defense current expenditures rose slightly, from 13.7 percent of GNP to 14.7 percent; social expenditures, administration, and price subsidies all grew moderately in terms of GNP, while debt service grew very rapidly, albeit from an extremely small base. Decentralization of government functions enlarged the budgetary presence of local government, and the devolution of decision power increased the importance of local government in the budgetary process. The central government's share of budgetary expenditure is now below 40 percent, down from a peak of 54 percent in 1981.

Some of the most rapidly rising expenditure categories have increasingly fallen on local authorities, which in turn have developed extrabudgetary sources of income to finance their current and capital expenditures. The decline of the public sector's economic functions is reflected in the reduced share of investments (capital construction and technological transformation). This has been particularly sharp at the local government level: in 1978, the central-to-local split was about 56:44; in 1991, it was 74:26. Culture, education, science, and health enlarged their share of the budget, and price subsidies increased from nil to 10 percent of the budget. Budgetary revenues have declined in parallel largely because of price and enterprise reforms. By 1991, the ratio of revenues to GNP was little more than half the level in 1978.

A prominent feature of the fiscal landscape in China during 1978-1994 was the growth of extrabudgetary funds. These were funds outside the scope of the formal budget (including in terms of monitoring and approval) but subject to control by different levels of government. Most extrabudgetary funds were controlled by local governments. Revenues for these funds initially included the retained earnings of local state-owned enterprises (SOEs), public utilities surcharges, transportation fees, rental income on public housing, and various social funds, as well as ad hoc fees and charges. Extrabudgetary expenditures were mainly directed toward priority capital projects of local governments. The balance of extrabudgetary revenue and expenditure remained in surplus. The size of extrabudgetary funds rose steadily in relation to budgetary funds, to nearly 100 percent (for revenues) and 80 percent (for expenditures) in 1992.

Local governments in principle were not allowed to borrow, but the guideline was often not followed. In practice, local budget deficits were often financed through extrabudgetary funds, grants from the central government, and arrears as well as through various financial instruments.

Sources: Intergovernmental Fiscal Relations: The Chinese System in Perspective, IMF Working Paper 97/129, October 1997; and Budgetary Policy and Intergovernmental Relations, World Bank, Report No. 11094-CHA, 1993.

These and other issues concerning the comprehensiveness of the budget are discussed below. While going through the discussion, the reader is advised to keep in mind the three key objectives of public expenditure management: expenditure control, strategic allocation, and operational efficiency. Certain general considerations and minimum rules, however, need to be stated at the outset, regardless of the reasons for placing an activity or expenditure outside the budget.

In general, when existing budgetary procedures are inadequate to manage certain activities, or do not allow spending agencies to use revenues from cost recovery, the optimal choice is either to improve the budgetary procedures and/or to set up specific procedures for those particular activities, but not to place the activities themselves outside the budget. In special cases, as we shall discuss, earmarking arrangements, separate funds, or autonomous management may be desirable for improving efficiency in public spending. However, autonomy in management must not be allowed to lead to loss of expenditure control and less efficient allocation of resources. The standards of scrutiny and accountability for expenditures financed from funds, autonomous agencies, or special accounts should not be lower than those applied to other expenditures.

Therefore, the following *minimum rules* should be applied to every program, whatever its mode of management:

- Estimates of revenue and expenditures should be consolidated into the budget in gross terms, whatever the form of legislative authorization for these expenditures, and not netted out;
- Expenditures and revenues should be classified on the basis of the same classification system as the overall budget;
- Accounts of autonomous funds and special accounts must be audited externally and regularly;

- Financial reports of government activities should consolidate the operations of autonomous funds/agencies with other operations.

1. **Need for a Comprehensive Budget**

a. *Extrabudgetary funds (EBFs)*

The reasons for creating EBFs depend on the country and cover various objectives such as protecting priority expenditures from budget cuts; avoiding implementation problems in budget execution; sidestepping the inapplicability of some appropriation management rules to certain types of expenditures according to requests from some powerful political barons or lobbies; resolving difficulties in the proper allocation of expenditures due to excessive bargaining during the budget preparation process; or insulating donors' projects and programs in priority sectors at their request. In a few cases, the clear motive for establishing an extrabudgetary fund is the desire to hide transactions from public or legislative scrutiny. In such cases, the implicit motive could be to permit theft and corruption.

Whatever the motive, EBFs pose problems for the allocation of resources. Transactions outside the budget are not subject to the same kind of fiscal discipline as are budget operations, partly because they "carry their own money" and partly because they are not explicitly compared with other expenditures. Consequently, activities that would not normally survive the scrutiny of a regular budget process often continue, from their own inertia or from vested interests. Often, transactions made from these funds are not classified according to the same criteria as budgetary expenditures, hampering a sound analysis of the government expenditure program. This classification aspect can be easily improved, provided that there is willingness for transparency.

Nevertheless, EBFs are a common feature of budgetary systems in most countries. In developed countries, non-budgetary function averages about one-third of total government expenditures (mostly from social securities which accounts for about 90 percent of non-budgetary expenditure). In developing countries, the weight of social security is lower, but other non-budgetary expenditure relatively higher---for about the

same overall percentages as in developed countries (although the variability is much greater).

Extrabudgetary funds are often financed from earmarked revenues (e.g., road funds, regional funds, energy funds). Some economists argue⁵ that total spending and its composition should be determined simultaneously. Earmarking would be a way of revealing taxpayers' willingness to pay for a desired service, and to make a trade-off between decreased taxes and the increased delivery of public goods. Both the level of public-service output and taxes would be determined through earmarking mechanisms. According to the public-choice school, this could lead to an optimal allocation of resources and a balanced budget, but only under restrictive assumptions that are generally not met for public goods (e.g., constant returns to scale and no externality). Actually, fiscal discipline cannot be enforced through a process where the budget will be derived from particular interests.

