LESSONS FROM THE WORLD BANK'S PUBLIC EXPENDITURE REVIEWS, 2000-2007, FOR IMPROVING THE EFFECTIVENESS OF PUBLIC SPENDING

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List of Country PERs Reviewed

<u>REGULAR PERS</u>

Aceh 2007 Afghanistan 2006 Albania 2001 Albania 2006 Algeria 2002 Angola 2005 Argentina 2003 Armenia 2003 Azerbaijan 2003 Bangladesh 2003 Belarus 2003 Benin 2004 Bolivia 2004 Bosnia and Herzegovina 2002 Bulgaria 2002 Bulgaria 2006 Burkina Faso 2005 Cambodia 2003 Cape Verde 2006 China 2002 Colombia 2005 Djibouti 2006 Dominican Republic 2004 Ecuador 2004 El Salvador 2004 Ethiopia 2004 Gabon 2006 Gambia 2005 Georgia 2002 Guinea 2004 Guinea Bissau 2007 Indonesia 2003 Indonesia 2007 Iran 2005 Ivory Coast 2003 Jamaica 2005 Kenya 2005 Kosovo 2006 Kyrgyz 2004 Laos 2002	Lesotho 2007 Madagascar 2004 Maldives 2002 Mauritania 2006 Mexico 2004 Moldova 2003 Moldova 2007 Mongolia 2002 Montenegro 2006 Mozambique 2001 Mozambique 2003 Niger 2004 Nigeria 2006 Pakistan 2004 Papua New Guinea 2004 Paraguay 2006 Peru 2002 Poland 2003 Romania 2002 Russia 2005 Rwansa 2003 Senegal 2004 Senegal 2005 Serbia and Montenegro 2003 Sierra Leone 2004 Sri Lanka 2006 Swaziland 2006 Tajikistan 2005 Tanzania 2003 Tanzania 2006 Turkey 2006 Uganda 2002 Uganda 2003 Ukraine 2006 Uruguay 2005 Uzbekistan 2005 Vietnam 2005 Zambia 2001 Zanzibar 2005

SPECIALIZED PERS

Costa Rica Social Spending 2002
Indonesia Decentralization 2003
Kenya Education 2004
Mexico Infrastructure 2005
Mexico State Level 2004
Mexico Veracruz-Llave
Nigeria Education 2006
Nigeria States 2003
Uganda Health 2006
Zambia Education 2006

I. Introduction

1. Since the 1980s, the World Bank has been conducting Public Expenditure Reviews (PERs) for low- and middle-income countries. These documents typically analyze the level and pattern of public expenditure in a country, assess the effectiveness and equity of public spending, and identify the bottlenecks to improved spending effectiveness. The PERs have provided valuable insights to guide policy dialogue and have frequently resulted in tangible fiscal reform programs in many countries. However, the knowledge of expenditure issues has tended to remain in the country units, with only a rare effort to draw out themes or to assess the information from a global perspective (or for groups of countries). Most of the Bank's internal efforts have been focused on providing frameworks for PERs, training for staff to improve their skills, and making coverage more systematic. The most recent Bank-wide review in 1998, for example, focused on the quality of the papers written, not lessons from the work.

2. As civil society organizations, domestic think tanks, advocacy groups, and other international organizations become increasingly engaged in the analysis of public expenditure in developing countries, it will be useful for them to draw upon the knowledge generated by the World Bank PERs. The objective of this paper is to review roughly 60 PERs conducted by the World Bank between 2000 and 2007, and define common problems and proposed solutions to improve the impact, quality, and equity of public spending.

3. The PERs reviewed for this paper include those done for virtually all the regions of the world: Africa, Asia (including the Central Asian republics), Central and Latin America, and Eastern Europe. The goal of the paper is to identify key issues in public expenditure that are common to many of the countries, focusing especially on the role that civil society can play in improving expenditure effectiveness.

II. What are Public Expenditure Reviews?

4. At the heart of a PER is the issue of the optimal allocation of public resources – in other words, where should the government put its limited money so as to maximize economic growth and poverty reduction? Of course, there are many ways of analyzing the efficiency and equity of public spending, which is why there is substantial variation in the content of and approaches adopted by different PERs.

5. Despite these variations, there are many elements that are common to virtually all PERs. For instance, most PERs include an overview of a country's macroeconomic and fiscal performance, such as trends in aggregate revenue, public spending, deficit financing, and the macroeconomic constraints to public expenditure. Almost all PERs include a discussion of the economic composition of public spending – for instance, the breakdown of aggregate expenditure into recurrent and capital spending, and the allocation of recurrent expenditure across wages, interest, operation and maintenance, and transfers. Nearly every PER contains a discussion of the functional classification of public expenditure – viz., the allocation of expenditure across sectors such as health, education, defense, and infrastructure. A large number of PERs address public spending in the vitally-important social sectors, focusing in particular on the patterns of public spending on health and education, the distribution of such expenditures across levels (e.g., primary versus secondary education and public health versus tertiary care), and the benefit incidence of social-sector spending (e.g., which economic groups benefit most from public spending on education and health).

6. Most PERs also situate a country's pattern of public expenditure within the broader context of its poverty reduction and other goals. This is usually accomplished by a discussion of the country's Poverty Reduction Strategy Paper (PRSP) as well as its Medium-Term Economic Framework (MTEF). Almost every low- and middle-income country has a PRSP and MTEF process, and, in principle at least, these provide the rationale for its spending priorities. In practice, however, the link between a country's policy goals and expenditure patterns varies greatly across countries.

7. More recent PERs have moved beyond a review and analysis of budget issues and policy in a country to an examination of the institutional aspects of budget making. This has been an important and welcome shift as institutions, politics, and incentives ultimately shape budget and expenditure outcomes.

8. Beyond these common elements, there is large variation in the content of individual PERs. Some focus on public spending in particular sectors, such as agriculture, transport, or water and sanitation. Others touch upon the different aspects of the public expenditure process, such as budget planning and formulation, expenditure accounting and reporting, and budget oversight by legislators. Depending upon the country context, some PERs focus on special topics such as expenditure and financial decentralization and comprehensiveness of the budget (e.g., the extent to which it includes spending by local governments, by parastatals, and by donors). A few PERs, especially those that focus on decentralization, analyze the distribution of public spending across sub-national units (e.g., provinces and regions).

9. A review of public expenditure reviews by Pradhan (1996) provides a useful listing of the six essential elements of a PER:

- Discussion of the aggregate level of public spending and deficit of the consolidated public sector and its consistency with the country's macroeconomic framework;

- Analysis of the allocation of aggregate spending across and within sectors, and the extent to which this allocation is consistent with maximization of social welfare;

- Examination of the role of the public versus the private sector in the financing and provision of social programs (in particular, whether public expenditures complement or substitute for private-sector activities);

- Analysis of the impact of key public programs on the poor, including their incidence and total costs;

- Examination of the input mix (e.g., wages versus operations and maintenance), or the allocations for capital and recurrent expenditures, within programs and sectors (and the extent to which such allocation promotes "internal" efficiency); and

- Discussion of the budgetary institutions and processes and the extent to which such institutions and processes promote fiscal discipline, allocative efficiency and equity in the composition of spending, and technical efficiency in the use of budgeted resources.

10. To these should be added a seventh element – namely, a discussion of transparency and accountability in the budget formulation and execution process of a country. The issues of expenditure transparency and accountability have gained substantial prominence in recent years, as they are often necessary conditions to ensuring efficiency and equity in public spending.

III. A Strategic Approach to Expenditure Planning

11. A key and recurring theme in many PERs is the weak relationship between a country's strategic goals and its national budget. Although budget preparation is usually an elaborate exercise involving numerous government ministries and departments, it is often driven more by inertia than by strategic thinking. There is excessive reliance on input-oriented (or line-item) budgeting – e.g., managing inputs such as staff, travel, and supplies – and little emphasis on how, if at all, the overall budget allocation is likely to further national goals (Pradhan 1996). Ministries and departments often decide on the level of increase to be applied (over the previous year) to the main expenditure items in their budget (e.g., wages, utility costs, and travel). The sectoral objectives often boil down to seeking as many resources as possible for the sector from the central Ministry of Finance, instead of ensuring that the available resources are used more effectively to address policy goals.

12. For example, the PER for Burkina Faso notes that: "… the budget and PRSP (Poverty Reduction Strategy Paper) process [which reflects the government's poverty reduction objectives] currently unfold completely separately… Most ministries follow an imperfect and approximate mechanism … and the objectives contained in program budgets often reflect ambitions unrelated to allocations. Budget arbitration focuses on procedural issues, and the PRSP and program budgets only play a marginal role. The National Assembly also does not consider program budgets… Subsequent budgets thus do not reflect the lessons leamed from implementation during the past year" (Burkina Faso PER, p. ix-x).

13. The preoccupation with inputs coincides with an under-emphasis on outputs and outcomes. Very few countries have systematically tried to evaluate the effectiveness of public services, the role of increased public spending on the delivery of quality public services, and the impact of public expenditure on poverty and social outcomes (De Renzio 2004). The lack of rigorous evaluation of public spending means that it is difficult for policy-makers to learn from past mistakes in expenditure allocations.

14. Thus, the budget formulation process in many countries is structured in a manner that makes it difficult for the budget to reflect the government's overall policy objectives and priorities. The lack of serious evaluation analysis means that government agencies cannot be held accountable for their budget allocations and are not required to deliver performance (i.e., attainment of targeted outcomes) to justify their budgetary allocations (Norton and Elson 2002, Folscher and Cole 2006). The potentially powerful role of the budget as a policy tool for bringing about change and furthering the government's growth, poverty, and social objectives is thus forfeited.

15. There is thus an important need for the policy formulation process to be integrated so that it incorporates not only the different sector-specific strategies but also economy-wide government policy objectives and initiatives, including those pertaining to poverty eradication, millennium development goals, decentralization, human development, fiscal restraint, and economic stabilization (Folscher and Cole 2006). The medium-term expenditure implications of the different sector strategies and economy-wide policy

objectives need to be clearly spelled out and incorporated in the budget. In turn, this implies that different groups – not only the various line ministries but also local governments and civil society – need to participate fully in the preparation of the sectoral and the overall budgets.

16. Of course, the involvement of different groups, including the legislative branch, in the budget preparation process alone does not guarantee that the budgetary allocations will reflect national strategic priorities. For example, the PER for Indonesia notes that, while the Indonesian Parliament has strong powers over *ex ante* deliberation and approval of the annual budget, Parliamentary deliberations almost always focus on "… line items and discussion of details as opposed to overall allocations, political priorities and achievement of results" (World Bank 2007). This is likely the result of the country's lack of a performance-oriented culture. The Indonesian example suggests that an attitudinal change in thinking about budgets – and how they link to political priorities and national goals – may be the first step in budget reform in many countries. Of course, how such an attitudinal change can be engendered is not an easy question to answer.

17. An example of a country that has managed to link its policy goals to its budget allocations better than many other countries is South Africa. Surprisingly, this has been achieved by having 'rolling' policy frameworks – embodied in a set of rolling priorities – that are updated on an annual basis, rather than national strategic plans that are formulated only occasionally and remain unchanged over long periods of time. There is a tight connection between these rolling policy priorities and the government's spending, with each informing the other and being adjusted in response to changes in the other. Of course, the rolling priorities are, in turn, derived from a broad set of development mandates, many of which in turn are drawn from the Bill of Rights in the South African Constitution (Folscher and Cole 2006). It helps that the South African policy- and budget-making process is consultative and take place within the context of a vibrant national debate engendered by a robust free media and an engaged civil society.

IV. Redefining the Role of Government

18. Another overarching issue addressed by a number of PERs is the assessment of what governments should be spending their money on in the first place. A recurring problem in many countries is the large amount of public spending on activities and functions that are not strictly needed (Pradhan 1996). If functions that are not strictly needed for the government to perform (e.g., running commercially-oriented public enterprises or autonomous bodies of various types) can be shed or reduced, the overall size of government can be adjusted to the availability of resources. The remaining public functions can then be better focused on advancing the government's strategic agenda.

19. An example of this predicament comes from Pakistan, where the legislative framework and the Constitution subscribe to the notion of fiscal federalism. However, the federal government, in practice, has expanded itself into areas of shared responsibility (and even in functions which belong constitutionally to sub-national governments) and has even assumed some of the functions traditionally performed by the private sector (Pakistan PER).

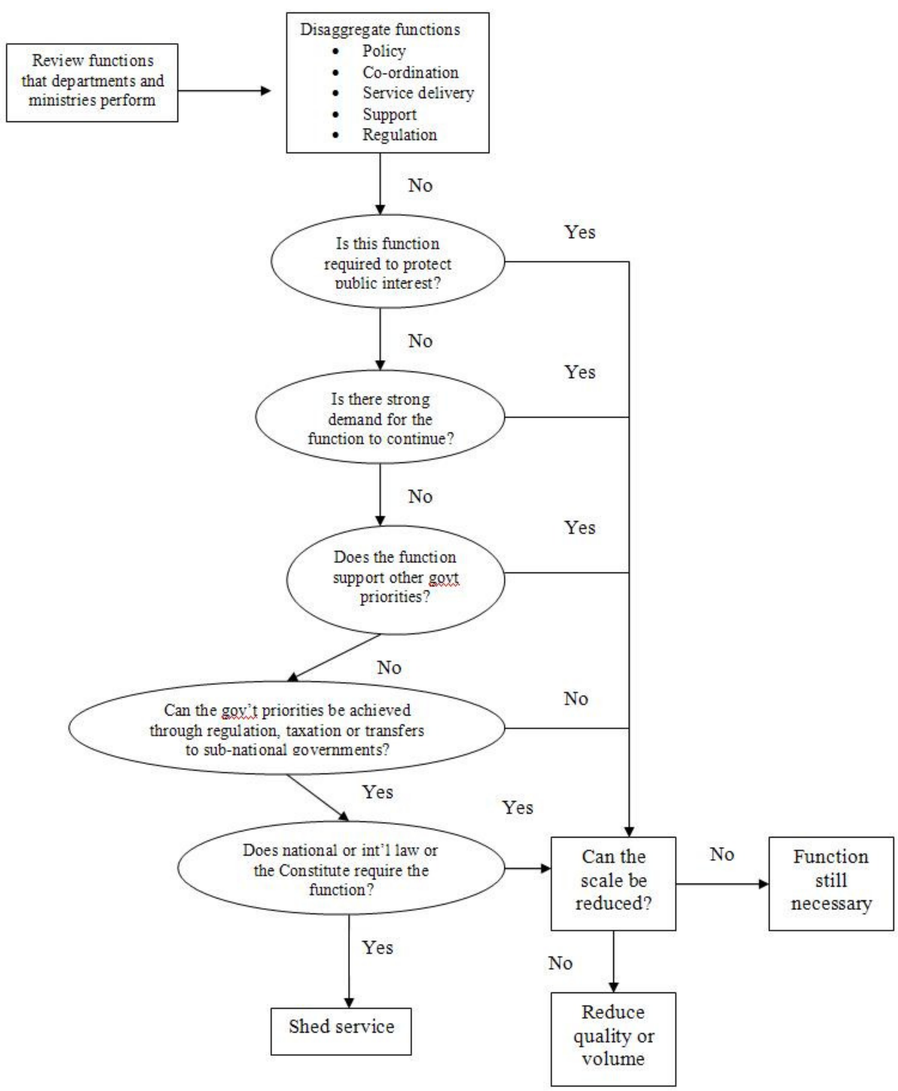
20. Unfortunately, Pakistan's case is not unique. Many governments spend scarce public resources on unnecessary and wasteful subsidies to loss-making, state-owned enterprises. In Zambia, which is one of the most heavily indebted countries in the world, the overall public sector (quasi-fiscal) deficit is estimated at 14-18 percent of GDP, with nearly 40 percent of it being accounted for by losses of state-owned corporations (Zambia PER). In Kenya, transfers to parastatals amounted to 11-12 percent of total public expenditure in 2002-03 and 2003-04. In Swaziland, subsidies to public enterprises and entities amounted to 1.3 percent of GDP in 2004-05, representing almost one-third of the actual budget deficit in that year (Kenya PER). More importantly, the subsidies to public enterprises were almost equal to the country's total recurrent public spending on health. This means that public expenditure on health could have been doubled had subsidies to public enterprises been eliminated and these enterprises made to operate on a commercial basis.

