Chapter VII

The Budget's Role in Planning

> . . . planning without regard for the realities of annual budget implementation becomes an academic exercise of little operational value.[1]

THE RELATIONSHIP BETWEEN PLAN AND BUDGET

SINCE ANNUAL budgets are the principal means by which governments authorize and control most of their expenditures, most outlays provided for in the public sector portion of a development plan must be incorporated into these budgets if the plan is to be carried out. From a practical point of view, therefore, the conversion of a public development plan into a series of annual budgets is likely to be the most important stage in the planning process. It is by examining the link between a plan and a budget that one can tell whether or not a government means to carry out a plan. If an operating organization can obtain a budgetary allocation for one of its projects or programs only if it has been approved as part of a development plan, we may assume that a government is in earnest about carrying out a plan. If, however, significant exceptions are permitted, doubts arise about a government's intentions to implement a plan. A government's budget is therefore a key element in converting a development plan into a program for action.

Where the relationship between a plan and a budget is close, the budget is, as far as it goes, the financial counterpart of the public sector plan. To perform this role adequately, the budget must provide not only for planned capital expenditures but also for associated current expenditures, as well as for revenue and other domestic financial resources which, in combination with available external financial resources, will support the required outlays. As indicated in Chapter V, the ideal connecting link between a plan—more specifically a medium-

[1] Herman, Robert S. "Two Aspects of Budgeting," p. 319.

term plan—and an annual budget is an annual plan. By identifying what must be done and the resources and measures needed to do them in the coming year, an annual plan reduces the multiannual tasks and targets of a medium-term plan to the quantities required for incorporation in an annual budget and, in this way, greatly simplifies the task of "translating" the relevant portions of a medium-term plan into an annual budget.

An annual plan reaches, or should reach, its conclusions after consideration of the totality of resources available to a country. These include physical factors, like natural resources, manpower and existing productive capacities, as well as financial resources in domestic currency and foreign exchange. The annual plan apportions these physical and financial resources among the various sector programs and, frequently, among projects included in the plan; and it sets savings, investment, export, import, output and other targets which involve the utilization of these resources in a way which is consistent with the institutional, administrative and managerial setup in a country.[2] An annual plan for the public sector includes the programs of autonomous and semiautonomous agencies, state, regional and local bodies, as well as those of ministries and departments. If the plan is comprehensive it must also provide a framework for development in the private sector.

[2] The foreign exchange availabilities and requirements to carry out a development plan are generally incorporated in a foreign exchange budget. There should be a foreign exchange budget for the entire period of a medium-term plan since the amount of foreign exchange available to a country is an important determinant of the size and composition of its plan. To fix the extent of foreign exchange needed for a medium-term plan, planners must estimate the foreign exchange required for imported capital goods, raw materials, components and services for planned projects and programs. The gap between total foreign exchange requirements and foreign exchange availabilities must equal the gap between planned investment and domestic savings. One is the counterpart of the other in a consistent plan. (UN. ECAFE. "Problems and Techniques of Foreign Exchange Budgeting," pp. 38–39.)

A detailed foreign exchange budget must be prepared annually in conjunction with an annual development plan and an annual budget. An annual foreign exchange budget shows both the sources and uses of foreign exchange. The sources side indicates the amount of accumulated foreign reserves, the amounts expected to be earned from exports of specific goods and services, receipts from foreign loans and grants, etc., by country and currency. The uses side allocates foreign exchange among competing demands in accordance with criteria laid down in a development plan. These include allocations of foreign exchange between the private and public sectors and between consumption and investment goods. Details will include payments for imports of goods and services, interest and principal payments on public and private foreign debt, reserves needed to be carried forward, etc., by country and type of currency.

Finally, an annual plan incorporates those instruments of economic policy and organizational and institutional measures required to mobilize resources and achieve plan objectives.

An annual plan is therefore broader in scope than a conventional administrative budget, which is almost always limited to the domestic funds required for general government activities, usually the only part of the public sector which is covered by the government budget. An annual plan takes a broader view than a budget in another sense. It is likely to be expressed in more general terms than a budget. An annual plan is mostly concerned in broad outline with objectives, priorities for the use of resources and expected outputs from proposed inputs of physical, human and financial resources. While an annual plan should indicate how financial and other resources are to be allocated among projects and programs, a budget must be concerned much more specifically with receipts from various taxes and other sources, the availability and commitment of funds, cost estimates for projects and programs, the administrative feasibility of individual projects and programs, and the canons of financial custodianship and control.

It is possible for a budget to substitute for an annual plan, and vice versa. In Malaya, for instance, annual budgets are prepared without an annual plan on the basis of recommendations of the Economic Planning Unit (EPU), which is guided generally by the terms of Malaya's Five-Year Plan. But since the EPU's recommendations for allocating capital expenditures and for reconciling these allocations with current expenditures generally form the basis for the budget, plan and budget are more completely related to each other than in most other countries. In contrast, Yugoslavia's annual development plans embody investments in the economy which are never incorporated in annual budgets. This is because annual budgets in that country are largely limited to "nonproductive" administrative expenditures for carrying on the ordinary business of government. In Yugoslavia, therefore, it is the annual development plan rather than the budget which directly determines how public financial resources are allocated from a General Investment Fund and a series of decentralized investment funds.

But for most countries, especially less developed countries, annual plans and budgets, and their co-ordination, are virtually *sine qua non* for putting medium-term plans into effect. The task of implementing a medium-term plan, without first phasing it in annual plans, appears to be well beyond the capacity of most less developed countries. In this respect, Malaya is an exception rather than an example.[3] Yugoslavia is even more exceptional since practically every other country includes a large part of its public development expenditures in its budgets.

In countries with Soviet-type economies, budgets based on annual plans are an integral part of the planning process. With retained profits of enterprises, they are in fact the principal source of investment funds for implementing annual development plans. But financial budgets are subordinate to development plans. In these countries, finance is

> conceived as an instrument of proper implementation of a development plan and not as an independent factor limiting the rate of economic development. The only limits to economic development are set by nature and the given historic heritage of society. They consist of limitations in natural resources, human skills and organising power. To allow finance to act as a limit would introduce a man made limit on economic development which has no justification in the state of available natural and human resources.
>
> However, finance is an important instrument for assuring a smooth course of economic development, for avoiding disturbances. Finance is an instrument by which the needed physical resources are made available for the plan and by which they are directed to their proper allocation. Furthermore, finance is an accounting device which shows whether the total requirement of physical resources balances with the available quantity. Such balance is necessary to avoid bottlenecks and inflationary disturbances in the course of realisation of the plan of economic development. Consequently, the plan of economic development must be balanced both in terms of physical and of financial requirements and availabilities.[4]

This concept of the role of a budget is clearly reflected in the budgets of countries which plan on the Soviet model. In the USSR, itself,

> the crucial budget figures . . . do not have an independent existence, but are built up at each stage on the draft or final figures of the national economic plan.[5]

Similarly, the Czechoslovak budget is thought of as mirroring

[3] Even in Malaya, however, the absence of annual development plans has made it necessary to revise medium-term plan totals to bring them into line with budgetary expenditures.

[4] Lange, Oskar. "The Tasks of Economic Planning in Ceylon," p. 78.

[5] Davies, R. W. *Development of the Soviet Budgetary System,* pp. 186–187.

> the material proportions of the comprehensive plan. Hence, a close connexion between plan and budget is unavoidable and necessary; [6]

while in Hungary, the budget is carefully

> drawn up in close conformity with the guide-lines and targets of the economic plans. Thus, the financial plan [i.e., the budget] of the economy is built upon the fundamental indicators of the economic plan and comprises their financial aspects.[7]

Consistency with an annual plan is therefore a prime requisite of a well-prepared budget in Soviet-type economies. A deficit in the budget

> indicates that the production, consumption and accumulation targets and the quantitative and qualitative indicators of the economic plan are not properly co-ordinated.[8]

Discrepancies arise between budgets and plans, especially when an annual plan has been revised at the last moment. But on the whole, consistency is achieved.

In contrast, there is only a tenuous relationship between plans and budgets in most mixed-economy countries. For example, the annual Income and Expenditure Budget in Honduras was supposed to be drawn on the basis of co-ordinated action by the Honduran Bureau of the Budget and the National Economic Council, the country's central planning agency. But the Council did not see the (1962) budget until after it had been approved by the President and only a few days before it was to be submitted to the Congress. As a result, there were

> serious and irreconcilable discrepancies between the plans drawn up and the appropriations recommended to Congress in the draft Budget.[9]

In Guatemala,

> inclusion of a project in the plan did not ensure that the necessary funds would be appropriated. Further, even if funds were appro-

[6] Vergner, Zdenek. "Economic Planning in Czechoslovakia," p. 8.

[7] Hungary. "The Main Features of National Economic Planning in Hungary," p. 22.

[8] Bor, Mikhail Zakharovich. "The Organization and Practice of National Economic Planning in the Union of Soviet Socialist Republics," p. 165.

[9] Collett and Clapp, Inc. *Organización y Administración de la Función de Planeación,* p. 15.

> priated, the implementing agencies retained substantial leeway to use the funds for projects not forming part of the development programs.[10]

And in Burma,

> there was no financial framework for the plan as a whole and no attempt was made to fit the plan into the Government budget.[11]

Investments made under Surinam's Ten-Year Plan are controlled by the Planning Bureau. Outlays for implementing the Plan are not incorporated in the budget which the Ministry of Finance prepares. But there are substantial amounts included in the Ministry's budget for development outside the Ten-Year Plan over which the Planning Bureau has no control.

Where, as in Pakistan and India, budgets are prepared on the basis of annual plans, this is a recent innovation. Even in France, the Fourth Plan was the first to be included in the budget when the Ministry of Finance finally consented to give up some of its traditional independence and include some plan items in the budget for 1962.[12]

Many problems other than the traditional independence of a Ministry of Finance impede the integration of plans and budgets. One of the most important problems is the failure of most less developed countries with medium-term plans to prepare annual development plans. In the absence of annual plans, many less developed countries with medium-term plans resort to annual budgets to co-ordinate their development efforts. In Tanganyika, for example, a World Bank survey mission reported that despite the issuance in the postwar period of a somewhat confusing sequence of development plans, in practice, planning has been largely carried on through annual budgets.[13] But since medium-term plans do not indicate clearly the action to be taken annually to fulfill plan targets, what is included in budgets may fall short of what is required by a plan.[14]

Where annual plans are prepared, they often do not relate proposed expenditures to physical targets. Many annual plans are little more

[10] OAS. Department of Economic Affairs. *Planning Organization and Implementation in Guatemala,* p. 33.

[11] Burma. Ministry of National Planning. *Second Four-Year Plan for the Union of Burma* (1961–62 to 1964–65), p. 1.

[12] Wickham, S. "French Planning: Retrospect and Prospect," p. 343.

[13] IBRD. *Economic Development of Tanganyika,* p. 340.