Moreover, the institutional negative aspects mentioned above cannot be ignored.⁶ Generally earmarking revenues, even when the funds are consolidated into the budget decreases flexibility in resource allocation and hampers adequate program prioritization. It makes programs dependent on specific revenues and can lead to a misallocation of resources with excessive spending, simply because the funds are available, or shortages because the activities in question do not benefit from general tax revenues. Earmarking does not allow the government expenditure program to be scrutinized as a whole and thus prevents making the necessary trade-off between different expenditures. Most troublesome is that earmarking subjects expenditure decisions not to efficient criteria but to the ability of politicians and lobbies to secure protection for their favored programs. Finally, extrabudgetary funds tend to proliferate over time: the existence of an extrabudgetary fund in one ministry is often used by other ministries to "justify" their right to earmark revenues and setup their own special funds. In some countries, this can reach the point where a minister's status and self-respect depends on his having an EBF of his own. Eventually, the budgeting system becomes totally fragmented and the government loses this essential instrument of economic policy. However, as discussed below, earmarking can be desirable in specific cases and under some precise conditions.

Box 5
Pork in the Philippines

The 1999 budget contains measures intended to end the use of “pork-barrel” funds, which members of Congress have hitherto drawn on to finance economic and social projects at their discretion in their home districts. The measures target the problems of wastage, program prioritization, inefficient fiscal management, and the lack of transparency associated with the allocation of these discretionary funds. These funds include mainly the congressmen’s Countrywide Development Fund (CDF) and the senators’ Congressional Initiative Allocations (CIAs).

The CDF started as three funds in 1989: the Visayas Development Fund, the Mindanao Development Fund and the Inter-regional Development Fund. It is intended to fund development projects in the depressed areas of Luzon, Visayas, and Mindanao. The Congress called it the CDF in 1990. The CDF should be utilized only for infrastructure projects, livelihood programs, health and social services, calamity assistance, and purchase of equipment. (For instance it cannot be used to fund salaries, new positions, and other personnel benefits). Also, the CDF can be used only for projects with a fixed project life. The CDF is one of the special purpose funds indicated in the General Appropriations Act (the legislation that authorizes the annual spending program of the government). While the legislators identify the projects to be funded, the money is released and the funding is implemented by a government agency or instrumentality.

The CIAs refer to congressional changes/modifications in the general appropriations proposal submitted by the President. Their amount is not fixed nor centralized under one appropriations item. Unlike the CDF, this account is spread across agencies and the allocation per legislator depends on his allocation in the budget of a particular agency. To the extent that the Appropriations and Finance Committees are able to reduce certain budgetary items, these reductions are realigned to the legislators’ respective pet programs or projects. The CIAs are more open to misuse and about ten times bigger than the CDF. Representatives impute their budgetary insertions and “pork barrel” funds to the inability of line departments and agencies to meet local needs. They argue that their “pork barrels” only correct the “error” in the national agencies’ budgets which do not consider the needs of their particular constituencies.

The Commission on Audit in its 1996 financial report found cases of one or all of the following illegal acts: making cash advances or claiming checks, signing disbursement vouchers and purchase orders, granting contracts to favored firms, allowing the overpricing of goods, and diverting the funds to purposes other than the approved ones.

A proposal for a legislative-executive Budget Accord has been included in the 1999 budget. The accord should end the use of pork-barrel funds and promote greater participation and transparency in budgeting.

Sources: Department of Budget and Management; Philippine newspapers, various issues.

b. *Funds managed by the Ministry of Finance*

Many Treasury Departments hold “special accounts” (for example, in Japan, Korea, Indonesia, and India). Some of these accounts are used to manage EBFs placed under the authority of the Ministry of Finance or line ministries, and therefore pose the same problems as other EBFs, as regards allocation of resources. In some cases, transactions made through these special accounts concern internal financial transfers within the government rather than true expenditures. To some extent, these are comparable to a common Treasury account where internal transactions are accounted for separately. However, such arrangements are complicated and time-consuming. Moreover, in reality, nontransparent and “true” expenditures are often made through these funds.⁷ “Reserve funds,” counterpart fund accounts for foreign grants or loans, etc., are often not transparent.

c. *“Black boxes” and parallel budgets*

In some countries, revenue from natural resources is often treated more as a contribution to the purse of the President or to a political slush fund “black box”, than as a contribution to the government budget. Secrecy of revenues from oil resources and of their uses is still common. In some developing countries, revenues from commodity boards were used in the 1970s to set up a parallel budget,⁸ which was not submitted to any scrutiny. Including these revenues and expenditures in the budget is a prerequisite to improving transparency and governance. Although there could be few exceptions (for example, for security reasons), *there is never a good reason for secrecy concerning revenues and rarely a good reason for secrecy concerning expenditures.* Thus, while exceptions are possible, the existence of “black boxes” or secrecy about revenues should be interpreted as prima facie evidence of weaknesses in governance or outright corruption.

There is also a general tendency to allocate windfall revenues and some nontax revenues to particular programs. This hampers adequate prioritization among expenditure programs. From a fiscal sustainability viewpoint, the optimal (and “safest”) use of windfall revenues is to pay off the more expensive types of debt in the

government's portfolio. Under unusual circumstances, and for specified and basic human needs (e.g., drought relief, crash vaccination programs), it may be appropriate to assign windfall revenues to those needs. Before the actual expenditures are made, however, sound and well-designed administrative arrangements must be in place.

d. Expenditures financed by external sources

In the 1970s and 1980s, expenditures financed with tied external loans or grants were often omitted in the budgets of aid-dependent countries. This was sometimes explained by the difficulties of monitoring these expenditures or by the fact that budgetary procedures were not adapted to project management. To a certain extent, the reasoning was similar to that used to justify extrabudgetary funds. Progress has been made toward better coverage of externally financed expenditures in the budget, although the coverage of grants, technical assistance, and expenditures financed by external loans often remains incomplete. Donors have a key responsibility to help and facilitate the incorporation of these expenditures into the budgets of recipient countries.