21. Indeed, government involvement in unneeded activities leads to a lack of strategic focus in public spending. Take the case of the health sector. As governments expand into the provision of a wide range of health services, including tertiary and specialized care for the entire population, their limited budget and staff resources are spread too thinly to be able to focus on the tasks that only the public sector can typically perform – viz., public health functions, financing of health services for the poor, and regulation of private health services. Governments have a critical role to play in providing public health services (such as immunizations and communicable disease control), financing health services for the poor and indigent, establishing the legal framework for the private sector, setting minimum quality-of-care standards, issuing decrees governing appropriate behavior of private and public providers, and implementing all of these regulations and laws through a system of regular inspections and monitoring. Ministries of Health that get into the business of curative health-care provision for the entire population typically get distracted from pursuing their original mission of providing public health services, serving the poor, and regulating privately-provided health services.

22. Figure 1 presents a decision tree for determining whether particular government functions should be shed, reduced, or maintained (World Bank 2001). It suggests that relatively few functions truly qualify for provision by the government. These include those which are required to protect the public interest, which support other government priorities, which cannot readily be provided by the private sector, and for which there is strong and continuing public demand. In some cases, even if the function needs to be provided by the public sector, there may be scope for reducing its scale.

Figure 1

Decision tree for identifying core governmental tasks



Source: Methodology for Functional Reviews, Paper produced by the Russian Federation Government, World Bank, July 2001.

V. Legislative Framework and the Budget Process

Budget Legislative Process

23. Many PERs include a discussion of the budgetary institutions in a country, since these institutions have an important role to play (at least in principle) in bringing about transparency and accountability in the public expenditure process. Most countries have clearly-written laws that define the framework for the preparation, execution, and reporting of public budgets (Stevens 2004). These laws provide a time-table within which the budget is to be prepared, lay down the objectives and institutional responsibilities for the preparation and execution of the budget, and identify penalties for breach of responsibilities. For instance, most countries' laws list the activities and expenditures that cannot be appropriated or reappropriated without the explicit approval of the legislature, limit the ability of the government to transfer expenditure provision from one line-item to another after the budget has been decided, and mandate the need for internal and external audit of public spending.

24. Vietnam is an example of a country that has significantly improved legislation relating to budget formulation and execution. The country adopted a sweeping budget law in 2002 – the State Budget Law of 2002 – which clarified the roles and responsibilities of central and provincial governments, and conferred new powers to the Provincial People's Councils (Vietnam PER). It mandated that the budget plans, budget final accounts, and auditing results of the entire state budget be made public. Indeed, it required the final accounts for executed budgets to be made public *for all levels of government*, not just the central government. The law declared the Treasury as the lead government agency in charge of expenditure control and financial management information at all levels of government. The State Audit of Vietnam was charged with conducting external audits covering all state budget revenues and expenditures, which then have to be reported to the National Assembly.

25. Another country with strong budget legislation is Turkey, which passed a very comprehensive law – the Public Financial Management and Control (PFMC) Law – in 2003 to establish a new and far-reaching legal framework for public expenditure management and accountability in the country (Turkey PER). Among other things, it strengthened strategic planning and performance-based budgeting, multi-year budgeting, and internal budget control and audit systems.

The Budget Formulation Process

26. The budget preparation process in most countries follows a typical timeline, as shown in Table 1 (Potter and Diamond 2000). Generally, it takes 8 months from the start of the process – when the government issues its macroeconomic outlook – to the time when the budget is approved by the legislature. At that point, the budget preparation is over, and the budget execution or implementation phase begins.

Table 1: Typical Timeline for Budget Preparation	
Typical number of months before passage	Steps in budget process
8	Forecast macroeconomic outlook
7	Determine affordable government expenditure total and subtotals by sector program or line ministry; seek cabinet approval of strategy.
6	Send out budget circular inviting bids from line ministries.
4	Line ministries/spending agencies submit budget requests.
3	Review and negotiation (usually between Ministry of Finance and individual line ministries) of budget requests leading to expenditure estimates (by line ministry, program, sector).
1	Executive budget is submitted to legislature.
0	Budget approved by legislature (appropriations).
Source: Potter, Barry H., and Jack Diamond. 2000. *Guidelines for Public Expenditure Management (Manuals and Guides)*. IMF, Washington DC.	

27. A common problem addressed by many PERs is a late start to the budget cycle, resulting in less time for legislative oversight. In other countries, the budget cycle is organized in a manner that makes legislative oversight perfunctory. For example, Tanzania's National Assembly created sectoral budget committees in 2001 to oversee draft legislation, review the budget proposals and budget performance of their sectoral ministries, and conduct an *ex post* review of audited accounts. The idea behind the creation of these committees was that Parliament would get to participate more in the budget formulation process. However, the budgetary cycle is organized so that the parliamentary committees' oversight of the budget process begins at a late stage, once estimates have been prepared, approved by the Ministry of Finance, and the Cabinet. As a result, the ability of Parliament to question or influence inter-sectoral allocations and ensure that they follow sectoral policy is very limited (Tanzania PER).

28. The inclusion of different groups – not only the Parliament and various line ministries but also local governments and civil society – in the budget formulation process is essential for broader ownership of the national budget as well as for public spending to accurately reflect national priorities and goals. However, here again, there is a difference between theory and practice. For example, the PER for Indonesia notes that, while, in principle, the Indonesian Parliament has strong powers over *ex ante* deliberation and approval of the annual budget, Parliamentary deliberations almost always focus on "… line items and discussion of details as opposed to overall allocations, political priorities and achievement of results" (World Bank 2007). This is likely the result of the country's lack of a performance-oriented culture.

VI. Budget Execution and Expenditure Framework

29. Budget execution is the stage of the budget process that often gets the most attention in PERs. This is the stage when broad sectoral expenditure allocations are broken down into more specific allocations for programs, government agencies, and local governments. Resources get transferred to agencies and local governments, which in turn spend them on the delivery of public goods and services. The execution stage is the stage of the budget process that is most beset by problems. Among some of these are, *inter alia*, lack of budget consolidation, separate budgeting of recurrent and capital expenditures, arrears, and unpredictability in expenditures. Weak budget execution results in leakages, such that a significant share of public expenditure does not reach front-line service providers (e.g., schools and health clinics).

Off-Budget Financing and Budget Consolidation

30. A common problem identified by many PERs is the lack of comprehensiveness of many national budgets. In the interests of transparency, the government budget needs to be complete and to reflect all outlays by all public agencies. It is not uncommon, however, to find considerable off-budget financing of activities and initiatives, especially losses and contingent liabilities accumulated by state-owned enterprises and some forms of military spending and indirect subsidies in many transition economies and in some Latin American countries. Such activities are usually financed via supplemental spending bills that bypass the normal appropriations process. Off- or extra-budgeting is most prevalent in the transition economies, although it occurs in many other countries as well. For instance, even in a highly-developed country such as the United States, Congress has funded a non-trivial portion of the Iraq war by passing "supplemental" spending bills that circumvent the normal budget process and are thus deemed off-budget (Lee *et al*. 2007). It is alleged that the off-budgeting has helped the government understate the true cost of the Iraq war.[1]

31. During President Suharto's rule in Indonesia, a significant portion of the revenues from natural resources sales – particularly the sales of oil and timber – were diverted for government spending outside the central budget. This was possible because, by their very nature, sales from oil and timber could be easily hidden from central government coffers with minimal public visibility. President Suharto allegedly used this off-budget financing to maximize his political power as well as to prevent political disunity within the Indonesian government (e.g., there would have been internal conflict had natural resource-rich provinces discovered that their wealth was being used to finance development programs in resource-poor but politically well-connected states) (Ascher 1998). This strategy of off-budget financing had a high cost, as it led to mismanagement in the oil sector, unsustainable forestry policies, and environmental degradation.

32. A second source of off-budget financing is the issuance of special bonds (typically for infrastructure and education) by central and local governments.

[1] For instance, according to the *International Herald Tribune* (9 May 2006), "… moving the war's financing off budget subjects the military's spending requests to less careful congressional scrutiny than they would receive during the usual budget process."

Expenditures from such bond revenues are typically not included in the regular budget. This practice is very common in China where subnational governments are banned from borrowing from non-governmental sources on their own credit (Mountfield and Wong 2005). To get around this restriction, these governments create economic entities which in turn sell 'corporate' bonds, the proceeds from which are used by the subnational government to finance infrastructure and other investments (Freire and Petersen 2004) (Box 1).

33. A third source of off-budget financing is user fees, especially at service facilities like health clinics and schools. To the extent that these fees are retained at the local level – either by the facility itself or by local governments, any expenditure out of user fees is typically not reflected in the regular public budget. In Kenya, for instance, there is significant spending by secondary schools out of their own revenues which is typically not included in the expenditure reported by the Ministry of Education (PER Kenya). Inclusion of user fees in expenditure planning is crucial for enabling governments and education ministries to have a complete picture of the full costs of secondary education in a country.

34. Finally, donor financing also contributes to incompleteness in budget coverage. There is generally limited information available in most countries regarding donor financing. Despite recent efforts at coordination, most donors often have their own disbursement mechanisms that are independent of the government. Indeed, it is not unusual to sometimes find the same donor having separate disbursement mechanisms for each of the donor's different projects in a country! Much of the donor assistance is typically disbursed by Project Management Units, which deal with the concerned line ministry and frequently do not inform the Ministry of Finance about their donor-financed disbursements. In some cases, donor projects are completely executed by the donors themselves. In either case, information on grants directly executed by donors is fragmented across different government ministries and departments, and not available centrally in one location. This lack of information on donor projects in the different sectors hampers the ability to plan and coordinate total resource allocation within the economy.

35. This is especially problematic in African countries, where foreign aid is large relative to GDP and accounts for an even larger share of public expenditure (Box 2). In Zambia, for instance, the ratio of public expenditure financed by foreign grants to that financed by domestic revenue was as much as one-half in 1999 and one-third in 2000 (Zambia PER). While estimates of donor financing are incorporated in the Zambian government budget during the budget preparation phase, most of the aid-financed projects are executed outside line ministries, either directly by donors or by NGOs on behalf of the donors. Consequently, the pattern of actual donor disbursements and expenditure are not systematically verified, consolidated, and accounted for.[2]

[2] It is important to note that including a donor-funded project in the national budget is not equivalent to taxing it 100%, which is historically what British colonies have done.

36. Afghanistan provides another example of an aid-dependent country in which a significant share of foreign aid circumvents the government budget. Although it is difficult to estimate the precise amount of funding that flows outside the government budget – either in terms of bypassing the Treasury or not even appearing as a donor project in the government's budget system, government estimates suggest that merely 10-20 percent of donor financing flowed through the Government's systems in 2002-04 (Rubin, Hamidzada and Stoddard 2003). In fact, in 2007, Afghanistan's Ambassador to the United States, H.E. Said Jawad, stated that out of "… the entire financial assistance that's been given to Afghanistan, only 5 percent has been given to the Afghan government. Twelve percent of the funds have been given to the Afghan reconstruction trust fund established for Afghanistan… The remaining 82 or 83 percent of the assistance has been spent outside the budget and control of the Afghan government" (McMahon 2007).

37. The lack of budget consolidation can be considerable. For instance, in Armenia, it is estimated that off-budget expenditures – items funded by non-cash external grants, sectoral extra-budgetary funds, and quasi-fiscal subsidies held by state-owned enterprises in the energy sector – together constituted 5-6 per cent of GDP in 2000 (PER Armenia). Thus, when fully consolidated, public spending amounted to 30 per cent – not 24-25 per cent (as reported in the government budget) – of GDP in Armenia. In some ministries, such as the Ministry of State Revenues, extra-budgetary funds accounted for 60 per cent of the regular budget of the Ministry (PER Armenia). The OECD estimates that China's officially-reported spending figures reflect only about three-quarters of total government spending, with extra-budgetary spending accounting for the rest (OECD 2006). In Nigeria, about a third of the total expenditures of the federal government remained off-budget in 2005. The main types of off-budget spending included: financing of oil sector investments, some costs of external debt service, other priority development projects funded from excess oil revenues (e.g., major investment in power generation), and statutory extra-budgetary funds (Nigeria PEMFAR Vol. 1).

38. Off-budget accounting is not uncommon in Latin America as well. For instance, Chile explicitly does not include its Ministry of Defense and its national copper company in its budget and accounting systems. In addition, it has a provision whereby some of the copper company's profits are transferred directly to the Ministry of Defense to provide independent funding for the military. However, both the Ministry of Defense and the copper company do report their results on a net basis to the parliament, and those reports are quite comprehensive, so very little of the operations of Chile's central government escape scrutiny (World Bank 2005c).

Argentina had very few off-budget accounts in 2001, before the most recent crisis. At the height of the crisis in 2002, the government created some off-budget accounts as a means of protecting favored programs from the broad budget cuts imposed by the government. Since then, although the country has largely recovered from the crisis, the number of off-budget activities has increased year by year (World Bank 2003). In fact, most countries in Latin America use off-budget accounts to some degree.

39. There is little justification in excluding certain public activities and expenditures from the public budget and not subjecting them to a vote in the legislature, as these activities are financed out of government revenue and are used to purchase goods and services in support of delivery of regular public services. By not consolidating such activities into the regular budget, the budget becomes fragmented, making it more difficult for public watchdogs to know exactly what and how the government is spending its resources and to demand accountability from the government.

40. Expanding budget coverage to include all user fees and contributions and all government debt, including on-lending and off-budget bonds, should be a high priority of public expenditure reform. Budgets need to include estimates of guaranteed debts and other contingent liabilities of the government. And donors need to be encouraged – if not obligated – to report and channel all their aid through the Treasury. The widespread prevalence of off-budget donor spending, especially in the aid-dependent countries of Africa, undermines accountability and thereby the effectiveness of public spending.