[14] UN. TAO. *Report of the Inter-Regional Workshop on Problems of Budget Classification and Management in Developing Countries,* p. 15.

than lists of projects with amounts to be included in a budget. In some countries, it is impossible to fit plans into budgets because annual plans are drawn up on a calendar year basis while annual budgets are prepared for a different fiscal period. Where this situation exists, the period used for plans and budgets must be made to coincide before plans and budgets can be integrated. Recently, Ghana, Guatemala, Italy, and Trinidad and Tobago, among other countries, provided for changing their fiscal years to the calendar year to integrate their budgetary and planning periods.

Where the periods of a plan and a budget coincide, the timetable for preparing the annual plan may not have been synchronized with the one for preparing the budget, with the result that the plan is not ready in time to be incorporated in the budget. If an annual plan is to provide guidelines for a budget, its preparation should begin before work on the budget starts. But work on a plan cannot begin too far ahead because the results of the current year's plan, on which the coming year's plan should be based, will not be known until late in the current year and because a plan prepared long in advance is likely to be out of date by the time its period begins. Moreover, the formulation of an annual plan cannot proceed very far without reasonably reliable budgetary estimates of the coming year's receipts, current expenditures, and surplus on current account available for public investment. This is because the size of an annual plan is usually influenced greatly by the balance available after nondevelopment requirements are met. Basic budgetary figures for the coming year are also needed because they help detect current economic trends and because the annual plan for the coming year must evaluate the probable effect of that year's budget on the economy. This is because a budget influences economic activity. Decisions on how much of total financial needs are to be covered by taxation and how much by domestic borrowing, drawing down cash balances, external loans and foreign grant aid will affect the levels of supply and demand for resources for the entire economy; and the proposed level and composition of taxes and budgetary spending will affect private savings and investment incentives.[15]

Planning and budgeting thus constitute a two-way process in which the data of each feed the other. It is therefore unavoidable that much of the work of preparing an annual plan and a budget must proceed simultaneously and with the close collaboration of planning and

[15] *Ibid.*, p. 19.

budget officials. In federal governments, such as in India and Pakistan, annual plans and budgets must also be prepared by each political subdivision and dovetailed with both the annual plan and budget of the federal government. This requires the establishment of a timetable with deadlines for the submission of new projects and programs by political subdivisions, as well as the provision of data on other aspects of their plans.

For foreign exchange allocations to be co-ordinated with the domestic currency component of financing required for projects, it is also essential that the preparation of an annual foreign exchange budget be synchronized with the preparation of an annual government budget and that both be presented for simultaneous consideration and approval by the appropriate authorities. Unless this is done, shortages of foreign exchange are likely to develop which will delay the execution of projects.

Delays in preparing a budget can also seriously hinder the integration of plans and budgets. It frequently happens that budgets are not ready at the start of a fiscal year. Thus, in Syria, budgets for the financial year beginning January 1 were supposed to be ready by the end of the preceding December. But a World Bank survey mission found that budget preparation often fell behind this schedule.[16] Until a budgetary reform was instituted in 1964, most of the Italian Parliament's time each year was consumed in approving 19 separate ministry budgets. They were supposed to be enacted into law by July 1, the start of the financial year, but the task was never completed before the end of October.[17]

INADEQUACIES OF CONVENTIONAL BUDGETS

Even when a budget is ready on time, it often is not an effective instrument for allocating financial resources in accordance with a plan. In many countries it is an incomplete statement of government receipts and expenditures, with significant exclusions; in some countries there are a multitude of segregated funds which complicate and restrict the usefulness of a budget; and in other countries formalistic controls take the place of efficient budget management. In a study which the Public Administration Service of Chicago, Illinois, completed for the U.S.

[16] IBRD. *Economic Development of Syria,* pp. 264–265.
[17] *Financial Times,* January 28, 1964.

Agency for International Development in 1962, legalistic restrictions were found to hamstring budgetary administration in the governments of many countries:

> Generally it will be found that the handling of individual fiscal transactions is controlled in minute and inflexible detail. Often there is much concern over how documents are authenticated, processed, and filed, how transactions are classified, and how accounts are maintained. At the same time, large areas of governmental expenditure are under little or no control, slight relationship exists between expenditure estimates and results, and many procedural requirements are met by *pro forma* and 'after the fact' actions.[18]

The same study also discovered many other shortcomings in budgets which greatly impeded their use as instruments for carrying out development plans. In fact,

> in some countries there is no central budget administration worthy of the name. Expenditure estimates are compiled on some historical basis, and programs and projects are initiated without any idea of when and how they may be completed or how they are related to one another. The annual budget represents a totaling up of departmental estimates of receipts and expenditures that are generally unrelated to governmental programs or foreign exchange resources or monetary policy.[19]

These countries may be extreme cases. Some countries have established the basic elements of a budgeting system and have introduced methods and techniques which are increasing the usefulness of their budgets for development purposes, but the study concludes that,

> in many countries, . . . budget administration is so inadequate as to make impossible the implementation of any reasonable development plan.[20]

Budgetary Fragmentation

The conventional administrative budget commonly used by governments does not encompass all public sector activities. Some exclusions result from political organization. The conventional budget does not,

[18] US. AID. *Modernizing Government Budget Administration,* p. 35.
[19] *Ibid.,* p. 24.
[20] *Ibid.,* p. 35.

for instance, include public sector transactions carried out by states or other political subdivisions, even when the national budget makes large contributions to their activities. Nor should a national budget include the expenditures and receipts of state and local governments which have a degree of independence.[21] But since budgetary transactions for development at subordinate levels of government may be substantial, especially in countries with a federal constitution, their exclusion from a central government's budget reduces the budget's comprehensiveness and may thereby reduce its capacity to implement public sector programs.

Other exclusions from national budgets are less understandable or defensible. A World Bank survey mission to Syria found, for example, that in that country

> the ordinary budget gives an incomplete and misleading impression of the fiscal position of the government because it does not cover certain extraordinary defense expenditures and receipts and transfers of funds between the Treasury and independent agencies.[22]

It is the failure to include transfers or other transactions of public or quasi-public agencies in the conventional administrative budgets commonly used in less developed countries which constitutes the most serious omission in these budgets.[23] When public and semipublic agencies, whose transactions are outside the budget, account for substantial proportions of public income and expenditure, the usefulness of the budget for allocating financial resources in accordance with a plan is greatly diminished. In Ecuador, for instance, 65 per cent of the public revenue was administered by over 700 public and semipublic agencies whose transactions were not recorded in the government budget,[24] while in Mexico about half of all public investment was

[21] As will be seen later, conventional budgets may not even include data on intergovernmental transfers between a central government and subordinate political governments.

[22] IBRD. *Economic Development of Syria,* p. 266.

[23] The extent to which data on autonomous and semiautonomous agencies are included or excluded in a national budget is largely the result of historical accident or tradition. In many countries, information on the transactions of these agencies is limited to budget transfers to agencies on current or capital account or net transfers from agencies to government.

[24] Ecuador. National Board of Economic Planning and Coordination. "Chapter IV. The Organization for the Plan for Economic Development and the Administrative Reform," p. 15.

financed by such agencies with extrabudgetary resources.[25] In Venezuela, also, 50 per cent of public investment outlays have been carried out by public and semipublic agencies, states and municipalities. Neither their transactions nor budgetary transfers to and from the autonomous agencies have been included in the national budget although a substantial part of their investment has been financed by National Government transfers.

The absence of information about transfers between a budget and public or semipublic agencies generally implies a lack of adequate government control over their activities. In Thailand, for instance, a World Bank survey mission reported inadequate financial controls over

> the 80 or more quasi-independent government organizations which are engaged in various commercial, industrial and financial activities. The scale of financial transactions of many of these is very large . . . , [yet] for the majority of these organizations supervision does not go beyond a routine audit of accounts.[26]

In many countries, semipublic or public enterprises circumvent national development plans and invest in low-priority projects and programs outside plans which they finance with loans from banks or with expensive, short-term foreign suppliers' credits. These activities may not only lead to a diversion of resources needed to implement national development plans but may also jeopardize a country's credit standing and balance of payments position.

While the omission of items which should be included in a budget is the more common weakness, some budgets are impaired by the inclusion of unnecessary or largely meaningless receipts and expenditures which reflect mainly the transfer of funds between accounts. For example, one Middle Eastern country has four types of budgets. Interrelationships among these budgets are not always clear; transfers from one budget to another are not easily distinguished from actual expenditures or revenues of the public sector; neither is it always clear whether certain receipts are revenues or only counterparts of increased government indebtedness. These and other procedural inadequacies make it almost impossible to obtain an over-all view of the financial position of the public sector.

[25] Beginning with the 1965 budget, transactions of about 20 semiautonomous agencies which in 1965 were expected to spend slightly more than the rest of the Mexican Government were included in the National Budget.

[26] IBRD. *A Public Development Program for Thailand,* p. 200.

The usefulness of a budget as an instrument for implementing a development plan may also be impaired by excessive "earmarking" of tax receipts or other revenues for specific purposes. Some earmarking, like a payroll tax to finance social security payments, gasoline taxes to finance road construction, or toll revenues from a bridge to retire indebtedness incurred to finance its construction, is economically and politically justifiable because it ties a government service to a tax or payment which made the service possible. There are other examples for which a case could be made for setting revenues aside in a special fund to be used for a designated purpose. Earmarking of taxes may make people less reluctant to pay increased taxes when they know that the proceeds from a tax will be used for a purpose from which they will benefit. Moreover, when taxes are increased and earmarked to pay for more or better government services approved by a legislature, there is increased assurance (if the tax is large enough) that the additional services will not require inflationary financing.

But when a substantial proportion of total budgetary revenues is segregated into special funds earmarked for specific use, a budget loses flexibility for development because it becomes difficult if not impossible to allocate financial resources in accordance with priorities called for by a plan. Earmarking of revenues is common in Latin America and is growing in Asia and Africa:

> In one Latin American country in 1961 income from 291 out of 330 taxes was wholly or partly earmarked for subordinate authorities or marginal entities, leaving only 39 to the national government for general use.[27]

In Costa Rica, at least 60 per cent of total current revenues have been allocated in the form of fixed percentages of budget estimates to the University, the judiciary and to a series of specific purposes like housing. It has been estimated that in another Latin American country

> 80 percent of the central Government's expenditure is predetermined and cannot be altered by those responsible for preparing the budget.[28]

Fragmentation of a budget into a series of separate funds or accounts because of earmarking of receipts and expenditures or

[27] US. AID. *Modernizing Government Budget Administration*, p. 25.

[28] UN. ECLA. *Fiscal Budget as an Instrument in the Programming of Economic Development*, p. 70.

because of a proliferation of more or less autonomous agencies whose transactions are extrabudgetary, generally results in unduly complex budgeting and accounting systems. It also makes it difficult for a government to follow a coherent budgetary policy and to determine how much money is available for development and other expenditures.[29] In Ecuador, for instance, more than 600 separate, earmarked taxes have been included in the budget. For most of these taxes separate accounts have had to be kept. This greatly complicates budget management.