3. Special Arrangements

a. Special management procedures

Funds are often created to bypass budgetary procedures. This may be due to lack of fiscal discipline, but may also be explained by the fact that the budgetary procedures are not adapted to the management of a certain category of expenditures. As discussed in chapter 5, in many countries, traditional appropriation management rules, such as rules for transfers between line items ("virements") or the cancellation of appropriations at the end of the fiscal year, are too rigid. Improvements in these rules should be considered and would limit the need to set up special arrangements.

Thus, expenditures financed from counterpart funds generated by sales of commodity aid need to be managed under specific procedures, taking into account the requirements of the donors. That such tying of counterpart funds is generally inefficient does not relieve the country of the burden of satisfying donor requirements.

Expenditures financed from counterpart funds must be included in the budget, but specific rules are needed to manage them (for example, exemption from the annual rule, and a flexible spending limit linked to the amount of revenues collected from the sales of commodities).

Revolving funds may also be needed to purchase goods that will not be delivered immediately and the payment for which would otherwise be jeopardized by the budget annual rule. Departmental enterprises need such mechanisms to carry out their trading activities.

Both for flexibility in management and institutional reasons, such as the special status of certain professions or activities, a number of “autonomous agencies” have been established in many countries, notably in the higher-education sector. These agencies are mainly financed with transfers from the budget of the central government, but have their own budget (called annexed budget in some countries).

Certain countries are increasing the number of their autonomous agencies. The aim is to separate (“decouple”) the delivery of services or administrative tasks from policy formulation and to establish contractual relationships between agencies and line ministries. This approach does not fit necessarily the administrative capacity and culture of every country. However, it could improve operational efficiency in public expenditure management, provided that it is implemented cautiously, in the sectors where it makes sense to separate the policy formulation function from the more operational functions, and provided further that contractual relationships are established in transparent manner.

However, establishing revolving funds or autonomous agencies for operational efficiency should not be an excuse to exclude programs and policies from legislative scrutiny or to renew them indefinitely. It should not lead to loss of expenditure control.

b. Road Funds

The fact that road users are identifiable and that they bear some taxes (such as

gasoline taxes) is used to justify earmarking arrangements for road maintenance or construction. Road funds have been set up in many developing countries: some are simple accounting arrangements, while others finance the provision of services. In general, experience with road funds has been disappointing and has led to the conclusion that, with some qualifications, earmarking ought to be avoided.⁹ Furthermore, when money was tight, earmarked funds were often frozen or diverted to other uses. Thus, the existence of road funds did not even guarantee an appropriate mix of maintenance, rehabilitation, and new investment in roads.

Taking this experience into account, the concept of second-generation road funds is being developed,¹⁰ inspired by the agency model developed in some OECD countries. The main features of this new approach are: involving road users in the management of roads; ensuring that all parties know their responsibilities; establishing clear accountability rules; and defining charging instruments related to road uses that are easy to separate from other taxes and charges and simple to administer. The simulation of market discipline could improve the management and the efficiency of “second-generation” road funds.

Box 6
Road Maintenance Initiative (RMI) of Africa

Why not bring roads into the marketplace, put them on a fee-for-service basis, and manage them like a business? This was the key concept of RMI launched by the United Nations Economic Commission for Africa (UNECA) and the World Bank in 1988, in an effort to identify the causes of poor road maintenance policies and develop an agenda for reforming them. However, since most of the roads will remain in government hands, commercialization requires changes in four important areas:

- Involving road users in the management of the roads;
- Securing enough money for road maintenance, year after year;
- Ensuring that all parties know what they are responsible for; and
- Establishing a system for managing road programs, with clear accountability.

These four areas are interconnected. The financing problem cannot be solved without the strong support of road users. But this support cannot be won without steps to ensure that resources are used efficiently, and for this, ways must be found to control monopoly power and constrain road spending to what is affordable, and managerial accountability must be increased. Furthermore, managers cannot be held accountable unless they have clearly defined responsibilities. These building blocks have far-reaching implications and could be applied to other sectors in Africa.

With road transport as the dominant form of transport in sub-Saharan Africa accounting for 80-90 percent of the region's passenger and freight movements, and providing the only access to most rural communities, the RMI has taken a fundamental long-term approach to reform: procedures cannot be changed until attitudes have changed. The task of changing attitudes begins with two steps: first, the costs of inadequate maintenance must be established; second, the group with the power to decide how much should be spent on roads needs to be enlarged to include the people who actually use the roads.

Source: *Finance and Development*, December 1995.

Only experience will tell. Some questions have already been raised.¹¹ Does the road fund meet good governance and anticorruption requirements? Can a board of directors genuinely represent consumer interests and not be subservient to contractors and producer interests? Is the road fund wholly devoted to roads or is merely a convenient “parking place” for money that ministers plan to divert elsewhere? Can the more demanding financial management requirements be competently handled in developing countries? Is the road fund independently audited? Despite these and other pertinent questions, the new concept is promising and merits cautious but positive support.