Dual Budgeting

41. Dual budgeting – the practice of making recurrent and capital expenditure decisions entirely separately – is another common budget issue addressed by many PERs. In many countries, two separate ministries are often involved in these two aspects of budget-setting – the Ministry of Finance, which typically prepares the fiscal framework and the recurrent estimates, and another agency (such as the Ministry of Planning, Ministry of Investment, or the Planning Commission), which prepares the Public Investment Program and the investment budget, including capital expenditures and donor-funded projects (Stevens 2004). In India, for instance, the Constitution mandates a distinction between revenue (recurrent) and capital expenditures. In addition, to confuse matters even further, the government maintains a strict 'plan' versus 'non-plan' expenditure distinction. The Planning Commission determines planning expenditure (which incidentally includes both capital and recurrent components), while the allocation of non-plan expenditure is typically requested by line ministries and approved by the Ministry of Finance.

42. Dual budgeting results in poor coordination of capital and recurrent spending. Capital investments are made without fully ensuring that the future recurrent needs of the project will be met in subsequent years, with the result that physical capital (such as roads) deteriorates prematurely owing to poor maintenance and rehabilitation (both of which are financed out of recurrent expenditures). The imbalance between recurrent and capital spending also results in the familiar problem of hospitals that lack funding for drugs and medical supplies and schools with no funding for books. The lack of coordination between recurrent and capital expenditures can result in an opposite type of problem, too; for instance, in the Vietnamese education sector, too much recurrent spending takes place relative to capital spending, with the result that there are many more teachers in proportion to primary school facilities.

43. The importance of coordinating the two sets of expenditures and of having a fully-integrated budget subject to an overall resource envelope cannot be over-

emphasized. Ultimately, the opportunity cost of resources is the same whether they are spent on recurrent or investment items. Fragmenting the two decisions introduces inefficiency in the proper allocation of budget resources across the two uses.

44. A solution to the problem of dual budgeting is a Medium-Term Expenditure Framework (MTEF) or Medium-Term Budget Framework (MTBF) – one in which all concerned ministries, but particularly the ministries responsible for recurrent budgeting and those responsible for capital budgeting, are involved. Since the mid-1990s, there has been a proliferation of countries adopting an MTEF or MTBF. By some counts, over three dozen countries in Africa, Asia and Latin America now employ an MTEF. Nearly half of these are in Africa, which was the regional leader in MTEF implementation. Indeed, the MTEF, which is regarded as a *sine quo non* of good public expenditure management (PEM), has become a standard item in the World Bank's PEM toolkit. An MTEF goes well beyond integration of recurrent and capital budgeting; as Box 3 indicates, it allows for better macroeconomic balance, coordination across sectors, greater predictability in policy and funding, and increased autonomy to ministries, among other things. Above all, it introduces a multi-year perspective to annual budgeting. Box 4 indicates the steps that typically take place in MTEF preparation.

45. Vietnam provides a good example of how an MTEF can be introduced gradually in national budgeting. The Government of Vietnam began piloting a Medium-Term Expenditure Framework (MTEF) in four sectors (Education, Health, Agriculture and Rural Development, and Transport) and four provinces in 2004. The objective of Vietnam's MTEF was to harmonize capital and recurrent expenditure budgeting across an entire sector within a single, forward-looking macroeconomic and expenditure framework and with a single, unified set of development goals.

46. To formulate the MTEF, the Vietnamese government established an inter-ministerial working group, comprising senior officials of both the Ministry of Finance (MOF) and the Ministry of Planning and Investment (MPI); similar inter-ministerial groups were also established in the four pilot sectors, comprising representatives of the finance and planning functions of the relevant sector ministry as well as the relevant sectoral expenditure specialists from the MOF and the MPI. After the successful pilots, the MTEF was extended nationally.

Budget Arrears

47. Arrears represent another common problem in budget execution and management in several countries. Arrears arise because of poor and unrealistic budget preparation resulting in over-estimated revenue and under-estimated expenditure. They may also, of course, reflect a lack of commitment on the part of governments – or more often, some ministries – to adhere to a hard budget constraint. Large arrears from the past fiscal year to the next weaken the execution of that year's budget allocation.

48. Arrears are large in some developing countries. In Ecuador, for instance, arrears constituted nearly a third of total government expenditure in 2000 – much greater than

the international norm of 5 per cent (Ecuador PER).[3] In Kenya, the stock of expenditure arrears constituted approximately 2 per cent of GDP in 2003. Most of these arrears were in the form of pending (unpaid) bills for utilities, particularly water, telephone and electricity, since there is a tendency among many government departments in Kenya to use appropriations allocated to utilities for other spending items (Kenya PER). In Armenia, the stock of arrears as a percentage of GDP was even higher than in Kenya – 5.6 per cent in 1999, 6.25 per cent in 2000, and 5.5 per cent in 2001 (Armenia PER).

49. As noted earlier, large arrears almost always reflect weak financial compliance and a lack of budget discipline. Russia is an example of a country that was able to virtually eliminate the problems of non-cash budget execution, pension and wage arrears by 2002 through improved budget discipline (Russia PER). Of course, robust economic growth following the 1998 crisis contributed to the growth of budget revenues and made it easier for the government to eliminate budget arrears.

Budget Classification

50. An important element of opening up budget information to public scrutiny is ensuring that the classifications in the budget are easy for individuals and agencies outside the government to decipher, analyze, and understand. Many countries use antiquated budgetary classifications that lack sufficient detail to plan, budget, and account for transactions. Often, the use of budget coding is inconsistent across line ministries, making it difficult to compare budgets across sectors. In China, for instance, the budget classification system in use is a hold-over from the days of Soviet central planning that uses a mix of functional, economic and organizational categories. The classification system also does not make a clear distinction between investment and recurrent expenditures. More significantly, expenditures by different ministries in the budget do not represent functional categories, while a single function can sometimes be split across several headings. For example, administrative expenditures are scattered through several headings including ‘administration’ and ‘other administration’ (China PER). In Kenya, as well, teacher salary costs are all included under the ‘general administration’ heading in the budget, making it difficult to analyze meaningfully the costs of service delivery (Kenya PER).

51. There is an international standard for budget classification – viz., the Government Finance Statistics (GFS) 2001 system proposed by the IMF. The GFS 2001 system makes it easy to analyze the functional composition of government expenditure, such as the total amount spent on a type of social service. Several countries, especially in Latin America, have adopted the GFS standard (e.g., Argentina, Brazil, Colombia, Dominican Republic, El Salvador, Panama, and Uruguay). But even in these countries, few local governments report their expenditures in GFS detail.

52. Tanzania is an example of a country that has adopted the GFS coding system and benefited considerably from this move. In the late 1990s, the Government of Tanzania

[3] However, the ratio of arrears to expenditure did decline in subsequent years – to 15 per cent in 2001 and 2002 and further to 5 per cent in 2003.

felt the need for a new classification system because of the weakness in the budget coding system that was then in use by the government (Tanzania PER, IMF 2004, UNCDF 2006). The structure of the old classification was not consistent with the preparation of a performance-based budget. What was needed was a consistent and unified classification system to determine exactly what was being spent on different services and to assess the outcomes associated with this spending. In addition, the government had plans to computerize its accounting system, and the old coding system was not conducive for computerization.

53. The government therefore took the opportunity of adopting a common international reporting standard (viz., the GFS). Reclassification of the budget along the GFS standard began in 1999. The work was carried out progressively, starting with the economic classification of recurrent budgets of ministries, departments and regions. Subsequently, the budgets of the local government authorities were also classified using the GFS codes. By 2001-02, the entire recurrent budget was processed using GFS item codes, and the development budget followed suit by 2003-04.

54. The adoption of the GFS economic classification has considerably improved the coding of the budget estimates in Tanzania. It has helped identify more clearly the details of expenditure allocations to education, health, water, agriculture, roads and general activities. More importantly, it has enabled the introduction of performance budgeting in the country (UNCDF 2006). Tanzania is one of the few countries in Africa where performance budgeting has become a reality. Resource allocation is now linked to specific quantitative and monitorable targets, and management accountability has been enhanced through performance monitoring and reviews.

Expenditure Leakages

55. One of the important manifestations of poor budget execution is the failure of public funds to actually reach their intended beneficiaries – viz., grass-roots service providers. During the 1990s, a methodology was developed, and applied, to track the flow of public funds through the administrative hierarchy – all the way from the central government level to the front-line service providers. The methodology consisted of Public Expenditure Tracking Surveys (PETS) administered at the service facility level (viz., health facilities, health staff, schools, and teachers).

56. PETS not only identify the extent of funds leakage – i.e., the difference between the amount of funds disbursed from the central level and the amount of funds actually received by the service facilities – but also the amount of leakage at each step of the delivery chain and the potential reasons for the leakage (e.g., institutional shortcomings, including lack of absorptive capacity and non-compliance with procurement procedures; inefficient delivery arrangements; or corruption and embezzlement). In addition, PETS enable policy-makers to identify delays in the transfer of resources at each step of the delivery ladder.

57. One of the first PETS to be done was in Uganda in 1991-95. A sample of government primary schools were surveyed in selected districts to examine how much

they received of the non-salary expenditures (central government capitation grants) that were channeled to them through the local (district) government. The survey indicated that while the central government had almost fully released the entire amount of the capitation grant to the district governments, most schools had received none of the monies from the capitation grant. On average, schools received only 13 per cent of central government spending on the program, with the remainder being captured by local government officials and politicians. Further, there was large variation in grants received by different schools, with schools in better-off communities receiving more of the funds to which they were entitled than schools in poor communities. In addition, PETS found that most districts lacked reliable records of disbursements to individual schools. There was thus significant leakage of school funds, with poorer schools experiencing larger leakages (Ablo and Reinikka 1998, Reinikka and Svensson 2000).

58. Interestingly, when a follow-up PETS was done in 2001 with virtually the same sample of schools, it was observed that schools received 82 per cent of the capitation grants. Thus, the leakage of funds had declined considerably since the earlier period. (Between the two surveys, the government had launched a major publicity campaign to inform schools and communities about the capitation grants that they were entitled to receive.) Moreover, the observed reduction in leakage was significantly larger for schools that had been exposed to the PETS publicity campaign. Thus, schools that were aware of the funds to which they were entitled were more likely to demand and obtain these funds (Reinikka and Svensson 2000).

59. PETS have subsequently been carried out in other sectors (particularly health) and in numerous other countries in Africa, Asia, and Latin America, including Tanzania, Zambia, Rwanda, Ghana, Nigeria, Peru, Ecuador, Colombia, Cambodia, Laos, and Pakistan. While there are variations in findings across countries, PETS have helped shed light on the complex nature of the flow of funds from the national government through local governments and down to individual service facilities. They have also helped identify major bottlenecks in expenditure execution and revealed systemic problems (either at the level of the Treasury or the line ministries) that are in need of reform.

The Public Sector and Financial Accountability (PEFA) Program

60. As a response to the many problems of budget execution in developing countries, several donors, including the World Bank, European Commission, UK's DFID, and the IMF, launched the Public Sector and Financial Accountability (PEFA) Program in 2001. The main objective of the PEFA Program is to assess public financial management (PFM) in aid-recipient countries via the use of a PFM performance measurement framework that provides consistent information for monitoring and evaluating PFM performance (PEFA 2006). The PEFA measurement framework consists of 28 country and 3 donor indicators, covering the areas of budget credibility; budget comprehensiveness and transparency; orderliness, participation and multi-year perspective in the budget cycle; accounting, recording and reporting of the budget; and external scrutiny and audit. A national (or subnational) government is scored on an ordinal scale on each of the indicators. A list of the indictors typically used is shown in Appendix Table A.

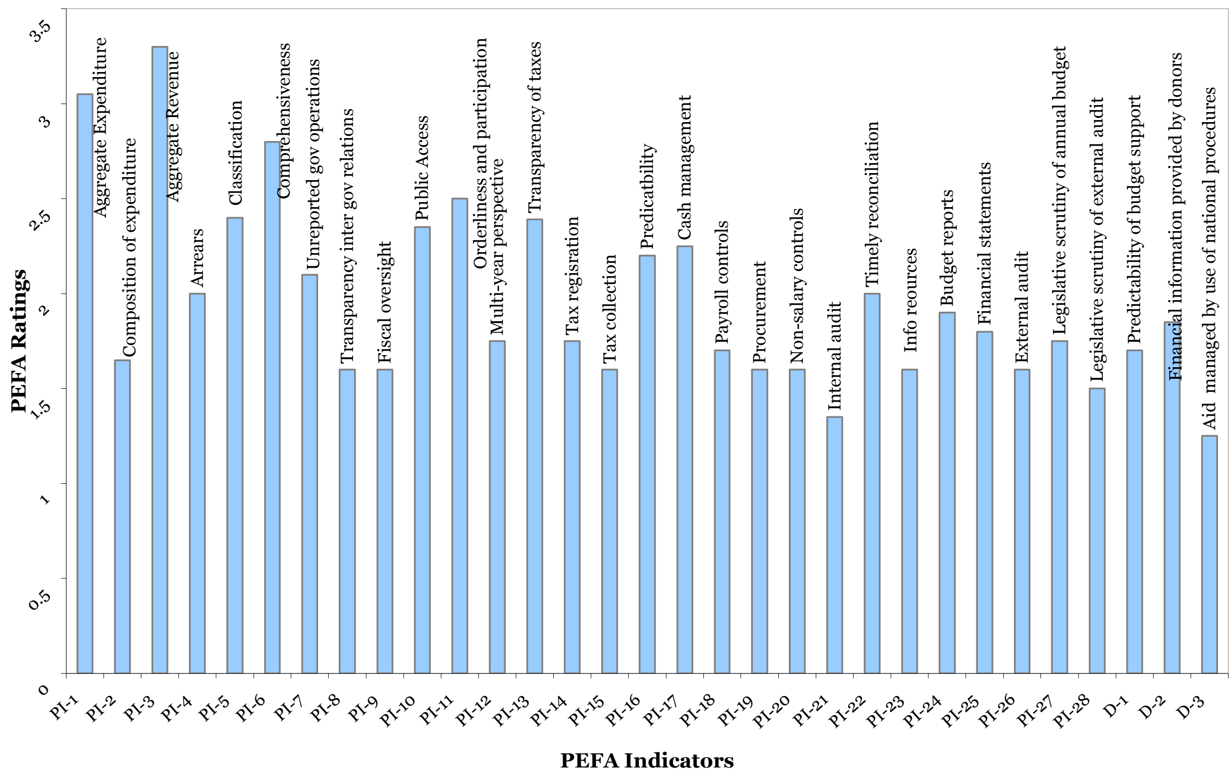
61. The PEFA program has focused on strengthening the capacity of countries to use this measurement framework to reform their public expenditure, procurement, and financial accountability systems. The program seeks to encourage country ownership of financial accountability reforms, and attempts, among other things, to improve donor harmonization and reduce transaction costs to recipient countries.