Consequences of Staff Inadequacies

Largely because of a lack of qualified staff and poor organization, budget agencies in most less developed countries are little more than bookkeeping offices. Budget personnel frequently lack the stature and prestige needed to review the submissions of operating organizations. Even where budget staffs have the necessary competence and standing, the short time usually allowed for a budget to be prepared does not permit adequate review and analysis. All too often a budget is only the sum of the budget requests of operating ministries, departments and agencies, put together without adequate examination or screening. The Organization of American States has reported that in Latin American countries, budget offices have seldom-challenged authority to reshape budget requests, but that this authority is not enforced to a very considerable extent

> and many budget offices are often concerned with little more than adding up the requests for funds of individual ministries. There is remarkably little pruning of expenditures; and what cutting off takes place is often overcompensated for by politically inspired last-minute requests for special-interest expenditures.[30]

Deficiencies in Budget Procedures

In a report which is typical of those for other countries, the World Bank survey mission which visited Thailand in 1958 found that

> the procedure for preparing the annual budget is deficient. Government departments request appropriations with only vague

[29] Herman, Robert S. "Two Aspects of Budgeting," p. 322.

[30] OAS. Inter-American Economic and Social Council, etc. *Programming for Development: Five Urgent Problems*, p. 5.

> justification and in amounts that are consciously set beyond any expectation of achievement . . . the Ministry of Finance lacks personnel with the necessary competence and detailed knowledge of departmental requirements to evaluate adequately the reasonableness and priority of requests. In these circumstances it is almost axiomatic that requests for appropriations will be cut; but the nature and extent of cutting involves substantial elements of arbitrary judgment and political pressure. Hence some appropriations may be unrealistically low and in important cases almost certain to be exceeded, while others may be well in excess of any reasonable justification. The result has invariably been the enactment of total appropriations substantially beyond the available non-inflationary sources of financing.[31]

This method of operation has not been limited to Thailand. The budgeting procedure followed by Pakistan's Ministry of Finance, particularly during the period of the First Five Year Plan, was similar. The Ministry incorporated into the budget estimates, submitted by ministries and departments, which it knew were unsound or projects which it knew were not ready. After the budget had been approved, however, the Ministry scrutinized all proposals before it allowed any expenditures to be made. This only compounded the problem. Since a project's inclusion in the budget and an allotment for it gave no assurance that the Ministry of Finance would later approve expenditures to carry it out, operating organizations made little effort to submit accurate budget estimates when the budget was being prepared and generally made excessive demands for funds. This in turn led to indiscriminate budget cutting by the Ministry of Finance and the substitution of bargaining and haggling between the Ministry and the operating organizations in lieu of rational consideration of projects.[32] In Burma,

> review of the current budget was made difficult by the inadequate submissions of the operating ministries and departments and by the lack of Finance Ministry staff appreciative of the need for and capable of adequate substantive review. Knowledge that even after budgetary approval the agencies concerned would still be required to obtain financial sanctions for all but routine expendi-

[31] IBRD. *A Public Development Program for Thailand*, pp. 201–202. In Thailand, the story has a happy ending. Subsequent to the mission's visit, the Government introduced budgetary reforms which greatly improved the situation described in the mission's report.

[32] Waterston, Albert. *Planning in Pakistan*, pp. 51–52.

> tures, and the possibility of rectifying errors at mid-year, led to disinterest on the part of both the Ministry of Finance and the submitting agencies in the quality of current budget submissions.[33]

In Ecuador, also, the budget as submitted to the Congress was largely a conglomeration of ministry and other proposals compiled by the budget authority without any attempt at review. The budget office understated expenditures and overstated revenues to give the budget the appearance of being balanced. The real "budget-making" occurred after the Congress had approved the budget and had adjourned. Then, a series of executive decrees were issued which transferred money from one budget purpose to another. In one year (1957), the President signed more than 400 such decrees.

Other countries also make unrealistic estimates of revenues and expenditures. While some budget offices, like Ecuador's, tend to overstate revenues and understate expenditures in order to bring budgets into nominal balance, more often they tend to do the opposite. A budgetary authority may underestimate receipts to restrain demands of operating organizations or to provide a reserve for new projects and program changes. For instance, in Burma,

> typically, the Finance Ministry would underestimate prospective revenues and overstate requirements for current government expenditures, thus tending to minimize resources available for public capital investment.[34]

Sometimes, as when a country depends greatly on agriculture or foreign trade, it may be difficult to predict receipts and expenditures. Rapid price inflation may also interpose serious difficulties in the way of accurate forecasting of receipts or expenditures.[35] In these events, wide discrepancies between estimated and actual receipts and expenditures may be unavoidable. But deviations from estimates are also frequently due to poor or misguided techniques. Whatever the reason, however, in many countries emergency, supplementary, or other extraordinary appropriations often have to be made to fill gaps or correct

[33] Walinsky, Louis J. "Burma," p. 42.

[34] *Ibid.*, p. 43.

[35] In Brazil, for example, budget estimates made during periods of inflation could not be taken seriously because everyone expected the estimates to be obsolete before long. The Government could have tried to make realistic guesses about the degree of inflation to be expected during the year, but it hesitated to do so for obvious reasons.

miscalculations which become evident after a basic budget has been authorized. These additional authorizations may reach sizable proportions of total budgetary outlays. Continued and unco-ordinated use of such special appropriations reduces the effectiveness of expenditure controls and the usefulness of budgets for carrying out development plans.

Paradoxically, laxness in major budgetary matters is often accompanied by excessively rigid and formalistic controls over details of budget execution.[36] In many countries, unduly detailed systems of expenditure control are often a substitute for good budget practice. Requirements for the preaudit of expenditures by a budget authority or a general accounting office before authorized funds are disbursed, as well as involved rules which ministries, departments or agencies are expected to apply, result in cumbersome procedures which place great stress on legal niceties but put little emphasis on prudent economic use of resources.[37] These controls and procedures, which are usually more apparent than real and almost invariably have the effect of impeding the implementation of plans, are discussed in greater detail in the next chapter.

Poor Accounting

Out-of-date, complex, confusing or otherwise inadequate accounting systems widely used in less developed countries, as well as poor accounting practices, also diminish the effectiveness of national budgets, either as instruments of financial control or as means for giving effect to development plans. As one of many examples which could be cited, a World Bank survey mission found archaic accounting methods employed in Libya. In that country, there was considerable laxity in the control of public expenditures, long delay in closing accounts, as well as a general lack of information about how much money was being spent and on what it was being spent.[38]

In many countries, accounting systems and procedures used in operating ministries, departments and agencies seriously interfere with proper budgetary control. In Pakistan, for instance, three different systems of accounting have been employed in operating organizations. All have defects, some of which are serious. Accounts often are not

[36] US. AID. *Modernizing Government Budget Administration,* pp. 25–26.
[37] IBRD. *Economic Development of Syria,* p. 266.
[38] IBRD. *Economic Development of Libya,* p. 93.

maintained to keep pace with the execution of projects and programs. Because expenditures are not entered to appropriate accounts as they occur, large sums remain in suspense accounts which have become convenient repositories for disbursements of unidentified purpose. In many cases, as in Libya, accounts remain unclosed for long periods after completion of projects and programs. Consequently, it is often impossible to determine the capital costs or recurrent requirements of a project or program. If a project is a plant which is to produce and sell commodities or services, it is difficult to estimate costs of production and to fix selling prices for the output which will bring an appropriate return on investment.[39]

A clear distinction must be made between budgetary estimates and actual receipts or expenditures. Budgets necessarily are first presented as estimates, and actual receipts and expenditures frequently differ substantially from original or even revised estimates. It is the actual transactions rather than the estimates which are, of course, most important for planning, as well as for management and budgetary review. But reliable "actuals" generally become available only after a budget audit has been completed at the end of a fiscal period. Because of this, it is of the utmost importance for a budgetary audit to be completed as soon as possible after the close of a fiscal period. But delays of one or two years are frequent, with the result that planners too often must prepare annual and medium-term plans on the basis of guesses and assumptions instead of facts about budgetary performance.

Classification Systems

The system used to classify accounts and the form in which they are presented in conventional budgets may also make it difficult or impossible to obtain information needed for development planning purposes. Among other things, accounts may be so detailed and voluminous that it becomes difficult or impossible to group them into categories related to specific projects, programs or activities; or they may be insufficiently itemized for this purpose. Thus, the World Bank survey mission to Nicaragua reported that

> in its present form the budget is essentially a list of salaries to be paid by the government. . . . No uniform principle governs the

[39] Waterston, Albert. *Planning in Pakistan*, p. 16.

> detail given on non-salary expenditures. In some cases they are given in superabundant detail, while in others relatively large items, mainly for the purchase of goods and services, are not broken down.
> In spite of its bulk and detail, the budget is of extremely limited analytical value. Total expenditures are not broken down between salary, capital, and other categories of expenditures. It is impossible to appraise from the budget either the actual cost of the various functions of government or the profitability of the various quasi-business activities of the government.[40]

For a budget to be a reasonably efficient instrument for plan execution it must have a classification system which (a) permits allocations and expenditures to be related to specific projects, programs and other purposes in a plan; (b) distinguishes between capital and current expenditures and receipts, and shows the extent of public savings (in the form of a surplus on current account) available for investment; and (c) distinguishes between development and nondevelopment expenditures on both capital and current account. The classification system employed in conventional administrative budgets does not meet these requirements. It was designed primarily as a framework for making appropriations to government ministries and departments, facilitate internal management and control, insure accountability, usually to a legislature, and help execute government policies under conditions which antedate postwar development planning. It virtually precludes an assessment of the full cost of most government functions or services.

A conventional budget is divided into separate sections for each ministry, department or agency. Under each spending organization, expenditures are classified according to "object accounts," e.g., wages and salaries, travel allowances, purchases of specified materials and equipment, etc. Within a spending organization, expenditures for each of these "object accounts" may be lumped together under a single "head." This may be done for administrative convenience, to insure centralized control or for other reasons, although the expenditures relate to different functions, programs, projects or activities. Thus, a partial or no breakdown of wages and salaries by purpose, program or project may be available in the budget of a ministry of public works whose responsibilities include the construction and maintenance of

[40] IBRD. *Economic Development of Nicaragua*, pp. 395–396.

highways, ports, railways and air transport facilities. It may therefore be difficult if not impossible to determine the costs allocable to each of these fields or to individual projects or programs within each field. In Afghanistan, typically, "object" budgeting has resulted in

> a serious lack of data respecting development projects. While the development activities are planned on a project-by-project basis, and the Ministry of Planning tries to follow the execution of the plan on a project-by-project basis, annual appropriations to the agencies and the agencies' own records of expenditures are maintained according to objects of expenditure rather than projects or program.[41]

It may be equally difficult or impossible to separate expenditures on capital account from those on current account (e.g., new construction as against maintenance); or for development as opposed to nondevelopment purposes (e.g., work on a highway as opposed to work on a stadium or monument), either on capital or on current account.