Box 7

Road Funds: Some Lessons From a Developing Country

Several developing countries, including Ghana, have road funds. Although Ghana's road fund has been in place for more than ten years, it has not been able to create the basis for sustainable road maintenance financing. Levels of financing have been unstable, fluctuating from year to year. To arrest this trend, the government has agreed to increase the fuel levy significantly to a level sufficient to maintain the entire road network. Getting the Treasury to agree to this graduated path to sustainable financing was a significant accomplishment, and required considerable political skill and goodwill within the Ghanaian government. For example, to avoid passing all of the proposed increases directly and immediately on to the consumer, Ghana's Treasury agreed to cede some of its other excise revenues to the road fund, so that overall fuel taxes would remain at basically the same level, even as the proportion earmarked for the road fund rises.

A key lesson from the Ghanaian experience is that having a fund is not sufficient in itself to ensure road maintenance. The creation of a board to oversee the fund, with sufficient authority and autonomy, is essential to reduce the possibility of raids on the fund by other government offices. Significant portions of Ghana's road network are still in poor condition. The fact that their road fund can only partly fund the required maintenance is typical of most road funds. The gap is normally financed with budgetary allocations and donor financing. In contrast, other developing countries (e.g. Burkina Faso) are able to finance virtually all their road maintenance requirements without a dedicated road fund.

Source: World Bank Internet page, adapted from Sam M. Mwale, Policy Research Group, Nairobi, Africa Transport Technical Note No. 8, May 1997.

c. Tax earmarking

Different tax earmarking arrangements may be found.¹²

- A specific tax or fee for a specific end-use, e.g., social security taxes, gasoline taxes for highway investments;
- specific tax or fee for a broad end-use, e.g., lottery proceeds that finance investments;
- general tax earmarked for a specific end-use, e.g., a fixed-percentage revenue devoted to specific programs.

In most cases, arrangements that earmark a share of total revenues from general taxes are questionable (issues of social security are reviewed below). Concerning other specific taxes and fees, a distinction is generally made between: (i) strong earmarking, where there is a close link between the payment of a user charge and the associated expenditure (e.g., fees for attending courses of a university); and (ii) weak earmarking where the link between the benefit and the fees or the taxes is less clear (e.g., the use of lottery proceeds for investments).¹³

As previewed in the earlier discussion on road funds, when there is a strong benefit-revenue link and the service is provided to well-identified users, earmarking may be desirable to induce agencies to improve performance and facilitate cost recovery. The use of earmarked taxes could increase taxpayers' knowledge of how the taxes they pay are used, making it more likely that they will exercise vigilance over the efficiency of the services.¹⁴

d. User charges

The issue of user charges is complex. Among other things, the benefits need to be weighed against the additional "transaction costs" of defining and collecting the

charges. In general, however, for both revenue and technical efficiency reasons, it is necessary for the government to require user charges when providing quasi-private goods, provided that the spending agencies that collect revenues are free to retain at least a significant portion of the revenue. (A hospital or a university would have no incentive to improve its efficiency if it could not use freely some of the revenue from selling its services.) Even when earmarking is desirable, however, an estimate of the revenue and the corresponding expenditures must be provided in the budget.

Box 8

User Charges: Electricity Provision to Outer Islands in Tuvalu

The Tuvalu Solar Electric Cooperative Society (TSECS), formed in 1984, is a commercial enterprise with a charter to promote solar photo voltaic (PV)-derived electricity for household lighting on the outer islands. After several years of trial and error, TSECS is now able to provide reliable PV-based electricity for lighting needs on a fee-for-service basis to about 400 households on the outer islands. The utility maintained by a well-trained technical staff with local and visiting technicians. It benefits from fee collection through an outside agency preventing diversion of funds to other projects, local user committees mediating between users and the utility, and an exclusive focus on PV systems.

Tuvalu's experience indicates that solar PV systems can be used successfully in remote areas for rural electrification at costs lower than those of commonly used diesel systems.

- Good rate of fee collection by an impartial organization based outside the community and use of the fees exclusively for the project;
- Local user committees, which can arbitrate disputes between the users and technicians about fee collections, disconnections and poorly functioning systems and keep the users informed about the functioning of the enterprise;
- Good maintenance, provided by local technicians and visiting senior technicians;
- TSEC's exclusive focus on PV systems;
- Availability of systems of different sizes to meet the varying technical needs and financial resources of the users;
- Continuing and competent internal and external training; and
- Readily available external technical support to assist with system design and training development.

The Tuvalu case indicates that the success of its solar PV system depends not only on the technology itself but on personnel training, good fee collection systems, and careful financial management.

Source: Andres Liebenenthal, Subodh Mathur, and Herbert Wade, "Solar energy: Lessons from the Pacific Island experience," World Bank Technical Paper 244, May 1994.

Systems for user charges must be transparent and efficient. The following principles should be adopted when setting up user charges.¹⁵

- *Clear legal authority.* The legal authority for an organization to charge the services should be clearly defined. This authority should be a general framework and should not set the precise amount of the charge to be applied, to allow the charges to be adjusted without further legislative authority;
- *Consultation with users.* Consultations serve to avoid misunderstandings and are useful in designing and implementing the charging system;
- *Full costing.* The full cost of each service should be determined, regardless of whether the intention is to recover costs fully or only partly. In the latter case, this information will make transparent the subsidy granted for the service (cost measurement is reviewed in chapter 10);
- *Appropriate pricing strategy.* Wherever relevant, pricing should be based on competitive market prices or on full cost recovery, or should take into account studies on variations in demand to limit congestion.
- *Equity considerations.* For equity considerations, reduced charges can be applied to lower-income individuals, users located in remote areas, etc. The criteria for applying reduced charges must be transparent. Different ways of meeting these equity objectives should be reviewed, since providing benefits directly is generally more transparent and efficient than providing them through reductions in user charges;
- *Competitive neutrality.* When pricing services, the costing should be accurate and should incorporate all items of cost faced by private-sector entities operating in the same sector;

- *Effective collection system.* The system for collecting user charges must be efficient. Nonpayment of user charges should be followed up immediately;
- *Audit.* Regular audits of the organization levying and collecting the charge are required;
- *Performance.* The performance of organizations should be monitored regularly to ensure appropriate levels of efficiency and service quality (see chapter 15 for a detailed discussion of this issue).