62. The PEFA-based PFM assessment has been adopted by a number of countries; it is estimated that by the end of 2007, nearly 70 countries around the world have been covered by PFM assessments based on the Framework. About 40% of these are in Sub-Saharan Africa. While most of the PFM assessments have been done at the central government level, the framework has been used in Ethiopia, Uganda, Tanzania, Mexico, and Pakistan to assess PFM performance at the subnational government level (PEFA 2006).[4] Unfortunately, virtually all of the PFM assessments have been initiated by donor agencies – only the Zambian PFM assessment was led by the Zambian government – which suggests that the PEFA program continues to remain largely donor-driven despite its stated objectives.

63. Much like the MDG framework that pioneered the use of concrete, quantitative indicators to assess the development performance of different countries, the PEFA Program has brought a much-needed objective, empirical framework to assessing country budgets and public financial management. While the resources required to collect the data on the different indicators and to quantify PFM performance are considerable, the Program seeks to instill a culture of budget process and performance evaluation across countries. While it is too early to make a final judgment on the success of the program, a recent PEFA assessment for 13 countries in Africa is promising (PEFA Secretariat 2006, Balakrishnan 2007). Figure 2 shows the average grades (on an A-D scale) of the 13 countries on each of the 31 PEFA indicators. In general, the group of 13 countries received a grade of B/B+ on aggregate revenue and aggregate expenditure out-turn compared to the original approved budget and a rating of C+/B on comprehensiveness of information included in budget documents. Interestingly, the indicator receiving the lowest grade (D/D+) was donor-related – viz., the proportion of aid managed by use of national procedures. Effectiveness of internal audit and legislative scrutiny of external audit reports also received some of the lowest grades (D/D+).

[4] In Pakistan, only one state government budget (Punjab) was assessed, while in Mexico eight state governments participated on a voluntary basis. In Uganda, six subnational governments, accounting for 10 per cent of the country’s population, were assessed.

Figure 2. Africa PFM PEFA Ratings: PEFA Assessment Results 2006 for 13 Countries



Ratings: A=4, B+=3.5, B=3, C+=2.5, C=2, D+=1.5, D=1, NR=0

Sources: PEFA Secretariat (2006), Balakrishnan (2007)

Box 1: Off-Budget Finance and the 'Transmuted Bond' in China

"Under the series of changes in the intergovernmental fiscal system that have occurred in China over the past two decades, Chinese localities found it increasingly attractive to hive off many activities into the off-budget category and have them carried on by government entities. Given the austerity in many subnational governments and the changing mechanics of tax-sharing, the local government-owned companies had the appeal of raising their own revenues, being kept away from the formal budget calculations, and being able to pursue activities either not allowed or not financeable by the subnational government itself. While information is incomplete, it appears that such off-budget activity is about equal to that carried on by the regional and local governments on their formal budgets and may represent as much as 20% of Chinese GDP…

One appeal of the off-budget financing is the ban against subnational borrowing from nongovernmental sources on the local government's own credit. However, the special-purpose entities that they create and own can borrow. This is especially important in financing infrastructure and has resulted in a phenomenon known as the 'transmuted bond.' To access credit, a Chinese subnational government will create an economic entity, which has a close, if legally murky, relationship to the parent, to accomplish the financing through the sale of 'corporate' bonds…"

Source: Mila Freire and John E. Petersen, 2004, p. 59.

Box 2: Aid Dependence in Africa

Aid dependence is widespread in Africa. Data from the *World Development Report 2008* show that ten countries in Africa receive $50 or more in overseas development assistance (ODA) per capita, with some countries (Eritrea and Zambia) receiving as much as $81 per capita in overseas development assistance (ODA) (see table below). Thus, ODA constitutes anywhere from one-fifth to one-half of GDP – and between two to four times gross capital formation – in the poorest African countries.

Overseas development assistance in selected African countries, 2005

	Overseas development assistance (ODA)		
Country	per capita ($)	as % of GDP	as % of gross capital formation
Angola	28	1.4	17.7
Benin	41	7.6	38.0
Burkina Faso	50	10.9	.
Burundi	48	48.0	400.0
Central African Rep.	24	6.7	.
Chad	39	8.1	36.9
Eritrea	81	40.5	213.2
Ghana	51	9.8	30.6
Guinea	20	4.9	37.5
Kenya	22	3.8	22.3
Madagascar	50	17.9	71.4
Malawi	45	26.5	165.4
Mali	51	11.6	48.3
Mauritania	62	8.4	36.4
Mozambique	65	19.1	76.5
Rwanda	64	25.6	121.9
Sierra Leone	62	25.8	172.2
Tanzania	39	11.1	58.6
Uganda	42	14.0	56.0
Zambia	81	12.9	47.6

Source: World Bank, 2007, *World Development Report 2008*, Washington DC.

Box 3: Objectives of a Medium-Term Expenditure Framework

- Improving *macroeconomic balance* by developing a single, consistent and realistic resource framework.

- Improving the *allocation of resources* to strategic priorities between and within sectors by building budgets around a single, consistent and realistic set of policy objectives.

- Improving *coordination and balance* between capital and recurrent expenditures by integrating the planning for both of these within a single, forward-looking budgetary process.

- Increasing *commitment and predictability* both in policy and funding so that ministries and provinces can plan ahead and programs can be sustained.

- Providing ministries and provinces with a *hard budget constraint* and *increased autonomy*, thereby increasing incentives for efficient and effective use of funds.

Source: World Bank, 2005, Table 4.1, page 53.

Box 4: Steps in Preparation of a Medium-Term Budget Framework (MTBF)

A typical MTBF entails the following steps:

- Initiating a process of rigorous costing and analysis of existing policy commitments, with a view to improving efficiency and developing a fm baseline cost for essential continuing services of government. Maintaining a continuous medium-term view of these elements provides an essential foundation for a full MTBF.
- Developing a three-year macroeconomic framework as a starting point for the MTBF.
- Utilizing improved techniques for macroeconomic analysis and revenue forecasting, and publishing the basis and assumptions for medium-term macroeconomic and revenue forecasts.
- Establishing expenditure review teams with the task of reviewing all of the government's existing commitments (Part A of the budget) through a series of intensive studies of different sectors. The overall objective will be to establish a baseline cost for the continuing essential services of government. Once established, this baseline can be projected forward and published as forward estimates in the MTBF framework.
- Developing broad aggregates for revenues and sectoral (and, for important sub-sectors, sub-sectoral) expenditure ceilings.
- Making all ministries and departments responsible for extending their permanent and temporary budget forecasts beyond the budget year by another two years, and separately identifying additional costs over the three-year period that arise from implementation of government policies and development projects.
- Strengthening capacity for sectoral and expenditure policy assessments. These assessments should take into account relevant performance information.
- Making the budget for the following year in a 'rolling' format. That is, in the following year's budget, the existing policy estimate for the first out-year will be taken as the baseline estimate for the ministry in negotiating the budget, and similar procedures will be followed each year."

Source: World Bank, 2004, p. 70.

VII. Efficiency and Equity of Public Expenditure

64. Efficiency and equity are two important goals of public expenditure. Efficiency refers to the allocation of public expenditure across different uses so as to obtain the maximum output from the allocated spending. On the other hand, equity in public spending refers to the distribution of benefits from public spending; if a disproportionate share of the benefits accrues to the better-off sections of society, who typically constitute a smaller share of the population than the poor, public spending is considered inequitable and not pro-poor.

65. Unfortunately, it is not straightforward to compare the returns to public spending across sectors, as many sectors produce goods and services that are not readily marketable and therefore difficult to value. In addition, there are all sorts of externalities (effects outside the sector) associated with certain types of public spending that complicate estimation of returns to spending in a single sector. Even though attempts have been made – sometimes under heroic assumptions – to estimate the broad returns from investing in different sectors, these estimates are too tenuous for policy formulation and budget allocation.

66. It is sometimes easier to compare returns across different public types of public spending within a single sector. For instance, there is empirical research that establishes that the returns (both private and social) to lower (primary) levels of schooling are typically greater than those to higher levels of schooling (viz., secondary and higher education) (Psacharopoulos 1994, Psacharopoulos and Patrinos 2002) (Table 2). This research has been used by several PERs to recommend that public educational spending be tilted more heavily toward lower levels of schooling in order to improve efficiency.[5] Likewise, there is plenty of evidence to suggest that government expenditure on public health activities, such as communicable disease control and disease prevention (e.g., prenatal care and child immunization), has higher social returns than spending on curative care.

67. At the same time, public expenditure on primary education is decidedly pro-poor for three reasons: first, the poor tend to have more primary-school-aged children than the non-poor; second, poor children are more likely to attend *public* primary schools than better-off children who tend to attend *private* primary schools; and, third, children from poor households are much less likely than those from high-income households to enroll in secondary school or tertiary institutions. Likewise, public spending on primary health care is typically much more pro-poor than spending on secondary and tertiary care for much the same reasons: the poor are more likely than the better-off to use *public* (as opposed to *private*) primary facilities and they are less likely to access secondary or tertiary care. Thus, spending on elementary education and primary health care advance

[5] Most of the estimated returns in the literature are based on cross-sectional data and do not necessarily reflect the causal effect of schooling on wages. In addition, these estimates typically do not control for unobserved heterogeneity, such as innate ability or family background, that may result in bias. A review by Card (2001) suggests that the failure to control for unobserved heterogeneity typically results in the estimated returns to schooling being overestimated, while the failure to account for the endogeneity of schooling decisions causes the estimated returns to be underestimated.

both efficiency and equity goals relative to spending on secondary and tertiary education and health services.

Table 2: Average estimated rates of return to schooling, by region, 1990s

Region	Social rates of return for schooling level:			Private rates of return for schooling level:		
	Primary	Secondary	Higher	Primary	Secondary	Higher
Sub-Saharan Africa	25.4	18.4	11.3	37.6	24.6	27.8
Asia	16.2	11.1	11.0	20.0	15.8	18.2
Europe, Middle East, North Africa	15.6	9.7	9.9	13.8	13.6	18.8
Latin America, Caribbean	17.4	12.9	12.3	26.6	17.0	19.5
OECD countries	8.5	9.4	8.5	13.4	11.3	11.6
World	18.9	13.1	10.8	26.6	17.9	19.0

Source: Psacharopoulos, George, and Harry A. Patrinos (2002).

68. Yet public spending in many countries tends to be skewed toward higher levels of schooling and health. Table 3, which reports the benefit incidence of public spending in seven countries in Asia and Latin America, suggests that public expenditures tend to be more pro-poorly distributed in Latin America (viz., Argentina, Chile, and Colombia) than in Asia (Indonesia and Pakistan). Across all countries, public spending on health care and primary education is decidedly more pro-poor than public expenditure on secondary education. In the case of Indonesia, for example, 68 percent of the public spending on secondary education benefits the richest 40 percent of the population, while merely 16 percent of this spending benefits the poorest 40 percent. In case of spending on health care, the respective numbers for Indonesia are 53 percent and 28 percent.

Table 3: Benefit Incidence of Public Spending, Selected Countries, 1990s

Country	Percent share of public spending accruing to:					Year of incidence data
	Bottom quintile	Second quintile	Third quintile	Fourth quintile	Top quintile	
			Health			
Chile	32	26	21	15	6	1992
Colombia	27	26	19	16	13	1992
Indonesia	12	16	19	24	29	1990
Romania	12	15	20	24	29	1994
			Primary education			
Argentina	37	23	15	15	9	1993
Chile	36	27	18	13	7	1990
Colombia	39	26	19	11	4	1992
Guyana	29	25	19	19	9	1992
Pakistan	19	23	22	21	15	1991
			Secondary education			
Argentina	22	21	21	21	15	1993
Chile	24	24	21	18	13	1990
Colombia	21	27	25	18	10	1992

Table 3: Benefit Incidence of Public Spending, Selected Countries, 1990s

Country	Percent share of public spending accruing to: Bottom quintile	Second quintile	Third quintile	Fourth quintile	Top quintile	Year of incidence data
Indonesia	5	11	17	26	42	1989
Romania	18	22	22	21	18	1994

Source: Davoodi *et al.* 2001, De Mello 2004.

69. Table 4, which reports the benefit incidence of spending on all education and on primary education for 8 countries in Africa, shows that there are wide variations in the pro-poor nature of educational spending even within Sub-Saharan Africa. At one end is Madagascar, where the richest fifth of the population benefits five times as much from public spending on education as the poorest fifth, while at the other end is Kenya, where the corresponding ratio is merely 1.2. In most countries, public spending on primary education is observed to be decidedly pro-poor, although South Africa appears to be an outlier.

Table 4: Incidence of Public Expenditure on Education by Income Quintile

	All Education		Primary Level Only	
Country	Poorest quintile	Richest quintile	Poorest quintile	Richest quintile
Lesotho (2002)	13	33	20	20
Kenya (1992)	17	21	22	15
Madagascar (1993-94)	8	41	17	14
Malawi (1995)	16	25	20	16
Namibia (2003)	17	27	17	16
South Africa (1994)	14	35	19	28
Tanzania (1993-94)	14	37	19	18
Uganda (1992-93)	13	32	19	18

Source: Kingdom of Lesotho PER 2004

70. There is some evidence from Ecuador on which public programs tend to be more pro-poor than others. Table 5 shows the benefit incidence of different public programs, as well as the distribution of public spending in Ecuador across these programs. Large differences in the benefit incidence of different forms of social expenditure are observed. For instance, more than a third of spending on public expenditure on primary schools and school breakfasts – but only 3 per cent of public spending on universities – accrues to the poorest 20 per cent of the population. Indeed, 41 per cent of the public spending on universities is captured by the richest 20 per cent of the population. In addition, the subsidy on gasoline (which was abolished in 2003) and cooking gas, as well as social security-based health spending, are not pro-poor. In aggregate terms, the poorest population quintile receives 17.4 per cent of all government social outlays, compared to 21.4 per cent for the richest quintile.

Table 5: Incidence of Social Expenditure and Energy Subsidies by Income Quintile, Ecuador, 1999

Less Pro-Poor Expenditure → More Pro-Poor Expenditure

Income quintile	Gasoline subsidy	University tuition	Health Care IESS	Cooking Gas	Secondary school	Health Care MSP	Health Care SSC	Bono (Social Insurance)	Primary School	School Breakfast
Poorest	0	3	5	8	15	19	26	27	35	38
Second	1	12	7	14	23	23	35	28	26	15
Third	4	16	21	20	22	22	13	25	20	12
Fourth	10	28	22	24	24	24	21	16	13	33
Richest	85	41	45	34	14	12	5	4	6	2
Gov't social exp. ($m, 2003)		366.4	191.4	221.0	304.0	160.2	35.9	159.9	453.4	17.0
Gov't social exp. (% of total)		19.2	10.0	11.6	15.9	8.4	1.9	8.4	23.7	0.9

Note: IESS=Ecuadorian Social Security Institute, SSC=Rural Social Security, MSP=Expenditure by Ministry of Health

Source: World Bank (2004).