Similarly, where expenditures on the same program, project or activity are made by more than one government organization, each with its own set of not always comparable object accounts, it becomes difficult or impossible to determine the total expended on the program, project or activity. Thus, it would not be easy where budget accounts are maintained on an object basis to get the total expenditures on an agricultural program where a ministry of public works cleared land for the project, a ministry of education provided training and a ministry of agriculture furnished expertise, seed and implements. The problem would become even more complex if autonomous or semiautonomous public agencies, whose transactions were not included in the budget, contributed to the program. Not only would the budgetary classification systems, and the rules and standards of the agencies probably differ from each other and the ones used by the ministries; the relevant information would probably not be available in one place to make aggregation or comparison possible.

Still another complication arises when expenditures are undertaken for the same program, project or activity by governments at different levels, each with its unique set of undifferentiated object accounts. An example of this would be expenditures on an educational program financed partly by a central government and partly by a state or local

[41] United Nations Conference on the Application of Science and Technology, etc. *Planning Machinery in Afghanistan,* p. 6.

government.[42] In this case, also the total spent on the program or project would probably be difficult to come by.

Limitations of classification and lack of comprehensiveness in conventional budgets not only make it hard for a government to know the magnitude and composition of its public investment, as well as the quantity and kind of capital produced; they also make it hard for governments to acquire information on the financial resources available for current as against capital expenditures. In some countries, budget authorities do not always clearly distinguish tax receipts from sales of goods and services, dividends from state enterprises or other receipts. Sometimes, receipts from several sources are lumped together in a miscellaneous or other catchall account so that receipts from each source are unknown; sometimes, the price of goods and services includes a tax component; sometimes receipts from one source are improperly credited to another. These problems are frequently encountered in Latin American countries, but they are by no means limited to them. In Afghanistan, for example,

> there were no very clear definitions of . . . receipt sources, which made comparisons from one year to the next and from estimates to actuals very difficult.[43]

A reliable breakdown of receipts from at least the major types of taxes and other revenues is needed for estimating annual budgetary receipts since individual tax and other revenues are affected differently by changes in production, income, employment, foreign trade or other economic variables.[44] Without this information, projections of multi-annual budgetary receipts required for planning purposes are especially difficult to make.

Nor do conventional budgets sometimes distinguish sufficiently among resources available to a government for capital investment. It then may become uncertain whether public investment is financed from current receipts; drawings on accumulated balances; borrowings from a central bank, a commercial banking system or the public; loans or grants from autonomous agencies, foreign governments or international agencies; or foreign supplier's credits. Lack of clarity or uni-

[42] OAS. Inter-American Economic and Social Council, etc. *Development Planning and Budgeting*, pp. 4–5.

[43] United Nations Conference on the Application of Science and Technology, etc. *Planning Machinery in Afghanistan*, p. 5.

[44] OAS. Inter-American Economic and Social Council, etc. *Development Planning and Budgeting*, p. 8.

formity in defining transactions leads to the confusion of capital with current transactions. For example, in Ecuador, payments on the public debt which should be treated as capital transfers, are classified as ordinary expenditures. Moreover,

> the classification of revenue is not clear either. Some of the revenue, which should finance investments, is considered among the sources of the Current Budget while obviously ordinary revenue backs up capital expenditures.[45]

Finally, because the conventional budget does not usually distinguish in sufficient detail between current and capital receipts and current and capital outlays, it is an inadequate tool for economic analysis. It is therefore difficult to assess the impact of budgetary transactions on such economic variables as public savings and public investment.

BUDGETARY REFORM

The many shortcomings of conventional administrative budgets as instruments of financial management, greatly aggravated by the requirements of development planning, have given rise to widespread demands for budgetary reforms. If a budget were only a document for giving effect to a country's development plans, problems of budgetary reform and modernization, while difficult, would be much easier to resolve than they are. But since a budget is, or should be, an instrument through which a government carries out the full range of its activities, a budget has many functions. Besides being a device for implementing development plans, a budget must be a means for financial control and management of government operations; it must provide data required to make basic decisions on fiscal and economic policy; it must be a suitable vehicle for carrying out the decisions which are made; and it must be designed to provide for accountability to a national legislature or other body and to the public. Thus, in addition to the need for making budgets better for the purpose of implementing plans, the need for improving budgets is

[45] Ecuador. National Board of Economic Planning and Coordination. "Chapter IV. The Organization for the Plan for Economic Development and the Administrative Reform," pp. 35–36.

> frequently made synonymous with such objectives as strengthening administrative processes, achieving more effective or more stringent fiscal controls, securing efficiency and economy, effecting better utilization of resources, controlling inflation or improving economic conditions, or simply broadening the awareness and understanding of budget content.[46]

Not surprisingly, therefore, a wide variety of proposals has been advanced for improving budgets. Some are merely intended to make conventional budgets more informative and more effective as instruments of management and control through improvements in the practices and methods by which they are prepared and executed. These proposals concentrate on such matters as improving the timetable for budget preparation; extending the period covered by a budget to provide information on receipts and expenditures for more than one fiscal year; [47] improved budgetary and accounting practices in spending agencies and better screening of their budgetary requests; reduced budgetary fragmentation arising from earmarking of revenues and expenditures or exclusion of transactions of autonomous and semiautonomous agencies; reduced supplementary and other special appropriations; uniform accounting systems and adherence to established accounting precepts and practices; clarity and uniformity in defining development and nondevelopment budgetary transactions, especially with regard to capital as compared with current account; and the replacement of formalistic and restrictive rules, regulations and procedures with more efficient and effective financial controls. Of these examples, further discussion of two, i.e., the comprehensiveness of a

[46] US. AID. *Modernizing Government Budget Administration,* p. 24.

[47] Among other things, multiannual budgets provide much more useful information for planning than do annual budgets. There has been an increasing trend recently toward multiannual budgetary projections. For example, Puerto Rico has a six-year budget and now prepares a four-year budget. In Israel, five-year expenditure projections for individual ministries have been prepared each year since 1959. This is sometimes also done in the United States, particularly in the Department of Defense. The United Kingdom is making expenditure surveys for five years ahead to ensure that the size and composition of public expenditures conform with the expected availability of financial resources. In 1963, a White Paper was issued giving figures from the latest Survey (Great Britain. Chancellor of the Exchequer. *Public Expenditure in 1963–64 and 1967–68*). Other European countries are also making multiannual projections of expenditures and receipts to obtain better budgetary control over expenditures. (UN. TAO. *Report of the Inter-Regional Workshop on Problems of Budget Classification and Management in Developing Countries,* p. 31.)

budget and the close relationship between capital and current transactions, is desirable.

Budgetary Comprehensiveness

There is universal agreement that a consolidated set of figures encompassing all financial transactions in the public sector is a useful tool for both development planning and formulation of financial policy. This set of figures should include pertinent transactions of quasi-autonomous and autonomous public agencies usually outside a government budget, as well as those of governments at national and subordinate levels. To reveal the full extent of income available to the public sector, as well as the amount and kinds of public subsidies, it is especially important that a consolidated table of public financial transactions show intergovernmental transfers, as well as transfers between government on the one hand, and autonomous and semiautonomous agencies on the other.[48]

There is less agreement about where the consolidated figures should be prepared and who should do it. One view is that all public sector transactions should be included in the budget of a national government. Thus, the Economic Commission for Latin America has contended that

> specialists in budgetary problems have long been stressing the need to conceive of the public budget as a single unit, in the sense that it must embody absolutely all the income and expenditure of the public sector. This emphasis is dictated by the conviction that the budget statement should be the instrument wherewith to judge the direction and cohesion of Government policy.[49]

In contrast, others think it would be impractical in most countries to require that all transactions conducted by every semiautonomous and autonomous agency or at every government level be recorded in a single budget document. For instance, a paper prepared by the United

[48] To avoid double counting in making up a consolidated set of figures, these transfers have to be adjusted to arrive at net payments among them. Thus, it is necessary to eliminate ("wash out" or "net out") grants which local governments receive from a national government and the amounts which agencies charge for goods or services supplied to other government units, although these transactions must be fully detailed in the accounts of each agency and government unit.

[49] UN. ECLA. *Fiscal Budget as an Instrument in the Programming of Economic Development,* p. 29.

Nations recognized that it might not be feasible to include all transactions of public enterprises in one budget for the public sector as a whole.[50] It would probably be equally unfeasible in some countries, especially those with federal governments, to arrange for the inclusion of the transactions of political subdivisions in a national budget. Most authorities would probably agree that the best approach for getting the information needed for planning would be to prepare a consolidated table in which gross receipts and expenditures in the public sector are combined with intergovernmental, interagency and governmental-agency transfers, with the budgets of each government and agency annexed as appendices.

For planning purposes, it matters little whether the combination of public sector transactions takes the form of a budget prepared by a budget authority or a consolidated table prepared by a central planning agency or other government office. What is important is that where the budget of a central government incompletely reflects development activities in the public sector, a government body can and regularly does assemble and consolidate all the relevant information in one document.

Complementarity of Capital and Current Expenditures

As important for development planning as the consolidation of all public sector transactions is the relationship of capital and current expenditures. Capital expenditures for development always require increases in current expenditures, but there is a widespread failure among planners and budgeters to recognize their complementarity. In Burma, it proved very difficult for foreign advisers to the Government

> to ascertain and make the Finance Ministry sensitive to those components in current budget submissions which require priority consideration because of their essentiality to capital projects and programs. Indeed this problem was never satisfactorily solved.[51]

Planners and budgeters tend to concentrate on capital expenditures. Thus foreign economic advisers who helped Nigeria prepare its Six-Year Development Plan found that

[50] UN. Inter-Regional Workshop on Problems of Budget Classification, etc. *Relationship Between Planning and Government Budgeting in Developing Countries,* [Part I], p. 11.

[51] Walinsky, Louis J. "Burma," p. 43.

> none of the [regional and federal] governments . . . was able to make a head-by-head [i.e., object-by-object] budgetary estimate of its future recurrent costs. Instead, officials turned mainly to the contemplation of new capital expenditures. . . . The danger that rising recurrent expenditure would encroach seriously on the pace of the development program was given little weight.[52]

Every capital investment requires current expenditures of some kind. Sometimes, current expenditures must precede or coincide with capital outlays for the purpose of conducting preliminary experiments (as in agriculture) or to train operating personnel for the completed projects; today's capital expenditure leads to tomorrow's current expenditure for maintaining and operating the facilities created by the capital expenditure.[53] Over five years the recurrent expenditure on a school is likely to be more than twice the capital cost.[54] Even if a hospital is obtained as a gift, the recurrent budget must provide money for paying its staff.[55] In Upper Volta, road construction equipment obtained through foreign aid produced considerable problems because expenditures on fuel, spare parts, maintenance and personnel increased the size of the budget by 12 per cent.[56] A careful comparison of current and capital cost requirements for a project or program can also reveal that increases in capital outlay are desirable. For example, in Iran, the annual cost of maintaining gravel roads was found to be so high in comparison with the cost of paving and maintaining them as asphalt roads that it led planners to recommend increased capital outlays for paving gravel roads in order to reduce recurrent expenditures for maintenance.