Several countries include in the budget only net expenditures of agencies that exercise commercial activities or recovery costs, and the budget appropriation corresponds to the difference between planned expenditures and expected revenues. If the gross amounts are large, netting out could impede a sound analysis of the government activities and an accurate estimate of economic costs. “A move to net budgeting will reduce the *measured* size of government, and lead to a reduced comparability of expenditure data relating to general government.”¹⁶ Efficiency requirements cannot supersede the need of Parliament and the public to know what the government agencies are doing. In some countries that net out appropriations, books are kept internally by the agencies on an accrual basis,¹⁷ and gross expenditures and revenues are recorded, but this is insufficient to satisfy the needs for Parliamentary scrutiny and public information.

e. *Social security*

Social security covers a variety of services classified into three broad categories:¹⁸ (i) social insurance, which is generally financed with contributions from employers and employees, and yields benefits linked to the contributions; (ii) the direct provision of a service or cash payment to a defined group of beneficiaries (e.g., family allowances, pensions, maternity grants); and (iii) social assistance, i.e., payments or services contingent on the investigation of the needs and financial status of the beneficiary (assistance to the elderly, handicapped, jobless, etc.).

The compulsory nature of social insurance and its far-reaching social, economic, and financial implications call for the inclusion of social security funds in the budget. A possible exception exists for countries where management of these funds also involves employers and employee unions.¹⁹ It could be difficult to integrate into the budget social security funds that are not directly managed by government entities. Nevertheless, taking into account the fact that they may cover a significant share of government expenditures, social security funds should at least be consolidated in a financial report (see chapter 11). Their budget should be annexed to the budget of the central government as well.

C. BEYOND DIRECT EXPENDITURE

1. Quasi-fiscal activities²⁰

Quasi-fiscal activities are financial transactions undertaken by the Central Bank or state-owned banks to achieve government policy goals. These operations include interest rate subsidies, support for ailing enterprises and financial institutions, payment of government debt, and financing of exchange rate losses incurred by the government. Accomplishing the desired goal through transparent subsidies in the budget rather than through quasi-fiscal operations is generally preferable. Also, a country's monetary authorities should concentrate on monetary policy and operations, and not get involved in activities that in effect substitute for fiscal operations through the budget. In any case, the quasi-fiscal operations of the Central Bank and other banking institutions should be scrutinized along with direct government expenditure programs and shown in the budget documents. At a minimum, a statement on the quasi-fiscal activities of the banking sector should be annexed to the budget. The production of transparent accounts from the Central Bank is also important since estimating the cost of quasi-fiscal operations is not a simple matter.

2. Government liabilities and contingent liabilities²¹

In addition to legal commitments, governments have other explicit or implicit commitments that can have an immediate or future fiscal impact. Fiscal risks and

uncertainties are increasing. The international integration of financial markets generates more abundant rapid, and volatile cross-border flows, and governments may become obliged to intervene to support the financial system. State guarantees and insurance schemes have become common. Privatization is often accompanied by implicit or explicit state guarantees.

Government liabilities can therefore be certain or uncertain (contingent), and explicit or implicit (see box 10). In descending order of fiscal predictability, these liabilities are as follows:

- *Explicit liabilities and commitments* are legally mandatory and predictable. This category includes, for example, budgeted expenditure programs, multiyear investment contracts, civil service salaries, pensions, and debt obligations;
- *Explicit and contingent liabilities* are legal or contractual obligations triggered by a discrete event that may or may not occur. This category includes, for example, state guarantees for loans contracted by non-central government entities (subnational governments, public and private enterprises) and state insurance schemes (for banking deposits, floods, crops damage, etc.). Often, the probability that the event will trigger the guarantee is high, since these guarantees are typically granted to support ailing enterprises or sectors in difficulties.
- *Implicit liabilities* represent an obligation or expected burden for the government that is not legal but arises from public expectations. For example, governments are expected to maintain public infrastructure, and to support a social security scheme, even not required to do so by law;
- *Implicit and contingent liabilities* are the least predictable category, representing a nonlegal obligation triggered by a discrete event that may or may not occur. For example, the government is generally expected to intervene if the banking sector risks bankruptcy, or the country faces natural

a catastrophe.

Generally in budgeting, decision making focuses on expenditure programs and, in part, on multiyear legal commitments, such as debt servicing. In most countries, no attention is paid in the budget to other long-term obligations and to implicit or contingent liabilities. When a country faces financial difficulties or is undergoing fiscal adjustment, there is often a tendency to overlook nonimmediate or nonexplicit fiscal risks. Sometimes, to solve immediate problems, an evasion strategy is developed that consists of substituting contingent liabilities for direct spending or making promises for the future to overcome immediate pressures. This tendency makes future problems worse than they would be if the realities were faced more forthrightly.

“Unfunded liabilities” are explained partly by the variety of sources of fiscal risk for central governments and by the fact that they are insufficiently taken into account when formulating the budget. Pension liabilities are demographically driven and are, in most countries, increasing steadily. Financing requirements for health care are rising in aging societies. Meanwhile, lack of funding for recurrent costs of investment cuts down the efficiency of the original investment, and government commitments and promises outside the budgetary systems reduce fiscal sustainability.

