Public Expenditure Management in Developing Countries

March 2001

Research Institute for Development and Finance
Japan Bank for International Cooperation
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Upon the establishment of JBIC, the Research Institute for Development and Finance (JBICI) was created as its research arm. Its research activities are geared toward improving the overall quality of JBIC's operations through systematic analysis of various issues and policies related to JBIC's activities. JBICI was established by merging the two former research institutes: the Research Institute for International Investment and Development (RIIID) of JEXIM and the Research Institute of Development Assistance (RIDA) of OECF.
Foreword

Government always plays vital roles in the process of economic development, but the status has changed dramatically in accordance with the political situation. When excessive policy interventions and their harmful influence were criticized, privatization of some parts of the government functions started. After we have realized that privatization does not always show good performance, the initiative of a government in the development process has been accordingly recognized again. Collaborating with the international/bilateral donors, some developing countries attempt to build up the capacity of government and improve the outcomes of policy intervention for development, in the 90s with the application of some developed countries' experiences on the public sector reform. The reform of this kind is called “Public Expenditure Management Reform”, which particularly focuses on the expenditure side of the fiscal system.

The Research Institute for Development and Finance of the Japan Bank for International Cooperation (here by referred to as JBICI) recognized the significance of Public Expenditure Management in the near future of development assistance and implemented a research project named “Public Expenditure Management in Developing Countries” as Special Assistance for Development Policy and Project (SADEP) in 1999 and 2000. JBICI consigned case studies of the Philippines and Pakistan to the study team consisting of Consulting House the Minerva’s Owl and SHINKO Overseas Management Consulting, Inc. This research paper aims at introducing the result of the consigned study and JBICI’s original research.

In conducting the research, we received the multifaceted support of the governments and related institutions of the Philippines and Pakistan and the staff of the Asian Development Bank, International Monetary Fund, and World Bank. Dr. Soshiro Osumi, Professor of Economics at Niigata University kindly gave us a lot of profitable comments and suggestions to the study in terms of New Public Management theory. We would like to express our deepest gratitude to all these people.

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<th>Full Form</th>
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<tbody>
<tr>
<td>ABC</td>
<td>Activity-Based Costing</td>
</tr>
<tr>
<td>ABM</td>
<td>Agency Budget Matrix</td>
</tr>
<tr>
<td>AD</td>
<td>Agriculture Department, Punjab</td>
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<tr>
<td>ADB</td>
<td>Asian Development Bank</td>
</tr>
<tr>
<td>A/Ps</td>
<td>Accounts Payables</td>
</tr>
<tr>
<td>ASOSAI</td>
<td>Asian Organization of Supreme Audit Institution</td>
</tr>
<tr>
<td>AusAID</td>
<td>Australian Agency for International Development</td>
</tr>
<tr>
<td>BOT</td>
<td>Bureau of Treasury</td>
</tr>
<tr>
<td>BSP</td>
<td>Banko Sentral ng Pilipinas</td>
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<tr>
<td>BTr</td>
<td>Board of Treasury</td>
</tr>
<tr>
<td>CAP</td>
<td>Country Assistance Plan</td>
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<tr>
<td>CCPAP</td>
<td>Coordinating Council on Philippines Assistance Program</td>
</tr>
<tr>
<td>CDF</td>
<td>Comprehensive Development Framework</td>
</tr>
<tr>
<td>CNAO</td>
<td>China National Audit Office</td>
</tr>
<tr>
<td>COA</td>
<td>Commission on Audit</td>
</tr>
<tr>
<td>DA</td>
<td>Department of Agriculture</td>
</tr>
<tr>
<td>DBCC</td>
<td>Development Budget Coordinating Committee</td>
</tr>
<tr>
<td>DBM</td>
<td>Department of Budget and Management</td>
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<tr>
<td>DECS</td>
<td>Department of Education, Culture, and Sports</td>
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<tr>
<td>DF</td>
<td>Development Function</td>
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<tr>
<td>DILG</td>
<td>Department of Interior and Local Government</td>
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<tr>
<td>DOF</td>
<td>Department of Finance</td>
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<tr>
<td>DPWH</td>
<td>Department of Public Works and Highways</td>
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<tr>
<td>EO</td>
<td>Executive Order</td>
</tr>
<tr>
<td>ESW</td>
<td>Economic and Sector Works</td>
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<tr>
<td>FE</td>
<td>Forward Estimates</td>
</tr>
<tr>
<td>GAA</td>
<td>General Appropriations Act</td>
</tr>
<tr>
<td>GAB</td>
<td>General Appropriation Bill</td>
</tr>
<tr>
<td>GAAP</td>
<td>Generally Accepted Accounting Practice</td>
</tr>
<tr>
<td>GARO</td>
<td>General Allotment Release Order</td>
</tr>
<tr>
<td>GASS</td>
<td>General Administrative and Support Service</td>
</tr>
<tr>
<td>GOCC</td>
<td>Government Owned and Controlled Corporation</td>
</tr>
<tr>
<td>GOP</td>
<td>Government of the Philippines</td>
</tr>
<tr>
<td>GP</td>
<td>Guidelines on Operational Procedures</td>
</tr>
<tr>
<td>GTZ</td>
<td>Deutsche Gesellschaft fur Technische Zusammenarbeit GmbH</td>
</tr>
<tr>
<td>HoR</td>
<td>House of Representative</td>
</tr>
<tr>
<td>ICC</td>
<td>Investment Coordinating Committee</td>
</tr>
<tr>
<td>IRA</td>
<td>Internal Revenue Allotment</td>
</tr>
<tr>
<td>JBIC</td>
<td>Japan Bank for International Cooperation</td>
</tr>
</tbody>
</table>
LCE Local Chief Executive
LDC Local Development Council
LEDAC Legislative-Executive Development Advisory Council
LGU Local Government Unit
LIBOR London Inter-Bank Offered Rate
MDS Modified Disbursement Scheme
MEF Ministry of Economy and Finance
MIS Management Information System
MOOE Maintenance and Other Operating Expenditure
MTEF Medium-Term Expenditure Framework
MTEP Medium-Term Expenditure Plan
MTFP Medium-Term Fiscal Plan
MTMF Medium-Term Macroeconomic Framework
MTPDP Medium-Term Philippines Development Plan
MTPIP Medium-Term Philippines Investment Plan
NCA Notice of Cash Allocation
NDF Non-Development Function
NEDA National Economic and Development Authority
NGO Non-Governmental Organization
ODA Official Development Assistance
OED Operations Evaluation Department
OFWMP On-farm Water Management Programme
PAD Pakistan Audit Department
PAGF Philippines-Australia Governance Facility
PE Performance Evaluation
PEM Public Expenditure Management
PEMIP Public Expenditure Management Improvement Project
PER Public Expenditure Review
PIFRA Pakistan Improvement to Financial Reporting and Auditing Project
PIP Public Investment Program
PO People's Organizations
PPF Priority Projects Fund
PREM Poverty Reduction and Economic Management
RDC Regional Development Council
SAP Social Action Program
SLCIC Summary List of Checks Issued and Cancelled
SPPPBS Synchronized Planning-Programming-Budgeting System
SUC State Universities and College
T/A Technical Assistance
UNDP United Nations Development Programme
VFM Value-for-Money
WB          World Bank
WSRP        Whole Spectrum of Reforms in the Public Sector
WUA         Water Users Association
WYSIWYG     What You See Is What You Get
Introduction

Public Expenditure Management (PEM) reform is a continuous process of redefining the role of government and the whole public sector since their roles are not permanently set and should be adapted to developments in the world. Recently PEM has been introduced not only in developed countries but in developing countries.

The basic idea of Public Expenditure Management is the way the government and public sector should work to improve their economic management and to increase the nation's welfare. This is quite a traditional approach for the government and public sector, but there are many new concepts and practices. One of the new concepts is "Management". Economic management has been one of the important roles of the government, but the area which economic management handles is getting wider and deeper according to economic developments in both developed and developing countries. A lot of information which was never handled by governments some decades ago, nowadays should be processed to make a national plan, compile a budget, implement the budget, and conduct other procedures, which need more capacity than before. Processing this information, the traditional institutional setting had been loosing its effectiveness. In addition, recently, economic growth in developed countries is getting flatter and the financial situation is getting tighter. This caused governments to change their policy from rapid growth to staple growth so that the size of the government and public sector started to be revised. Information grows but the number of civil servants does not increase. One of the ways to solve this problem has been to foster an 'effective and efficient working government and public sector'. The concept of "Management" is being introduced in order to break through these difficulties. In line with this concept, various reforms were introduced. For example, more manageable frameworks are being discussed and the most local capacity friendly reform is being introduced into the planning and budgeting process for more integrated style. In each civil servant's section, department, and ministry, and in local and central governments, their structure of responsibilities started to be reconsidered. Devolution is one of the important concepts to reconsider in their structure.

There are other points which are taken up in parallel with the government and public sector's situation above. One of them is the role of the private sector and non-governmental activities. As they develop, they have played an important role for economic and social development and they have replaced the role of the government and public sector. Not only has this replacement taken place but a new role also has emerged in private sector and non-governmental activities. Expanding
the concept of the "effectiveness and efficiency" of "Management", and ensuring accountability is one of the important issues in the PEM process so that private sectoral and non-governmental activities can admit governmental and public sector's activities. The part of the role which the government and public sector solely had played for a long time, is being divided and shifted to private and non-governmental activities. National process is being managed mutually more by the government and public sector, and private and non-governmental activities.

In the light of the above, our research attempts to analyze two cases: the Philippines and the Province of Punjab, Pakistan, based on the analytical framework which is traditional but newly reexamined for PEM research. Then, we conclude the research with a brief discussion of practices in PEM reform.
Chapter I. Analytical Framework

1.1 Public Expenditure Management Cycle

It is the fundamental concept of this study to consider the Public Expenditure Management (PEM) as a cyclical management process that is universally applicable to any organization, whatever entity functionally organized to achieve its common objective efficiently, economically and effectively, regardless whether it works in a private or a public sector of an economic society. The management cycle consists of "Plan", "Do", "See" and “Feedback" processes, or they are more realistically interpreted in the context of PEM as "Plan/Program/Activity", "Budgeting", "Execution", "Evaluation" and "Feedback" stages, respectively. The effectiveness of a PEM structure and operation should be viewed from the perspective of whether these cyclical processes are properly structured (a static aspect) and are smoothly working (dynamic aspect) or not.
The field study conducted in Pakistan and the Philippines identified major findings at each stage of the management cycle to support effective PEM operation enabling smooth transition from one to the next.¹

¹ For further information, see Appendix 1.
Table 1.1  Major Elements of PEM

<table>
<thead>
<tr>
<th>Stages of PEM Cycle</th>
<th>Major Elements</th>
</tr>
</thead>
<tbody>
<tr>
<td>From “Plan/Program/Activity” to “Budgeting”</td>
<td>Departure from Incremental “Line-Item Budgeting” to “Activity-Based Budgeting” (Budget Projectization)</td>
</tr>
<tr>
<td></td>
<td>“Costing” as a Base for PEM Cycle (Costs Directization)</td>
</tr>
<tr>
<td>From “Budgeting” to “Execution”</td>
<td>Internal Control System</td>
</tr>
<tr>
<td></td>
<td>Compliance Audit by External Auditors</td>
</tr>
<tr>
<td>From “Execution” to “Evaluation”</td>
<td>Financial Statements based on Generally Accepted Public Accounting Standard</td>
</tr>
<tr>
<td></td>
<td>Performance Statement</td>
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<td></td>
<td>Multi-Layered Performance Evaluation System</td>
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<tr>
<td>From “Evaluation” to “Feedback”</td>
<td>Internal Monitoring System of Feedback Action</td>
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<td></td>
<td>Feedback Monitoring by External Auditors</td>
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</table>

1.2 Objectives of Public Expenditure Management

This section shows how public expenditure is analyzed in contemporary style.

1.2.1 General view

The objective of contemporary Public Expenditure Management is to focus on improving institutional arrangements and management practices to create incentives for better resource allocation, resource use and financial management. These viewpoints are based on both traditional fiscal policy and newly introduced institutional development. This section reviews its process and shows three elements of Public Expenditure Management as the analytical framework.

After WW II, the situation around fiscal policy has changed. Many discussions arose to analyze each fiscal change and the findings had been accumulated. Musgrave compiled these findings, explored the approach to frame the theory for public economy and proposed to show effective rules and principles for leading the public economy, say, an optimal theory for public accounting. Musgrave established three points below as the objectives for budgeting policy:

(‰) to adjust resource allocation

---

2 Musgrave and Musgrave (1980)
(Ⅰ) to adjust income and wealth allocation
(Ⅱ) to stabilize economy

To adjust resource allocation is related to resource allocation between the public and private sector, which has been an important issue in traditional public finance. To adjust income and wealth is to succeed from socio-public finance which was raised by the orthodox public finance school. To stabilize economy is an issue related to discussion for traditional fiscal policy. Musgrave covered many important issues about public finance and showed three roles for contemporary public finance from the viewpoint of Public Economics.

Public Expenditure Management which is making progress recently, organizes Musgrave's three objectives based on the viewpoint of new institutional economics: Ⅰ beneficiaries regard budgetary resource as commons and try to consume it as much as possible (Public Choice, Tragedy of commons), Ⅱ Depending on preferences by many beneficiaries makes it impossible to put strategic priority on political choice (Public Choice, voting paradox), and Ⅲ information asymmetry and discouraged incentive (Agency theory between central ministries and line ministries). These three objectives are as follows,

(Ⅰ) Fiscal discipline
(Ⅱ) Resource allocation according to strategic priority (Allocative Efficiency)
(Ⅲ) Effective and efficient usage of resource according to strategic priority (Operational Efficiency)

The basic ideas to accomplish these objectives are Ⅰ to introduce a clear operational method into the bureaucracy, develop the institution, and improve the quality of public resource allocation and efficiency, and Ⅱ to put emphasis on output and outcome, moving from due process. Based on these ideas, basic elements and institutional arrangement of Public Expenditure Management are analyzed on Table 1.2., using three points, Ⅰ objectives of public expenditure management, Ⅱ important information in order to attain Ⅰ's objectives, and Ⅲ accountability to support Ⅰ. This paper analyzes the case studies (the Philippines and the province of Punjab, Pakistan) using this analytical framework.

3 These three objectives are adopted in some published studies, for example, Campos and Pradhan (1996), Schick (1998), and World Bank (1998e).
<table>
<thead>
<tr>
<th>Three Basic Elements</th>
<th>(1): PEM’s Objectives</th>
<th>(2): Information for PEM</th>
<th>(3): Accountability for PEM</th>
</tr>
</thead>
<tbody>
<tr>
<td>Aggregate Fiscal Discipline</td>
<td>-Strict Constraints on total expenditure of whole public sector and deficiency&lt;br&gt;-Adjustment among central ministries (Planning Agency, Financial Ministry, Central Bank, and so forth)&lt;br&gt;-Enhancing budget management&lt;br&gt;-Incorporating off-budget expenses into on-budget expenses, based on budget principle</td>
<td>-Medium Term Expenditure Framework&lt;br&gt;-Baseline information for measuring the effects on fiscal level by policy changes&lt;br&gt;-Revising baseline information according to policy changes during budgeting&lt;br&gt;-Monitoring information from budget execution for budgeting</td>
<td>Freedom of Information&lt;br&gt;-Announcing publicly the difference between estimates and results of expenditure and deficit.</td>
</tr>
<tr>
<td>Allocative Efficiency</td>
<td>-Flexible allocation and reallocation of resources, based on each line ministry’s priority under strict budget constraint by central ministries&lt;br&gt;-Comprehensive budget including all the off-budget resources&lt;br&gt;-Objective criterion setting for policy choice or resource allocation&lt;br&gt;-Feedback of stakeholders’ preferences to budgeting process through Parliament</td>
<td>-Forward Estimates (Multi-year budgeting)&lt;br&gt;-Developing Performance Indicator for Outcomes&lt;br&gt;-Comparing efficiency among programs within a certain plan&lt;br&gt;-Measuring social impacts caused by budget reallocation based on rolling plan.</td>
<td>Freedom of Information&lt;br&gt;-Developing Performance Indicators for expenditure allocation.&lt;br&gt;-Reconciling budget and expenditure&lt;br&gt;-Reconciling Forward Estimates and budget call&lt;br&gt;-Periodical post-evaluation and public announcement (Responsibility for attaining outputs)&lt;br&gt;-Auditing the results of budget allocation by Parliament.</td>
</tr>
<tr>
<td>Operational Efficiency</td>
<td>-Independent financial management of line ministries&lt;br&gt;-Increasing self financial resources and refraining from borrowings&lt;br&gt;-Manager’s wide discretion on allocation&lt;br&gt;-Cutting operational cost according to the planned growth rate of efficiency&lt;br&gt;-Merit based personnel management</td>
<td>-Setting Output before implementation&lt;br&gt;-Allocating resources to activities following outputs (Activity Based Budgeting)&lt;br&gt;-Costing to attain outputs as efficiently as possible.&lt;br&gt;-Performance contract between executive manager and staff&lt;br&gt;-Introducing contestability in order to attain outputs&lt;br&gt;-Understanding taxpayers’ needs in order to accomplish activities.</td>
<td>-Comparing estimated output and its results.&lt;br&gt;-Reporting Performance Audit&lt;br&gt;-Announcing publicly financial statement.&lt;br&gt;-Announcing publicly financial audit reports&lt;br&gt;-Checking these above reports by Parliament.</td>
</tr>
</tbody>
</table>

The "New Public Management Theory" has lately attracted considerable attention as a theory for fiscal and institutional reform in the public sector. The "New Public Management Theory" proposes to introduce the management method from the private sector as much as possible and to make the public sector efficient under the influence of the Public Choice Theory and Principal-agent theory. Its ideas and Public Expenditure Management overlap in many parts, but application of the "New Public Management Theory" to developing countries does not mean Public Expenditure Management in developing countries. In the public sector, some parts may be reformed by applying the management idea of the private sector, but other parts may not. There exist limits where the "New Public Management Theory" can apply. In addition, management in the private sector is evaluated whether its company makes profit or not, but the
management in the public sector is evaluated through accountability which is not simply evaluated. It is sometimes difficult to measure its performance. Public Expenditure Management is closely related to the "New Public Management Theory", but it is not a theoretical approach toward the public sector but an administrative approach.

1.2.2 Fiscal discipline

There are various institutional arrangements for fiscal discipline such as constraints for total expenditure by Constitution in Indonesia and constraints by law in New Zealand and Australia, and official commitments by the legislature. In any cases, strict constraints are imposed. These constraints are set under revenue estimation through adjustment of fiscal framework among the central bank, finance ministry, and planning agency. A consistent macroeconomic program such as Medium Term Expenditure Framework (MTEF) is often necessary for budgeting. On the other hand, line ministries incline to estimate higher expenditure than actual in order to keep their budget as high as possible. A higher expenditure estimate than actual may not become a serious problem on the fiscal discipline level. However, if each budget is estimated higher than actual and is filed, it is necessary to cut those expenditures in order to attain total fiscal objectives. In this case, two types of budget, for planning and for implementation, are prepared. This causes inefficiency in resource allocation and operation.

For effective fiscal policy, it is necessary to put an expenditure ceiling on an overall level. The previous ceiling is adjusted on Forward Estimates which show the previous year's new information when public finance is under a medium-term plan. In addition, based on an overall expenditure ceiling, expenditure is monitored during its implementation in order to find the influence on the overall expenditure and baseline budget as soon as possible. This monitoring which checks the difference between projected budget and actual expenditure, contributes to feedback to both economic management during the financial year and the next year's budgeting.

From the viewpoint of institutional building for strengthening fiscal discipline, the principle of budget consistency in which total government revenue is consolidated and only the fund appropriated by the legislature can be disbursed, is important. This principle is not always followed because development of public finances caused the budget’s function to vary. However, financial authorities are usually watched by their financial market and mass communications whether they can manage fiscal policy under the situation beyond its principle. There are countries which do not have such open financial markets. In these countries, international financial institutions replace
their role.

For effective fiscal discipline, comprehensiveness and transparency are important. The off-budget fund or ear-marked fund are sometimes obstacles for fiscal discipline even in developed countries. Open rules to keep track of fiscal discipline cause off-budget expenditure to decrease. Freedom of Information is an important means to make sure of accountability. Transparency and accountability work to decrease politicians’ and bureaucrats’ deviation from their responsibility and duty because this deviation gives severe damage to them if this transparent and accountable situation is secured.

1.2.3 Allocative Efficiency

Allocative Efficiency can be attained by putting strategic priority on various policies, based on people’s opinion that try to acquire limited resources for their sake. In order to attain this objective, two problems should be solved: □ It is necessary to hear people’s opinions on which issues have priority and resources are allocated to. However, its transaction cost is high, and □ line ministries which implement its policy have more information than central ministries which put priority on the policy and allocate resources. This causes the 'principal-agent problem'.

In order to achieve allocative efficiency in budgeting, it is necessary to build institutions which have □ incentives for strategic priority, □ improvement of information needed for effective resource allocation, and □ transparent allocation procedures and results.

In addition, since resource allocation is a political process, political intervention may happen. This intervention often causes policy change even after the budget is authorized if the consulting system to hear the people’s views is weak. This may undermine the bureaucrats’ incentives. In order to avoid such a situation, in addition to securing flexible allocation and reallocation of resources, changes should be based on the full responsibility of policy makers and strategic priority supported by strict budget constraint.

In order to attain allocative efficiency, the necessary institutions ensuring strategic priority are as follows.

(□) An influential politician shows national development vision and legislates for it.
(□) At the decision making stage in setting priorities, resource availability in the medium term is examined and one priority is compared with others through a clear and objective decision criteria. Through this process, it becomes possible to connect
firmly decision making, planning, and budgeting. In this process, the civil society, private sector, and legislature take part in the discussion, and then, in turn, this policy is wildly accepted.