Failure to give adequate consideration to current cost requirements stemming from capital outlays may lead to increased current expenditures which cut into investment resources and threaten a whole plan. What a World Bank survey mission to Ceylon found in the early 1950's is just as true today in other countries. In Ceylon, lack of information on the relationship between public capital investment and costs of

[52] Clark, Peter Bentley. "Economic Planning for a Country in Transition: Nigeria," p. 275.

[53] UN. ECA. *Problems Concerning Techniques of Development Programming in African Countries,* p. 4.

[54] Lewis, W. Arthur. "Planning Public Expenditure," p. 11.

[55] Stolper, Wolfgang F. "The Development of Nigeria," p. 174.

[56] United Nations Meeting of Experts on Administrative Aspects of National Development Planning. *Administrative Aspects of Planning in Developing Countries,* p. 70.

operation made execution of a development plan a hazardous financial undertaking:

> The danger is that current expenditures may be driven up to a level where they absorb the government's revenue completely, leaving no surplus for further capital development. Estimates for 1951–52 already foreshadow this danger, since they provide for an increase of almost 100 per cent in capital investment. This large volume of new investments—if it were carried out—would undoubtedly require a higher level of current expenditure in 1952–53; but, so far as we know, no attempt has been made to draw up detailed estimates in this respect.[57]

If current funds for maintenance and operation are not made available, full use cannot be made of the facilities created by capital expenditures. For instance, in their review of the results obtained from the Second Five-Year Plan, Iran's planners indicated what happened in their country when current expenditures were not co-ordinated with capital outlays:

> The agriculture and irrigation programs have suffered greatly from this lack of coordination between investment and operating requirements. We see appropriations for animal husbandry stations that are not given the necessary operating budget for personnel and investigations. We see irrigation systems constructed with no provision for operating and maintenance expenses. Perhaps most wasteful of all is the present system of sending students abroad for scientific training and then failing to provide adequate salary and other employment conditions upon their return.[58]

Is a Divided Budget Desirable for Planning?

Because there is need to establish an effective relationship between capital and current expenditures, it is important that each type of expenditure be clearly identified and consistently defined. Some authorities go further. They advocate that budgetary estimates of receipts and expenditures be divided into a completely separate capital (sometimes also referred to as "extraordinary," "nonrecurrent," "investment" or "development") budget and current (sometimes also referred

[57] IBRD. *Economic Development of Ceylon,* pp. 186–187.
[58] Iran. Plan Organization. *Review of the Second Seven Year Plan Program of Iran,* p. 32.

to as "operating," "recurrent" or "ordinary") budget. This divided, dual or double budget, with its separate capital and current components, is considered especially desirable where large additions to budgetary expenditures for investment are contemplated.[59] In these cases, there is a danger that a government will resort to inflationary financing if it cannot finance the increased capital requirements from current receipts. Those who favor a divided budget, as well as others, feel that all current expenditures should be fully financed from current receipts. If current receipts are insufficient to cover current expenses, taxes or other revenues should be increased. In contrast, when the surplus on current account is inadequate, proponents of the divided budget believe that the loan financing of capital expenditures is justifiable as long as investments financed by loans yield a return which is higher than the cost of the loans. If loans are not available in required amounts to finance proposed capital expenditures and the surplus on current account cannot fill the gap, or if the increased level of recurrent expenditures made necessary by the higher investment cannot be financed from current receipts, proposed capital expenditures should be reduced accordingly.[60]

[59] The discussion which follows assumes that only capital items are included in capital budgets and only current items are included in ordinary budgets. This is an oversimplification. Governments follow a great variety of practices in preparing so-called capital budgets. In Western Europe, for example, only the Netherlands has a divided budget of the classical capital-current type. Sweden's capital budget includes only items which produce revenue. This relegates expenditures for road construction to the current budget (U.N. Inter-Regional Workshop on Problems of Budget Classification, etc. *Relationship Between Planning and Government in Developing Countries* [Part I], p. 9). In Ghana, the capital budget (called the Development Budget) includes some current expenditures, while in Nigeria, the capital budget (also called the Development Budget) contains only capital and other nonrecurrent items.

[60] It is accepted practice for a private business concern to finance its capital requirements by borrowing. Those who advocate that governments adopt a double budget frequently consider it equally desirable that governments finance their capital outlays in the same way. In fact, one budget authority has written:

> Double budgets, almost without exception, have had their origin in attempts to justify loan finance, so that the extraordinary portion, or the nonrecurring portion, or the capital portion could be identified to serve as a rationalization, sound or unsound as the case may be, for government borrowing. (Burkhead, Jesse. *Government Budgeting,* p. 182.)

The idea of separating capital from current estimates and expenditures in a government capital budget first gained acceptance in some countries during the depression of the 1930's, when governments greatly increased outlays on public works to provide employment. In Sweden, for instance, where a capital budget was introduced to overcome the traditional notion that it was fiscally irresponsible

Advocates of a divided budget hold that where estimates of current expenditures are separated from those of capital outlays, it becomes easier to finance each in a noninflationary manner. This, they say, is because the separation enables those concerned to maintain a close watch on the size of current expenditures (including the servicing of public debt), whether caused by increased investment, growing population or increases in the cost of government services. If recurrent expenditures concentrated in a separate budget rise above current receipts, it quickly becomes apparent that compensatory action is required. They hold that a dual budget also permits capital outlays to be handled with the flexibility they require. It is not always possible at the beginning of a fiscal period to know precisely how much capital financing will be required or obtained during the fiscal period because projects and programs may not be ready, agreements for foreign loans or aid may not have been concluded, or progress made in the construction of projects begun in previous periods may not be known. It has also been contended that a separate capital budget makes it easier to insure that loans and grants are utilized only for capital expenditures and are not diverted to current outlays. Summing up the advantages which they saw in a divided budget, several participants in a Workshop on Budgetary Classification and Management conducted by the Economic Commission for Latin America held that

> separate identification of capital programmes facilitates the formulation of fiscal policy and leads to clearer decisions on current expenditure and the treatment of capital expenditure, thus expediting the means of financing with respect to the contracting of loans and to increases in domestic taxation.[61]

But there are also cogent arguments against the use of a divided budget. For while a divided budget may facilitate the solution of some

---

for a budget not to be balanced every year by current receipts, the use of a capital budget permitted a public investment plan to be financed by borrowing:

> By greatly widening the scope of the loan budget the Government procured funds for realizing the plan, and the intention was that these loans should be repaid when times had improved and production had again reached a more normal level. If calculated over the trade cycle in its entirety the budget would by this means be put in equilibrium; on the other hand, it meant the abandonment of the principle that each individual year's budget should be made to balance in conformity with traditional practice. . . . (Montgomery, Arthur. *How Sweden Overcame the Depression, 1930–1933,* p. 49.)

[61] UN. TAO. *Report of the Workshop on Budgetary Classification and Management in South America,* p. 27.

problems in some countries, it can introduce problems in other countries which are not easy to resolve. One problem involves a confusion of concepts. In many countries, a capital budget is considered to be the same as a development budget, and an ordinary budget the same as a nondevelopment budget. This is wrong.

> It is wrong because not all capital expenditure is developmental, nor is all developmental expenditure capital. Expenditure on splendid public buildings is capital expenditure but not necessarily developmental. . . . The salaries of agricultural extension workers are developmental, but they are recurrent expenditures, not capital expenditures.[62]

Those who oppose the use of a separate capital budget contend that

> it tends to consider asset formation from a narrowly physical point of view to the detriment of other expenditures . . . which contribute to the asset formation of the nation. The emphasis on physical assets, it is argued, may prevent sufficient investment in human resources which are equally important for development.[63]

Current outlays for such programs as the expansion and development of health and educational services, research, vocational training, and agricultural experimentation and extension work may contribute greatly toward raising productivity although they do not lead to direct additions to a nation's capital stock. In fact, recent research indicates that the rate-of-return on investments in the health and education of human beings may be at least as large as that on physical capital.[64] What is even more important, unless such expenditures, which are generally of a recurrent nature, also expand, mere physical asset creation by itself is unlikely to raise national output appreciably.

It therefore appears illogical when those who favor a divided budget contend that it is all right to finance capital outlays with loans, whether or not they aid a country's development, but inappropriate to do so for current expenditures which promote development. Moreover, the argument that it is justifiable to finance capital outlays by borrowing is

[62] UN. ECA. *Problems Concerning Techniques of Development Programming in African Countries,* p. 85.

[63] UN. Inter-Regional Workshop on Problems of Budget Classification, etc. *Relationship Between Planning and Government Budgeting in Developing Countries* [Part I], p. 10.

[64] Aukrust, Odd. "Factors of Economic Development: A Review of Recent Research," p. 41. The author also cites a survey of recent research in this field in "Investment in Human Beings," p. 2.

not without danger in many less developed countries, even when it can be shown that these outlays advance development. This approach may lead to reduced efforts by a government to finance capital outlays through feasible and desirable increases in taxation. Especially in the absence of real savings and capital markets, conditions which are common in many less developed countries, it can also lead to undue inflationary domestic borrowing, usually from a central bank, to finance public investment. Or it may help persuade a government to engage in excessive borrowing abroad which can overburden a country with debt and lead to impairment of its future rate of development.

Finally, experience in some less developed countries has demonstrated that a divided budget may lead to practices which make it especially difficult to co-ordinate capital and current expenditures. In these countries, a capital budget may be prepared by a central planning agency and a current budget by a ministry of finance without co-ordination. Before 1964 in Malaya, for example, the recurrent budget was prepared in April by the Ministry of Finance and the Development Budget was prepared in October, largely by the Economic Planning Unit (the central planning agency), with the result that the effects of investment on recurrent expenditures were not always considered.[65] When Burma's Ministry of Planning prepared the capital budget and the Ministry of Finance prepared the current budget there was also inadequate co-ordination between the two agencies.[66] And in Iran, where the Plan Organization prepared the capital budget and the Ministry of Finance prepared the current budget, the Plan Organization reported that, although the separate capital budget may have helped the investment process,

> it has led to a dangerous neglect of the future financial requirements for making good use of the new facilities. It is true of course that the development program has gone forward in an atmosphere where careful program planning and budgeting are not yet part of government tradition. It is therefore not surprising that there has been little or no coordination between investment decisions and the effect these would have on the annual budgets of the ministries or other agencies that would be responsible for projects upon completion.[67]

[65] United Nations Meeting of Experts on Administrative Aspects of National Development Planning. *Administration of Planning in Malaya*, p. 21.

[66] United Nations Conference on the Application of Science and Technology, etc. *Organization of Planning Machinery: Lessons from Burmese Experience*, pp. 10–11.

[67] Iran. Plan Organization. *Review of the Second Seven Year Plan Program of Iran*, p. 31.