Sound budgeting and policy formulation requires a wider and more courageous approach, covering more effectively the fiscal risks faced by governments in the shortterm as well as in the longterm. Systems are needed to make governments both more aware of the financial impact of their decisions and more accountable. Most important, however, are political determination, leadership and effective communication of the fiscal realities to the public. Accordingly, the obligations arising from current or new expenditure programs and policy measures must be assessed realistically, whatever their nature (implicit or explicit, direct or contingent). This assessment is crucial in defining fiscal targets and making choices among alternative policies and expenditure programs. Fiscal risks should be part of this assessment. Explicit liabilities and contingent liabilities should be disclosed in financial statements (see chapter 10), and statements on debt and contingent liabilities presented along with the budget. Implicit and contingent liabilities cannot by definition be quantified or predicted

accurately; the reality of their existence, however, should add to fiscal prudence, and decision-making mechanisms should be in place to permit fast and efficient response if and when the event occurs.

Certain instruments reviewed in this volume can help in this assessment and disclosure. A multiyear expenditure approach permits assessing the fiscal sustainability of ongoing policy commitments over a medium-term period, as well as some implicit liabilities (such as the recurrent costs of investment projects; see chapter 12). Accrual accounting (either “modified” or “full”) gives a framework for assessing explicit liabilities (see chapter 10). However, these instruments are neither necessary nor sufficient for assessing fiscal risk. The key requirements are awareness of the existence of fiscal risks; assessment; disclosure; and explicit *consideration* of fiscal risks during the budgeting process.

Box 9	
Dealing with Fiscal Obligations and Risks	
Obligations and Risks	Possible Instruments
Explicit Liabilities and Commitments	
Budgetary outlays	Budget
Debt	Debt accounting Data annexed to budget
Entitlements	
Salaries	Multiyear expenditure programs
Pension liabilities	Accrual/modified accrual accounting
Explicit and Contingent Liabilities	
Loan guarantees	Notes to financial reports and the budget Assessment of fiscal risk
State insurance schemes (e.g., floods, crop failure)	- ditto -
Implicit Liabilities	
Forward costs of ongoing programs	Multiyear expenditure programs
Recurrent costs of investment projects	Public investment program or Multiyear expenditure programs
Hidden liabilities (e.g., pensions in public enterprises)	Assessment
Future health and social security financing	Assessment
Implicit and Contingent Liabilities	
Local government and public enterprise debts	Consolidated accounts/financial reports
Financial sector risks	Assessment
Social welfare functions	- ditto -
Environmental or natural catastrophe	- ditto -

Note: This list is merely illustrative and not exhaustive.

3. Loan guarantees

The most frequent explicit and contingent liabilities are loan guarantees. Guarantees can be provided by the government for loans undertaken by agencies, enterprises, and other autonomous agencies under its broad control as well as for private-sector corporations in selected situations. Guarantees can be provided for domestic or foreign loans. Loans to nongovernment entities by international financial institutions typically require a government guarantee.

While guarantees have long been recognized as an appropriate government instrument, they can have a significant impact on fiscal deficits, sustainability, and vulnerability. This became evident from the experience of many countries in Latin America and Africa in the 1980s, where most loans were defaulted by the borrowers. Debt servicing and repayment of these loans in default naturally had to be assumed by the government, thereby adding a lasting burden to an already stretched government budget.

In general, government guarantees are justified in cases where the borrower lacks the required creditworthiness (or where limited creditworthiness entails high borrowing costs), as long as their purposes are consistent with government objectives, programs, and policies of the government. When imperfect information gives potential lenders an inadequate picture of the borrower's creditworthiness, government guarantees remedy the market distortion and are appropriate from both an economic and a policy viewpoint. However, in practice, these guarantees are often granted without an assessment of the capacity of the beneficiary entity to reimburse the loan, or as favors to well-connected borrowers, and are not systematically recorded.

The expenditure equivalent of guarantees is difficult to estimate reliably, as it depends on a largely subjective judgment of the risk of default. However, the budget should at least include a *list* of guarantees that the government intends to grant and/or an aggregate monetary ceiling for these guarantees. (Appropriate management and accounting is also needed.) In several countries the government levies a fee when it

guarantees loans²². This procedure presents the advantage of creating a mechanism of registration and monitoring, and also constitutes to some extent an insurance payment in case of default. If the guarantee fee is proportionate to the risk of default (and the risk is assessed correctly) in the aggregate it will suffice to cover the cost. Of course, in this case the implicit subsidy element will disappear; but the purpose of guarantees is to offset lack of creditworthiness and not to subsidize credit.

Effective budget management calls for equally effective management of guarantees. First, there should be a system to compel consideration of the implications of the proposed guarantees, and to allow the subsidy element in such guarantees to be calculated. Second, there should be procedural safeguards to minimize the adverse impact of guarantees on the fiscal position. Third, there should be a system for monitoring the financial performance of the recipients of guarantees. Finally, there should be sufficient scrutiny and accountability to prevent the misuse of this instrument .

A well-designed system to provide guarantees should recognize the important role of guarantees in the context of all other government policy instruments. As noted, direct expenditures, loans, guarantees, and tax incentives each offer some scope for pursuing a stated objective. A ceiling on guarantees could also be prescribed. Without such ceilings, liberal provision of guarantees could adversely affect the creditworthiness of the government itself and, as a consequence, could lead to higher interest costs in the medium term. Moreover, such ceilings induce a more rigorous scrutiny and thus promote competition among potential borrowers, channeling the guarantees to entities that are financially more sound. The risk element therefore needs to be computed and explicitly recorded and shown in the budget documents.

Finally, monitoring of guarantees, parallel to the budget system, would require a periodic review and anticipate possible defaults and ways of financing them. An initial important step would be the publication of data on guarantees as part of the budgetary information and of the completed accounts of the government.

4. Government lending

Government loans are another possible means of achieving government policy goals, and can substitute for direct spending. Therefore, loans should be decided in a transparent manner, submitted to the same scrutiny as direct spending, and appropriately shown in the budget.