(Ⅰ) In order to avoid the principal-agent problem, it is indispensable for central ministries to devolve decision on budgeting to line ministries, for example, through introduction of a new program and cancellation of the stacked program. However, there is the prerequisite that central ministries can evaluate policies which are decided by line ministries on these two points: Ⅰ whether a certain policy follows overall governmental strategic objectives, and Ⅱ enough resources are kept available until the end of the policy implementation.

(Ⅱ) The countries where foreign aid is important need comprehensive and integrated management of aid money. These countries should decide strategic priority based on availability of foreign aid.

In order to secure these institutional buildings, the information below is necessary.

(Ⅲ) Forward Estimates: This is information for medium-term costs of policy which have continued for one or more years. This may include both development expenditure and recurrent expenditure without policy change.

(Ⅳ) Information for output and outcome in each policy

(Ⅴ) Information for cost, output, and outcome while a new policy is under preparation

In order to have reliable and timely information, it is necessary to have a fair accounting system and rules, financial and non-financial management information system, and the ability to monitor and evaluate in administration. In addition, an independent and external audit function is a very important element for control and balance.

After preparing the budget, the administration proposes the budget as the government's decision to the legislature. Whatever appropriation system is adopted, the administrator should show information about the projected cost, actual expenditure, output, and outcome of each policy.

Each implementation ministry has the responsibility for monitoring consistency of policy which is under implementation. The legislature and planning ministries require implementation ministries and agencies to adjust the gap between actual expenditure and projected expenditure of each sector and program and to report officially output and outcome which are actually attained. Through these processes, policies approved for appropriation, are monitored.
In addition, by increasing transparency and accountability, it becomes possible to secure incentives for politicians and government staffs to follow rules. Especially, in developing countries, premises to follow laws and rules are not often satisfied. In order to secure this, it is effective to show how costly it is to break these rules.

(Ⅰ) To publish a budget which shows financial allocation and to present clearly outcomes of the policies which are appropriated in the expenditure plan. This can be used to require them to show the reason why certain policies are changed by politicians or the government.

(Ⅱ) To examine and publish the gap between actual expenditure and projected budget, the gap between Forward Estimates and the revised plan for rolling. This requires the government to explain the reason for revision. Without any reason, the government cannot change priorities.

(Ⅲ) To conduct periodical post-evaluation and publish its result. This causes policy implementation ministries and agencies to continue to have responsibility to attain outputs on a medium-term basis.

(Ⅳ) To foster parliament's institutional basis and its members' ability to evaluate government programs. If parliament can examine government performance properly, it becomes possible to put pressure on the government to follow the expenditure plan. In order to secure this, it may be good idea to appropriate more money for the parliament's staff hiring so that more experienced staff for evaluation can increase.

1.2.4 Operational Efficiency

Improvement of operational efficiency has been discussed under civil service reform. However, it contributes not only to fostering ability and incentives but becomes a basis for public sector reform in the long run. From the viewpoint of Public Expenditure Management, operational efficiency means independent management of implementation ministries and agencies, and merit-based evaluation.

(Ⅰ) Independent management of implementation ministries and agencies.

ⅰ Output which should be attained is set at budgeting and both the recurrent expenditure and development expenditure’s allocation to projects or programs according to output makes it possible to clearly show the relationship between a record of how the money was spent and output. In the budget system, a shift from Line-Item Budgeting to Activity-Based Budgeting is necessary. However, it seems when an Activity Based budgeting is introduced, it is often found that there is only a rearrangement of the Line Item budgeting. Thinking in Activity-Based Budgeting is
not well fostered. An Activity-Based Budgeting should be formulated to focus on accomplishment of output as efficiently as possible, managing both recurrent expenditure and development expenditure.

 Funds to implement policy basically do not depend on resources through loans. Financial demand changes variously due to many reasons. If its deviation is within projection and considered to be handled, the upper level of its deviation should be adopted as a projected amount. When its demand deviates beyond its projected amount due to a change of the macroeconomic situation or priority, its policy should be changed so that the demand may be adjusted. However, if the fund for the demand decreases without policy change, there is a very high possibility to be stuck with its implementation.

 Increasing efficiency for policy implementation is set as quantitative objectives in some developed countries. According to its improvement rate, operational cost is deducted from the budget. This is one possibility to get out of incrementalism in budgeting.

 It is important to proceed to devolve responsibility to accomplish output and the right to decide usage of financial and human resources to accomplish it, to a manager. This includes decision to carry the budget forward to the next year's budget and to move up the next year's budget to this year's budget. As such an important decision devolves, the managers bear heavy responsibility to accomplish output. Output and cost which previously are set, are audited by internal auditors and external auditors. External auditors conduct not only a compliance audit but a performance audit as well. It should be noted that accountability is secured only when the right to make important decisions for various input is devolved under strict constraint. When the right for important decision is not enough, it is difficult to attain strict objectives for output and cost.

(_Var) Merit based management

 There are some important points for merit based management. Since some of them overlap with the part above, these are briefly explained below:

 Responsibility for output with financial and human resources,

 Definite objectives and work (This mainly means clear output and outcome which should be accomplished),

 Introduction of performance contract between manager and staff, and

 Accountability for their right.
Chapter II. Donor Assistance

2.1 Public Expenditure Review

2.1.1 Overview

Public Expenditure Review (PER) executed by the World Bank stands for a process that analyzes the budget process, its system, and the fiscal system of a government, and its report. The first PER was conducted in the 1950's, but PER in the context of Public Expenditure Management started in 1980's. Though the actual results of PER before 1979 were only three cases, the achievement has since increased dramatically and a dozen of PERs have been done every year. This is because the developing countries constantly faced a budget deficit after the 1980's and couldn't finance the counterpart fund on their development project. PER has been adopted as a basic tool when the Bank's loan officers examine the management of the macro-economy of the recipient country and the consistency between a development project and their development plan. The World Bank has also made use of PER as an important instrument in the policy dialogue with the counterpart countries. The importance of PER is now getting greater and greater both as an indispensable element for the practice of the "Comprehensive Development Framework (CDF)" and as an important instrument.

During 37 years from 1957 to 1993, 70% of the PERs were executed in Africa and in Latin America. On the other hand, there have been fewer cases in Asia. For example, 20 cases were conducted in Africa, but only four in East Asia and nine in South Asia, in 1996.

The contents of a desirable PER that has these important roles are as follows. Though every PER has its own stress, Swaroop (1999) suggests that the typical PER contains such information as:

1. Analysis and prospects of revenue,
2. Decision on the structure of expenditure and its allocation,
3. Evaluation on the fund allocation within a sector and among sectors,
4. Review on the state owned companies,

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4 This part is written mainly based on Urade (2000).
5 World Bank (1997a)
6 World Bank (1998b)
(α) Review on the structure of governance, and
(β) Review on the functions of the public sector.

2.1.2 Some Implications of Public Expenditure Review - Problems in Public Expenditure Management in five Asian countries.

The purpose of this section is to review some PERs and to find out the typical problems in the budget process in the developing countries. It indicates how to make good use of PER for operations of their development projects.

We reviewed five Asian countries' (Pakistan, Laos, Indonesia, Cambodia, and the Philippines) PERs and found a lot of issues in their public expenditure management. We'll introduce them along with the budget process in this section. Dividing the budget process into three stages - budget formation, budget execution, and monitoring and reporting -, we will discuss the problems in the budget process, the probability of inconsistency between the plan and actual consequences, the World Bank's suggestion, and its implications to JBIC's loan operation. However, it is difficult to compare the budget processes of all five countries because each PER doesn't contain the same subjects.

(1) Budget Formation Process

Generally, we can see a budget formation process as a negotiation process to allocate budget resources between each line ministry and Ministry of Finance, between the central government and each local government, or in the parliament, among a variety of committees, and line ministries. In some cases, a variety of interest groups or donors may participate in these processes. Because their decisions are not necessarily consistent with the optimal allocation of all of the budget resources of the country, there happen to be problems such as inferior projects preceding a priority project or the implementation of a project is delayed. In the sections that follow, we will examine these kinds of problems in terms of allocation between the recurrent budget and development budget, the position of a single year budget in the medium- or long-term development plan, the position of a development project in a single year budget, and the transfer between the central government and local governments.

(α) Allocation between Recurrent Budget and Development Budget

If you examine the allocation process between the development budget and recurrent budget, you can easily find the common tendency in a lot of countries that the appropriation for the development budget has priority over that for the recurrent
budget. The PERs point out that the budget for new development projects tends to have priority over the estimate of the recurrent budget of completed projects because of lack of a policy framework within a sector.

Though each country has prepared a medium-term development plan, its linkage with a single year budget is generally weak. Each country makes a five-year development plan as the medium-term development plan, but a single year budget tends to reflect it only partially.

For example, in Laos, the development budget is prior to the recurrent budget because of these three reasons: To begin with, the recurrent budget that the State Planning Committee plans in the framework of its five-year plan (Public Investment Plan) is different from the recurrent budget that the Ministry of Finance appropriates in the single year budget; Secondly, the allocation to the new development projects tends to have priority over the operation and maintenance of completed projects; Finally, the recurrent budget of projects assisted by foreign countries is not estimated in detail when discussing the Loan Agreement for them.

(Ⅰ) Position of a Single Year Budget in the Medium- or Long-term Development Plan

The position of each project in a single year budget is often decided by political judgment rather than objective analysis. Therefore, there's a strong possibility that the optimal resource allocation intended in the medium-term development plan tends to be distorted. One of the reasons for this is that a ministry who makes the medium-term development plan doesn't have the right to form a single year budget.

In these five Asian countries, the budget resources of local governments are largely dependent upon the one of the central government. Therefore, fiscal transfers from the central government to local governments often have a large impact on the development or recurrent cost of a project executed by a local government. Some countries initiate decentralization, but don't succeed because of the weak linkage between the central government and local governments, and so on.

(2) Budget Execution Process

In the budget execution process, a variety of institutional problems indicated below cause execution delays or distortion of resource allocation, and that leads to diminishing the effect of a budget activity.

In Pakistan, the Ministry of Finance tends to delay budget execution and that has
a negative impact on the project execution because the Ministry of Finance and the Planning Commission share the budget powers.

In Laos, the central government pays about 85% of the budget resource of the public sector appropriated to the Public Investment Plan for local governments through each line ministry. Therefore, the local governments manage the public expenditure of the line ministries, but the management system doesn’t work well. Problems such as lack of clear segmentation of budget powers between the central line ministries and its local agency or arrears of counterpart funding often delay the budget execution.

Budget execution in Cambodia is considerably centralized. The Ministry of Economy and Finance is basically supposed to approve almost all of the expenditure of each line ministry. However, this system often leads to a loss in the efficiency of the budget process because it is very difficult for the line ministries to manage their programs or projects flexibly. Another problem is the appropriations of the government budget. Priority of projects is often changed unofficially. Because of these problems, the execution tends to be different from the budget.

The Philippines has attempted various reforms in the budget process to execute the priority projects in a timely way but they have ended up without much results because of the reasons below:

(□) The Congress often inserts projects that have its preference into the budget. (That makes line ministries modify the budget again and leads to arrears in execution.)
(□) The Congress has not approved the Medium-Term Philippines Investment Plan (MTPIP) drawn up by the National Economic and Development Authority (NEDA). Therefore, there are no brakes on the Congress to insert its new projects.
(□) The line ministries and NEDA do not necessarily have the capacity for evaluating the projects and programs properly.
(□) Hard negotiations for prioritizing the projects and programs between the line ministries lead to neglect of the priority decided in the President's Proposals.

(3) Monitoring and Reporting System

In this section, we will examine whether the monitoring system and reporting system described in the PERs can become a part of the budget cycle. The budget activity does not conclude within a one-year process because the new budget plan must reflect the results of audit of the previous year.

(□) Monitoring System
Pakistan lacks the necessary conditions for an effective monitoring system: reasonable and adequate flow of budget information, an independent monitoring agency, sufficient resources, feedback to the budget formation process, and so on. The audit system of Pakistan lacks the capacity in itself and independence from the government. The Pakistan Audit Department (PAD) does not work sufficiently because it has to function as an auditor not only of agencies but also of the government.

Laos does not have an independent audit system of public sectors. So, a limited number of auditors in the Ministry of Finance are in charge of auditing in a haphazard way, but their capacity is not so sufficient. They do not work as a part of budgetary process based on fixed criteria.

The lack of a monitoring system in Cambodia is terribly serious. They do not have a system that confirms expenditure in sectors or sub-sectors. The reason is that the line ministries lack an adequate auditing system and sound financial management. The government is preparing the Audit Law and the corresponding Auditor General’s Office. The Office is supposed to report the results of auditing to the Parliament after an enactment. If a Law on Accountability of Public Managers that is currently under examination will be enacted, the improvement in the capacity of auditing can be anticipated through the penalties, disciplinary measures, and counsels based on the criminal law.

In the Philippines, a lot of institutes monitor the budget executions. Especially, the National Economic and Development Authority (NEDA) and the Coordinating Council on Philippines Assistance Program (CCPAP) monitor the aid-funded development projects in detail. The Parliament obliges line ministries to report their cumulative allotment, incurred/liquidated obligations, total appropriations, the results of expended appropriations, and so on. It is said that the Parliament does not make the most of data efficiently because the amount of the data is huge and cannot grasp the actual circumstances of appropriations. In addition, the Commission of Audit (COA) is by the Constitution bound to monitor the budget transactions of the government and is in charge of the Management Audit of the evaluation of the cost efficiency and management efficiency of projects, but its capacity is not satisfactory.

(☐) Reporting System

In the context of the Public Expenditure Management, the purposes of the financial reporting system are:
- Monitoring the budget deficit and its finance,
- Managing the cash flow and debt of the government,
- Monitoring the disbursements of the governmental expenditures, and
- Offering analyses to help the policy formation and the performance evaluation.

The financial reporting system of Pakistan does not play such roles. Classification of the appropriation items is out-of-date and that is not only for Public Expenditure Management but for financial management. Some of the data are administrated neither by the ministry that did the appropriation nor by the Pakistan Audit Department. To make matters worse, the data often have flaws.

On the other hand, the Ministry of Finance in Cambodia draws up the monthly audit information in the budget reporting system called TOFE. The data are used for the administration of the monthly budget planning, actual revenues and appropriations, and procurement sources. The accounting department in a line ministry also makes use of them as the basic data to get the approval of the appropriation from the financial controller of the MEF.

2.2 Technical Assistance of the World Bank and Asian Development Bank

Technical assistance plays a vital role in the development assistance strategy of the World Bank and Asian Development Bank. It is also an important tool of their assistance for Public Expenditure Management. In this chapter, we will discuss their technical assistance as one of the important instruments of the assistance for Public Expenditure Management. We will begin by introducing the procedure and case of the World Bank's technical assistance, and then go on to examine those of the Asian Development Bank.

2.2.1 World Bank's Technical Assistance

The World Bank prepares technical assistance (T/A) and the Public Sector Reform Loan as assistance instruments for Public Expenditure Management. The Public Sector Reform Loan is a new loan scheme that was developed within the framework of Public Expenditure Management. Besides, the World Bank employs its conventional T/A as a tool of support for the Public Expenditure Management reform of the recipient countries.

The World Bank will select T/A after the operation of the Public Expenditure Review. They conduct the assessment of the Public Expenditure Management of their recipient countries through PER. Therefore it proposes T/A or a Public Sector Reform
Loan for the assistance of strengthening the PEM.

As an example, take the Public Expenditure Management Improvement Project (PEMIP) that was conducted in the Philippines and commenced in early 1999. The major objective of this T/A is to improve the Public Expenditure Management in the light of changing development needs and the role of the government as well as the need for increased efficiency and impact. This T/A study is intended to support the government in establishing a Medium-Term Expenditure Framework (MTEF) and strengthening the performance measurement, monitoring, and reporting in the budget process. The draft final report of the study submitted to the Department of Budget and Management by the consultant team shows some important findings of this T/A study. Three major points are:

1. MTEF leads to the improvement of Aggregate Fiscal Discipline by enabling the government entities to estimate the future public revenues in reference to the long-term macroeconomic framework;
2. MTEF enriches Operational Efficiency through Forward Estimates that shows financial constraints of the government in the future; and
3. Strengthening performance evaluation leads to accountability of the implementing agencies through fostering their incentive to improve the performance and incentives.

2.2.2 Asian Development Bank's Technical Assistance

Implements for the PEM assistance of the Asian Development Bank are T/A and loan operation like the Public Sector Reform Loan of the World Bank.

ADB ranks Public Expenditure Management as one of the important components of the governance issues. The Program Departments examine the governance of each sector of the recipient country and discuss with the central government or local governments through a Country Operation Strategy study. Reflecting the results of this process, the Country Assistance Plan (CAP) will be executed. If any problem is found in the country's governance, an Advisory T/A will be provided and the appropriate policy to meet it will be included in CAP. The Program Departments will practice Economic and Sector Works (ESW) that includes the evaluation of organizational and managerial capacity of the assumed executing agencies in case the study leads to providing any kind of loan.

In addition to such an Advisory T/A, ADB prepares an Advisory T/A for the purpose of promoting privatization and reforming the law and regulation system to improve the governance of a project or program in a particular sector in which the ADB is concerned, and Regional T/A in reforming the public sector. (Source: ADB, Guidelines on Operational Procedures (GP) - Governance, 1994) Though the governance of the
recipient countries differ greatly from each other, loan officers are supposed to consider executing these T/As, if necessary, when operating a project or program.

(1) Cases of Advisory Technical Assistance of ADB

As mentioned above, ADB conducts some T/As for the purpose of fostering or strengthening the ability of Public Expenditure Management of the Developing Member Countries. In this section, we will survey these three T/As as examples: Sri Lanka (T/A for Strengthening Public Expenditure Management), Mongolia (Governance Reform Program), and Indonesia (A study of Public Expenditure Management in Indonesia and the Implication of Decentralization).

The Programs Department West is preparing for the T/A for Sri Lanka. This is a Cluster T/A consisting of a plural T/A and the whole amount of the budget is US$300 million. It aims at modernizing their public financial management system. The following are details of the assistance for the executing agency, the Ministry of Finance.

(ᾲ) Improving Public Investment Programming (PIP-Detailed Forward Budgets) that will lead to a three-year Medium Term Expenditure Framework (MTEF).
(ᾳ) Improving Internal Auditing System.
(ᾴ) Developing the finance law.
(᾵) Introducing computerized Management Information System (MIS) developed all over the government.
(ᾶ) Reviewing the existent computerized financial reporting system and reacting to the Y2K problem.

Supported by ADB and other donors, the government of Mongolia started an ambitious and comprehensive survey for public sector reform from 1996, including inspection studies in New Zealand and Australia which successfully completed public sector reform. The results are organized as a report, "The Whole Spectrum of Reforms in the Public Sector (WSRP)" that shows a comprehensive framework of the public sector reform in Mongolia. The government made a long-term action plan for 10 years (1999-2009), set down the initial three years (1999-2002) as the pilot phase, and drew up a pilot program consisting of two parts: ῀ Improvement of financial management of the public sector, and ῄ Administrative reform in five public institutions. They designed it to accomplish the reform of all of the public sector by diffusing the offspring of this pilot program. The purpose of this "Governance Reform Program" is to assist the government of Mongolia in executing the pilot program.

In this program, the ADB provides T/A for three areas as follows amounting to
US$1.8 million with a program loan:

(I) Strengthening the capacity of the Ministry of Finance in the Public Expenditure Management,
(II) Strengthening the capacity of the Secretariat for performance evaluation of this program, initiation for the administrative reform, and the prevalence of the results of the reform, and
(III) Supporting the five institutions that are the targets of the administrative reform in the reforms in two aims.

In this connection, ADB will be mainly in charge of strengthening the capacity for making a Medium-Term Expenditure Framework and the rest of the fields are divided with other donors, because the fields that need donor's assistance are so wide.

After the sequence of the disturbance of the Asian Crisis, Indonesia is reviewing its Public Expenditure Management in consideration for decentralization that they are planning to undertake in the near future. Assisted by the "Financial Governance Reform Program" of ADB, the government of Indonesia is carrying out comprehensive research on Public Expenditure Management reform, "Research Study on Public Administration Reform". Providing various kinds of T/As, "A study of Public Expenditure Management in Indonesia and the Implication of Decentralization" of ADB complements this research and intends to reinforce their Public Expenditure Management by disseminating ideas of Public Expenditure Management and evaluating the present system.

The most notable point of this T/A is an effort to establish desirable Public Expenditure Management by donors' collaboration with the Indonesia government. Ten people are supposed to be selected from the Ministry of Finance, BAPPENAS, the Department of the Interior, some local governments, and universities, as the participants in the collaboration.

(2) T/A for establishing and strengthening the national audit system

ADB makes much of the role of the public audit system when establishing the governance of a country and supports the strengthening the national audit system of the Developing Member Countries with Advisory T/As. The contents of T/A support depend on the level of the development of the national audit system of a recipient country because it varies widely by country. The minimum requirement for a public audit system is the existence of the institution, benchmark, and regulation for audit. Some countries are lacking even this requirement, but others are asking for highly
advanced support for a comprehensive performance audit of projects as an audit for
development. ADB is now supporting Indonesia (Capacity Building for Financial
Governance - Assistance to BPKP), China (Technical Assistance to the People's
Republic of China for Strengthening the Government Auditing System), and Laos
(Technical Assistance to the Lao People's Democratic Republic for Establishing the
National Audit Office) etc. Indonesia has a higher-level audit system in Asia, but in
contrast, Laos is reconciled to a low-level. China is in between.