Because of the serious problems encountered when a divided budget has been adopted, especially in countries where "careful program planning and budgeting are not yet part of government tradition,"

> many countries are increasingly swinging around to the idea that it is really the over-all deficit or surplus that is relevant, and not the current or capital deficit or surplus.[68]

The World Bank survey mission to Tanganyika took a similar position. The mission concluded that because

> the feasible level of expenditures on projects and activities of the most direct relevance to development is influenced by the amounts which it is considered necessary to spend on other things of less direct relevance to the developmental process . . . , meaningful planning of government development activities involves planning of the budget as a whole.[69]

When a country starts to plan, it is important that its budgetary system permit capital transactions to be identified and separated from current transactions. This information is needed to determine the extent to which a surplus on current account can be mobilized from domestic public savings for investment. But because capital expenditures may be nondevelopmental and current expenditures may be developmental, it is at least as important for effective integration of a plan and budget that development transactions, whether capital or current, be identified and separated from nondevelopment transactions. Where a development plan exists, development expenditures in a budget are tantamount to the capital and current expenditures required by the plan, while nondevelopment (sometimes referred to as "nonplan") expenditures are outside it. More important for planning, therefore, than the choice between a unitary or divided budget is the choice of a system of classification which permits budgetary transactions to be identified and classified in two ways, firstly, as development or nondevelopment outlays, and secondly, as capital or current outlays. Such classification systems are in use in the budgets of some countries.

Functional classification permits budgetary transactions to be identified or separated by general purpose or function (e.g., agriculture, health, education or highways). Each general head can then be divided into several subheads. Outlays for education, for instance, may

[68] UN. Inter-Regional Workshop on Problems of Budget Classification, etc. *Relationship Between Planning and Government Budgeting in Developing Countries* [Part I], p. 9.

[69] IBRD. *Economic Development of Tanganyika,* p. 341.

be divided into expenditures for primary, secondary and higher education. Classification of budgetary transactions along functional lines makes it possible to distinguish development from nondevelopment estimates and expenditures. It also enables all expenditures in a specific field to be grouped under one heading, e.g., agriculture, regardless of the ministry or other government entity making the expenditure, thereby making it possible to aggregate a government's total effort in each field. Functional classification is especially useful to insure comparability of budgetary data over time where responsibility for a function, e.g., agriculture, may be shifted from one entity to another or where government entities themselves are undergoing change.[70]

In contrast to functional classification, economic classification permits government transactions to be divided into current expenditures and receipts, capital outlays and receipts, and transfers made and received on both capital and current account. These main headings may then be divided into subheadings.[71] The distinction between capital and current transactions is particularly important for planning purposes since it makes it possible to determine the extent to which a government is able to develop a surplus on current account to apply to capital formation. By identifying economically significant items in a budget, economic classification also makes it easier to include government transactions in a country's national income and product accounts. Economic classification of a budget therefore constitutes a useful tool for analyzing the impact of a government budget on a national economy and, hence, provides data for determining public policy.

Functional and economic classifications can be reconciled and combined into a compatible cross-classification system which distinguishes between development and nondevelopment transactions on current or capital account.[72] The value of an economic-functional cross-classifica-

[70] UN. TAO. *Report of the Workshop on Problems of Budget Reclassification and Management in Africa*, p. 19.

[71] Thus, economic classification makes it possible to distinguish among such receipt and expenditure items as wage and salary payments to government employees; purchases and sales of property, goods and services; income from property; intergovernmental and other transfer payments and receipts; and interest and principal payments on public debt. The importance of such a breakdown arises from the fact that different kinds of expenditure have a varying impact on an economy and on the shares of each economic sector.

[72] The United Nations has issued two publications as guides to the preparation of economic and functional classification systems: UN. Department of Economic and Social Affairs. *A Manual for Economic and Functional Classification of Gov-*

tion system is, of course, greatly increased if it is adopted by all levels of government in a country and by semiautonomous and autonomous agencies.

Whether or not a budget making use of the combined functional-economic classification system is presented as a unitary or divided budget is a matter of convenience. For planning purposes, it is important only that the form of budget adopted by a government facilitates the identification of development, nondevelopment, capital and current items, and their co-ordination with each other and with an existing development plan. It is conceivable that in some countries a divided budget will be most effective for these purposes and that, in other countries, a unitary budget will be preferred.[73]

Program and Performance Budgeting

But some budget specialists are convinced that mere reclassification of government transactions from the usual object-oriented classification to a functional-economic system, although a step in the right direction, is not enough. They believe that the conventional administrative budget is completely outmoded and propose its replacement by an entirely new approach to budget formulation and execution which they consider to be best suited to the needs of a modern government. The system of "program" and "performance" budgeting which they advocate stresses a government's ends and the progress made in achieving them rather than the means by which those ends are achieved. This method of budgeting focuses

> attention upon the general character and relative importance of the work to be done, or upon the service to be rendered, rather than upon the things to be acquired such as personal services, supplies, equipment, and so on. These latter objects are, after all, only the means to an end. The all-important thing in budgeting is the work or service to be accomplished, and what that work or service will cost.

Under performance budgeting, attention is centered on the func-

---

ernment Transactions, and UN. Statistical Office. *A System of National Accounts and Supporting Tables.*

[73] For a discussion of criteria and problems associated with the use of dual budgets, see Goode, Richard and Birnbaum, Eugene A. "Government Capital Budgets," pp. 23–45.

tion or activity—on the accomplishment of the purpose—instead of on lists of employees or authorizations of purchases.[74]

This is why this form of budgeting is alternatively called "program" budgeting (to emphasize its concern with programs instead of objects of expenditure), or "performance" budgeting (to emphasize its concern with accomplishments instead of means). In program and performance budgeting, both the government entities and the objects of expenditure are secondary. What is primary is that the data are detailed under specific programs in terms of workloads, units of work and unit costs.[75]

But program and performance budgeting is much more than an improved system of classifying or presenting a budget. Whereas traditional budgetary procedures emphasize only the financial aspects of expenditures when a budget is formulated, executed or audited, the distinguishing feature of program and performance budgeting is that it seeks, whenever possible, to measure the results achieved in physical or real, as well as in financial, terms. Thus, at the start of a budgetary period a program and performance budget may show estimates of miles of roads to be leveled or paved, the number of teachers to be trained, additional number of students to attend schools, acres of land to be cultivated, irrigated or cleared, as well as the expected cost of each function, program, project or activity.[76] After the budgeting

[74] Yoingco, Angel Q. "Performance Budgeting for the Philippine Government," p. 230, citing the report of the U.S. (Hoover) Commission on Organization of the Executive Branch of the Government on Budgeting and Accounting Systems of the Federal Government (February 1949).

[75] *Ibid.*

[76] The classification system used in program and performance budgeting generally comprises functions, programs, projects and activities. A program is a subdivision of a function. Current and capital expenditure programs are separately identified and are subdivided into projects or activities. Thus, where agriculture is the function, production of fertilizers is a program, construction of a fertilizer plant is a project and agricultural research is an activity. This system can easily be related to workload data, use of human and material resources and to financial outlays. (UN. Inter-Regional Workshop on Problems of Budget Classification, etc. *Relationship Between Planning and Government Budgeting in Developing Countries* [Part I], p. 15.)

Some authorities believe that a distinction should be made between program budgeting and performance budgeting. They consider the term "program budgeting" appropriate whenever expenditures are separated in accordance with the classification system described in the previous paragraph. They contend that the term "performance budgeting" is applicable only when, in addition to the use of program budgetary classification, an attempt is made to measure physical output in terms of output per employee, unit cost or by some other standard of period has passed, a program and performance budget can show the actual achievement in each of these fields obtained from actual budgeting expenditures. When reporting and accounting systems are based on such breakdowns, they provide data on work accomplished and its cost, thereby enabling direct comparisons to be made with plan expenditure estimates originally approved in a budget.[77]

A conventional budget with object headings is therefore a much more limited instrument than a performance budget for planning and other purposes. It does not supply physical measurements or comparisons. Even as a financial instrument it is inadequate for planning because it does not relate what is bought with what is done. For since the object heading shows *what* government buys but not *why*, it does not reveal the nature of government programs or accomplishment under those programs.[78] A budget which does not relate expenditures to specific programs and projects cannot easily be linked to a development plan which is couched in terms of programs and projects. This explains some of the difficulties encountered when attempts are made to implement a development plan through a budget classified by object. In contrast, as those who favor program budgeting quite correctly point out, program budgeting is "attuned to planning" because it has taken over

> some of the main characteristics of a plan. The basic features of a plan are the use of programmes or projects as operational units, the emphasis on their physical inputs and results or benefits and on their cost in relation to benefits. Cost-benefit analysis plays an important role in the selection of projects. These are also the attributes of a programme budget.[79]

---

measurement. There is much to be said for this point of view. But because most writers in the budgetary field use program budgeting and performance budgeting in conjunction with each other or interchangeably, it proved to be simpler to use these terms in the same way in this chapter.

[77] UN. Department of Economic and Social Affairs. "Some Problems of Financial Administration in African Countries," p. 104. Performance budgeting cannot quantify all benefits received from expenditures. For example, it would be difficult to measure the benefits derived from outlays on maintenance of public parks or the performance of a ministry of finance. Nor can performance budgeting measure the *quality* of benefits received from expenditures. Thus, it would be difficult to measure objectively qualitative improvements in education obtained from expenditures which were not reflected in increases in quantity.

[78] Burkhead, Jesse. *Government Budgeting,* p. 133.

[79] UN. Inter-Regional Workshop on Problems of Budget Classification, etc. *Relationship Between Planning and Government Budgeting in Developing Countries* [Part I], p. 12.

Some budget authorities consider program budgeting to be only a means for bringing

> budgeting and development planning closer together by providing a common language which is useful to both. . . . [80]

But others believe that a program budget *is* a development plan because

> the programme budget makes it possible to determine exactly what the Government has to do to meet its development aims and targets. It translates the direct participation of the Government in the programme into terms of specific decisions and becomes the operative instrument for short-term governmental action. In this sense, it may be said that the programme budget is a veritable short-term plan, since it relates to the Government's direct sphere of action for the attainment of medium- and long-term objectives.[81]

According to one group of specialists, a program budget differs in one important respect from a plan in that it

> centers attention on direct and immediate outputs of project execution and not on indirect or total, including inadvertent, benefits although such benefits may have been intended. For example, on a road construction project a performance budget would give information on miles of road constructed but not on its effects, among others, on the increases in marketable surpluses of different commodities. Such information on total benefits may be found in the plan or assessed by the planning agency.[82]

Nevertheless, those who promote program budgeting generally believe that a budget authority should go beyond ensuring that the required funds are made available for implementing a plan and that the most economical means are employed in the process. They consider that, in addition, a budget authority should advise a government whether the most effective combination of programs is being employed to achieve its development objectives and assist it in appraising alternative proposals for expenditure as well as tax programs.[83] As a proponent of this approach says:

[80] Herman, Robert S. "Two Aspects of Budgeting," p. 325.