71. The data in Table 5 indicate that, in 2003, the most pro-poor program, school breakfast, received an annual allocation that was less than 1 per cent of total social spending. In contrast, university education, which is one of the most regressive social subsidies, accounted for nearly one-fifth of social spending. Likewise, the pro-poor SSC spending on health care received only one-fifth of the government resources than the non-pro poor IESS health care program.

72. Mongolia is another example of a low-income country where the distribution of public spending is lop-sided. Being a poor country, Mongolia suffers from high rates of infant morality and a high burden of communicable diseases, such as tuberculosis; despite this, much of its public spending goes toward hospital-based services that tend not be neither pro-poor nor public health in nature. In 2000, general and specialized hospitals received more than two-thirds of the national health budget. In contrast, lower-level health facilities received only 18 percent, with another 6 percent going to primary and public health services (Mongolia PER). Likewise, in Kenya, just two tertiary hospitals – Kenyatta National Hospital and Moi Referral Hospital – accounted for 18 per cent of all recurrent public expenditure on health in 2002-03 (Kenya PER). Overall, like Mongolia, 68 per cent of recurrent public spending on health in Kenya was spent on curative services.[6]

[6] Of course, it is not clear what mix of services these two hospitals provide. It is possible that tertiary-level institutions and provincial and district hospitals may be delivering a substantial share of basic health care and primary services owing to a failure of lower-level facilities and individuals bypassing these facilities.

73. An example of a low-income country whose budgetary expenditures are broadly consistent with its economic and social development goals – especially in the areas of human development, disaster management and agricultural development – is Bangladesh. In particular, the Bangladeshi government has maintained a strategic balance in its public expenditure on education. As in other low-income countries, public spending on primary education in Bangladesh is decidedly pro-poor, while public spending on tertiary education largely benefits the better-off groups (Table 6).

Table 6: Benefit incidence of public expenditure on education, Bangladesh, 2000

Level of education	Quintile based on consumption expenditure					
	Poorest	Second	Third	Fourth	Richest	Total
Primary education	22	23	22	19	14	100
Secondary	6	11	16	28	40	100
Tertiary	6	6	10	21	57	100
All education	12	15	17	23	32	100

Source: World Bank, 2003, "Bangladesh Public Expenditure Review", Report No. 24370-BD, Washington DC.

74. In the early 1990s, Bangladesh spent nearly half of all its recurrent educational expenditure at the primary level (Table 7). There was a sharp increase in primary enrollment during the 1990s, with the country achieving near-universal primary enrollment by the mid-1990s. The large increase in primary enrollments during the early 1990s began generating increased demand for secondary education during the latter part of the decade. As a result, spending on secondary education increased steadily through the decade of the 1990s. However, even by 1999-2000, 40 per cent of recurrent educational spending was on primary education. More impressively, the government has struck a successful partnership with the private sector and NGOs in expanding secondary school enrollments. Indeed, partnering with the private and NGO sector is a hallmark of Bangladesh's entire – not just educational – development strategy.

Table 7: Recurrent public expenditure on education, by level of education, Bangladesh, 1991-92 to 1999-2000

Fiscal year	As % of GDP	% distribution of recurrent public expenditure on education:					
		Primary	Secondary	Technical	University	Other	Total
1991-92	1.14	48.5	36.8	2.4	8.5	3.7	100.0
1993-94	1.30	47.0	41.1	2.2	7.9	1.8	100.0
1996-97	1.30	43.5	42.9	2.1	7.9	3.6	100.0
1998-99	1.35	40.4	47.6	1.4	7.0	3.7	100.0
1999-2000	1.37	39.5	48.4	1.4	8.0	2.7	100.0

Source: World Bank, 2003, "Bangladesh Public Expenditure Review", Report No. 24370-BD, Washington DC.

75. Of course, Bangladesh also provides a telling example of how inefficiencies in service delivery can prevent the poor from benefiting as much as they should from what are generally pro-poor programs. For instance, the country's two main development programs – the Vulnerable Group Development and Food for Work program – are well-targeted, with the poorest fifth of the population is more than three times as likely to participate in the programs as the richest fifth. However, while the allocation of expenditures in these programs is broadly pro-poor, the benefits that the poor receive fall

short of the initial volume of resources intended. In this case, the 'weak links' in the process are the institutions of service delivery, which remain mired in bureaucratic inefficiencies and corruption (Bangladesh PER).

76. Another measure of efficiency is internal efficiency, which refers to the combination of inputs allocated to produce outputs or outcomes *within a sector*. The 'overuse' of one input relative to other inputs is generally considered inefficient. Of course, determining the most efficient combination of inputs to produce a given amount of output *a priori* is difficult in most sectors. However, if 90 per cent of recurrent spending in, say, the education sector is spent on teacher salaries, it could be inferred that the government has little to spend on other important inputs in the education process, such as textbooks, instructional materials, and student scholarships. Likewise, if personnel costs account for three-quarters of recurrent spending in the health sector, there would be few resources available for drugs and medical supplies, which are essential for the delivery of quality health services. Several PERs suggest that there is ample scope in low- and middle-income countries to improve internal efficiency by reducing the very high share of salaries and wages in public expenditure and increasing the share of non-salary inputs.

77. The poor funding for non-salary expenses is widespread in the education sector. In China, for instance, only 7-9 percent of total budgetary expenditures on education go to non-salary items. In some Chinese provinces, such as Hezheng and Jishishan, wages and salaries absorb 93-98 percent of total recurrent expenditures in education (China PER). As a result, schools are run-down and lacking in instructional materials. Further, the share of salaries in total educational spending has increased in most provinces, as teachers' salaries have grown and squeezed out other needed expenditures.

78. The situation in sub-Saharan Africa is no different (Table 8). In Burundi, for instance, salaries account for 99.6 percent of recurrent expenditure on primary education. Swaziland, Ghana, Zimbabwe, Eritrea, South Africa, and Zambia all spend 90 percent or more of their public spending on primary education on salaries alone. What this means is that parents are supposed to pay for everything else, including text books and supplies.

Table 8: Personal Emolument in Primary Schools as a Percent of Recurrent Expenditure, 2002-2004

Country	%
Burundi	99.6
Ghana	98.2
Zimbabwe	97.6
Eritrea	97.2
South Africa	95.9
Zambia	95.3
Swaziland	93.6
Togo	85.6
Seychelles	84.9
Lesotho	75.6
Comoros	65.5

Source: Swaziland PER 2006

79. One reason for the high share of salary costs in recurrent educational spending is that there are political pressures in many low- and middle-income countries to hire more teachers in government schools than are needed. Teachers are civil servants, and the civil service is seen as an employer of first resort. This results in relatively high teacher-student ratios. For instance, Uzbekistan has a lower student-teacher (or higher teacher-student) ratio than many OECD countries (Table 9), which represents an inefficient use of teacher resources.

Table 9: Student-teacher ratios by level of education, selected countries, circa 2000

Country	Student-teacher ratios				
	Preschool	Primary	Lower Secondary	Upper Secondary	Higher
Uzbekistan	11.0	18.0	13.0	15.0	12.0
S. Korea	23.9	32.2	21.9	22.5	NA
U.K.	16.5	22.5	17.4	12.4	18.5
U.S.A.	19.3	16.3	16.8	14.5	14.0
OECD average	15.4	18.0	15.2	14.1	15.3

Source: World Bank, 2005, Republic of Uzbekistan: Public Expenditure Review, Report No. 31014-UZ, Washington, DC.

80. There are, of course, large variations in the student-teacher ratio across developing countries. Table 10 shows that, within sub-Saharan Africa itself, the primary school student-teacher ratio varies from 26 in Cape Verde to 72 in Ethiopia. In general, student-teacher ratios tend to be larger at the primary than at the secondary school level in all countries (with the surprising exception of Eritrea).

Table 10: Student-teacher ratios in primary and secondary schools, selected African countries, 2005

Country	Student-teacher ratios	
	Primary	Secondary
Cape Verde	26	23
Sudan	29	22
Swaziland	32	18
Mauritania	40	31
Kenya	40	32
Senegal	42	26
Guinea	45	36
Cameroon	48	25
Eritrea	48	51
Uganda	52	21
Mozambique	62	26
Chad	63	34
Ethiopia	72	55

Source: UNESCO (2006).

81. The large ratio of wages and salaries in non-recurrent public spending is not a phenomenon restricted to the education sector; it occurs throughout the public sector, although the share of personnel costs in recurrent public expenditure is not as high in other sectors as in the education sector. Many governments find it difficult to restrict

growth in public employment, and which in turn squeezes out expenditure allocated to non-wage operations and maintenance. In Ecuador, for instance, the real rate of growth of the public payroll was 21.3 percent in 2001, 35.4 percent in 2002, and 19.5 percent in 2003. Not surprisingly, the share in current expenditure going to wages and salaries almost doubled during this period, rising from 25 percent in 2000 to 45 percent in 2003.

82. High salaries for teachers are another reason for the large share of salary expenses in recurrent public spending on education. High teacher salaries can result in the already-scarce resources of the education sector being diverted to their payment, leading to fewer resources being available for complementary inputs such as textbooks. Of course, very low teacher salaries can lead to low morale, less teacher commitment to their jobs, and widespread teacher absenteeism. UNESCO suggests that, on average for countries that are seeking to reach the Education for All (EFA) targets, a reasonable level for an average primary-school teachers' salary would be 3.5 times a country's per capita GDP (UNESCO 2003). Unfortunately, teacher salaries tend to be relatively high in sub-Saharan Africa, especially in those countries that have not yet met EFA targets. Table 11 shows that in Burkina Faso and Ethiopia, primary school teachers are paid salaries that are eight or more times as large as per capita GDP. The multiples are more reasonable in Malawi and Tanzania, although not still as low as the UNESCO recommended level.

Table 11: Comparative Primary School Teacher Salaries as a multiple of GDP per capita, selected countries, circa 2000

Country	Ratio of Salary/GDP per capita
Bangladesh	5.3
Burkina Faso	8.0
Ethiopia	8.1
Malawi	4.0
Tanzania	3.6

Source: Ethiopia PER 2004, vol. 1, p. 42

Reducing or Eliminating Subsidies

83. Many of the most wasteful, inefficient and regressive subsidies tend to be the ones to state-owned enterprises and to utilities. And often these subsidies constitute a large share of the total subsidy bill in a country. In Armenia, for instance, it is estimated that subsidies in the form of accumulated debts to utilities and tax arrears constituted 6-7.5% of GDP in 1996-2002. At least half of these subsidies were provided through quasi-fiscal channels (Armenia PER). Sometimes, the subsidies are implicit, and not reflected in the budget. For instance, in Iran, energy, consisting of electricity, gas, kerosene and gasoline, is the most heavily subsidized item. The total amount of the implicit subsidy on energy was as high as 11 per cent of GDP during the 1990s (Iran PER).

84. These implicit and explicit subsidies are regressive, consuming scarce public resources that could be used more efficiently to provide targeted social assistance to the needy. For instance, it is estimated that only 11 per cent of the energy subsidies in Iran accrue to the poor in rural areas; the corresponding ratio for the urban poor is even smaller (6 per cent) (Table 12) (Iran PER).

Table 12: Share of subsidies accruing to the poor and non-poor for specific goods, Iran, 1998

Subsidized item	Rural poor	Rural non-poor	Urban poor	Urban non-poor
Energy	11	89	6	94
Wheat	10	91	6	94
Pharmaceuticals	18	82	3	97
Edible oil and sugar	13	87	8	92

Source: World Bank (2005), p. 45.

85. In Ecuador, the three subsidies to basic services – water, telecom, and electricity – constitute a major element of public expenditure. Together, they cost US$341 million or 1.3 per cent of the country's GDP. Not only are these subsidies distortionary from an efficiency perspective,[7] but they hardly benefit the poor. The subsidy for telephone service is the most unequally distributed, with almost half of it going to the richest two consumption quintiles (Table 13). In contrast, only 5 per cent of the subsidy goes to the poorest 20 per cent of the population. Taken together, the three subsidies benefit the top quintile three times as much as they benefit the poorest quintile (Ecuador PER).

Table 13: Benefit incidence of subsidies on basic services, Ecuador, 2003

Subsidy	Consumption expenditure quintile				
	Poorest	Second	Third	Fourth	Richest
Electricity	8.4	12.0	16.4	23.4	39.8
Water	7.9	12.0	15.2	23.6	41.3
Telephone	5.0	9.0	13.0	25.0	48.0
All three	7.3	11.2	15.0	23.9	42.6

Source: World Bank (2004)

86. Fortunately, most developing countries have reduced significantly the share of general price subsidies in public expenditure over the last decade or two. The most telling example comes from China where the government gradually reduced subsidies to state-owned enterprises even as the number of loss-making state-owned enterprise continued to grow through the 1990s. Spending on all subsidies fell from 27% of total budgetary expenditure in 1986 to only 7% by 1998, while spending on enterprise loss subsidies fell from 9.2 per cent to 3.3 per cent of total public expenditure (China PER).

87. The political economy of general price subsidies is that, once provided, they are difficult to remove without public opposition. However, several countries have been able to successfully reduce price subsidies without major political upheaval. Tunisia provides an example of a country that was able to "sell" its subsidy reform to its people and implement it successfully after an initial failed attempt.

88. Up until the early 1990s, Tunisia had an extensive system of universal food subsidies (with nearly 80 percent of the population benefiting from the subsidies) (World Bank 1999). As in other countries, the subsidies had their origins in good intentions: price stabilization and protecting the poor and vulnerable from high food prices. However, by 1990, the cost of the food subsidies had risen significantly (in large part because of

[7] In addition to economic distortions, there is often enormous waste associated with these subsidies. For instance, many countries experience high losses in the power sector due to outright theft of power, incorrect billing, and transmission leakages.

extensive leakage of subsidy benefits to the better-off), and constituted as much as 3 percent of GDP (World Bank 1999). An initial attempt at food subsidy reform failed, with the eruption of public riots at the removal of the subsidies.

89. However, beginning in the early 1990s, Tunisia implemented new reform measures. Food subsidies were lowered gradually so that the resulting increases in food prices were also gradual. More importantly, subsidies on 'inferior foods' (i.e., foods typically bought by the poor and not much in demand at higher levels of income) were maintained, while those on 'superior' foods were phased out, to minimize the leakage of subsidy benefits to the better-off. The entire reform package was announced well before it was implemented, so that consumers could adapt, or at least get used, to the resulting price increases. Additionally, since the riots accompanying the earlier reforms had been largely instigated by students, the reform was announced in the summer months when universities were closed (Tuck and Lindert 1996, Pearce 1999).

90. The government also launched awareness campaigns to try to explain to the population why the removal of the food subsidies was important for fiscal reform and how the reduction of the subsidies could result in greater public expenditure on other social programs. In addition, the government introduced compensatory measures for vulnerable groups that were most affected by the rise in food prices accompanying the reform. Finally, the government liberalized and developed markets in the superior foods (subsidies on which had been withdrawn), so that the high-income households would consume more of them and be diverted from the inferior foods and thereby the subsidies (Tuck and Lindert 1996).