Laos does not have an independent institution for public audit. So, the
Department of Inspection, which is one of the departments of the Ministry of Finance, is
in charge of that function, but it does not have staff with sufficient expertise in
accounting and auditing. Therefore, what this department can do and actually does is
an irregular inspection as a half measure. Under these circumstances, the contents of
T/A to Laos will start with making rules and regulations of audit and preparing for
establishment of an independent public audit institution, "National Audit Office", from
scratch.

On the other hand, Indonesia has prepared a national audit system, BPKP, which
has an adequate ability to audit and an audit standard and an audit manual that was
developed by them. The T/A has highly sophisticated contents, such as strengthening
their capacity to prepare the extension of the scope for performance auditing to the
national development project, beyond the financial audit or compliance audit.

China already has the rules and regulations for public audit and its audit system.
In addition, the National Audit Office (CNAO), which has offices on the national,
provincial, and prefectural level, and a total of 80,000 staff members, is in charge of
public audit as an independent national audit institution. The T/A will proceed as
follows:

(Ⅰ) Examining the audit standard of China and its validity, as compared with the
principle of audit that was considered to be generally fair and valid, and adjusting it
to the international standard while taking the conditions of China into
consideration,

(Ⅱ) Drawing a blueprint for a new audit standard of China on the basis of (Ⅰ),

(Ⅲ) Attempting audit reflected in this blueprint as a pilot experiment. In this process,
examining practical applicability of the blueprint and fostering the ability of CNAO
are expected, and

(Ⅳ) Connecting the defects of CNAO dug out in the process of (Ⅲ), and designing and
implementing training programs.
Finally, as an example of Regional T/A, we will take up the "Long-term Regional Training Program 1996-2000 for Members of ASOSAI (Asian Organization of Supreme Audit Institution)" to establish and strengthen the national audit system of the member countries.

Complying with the request of ASOSAI in 1995, ADB decided to provide a long-term training program for external auditors and has implemented it until now. The scope of this T/A includes strengthening the organizational capacity of ASOSAI and each country's Supreme Audit Institution, enhancing the coordination of the member countries, and supplying the equipment for making and implementing the intra-regional training programs by the end of 2000. The T/A is divided into two phases: The main objective of the 1st phase is making and implementing training programs that met the needs of each member country; The 2nd phase is implementing sub-regional training programs especially for the transitional economies and two independent programs. The 1st phase was finished before the summer of 1999, and the 2nd phase started from the fall in three ASOSAI member countries including Japan. In the meantime, the Office of International Affairs, Research Division, Secretariat, the Board of Audit of Japan, substantially functions as the secretariat for implementing this T/A.
Chapter III. Case Studies

New Zealand and Australia

In this section, we will discuss the features of Public Expenditure Management reform of New Zealand and Australia as advanced cases from the view of our study framework. As we mentioned before in this paper, Public Expenditure Management has three frames of reference: such as Aggregate Fiscal Discipline, Allocative Efficiency, and Operational Efficiency. First, we will examine their budget processes from the three frames of reference. Then, we will continue to discuss their similar/dissimilar characters.

3.1 New Zealand

3.1.1 Background

New Zealand was faced with a serious economic recession during the low 1980’s after the aggravation of the terms of trade in the late 1960’s, the oil crises in the 1970’s, and the failure of the interventionist policy of the government. However, Roger Douglas, the finance minister of the David Lange’s Labor cabinet that was formed in 1984, implemented a liberal improvement policy, called “Rogernomics”. The economy made a remarkable recovery with the economic reform. The characteristics of the reform are as follows:

(Ⅰ) Starting with the reform of Operational Efficiency, then going onto Allocative Efficiency, and finally undertaking Aggregate Fiscal Discipline.
(Ⅱ) Building the incentive structure based on contracts.
(Ⅲ) Evaluating the actual results by comparison with the specific object of a government activity.
(Ⅳ) Employing output as performance indicators.

3.1.2 Privatization of State-owned Enterprises

Privatization of State-owned Enterprises in New Zealand proceeded based on the State-owned Enterprise Act (established in 1986). Through the three stages below, the reform proceeded by introducing the managing method of a private company to the

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7 There is a great deal of literature which discusses the reforms in New Zealand and Australia. For example, see Campos and Pradhan (1996) or Schick (1998).
public sector.

1st stage: Corporatization of the operation divisions or departments of line ministries.
2nd stage: Deregulation of the sectors where the corporations are doing business.
3rd stage: Achieving the full privatization by disposal of assets of the corporations.

### 3.1.3 Reorganizing the central ministries

In the process of the public sector reform in New Zealand, the central ministries were reorganized, separating them into policy-making ministries and executing ministries. Though the United Kingdom, which practiced the same kind of reform as New Zealand, separated the policy-making division and executing division by establishing agencies in a ministry, the specific characteristic of New Zealand's reform was based on independently separating the policy-making ministries and executing ministries.

Furthermore, the Public Sector Act (1988) and the Public Finance Act (1989) restructured the labor market of the public sector. The Public Sector Act, that is aimed at applying to public officials most of the articles of the new labor standards law, (i) clarifies the roles and responsibilities of a minister and undersecretary, (ii) introduces the recruiting and contracting system of the undersecretary for only five years, and (iii) grants the undersecretary the discretion and responsibility of the personnel management. The Public Sector Act yields to the undersecretary the discretion and responsibility of the budget management to produce public goods and services.

By these two laws, each minister and undersecretary is supposed to win contracts called a "Performance Agreement" and "Purchase Agreement". A Performance Agreement is a single-year policy target set by each line ministry, based on the medium-term policy target of the whole government entity, and mainly consists of the "Key Result Area" that shows the objectives of the public activities of each ministry. A minister who is supposed to buy goods or services from his or her ministry will make a Purchase Agreement with the undersecretary. The Purchase Agreement is a contract between the Minister as a purchaser of output of his or her line ministry and the chief executive as a supplier of it, and stipulates the type, quantity, quality, cost, and timing of an output, and a specific object and its evaluation method of a budget activity.

### 3.1.4 Introduction of full accrual-based budgeting

The Public Finance Act also changed the public accounting system to Generally Accepted Accounting Practice (GAAP) that is same as a private company's accounting
system. This enables an undersecretary to efficiently manage the budget of his or her ministry by clearly grasping how much of asset and debt the ministry has. It was based on the concept that an undersecretary with discretion should be able to manage the portfolio freely corresponding to the budget constraint.

### 3.1.5 Keeping Aggregate Discipline

Finally, the Public Responsibility Act (1994) makes the government keep a commitment to Aggregate Discipline. The purposes of this law are (i) making the budget process as accountable to the public as possible and excluding a political bias from it, (ii) setting principles of the budget activity to aim at sound management of the budget, evaluating every budget activity against these principles, and clearly demonstrating the reason in case of the deviation from the principles, and (iii) announcing the medium- and long-term budget objectives periodically.

### 3.2 Australia

With the introducing of the Forward Estimate from early 1980’s, the Australia government started to make the Medium Term Expenditure Framework (MTEF). Appropriations are made based on the Forward Estimate for the part that has no change in the strategic priority, and then the proceedings of appropriation are simplified. Therefore, a budget appropriation process that was focused on the part with changes in policy was established. The executing agencies have an incentive to save on expenditures, given much discretion. And Australia applied outcome as a performance indicator though New Zealand uses output. Australia employs outcome for evaluating the budget portfolio presented by the executing agencies and the budget allocation corresponding to it.

As a result of a series of these reforms, the total amount of the expenditure was reduced and its budget balance has got into the black. This is also due to the fact that the budget activities are classified by activity-based programs and this leads to a drastic change of the structure of the expenditures. The executing agencies become able to reconsider their programs that are not cost-effective, and then reduction and saving of the expenditures are achieved.

In contract to New Zealand, Australia started the reform process with Operational Efficiency, and then moved on to Allocative Efficiency. Finally, they undertook Fiscal Discipline, similar to New Zealand.


3.3 Similar/Different characters

As we mentioned above, the most distinguished difference in the reform processes of the budget system of New Zealand and Australia is the initial stage that each government primarily undertook. That is to say, New Zealand started with the reform of Operational Efficiency, and Australia, Allocative Efficiency. In this section, we will verify the similar/dissimilar characteristics of their reform processes.

<table>
<thead>
<tr>
<th>Background</th>
<th>New Zealand</th>
<th>Australia</th>
</tr>
</thead>
<tbody>
<tr>
<td>Direction</td>
<td>Large-scale Privatization Restructuring Role of Government (Instituting Incentive Mechanism) Achievement of Operational Efficiency</td>
<td>Efficient Allocation of Budget and Prioritizing Projects Devotion to Executing Ministries and Flexible Allocation of Budget</td>
</tr>
<tr>
<td>Accountability</td>
<td>Strong Contract for Effective Production of Output (for Solving Principal-Agent Problem)</td>
<td>Publication of Reports of Performance Evaluation and Post Evaluation (Concentration on Outcome)</td>
</tr>
<tr>
<td>Problem</td>
<td>Overlooking of Linkage between Output and Outcome</td>
<td>Lack of Sound Accountability</td>
</tr>
</tbody>
</table>

3.3.1 Similar characters

The first common feature of them is to create incentives for using their limited budget resources as efficiently as possible by strengthening transparency to the public. In New Zealand, the Public Finance Act provides that the public finance statements should be comprehensively put on an accrual accounting basis for the first time in the world. That leads to making the public finance statement obtainable and understood easily by the general public, though they were very difficult to grasp before the reform. On the other hand in Australia, publication of a reconciliation table that shows the gap between Forward Estimate and the actual allocation of the budget helps improve transparency and accountability of its budget process.

A second shared characteristic is leaving the management of a ministry to the chief executive's discretion and creating the incentive to improve the efficiency of their operation and to identify their savings option. In New Zealand, the State Sector Act ordains that the undersecretary of each line ministry does not have a conventional permanent tenure, makes contracts with the minister, and has complete autonomy on hiring and firing his or her staff and allocates their budget to the programs. Then a minister and undersecretary are supposed to contract two agreements: Performance Agreement and Purchase Agreement, as we mentioned before. Each of the line ministries of Australia holds a single running cost item that includes all administrative
and salary costs. The single running cost item as well as portfolio budgeting system contributes to identify spending and savings of the line ministries. These kinds of reforms lead to improving their allocative and operational efficiency.

Another shared characteristic is to introduce contestability in service delivery. Especially in New Zealand, they implemented a series of reforms such as making a public institution a corporation, deregulating and introducing competition with the private sector, and privatizing the corporation.

A final common feature is to keep aggregate fiscal discipline. New Zealand established the Fiscal Responsibility Act that comprehensively prescribes the disclosure of the fiscal information and rigid constraints of deficit spending and financing for the government entity. Australia prepared a system for macroeconomic planning that helps reconcile the forward estimates with the actual outlays and set a target for the budget deficit. In both countries, these mechanisms facilitate the transparency and accountability of the fiscal conditions of the government and force commitment to achievement of policy.

3.3.2 Different characters

Generally speaking, New Zealand puts more emphasis on operational efficiency: Australia, allocative efficiency. However, there is a tradeoff between operational efficiency and allocative efficiency. People may often easily misunderstand that there is a "triarchy" of aggregate fiscal discipline, allocative efficiency and operational efficiency, but it may be difficult to find out the best mixture of the New Zealand model and Australia model.

New Zealand had an inefficient and enormous public sector like former centrally-planning socialist economies. Therefore, they tried to resolve it by privatizing the public agencies and restructuring the rigid structure of the state. This led to achieving the efficient and competitive delivery of public service.

On the other hand, Australian reforms have stressed allocative efficiency as mentioned above. Its decision-making mechanism and portfolio budgeting contributed setting the priority to allocate their limited resources. It also facilitates identifying the spending and savings option within the budget of each ministry.
3.4 The Philippines

3.4.1 Budget Formation Process

(1) An Overview

The ADB's "Managing Government Expenditure" describes the history of the Philippine PEM as follows:

A generation before the emergence of the "New Public Management", a performance budgeting experiment was launched in 1954 in the Philippines, following the unsuccessful U.S. experiment. For fiscal year 1956, 12 government agencies adopted a "performance budget" model; detailed line items were abandoned and expenditures were presented in the budget by blocks corresponding to programs and projects. The system reverted back to the more traditional model, as a result of the constant complexities of the "performance budget" and some loss of expenditure control. The preparation of budget submission focuses on programs rather than on line items. However, these changes in the budgetary decision-making process are more formal than real.

The Executive Order (EO) 292 sustains the use of the above performance budgeting (as opposed to line-item budgeting) that was initiated in 1954. Although EO 292 provides that the budget estimates of the agencies include a description of their major thrusts, priority programs and projects, the results expected for each budgetary program and project, nature of work to be performed, and estimated costs per unit of work measurement, the system has essentially followed a hybrid model wherein budget items focus on programs but where some line-items are also apparent. In particular, Congress has shown a greater propensity for line-item budgeting with its concomitant itemization of various expenditure objects.

Also, the actual system at present is closer to compliance budgeting and input-oriented budgeting because of the disconnect in program structure and administrative structure and difficulties in estimating unit costs and some loss of expenditure control. On the positive side, the experiment in performance budgeting has improved the presentation of the budget and has increased the performance orientation of budget officials.

(2) Key Institutions and organizations

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Schiavo-Campo and Tommasi (1999)
In the Philippines, a number of administrative bodies individually and interchangeably play key roles in the preparation and implementation of the budget. These administrative bodies and their mutual relationship in roles and functions are in (Figure 3.1).

(_indent) Development Budget Coordinating Committee (DBCC)

At the national level, the President steers the fiscal policy formulation process through the Development Budget Coordinating Committee (DBCC) that comprises the Secretary of the Department of Budget and Management (DBM) as chairman, with the Secretaries of National Economic Development Authority (NEDA) and the Department of Finance (DOF) and the Governor of the Bangko Sentral ng Pilipinas (BSP) as members. The composition of DBCC is designed to allow for the close coordination between the planning, fiscal and monetary agencies within the government, as such a closer linkage between planning and budgeting is ensured.

(_indent) Department of Budget and Management (DBM)

DBM is mandated to assist the President in the preparation of a national resources and expenditures budget with the goal of attaining national socio-economic plans and objectives. DBM has four main program areas, covering:

- budget operations - particularly the formulation of annual and medium-term fiscal plans, and their translation into annual budget policies; plus programming releases of agency funds,
- accounting and financial services - covering the determination of cash replenishment levels of agencies; issuance of Notice of Cash Allocations (NCAs); and analysis of agency disbursements against planned targets,
- management services - covering the size, structure and appropriate staffing of the government bureaucracy; compensation; and systems improvement, and
- support services - involving support to DOF’s units in area of internal management and logistics.

(_indent) National Economic and Development Authority (NEDA)

The National Economic and Development Authority (NEDA) is the economic planning agency, with the responsibility of formulating the medium-term development

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9 NEDA-ISP (1997)
plan. It also coordinates the preparation of development plans in line agencies. Capital projects that cost more than P.300 million or involve Official Development Aid (ODA) funds in excess of US$10 million are, through the Investment Coordinating Committee (ICC), all subject to evaluation and endorsement by NEDA. Prior to application to NEDA, these capital projects for funding are identified by line agencies as well as local government units (LGUs) who forward their suggestions to the Regional Development Councils (RDCs). Together with DBCC, NEDA acts as an arbiter in settling cross-cutting policy issues.

(_indent) Department of Finance (DOF)

The Department of Finance was restructured in 1987. It is the institution charged with ensuring sound and efficient generation and management of the fiscal and financial resources of Government. It reviews, approves, and manages all public sector debt, plus the rationalization and monitoring of Government corporations and financial institutions. DOF handles the formulation of policy recommendations on taxation, government borrowing, guarantees and financial assistance in coordination with NEDA, the Central Bank, DBM and other relevant agencies. This includes development of policies to ensure maximum advantage in the use of external resources.

(_indent) Bangko Sentral ng Pilipinas (BSP)

The BSP is the central bank of the Philippines which was recently reorganized. The BSP provides policy direction in the areas of money, banking and credit, and the strengthening of supervisory and/or regulatory powers over the operations of banks and non-bank financial institutions with quasi-banking functions. The law creating the BSP prohibits its involvement in development banking or financial activities.

(_indent) Congress and Commission on Audit (COA)

Meanwhile, the legislature (Congress) has the principal responsibility for the enactment of the General Appropriations Act (GAA). However, the power of the purse that is granted to the legislative branch is constrained by the limitations on allowable budgetary actions of Congress (This will be described in details later) and the veto power of the President that is available in the Constitution.

In the budget execution phase, the Bureau of Treasury (BOT) is tasked with making fund transfers for DBM and is responsible for managing public debt. The Commission on Audit (COA) is mandated to undertake a detailed examination of the agencies’ accounting books and statements in order to ensure that all expenses were
disbursed in accordance with the accounting regulations and for the purpose for which the funds have been authorized. Likewise, DBM also monitors the status of fund releases even as the heads of agencies monitor actual physical accomplishment of the agency in relation to actual expenses incurred.

(ǐ) LEDAC

An important link between the legislative and executive branches of government is provided by the Legislative-Executive Development Advisory Council (LEDAC), established in 1992 under the Ramos Administration with a major objective of achieving consistency between development plans deemed at the executive branches and the law making priorities at the legislative branch. LEDAC, an advisory board chaired by the President of the Republic and co-chaired by the Senate President and the Speaker of the House of Representatives, has provided a regular venue in which counterparts from both branches of the government and representatives of other concerned sectors inclusive of local government units (LGUs), the private sector and the youth could discuss and harmonize their development efforts.

<table>
<thead>
<tr>
<th>Box 3.1. The Legislative-Executive Development Advisory Council (LEDAC)</th>
</tr>
</thead>
</table>
| **Membership (20 total):**  
  President (chair);  
  Vice President;  
  President of the Senate;  
  Speaker of the House of Representatives (HoR);  
  Seven members of Cabinet (designated by the President of the Senate);  
  Three members of the HoR (designated by the Speaker, one from the dominant minority party);  
  Representatives, appointed by President, for LGUs; youth; and private sector (from any or a combination of business, cooperatives, agriculture and labor). |
| **Functions:**  
  (ǐ) determine and recommend socioeconomic development goals in pursuance of established policies, which shall guide the formulation and implementation of the national development plan;  
  (ǐ) provide policy advice to the President on vital issues affecting the socioeconomic development of the country;  
  (ǐ) direct the study of measures to ensure that regional development plans and programs are integrated into the national development plan;  
  (ǐ) receive, and in inappropriate cases, require reports on, and study measures to improve the implementation of official development assistance;  
  (ǐ) assess effectiveness of implementation of the national development plan;  
  (ǐ) integrate environmental concepts, principles and practices into the national development plan for a balanced and cohesive approach to national development;  
  (ǐ) review the relationship of the legislative agenda to the national development plan to ensure the integration of both;  
  (ǐ) study and recommend to the President and to Congress sources of revenue as measures to reduce unnecessary expenditures to the end that the resources of the government will be used to the optimum. |

10 Republic Act No. 7640
(Ⅰ) Regional level Institutions

The local chief executive (LCE), i.e., the mayor and the governor for respective cities/municipalities and provinces, takes the initiative in defining the overall policy thrusts of the LGU. Notwithstanding, the local legislature (Sanggunian) plays a key role in the formulation of the local development plans and in the enactment of the appropriations ordinance. At the LGU-level, the Local Development Council (LDC) provides a venue for non-government organizations (NGOs) and people’s organizations (POs) to participate in the formulation of the plan.

(3) Budget Preparation Calendar

In this subsection, the outline view of budgeting in time framework will be given in somewhat in detail. It should be noted that since this research was conducted in January and February 2000, the budget process described here is mainly the process for FY2000. The evolution of budget mechanism in the chronological context in the Philippines is given in (Figure 3.1).

The Philippine fiscal year is identical with the calendar year. The schedule for the preparation of the budget for any given year usually starts in November or December of the second year preceding the concerned budget year with the formulation of the macroeconomic assumptions, targets and projections by Development Budget Coordinating Committee (DBCC). With these assumptive parameters, the broad outline of the budget program is developed to outline the aggregate spending ceiling, aggregate revenue target and the means of financing deficits. Subsequently, the broad budget program is submitted to the Cabinet for approval.

Following the budget submission to the Congress, Department of Budget and Management (DBM) issues sometime in January the Budget Call to the executive administrative branches. This advises of the economic assumptions to be used in the preparation of their budget requests, provides guidance on their budget ceilings, together with information on proposed salary adjustments, criteria for choosing priority projects, budget innovations for implementation, and so forth. During the period of January through March of the year immediately preceding the concerned budget year, the national agencies undertake sectoral and regional (through the regional development councils-RDCs) consultations in a bid to prepare their detailed budget estimates for submission to DBM in forthcoming April. Considerable time is also spent in consulting with DBM during the same period. Subsequently by the end of June, DBM, through evaluation and formal budget hearings with national agencies, consolidates agency budgets into the President’s Budget that is submitted to the Cabinet and the
President for approval.

By the Constitution, the President is to submit the President’s Budget to Congress by the end of the third week of July when its session is on. The House of Representatives reviews the President’s Budget and conducts budget hearings with the different national agencies through which the draft General Appropriation Bill (GAB) is crafted and submitted to the Senate by September or October. Subsequent to review, evaluation, and its own budget hearings, the Senate amends GAB and drafts its version by November or early December. Next comes the Bicameral Conference Committee that enacts GAB and submits to the President by the end of December for approval and enactment to General Appropriation Act (GAA) by the President with his signature. Consequently, DBM requires, at the outset of budget year, the national agencies to submit work and financial plans that constitute part of the documents in need for the release of allotment advice and cash allocations.