[81] UN. ECLA. *Experience of the Advisory Groups and the Practical Problems of Economic Development,* p. 41.

[82] UN. Inter-Regional Workshop on Problems of Budget Classification, etc. *Relationship Between Planning and Government Budgeting in Developing Countries* [Part I], p. 13.

[83] Johnson, A. W. "Planning and Budgeting," pp. 148–149.

> All of this begins to sound very much like planning as most people in government think of it. This is scarcely surprising, for the culmination of the budgetary process is a document which outlines the programmes and the resources required to implement the programmes which the government believes to be the most effective for implementing its policies.[84]

There can be no doubt about the usefulness of the data which program budgeting seeks to develop. They are substantially like those which central planning agencies try to get operating organizations to produce and to supply in reports on the progress of program and project execution. Such information is essential for formulating well-conceived plans. The assignment of physical output targets and the use of unit costs for each program, project and activity provides norms and yardsticks for efficient and timely implementation of plans. They also provide a basis for instilling in the personnel of operating organizations a greater sense of cost-consciousness and responsibility for adhering to work schedules.

Planners and budgeters are therefore likely to agree on the necessity for physical as well as financial accounting and reporting for programs, projects and activities. They may, however, part company on the question of who should be responsible for collecting and evaluating these data. Whether a budget office or a central planning agency should perform these tasks is, of course, a political decision. But it is important that duplication of effort be avoided. The scarcity of talent in less developed countries would make such duplication too costly.

Because of the great scarcity of trained accountants, economists and planners in these countries, a question also arises whether current efforts to improve budgets which place primary emphasis on the introduction of program and performance budgeting constitute the best use of available technicians. In recent years, the United Nations and its regional economic commissions, as well as budget specialists from the United States (which first applied program and performance techniques to its 1951 Federal Budget), have made considerable efforts to get less developed countries to adopt program budgeting.[85]

[84] *Ibid.* This point of view is, of course, in sharp contrast with Oskar Lange's, as described earlier in the chapter. It is interesting to speculate whether the divergence is due mainly to differences inherent in planning for a socialized as against a mixed-economy country or differences in the attitude of a planner as against a budgeter.

[85] The Economic Commission for Asia and the Far East and the Economic Commission for Latin America have each conducted three workshops on budget reclassification in their regions to spread knowledge of program budgeting tech-

Largely as a result of these efforts, some less developed countries have adopted or have taken steps to adopt program budgeting. The best-known example of the application of program budgeting techniques in a developing country is the Philippines, where the new techniques were initiated partially in the 1956 budget and more fully in the 1957 budget. Latin America has been particularly receptive to the new budgetary form. Reforms instituted in the early 1960's in the budgets of countries in the region, including Bolivia, Colombia, El Salvador, Honduras, Paraguay and Peru, and those still in progress in Argentina, Chile, Columbia, Ecuador and Venezuela and in other Central American countries, reflect a desire to use program budgeting techniques. In Africa, program budgeting has been mainly attempted in Ghana and the United Arab Republic. Israel has used program budgeting procedures for capital outlays for several years and for current operations since 1961. Program budgeting has also been introduced to some extent in Iran and Thailand,[86] and a start has been made in the Republic of Viet Nam.[87]

But the results obtained thus far indicate that it takes a long time before less developed countries can make effective use of these techniques. As one budget authority has pointed out, those who would have countries adopt program budgeting often overlook that

> its installation requires much work and study over a fairly long period of time. The effectiveness of this approach to budgeting depends upon the manner in which it is applied and used. Standards can be set only after considerable analysis and understanding of programmes, and these standards must be subject to continuous review and re-evaluation. Data must be constantly refined, policies re-considered in the light of new development,

---

niques. The Economic Commission for Africa has conducted one workshop in its region. In September 1964, the United Nations also held an interregional workshop on budget classification. In addition, the Fiscal and Financial Branch of the Department of Economic and Social Affairs has produced for the United Nations Economic Commission for Latin America, *A Manual for Programme and Performance Budgeting (Draft)*, which sets guidelines for the installation of program and performance budgets. Technicians provided by the US. AID. Mission in the Philippines played a major part in introducing program budgeting in that country.

[86] UN. TAO. *Report of the Inter-Regional Workshop on Problems of Budget Classification and Management in Developing Countries*, p. 10.

[87] UN. TAO. *Report of the Third Workshop on Problems of Budget Reclassification and Management in the ECAFE Region*, p. 10.

> and the applicability of unit costs continuously tested on the basis of changing conditions.[88]

Few budget offices are adequately equipped with staffs qualified to perform these difficult and continuing tasks. In fact, in some countries, budget agencies and ministries of finance have not even had the capacity to change the budget presentation from an object to a functional or economic classification. In Peru, for example, it was the central planning agency which performed this task.

Needless to stress, attempts by outsiders to initiate new approaches to budgeting have only rarely had an appreciable and lasting effect on the budgetary procedures of budget offices. Even when a budget office actively participated in the introduction of program budgeting techniques, the results have almost always been incipient and inchoate. Thus, Ecuador's planners reported on the attempt to introduce a program budget in their country:

> It must be admitted that . . . the traditional form has not been changed. It is not yet feasible to obtain data on the achievements of the different programs which form part of the budget. Therefore it is not yet possible . . . that the agencies responsible for the execution of the budget can take measures to avoid waste and immorality.[89]

These results, in other developing countries which have sought to introduce program budgets as in Ecuador, are unavoidable as long as spending ministries and agencies lack organization, staff and information about projects and programs to formulate their own budgetary requirements on a reliable basis, maintain adequate accounts and prepare reasonably accurate and timely reports on the progress of their work. What Paul H. Appleby said about India in the period between 1954 and 1956 has as much import for other developing countries, many of which have a long way to go before they reach the Indian level of development:

> Expenditure control in the proper terms which relate outgo to program objectives can only be closely and usefully achieved in the program agencies. It is only when these agencies have had experience in this superior kind of financial management that they

[88] Herman, Robert S. "Two Aspects of Budgeting," p. 330.

[89] Ecuador. National Board of Economic Planning and Coordination. "Chapter IV. The Organization for the Plan for Economic Development and the Administrative Reform," p. 110.

> begin to be able to make budget submissions of a proper sort. It is only after the ministries are thus doing an improved job of budgeting that the Ministry of Finance can produce the kind of budget appropriate to its responsibility.[90]

In recognition of this fact, program budgeting has been introduced in a few countries by authorities who were willing to start on a modest scale in an agency or two. This was done, for example, in 1959 in the Republic of China for the budget of the Shihmen Development Commission, an entity mainly concerned with construction and operation of irrigation, flood control, water supply and power generating facilities.[91] But it is generally much more difficult to introduce budgetary innovations in operating organizations than in a central budget office. Those who favor the use of program budgets therefore tend to postpone tackling operating organizations and begin instead by introducing program budgeting in a central budget office. They hope that they can then gradually get operating ministries and agencies to accept the new system. This approach was reflected in the advice given by the Workshop on Budgetary Administration in Central America and Panama, held in September 1963. The Workshop felt that countries introducing program budgeting

> should do so on as broad a basis as possible, and try to cover in the first year the whole of the central administration, with a view to extending the system in subsequent years to autonomous agencies and enterprises.[92]

But experience in the United States, the Philippines and other countries where this general approach has been tried demonstrate that program budgeting cannot be grafted onto a government's administrative structure from above.[93] The obstacles to installing the new system in ministries, departments and agencies, which are found to be too difficult to surmount at first, generally remain insurmountable; and without operating organizations capable of providing accurate budget-

[90] Appleby, Paul H. *Re-Examination of India's Administrative System with Special Reference to Administration of Government's Industrial and Commercial Enterprises,* p. 31.

[91] UN. TAO. *Report of the Third Workshop on Problems of Budget Reclassification and Management in the ECAFE Region,* p. 10.

[92] UN. Inter-Regional Workshop on Problems of Budget Classification, etc. *Review of Developments in the Budget Field,* p. 93.

[93] UN. ECLA. *Fiscal Budget as an Instrument in the Programming of Economic Development,* p. 67.

ary estimates and measurements of progress, most program budgeting procedures carried out by central budget offices are largely shadow without substance.[94]

The incomplete implementation of program and performance budgeting in countries where it has been tried is partly due to its complexity. It attempts to do much more than conventional budgeting. It also requires that a government break with traditional concepts and methods of budget management. As those in the United Nations who favor program budgeting recognize,

> the establishment of a budget of this type implies radical alterations in the structure and operation of governmental machinery, and, what is more, a metamorphosis of the behaviour patterns and mental attitude of public officials. . . . Hence, in order to introduce the system, an invisible and powerful enemy must first be overcome—established custom.[95]

How difficult it is to overcome custom is well illustrated in the Philippines. Eight years after performance budgeting was introduced in that country, the Commissioner of the Budget reported that

> there has been a noticeable lack of enthusiasm on the part of Congress to adopt it fully. . . . [With some exceptions], the appropriations for the departments, bureaus and other agencies of the National Government continue to be enacted on the line item basis. . . .[96]

Performance budgeting has also been slow in spreading after its introduction in most countries because of the scarcity of superior personnel, an effective public administration and efficient procedures within operating organizations, as well as in a central budget office. To a degree unknown in object budgeting, success in performance budgeting depends on the prevailing standards of measurement, the level of personnel and public administration and the organizational efficiency of a government. The strength and weaknesses of these determine the strength and weaknesses of performance budgeting.[97] Hence, although performance budgeting is conceptually superior to

[94] Parsons, Malcolm B. "Performance Budgeting in the Philippines," p. 175.

[95] UN. ECLA. *Fiscal Budget as an Instrument in the Programming of Economic Development,* p. 67.

[96] UN. Inter-Regional Workshop on Problems of Budget Classification, etc. *Budgetary Developments in the Philippines Since the Early 1950's,* p. 26.

[97] Parsons, Malcolm B. "Performance Budgeting in the Philippines," pp. 178–179.

other budgetary systems, it is rarely much more effective because little is done to remedy underlying personnel, organization and procedural inadequacies which exist in all governments. This was well illustrated in the Philippines. As one foreign technician closely associated with the effort to initiate performance budgeting in that country pointed out,

> no serious attempt was made to come to grips with excessive organizational rigidity stemming from legislative prescription of even minor structural details. In most instances, the implementation of an approved plan merely substitutes an equally inflexible new structure. This will be a serious handicap in the administration of a budget having for its rationale the transferability of resources to activities of greatest need and priority.[98]

Small wonder, then, that the record of success has not been up to promise. Small wonder that performance budgeting frequently encounters misgivings and even opposition in countries where it is introduced.[99] In these circumstances it is perhaps unfortunate that many countries have been made to feel that better budgeting and performance budgeting are synonymous. Performance budgeting has sometimes been represented as the remedy for most fiscal ills.[100] But the truth is that even at best, the adoption of performance budgeting cannot solve all budgetary problems. And where, as in most less developed countries, the situation is not propitious, innovation of performance budgeting may produce only the appearance, not the reality, of improvement. While the educational value of an effort to install performance budgeting may be applauded, it may have been carried out at a high "opportunity cost" by absorbing the time of scarce technicians who might have been put to better use elsewhere.[101] It may also have had the effect of obscuring inability or unwillingness to undertake needed reforms or other action elsewhere.[102]

Order of Priority

Experience shows that there is no one budget system which meets the planning and other needs of all countries. The kind of budget

[98] Zimmerman, Virgil B. "Comments on 'Performance Budgeting in the Philippines,'" p. 45.