91. The Tunisian case is a good example of how a country can 'sell' subsidy reform to its population through careful planning and phased, gradual implementation. Several other countries in the Middle East and North Africa, including Jordan, Egypt, Algeria, Morocco, and Yemen, have also been successful in reforming their extensive food subsidies (World Bank 1999).

VIII. Decentralization of Public Spending

92. Beginning in the 1980s in Latin America and in the 1990s in Asia,[8] decentralize-tion has rapidly spread around the developing world. Country after country has attempted to decentralize public services to lower levels of government. Decentralization has largely been driven by political, not budgetary or administrative, considerations. Adjustments to make it work can take many years as public management and expenditure responsibilities slowly catch up to the changes.

93. Decentralization results in the downsizing of central administration and bureaucracies, elimination of superfluous layers of bureaucracy, and empowerment of local governments. But a critical part of decentralization is the devolution of government expenditure, staffing, and allocation decision authority from a central administration to lower levels of government. This is the part of decentralization where much remains to be done, even in countries where decentralization has proceeded with remarkable speed.

Budgetary Autonomy to Local Governments

94. A strong theme of several PERs is that decentralization in the developing world often tends to assign local governments responsibilities to deliver services without giving them budgetary power and autonomy to carry out the responsibility, thus defeating the very purpose of decentralization. Many central governments are worried about ceding control over expenditure allocation decisions to local governments for fear that the loosening of spending controls will result in greater corruption, misuse and waste of resources.

95. Table 14 highlights this point in the case of West Africa. Local government expenditures account for no more than 5 percent of central government expenditure. Most of the local government expenditure is accounted for by public expenditure of the two largest cities or metro areas in the province.

Table 14: Relative weight of local government budgets in selected West African countries, 1992

	Benin	Burkina Faso	Cameroon	Cote d'Ivoire	Senegal
Share of GDP of central government	13	15	18	23	20
Share of GDP of local government	0.3	0.3	0.8	0.9	0.9
Local government as a share of the central government	2	2	5	4	5
Largest city (metro area)					
Share of total local expenditure	73	66	68	65	71

[8] During the 1980s, for example, decentralization in the administration and delivery of education and health took place in many countries in Latin America as a logical response to the process of political democratiza-tion taking place in these countries. In India, decentralization began in earnest with the passage of the local government or *Panchayati Raj* Act of 1992. The Act gave control to elected village and urban councils (*panchayati raj* institutions or PRIs) over a wide range of social and developmental activities of govern-ments, including education, health care, nutrition, and safe drinking water and sanitation. Likewise, greater fiscal decentralization was mandated in the Philippines by the Local Government Code (LGC) of 1991 and facilitated in Vietnam by the State Budget Laws of 1996 and 2002.

Table 14: Relative weight of local government budgets in selected West African countries, 1992					
	Benin	Burkina Faso	Cameroon	Cote d'Ivoire	Senegal
Share on national population	11	8	8	22	22
Second largest city					
Share on total local expenditure	10	22	17	6	3
Share on national population	4	4	7	4	3
Sources: Farvacque-Vitkovi and Godin (1997), Brosio (2000).					

96. Yet there is compelling evidence that in order to deliver services effectively and responsively (i.e., responsive to local needs), subnational governments need to be provided a degree of budget autonomy (Ahmad *et al.* 2005, Besley *et al*. 2004). Of course, they also need to be held accountable for the use of the resources over which they have a real degree of control. Balancing autonomy with accountability is a key challenge during the process of budgetary decentralization.

97. Autonomy includes, among other things, the flexibility to let local units (e.g., provinces) have differential expenditure policies with respect to even lower levels of government (e.g., districts or villages). This would allow the provincial governments to adapt their policies toward lower levels of government to account for intra-provincial variations and diversity (e.g., urban-rural variations or differences between interior and coastal regions). In turn, this would permit more efficiency and equity in resource mobilization and allocation. Of course, such an approach always carries the risk that provincial governments might shift expenditure responsibilities, but not revenues, to even lower levels of government (e.g., districts or villages), thus retaining a larger proportion of central government transfers for their own use. This would not only be inequitable but would also make it difficult for central government policies to be implemented effectively in all the districts and villages. However, as long as provincial governments are held accountable for the performance of all their sub-provincial units on key national goals, they will have the right incentives to allocate resources according to need and to both provide autonomy to and demand accountability from their sub-provincial governments.

98. An important element of budgetary autonomy is that subnational governments are able to plan and approve their own budgets separately from those of the central government. In some countries (e.g., Vietnam), the national legislature has to approve the entire state budget, which includes the budget of the central government as well as the budgets of the provinces, districts, and even lower levels of government (Vietnam PER). This makes little sense for two reasons: first, it is not clear to what extent the national legislature can really contribute to or monitor the elaborate budgets of so many lower units. Second, this type of control actually prevents local governments from becoming accountable for their spending and actions in the long run.

99. Finally, budgetary autonomy requires that subnational governments not only have the flexibility to allocate expenditures across needs that are based on their own priorities but also enjoy the discretion to choose the most cost-effective combination of inputs to deliver public services (Andrews and Shah 2003). In many countries, there are very tight restrictions on how subnational governments can spend their resources. For instance,

local governments have to reconcile their budgets in line-item detail and are not allowed to reallocate spending across different narrow categories of expenditure without formal approval from the central Ministry of Finance. In other countries, local governments have to conform to strict physical and allocative norms provided by central sectoral ministries. Again, this type of spending control not only stifles efficiency in input choices at the local level but also prevents local governments from becoming more responsible and accountable for their expenditures.

100. Instead of coercing local governments to follow centrally-established norms or to adopt centrally-derived expenditure and input allocations in the hopes that this will further national goals, it makes much more sense for the central government to provide budgetary autonomy to local governments, but, at the same time, create strong incentives for them to pursue national objectives. One such incentive-based mechanism is a conditional matching grant in which the central government matches, on a one-on-one or even two-on-one basis, expenditures by subnational governments on particular items of national importance (Shah 2006). Of course, this mechanism will not be as effective as a central government grant conditioned on attainment of specific social outcomes by the local government, but it will at least encourage local governments to allocate more expenditure to national-priority activities than they might have. A shortcoming of matching grants is that they can lead to greater inequities as better-off local governments are better able to afford matching contributions than poorer local governments. However, this is something that can be addressed by the central government through alternative policy mechanisms.

101. Vietnam provides a good example of a country that has gone from being a highly-centralized to a highly-decentralized economy over the last decade. With the passage of the 1996 State Budget Law, the country began devolving many government functions to subnational governments; the result was an increase in the share of subnational governments in total public expenditure from 26 percent in 1992 to 43 percent in 1998 to 48 percent in 2002 (Vietnam PER).[9] In 1999, the Government of Vietnam piloted an experiment in the province of Ho Chi Minh City (HCMC) to introduce block grants or "lump sum" budgeting, along with more flexible personnel arrangements (Box 5). This was followed by the passage of a 2002 State Budget Law, which substantially increased the authority of provincial governments to organize the budgets of their district and commune governments and conferred additional recurrent budget flexibility to all levels of government. Local governments were given discretion to reallocate recurrent spending within three broad blocks of controlled expenditure – personnel expenditures, operations and maintenance, and other expenditures (Vietnam PER). This was a significant departure from an earlier practice of requiring spending units to agree their budgets with the finance function to line item detail.

[9] Of course, this ratio still remains lower than in some countries like China, where subnational governments account for nearly two-thirds of total public expenditure (World Bank 2002). But the change in China has been much slower; for instance, the subnational government share was as high as 54 per cent even back in 1978.

Box 5: The Ho Chi Minh City Experiment

Vietnam began its reforms at delegating budget formulation and execution authority to subnational governments in 1999 with a pilot experiment in the province of Ho Chi Minh City (HCMC). The pilot involved the introduction of "block grant" or "lump sum" budgeting, along with more flexible personnel arrangements, in 10 selected districts and departments in HCMC. Under the then 1996 State Budget Law, spending units (i.e., subnational governments and front-line service providers) were required to agree their budgets with the finance function to line-item detail; and they were then not allowed to reallocate spending across the nine blocks of controlled expenditure without formal approval. In addition, spending units were mandated to comply with physical and allocative norms established by sectoral ministries.

The objectives of the pilot were to

- restructure administrative units and streamline administrative procedures;
- rationalize administrative costs;
- reduce over-staffing;
- raise incomes of employees by using savings from the measures above; and
- increase levels of transparency.

Under the pilot scheme, budget appropriations to the 10 administrative units were converted into block grants, whose amounts were fixed for a 3-year period. Within these fixed budget constraints, administrative units could reallocate expenditure between line items, without having to seek special permission for a transfer of expenditures between approved budget lines. Administrative units were free to reduce staff numbers and to reprioritize between categories of administrative expenditures (with a few limited exceptions). Any savings could be retained and used to increase staff incomes through additional salary or bonuses. Thus administrative units could choose how to reduce material expenditures and eliminate unproductive staff; and the direct link between cost reductions and pay increases provided a powerful incentive to do both. However, administrative units were required to maintain previously-specified levels and standards of service.

Significant financial impacts were quickly felt. All administrative units reported considerable reductions in expenditure on administrative items, with reported financial savings in the first year of the pilots ranging from 13 percent up to 29 percent. The majority of these arose from savings on communication expenses, utility bills such as fuel, water and electricity, routine repairs and maintenance, purchasing of goods and services, printing and production of documents. Nearly all administrative units also reduced their staff numbers below the official quota-most units reduced their staff by around 15 percent (compared to the staff quota), with some making bigger cuts.

Although evidence remains quite limited, there is little evidence to suggest that service quality has declined in the pilot administrative units. Official administrative data indicate that indicators of service standards, such as waiting times, generally improved (with unnecessary layers of bureaucracy eliminated in the pursuit of savings). However, there is some evidence to suggest that some of the savings in the pilot units may have reflected deferral rather than elimination of expenditures. Almost all of them reported sizeable reductions in expenditure on routine repairs and maintenance (although major repairs were not included in the block grant).

Source: World Bank 2005.

Accountability of Local Governments

102. A recurring theme of PERs is that greater budgetary autonomy to local governments has to go hand-in-hand with increased accountability. The accountability should not just flow up – i.e., accountability of the local governments to the central government – but sideways and down as well (i.e., provincial governments should be held accountable to district governments, to village councils, and to local communities). An important means of accomplishing greater local accountability is by requiring all subnational governments to open up their proposed and executed budgets to full public scrutiny – by publishing them in newspapers or on the internet. Further, such a requirement needs to be enforced strictly, perhaps by making future central government grants to local governments contingent upon their meeting the full-public-scrutiny requirement (Khemani 2006).

103. Increased public scrutiny of local budgets is the best way of ensuring that local governments are responsive to the needs and demands of their residents, which is the main advantage of a system of decentralized governance over a system of centralized authority.

104. A number of countries have been making efforts to introduce greater transparency in local government budgets. For instance, the 2002 State Budget Law in Vietnam required that the final accounts for executed budgets *at all levels of government*, not just the central government, are made public. The law also conferred authority on the State Audit of Vietnam to conduct external audits on the revenues and expenditures of all national and subnational governments. The audit results are reported to the National Assembly. Despite these legal requirements, public availability of budgets of local governments below the provincial level (i.e., district and commune budgets) is often spotty, incorrect and delayed. The participation of local residents in the provincial, district and commune budget processes is still in a very nascent stage (Vietnam PER).

105. In Ecuador, the central government has made an effort to improve the flow of budgetary information among different levels of government since 2003. Nevertheless, reporting on local budgets remains poor. Although executed municipal and provincial budgets are required to be submitted to the central Ministry of Economy and Finance before the end of March of every year, a large number of local administrations still send incomplete information or completely disregard the rule (Ecuador PER).

Decentralization and Regional Disparities

106. While decentralized public spending is generally desirable as local governments are typically more responsive than the central government to the needs and preferences of their residents, too much devolution of expenditure responsibilities – without a concomitant increase in revenue transfers to local governments – can exacerbate regional inequalities. China provides an example of an economy that is very highly decentralized. Subnational governments account for 64 per cent of total public spending (World Bank 2002). Much of the expenditure responsibility is at the sub-provincial level, with

counties, prefectures and townships accounting for 43 per cent of national public expenditure (and provincial governments accounting only for the remaining 21 per cent).

107. It is not uncommon to find county and township governments in many Chinese provinces being responsible for two-thirds to three-quarters of budgetary expenditure on education and health and 100 per cent of expenditure for unemployment insurance and social security and welfare. These heavy expenditure responsibilities are especially onerous in light of three facts: (i) the lowest levels of government often do not have the resources to finance their expenditure assignments, (ii) the tax sharing system in China has re-centralized revenue assignments, thus depriving the lower levels of government of an important source of income, and (iii) the volume of inter-governmental transfers has not been large enough to offset the fiscal imbalance at the lowest levels of government (World Bank 2002).

108. The resulting fiscal strain has caused many counties, prefectures and townships to either shift responsibility for social expenditures down to households or to simply default on service provision. Since there is no centrally-sponsored system of ensuring a minimum level of service provision in a county or township, the poorest sub-provincial governments often have to manage with the barest of public services. As a result of these developments, inter-regional disparities in health and education services and inter-household inequalities in social outcomes have worsened in recent years.

IX. Expenditure Oversight by Citizens and Users

109. Another persistent argument in the PERs is that openness and transparency of government budgets and public expenditure form the underpinnings of public trust in government. Only if the public has accurate and timely information on the amount, pattern, and effectiveness of government expenditure can citizens hold the government accountable for its expenditure actions. Information is power, as the experience of the public expenditure tracking surveys in Uganda reveals. When residents in Uganda were informed about the amount of school budget that their communities were entitled to receive from the district government, schools managed to obtain nearly all of their earmarked budgets. Before they had this information, the volume of expenditure leakage was enormous, with district officials and politicians siphoning off the bulk of non-salary funds received from the central government for disbursements to individual schools Ablo and Reinikka 1998, Reinikka and Svensson 2000).

110. Budget transparency can be manifested in a number of different ways, including making information on budget processes and allocations publicly available, issuing timely and accurate *ex post* external audits, or in specifying *ex ante* performance targets. Recently, the IMF has developed a code of good practices on fiscal transparency, which is summarized in Box 6.

111. Peru provides an example of a middle-income country that has strived to make public its budget and expenditure information. As far back as 2000, several social programs, as well as two popular infrastructure programs, in the country began posting their district-wise expenditures on the Internet. The Ministry of Economy and Finance has an Economic Transparency website that provides detailed information on budget execution. The information provides citizens and civil society organizations with the tools to verify that expenditure outlays are actually spent as indicated by the government, that targeting is appropriate, and that there is no misuse of public funds (Peru PER).