In the meantime, the budget preparation calendar applicable to the local government units is actually longer than that for the national government. Since the national government transfers are based on the revenues of the past (year t-3) and the allocation formula is known, the Local Government Unit (LGU) budget preparation could start as early as the transfer amounts are known, i.e. even before the national budget preparations. Minor adjustments can be made after the budget call by DBM. The period is thus de facto much longer.11

(4) Budgetary Reform in the first year of Estrada Administration

Under the current Administration in February 1999, Finance Secretary, Dr. Benjamin E. Djokno, presented to LEDAC members including Mr. J. Estrada the implication of the 1999 budget, while articulating specifically the new budget procedure reforms. Adoption of the WYSIWYG (What You See Is What You Get) principle, three-year-planning framework (MTEF), and direct payments to suppliers/creditors via servicing banks were, among others, the major thrusts in terms of transparency in appropriation, enhanced medium-term policy planning and budgeting linkages and fiscal discipline, and transparency/predictability in government transactions and eradication of irregular practices, in that order. Other reforms proposed included non-reserve on non-personnel services and Internal Revenue Allotment (IRA) for further efficiency and certainty in funds programming at the levels of the central administrative branches and LGUs, quarterly release of allotment for more flexibility in expenditure programming, and the Budget Dialogue Group with the

private sector in a bid to foster responsive resource allocations/procedures under the private sector participatory scheme in the economy.

In connection with the release of funds, agencies are strictly requested to comply with the "No Report, No Release of Funds" principle, with the submission to DBM of the special reports including Agency Budget Matrix (ABM), Performance Target, Annual Cash Program, and Journal Voucher to cover the previous year appropriation on the due dates as respectively specified. Further, accountability reports, notably, a Summary List of Checks Issued and Cancelled (SLCIC), A Statement of Allotment and others are also the same practice for fund release by DBM.

### 3.4.2 Aggregate Fiscal Discipline

#### (1) Legal framework for Budgeting

The legal and institutional framework for budgeting in the Philippines is well articulated in the Constitution. The Constitution stipulates that no public money is to be spent without legislative authorization (i.e., appropriation), thus making the Constitution function as an effective mechanism of budget control. It also delineates the relative power of the legislative and the executive branches of government in public finance. In the Philippines, the power of the purse that is granted to the legislative branch is counterbalanced by the possibility of presidential veto. At the same time, the Constitution defines the financial relationship between the central government and local government units (LGUs).

The parts that refer to national government budgeting, describe the form, content and manner of budget preparation, authorization, execution and accountability for the central government. Moreover, it mandates that the government budget process should be guided by the following approaches: planning and budgeting linkage, national resource budgeting, regional budgeting, and long-term budgeting.

At the local government level, the legal basis of relevance is stipulated. Not only does it define intergovernmental fiscal relations, but it prescribes the form, content and manner of budget preparation, authorization, execution and accountability for LGUs. These include the preference for the one-fund concept and the planning and budgeting linkage.

#### (2) Coordination among central ministries

In the first instance, the purpose of the framework is to ensure that the budget is
consistent with the macroeconomic policies and resource constraints. In this regard, the Development Budget Coordination Committee (DBCC) sets the overall budget obligation ceiling (i.e., maximum expenditures for current and capital expenditures) based on projections of central government revenues, including ODA, the fiscal deficit target and upper limit for new borrowings for the year. DBCC focuses on the consistency of the overall budget ceiling and financing plan with projections/targets of key macroeconomic variables like GNP/GDP growth rate, inflation rate, Treasury bill rate, foreign exchange rate, and the London Inter-bank Offered Rate (LIBOR).

In practice, the responsibility for the macroeconomic projections is fragmented. The Department of Finance (DOF) is responsible for projections of government revenue, the National Economic Development Authority (NEDA) for projections of the real sector and prices as well as ODA flows and Bangko Sentral ng Pilipinas (BSP) for projections of monetary aggregates and balance-of-payment variables. DBCC, with DBM performing secretariat function, acts as the clearinghouse that evaluates the different projections. Nonetheless, this arrangement has oftentimes resulted in the lack of consistency of the projections.

(3) Fiscal Control

The government, or DMB has two instruments of fiscal control, limited issuance of obligation authorities and other measures to keep on the track of fiscal discipline, and cash programming.

One measure of the fiscal discipline is for DBM to apply reserves on agencies' appropriations by issuing obligation authorities that are less than the appropriation cover as they appear in the GAA. Moreover, DBM may release the obligation authorities in installments over the year, or alternatively may release cash authorization in line with actual cash availability.

Another instrument DBM uses to achieve fiscal control is cash programming. In this regard, DBM in close coordination with DOF prepares the annual program of cash expenditures, including an Annual Program of Monthly NCA (the Notice of Cash Allocations) Releases. This process was initiated to ensure better control over fund releases and harmonize them with revenue collections. This process was facilitated in 1991 by the creation of an inter-agency committee on cash programming which is composed by representatives from DBM, DOF, the Board of Treasury (BTr) and bangko Sentral ng Pilipinas. The committee holds regular bi-monthly meetings to assess the fiscal performance of the national government for the previous month and discuss prospects for the following month. Anticipated revenue shortfalls in original revenue
projections are matched either with new revenue measures or with expenditure cuts to keep within the targeted deficit level for the period. The allowable level of disbursements determines the monthly ceilings for the issuance of NCAs. In the event that the estimated cash balance of the government reaches a level where budget cuts in the programmed releases cannot be avoided, DBM implements across-the-board budget reductions. Government agencies, however, continue to determine the prioritization of disbursements provided they set aside the amount necessary for the payment of salaries and other mandatory.

(4) WYSIWYG policy and Notice of Cash Allocations (NCA)

Starting 1999, DBM initiated a number of reforms in budgeting with the ultimate goal of establishing line agencies to speed up the delivery of essential public services with less paperwork. In so doing, the policy objective was set to specifically simplify the process and expedite budgetary release, by way of reducing uncertainty in allotment and cash flow, and to improve transparency, accountability, and predictability in government transactions and cash management.

WYSIWYG (What You See Is What You Get) policy was on a top of budgetary reform agenda for the current administration. Under this, the General Appropriation Act (GAA) serves as the authority of agencies to expend, thereby having allotment to national/local government agencies released comprehensively every quarter without the need for the issuance of the General Allotment Release Order (GARO). With this, the release of funds allocated to agencies accounted for some 99.3 percent as of the end October in 1999.

Further, the Notice of Cash Allocations (NCA) to facilitate payment of due and demandable Accounts Payables (A/Ps) has since the 1999 budget been released quarterly in lieu of monthly rations imposed by DBM. Consequently, adequate amounts of cash became available for administrative agencies, by facilitating more flexibility in the program and in planning their cash requirements for programs/projects. In this connection, all national government agencies were requested to open and maintain a separate Modified Disbursement Scheme (MDS) Account for accounts payables (A/Ps). In the meantime, some DBM officials advised the mission of the binding constraint currently they face of fluctuating and diminutive national revenue that inevitably led DBM in fund release (far) behind the schedule.

(5) From SPPBS to Medium-Term Expenditure Framework (MTEF)

(☐) SPPBS
In addition to the need for better coordination in the preparation of the macroeconomic projections, there is also a need for strengthening the linkage between planning, programming and budgeting. The issuance of the Synchronized Planning-Programming-Budgeting System (SPPBS) in 1990 was meant to address the problem. It was intended to improve the coordination among the budget, planning and revenue agencies so as to ensure the consistency of budget plans with development goals and available finance. This system involves the implementation of a calendar which arranges the sequence of planning, programming and budgeting activities in harmony with the relationship between their inputs and outputs; a synchronization of procedures, and the coordination of relevant documents like the Medium-Term Fiscal Plan, the Medium-Term Public Investment Plan, the Medium-Term Philippine Development Plan, and the Regional Development Investment Plans.

The concept dates back to the late 1980s. After a decade, the general assessment has to be that, in its own terms, it failed. Its started objectives are laudable, but the chosen approach of synchronization across agencies and regions (with regions in turn synchronizing with LGUs) proved over elaborate. The failure of SPPBS was not due to lack of quality, energetic personnel. The management structures for inter-agency cooperation are also there and operating remarkably well. This reinforces the conclusion that SPPBS was flawed in design - carrying a mechanical approach to plan-budget links to its logical, but impractical conclusion. Although one stated objective was "to decentralize planning, programming and budgeting powers and authority", this cannot practically be done in a manner which required detailed plans to consolidate upwards into an overall national plan. What is needed is a subtle, but important, shift of emphasis, whereby the focus is on resource ceilings being transmitted downwards, rather than on expenditure bids being relayed upwards.

( 추진 ) MTEF ( 추진 ) : Fiscal level and ceiling

These problems were expected to be addressed in the context of a Medium Term Expenditure Framework (MTEF). It is regarded as a more appropriate way of trying to achieve the objectives of the PPBS. The Government of the Philippines (GOP) embarked on budgetary reform in the Budget Call for FY2000 that signaled the implementation of MTEF. The overall objective of MTEF is perceived in the country to include 추진 enhancing planning and budgeting linkages, 추진 strengthening fiscal discipline, 추진 improving allocation of budgetary resources, and 추진 enhancing agency in program implementation.

12 NEDA-IS (1997)
In the administrative arena in the country, MTEF calls for greater integration of the planning and budgeting systems involving NEDA, the DBM, and the DOF. The framework has two salient features, vis-a-vis, a consistent set of macroeconomic and revenue forecasts, and forward estimates (FEs) of costs accruable to the ongoing programs/projects for the following two years. While the budget will still be enacted on an annual basis, proposed appropriations will be defined within the context of a six-year macroeconomic plan, the Medium-term Philippine Development Plan (MTPDP) 1999-2004, a three-year prioritized public investment plan, the Medium-term Public Investment Plan (MTPIP), and a three-year costing of agency programs, projects and activities.

The importance of a medium-term outlook in budgeting cannot be overemphasized while taking the view that most expenditures of the budget year had already been committed at the time the budget is formulated. For instance, salaries of civil servants, retirement benefits, debt service and public investment outlays are not variable in the short term, thus leading to the new budgeting perception that "any real adjustment of budget priorities has to take place over a time span of several years." It is also strongly addressed in MTPDP that predictability in the budget ceilings for government agencies needs to be ensured so as not to compromise continuity of programs/projects in need.

MTEF also divides an agency's budget into two parts, that are, the baseline (or operating) budget, and other claims over and above the baseline budget for funding of new programs and projects. The baseline budget refers to the minimum level of expenditure at which the agency will continue to operate at the current year's level and be able to perform its basic mandate and functions. On the other hand, sectoral and sub-sectoral budget ceilings for the non-baseline portion of the government budget are first determined by the Development Budget Coordinating Committee (DBCC). Subsequently, a two-track process is followed whereby department ceilings for agencies under the Economic and Social Sectors are determined by the Planning Committee in NEDA in preparing the Medium-Term Development Plan, whereas those agencies under the General Public Services and Defense Sectors are determined by DBM. The approach, thus, attempts to focus policy discussions on above-the-baseline expenditures. At the same time, the regional/spatial dimension of the budget will be taken into account through the inputs of the Regional Development Councils. This will ensure the consistency of the proposals with Regional Development Investment Programs.

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13 DBM (2000)
The annual budgetary sources in the Philippines include (1) newly generated appropriations legislated by Congress, and (2) existing appropriations previously enacted and remaining valid as an appropriation authority for public expenditure. The latter is called the Baseline Budget which includes both continuing appropriation and automatic appropriation. Continuing Appropriations refer to those available for obligatory spending of specific-purpose, or multi-year programs/projects that require incurrence of obligations beyond the budget year. Those for capital outlays, operation and maintenance expenditures are currently confined to two-year obligations. Meanwhile, Automatic Appropriations are those annually programmed for a prescribed period of years by law, thereby leading to no need of annual appropriation. Expenditures falling into this category include, among others, servicing domestic and foreign debts, retirement and insurance premiums of government employees, and net lending to government corporations.

Subsequently, the heads of the different departments agree on the distribution of the allocable component of the sub-sectoral ceilings, that is, the difference between the sub-sectoral ceiling and the total baseline budgets of department/agencies within the sub-sector, among themselves. In later years, the prioritization was essentially left to the Cabinet or DBCC.

In 1990, DBM first computed the baseline budget. Before that, the procedure that was followed in determining the sectoral and sub-sectoral ceilings changed over time. During the early part of the Aquino administration, DBM essentially determined the sectoral allocation of the budget after a series of consultations with the heads of the different agencies. This process whereby DBM and the agencies jointly determine spending priorities was found to be both time-consuming and acrimonious.

3.4.3 Allocative Efficiency

(1) Prioritization Procedure

During the preparation of the 1993 budget, the prioritization strategy was developed by DBCC's Sub-committee on Prioritization that was headed by NEDA, with representatives from DOF, DBM and the Coordinating Council for the Philippine Aid Plan (CCPAP). After making provisions for a government-wide baseline budget, the Priority Projects Fund (PPF) was created and all other agency activities are lined up against the PPF.

Prioritization for the PPF then followed a two-stage process. Projects/activities with the following characteristics were given first priority and are included in the agency budget.

(i) On-going foreign-assisted projects with an expenditure ratio (1991 expenditure obligation over budgetary release) of 60 percent or above;

14 World Bank (1992)
Projects for completion in 1993;
Projects/activities tied to program loans with budget support implications; and
Positive net revenue generating activities in 1993.

In the second stage, all other projects/activities not included under first stage were prioritized based on a point system with the following criteria: development goal, regional distribution, source of finance, and implementation capability. The weight for the regional criterion was based on poverty incidence. On the other hand, the points assigned for the other criteria were determined based on a Delphi survey of the Subcommittee members. Under the development goal criterion, social service projects/activities and physical infrastructure projects/activities received the same weight and tied for first place. Agriculture, agrarian reform and industrial development ranked a close second. The allocable sectoral and sub-sectoral ceilings were implicitly derived as the ratio of the sum of a given sector's expenditures on projects/activities that passed the hurdle rate to the total PPF.

In the preparation of 1994 and 1995 budgets, a different prioritization strategy was followed. Firstly, money was set aside for personnel services and maintenance expenditures of regular agency functions. Budget proposals of the different agencies over and above their minimum requirements were prioritized in relation to the Medium-Term Public Investment Plan (MTPIP). Specifically, only activities included in MTPIP were considered. In turn, the inclusion of projects/activities in MTPIP was decided by sectoral steering committees during its yearly review. In principle, activities are ranked on the basis of their readiness for implementation and the contribution of the activity to agency efficiency and the overall streamlining effort of the government. In practice, the choice is based on the ability of agency heads to convince the sectoral or sub-sectoral committee on the advantages of his agency's proposed activity over those of other agencies. Thus, a good deal of bargaining amongst the secretaries of the line departments drives the setting of the sectoral/agency budget ceiling. To some extent, allocation decisions are made based on the political clout of the different actors rather than on objective indicators of needs and results. DBM officials admit that apart from the formal procedure in setting department/agency ceilings described thus far, there also exists an informal appeals process through which department heads attempt to increase their budget ceilings by asking for reconsideration from the DBM Secretary or the President prior to the Cabinet approval of the same.

(2) Limitations on legislature

The 1987 Constitution provides that "no money shall be paid out of the Treasury except in pursuance of an appropriation made by law." This is generally interpreted to
mean that the legislature has the power of the purse. However, it should be emphasized that there are statutory limitations on the extent to which the legislature may influence budget allocation. On the one hand, Book VI Section 24 of EO 292 provides that Congress is not authorized to increase the proposed outlays for each expenditure item included in the President's budget. It can only reduce them. Thus, many analysts express concern about the increasing incidence of Congressional cuts on certain expenditure programs and corresponding increases in other programs/projects (or insertions of new programs) which are way beyond the authority of the legislative branch to do so. In reaction to this, the President's veto message for 1994 provided that increases in various expenditure items in the President's budget made by Congress shall only be implemented by DBM upon approval of the President himself. On the other hand, Congress asserts that it is allowed by the Constitution to realign the President's budget as long as it does not increase the overall outlay. Moreover, there is growing sentiment that the legislative branch should exercise greater control over budget allocation.

Congressional insertions/substitutions come via two routes. "They may have the strong backing of local officials and the constituents of politicians. Alternatively, they may have the backing of agency officials who are, in effect, making an end run around the President's budget and appealing directly to the Congress on behalf of their own strongly felt priorities". Congressional initiatives and insertion of new projects tend to result in an increase in the overall budget deficit. This occurs as Congress goes through the ruse of cutting debt service (even if the latter is automatically appropriated anyway). Two types of discipline are required to address this problem. First, agencies have to be disciplined so that they do not attempt to circumvent the President's Budget. Second, Congress must be willing to discipline itself. This is easier said than done.

(3) MTEF and Forward Estimates (FE)

(∎) MTEF ⊕ : Allocation level

MTEF comprises the following official documents. It is important to know that MTEF is not only documents but also is a process.

(a) The Medium-Term Philippine Development Plan (MTPDP) 1999-2004,
(b) The Medium-Term Public Investment Plan (MTPIP),
(c) The Medium-Term Macroeconomic Framework (MTMF),
(d) The Medium-Term Fiscal Plan (MTFP), and
(e) The Medium-Term Expenditure Plan (MTEP)
MTPDP is the official document revised once every six-years by NEDA and embodies the vision and policy thrusts of the administration. The latest version of MTPDP 1999-2004 spells out all the political, economic, and administrative factors pertaining to the six priority areas, vis-a-vis, delivering basic social development services, accelerating rural development, accelerating infrastructure development, enhancing global competitiveness, ensuring macroeconomic stability, and setting up and reforming governance. Above all, growth and reducing poverty is atop of the policy agenda upon these major areas of concern above.

MTPIP comprises the three-year public investment program of ongoing and new priority projects with their annual funding requirements. This priority investment table is reviewed and rolled annually in line with the change of the policy environment and the government thrusts.

MTMF is a three-year projection of macroeconomic parameters against which the fiscal plan will be drawn up. Projections and targets reflected in MTMF will, together with the policy reforms in need and the underlying macroeconomic assumptions contained therein, be reviewed at least three times (Semester-basis) a year during the initial period of MTEF.

MTEP comprises a three-year projection of baseline expenditure requirements of approved programs and projects that are rolled over annually. Renegotiation of the Baseline budget between DBM and the national agency concerned could take place during the initial stage of budget preparation if the occasion arises, or new programs/projects are proposed.

The proposed mechanisms that sequentially are aligned for transforming the conventional budgeting process to the proposed new one in pursuant to the overall framework of MTEF are impressive. The draft prescribes the two-folded approach that comprises the mechanism in implementation of the full MTEF procedure for the preparation of the 2002 and subsequent budgets and transitional MTEF system for the preparation of the 2001 budget. The former mechanism differs from the latter in the light of the use of an improved agency strategic plan as reflected in MTPDP with the assistance from NEDA, the use, to the extent possible, of output-based funding requirements that specify the cost components, expenditure fund requests that are confined to new proposals, and saving proposals being required for new expenditure requirements that specify the cost components, expenditure fund requests that are confined to new proposals, and saving proposals being required for new expenditure

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15 President Estrada pronounced in the opening remarks of MTPDP that the policy target of poverty alleviation in the country be proceeded, with the poverty incidence of 25 - 28 percent in 2004 downsizing from 32 percent in 1997.
proposals.

The full MTEF implementation mechanism comprises the four components, vis-a-vis,visor budget preparation,visor budget release for major capital expenditures and auxiliaries chargeable against special purpose funds,visor contingent liabilities, andvisor Congressional bills with fund requirements. As noted above, the transitional MTEF mechanism for the CY2001 budget requires thatvisor the above-the-baseline proposals include augmentations for existing programs/projects, andvisor no saving proposals being embodied in the light of underestimation of baseline expenditure. In the meantime, baseline-expenditure is notified by DBM to the executive administrative branches during the budget processing while being calculated based on the actual budget for three years with the inflationary adjustment. Likewise, the Development budget Coordination Committee (DBCC) issues an overall expenditure ceiling sometime in August based on the resource availability and targets predicated in the latest MTPD fiscal framework. The time frameworks for the implementation of the full and transitional MTEF budgeting are given in Figure 3.1 and 3.2, respectively.

(visor) Forward Estimates (FE)

The concept of Forward Estimates has been introduced by the Australian Government as part of its own public sector reform in the mid 1980's. The purpose of Forward Estimates is the determination of the block allocation for increased managerial flexibility. In the Philippines, experience of the baseline budget is a good basis for the Forward Estimate. For the full implementation of MTEF budgeting in the Philippines, forward estimates for the years 2002 and 2003 are to be prepared based on the 2001 budget, followed by the estimation of that for the year 2004 in November. The estimation methodology is briefly described in the following.

visor Identify major operating programs/projects, associated with major final outputs;
visor Prepare Summary Expenditure Matrix indicating detailed expense classes and major operating programs/projects for the budget year;
visor Identify cost drivers for Agency's current operating expenditures allocable to the programs/projects;
visor Aggregate cost driver data for the budget year and forecast the aggregates for the ensuing years;
visor Specify General Administrative and Support Services (GASS) expenditures and Non-Key Result Areas (KRAs28) programs as fixed costs;
visor Aggregate the official budget year data on personnel expenditures as well as maintenance and other operating expenditures (MOOE), immediately followed by declassification of those into fixed and variable costs;
Derive the unit cost per unit of administrative service;

Apply an Attrition Policy to fixed permanent personnel positions;

Forecast the level of the last cost driver (total basic salaries);

Adjust fixed MOOE, unit variable MOOE, and MOOE budgets of Non-core programs to inflation, index importations of goods and services to the foreign currency quotation rate from the budget year to the ensuing years, and continue expressing personnel services expenditures at the prevailing compensation rates;

Multiply the forecasted cost drivers with corresponding unit variable costs;

Add variable and fixed costs/budgets for Non-core programs;

Multiply the "casuals, contractual, and emergency personnel fund" and MOOE (net of retirement gratuity) by a factor equal to one minus targeted efficiency improvement rate; and

Add the expenditure items adjusted in procedure 13 above to the rest of MOOE.