[99] UN. TAO. *Report of the Inter-Regional Workshop on Problems of Budget Classification and Management in Developing Countries,* p. 22.

[100] Waldby, Odell. "Chapter 5, Performance Budgeting," p. 228.

[101] This is equally true of attempts to adopt performance budgeting on a step-by-step basis, as proponents of this system of budgeting have advocated.

[102] Parsons, Malcolm B. "Performance Budgeting in the Philippines," p. 179.

which a country requires is determined not only by the objectives of the budgetary process but also by its institutional structure and stage of development. Thus, although the introduction of program and performance budgeting may be desirable for one country, it is by no means the only reform, or even the most immediate reform, needed in the budgeting of most countries engaged in development planning.

Attractive though they are in theory, performance budgeting techniques which require unit cost measurements of all government functions, programs, projects and activities are much too advanced for application in most less developed countries. In these countries, the foundations on which this kind of budgeting system must be erected are largely lacking. There is a shortage of accounting and administrative skills; there are gaps in government organization; there is sometimes an inadequate sense of personal responsibility for the conduct of government affairs.[103] In this environment it is not possible to build a budgeting system of considerable complexity without first improving established budgetary practices and strengthening existing staff and organization in central budget offices, operating ministries, departments and agencies. This was the general position taken by the participants of a Seminar on Urgent Administrative Problems of African Governments conducted by the Economic Commission for Africa in February and March 1963, when they decided that the time was not ripe for most African countries to adopt performance budgeting. Although the Workshop considered the prevailing circumstances not to be propitious for undertaking major reforms in financial administration in African countries, it felt that it was, nevertheless,

> possible and desirable, if the overriding objective of planned economic development is to be effectively pursued, to conceive of certain goals of improvement in the systems of financial administration. . . . Such goals could be envisaged, firstly, in developing appropriate information on the public sector transactions and, secondly, in improving the efficiency of budget management technique and procedures.[104]

Much could be done to improve existing budgets, in most less developed countries outside as well as inside Africa, if effect could be given to these goals. Because all budgetary systems are limited by deficiencies of discipline in formulating and executing a budget, the

[103] Burkhead, Jesse. *Government Budgeting,* pp. 455, 480.
[104] UN. Department of Economic and Social Affairs. "Some Problems of Financial Administration in African Countries," p. 99.

achievement of these goals is a precondition to effective budgeting, including program and performance budgeting. Since there can be no authoritative budgetary model which fits all countries, modernization of budgetary systems and procedures must be planned to meet the needs of each country. Hasty implementation of ambitious budget reforms have shown themselves to be self-defeating.

For planning purposes, therefore, it is essential that a high order of priority be given to reforms for improving budgetary presentation, management and control. Among these would be the adoption of a simple functional-economic classification to distinguish between development and nondevelopment, on capital and current account;[105] improvement of methods and procedures for formulating and executing budgets;[106] establishment of viable budgetary units in operating ministries, departments and agencies; and the strengthening of existing central budget offices and budget units in operating entities through the establishment of training programs for their staffs and the supply of appropriate technical assistance.

If it were possible to do these things and install a workable system of performance budgeting, too, there would be no problem of priorities. But given the shortage of manpower in most less developed countries, there is need to concentrate mostly on improvements of current methods and procedures which can greatly enhance a budget's value for planning in reasonably short periods of time. Since, in addition, these improvements are basic prerequisites for effectively carrying out major reforms like program and performance budgeting, there is much to be said for beginning with them.

SUMMARY AND CONCLUSIONS

A government budget is a key element in giving effect to a development plan. The ideal connecting link between a medium-term plan and

[105] Less need is likely, however, for a detailed economic breakdown whose main justification is that it facilitates the preparation of statistical estimates for the government sector in the national accounts of a country.

[106] These have already been discussed. They would include alignment of an annual plan with a budget, preparation of a consolidated table of government accounts, elimination of practices which unduly fragmentize budgets, elimination of rigid and restrictive systems of expenditure control, reduction in the number of special budgetary appropriations, improved accounting systems and practices, preparation of medium-term projections of revenues and expenditures and so forth.

an annual budget is an annual plan. An annual plan is generally broader in scope than a conventional administrative budget.

In Soviet-type countries budgets are, in fact, the financial counterparts of development plans. In contrast, there is only a tenuous relationship between plans and budgets in most mixed-economy countries. Where budgets are prepared on the basis of annual plans, this is generally a recent innovation. And where annual plans are prepared, they are often little more than lists of projects with amounts to be included in a budget.

Sometimes, it is impossible to co-ordinate annual plans and budgets because the periods of plan and budget do not coincide. Delays in the preparation of either hinder the integration of plans and budgets. Because planning and budgeting constitute a two-way process in which the data of each feed the other, it is unavoidable that much of the work of preparing an annual plan and budget should proceed simultaneously and with the close collaboration of planning and budget officials.

The conventional national administrative budget in common use in most countries normally does not include all transactions of the public sector. Thus, it does not usually include transactions at subordinate levels of government or those of autonomous and semiautonomous agencies. These omissions can greatly diminish the value of a budget for allocating public resources in accordance with a plan's objectives. The usefulness of a budget is also often impaired by excessive earmarking of tax receipts or other revenues for specific purposes. Finally, considerable constraints on the allocation of budgetary resources are imposed where budgetary commitments to ongoing projects and programs are already so great that little is left for new projects and programs.

Fragmentation of a budget into a series of separate funds or accounts because of earmarking of receipts and expenditures or because of a proliferation of more or less autonomous agencies whose transactions are extrabudgetary generally produces unduly complex budgeting and accounting systems; it also makes it difficult for a government to follow a consistent budgetary policy and to determine how much money is available for development and other expenditures.

Conventional budgets also suffer from a series of other major defects. Lack of qualified staff and poor organization convert budget agencies into mere bookkeeping offices in most less developed countries. Procedures followed in formulating budgets are loose and haphazard. In many countries, real "budget-making" takes place when operating agencies seek to spend budgetary allocations. At that time, indiscriminate budget-cutting may occur with little relevance to the real issues involved. Some budget authorities habitually overstate revenues and understate expenditures in order to bring them into balance; more often, however, budget authorities understate receipts to restrain demands of operating organizations or to provide a reserve for new ventures. Such misguided procedures make it necessary for many countries to resort repeatedly to supplementary or extraordinary appropriations, thus reducing the effectiveness of expenditure controls and the usefulness of budgets for implementing plans.

Laxness in major budgetary preparation is often accompanied by unduly rigid and formalistic controls over budget execution. Inadequate accounting systems and practices, widely used in less developed countries, also diminish the effectiveness of budgets as means for giving effect to development plans. Delays of one or two years in auditing accounts often make it necessary for planners to prepare their plans on the basis of guesswork instead of facts about budgetary performance.

The system used to classify accounts in conventional budgets may also make it difficult or impossible to obtain information needed for planning. The so-called "object" classification system used in these budgets was designed primarily with accountability and management control in mind. It virtually precludes an assessment of the true cost of most government functions, programs, projects and activities needed for planning purposes. And it makes it difficult or impossible to separate capital from current, or development from nondevelopment expenditures.

Limitations in classification also make it difficult for governments to acquire information on the financial resources available for current as against capital expenditures. This not only hinders current budget operations but makes it difficult to make projections of multiannual budgetary receipts required for planning purposes.

If a budget were only a document for giving effect to a country's development plans, problems of budgetary reform and modernization would be easier to resolve than they are. But a budget is an instrument through which a government attempts to carry out the full range of its activities, and this accounts for the wide variety of proposals which have been put forward to improve budgets. Some are only intended to make conventional budgets more informative and more effective as instruments of management and control through improvements in the current practices, methods and procedures by which they are prepared and executed. Everyone agrees, for example, that there is need for a consolidated set of figures encompassing all financial transactions in the public sector. Similarly, there is general agreement that it is essential that planners and budgeters give more attention to the complementarity of capital and current outlays. Because of the need to ensure an effective relationship between capital and current expenditures, some authorities recommend the establishment of a divided budget with separate capital and current components. Advocates of a divided budget contend that where estimates of current expenditures are separated from those of capital outlays, the differing treatment which each type of expenditure requires is facilitated. They believe that separation of capital from current requirements makes it more readily apparent when one or the other must be reduced if noninflationary financing is not available.

Those who oppose divided budgets feel it is not enough merely to identify capital and current expenditures since some capital expenditures are nondevelopmental and some current expenditures are developmental. They also point out that when a capital budget is separated from a current budget, it leads in some countries to the very lack of co-ordination between the two which advocates of a divided budget contend a divided budget ensures. Finally, a divided budget may induce governments in countries with inadequate savings to rely unduly on inflationary domestic borrowing or on excessive foreign borrowing to finance development plans.

Fortunately, there is a way out of the apparent impasse. A combined functional-economic classification is available which permits budgetary transactions to be broken down into capital and current, as well as development and nondevelopment, expenditures. Whether or not a budget making use of a functional-economic classification is presented as a unitary or divided budget becomes, then, a matter of convenience.

But some budget specialists are convinced that mere reclassification of government transactions, although generally desirable, does not go far enough. They believe the conventional administrative budget must be replaced by an entirely new system, alternatively or synonymously called program and performance budgeting. This form of budgeting attempts to classify budgetary transactions on the basis of government functions, programs, projects and activities and to measure results achieved in physical, as well as in financial, terms. Some of the more enthusiastic sponsors of program and performance budgeting visualize it as essentially a public sector development plan.

There can be no doubt about the usefulness of the data which program and performance budgeting seeks to develop. Such information is essential for formulating and implementing soundly conceived plans. A question arises, however, whether current efforts to improve budgets which place primary emphasis on the introduction of program and performance budgeting procedures constitute the best use of scarce technicians. Results obtained thus far in countries which have sought to apply these techniques indicate that it will take a long time to make effective use of them, due to the complexity of the method, the necessary break with traditional concepts and practices, and the elimination of underlying personnel, organizational and procedural inadequacies.

In some circles, better budgeting is equated with this form of budgeting. But experience shows that there is no one budget system which meets the needs of every country at every stage of its development. Although program and performance budgeting may be desirable and feasible for one country, it is by no means the only reform, or even the most immediate reform, needed by most less developed countries which plan. For planning purposes much more could be gained if highest priority were given to improving current budgetary presentation, management and control instead of to a radical reform like the installation of program and performance budgeting.