Government lending is often directed to entities that cannot afford to borrow at commercial terms, either because these entities need to be subsidized or because the creditworthiness of beneficiary entities is weak (a typical example is lending for crop production or to state-owned enterprises). Government lending can also be used to leverage commercial lending and supplement it. This lending is frequent in developing countries since external loans that finance public-sector entities are granted to the Government to “on-lend” them to the beneficiary entity.

The fact that loans are (in principle) repayable can make government lending a more cost-effective instrument for achieving public policy than direct spending. However, lending can also be a way of avoiding budget constraints. Loans are often submitted to a weaker scrutiny than direct spending and do not have to be authorized by the legislature.

Typically, government loans include an interest subsidy²³ and present higher risks than loans granted by commercial banks. Concessional external loans granted to the government to be on-lent to public entities usually include a provision that the on-lending should be at commercial terms, to avoid creating distortions in the financial market. In practice, this provision is not systematically enforced. Exchange rate losses may be incurred and borne by the government, and risks of insolvency can be high.

Hence, the budgetary treatment of government lending should include the following:

- Since lending must be traded off against expenditure decisions, the lending program should be reviewed together with the expenditure programs during

budget preparation;

- Loans should be included in the budget, with a full explanation of their terms, and submitted to the authorization of the legislature;
- Interest subsidies must always be budgeted as an expenditure. Two approaches may be considered: (i) budgeting the discounted value of the subsidies when the loan is granted (as in the U.S.); or (ii) budgeting the subsidy according to the interest schedule. The first approach is preferable, since the subsidy is budgeted in the year the decision is made, but needs adequate technical capacity in financial analysis and accounting.
- To ensure accountability and allow review lending programs together with expenditure programs, lending must be included in gross terms in the budget.

5. Tax expenditures

Tax expenditures are another instrument of fiscal policy. Like government lending, they should be transparent and should be included in the budget. A tax expenditure is “the revenue foregone because of preferential provisions of the tax structure”²⁴ and covers the following:

- Exemptions, which exclude the revenues of a special group of taxpayers from the tax base;
- Deductions, which reduce the tax base by some expenses or a lump sum;
- Credits, which are deducted from the tax due (as opposed to deductions which reduce taxable income);
- Deferrals, or postponements of the deadline to pay taxes, without interest or penalties;
- Reduced tax rates for certain categories of taxpayers or activities.

Tax expenditures are aimed at achieving certain public policy objectives by providing benefits to qualified individuals or entities or by encouraging particular activities. They may also be intended to improve tax equity or offset imperfections in other parts of the tax structure. The same set of objectives (for example financial

assistance to families) can be achieved either through direct spending or through tax waivers or exemptions. In principle, spending a given amount is exactly equivalent to reducing the tax on the beneficiary by the same amount. In practice, tax expenditures and direct expenditures are handled separately.

To determine whether a particular tax measure generates a “tax expenditure,” it is necessary first to establish the “normal” tax structure from which the measure departs. This is relatively easy when the tax expenditure corresponds to specific exemptions (e.g., a special income tax rate for agriculture activities), but when the whole tax structure is affected (e.g., differentiated income tax rate according to the family status of the taxpayer) the existence of a tax expenditure may be debated. There is also debate on the methodology for assessing the impact of tax expenditure, since some tax expenditures may have an impact different from direct spending, taking into account the changes in behavior of taxpayers.²⁵

Tax expenditures are granted through tax laws, in several countries, these expenditures are presented together with the expenditure budget, but are not submitted to the same system of internal control and legislative authorization as other expenditures. Therefore, tax expenditures are often an easy and less transparent way of granting special benefits to specific groups. In certain cases, the beneficiaries are less clearly identified than those who would benefit from direct spending. As a result, tax offsets can often give results that are completely different from the stated objectives. For example, high-income households can benefit more than the needier households from tax credits than from family allowances targeted to the low-income groups. Moreover, tax offsets (particularly on goods and services) create loopholes within the tax system itself.

Tax expenditures should be subject to an explicit trade-off against new spending initiatives and should be as transparent as possible. Ideally, as in the case of government lending, the direct impact of tax expenditures should be budgeted in gross terms both on the revenue and on the expenditure side. This approach can be adopted for tax expenditures that are easy to measure and monitor (such as tax refunds or tax offsets granted according to the provisions of a contract). However, since measuring

tax expenditures is difficult, this approach cannot be generalized.

Even though explicit budgeting of tax expenditures can be considered only in specific cases, an *assessment* of tax expenditures should be included in the regular process of budget decision making. For this purpose, a statement of tax expenditures should be produced regularly to allow a review of tax expenditure policy during budget preparation, and trade-offs between tax expenditures and direct spending. Some industrialized countries (e.g., Belgium, France, and the US)²⁶ annex such a statement to the budget document. This enhances legislative scrutiny of government policy.

D. KEY POINTS AND DIRECTIONS FOR REFORM

1. Key points

“General government” consists of the central government and subnational governments (state governments and local governments). The public sector includes the general government and all the entities that it controls (e.g., state-owned enterprises). Each government and public-sector entity should have its own budget. For accountability and financial control, reports should consolidate the financial operations of the general government and (to the extent possible) the financial activities of all entities controlled by the government.

For fiscal management, expenditure control and strategic allocation of resources among programs, the coverage of the budget should be comprehensive. The budget should include:

- Both revenues and expenditures of the government;
- All expenditures of the government, whatever the arrangements for managing some particular programs and the legal provisions for authorizing expenditures, and whatever the financing source.

Operational efficiency requires taking into account the specificity of expenditure

programs when designing budget management rules. When (but only when) there is a strong link between revenue and benefit, earmarking arrangements and user charges may be considered, to improve performance in public-service delivery.