(4) Performance Indicators

Faced with the urgent needs to promote a more responsive and effective government, ensure greater accountability in the use of public money, and to improve fiscal discipline and transparency, the Government of the Philippines (GOP) avowed in MTPDP 1999-2004 development and adoption of performance indicators, monitoring and reporting mechanism in the budget process.

All National Agencies and Government Owned and Controlled Corporations (GOCCs) are requested by DBM to provide their performance targets and the indicators applied to measure said targets, normally by the end of the first month of the calendar year for the ensuing budget. Subsequently, a mid-year review of the financial and physical performance of those public undertakings and entities are carried out by DBM, while taking into account the Agency's actual physical accomplishment and the cost involved in the attainment thereof against the targets committed by each of the Agencies and GOCCs at the beginning of the year. The Agency's performance as gauged during the mid-year review is to serve as a basis for either providing for additional allotment from Special Purpose Funds or withdrawal of the allotment already issued to the Agency.16

Development of performance indicators in the Philippines greatly owed to some donors' assistance. The AusAID TA was one of those financed under the Philippines-Australia Governance Facility (PAGF). In support of the Government's persistent effort since 1950's to improve public service efficiency and effectiveness for lower costs, PAGF

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16 DBM (1999)
under Australia’s Development Cooperation Program has since 1997 extended a range of technical supports to the Government and private sector organizations for pursuing economic, financial and administrative reform processes in the country, implementing political environment and policies in favor of the poor, planning/monitoring/evaluating pro-poor programs, and improving administration of justice, civil rights and democratic processes.

The overall objective of the TA is envisaged to enhance human capacity within the government in strategic planning, and performance monitoring and evaluation in line with PEM improvement. To this end, the Project will introduce the pilot performance evaluation (PE) system with indicators in the selected agencies, align the framework and the empirical findings-based key performance indicators developed under the WB-financed TA, PEMIP, and seek for advocacy for PEM reform within other oversight agencies and the Congress. With the maximum allocation of fund under PAGF of A$500,000, duration of TA is one year supposedly ending by the end of the year 2000.

<table>
<thead>
<tr>
<th>Government Agency</th>
<th>Supporting Foreign Technical Assistance</th>
<th>Donor</th>
</tr>
</thead>
<tbody>
<tr>
<td>Department of Budget and Management (DBM)</td>
<td>Country Study of Budgeting Systems</td>
<td>UNDP</td>
</tr>
<tr>
<td>Ditto</td>
<td>Public Expenditure Management Improvement Project</td>
<td>World Bank</td>
</tr>
<tr>
<td>Ditto</td>
<td>Performance Management-Education, Training and Advocacy</td>
<td>AusAid</td>
</tr>
<tr>
<td>National Economic and Development Authority (NEDA)</td>
<td>Strengthening the Planning Capacity of NEDA Project</td>
<td>GTZ</td>
</tr>
<tr>
<td>Commission on Audit (COA)</td>
<td>None</td>
<td>N/A</td>
</tr>
</tbody>
</table>

3.4.4 Operational Efficiency

(1) Reengineering Bureaucracy

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17 These include the large-scale implementing agencies, vis-à-vis, the Departments of Agriculture (DA), Interior and Local Government (DILG), Education, Culture, and Sports (DECS), Public Works and Highways (DPWH), and State Universities and Colleges (SUCs).
As seen in the Budget Call 2000, the government stressed the need to improve productivity through the proper management of the bureaucracy, while recognizing the urgent need for responsive, streamlined and efficient public service undertaking. To this end, the government has certified a House Bill as a priority measure with the fund of P.2 billion for FY1999. The proposed measure gave the President authority to re-organize all departments, agencies and offices of the Executive Branch, including government-owned-or-controlled corporations (GOCCs). The bill also advocated the adoption of a "scrap-and-build" policy that is aimed at limiting the creation of agencies. The aforementioned budget was to implement the re-engineering program, specifically the payment of separation benefits of affected employees whose positions may be found redundant. The Estrada administration has deemed it urgent to intensify the reengineering program as a part of its 10-point agenda for economic recovery.

(2) Performance Evaluation and Costing

(Ⅰ) Performance Evaluation

Performance Evaluation has to look at both the "Performance" and the "Cost" sides like a Profit and Loss Statement of an income earning entity in the private and public sectors. In the Philippines, the "Performance" side involving also the issue of which to take "Output" or "Outcome" is now being discussed with foreign technical assistance. In enforcing the new budget regulation, each agency is required to submit performance targets at the time of their budget request and to make a quarterly report on the target achievements.

(Ⅱ) Costing

Appropriate costing is an integral element of a PEM Cycle as a value information provider to three key functions of PEM; "Activity-based Budgeting", "Management Accounting" and "Performance Statement" for fulfilling Accountability as well as for Performance Evaluation. In the Philippines, appropriate costing practice is required in the Executive Order, but the "Costing System" has not been established.

The process of budget formulation was changed from the Budget of 2000. Under the new process, an agency is requested to prepare its expenditure program for a fiscal year without prior knowledge of its budgetary ceiling. The indicative ceiling is usually issued after the agency expenditure program is formulated. Thus, with no guide on its monetary ceiling, every agency has to prepare a more accurate budget estimation based

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18 DBM (1999b)
19 DBM (1998)
on a rational and justifiable method. This inevitably requires each agency to improve its prevailing budget or cost estimation procedures.

**BOX 3.3. Costing stipulated in Executive Order**

Some of the recent projects in the Philippines are supposed to be assigned to cope with the demands of the new budgeting rules, but can be expected to realize the requests by the following stipulations (underlined phrases) of the Executive Order 292.

* Agency proposals shall be reviewed on the basis of their own merits and not on the basis of a given percentage or peso increase or decrease from a prior year's budget level, or other similar rule of thumb that is not based on specific justification. Proposed activities, whether new or ongoing, shall be evaluated using a zero-base approach and on the basis of relationship with the approved development plan, agency capability as demonstrated by past performance, complemental role with related activities of other agencies, and other similar criteria.

* The President, through the Secretary shall evaluate on a continuing basis the quantitative and qualitative measures of agency performance as reflected in the units of work measurement and other indicators of agency performance, including the standard and actual costs per unit of work.

* The Department of Budget and Management shall develop standard costs for duly approved units of work measurement for each agency's budgetary projects or activities. These standard costs shall be compared with actual unit costs and utilized in the evaluation of agency budgetary performance.

(3) Audit

The Commission on Audit (COA) is one of the three Constitutional Commissions, together with the Civil Service Commission and the Commission on Elections, stipulated in the Constitution of the Republic of the Philippines 1987. Its major functions are below.

(Audit Function)

Its function is to examine, audit and settle all accounts pertaining to the revenue and receipts of, and expenditures of uses of funds and property owed or held in trust by, or pertaining to, of all political subdivisions of the government, such as the provinces, cities, and municipalities, including government-owned or-controlled corporations. Types of audit that COA performs are as follows:

- Compliance Audit: Audit to determine if transactions comply with government auditing laws, rules and regulations.
- Financial Audit: Audit to determine whether financial statements fairly reflect the financial position and results of operations of audited agencies in accordance with government accounting and auditing standards.

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20 COA. *What you need to know about COA.*
Performance or Value-for-Money (VFM) Audit: Audit to determine whether value is derived from public resources spent by public administrators. This is traditionally called performance audit and sometimes called 3 E's audit, pertaining to efficiency, economy and effectiveness audits.

The results of each audit are reported to the President and the National Congress, and after their approval, compiled and published as an "Annual Financial Report of the National Government".

(☐) Rule-making Function
To promulgate accounting and auditing rules and regulations including those for the disallowance of irregular, unnecessary, excessive, extravagant or unconscionable expenditures, or uses of government funds and properties.

(☐) Reporting Function
To submit to the President, the Congress, the auditee and other concerned officials of the government, an annual report on the financial condition and operation of the government, its subdivisions, agencies, and instrumentalities including government owned or-controlled corporations.

(☐) Recommendatory Function
To recommend measures to improve the efficiency and effectiveness of government operations.

(☐) Limited Accounting Function
To keep the general accounts of the government.

(☐) Custodial or Archival Function
To keep and preserve the vouchers or documents evidencing transactions pertaining thereto.

(4) Public Accounting Practices

The public accounting system of the Philippines will be relatively advanced compared to those being currently practiced in the rest of the world in terms of their application of a complete double entry bookkeeping procedure and, even partially, the adoption of accrual accounting. The accrual accounting being adopted is what they call the "Obligation Accounting System" in which expenditures are recorded when incurred regardless the accompanied cash payment, and the "incurrence" is recognized when "Obligation" arises.
However, accrual accounting is not applied to the Revenue side. The constitution stipulates that COA shall have the power, authority, and duty to settle the government account. Practically for the execution, all the government agencies must submit their trial balances and supporting statements, which are subject to the COA's audit, and the trial balances are consolidated by COA into the Government Consolidated Financial Statements which are submitted to the President and the National Congress.

Thanks to this accounting system, the government is able to prepare a set of financial statements consisting of the following three statements:

(Ⅰ) Balance Sheet (Statements of Financial Position)
The Balance Sheet discloses the balances of assets, liabilities and residual equity of the National Government.

(Ⅱ) Statement of Operations (Statement of Financial Position)
The Statement of Operation presents the revenues and other receipts including borrowings of the government, the expenditures incurred and the deficit or earnings for the fiscal year being reported. Expenditures in the government refer to the obligations incurred during the year. Such obligations represent amounts already paid and amounts committed to be paid by government agencies. The amounts committed to be paid are included among the liabilities. The concept of obligations is to charge expenditures in the year they were appropriated or allotted.

(Ⅲ) Cumulative Results of Operation
The Cumulative Results Operation shows the balance of the unappropriated surplus and reserves, the appropriated surplus comprising the released and unreleased continuing appropriations and the overdrafts. The balance of this account could be a useful reference in determining the budgetary levels for the succeeding fiscal year.

(5) Strength of the Philippine System in Feedback Function

The unique structure of the Philippine Public Audit is the system of "Resident Auditors" from COA being stationed at each office of every government agency. In the Department of Agriculture, for instance, there are 13 functional units within the Department shown in the Section B of the audit report, and COA Auditors are assigned and station at each unit without omission. They are charged with implementing VFM

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22 This is based on the Financial Statements of FY 1997.
Audit at each site and prepare primary evaluation reports which are compiled later at the central Department level into a single consolidated auditing report. Thus the evaluation from the VFM viewpoint is carried out at the grass-roots levels, including site visits and interviews of the beneficiaries if necessary.

The more important function in the PEM Cycle is that performed by the "Feedback". Normally the "Feedback" is the weakest function, but, in "Feedback Function", the Philippine PEM system has a strong advantage from two aspects listed below.

(❑) The first strength is the "Resident Auditor System" stated above functioning as day-to-day monitoring and fostering corrective actions.
(❑) The second advantage is the disclosure system of the government performance accompanied by its evaluation. All the financial and operational results of every government agency are disclosed to the public after the approval of the President and the Congress. All the audit results articulating the weaknesses, findings and recommendations for corrective action are to be also open to public. Those practices coupled with the COA’s strict audit can inspire Social Control over government operations, which potentially carries the strongest power of control.

However, withdrawal of the Resident Auditors is gradually proceeding being replaced by newly organized Audit Teams. This is the "Audit Team Approach Plan" which was launched in 1998, mainly aiming to strengthen the independence of the auditors of COA. It is preferable to promote their replacement by a completely external Auditing Team in this aspect, but there are also irreplaceable functional merits attached to the current Residential Auditor System as discussed above. It is strongly requested that the Plan be implemented in such a way that the newly organized Audit Teams could maintain the merits of the residential auditors stated above by not giving up the good cooperative relationship with every agency established by the resident auditors, while enforcing the capability of Departmental Internal Auditors.

### 3.5 The Province of Punjab, Pakistan

#### 3.5.1 Budget Formation Process

(1) An Overview

This chapter outlines and discusses the new wave of Public Expenditure Management or Public Sector Management Reform in the Province of Punjab. The Province of Punjab has started introducing the "Performance Budget", which is an
ambitious attempt to apply an "Activity-Based Budget", getting rid of their conventional "incrementalism" under the "Line-Item Budget" system. The Province is also leading the rest of the country in the field of Performance Auditing which plays one of the key roles in Public Management Reform. This effort has just been started and thus far tried mainly to improve Operational Efficiency. But how will Allocative Efficiency be tackled on provincial level and how will Fiscal Efficiency be achieved in the next step for the reform. This part describes the endeavor to reform Public Expenditure Management in an infant but prospective stage.

(2) Key Institutions and organizations

( ☐ ) Finance Department

In the introduction of the Performance budget, the Punjab provincial financial department played an important role. The Punjab provincial financial department advised all provincial departments to prepare their 1999/2000 budgets as per the revised format, which would be based on specification by each department's duties (i.e. the mission statement); outputs that the department intends to produce/deliver during the year; and inputs required to produce these outputs. Moreover, the financial department planned to remove from the budget books and process all unfilled sanctioned posts, so that the new posts could be created/sanctioned only after reviewing the genuine needs of the departments.

The Finance department is a member of the evaluation committee composed of the Planning and Development Board, the Finance Department, other departments concerned, and an executing agency for consultation. The final recommendation of the Committee has a binding legal force for the Finance Department to determine whether the evaluated project be entitled for the ensuing non-development budget allocation after its completion.

( ☑ ) Office of Director General Performance Audit Wing, Lahore

The Office of Director General Performance Audit Wing is the spring of the Performance Audit of Pakistan. The wing is the development center of the Performance Audit and conducts comprehensive training for internal staff as well as for key officials of the whole governmental sector throughout the country to be involved in performance evaluation. In addition to the domestic training, the Wing also plays an important role in international training inviting auditors and other key relevant officials from various countries including Malaysia, Sri Lanka, Nepal, Indonesia, Bangladesh, Saudi Arabia, UAE, Oman, Iran, Yemen, Turkey, China, Korea, Uzbekistan, Kazakhstan and other
Central Asian countries, in close cooperation with ASOSAI (Asian Organization of Supreme Audit Institutions).

(Office of Director General Audit, Punjab)

While the D.G. Performance Audit Wing is the developer and trainer of Performance Audit, the executor is the Office of Director General Audit. The Office has performed over 500 cases of performance audit since the scheme had commenced in the early 1980s. The audits are performed in accordance with the Performance Audit Guidelines above, and the results are sent to the auditees and also reported to the Assembly, but never disclosed to the public.

3.5.2 Aggregate Fiscal Discipline and Allocative Efficiency

In Punjab and other provinces in Pakistan, budget structure and its budgeting process have a lot of things to be resolved. These two tables bring out the basic budgeting principle of the Government of Punjab.

<table>
<thead>
<tr>
<th>Table 3.3 Budget Structure of Punjab</th>
<th>(Rs. in million)</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Revised Budget</td>
</tr>
<tr>
<td><strong>Current Budget</strong></td>
<td></td>
</tr>
<tr>
<td>(General Revenue Accounts)</td>
<td></td>
</tr>
<tr>
<td>General Revenue Receipts</td>
<td>83,230,604</td>
</tr>
<tr>
<td>Revenue Expenditure</td>
<td>82,853,603</td>
</tr>
<tr>
<td>Deficit (-)/ Surplus (+)</td>
<td>(+) 377,001</td>
</tr>
<tr>
<td>(Current Capital Accounts)</td>
<td></td>
</tr>
<tr>
<td>Current Capital Receipts</td>
<td>19,497,723</td>
</tr>
<tr>
<td>Current Capital Expenditure</td>
<td>19,874,724</td>
</tr>
<tr>
<td>Net Capital Receipts</td>
<td>(-) 377,001</td>
</tr>
<tr>
<td>(Public Accounts)</td>
<td></td>
</tr>
<tr>
<td>Public Account Receipts</td>
<td>67,919,360</td>
</tr>
<tr>
<td>Public Account Disbursements</td>
<td>67,909,360</td>
</tr>
<tr>
<td>Net Public Account Receipts</td>
<td>(+) 10,000</td>
</tr>
<tr>
<td>Net Deficit (-)/Surplus (+) in the Current Budget</td>
<td>(+) 10,000</td>
</tr>
<tr>
<td><strong>Development Budget</strong></td>
<td></td>
</tr>
<tr>
<td>Expenditure</td>
<td>14,946,114</td>
</tr>
<tr>
<td>Resources</td>
<td>14,946,114</td>
</tr>
<tr>
<td>Operational Shortfall</td>
<td>0</td>
</tr>
</tbody>
</table>

The following table shows the contents of each component of the Budget.

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23 In marked contrast with this practice, the auditing results of the government auditor (Commission on Audit) of the Philippines are disclosed to the public once they have been approved by the Congress.
Table 3.4 Contents of Punjab Budget

<table>
<thead>
<tr>
<th>Current Budget</th>
<th>Receipts/Resources</th>
<th>Expenditure/Disbursements</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>General Revenue</strong></td>
<td>¶ Proceeds from taxes (Province’s share from Federal divisible taxes)</td>
<td>¶ General administration</td>
</tr>
<tr>
<td></td>
<td>‣ Export duty on cotton</td>
<td>¶ Law and order</td>
</tr>
<tr>
<td></td>
<td>‣ Sales tax</td>
<td>‣ Justice</td>
</tr>
<tr>
<td></td>
<td>‣ Income and corporation tax</td>
<td>‣ Police and Civil Security Forces</td>
</tr>
<tr>
<td></td>
<td>‣ Excise duty on tobacco &amp; sugar (Provincial tax receipts)</td>
<td>‣ Jails and Detention Places</td>
</tr>
<tr>
<td></td>
<td>‣ Direct taxes</td>
<td>‣ Civil defense</td>
</tr>
<tr>
<td></td>
<td>‣ Indirect taxes</td>
<td>¶ Social services</td>
</tr>
<tr>
<td></td>
<td>‣ Other Federal transfers</td>
<td>‣ Education</td>
</tr>
<tr>
<td></td>
<td>‣ Excise duty, royalty and development surcharge on natural gas</td>
<td>‣ Health</td>
</tr>
<tr>
<td></td>
<td>‣ Electricity profits</td>
<td>‣ Housing and physical planning</td>
</tr>
<tr>
<td></td>
<td>‣ Grant equal to royalty on crude oil</td>
<td>‣ Social security and welfare</td>
</tr>
<tr>
<td></td>
<td>¶ Income from commercial activities undertaken by some departments</td>
<td>‣ Natural calamities and disasters</td>
</tr>
<tr>
<td></td>
<td>¶ Return on investment in properties, securities and enterprises</td>
<td>‣ Religious affairs</td>
</tr>
<tr>
<td></td>
<td>¶ Interest on loans advanced to public corporations and local councils</td>
<td>¶ Community services</td>
</tr>
<tr>
<td></td>
<td>¶ Revenue incidental to the control functions of the Government (e.g. fines and forfeitures)</td>
<td>‣ Road network, government building</td>
</tr>
<tr>
<td></td>
<td>¶ Charges for services rendered by government agencies (e.g. social services, water, hospital, etc.)</td>
<td>‣ Water supply, sanitation and sewerage</td>
</tr>
<tr>
<td></td>
<td>¶ Federal grants and miscellaneous receipts (e.g. deficit subsidy, etc.)</td>
<td>¶ Economic services</td>
</tr>
<tr>
<td><strong>Current Capital</strong></td>
<td>¶ Accrue to Account No.1 (Non-food Account) maintained with the State Bank of Pakistan</td>
<td>¶ Agriculture and food</td>
</tr>
<tr>
<td></td>
<td>‣ Extraordinary receipts (e.g. Land sales)</td>
<td>‣ Irrigation</td>
</tr>
<tr>
<td></td>
<td>‣ Public borrowing</td>
<td>‣ Land reclamation</td>
</tr>
<tr>
<td></td>
<td>‣ Recovery of loans</td>
<td>‣ Rural development</td>
</tr>
<tr>
<td></td>
<td>¶ Accrue to Account No.2 (Food Account)</td>
<td>‣ Industrial and mineral resources</td>
</tr>
<tr>
<td></td>
<td>‣ Temporary advances from commercial banks for financing operations of state trading in food grains</td>
<td>¶ Interest payment, investible funds and grants</td>
</tr>
<tr>
<td></td>
<td>¶ Accrue to Account No.1 (Non-food Account)</td>
<td>¶ Miscellaneous (unallocable) items (e.g. Secret services)</td>
</tr>
<tr>
<td><strong>Public Accounts</strong></td>
<td>¶ Accrue to Account No.1 (Non-food Account)</td>
<td></td>
</tr>
<tr>
<td>(Article 118, Pakistani Constitution)</td>
<td>‣ Repayment of loans and advances, and state trading in medical stores and coal</td>
<td></td>
</tr>
<tr>
<td></td>
<td>‣ Accrue to Account No.2 (Food Account)</td>
<td>¶ Accrue to Account No.2 (Food Account)</td>
</tr>
<tr>
<td></td>
<td>‣ State trading in food grains, and repayment of loans taken from the commercial banks for state trading operations of the Food Department</td>
<td></td>
</tr>
<tr>
<td><strong>Development Budget</strong></td>
<td>¶ Provincial Contribution</td>
<td>Expenditures for provincial development programs</td>
</tr>
<tr>
<td><strong>Revenue Capital</strong></td>
<td>‣ Transfer from the Current Budget</td>
<td></td>
</tr>
<tr>
<td></td>
<td>‣ Savings</td>
<td></td>
</tr>
<tr>
<td></td>
<td>‣ Federal Assistance</td>
<td></td>
</tr>
<tr>
<td></td>
<td>‣ Cash Development Loans (SAP 24)</td>
<td></td>
</tr>
<tr>
<td></td>
<td>‣ Cash Development Loans (Non-SAP)</td>
<td></td>
</tr>
<tr>
<td></td>
<td>‣ Foreign Assistance</td>
<td></td>
</tr>
<tr>
<td></td>
<td>‣ Loans</td>
<td></td>
</tr>
<tr>
<td></td>
<td>¶ Multi-donor reimbursement</td>
<td></td>
</tr>
<tr>
<td></td>
<td>¶ Grants</td>
<td></td>
</tr>
</tbody>
</table>

24 SAP: Social Action Program
The Current Budget is divided into three categories; namely, "General Revenue", "Current Capital" and "Public Accounts", and "Receipts" (Money-in) and "Expenditure" (Money-out) within the same category are to be kept balanced respectively. The "General Revenue" Category corresponds to a private income statement on a cash basis. Therefore, the "General Revenue Expenditure" which is the Province's cost of services should be limited within the amount of the "General Revenue Receipt", the fund from the Province's recurrent receipt.