112. In 2003, an independent group in Latin America undertook a survey on budget transparency across 10 countries in Latin America (IBP 2003). The countries were scored on budget transparency based on responses to 70 detailed questions on budget openness by a sample of legislators, journalists, academics, and civil-society organizations in each of the ten countries. Figure 3 shows the final budget transparency score for the sample countries. Chile had the highest score on (perceived) budget transparency, followed by Mexico, Brazil, Costa Rica, Nicaragua and Peru. At the other end, Ecuador has the lowest score.

113. More recently, the International Budget Project (IBP), an arm of the Center on Budget and Policy Priorities in Washington DC, has constructed an Open Budget Index based on comparative information on the transparency of national budgets in 59 countries around the world. Data were also collected on the amount of publicly-available budget information in seven key budget documents that governments typically issue during the course of the budget year. The study by the IBP concluded that 90 per cent of the countries surveyed did not meet the standard of "… accurate, timely and comprehensive

information during each stage of the budget cycle … required to ensure the accountability of government to citizens" (IBP, 2006).

Box 6: IMF Code of Good Practices on Fiscal Transparency

Clarity of Roles and Responsibilities

- The government sector should be clearly distinguished from the rest of the economy, and policy and management roles within government should be well defined.
- There should be a clear legal and administrative framework for fiscal management.

Public Availability of Information

- The public should be provided with full information on the past, current, and projected fiscal activity of government.
- A public commitment should be made to the timely publication of fiscal information.

Open Budget Preparation, Execution, and Reporting

- Budget documentation should specify fiscal policy objectives, the macroeconomic framework, the policy basis for the budget, and identifiable major fiscal risks.
- Budget estimates should be classified and presented in a way that facilitates policy analysis and promotes accountability.
- Procedures for the execution and monitoring of approved expenditures should be clearly specified.
- Fiscal reporting should be timely, comprehensive, reliable, and identify deviations from the budget.

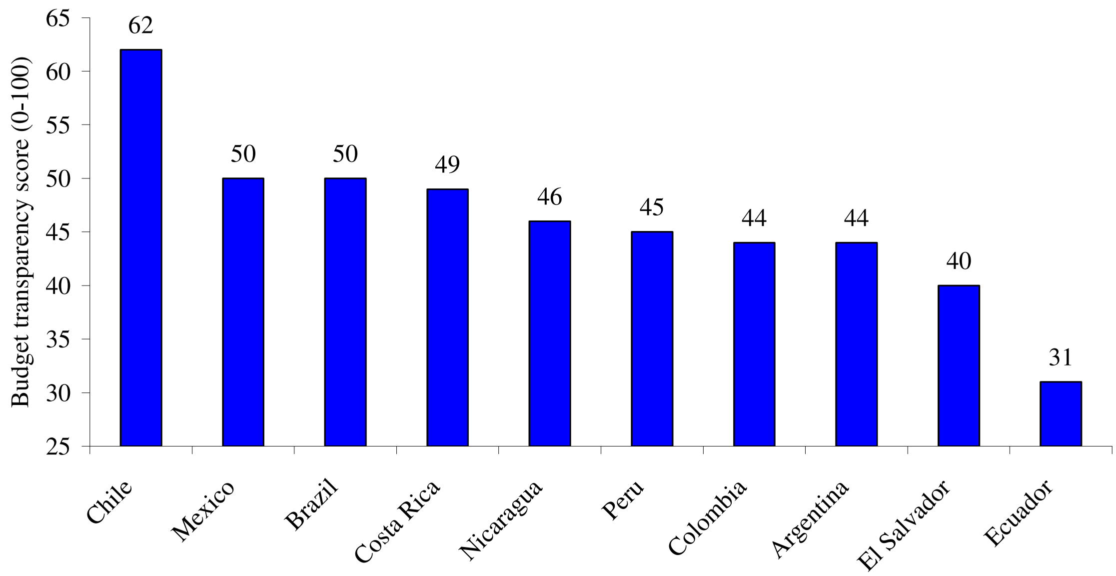
Independent Assurances of Integrity

- The integrity of fiscal information should be subject to public and independent scrutiny.

Source: IMF (2007).

114. Figure 4 shows the summary score of the 59 countries. Six countries – France, United Kingdom, New Zealand, South Africa, Slovenia, and the United States – provided 'extensive' budget information in their budget documents and scored well. In 30 of the countries, the government provided 'significant' or 'some' budget information to citizens. This group included countries in Asia (South Korea, India, Pakistan, and the Philippines), Africa (Botswana, Namibia, Kenya, and Tanzania), Latin America (Peru, Brazil, and Colombia), and Europe (Poland, Romania, Czech Republic, and Bulgaria). Finally, the remaining 23 countries provided "minimal, scant or no" information on budgets to their citizens. Again, this list included countries in all four regions.

Latin American Index of Budget Transparency



Source: "Latin American Index of Budget Transparency," 2003, report published by the International Budget Project, Lima, Peru.

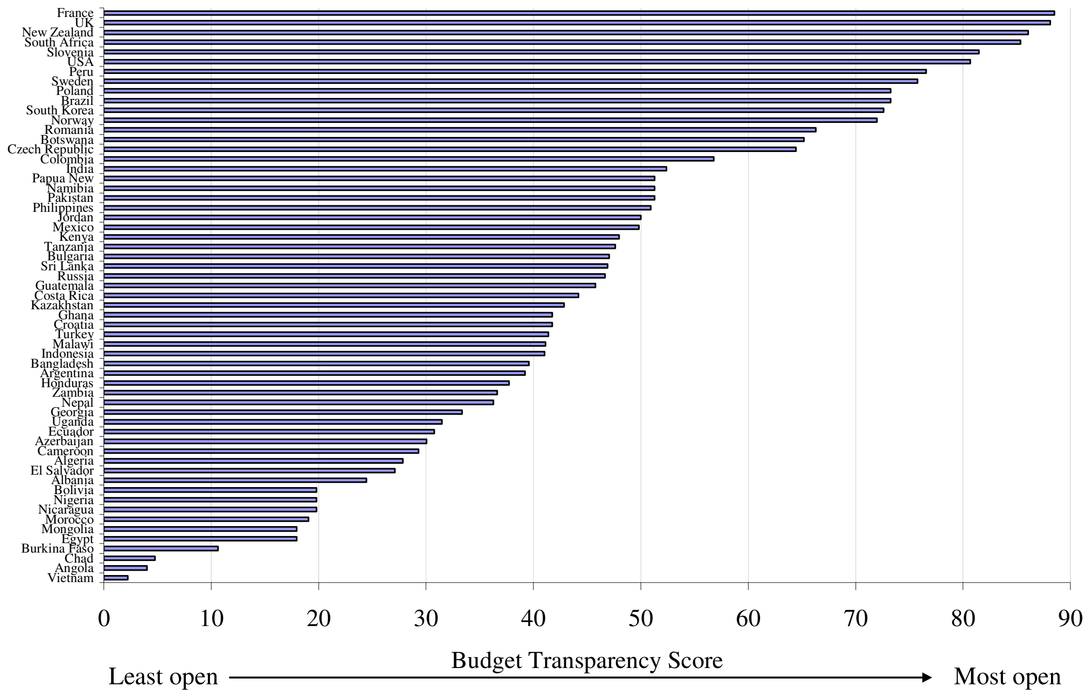
Figure 3

115. It is important to reiterate that the index only ranks the 59 countries based on the volume of budget information that they open up to public scrutiny. A low score on the index does not mean that the country has weak public expenditure management, since the latter depends on several factors, only one of which is budget accountability and transparency. The overall state of governance in a country has a significant influence on public expenditure management, so that increased budget transparency – perhaps imposed on a country by external donors – may not be able to fully offset the adverse effect of poor overall governance on public expenditure management. In the same manner, some governments might practice good governance – and manage their public expenditure well –yet not be fully open about their budget information. They may lack democratic institutions that promote effective non-government participation in the budget process. Vietnam is a case in point. The country has made significant strides in improving public expenditure management, including granting greater expenditure autonomy to its subnational governments. By most indicators, its public expenditure policies are more efficient, equitable, and responsive to local needs than those of, say, Kenya even though the Open Budget Index ranks Kenya higher than Vietnam.[10]

[10] Note that inter-country comparisons of public expenditure management and effectiveness are notoriously difficult.

Figure 2

Open Budget Index, 59 countries, 2006



116. Subnational governments often do not have the same degree of transparency in budget and expenditure decisions as the central government. One reason for this is lower capacity; for instance, sub-national governments often have less technical capacity and expertise (relative to the central government) to audit their expenditures in a timely and comprehensive manner. But another reason may be related to the public spotlight focused on national versus sub-national governments. In most countries, central government expenditure decisions receive a great deal of attention from the media, public watchdog agencies, foreign donors, and international organizations such as the World Bank and the IMF. In contrast, local governments, especially at the sub-provincial level, are not in the public spotlight to the same degree, simply because there are far too many of them for the national media and international donors to watch and monitor. In turn, this suggests that there might be large returns from efforts by civil-society groups to rank sub-national governments on their budget transparency and to publicize widely these rankings.

117. Finally, it is important to note that the publication of ‘league tables’ of national and local governments on their expenditure effectiveness can translate into real improvements in the effectiveness of public spending only if there an awareness and interest in government budget issues in the population at large. Unfortunately, the state of budget literacy in most low- and middle-income countries is woefully inadequate. Not only is the general population ignorant of budget and public expenditure issues, even grass-roots NGOs, journalists, and legislators are ill-informed about (and mystified by) budget matters. In such a situation, it is difficult for legislators to ask the right questions on public spending to government bureaucrats and Treasury officials in budget legislative

sessions, or for journalists to probe issues of the misuse of public funds. It is also difficult to get citizens energized about public expenditure mismanagement.

92. An example of a grass-roots organization devoted to increasing the level of budget literacy is Unnayan Shamannay (or Development Coordination) in Bangladesh. Unnayan Shamannay's objective is to try to de-mystify intricate budget documents for the lay person. Unnayan Shamannay develops budget manuals for lay-people, development practitioners, and even school children (with production titles such as "Government Budget Made Easy" and "Budget-Making for Schools."). It has developed illustrated books for children on the concept of household and government budgets. Unnayan Shamannay also conducts regular training programs in budget analysis and village-needs assessment for union *parishad* (village council) heads and members. Finally, the organization holds press conferences immediately after the government releases its budget to clarify the budget numbers to journalists.

92. Another grass-roots organization that has done much to increase budget literacy among legislators is the Development Initiative for Social and Human Action (DISHA) based in the Indian state of Gujarat. DISHA is a social activist movement that began in 1985 with the objective of changing power relationships in society to bring about social change benefiting the poor. DISHA started by working in the tribal belt of Gujarat, representing the tribal groups (which are among the poorest and weakest sections of rural Indian society) in their demands for increased services and resources from the state government and for an increased tribal allocation in the state budget. DISHA gingerly embarked on probing the complexities of the Gujarat state budget to figure out exactly how much was being spent by the state government on tribal development schemes, and then advocated for a larger budgetary allocation to tribal programs and to villages located in tribal areas.

92. The idea behind DISHA was simple – viz., to better understand state government budgets and state finances, thereby equipping NGOs and mass organizations to lobby the state government with better, sharper, and sounder arguments for increased resources to fight poverty. DISHA educates elected representatives – from village councils all the way to the state legislature – to use the budget information to lobby for the desired changes in state budget allocations. It also helps frame questions which elected representatives can raise and debate in the budget sessions of the state legislature. The budget data are also provided to all grassroots-level NGOs working in the state. Finally, another of DISHA's advocacy tools is to submit written questions and recommendations to the State Finance Commission.

92. Though DISHA mainly concentrates on Gujarat, it has lately started training people in participatory budget analysis in about 12 other Indian states. In addition to its budget literacy programs, DISHA also undertakes social audits of the state government and its programs. For instance, it sends out letters to village *sarpanches* (heads) about development work earmarked for a particular village or cluster, such as a road link or percolation tank. It seeks feedback on whether the work was performed or not. If the projects have not materialized and the figures prove otherwise, DISHA approaches the relevant estimates and the vigilance committees.

92. Thanks to its efforts, state legislators in Gujarat are much better informed on budget issues, and budget discussions in the state legislature have come alive in recent years. Legislative representatives are quoting figures, analysis, and their own interpretations in the state legislatures. This has forced government bureaucrats to be much more alert during the budget discussion. Additionally, the budget information collated and interpreted by DISHA has forced the Gujarat state government to allocate and spend more public resources on tribal regional development and tribal schemes and programs. Finally, the Gujarat state budget now contains fewer arithmetic, calculation and accounting errors than it used to before. The Finance bureaucracy (or a handful who are involved) has become alert now that organizations like DISHA are probing carefully into the budget figures.

X. Concluding Remarks

118. This review of PERs suggests that here has been significant progress in public expenditure management in low- and middle-income countries during the last two decades. A number of these countries have adopted comprehensive budget legislation, reduced waste and inefficiency in public expenditure, given greater budget autonomy to local governments, and attempted to open budgets to public scrutiny. Nearly 40 countries around the world, led, surprisingly, by Africa, have adopted the Medium-Term Expenditure Framework to guide budget formulation and execution. The MTEF has allowed countries to introduce a multi-year perspective in annual budgets and has helped coordinate budgeting across sectors and across functions (e.g., recurrent and capital spending). Likewise, scores of countries now use the public financial management (PFM) performance measurement framework, launched in 2001, that provides consistent information for monitoring and evaluating PFM performance. Although it is too early to evaluate the full effects of this framework, there is little doubt that use of this framework has improved the quality of public financial management. Likewise, the use of the international standard for budget classification – viz., the Government Finance Statistics (GFS) 2001 – has considerably improved the coding of budget estimates in many countries, and helped identify more clearly the details of expenditure allocations to education, health, water, agriculture, roads and general activities. This in turn has enabled the introduction of performance budgeting in several countries. Naturally, there has been uneven progress on all these fronts, with some countries having gone much farther in expenditure reform than others.

119. Yet there are several areas in which both the study and practice of public expenditure management can be improved. First, as noted in Section III, despite some progress, budget formulation in most developing countries still largely remains an incremental and mechanistic exercise, with excessive attention paid to inputs and not enough attention to outputs and outcomes. A part of the problem is that the complex web of relationships among project interventions, sectoral policies, public expenditure, household socioeconomic outcomes, and major development goals are poorly understood by policy-makers and indeed by the entire development community. During the last few years, with the emergence of the millennium development goals (MDGs) as the basic yardstick of development, increasing attention is being paid to the identification and costing of sectoral and cross-sectoral interventions that can help countries attain the MDGs. However, this research is in an embryonic stage, and has yet to yield much operational insight. As a result, there is simply not enough clarity on what levels – and composition – of public expenditure are required to attain specific policy goals.