Special arrangements for managing some programs should not impede expenditure control and efficiency of resource allocation:

- Extrabudgetary funds, special accounts, expenditures financed by external sources, etc., should be submitted to the same scrutiny as other expenditures;
- Funds, special accounts, autonomous agencies, etc., should adopt the same expenditure classification system as other programs;
- Transactions should be recorded in gross terms (whatever the coverage of the budget appropriation).

All policy commitments and decisions that have an immediate or future fiscal impact, or generate fiscal risks, (tax expenditures, contingent liabilities, loans, and quasi-fiscal expenditures) should be disclosed and scrutinized together with direct spending.

2. Directions in reforms

Priority actions should consist of laying the foundations required for any sound budgeting and policy formulation system, including:

- A comprehensive coverage of the budget;
- Assessment, disclosure, and review, together with expenditure decisions, of all policy decisions that have an immediate or future fiscal impact, such as contingent liabilities, lending, tax expenditures, and quasi-fiscal expenditures;

- An expenditure classification system that fits the needs of policy analysis and management and covers all government expenditures.

These actions should be carried out together with the priority actions aimed at improving budget preparation, execution, and accounting procedures (see chapters 4, 6, 7 and 10). They are a prerequisite for further improvements in the budget system.

Among these further improvements the following can be considered:

- Aside from the annual budget, instruments that facilitate an for better assessment of liabilities, contingent liabilities, and policy commitments. These instruments can include a modified accrual accounting system, or multiyear expenditure programming (see chapters 10 and 13);
- A performance-oriented approach (see chapter 15);
- Management arrangements for some expenditure programs (e.g. user charges, and earmarking where there is a strong revenue-benefit link, autonomous management for service delivery agencies contracting out) to improve their operational efficiency. However, these arrangements should not make the budget any less comprehensive or impede legislative accountability and control over expenditures in the aggregate.
- A classification of expenditure by activity and program, which allows performance indicators to be defined at an appropriate level.

¹ Ministère de l'Economie et des Finances "France's state budget", Paris, 1996.

² These definitions are drawn from the 1986 Government Finance Statistics (GFS) and the 1993 System of National Accounts (SNA). The comments on Social Security funds come from the 1993 SNA..

³ 1993 SNA, page 104.

⁴ In centrally planned economies, the demarcation between the activities of public enterprises and government activities was unclear, since state-owned enterprises were involved in public-services delivery.

⁵ See, for example, James Buchanan in *The Demand and the Supply of Public Goods*, Rand McNally, 1968.

⁶ For a discussion of this issue, see McCleary, 1991.

⁷ According to the 1993 ESCAP, in Thailand, extrabudgetary funds (advance spending, temporary deposits

of government agencies, foreign aid, etc.) covered more than 60% of the government expenditures reported by the Department of the Comptroller-General. However, the larger part of these expenditures concerned internal financial transactions and the accounting system allowed multiple accounting. The "true" fiscal operations accounted only for a small percentage of transactions made through these funds.

⁸ As in the Ivory Coast.

⁹ William McCleary, The earmarking of government revenue: A review of some World Bank experiences." *The World Bank Research Observer*, January 1991.

¹⁰ Ruper Pennant-Rae and Ian Heggie, Commercializing Africa's roads, "*Finance and Development*, 1995; and Ian Heggie, Managing and financing of roads: An agenda for reform, 1995.

¹¹ Barry H. Potter, Dedicated road funds: a preliminary view on a World Bank initiative, 1997.

¹² See William McCleary, "The earmarking of government revenue: A review of some World Bank experiences," *The World Bank Research Observer*, January 1991.

¹³ See Richard Hemming and Kenneth Miranda, Pricing and cost recovery," in Ke-young Chu and Richard Hemming, Public expenditure handbook, IMF, 1991.

¹⁴ See Humberto Petrei, "Budget and control," Inter-American Development Bank, 1998.

¹⁵ Drawn from OECD "User charging for government services," 1998.

¹⁶ David Heald and Gorge Georgiou, "Consolidation Principles and Practices for the Government Sector", University of Aberdeen, 1996.

¹⁷ As in several FSU countries.

¹⁸ See Premchand, 1983.

¹⁹ Notably in Continental Western Europe.

²⁰ See G.A. Mackenzie and Peter Stella, Quasi-fiscal operations of public financial Institutions, IMF, 1996; and David J. Robinson and Peter Stella, Amalgamating Central Bank and fiscal deficits," in M. Blejer and A. Cheasty, *How to measure the fiscal deficit*, IMF, 1993.

²¹ This section is drawn up largely from Hana Palackova, "Government contingent liabilities: A hidden risk to fiscal stability," World Bank, 1998.

²² See Premchand, 1983.

²³ Methods separating the pure loan from its grant component are reviewed in Michael A. Wattleworth, Credit subsidies in budgetary lending: Computation, effects, and fiscal implications," in IMF, *How to measure the fiscal deficit*, 1993.

²⁴ U. S. Office of Management and Budget (OMB); Statement of Federal Financial Accounting Standards (SFFAS) No. 7, 1996.

²⁵ The Federal Government Reporting Study, undertaken jointly by the Office of the Auditor General of Canada and the United States General Accounting Office in March 1986, had this to say about statements of tax expenditures: "Removal of a major tax expenditure might in fact have a negative impact on outputs and incomes in the economy, producing less additional tax revenue in total than the estimates in the table would suggest.... Tax expenditures may have a greater effect than direct aid in the form of grants, because selective measures directly increase after-tax income and grants would normally be taxed or would reduce deductible expense."

²⁶ See OECD, *Tax expenditures*, 1996.