General Revenue Receipt is alternatively called "Current Revenue Receipt" which shows revenue for recurrent cost. It is composed of Federal transfers and Provincial receipts. While the share of the Federal transfers has 79.60% in FY 1998-99, that of Punjab has 20.40%. This shows that short-run factors like shortfalls in revenue transfers from the federal government and increased expenditure liabilities can cause a fiscal crisis in the Provincial budget.

<table>
<thead>
<tr>
<th>Province</th>
<th>Share</th>
</tr>
</thead>
<tbody>
<tr>
<td>Punjab</td>
<td>57.88%</td>
</tr>
<tr>
<td>Sindh</td>
<td>23.28%</td>
</tr>
<tr>
<td>North Western F.P.</td>
<td>13.54%</td>
</tr>
<tr>
<td>Balochistan</td>
<td>5.30%</td>
</tr>
</tbody>
</table>

This distributable share is shared by the Federal and Provincial Governments in the ratio of 62.5:37.5 in total. The provincial shares in the divisible pool is based on the respective population ratios according to the 1981 Census as shown in Table 3.5. As a result, since federal transfers constitute 80% of provincial resources, then the shortfall in federal transfers has squeezed provincial resources to the extent that even high-priority provincial expenditures are being affected.

The "Current Capital Accounts" accommodates the Province's financial money receipts and expenditure, which would not be recorded in a private income statement. The "Current Capital Accounts" must be also balanced, so debt receipt is always controlled watching the balance of this account. The "Development Budget" is to be kept balanced. It means the Province's development programs must be financed by a long-term fund earmarked for those purposes except the transfer from the current budget surplus which amounted to only 0.69% of the total Development resources in the Budget for FY 1999 - 2000.

The principle of the Punjabi budgeting which keeps a category-wise balance is perfectly sound to emphasize proper linkages between the receipts and expenditures based on their respective nature. However, the distinction between the Current and
Development budget putting them under different control prevents the Government of Punjab from efficient implementation of the new attempt toward New Public Management. This issue will be discussed in the following sections.

3.5.3 Operational Efficiency

(1) Retrenching redundant workforce

On the public expenditure front, the biggest structural problem faced by provisional governance is the excessive size of the civil service to the resources available. Streamlining and realignment of the roles and functions of the State and Province is considered in tandem with diminution of public employees by retirement. However, the Federal and Provincial authorities in finance expressed their reluctance to downsize and rightsise the public sector by way of retrenching the "redundant" workforce.

(2) Introduction of Public Expenditure Reform

The source of Public Expenditure Management in Punjab dates back to the beginning of the 1980s when the Department of the Auditor General, Punjab decided to introduce Performance Auditing to the public sector by its strong initiative. The following is a part of the Auditor General’s statement about the Performance Auditing, a compilation of all the preparation efforts since 1980:

It (Performance Audit) is particularly relevant to the Public Sector where expenditure on development has greatly increased over the last few decades. The process of accountability demands that the tax-payer be informed of the outcome of this expenditure. The Government auditors have, therefore, to report on the economy, efficiency and effectiveness in incurring the same, for which purpose a more complete knowledge of the functioning of executive departments thus becomes necessary.

The introduction of performance auditing was assisted by the Technical Assistance of BMB, the Netherlands Government, which started in 1982. The relation with the Dutch Government in the area of institutional development T/A, commenced when the Government of Pakistan requested assistance for the financial evaluation of private enterprises to be nationalized in the schemes under the Federal Government’s nationalization policy. The efforts were materialized as the "Performance Audit Guidelines" in 1986, which comprises 12 volumes covering auditing procedures for nine economic sectors, and the practice commenced. Until last year (1999), the Directorate...
General Audit, Punjab, had conducted more than 500 cases of performance audit covering a wide range. The Directorate General Performance Audit Wing is conducting the training inviting not only auditors but other key officials throughout the country.

Along with this advanced step toward Public Expenditure Management in the auditing aspect, a new initiative in the budgeting side, "Performance Budgeting", was launched in 1999. This was initiated by the former Chief Minister of Punjab, Muhammad Shahbaz Sharif, and put into practice under the leadership of the Finance Secretary of Punjab, M. Akram Malik.

Thus the move toward Public Expenditure Management, even if it is still at an infant stage except for the area of Performance Auditing, has been proceeding actively, leading the rest of the country. The Province has been positively adopting in the initiatives and management techniques for public management provided by bilateral and multilateral aid agencies like BMB, the World Bank and ADB during the course of its progress. However, this momentum seems spontaneous rather than imposed and has been led by internal initiatives as mentioned above.

(3) Performance Budgeting

(Ⅰ) Outline of Punjab Performance Budgeting

A departure from incremental "Line-Item Budgeting" to "Activity-Based Budgeting" is the prerequisite for a "Budget" to carry out its mandated functions: planning and control. The Province of Punjab introduced in FY 1999 (July to June) "Performance Budgeting", which is a drastic change from its conventional "Line-Item Budgeting". "Performance Budgeting" was applied to the following six departments to pilot the rest of the Provincial Government. The six pilot departments are Agriculture Department, Education Department, Health Department, Irrigation and Power Department, Labour & Manpower Department, Social Welfare, Women Development & Bait ul Maal Department.

The selection of the six departments was not based on a significant reason, and it took a "learning by doing" method skipping thorough preparation before the introduction. The Department of Finance held several explanation meetings about the introduction of "Performance Budgeting" (termed "Zero Based Budgeting" at the time) inviting all the provincial departments not so long before the start of its application in July 1999, and a workshop was held on the same topic on June 8 and 9, 1998. The six departments were chosen simply because they understood relatively well the new scheme and were ready to follow its adoption. After this initial experimentation, the
The Finance Secretary M. Akram Malik announced the introduction of the "Performance Budgeting" in his letter to the Secretaries of the six departments dated March 20, 1999 telling:

"......As a first step the departments are required to provide quantitative and physical targets for every financial allocation with an explanatory memorandum, for each activity that the department undertakes with the funding provided in the budget. This is, therefore, a transition of budgetary figures into physical targets/performance indicators. It could also be stated that the chain of activities of a department are required to be monetized and reflected as its budget. These targets & their explanatory memorandums shall be made part of the budget that is to be presented to the Assembly."

The underlined phrases clearly depicts that  Ɐ every department shall specify and propose quantified performance targets for each activity, and  Ɐ the budgets are estimated and allocated for these activities to achieve the targets proposed.

Looking at the Agricultural Department as the example, the Performance Budgeting specifies the following seven items first as the "Functions" of the Agriculture Department.

### Table 3.6  Functions of Agriculture Department of Punjab

<table>
<thead>
<tr>
<th>Functions</th>
<th>Details</th>
</tr>
</thead>
<tbody>
<tr>
<td>Agriculture</td>
<td>- Agricultural education, training, and research including Agricultural University, Faisalabad and University of Arid Agriculture, Rawalpindi</td>
</tr>
<tr>
<td></td>
<td>- Experimental and demonstration farms</td>
</tr>
<tr>
<td></td>
<td>- Improvement of agricultural methods</td>
</tr>
<tr>
<td></td>
<td>- Protection against insects, pests and prevention of plant diseases</td>
</tr>
<tr>
<td></td>
<td>- Soil fertility and soil conservation</td>
</tr>
<tr>
<td>Arboricultural Operations</td>
<td>- Mechanization, reclamation of land, use of agricultural machinery, ploughing, tube-wells, installations and research in Agricultural Engineering (Agricultural Machinery and Implements)</td>
</tr>
<tr>
<td>Government Gardens</td>
<td>- Agricultural information and publications</td>
</tr>
<tr>
<td>Market Committees and Regional Markets set up under the Agricultural Produce Market Act, Development of Agricultural Marketing</td>
<td>- Agricultural statistics</td>
</tr>
<tr>
<td>Agricultural Loans/subsidies</td>
<td>-</td>
</tr>
<tr>
<td>Water Course Conveyance-efficiency through improvement of watercourses</td>
<td>-</td>
</tr>
<tr>
<td>Production, multiplication and marketing of certified seed through Punjab Seed Corporation</td>
<td>-</td>
</tr>
</tbody>
</table>

Then "Activities" are specified with coding to perform the above "Functions" as follows:
<table>
<thead>
<tr>
<th>Code</th>
<th>Description</th>
<th>Activity</th>
</tr>
</thead>
<tbody>
<tr>
<td>6-06300</td>
<td>Agricultural Census / Statistics</td>
<td>Crop Reporting Service</td>
</tr>
<tr>
<td>6-07300</td>
<td>Publicity</td>
<td>Agriculture Information Bureau</td>
</tr>
<tr>
<td>6-39900</td>
<td>Others</td>
<td>Maintenance of Bagh-e-Jinah, Lahore</td>
</tr>
<tr>
<td>6-41300</td>
<td>Profession / Technical Universities / Colleges / Institutes</td>
<td>Partial Funding of the University of Arid Agriculture</td>
</tr>
<tr>
<td>6-51100</td>
<td>Administration / Land Commission</td>
<td>Three Agricultural Training Institutes</td>
</tr>
<tr>
<td>6-51300</td>
<td>Agricultural Research Extension Services</td>
<td>Economics and Marketing Services</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Maintenance of Experimental Farms, Seed Farms and Green Belt</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Extension Services including Information, Adaptive Research, Pest Warning and Quality Control, and Floriculture</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Agricultural Information Services</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Floriculture Training and Research</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Agricultural Research in Punjab on all Crops in all Zones</td>
</tr>
<tr>
<td>Activity</td>
<td>On-farm Water Management Programme</td>
<td></td>
</tr>
<tr>
<td>----------</td>
<td>-----------------------------------</td>
<td></td>
</tr>
<tr>
<td>013</td>
<td>Agricultural Engineering, Soil Conservation and Boring Operations</td>
<td></td>
</tr>
<tr>
<td>Activity</td>
<td>Bulldozer Operations</td>
<td></td>
</tr>
<tr>
<td>Activity</td>
<td>Well Drilling</td>
<td></td>
</tr>
<tr>
<td>Activity</td>
<td>Agricultural Machinery Training Schools</td>
<td></td>
</tr>
<tr>
<td>Activity</td>
<td>Directorate of Soil Conservation</td>
<td></td>
</tr>
<tr>
<td>Activity</td>
<td>Agricultural Mechanization Research</td>
<td></td>
</tr>
<tr>
<td>014</td>
<td>Grant to Research Co-ordination Board</td>
<td></td>
</tr>
<tr>
<td>Activity</td>
<td>Planning, Co-ordination, Monitoring and Evaluation of Research in Agriculture, Livestock, Irrigation, Forestry and Fishery Sub-sectors</td>
<td></td>
</tr>
<tr>
<td>015</td>
<td>Works</td>
<td></td>
</tr>
<tr>
<td>Activity</td>
<td>Construction Works in Field Wing</td>
<td></td>
</tr>
<tr>
<td>Activity</td>
<td>Construction Works in Extension Wing</td>
<td></td>
</tr>
<tr>
<td>Activity</td>
<td>Construction Works in Research Wing</td>
<td></td>
</tr>
<tr>
<td>016</td>
<td>Lump Sum Provision for Incentives</td>
<td></td>
</tr>
<tr>
<td>Activity</td>
<td>Incentives</td>
<td></td>
</tr>
<tr>
<td>017</td>
<td>RAEDC, Vehari</td>
<td></td>
</tr>
<tr>
<td>Activity</td>
<td>Regional Agricultural Economic Development Centre</td>
<td></td>
</tr>
</tbody>
</table>

The followings are the “Performance Budget” of FY 1999/2000 for the Activity "On-farm Water Management Programme" as an example.
### Table 3.8  Details for Activity: On-farm Water Management Programme

<table>
<thead>
<tr>
<th></th>
<th>COST</th>
</tr>
</thead>
<tbody>
<tr>
<td>Establishment Charges</td>
<td>24,374,000 Rupies</td>
</tr>
<tr>
<td>Operational Charges</td>
<td>6,523,000 Rupies</td>
</tr>
<tr>
<td>Total</td>
<td>30,897,00 Rupies</td>
</tr>
</tbody>
</table>

#### Performance Measures of Each Activity for Targets

<table>
<thead>
<tr>
<th>Performance Measures</th>
<th>Performance Standards</th>
</tr>
</thead>
<tbody>
<tr>
<td>Improvement of water courses</td>
<td>2,100 units</td>
</tr>
<tr>
<td>Construction of water storage tanks</td>
<td>150 tanks</td>
</tr>
<tr>
<td>Establishment of demonstration centers</td>
<td>800 centres</td>
</tr>
<tr>
<td>Provision of on-farm drainage</td>
<td>9,000 ha</td>
</tr>
<tr>
<td>Precision-land-leveling</td>
<td>15,000 ha</td>
</tr>
<tr>
<td>Community mobilization and training of farmers</td>
<td>5,000 farmers</td>
</tr>
<tr>
<td>Reconciliation of expenditure / receipts by each DDO with respective Allocation Officer, for each month by 12 th of next month.</td>
<td>100 %</td>
</tr>
<tr>
<td>Collection of receipts as per prescribed targets, to be fixed by the Head of the Department, in accordance with the overall provincial targets for the department.</td>
<td>100 %</td>
</tr>
<tr>
<td>Monitoring of Audit Practice, proceedings under E &amp; D rules and Court cases.</td>
<td>Quarterly</td>
</tr>
</tbody>
</table>

The Activity of the "On Farm Water Management Programme (OFWMP)" is a functional unit under the Agriculture Department of Punjab to deal with comprehensive undertakings solely regarding the Programme including its implementation, supervision, operation support and evaluation.

The OFWMP's function in relation to Performance Budgeting is summarized as follows:

- The functions of OFWMP consist of "Development Function (DF)" and "Non-Development Function (NDF)".
- The cost to execute DF is charged to the "Development Budget", and the cost for NDF is charged to the "Non-Development Budget (Current Revenue Expenditure)" respectively.
- DF is regarded as an aggregate of development projects which is inherently "projectized" or "activity-based". Therefore, the newly adopted Performance Budgeting is applied only to the "Non-Development Budget" portion which includes, among others, the following main activities by the OFWMP staff to carry out the NDF above. The COST on the Budget Statement denotes only the NDF portion consisting of "Establishment Charges" as manpower cost and "Operational Charges" as other current cost.
Table 3.9  Non-Development Functions of OFWMP

<table>
<thead>
<tr>
<th>Functions</th>
<th>Details</th>
</tr>
</thead>
</table>
| Supervision, Implementation and Administration | * Implementation and supervision of development projects  
* Implementation of all establishment  
* Planning and designing of future schemes  
* Interaction with the donor agencies  
* Monitoring during project implementation, evaluation after completion and undertaking of remedial measures  
* Arrangement of funds  
* Quality control and efficient O & M  
* Supervision, organization and registration of Water Users Associations (WUAs) |
| Coordination                     | * Coordination with other agencies for transfer of irrigation and water management technologies  
* Coordination with other Departments to facilitate OFWMP implementation |
| Human Resource Development       | * Training for professionals, sub-professionals, extension workers, farm managers and water users. |

The NDF is a set of supporting activities to assist (a) smooth implementation of projected facility construction, and to (b) facilitate realization or maximization of the expected project benefit through its effective operation.

The Performance Budgeting requires to estimate the yearly cost needed for conducting a Non-Development activity collecting all the necessary expenses at the Cost Center representing the activity concerned in order to (a) rationalize the cost/budget estimation, and (b) facilitate its performance evaluation after the fiscal year-end.

( %+ ) Weaknesses in Punjab Performance Budgeting

The initiative of the Province to grow out of the incrementalism in budgeting into the activity basis should be appreciated as an important step forward to Public Management Reform. It is expected to facilitate better resource allocation on the departmental level, and will further strengthen the effectiveness of the Punjabi Performance Auditing which is already strong in the PEM elements. As the system has been launched without thorough preparations taking a learning/improving by doing method, it still has rudimental weaknesses. The major points identified are as follows:

- Imperfect integration of costs under an objective of an activity.

A set of objectives (the objective) is clearly stated in the budget statement of OFWMP. Under this objective, all the cost to be incurred in doing necessary activities for achieving the objective has to be collected and budgeted. The main activities of OFWMP would be physical works for constructing or improving facilities.
The Statement shows the physical targets of performance for improving 2,100 units of water courses, construction of 150 water storage tanks, establishment of 800 demonstration centers, provision of 9,000 hectares of on-farm drainage and implementation of 15,000 hectares of precision-land-leveling. However, none of the cost for these activities is included in the performance budget statement. On the contrary, performance measures and performance standards corresponding to the performance budget, that is the NDF or current costs, do not appear on the statement except for minor activities; reconciliation of expenditure/receipt, Collection of receipts and Monitoring of audit practice. According to the Director General Agriculture (Water Management), the performance of the NDF is embodied in the physical targets stated. However, it makes the comparison between the cost and performance ambiguous. Further, ensuing operation and maintenance costs accrued to the completed projects under the non-development budget (recurrent revenue budget) should be incorporated beforehand in development budget, thereby leading to the medium-long-term fund commitment to development projects in construction and continued operation. The brainchild given here duly represents the idea of MTEF, while addressing the issue of the flexibility in fund allocation and design alteration during the medium-term construction period.

Another example is the case of the "Immunization" Activity under the Health Department. The objective of immunization would be the reduction of infant epidemics. Under this objective to be achieved by immunization, all the relevant costs must be collected and compiled. But the code: 6-42502 001 "Immunization" Activity in the Performance Budget as a cost center of this activity only collects costs of implementation (injection) and does not include the costs of procuring vaccines.

For instance, improvement could be made designing the budget statement of OFWMP as follows. COST should also show, coupled with the current cost already on the Statement, the project costs of targeted improvement of water courses, construction of water storage tanks, establishment of demonstration centres and precision-land leveling.

TARGETS should also show, coupled with Performance Measures already on the Statement, the performance targets of ND activities, like "11 training courses for farm managers" etc., although all activities are not able to be quantified.

- Budget estimation with lack of accurate costing procedures.

As shown in the last paragraph of the Budget Statement of OFWMP, the budget estimation is merely based on a rough percentage allocation of the manpower cost. To improve this situation, the introduction of an accurate costing system is needed.
Lack of cooperation with the Department of Auditor General

The public auditing by Directors General of Audit, Punjab is very strong among the functions of PEM. They are the professional source of performance evaluation and accounting. The new attempt of Performance Budgeting would not be successfully established and operated without the Punjabi auditors' expertise and cooperation. However, there is no sign or intention in the Finance Department which has been leading Performance Budgeting to involve the Department of Auditor General in this area.

(4) Performance Auditing

Framework of Performance Auditing

The Performance Audit Guidelines issued in 1986 were further enriched into the new Performance Audit Guidelines in 1993 absorbing the results and lessons of the practical performances in this field. The Auditor-General of Pakistan, articulates the significance and concept of Performance Audit in the context of PEM in the preface of these audit guidelines:

"The extended scope of government activities has also resulted in concomitant increase in public outlays. Expenditures, therefore, now need to be looked at differently in addition to the traditional "post the fact" analysis of individual financial transactions. This need for a more comprehensive examination of public expenditure, particularly development expenditure, has led to the development of performance audit methodologies.

Performance auditors examine internal controls, key systems, and main operations to assess whether resources have been utilized for the purpose for which they were made available with due regard to "economy", "efficiency", and "effectiveness". Furthermore, this new discipline does not only aim to meet accountability requirements, it also assists management by highlighting areas of weak performance and putting forward proposals for improvement."

The new Guidelines have been enriched in terms of their comprehensive coverage, principle and practical auditing procedures, expanding their old scope covering nine economic sectors to accommodate more detailed conceptual framework with extended sectoral coverage including social and environmental aspects. The new Guidelines consist of two separate categories. The contents of each are as follows.
Table 3.10 Contents of New Performance Audit Guidelines

<table>
<thead>
<tr>
<th>PERFORMANCE AUDIT GUIDELINES</th>
<th>PROJECT PERFORMANCE AUDIT GUIDELINES</th>
</tr>
</thead>
<tbody>
<tr>
<td>Book</td>
<td>Title</td>
</tr>
<tr>
<td>1</td>
<td>Introduction to Performance Audit</td>
</tr>
<tr>
<td>2</td>
<td>Understanding Performance Audit</td>
</tr>
<tr>
<td>2.1</td>
<td>Report Writing</td>
</tr>
<tr>
<td>3</td>
<td>Project Audit Guidelines</td>
</tr>
<tr>
<td>4</td>
<td>Programme Audit Guidelines</td>
</tr>
<tr>
<td>4.1</td>
<td>Programme Audit – A Case Study</td>
</tr>
<tr>
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</tbody>
</table>

( ) Practice of Performance Audit

The objects of the Performance Audit conducted by the Office of Director General Audit, Punjab are Projects, Programmes and Operations/Activities. The "Program" is defined as an organized set of activities directed to achieve desired objectives. How is a programme different from a project? The Guidelines simply explain that the main difference lies in that a project is often conceived as a new undertaking, with a definite beginning and an expected completion; a programme is often an ongoing operation, not planned to end at a predetermined time.