120. Another reason for the tenuous link between a country's strategic objectives and its level and pattern of public expenditure is, of course, the vastness of most national bureaucracies. When there are scores, if not hundreds, of Ministries, departments, provinces, and local governments involved in the expenditure process, it is understandable that there will be a lag between a change in national priorities and the reflection of these priorities in the national budget. This is also the reason why it may be easier for local governments, which are leaner and presumably more nimble, to adjust

their budgets more swiftly in response to changing priorities or in response to their residents' needs and wishes.

121. The dearth of analytical and empirical research on the associations among projects, policies, public expenditure, and development goals results in a second, related problem with public expenditure management. While virtually all of the PERs reviewed in this paper address the issue of public expenditure effectiveness, they tend to focus more on *what steps* a country can typically take to improve the effectiveness of its public spending based on best practices or on the experiences of other countries rather than on *how a country can measure* the effectiveness of its spending in the first place. Measuring the effectiveness of public spending – especially its impact on household and community outcomes – is notoriously difficult, not only because there are many contemporaneous events influencing outcomes (for which it is difficult to control) but also because public spending can have externalities outside the sector in which the spending takes place. In addition, outcomes are measured very differently across sectors, and many outcomes do not have clear market value (e.g., infant deaths averted or the number of children prevented from becoming malnourished). All of this makes it very difficult to construct – and compare – measures of expenditure effectiveness across sectors. Of course, it is analytically less complicated to compare the effectiveness of public spending on different interventions *within a single sector* (e.g., formal versus non-formal education, or prenatal care versus child immunizations), but few PERs have ventured into these types of comparisons of spending effectiveness across interventions. As a result, our knowledge of what type of specific interventions are best suited for a specific sector within a particular country continues to be quite limited.

122. This is where a microeconomic focus – a focus on communities – could make a big difference. For instance, a comparison of the unit cost of providing an identical service across several different municipalities might not only be methodologically straightforward but also extremely revealing about expenditure effectiveness across communities. This is, in fact, what the Center for Budget and Policy Studies (CBPS) in Bangalore attempted during the period 1998-2001. The CBPS studied detailed budget documents, and obtained information on the level of infrastructure created and maintained (e.g., number of street lamps, bore wells, kilometers of roads, and tons of solid waste handled) for each of 12 urban municipalities in the state of Karnataka. Based on these data, the CBPS calculated the unit cost of providing and maintaining different types of infrastructural services across the dozen city municipal councils (CMCs). An interesting finding was that there were very large variations in the unit cost of providing basic services across the CMCs. For instance, the cost of installing and maintaining a city street lamp varied by a factor of more than 10 from one CMC to another. The findings of the study were an eye-opener for council-members in some of the CMCs, which had not realized that their municipality was paying considerably more for street lamps than a neighboring municipality. Although a follow-up survey was not done by the CBPS, it is very likely that the disparities in unit costs across CMCs declined drastically after publication of the CBPS findings.

123. The CBPS example highlights the importance of competition in improving expenditure effectiveness among local governments.[11] When one local government learns that it is getting fewer services or goods for the same amount of spending as a neighboring local government, it has a strong incentive to compete with the neighboring government in getting more "bang for its buck" – in other words, improving the cost effectiveness of its public spending. It does not matter how this incentive comes about – it could, for example, arise because the local government comes under pressure from its citizens or council-members after the information about unit costs is made public.

124. As noted earlier, improving expenditure effectiveness at the local level is vitally important, as problems of budget execution, elite capture, and misuse of funds are particularly egregious at the local government level. In most countries, the national budget is already under a great deal of scrutiny – from citizens, civil-society organizations, bilateral donors, and multi-lateral organizations (such as the World Bank and the IMF). However, because of their large numbers and geographical dispersion, local governments are often not subject to the same degree of attention. As a result, there are greater opportunities for local governments to misuse public funds or to use them less-than-effectively.

125. There is thus a strong need for public expenditure reviews at the sub-national level. Most of the PERs conducted by the World Bank have restricted themselves to national budget and expenditure decisions. At most, some of them have a chapter or two on local financing. However, very few PERs have been done at the provincial level and almost none at the sub-provincial level.[12]

126. It is unrealistic, however, to expect a multilateral organization such as the World Bank to undertake the thousands of sub-national PERs that would be required. Not only would the task be impossibly onerous for a single organization, it is not clear that a centralized group based in Washington or even in a nation's capital would have the community-specific knowledge and resources required to conduct sub-national PERs. This is where there is a clear role carved out for grass-roots-based civil society organizations (CSOs). The CSOs could be composed of local citizens, community workers, social activists, and teachers, all assisted by professional accountants and/or researchers familiar with budget issues. Research support to the CSOs could be provided by budget research groups that are already present in most countries – organizations such as the Center for Budget and Policy Studies (CBPS) in India, Unnayan Shamannay in Bangladesh, Center for Policy Analysis in Ghana, and the Centro de Investigación de la Universidad del Pacífico (CIUP) in Peru.

[11] In principle, it is possible to improve public expenditure effectiveness across countries in the same manner – viz., by fostering greater competition among them. However, inter-country comparisons of public expenditure effectiveness are significantly more complicated because of large differences in culture, history, context, and social conditions across countries.

[12] To date, the World Bank has conducted provincial PERs in very few countries – China, India, Vietnam and Pakistan. Even in these countries, PERs have not been done for all the provincial/state governments – only for a few (e.g., Maharashtra in India and Punjab in Pakistan).

127. An analogy can be drawn to the Human Development Reports (HDRs) that were pioneered by the United Nations Development Program (UNDP) in 1990 (UNDP 1990). The HDR is a review of the state of human development – measured primarily by health, education and income outcomes – across countries. Initially – at least for several years after its initial launch – the HDR was a global report, prepared almost exclusively by the UNDP head office in New York (albeit with inputs from country teams). Beginning in 1992, the UNDP began promoting national HDRs, the preparation of which was delegated to government and civil society organizations in individual countries.[13] Subsequently, many countries began undertaking sub-national (typically state- or province-level) HDRs,[14] and found these to be useful planning tools to inform policy dialogue and shape specific HD policies. More recently, a few countries have begun preparing district-level HDRs.[15] Civil-society organizations are heavily, if not exclusively, involved in district-level HDR preparation. Since the inception of the first global Human Development Report, more than 420 national and subnational HDRs have been produced.

128. Another often-overlooked issue in the PERs is the state of 'budget literacy,' which is woefully inadequate in most low- and middle-income countries. There is wide-spread ignorance of budget and public expenditure issues among ordinary citizens, grass-roots NGOs, journalists, and legislators. This makes it difficult for legislators to ask the right questions on public spending to government bureaucrats and Treasury officials in budget legislative sessions, or for journalists to probe issues of the misuse of public funds. It is also difficult to get citizens energized about public expenditure mismanage-ment. This is why improving budget literacy in the general population is a prerequisite to holding the government accountable for its expenditure decisions. Very few PERs have addressed the issue of bringing greater budget literacy to the population.

129. With increased budget literacy in the population, it may be possible for multi-lateral organizations, such as the World Bank, to include CSOs in the PER preparation teams. The participation of civil society is already common in the preparation of poverty assessments by the World Bank. However, PER teams do not typically include members of civil society. Since civil society is ultimately the beneficiary of improved public expenditure management, the inclusion of this stake-holder in the PER preparation process is imperative.

130. Finally, in undertaking this review of PERs, we found that, although national PERs are broadly similar in their overall scope and objectives, they differ a great deal in the type of data on public expenditure that they report. The lack of consistent and compa-rable data on public spending patterns and outcomes across countries is a serious impedi-ment to conducting a rigorous comparative analysis of expenditure trends and effective-

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[13] Bangladesh and Cameroon prepared the first national HDRs in 1992, followed by Botswana (1993) and the Philippines (1994) and Egypt (1994).

[14] One of the first subnational HDRs was the one prepared by the state of Madhya Pradesh in 1995. Since then, 16 states in India regularly produce their own HDRs. Several other countries in Africa, Asia and Latin America also produce their own sub-national HDRs.

[15] For instance, seven states in India – Madhya Pradesh, Himachal Pradesh, Karnataka, Tamil Nadu, Rajasthan, Sikkim and West Bengal – now produce district-level HDRs.

ness. The PEFA framework discussed in Section VI of this paper has brought a much-needed comparative approach to the study of *public expenditure* and financial management *processes and institutions*. The PEFA framework results in the collection of identical data on 31 public financial management indicators in each country. Likewise, it would be useful to introduce a similar comparative data-collection framework to the analysis of *expenditure patterns and outcomes*.

131. Some may fear that requiring each country or sub-national unit to collect and report comparable data on an identical set of expenditure and budget indicators might straitjacket the PERs and rob them of their country relevance, since each country faces a unique set of public expenditure issues and challenges that need to be addressed by that country's PER. However, this is a fallacious argument, as observed by the fact that the PEFA framework has not inhibited discussion of, and attention to, inter-country variations in budget processes and institutions.

132. What this paper advocates instead are national and sub-national PERs that are tailored to the specific needs of different countries and sub-national units but which nevertheless collect and report comparable data on a common (and minimum) set of budget and public expenditure indicators across countries and sub-national units. Obviously, the common list of indicators would need to be developed by an expert global committee after extensive consultations with governments, civil society organizations, and multilateral financial institutions. While it is beyond the scope of this paper to propose the indicators in such a common list, we have listed in Appendix Table B a few key indicators on which we were unable to obtain consistent and comparable data from the PERs we reviewed.

Appendix Table A: List of PEFA Indicators

A. PFM-OUT-TURNS: Credibility of the budget	
PI-1	Aggregate expenditure out-turn compared to original approved budget
PI-2	Composition of expenditure out-turn compared to original approved budget
PI-3	Aggregate revenue out-turn compared to original approved budget
PI-4	Stock and monitoring of expenditure payment arrears
B. KEY CROSS-CUTTING ISSUES: Comprehensiveness and Transparency	
PI-5	Classification of the budget
PI-6	Comprehensiveness of information included in budget documentation
PI-7	Extent of unreported government operations
PI-8	Transparency of inter-governmental fiscal relations
PI-9	Oversight of aggregate fiscal risk from other public sector entities.
PI-10	Public access to key fiscal information
C. BUDGET CYCLE	
C(i) Policy-Based Budgeting	
PI-11	Orderliness and participation in the annual budget process
PI-12	Multi-year perspective in fiscal planning, expenditure policy and budgeting
C(ii) Predictability and Control in Budget Execution	
PI-13	Transparency of taxpayer obligations and liabilities
PI-14	Effectiveness of measures for taxpayer registration and tax assessment
PI-15	Effectiveness in collection of tax payments
PI-16	Predictability in the availability of funds for commitment of expenditures
PI-17	Recording and management of cash balances, debt and guarantees
PI-18	Effectiveness of payroll controls
PI-19	Competition, value for money and controls in procurement
PI-20	Effectiveness of internal controls for non-salary expenditure
PI-21	Effectiveness of internal audit
C(iii) Accounting, Recording and Reporting	
PI-22	Timeliness and regularity of accounts reconciliation
PI-23	Availability of information on resources received by service delivery units
PI-24	Quality and timeliness of in-year budget reports
PI-25	Quality and timeliness of annual financial statements
C(iv) External Scrutiny and Audit	
PI-26	Scope, nature and follow-up of external audit
PI-27	Legislative scrutiny of the annual budget law
PI-28	Legislative scrutiny of external audit reports

D. DONOR PRACTICES	
D-1	Predictability of budget support
D-2	Financial information provided by donors for budgeting and reporting on project and program aid
D-3	Proportion of aid that is managed by use of national procedures

Source: World Bank, 2005, "The Public Financial Management Performance Measurement Framework, Washington DC (Reprinted May 2006, PEFA Secretariat, World Bank, Washington DC). www.pefa.org

Appendix Table B: Illustrative list of expenditure indicators on which consistent and comparable data are not usually available from reviewed PERs

Overall

- Aggregate government expenditure (in absolute terms, on per-capita basis, and as % of GDP)
- Sources of government expenditure (e.g.,
- Public and private expenditure in key sectors (e.g., agriculture, defense, education, health, infrastructure, etc.)
- Deficit of the consolidated public sector
- Total amount of expenditure arrears, by source (e.g., losses of state-owned enterprises)
- Gap between budget and realization (i.e., original budget estimates and actual expenditures)
- Amount of off-budget expenditure, by source (e.g., user fees, donor projects, commodity revenues, etc.)
- Province- or state-level public expenditure per capita, by sector (in absolute terms, on per-capita basis, and as % of GDP)
- Economic composition of public expenditure (personnel, materials, maintenance, travel, interest payments, subsidy, transfers to local governments, social assistance, development, capital, etc.)
- Total expenditure on subsidies by sector (fuel, food, fertilizer, power/electricity, other utilities, etc.)

Sectoral

- Public and private expenditure on education

- Economic composition of public spending on education (personnel, materials, maintenance, travel, interest payments, scholarships and bursaries, subsidies, transfers to local governments, development, capital, etc.)

- Functional composition of public spending on education (e.g., pre-primary, primary, secondary, higher, non-formal)

- Benefit incidence of public spending on education (i.e., % of public expenditure benefiting different income/consumption quintiles)

- Pupil/teacher ratios by level of schooling

- Average teacher salaries by level of schooling

- Geographical/regional distribution of public spending on education, in comparison to geographical distribution of net student enrollment rates and literacy rates

- Public and private expenditure on health

- Economic composition of public spending on health (personnel, materials, maintenance, travel, interest payments, subsidies to hospitals, transfers to local governments, health insurance subsidies, development, capital, etc.)

- Functional composition of public spending on health (e.g., hygiene and sanitation, communicable disease control, nutrition, primary health centers, medical training and education, curative medical services, administration, etc.)

- Public spending on health by level (e.g., primary, secondary, tertiary)

- Benefit incidence of public spending on health (i.e., % of public expenditure benefiting different income/consumption quintiles)

- Health insurance coverage by region/province

- Geographical/regional distribution of public spending on health, in comparison to geographical distribution of infant mortality rates and life expectancy

- Size of health workforce (doctors, nurses, midwives) per 1,000 population and number of primary health facilities per 1,000 population by region/province

- Public and private spending on infrastructure

- Economic composition of public spending on infrastructure (personnel, materials, maintenance, travel, interest payments, subsidies, transfers to local governments, development, capital, etc.)

- Functional distribution on infrastructure (e.g., electricity, transport, water and sanitation, telecoms, etc.)

- Infrastructure coverage (e.g., % of population with electricity coverage, with access to piped water, with sanitation access, road density, percent of roads that are paved)

- Geographical/regional distribution of public spending on infrastructure

- Public and private expenditure on agriculture

- Economic composition of public spending on agriculture (personnel, materials, maintenance, travel, interest payments, subsidies, transfers to local governments, development, capital, etc.)

- Functional composition of public spending on agriculture (expenditure on various programs, such as farmer debt forgiveness, agricultural cooperatives, etc.)

- Benefit incidence of public spending on agriculture (i.e., % of public expenditure benefiting different income/consumption quintiles and different land-owership groups)

- Geographical/regional distribution of public spending on agriculture, in comparison to geographical distribution of crop yields

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