Recent performance by the Office in this area includes, among others, the following subjects.

• Munition Production during 1990 - 95, June 1998
• Purchase of Medical Gases in Major Hospitals of Punjab during 1995 - 98, April 1999
• Flood Relief and Zakat Fund Disbursed during 1994 - 95 to 1996 - 97, April 1999
• Procurement of Education and Learning Material in Education Department of Punjab during 1993 - 95, April 1999
The Performance Audit of On-farm Water Management Projects in Punjab was conducted during 1994-95. The auditors of the Office, together with hired consultants, evaluated technical issues and project evaluation. Conducting a review of project documents completion and evaluation reports by various agencies, interviews with the beneficiaries and site visits and physical inspection of the project facilities, the team performed the audit from comprehensive viewpoints including technical, financial, economic, managerial and social aspects. Accordingly their findings and recommendations cover quite a wide range of important issues.

The Performance Auditing is judged considerably strong among the elements of PEM in the Province of Punjab in terms of not only its institutional framework but also the practices conducted especially in the fields of project and programme auditing. However, it is supposed that the auditing could not exercise its full capacity due to the lack of Performance Statement in the Pakistani public accounting system. The issue of the Performance Statement will be reviewed in the context of Punjab PEM from the accounting viewpoint in a later section.

(.ind) Project Evaluation by the Provincial Government

Performance Evaluation is carried out by the recommendation of the Finance Department and at the request of the department concerned with the completed projects. Largely due to a paucity of staff, budget, and time, project evaluation takes place selectively, covering not all of the completed projects. In the Forestry sector, 10 projects have been evaluated thus far in this fiscal year, of which three projects have been recommended to be terminated, or alternatively, disqualified for the ensuing allocation of operation and maintenance non-development budget.

Evaluation procedure begins with desk work, vis-a-vis, the comparison of PC-1 and the Project Completion Report (PC-4) prepared by the concerned department, while focusing on the compliance with technical and financial design as denoted in PC-1 and actual achievements as reflected in the Completion Report. Immediately following the office work on document checks, on-spot field inspection takes place that assess the physical progress and identifies the shortcomings. The outcome is compiled and the working paper is submitted to the evaluation committee with the members comprising the Planning and Development Board, the Finance Department, concerned Department, and executing agency for consultation. The final recommendation of the Committee has a binding legal force for the Finance Department to determine whether or not the evaluated project be entitled to the ensuing non-development budget allocation in the wake of its completion.
In due course of evaluation, the criteria are usually applied which include, among others, compliance with PC-1 utilization of funds allocated, physical achievements, compliance with the policy objectives of the project, and meeting the policy target of the Provincial Government that includes the increase of income level of the beneficiary people. Duration of project evaluation is somewhere around a couple of weeks at minimum and a couple of months at maximum.

The Guideline policies for project evaluation include "shifting redundant-cum-vacant posts to the new set-up", that means the salaries payable to vacant officers' posts due to assignment to the "project posts" should be shifted from the "current revenue expenditure" category to the "development revenue expenditure" category, and zero-base budgeting. The former policy has come in place since last fiscal year of 1998/1999. In respect to the Public Expenditure Management Cycle, the role and function of project monitoring and evaluation should be enhanced in a bid to secure "achievement-oriented" budgeting.

In the meantime, the lessons were learnt in the following dimensions: project monitoring should be encouraged to be undertaken during the project period by an external institution such as the Planning and Development Board in place of the current Department concerned, on such appropriate corrective measures as inadequate project implementation (misused or unused funds during the construction), and reconsideration of the decision of whether the completed project be entitled for the ensuing non-budgeting under the recurrent revenue budget should be enhanced in a bid to avoid the wasteful, futile use of public funds for operation and maintenance.

(5) Multi-Layered Evaluation System

A well organized multi-layered control system was observed in the On-Farm Water Management Programme (OFWMP) for its performance evaluation. The following is the system from internal control within the OFWMP Cell, the Office of Director General Agriculture (Water Management) Punjab, to the Office of Director General Audit.
Table 3.11  Multi-Layered Performance Evaluation System of OFWMP

<table>
<thead>
<tr>
<th>Layer</th>
<th>Executor of Control</th>
<th>For OFWMP</th>
<th>For AD</th>
<th>For GOP</th>
<th>For Congress</th>
<th>For Society</th>
</tr>
</thead>
<tbody>
<tr>
<td>1st</td>
<td>Self Evaluation Function of OFWMP</td>
<td>Internal</td>
<td>Internal</td>
<td>Internal</td>
<td>Internal</td>
<td>Internal</td>
</tr>
<tr>
<td>2nd</td>
<td>Planning &amp; Evaluation Cell of AD</td>
<td>External</td>
<td>Internal</td>
<td>Internal</td>
<td>Internal</td>
<td>Internal</td>
</tr>
<tr>
<td>3rd</td>
<td>Planning &amp; Development Department of GOP</td>
<td>External</td>
<td>External</td>
<td>Internal</td>
<td>Internal</td>
<td>Internal</td>
</tr>
<tr>
<td>4th</td>
<td>Office of Director General Audit</td>
<td>External</td>
<td>External</td>
<td>External</td>
<td>Internal</td>
<td>Internal</td>
</tr>
<tr>
<td>5th</td>
<td>-</td>
<td>External</td>
<td>External</td>
<td>External</td>
<td>External</td>
<td>Internal</td>
</tr>
</tbody>
</table>

Notes: AD = Agriculture Department Punjab, GOP = Provincial Government of Punjab

Whether an activity belongs to internal or external control is a relative concept, which varies depending on whether it is located inside or outside of the entity to be controlled.

As it is seen in the table above, the total control system is effectively structured, but the only weakness compared to the Philippine system is a lack of direct social control (5th layer). The audit result is reported up to the Provincial Assembly, whereas the Philippine government auditor (COA)'s auditing result is disclosed to the public after the approval of the Congress. From the viewpoint of operation, some opinions were heard from the external controllers' side that the internal control is rather weak being affected by the relevant internal authorities. However, this is a universal fact for any control system, and it is the very reason why a multi-layered control system is badly needed.

(6) Public Accounting System

An Accounting System is a major provider of monetary information to every stage (except Feedback) of a PEM Cycle, and double-entry bookkeeping procedures and accrual-basis accounting are important and effective functions. Additionally, a Performance Statement must be one of the main components of Public Accounting together with financial statements for the Evaluation stage as well as to carry out public accountability.

26 See Table 3.8. Non Development Function (NDF) of OFWMP
27 See Table 3.9. “Classified Activities of Agriculture Department under “Performance Budgeting” Code 6-5110-005
In Pakistan, the Department of Auditor General is preparing a new public accounting system under the World Bank technical assistance entitled "Pakistan Improvement to Financial Reporting and Auditing Project (PIFRA)" to be adopted throughout the country. The system itself is sophisticated based on double-entry and accrual accounting, however it has a weakness as public accounting in a sense that it only covers financial statements and omits the preparation of a Performance Statement.
Figure 3.1  Proposed Schedule of MTEF Activities for the Preparation of 2002 and Subsequent Budgets

For a sector, are the annual cost requirements of top priority projects > the allocable ceilings for 2002-2004?

A

Prepare FEs for 2004
Nov. 2000

Adjust FEs for parameter changes
Dec. 2000

Review all cost estimates of savings & new expenditure proposals
1-22 Mar. 2001

Prescribe overall/sector expenditure ceilings based on resource targets of the updated MTPDP fiscal framework & prescribe updated general economic parameters for adjusting FEs
Dec. 2000

Prepare/submit budget details, new expenditure & savings proposals for 2002-2004

Rank minor proposals
1-22 Mar. 2001

Rank major proposals
1-22 Mar. 2001

Set final budget for 2002
8-15 May 2001

Finalize 2002 budget & FEs for submission to President/Cabinet by DBM-OSEC
8-15 Jun. 2001

Prescribe general economic parameters for preparing FEs
Aug. 2000

Prescribe overall sectoral ceilings for 2002 & FEs for 2003 & 2004
Dec. 2000

Issue budget call incorporating overall sectoral ceilings for 2002 & FEs for 2003 & 2004
Dec. 2000

Decide on tradeoffs & adjustment of subsector ceilings if NEDA PC failed to submit on time
16-30 Apr. 2001

Choose cut-off level
22-30 Mar. 2001

Identify expenditure tradeoffs
22-30 Mar. 2001

Propose expenditure tradeoffs (if any) & submit data on "expenditures at the margin"
1-15 Apr. 2001

Decide on tradeoffs & adjustment of subsector ceilings on/or before set deadline
16-30 Apr. 2001

Finalize budget based on approved ceilings
23 May - 7 Jun. 2001

Finalize budget & FEs for submission to President/Cabinet by DBM-OSEC
8-15 Jun. 2001

Approve 2002 Budget & FEs for 2003 & 2004
about 17 Jun. 2001

Prescribe strategic planning based on the MTPDP
Nov. 1999 - July 2000

Prepare/submit budget details, new expenditure & savings proposals for 2002-2004

Prepare toward estimates (FEs) for 2002 and 2003 based on the 2001 budget

Adjust FEs for 2003 & 2004 based on 2002 budget
16-22 May 2001

Decide on tradeoffs & adjustment of subsector ceilings if NEDA PC failed to submit on time
16-30 Apr. 2001

23 May - 7 Jun. 2001

Finalize budget based on approved ceilings

Start of circle

Implemention for 2002 budget and Full MTEF Cycle
Figure 3.2  Proposed Schedule of MTEF Transition activities for 2001 Budget Preparation

[Diagram showing the schedule with key dates and activities]

- Nov. 1999: Prepare FEs for 2003
- Dec. 1999: Adjust FEs for parameter changes
- 1-22 Mar. 2000: Rank major proposals
- 1-22 Mar. 2000: Rank minor proposals
- 16-22 May 2000: Adjust FEs for 2003 & 2004 based on 2002 budget
- 16-30 Apr. 2000: Decide on tradeoffs & adjustment of subsector ceilings on/or before set deadline
- 23 May - 7 Jun. 2000: Finalize budget based on approved ceilings
- Approve 2001 Budget & FEs for 2002 & 2003

For a sector, are the annual cost requirements of top priority projects > the allocable ceilings for 2002-2004?
Chapter IV. Concluding Remarks -Comparison between the Province of Punjab and the Philippines in terms of Public Expenditure Management-

4.1 Public Expenditure Management Reform and its endowment

We have closely looked at each local or central government's reform of Public Expenditure Management according to the three elements of PEM's objectives: 'Aggregate Fiscal Discipline', 'Allocative Efficiency', and 'Operational Efficiency'. Examples of each reform are arranged in Table 4.1.

<table>
<thead>
<tr>
<th>Aggregate Fiscal Discipline</th>
<th>The Philippines</th>
<th>Punjab Province, Pakistan</th>
<th>New Zealand</th>
</tr>
</thead>
<tbody>
<tr>
<td>-Introducing Medium Term Expenditure Framework</td>
<td>-Managing budget through ceiling and other common methods, not yet introducing medium term perspectives (Single Year budgeting)</td>
<td>-Macroeconomic framework and its adjustment mechanism</td>
<td></td>
</tr>
<tr>
<td>-Obligation-based appropriation</td>
<td></td>
<td>-Strict management for aggregate fiscal level by Central ministries.</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>-Incorporating off-budget expenses into on-budget expenses, based on budget principle</td>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Allocative Efficiency</th>
<th>The Philippines</th>
<th>Punjab Province, Pakistan</th>
<th>New Zealand</th>
</tr>
</thead>
<tbody>
<tr>
<td>-Trial to make efficient resource allocation for each line Ministry through MTEF</td>
<td>(So far, not yet introducing measures to improve allocative efficiency)</td>
<td>-Decentralization of detailed resource allocation from central ministries to line ministries.</td>
<td></td>
</tr>
<tr>
<td>(-Weak capacity to make expenditure plan in line ministries)</td>
<td></td>
<td>-Flexible reallocation based on previous results</td>
<td></td>
</tr>
<tr>
<td>-Developing Performance Indicator concerning Outcome basis</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Operational Efficiency</th>
<th>The Philippines</th>
<th>Punjab Province, Pakistan</th>
<th>New Zealand</th>
</tr>
</thead>
<tbody>
<tr>
<td>-Partially introducing accrual accounting</td>
<td>-Trial of Activity Based Budgeting in some line ministries</td>
<td>-Introducing full accrual based accounting</td>
<td></td>
</tr>
<tr>
<td>-Auditing capacity is relatively high. Implementing Performance auditing. (-Actually still adopting Line Item Budgeting)</td>
<td>-Auditing capacity is relatively high. Implementing Performance auditing.</td>
<td>-Merit based personnel management</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>-Independent financial management by line Ministries.</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>-Full cost estimation by line ministries</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>-Performance Indicator concerning output basis.</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>-Implementing full performance auditing</td>
<td></td>
</tr>
</tbody>
</table>

In Punjab, introduction of the Performance Budget and implementation of the Performance audit are the main PEM reforms. In adopting the Performance Budget, Punjab started getting rid of line-item appropriation, then partially moved to activity-based appropriation although cash-based appropriation is still used and so far includes only the current budget. Both the Office of Director General Performance Audit Wing, Lahore and the Office of Director General Audit, Punjab are important organizations for
development of Performance Auditing. The role of the D. G. Performance Audit Wing is
the developer and trainer of Performance Audit, and the role of the Office of Director
General Audit is the executor. This mutual partnership was an indispensable basis for
introduction of Performance Budgeting in Punjab. These developments can be classified
into Operational Efficiency.

In the Philippines, the Performance Budget was introduced in the 1950's, then
SPPBS in 1980's. However, Both were not fully implemented. In 2000, Medium Term
Expenditure Framework (MTEF) was introduced and various reforms are being
carried out in all three layers. In Aggregate Fiscal Discipline and Allocative Efficiency,
MTEF is one of the important measures. Under MTEF, the aggregate budgetary
framework - effective budgetary procedure including planning and estimation, and
ceilings on an aggregate level - is planned to be set up. Here MTEF plays its very
important role to link the often-separated budget parts. Forward Estimate plays also an
important role to determine regular expenditure such as recurrent expenditure and
continuing development expenditure. The budget system adopts Obligation-based
appropriation. In Allocative Efficiency, constructing performance indicators mark
important progress for evaluation. In the Philippines, both outcome based performance
indicators and output based indicators are used, but for evaluation of policy and block
allocation of resources, outcome-based indicator is being actively adopted. In
Operational Efficiency, accrual accounting is being introduced in some parts. Performance
evaluation is implemented by the Commission of Audit. The budget framework is rationally structured and looks activity-based, but the figures of amounts
allocated never reflect costs which are regarded to be estimated on an activity basis.

Both developed countries and developing countries' cases show that there exist
countries where their reform started from "Allocative Efficiency" such as Australia and
the Philippines, and countries where their reform did start from "Operational
Efficiency" such as New Zealand and Punjab. Table 4.1. shows that developed countries
have accomplished many reforms in all three elements. The Philippines is one of the
countries which has experienced many reforms since the 1950's, but they do not cover
the variety of reforms which have been tackled by New Zealand and Australia.

However, as we pointed out in Chapter 3, these developed countries never tried to
reform in all three layers simultaneously. Based on each country's endowment, they
started conducting reforms of one category, then shifted to others. This is because public
sector reform costs not only monetary expenses but also a high institutional transaction
cost. In an unconstrained world, governments would seek concurrent improvements in
all three layers of public expenditure management. Simultaneous conducting of all
three layers of reforms is a big burden even in those developed countries.
Considering the endowment and institutional capacity in developing countries, such as the Philippines and Province of Punjab, the lesson learned is that Public Expenditure Reform should be implemented gradually and from one layer to another. And it is important at which layer a reform should be started. Of the three layers of reform, keeping "Aggregate Fiscal Discipline" is often political issue or required by international donors as assistance's objectives. Then, many countries often first start reforms in this layer. Recently, introduction of private sector management into the public sector is one of the important trends of reform. So, "Operational Efficiency" reform often started being conducted gradually by themselves or rapidly by donors' assistance. However, "Allocative Efficiency" includes redefining the role of many layers of the government and the role of central ministries such as the Financial Ministry and Planning Ministry and so on. Even if developing countries have a strong intention to reform, it is often difficult for this layer of reform to proceed always on track. The Philippines started its reform with the "Allocative Efficiency" layer since the 1950's. Many initiatives proceed slowly since MTEF and other initiatives for "Allocative Efficiency" are comprehensive but a difficult process. It should not be expected for developing countries to attain developed countries' level rapidly. Reaching to certain "Allocative Efficiency" level is a learning-by-doing process, not the situation where any country can jump and reach it a short period. The countries considering to start reform with "Allocative Efficiency" might be better to considered whether this direction is the best strategy for their overall public reform, checking their endowment. There may exist countries where the "Operational Efficiency" layer reform is appropriate for their endowment. The Province of Punjab is one of the good examples of starting with "Operational Efficiency".

<table>
<thead>
<tr>
<th>Box 4.1. How long does it take for &quot;Operational Efficiency&quot; reform?</th>
</tr>
</thead>
<tbody>
<tr>
<td>Reform of Public Expenditure Management is a learning-by-doing process and it should proceed gradually. Although this is an important point, is it appropriate to continue to introduce many reform tools? Allen Schick pointed out a direction.</td>
</tr>
</tbody>
</table>

Although developing and transitional countries may not be ripe for avant-garde managerial systems, the process of development need not stretch over decades or longer. The process can be accelerated by rationalizing external controls, removing duprivative and deadweight controls (for example, by consolidating budget items and civil service classifications); tendering internal control authority to well-managed departments that can handle enlarged responsibility; instilling a managerial ethic in the public service through skills-based and behavioral training; and developing first-generation performance measuring systems. These steps would enhance operational efficiency and prepare the way for bolder reforms in the future.

4.2 Getting the basics right

A reformer should focus on the basics on which reform is built, not on a particular technique. There are many basic key issues to be fostered by PEM. At the first stage of the reform, it is important to ensure that the existing method and system is working properly and transparency and accountability are achieved within this framework before attempting to change the method and system. Changing the system without changing the mindset to embrace transparency and accountability as part of good government practice will achieve little. Technical ‘solutions’ might just cover up existing systemic shortcomings without remedying the situation.

**BOX 4.2. Getting the basics right**

In elaborating Schick’s argument for “Getting the Basics Right29:

- Foster an environment that supports and demands performance before introducing performance or outcome budgeting.
- Control inputs before seeking to control outputs.
- Account for cash before accounting for accruals.
- Establish external controls before introducing managerial accountability.
- Operate a reliable accounting system before installing an integrated financial management system.
- Budget for work to be done before budgeting for results to be achieved.
- Enforce formal contracts in the market sector before introducing performance contracts in the public sector.
- Have effective financial auditing before moving to performance auditing.
- Adopt and implement predictable budgets before insisting that managers efficiently use the resources entrusted to them.

4.3 Specific issues

There are a lot of issues in PEM, MTEF, Forward Estimates, etc. Here we discuss some issues based on lessons learned from case studies of the Philippines and Punjab. These issues are very important institutional setting for managing public expenditure, but it should be known that appropriate introduction for each country is necessary in order to establish well these reforms

4.3.1 Accrual-based Accounting and Costing

Costing government activities and services and its value in directly contributing to an activity based budgeting increasingly draw attention in the context of the public sector management and governance. Realigning the framework for Costing coupled

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29 World Bank (1998e) p.8
with a concrete methodology is crucial to the implementation of qualified government activities through budgeting and public accountability.

Costing is not a mere methodology of estimation to sum up direct costs of personnel, administration, material inputs and other contingencies duly associated with the implementation of some specific projects or activities. The point to be stressed is that the Costing Methodology could answer the basic questions of:

( □ ) How much does the government, or tax payers, have to pay for a unit of public service inclusive of direct/indirect, accounting costs?
( □ ) Is that public service being delivered on a cost-effective basis?
( □ ) How could beneficiaries compare the quality of services provided with those possibly delivered by other sources, such as the private sector? And,
( □ ) How much is the optimum price for the public services currently delivered?

In the accrual concept, financial transactions such as revenues and costs are recognized as they are earned or incurred regardless of the timing of the associated cash transactions. Also, accruable accounting, in principle, reports economic resources or assets and liability of the entity while requiring the capitalization of expenditures on the acquisition of all capital assets and the depreciation of all assets as their service potential is consumed. Cost centers appropriately classified in accordance with activity function, or could be location and accrual-based accounting associated with the financial and managerial accounting documents, will be the means and ways that make it possible to correctly answer the questions above.

Although within the framework of PEM accurate costing should be a must for public goods and certain services, there still exist many challenges. In many cases, cost 'inseparabilities' exist. The determination of the cost allocation in the case of multiple uses can become costs in itself which outweigh the benefits for an accurate allocations the same might be true for indirect cost. Costing reform is an important initiative but it should be after the determination of the 'new' state functions. Following the selection and allocating the responsibilities for delivery to the different levels of government is a strategic planning exercise. Part thereof is as much as possible costing of activities. Thus, already at this stage, good costing information is relevant. The difficult but necessary task is to be realistic and innovative with respect to costing. The development of costing should be regarded as an evolutionary, learning and communication process as well. All parties concerned - oversight agencies, line agencies, auditors, technical personnel, accountants and economists - have to be included at an early stage to make it

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30 Schiavo-Campo and Tommasi (1999) p.492
4.3.2 Performance Evaluation

The outcome (program) or output (activity) level is at the center of budgeting. The issue is not which is adopted. What is necessary is to define output/outcome carefully and construct pertinent indicators for budget and performance measurement and monitoring purposes.

The Performance Evaluation (PE) cycle usually comprises inputs, process, outputs, utilization, and outcome or impact as given below:

(☐) Inputs: Resources for PE (human, pecuniary and other inputs, and time),
(☐) Process: PE processing with the specific indicators classified in the categories of financial, management, human resource management, information technology management, capital management, and managing for results, as well as the integrated parameters of leadership, employees, beneficiaries, and information,
(☐) Outputs: Performance Monitoring or Evaluation,
(☐) Utilization: Adjustment during budget year and recommendation for budgeting in the ensuing year(s), and
(☐) Outcomes: Better performance of the public sector for people in terms of delivery of public goods and services, and Public Accountability for the quality of public management.

In case of discussion of performance evaluation on the project level, firstly output is set, then monitored and evaluated. As the New Zealand experience has shown, it is difficult to define the appropriate output measure and monitor. At the program or policy level, evaluation on outcomes can not be ignored, but It is extremely difficult to define the appropriate outcome measure and monitor their achievements. One of the obstacles is caused as a result of the dichotomy of the organizational structure of governments (ministry, department, division) with the plan/budget structure (policy, program, activity), which is the basis of these budget systems. In most cases, they are not compatible. Then, the accountability problem often arises if evaluation on outcome is conducted. Programs (outcome level) have mostly no equivalent in the existing organizational structure of governments. Therefore the managers charged with the partial achievement of a certain outcome performance can only be held partially accountable.

Here, we do not discuss practically how output and outcome measures should be defined. With regard to performance measurement and monitoring, the distinction and the cognizance of the implication of the chosen approach is of extreme significance. Performance measurement, especially outcomes should be defined by gains of the target-group or the society.
Appendix 1. Elements to Support PEM Cycle

1. From “Plan/Program/Activity” to “Budgeting”

(1) Departure from Incremental “Line-Item Budgeting” to “Activity-Based Budgeting”- Budget Projectization

Plans are drawn up to achieve the policy objective of an organization with programs to be individually implemented to realize the plans concerned. The programs are further broken down into multiple activities as the practical components for their physical execution. These hierarchical action factors are expressed in monetary terms and compiled in a “Budget” for their implementation. Therefore the “Budget” carries out a two-fold function to realize optimal resource allocation among the action factors under the prescribed operational plan (planning function), as well as to control the execution evaluating respective performance (control function).

In order for the “Budget” to carry out these functions, it is obviously required to compile the budget on an activity basis. However, most of conventional practices have been preparing a budget on a line-item and incremental basis. The following example will simply illustrate this distorted state of affairs.

Let’s assume a research institute conducting four pieces of economic research every year. Contents and methods of the researches vary from year to year according to the institute’s medium term operation plan. A research requires a set of activities for its implementation, which incur different kinds of operational costs to carry them out. Apparently, the coming year’s operational budget must be compiled purely based on an analysis of the activities specifically required to conduct the planned research work and accompanied cost estimation, which are independent and must be different from the ones of the last year.

However, this way of practice has been hardly followed in the conventional budgeting procedures in most of the governments in the world. What they have been doing in most cases is to estimate (strictly speaking, this is not an “estimation”) the budget based on the previous year’s budget amount with incremental adjustment on each cost element (line-items).

The fundamental requirement for a real PEM is a departure from this “Line-Item” based incremental budgeting into the “Activity-Based” principle. The “Line-Item” or “Incremental” budgeting by no means represents the Plan and Programs to be pursued due to a lack of linkage with the activities concerned, and makes the
“Evaluation” imperfect failing to compare the performance and the cost for its achievement under a program. Therefore this shift would be one of the most significant elements as a base for the establishment and operation of a desirable PEM system. The term “Performance Budgeting” is normally used for undertakings toward this direction.


“A project is a specific activity with a specific objective. It is measurable both in its major costs and returns. It will have a relatively well-defined time sequence of investment and production activities. It will have a specific group of activities which we can identify and estimate its values. It will have a partially or wholly independent administrative structure and set of accounts.”

If we define a Project, following his observation, as “an identifiable unit of activities generally focused on achieving a specific output with a specific timeframe of implementation mobilizing all the resources necessary as input feeding the activities involved”, the initiative toward the “Activity-Based Budgeting” can be termed as “Budget Projectization”. From this perspective, the “Performance Budgeting” in the Province of Punjab, Pakistan and the current budgeting practices of the Philippines with their effort for New Public Management will be examined in the main text (Chapter III) respectively.

(2) “Costing” as a Base for PEM Cycle - Costs Directization

The movement toward NPM is not the recent advent, but has a history of several decades in various countries in the world. The Performance Budgeting launched in 1949 in the U.S. following the recommendation of the Hoover Commission, the first experimentation of Performance Budgeting in the Philippines in 1954 and the Planning Programming Budgeting System (PPBS) in the U.S implemented in 1960s are those historical precedents. The ADB’s hand book, “Managing Government Expenditure” comments that these adventurous attempts eventually ended in failure. The recurrent NPM boom prevailing in various countries including the Philippines which we have observed during the field study takes on an aspect like ever-lasting waves coming in and receding on a shore, and reminds us of the irony, “It is easy to stop smoking. I have already achieved it fifty

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32 Activity-Based Budgeting also facilitates the transparency to clearly show the concrete activities a Program unit is conducting, or is going to conduct.
It is our opinion that one of the greatest bottlenecks is a failure to step into the costing aspect of PEM or to establish an accurate costing system in the public sectors. The costing is an accounting technique to estimate the accurate product (including service) cost for various management purposes. The costing provides the upper stream of PEM; planning, prioritization among alternative programs and also evaluation at the downstream with value information about the cost of individual plans, programs and activities. Especially to the budgeting process after it has been compiled on an activity basis, the cost information is indispensable, or it should be even said that the budgeting represents the costing itself. Therefore it is plausible that the efforts to acquire effective PEM never succeed until an appropriate costing system has been established due to a lack of fundamental information.

The key point of the public costing is, again, a turn to the Activity Basis. One of the salient features of a public sector from an accounting point of view is the fact that indirect items are dominant in its cost structure in terms of that most of the cost items can not be directly attributed to a specific public service. Those indirect costs must be allocated to multiple products or services produced to get their unit cost, but the inherent problem is a lack of accurate allocation criteria for most of the cost items. It is this factor that prevents a public sector from accurate cost estimation of a unit of the public services provided, because the allocation processes of the indirect costs obscure the real cost incurred to produce a certain service. This problem is unavoidable until the costs cease to be indirect.

The costs continue to be indirect as long as their behaviors are linked with the products or services, however, they will become direct if they are considered in connection with production activities necessary to produce the final products or services. Thus the Directization of Costs can be mostly realized if we switch our idea of cost linkage from products (services) to activities. Same as the shift from the Line-Item to Activity-Based in the budgeting process, the shift to the Activity-Based Costing can mostly solve this problem through the Cost Directization.

2. From “Budgeting” to “Execution”

Once the Budget has been compiled, the Plan will start to be realized through the implementation of the Programs which consist of number of activities consuming the allocated Budget. This process must be carefully controlled in order to ensure the Plan/Program be executed in an efficient and effective manner. The allocated resources have to be utilized most economically with minimum leakage to unproductive use in pursuit of maximum output in terms of quantity and quality. To
support this process effectively, a double-layered control system, internally within the organization as well as externally by independent outsiders, is needed.

(1) Internal Control System

An Internal Control System is a total system of an organization including rules, procedures and tools to self-control safeguard of the assets, accuracy of the management information, efficiency of the operation and compliance with the policy and plan of the organization. Management control in the public sector has to ensure:

(口) The economical, efficient, and effective achievement of the entity’s objective
(口) Adherence to external rules (laws, regulations, etc.) and to management policies
(口) The safeguarding of assets and information
(口) The prevention and detection of fraud and error
(口) The quality of accounting records and the timely production of reliable financial and management information

An internal auditing system also constitutes an integral part of the internal control system as an interface with the external auditors. The major area of the internal auditing is the Operational and Compliance Audits.

(2) Compliance Audit by External Auditors

To facilitate common understanding about Auditing, a brief elucidation is given first in advance of the main topic to be discussed here.

(Basic Concept of Auditing)

Auditing is generally defined as the accumulation and evaluation of evidence about verifiable information of an economic entity to determine and report on the degree of correspondence between the information and established criteria. To do an audit, there must be some standards or criteria by which the auditor can evaluate the information, and the information to be audited must be in a verifiable form.

(Audit Categories by Purpose and Object)

(口) Financial Audit

The quantifiable information being verified is financial statements which vary in form and contents according to their own purposes. Typical financial statements are Balance Sheet, Income Statement and Statement of Cash Flows, and loan related statements which are usually audited at the donors’ request like Statement of Special Account, Statement of Expenditures (SOE) and Project Account also belong to the Financial Statement in question.

The purpose of “financial audit” is to enhance credibility of financial statements prepared for a certain purpose by ascertaining that the statements have been prepared in accordance with the generally accepted prescribed rules and the figures stated are fairly supported by convincing evidences.

(Ⅰ) Operational Audit

An operational Audit is a review of any part of an organization’s operating procedures and methods for the purpose of evaluating “efficiency” and “effectiveness”, and as a result of the audit, some recommendations to improve the weaknesses having been found are expected to be reported.

Because of the many different areas in which operational efficiency and effectiveness can be evaluated, it is difficult to characterize the conduct of a typical operational audit and specify the objects to be audited, or information to be verified, in a clear-cut manner. Efficiency and effectiveness of operations are far more difficult to evaluate objectively than compliance or the presentation of financial statements in accordance with prescribed standards, and establishing criteria for evaluating the quantifiable information in an operational audit is an extremely subjective matter. In this sense, operational auditing is more like management consulting than what is generally regarded as auditing. In general, operational auditing has increased in importance in this several decades.

(Ⅱ) Compliance Audit

The purpose of a compliance audit is to determine whether the auditee is following specific procedures, rules or regulations set down by some higher authority or controllers. The auditors are either internal auditors within the organization itself or, when an organization wants to determine whether individuals or organizations that are obliged to follow its requirements are actually complying, auditors employed by the entity issuing the requirements.

(Ⅲ) Performance Audit
Performance Audit characterizes the typical feature of Public Auditing, which can be defined as an independent appraisal of an entity to determine the extent to which resources were managed with due regard to economy, efficiency and effectiveness and in conformity with applicable regulations, rules and procedures. The performance auditing is a means for improving management practices in the public sector, and sharpening the accountability process of public managers.

“Economy” refers to acquisition of resources at the lowest cost keeping in view the objectives of the organization. It implies that the resources should be acquired at the right cost, at right time, at right place in right quantity and of right quality.

“Efficiency” means optimum utilization of resources keeping in view the objective of the organization. It implies maximizing output from given resources or minimizing input for given output.

“Effectiveness” refers to the achievement of objectives. It involves assessment of outcomes of programs and projects which are usually external to the organization.

The purpose and perspective of the external auditing in this stage are almost the same as the ones pursued by the total internal control system including the internal auditing having been discussed above. However, the significance of the external auditing is not merely for a double-checking purpose, but more importantly its considerably stronger power of control than the internal one whose independency is inherently weak.

3. From “Execution” to “Evaluation”

(1) Financial Statements based on Generally Accepted Public Accounting Principles

To facilitate common understanding about Accounting, a brief elucidation is also given first in advance of the main topic here. We are going to talk about the Financial Accounting here relating to the accountability of organizations in the public sector. However meaningful discussion about other elements of PEM like “Costing” requires clear perception of the role of accounting which carries dual aspects.

(Financial Accounting and Management Accounting)
Generally in a business world, decisions of investors and business managers allocate resources in the profit-oriented segment of the economy. The business resource allocations involve two levels of decision-makings, interfirm and intrafirm decisions. Investors, creditors, customers and other related parties standing outside the firm concerned make the former decision. They commit their resources to those firms where they believe they can earn best possible returns in their transactions. On the other hand, once resources have been invested in a firm as a result of the former decision, its managers must take decisions about how best to utilize them to attain the maximum output.

The role of accounting is to provide meaningful information for both of these resource-allocation decisions. In a broad sense, accounting is a vehicle for communicating the data necessary for making intelligent decisions. The focus of accounting data for interfirm resource allocations is termed “financial accounting”, whereas one for intrafirm allocations through the planning and control process is termed “management accounting”. There are, however, important differences in both data requirements and philosophical approach to these data reflecting their own purposes.

Public sectors in a national economy bear an analogy to a business world in terms of decision-makings for their resource allocations. Any organization in a public sector is a synonym of a business firm in a private sector. They have, therefore, a responsibility to provide the general public and other stakeholders with proper financial information for their allocation of national resources and overall control. By the same token, they are also responsible to generate appropriate management information internally to perform their operation economically, efficiently and effectively. Within the accounting, both elements are mutually supportive in an interacting process in terms of that a) the management accounting provides the financial accounting with cost information, on the other hand, b) the value information processed in the management accounting is produced within the framework of the financial accounting system.

In spite of the general features of accounting stated above, differences of the public accounting from the private accounting should be also emphasized. The financial accounting or accounting for external reporting of the public sector has to discharge its public accountability, which is the duty of the public organization to disclose the execution results of financial, managerial and operational responsibility for the appropriation of social resources entrusted by the general public. Necessary information to be stated in the annual statements of the public sector should include the following items.
Whether the current year's revenue has been enough to cover the expenditure spent, in other words, to clarify the share of public expenditure among generations.

To clarify compliance with the budget and laws.

To disclose the result of efforts to discharge public responsibility showing performance achieved and cost spent.

Presentation of proper accounting information in public financial statements requires transition from cash to accrual basis accounting, and a double-entry bookkeeping procedure supports its comprehensive application. Accrual accounting requires that financial transaction be recognized as they accrue regardless of the associated cash transactions, while cash-basis accounting recognizes accounting transactions based on cash deliveries. Accrual accounting facilitates matching period between cost and benefit earning or performance. A simple example illustrates its significance.

Under cash-basis accounting, construction cost of a children's hospital is recorded as “cost” during the construction period, while benefit (e.g. reduction of infant mortality) is never recorded until it has been realized by the operation of the hospital after it is completed. Thus this treatment distorts the contents of the Performance Statement in a certain accounting period failing to compare the performance and the corresponding cost in the period concerned.

Another noticeable fact is, as discussed in the previous section, that the activity-based management accounting can provide the financial side and the “Evaluation” stage with more accurate accounting information.

(2) Performance Statement

Most important aspect of the public sector's accountability is the disclosure of the performance achieved compared with cost incurred to attain it. For a commercial entity in the private sector, "Profit" is the indicator which most eloquently denotes the entity's performance. "Profit" is a single indicator measured in monetary terms, but the public sector does not have such a tool. The purpose of the public sector is an increase of people's welfare which has multiple aspects and is mostly not measurable in monetary value, whereas the ultimate objective of the private sector is profit maximization.

The Performance Statement (P/S) corresponds to a Profit and Loss Statement (P/L) in the income earning entity. Although both are common in their purpose to
report the entity’s operation result, the former statement differs from the latter in the following points:

- P/S is basically prepared for an individual program.
- All the performance items in P/S are not quantified or expressed in monetary terms.
- Performance in P/S is shown in comparison with the target set in advance.
- Standard procedures of preparation and format of P/S has not been established yet.

Performance Statement is important both for discharging public accountability and for the evaluation in the next step of the PEM cycle. But the field studies in Pakistan and the Philippines have shown that this element is among the weakest. It may be because of the poor preparation of costing side, while the performance side (e.g. preparation of performance targets and indicators) is far more actively proceeding.

Performance Evaluation is relatively easy for projects because all the resources are mobilized under the project objective (projectized), but non-project social services are difficult to be evaluated without the Performance Statement.

(3) Multi-Layered Performance Evaluation System

The prior section about the stage from “Budgeting” to “Execution” has discussed the necessity and importance of multiple-layered control system for Budget Execution. The same structure of control is also required for the Evaluation Stage. The multi-layered evaluation (or control) system is illustrated as follows:
Internal Control is self-evaluation operated by a permanent division internally installed. It can provide precise evaluation with close contact with the activities to be controlled, but strength of control is weakest because of its inherently scarce independency. On the other hand, Social Control as the other extreme has the strongest power of control, but its content of control is least precise. Thus, the multi-layered system makes the evaluation and control totally effective supplementing the weaknesses of each component.

(4) “Output” or “Outcome” Argument

There is an argument about the evaluation, which to take “Output” or “Outcome” as the performance. The ADB Handbook defines both with brief explanation as follows\textsuperscript{35}.

“Output” is the products and services produced by an activity. Outputs are important for measuring work performance, but do not in themselves indicate the extent to which progress has occurred toward achieving the program's purpose. Depending on their nature, outputs may or may not be easy to

\textsuperscript{35} Schiavo-Campo and Tommasi (1999) pp.497
measure, e.g., the number of hospital cases is easier to measure than the
date on a policy issue submitted by a health administrator.

“Outcome” is what is ultimately achieved by an activity, as distinct from its
outputs, which relate to more direct or immediate objectives. For example, the
outcome of a random breath-testing campaign conducted by the police may be
a decline in drunk driving, while one of the outputs could be the number of
drivers charged with exceeding the legal alcohol limit.

The Evaluation in the PEM Cycle is carried out from the 3E (Economy,
Efficiency, Effectiveness) or VFM (Value for Money) aspect. Such argument above
may be therefore empty, because it is obvious, if we take the definitions above, that
both must be taken as “Performance” in the evaluation, but in different dimensions.
The Economy and Efficiency aspects are properly evaluated comparing the output
and resources inputted to achieve it represented by the cost incurred. Whereas the
Effectiveness aspect should be separately assessed focusing on the outcomes, or
their relation to the outputs, by means of adequate analytical devices prevailing for
policy analysis like “Inter-industry Analysis”, “Benefit Incidence Analysis”, “Hednic
Approach” or “Cost-Benefit Analyses” in case of project evaluation.

4. From “Evaluation” to “Feedback”

(1) Internal Monitoring System of Feedback Action

Among the functions which constitute the PEM Cycle, the linkage from
“Evaluation” to “Feedback” is universally weakest in any organization particularly
in public sectors in any place of the world, whether developed or less developed.
Even the Province of Punjab, Pakistan and the Philippines which have relatively
strong “Evaluation” functions by the government auditors, the “Feedback” function
is the second weakest field following the “Costing” area. This practical topic is
discussed in the main text (Chapter III) respectively.

Conceivable measures to promote and strengthen this function are timely
issuance of the evaluation result and its transmission to the parties in charge of
policy and budget makers, installation of monitoring function within the
organizations to take corrective actions and exposure of the evaluation result to
public to inspire social control.

Among the effective means, most important function is to be carried out by
internal control systems, including internal auditors, which work closely and
permanently with the parties charged with taking corrective actions.
(2) Feedback Monitoring by External Auditors

As stated in the previous section, auditing performs a comprehensive function with wide coverage. “Feedback” is also within the arena of the auditors carried out by their “operational audit”. Although this function is primarily one of the tasks of internal auditors, as just have stated, external auditors should also involve this function in their scope of works. The resident auditors system in the Philippines is unique and effective from this point of view.
Appendix 2. Paradigm Shift of “Activity-Based Costing”

1. Costs Directization by Activity-Based Costing (ABC)

In order to consider public sector costing, we should start with taking the following significant facts into account.

(1) Economic and social activities of a public sector entity are normally characterized by the operation of the service industry.
(2) The costs structure of the service industry is different from the one of the manufacturing industry in terms of its feature where indirect costs are dominant.
(3) The indirect costs inevitably make costing ambiguous through their allocation among the various products or services under unavoidable arbitrariness of the allocation criteria.
(4) Because of the above, even in private sectors, appropriate costing or cost accounting for the service industry has not been well established.

The bottleneck is thus the existence and its dominance of the indirect costs in the service industry for their development of appropriate costing. The problem, therefore, will not be resolved until the costs cease to be indirect.

The costs continue to be indirect as long as their behaviors are linked with the products or services. However, they will become direct if they are considered in connection with production activities necessary to produce the final products or services. Thus the Directization of Costs can be mostly realized if we switch our idea of cost linkage from products (services) to activities. Like the shift from the Line-Item to Activity-Based in the budgeting process, the shift to the Activity-Based Costing (ABC) can mostly solve this problem through Cost Directization.

The ABC was initially developed for the manufacturing industry to elaborate their costing method aiming to avoid arbitrary allocation of indirect costs among the products. However, its theoretical advantage enabled it to be applied to a wide range including service industries, and now it has begun to be involved in the public sector costing. The leading precedent would be the attempt at New Public Management by Indianapolis, the capital of the U.S. State of Indiana, which introduced ABC as one of the key pillars of its administrative reform coupled with Performance Measurement, Intelligible Budgeting and Beneficiaries Survey. In other words, the reform of Indianapolis started with the attempt to precisely recognize the costs of administration corresponding to the service activities.
2. Procedural Framework of ABC

The procedural framework of ABC using a simple example of a “Delivery Division” of a retail company is presented in this section clarifying how its paradigm has shifted from the conventional costing.

The following are the simplified assumptions of a retail company which sells only three kinds of commodities X, Y and Z at a shop located in a different place from the delivery center. This is an example of costing of the Delivery Division (Center) of the company.

Cost Items Incurred at the Delivery Division (Center)

(☐) Packing and other supplemental materials
(☐) Staff salaries
(☐) Depreciation of office building, warehouse and vehicles
(☐) Utilities
(☐) Insurance
(☐) Telecommunications

All the cost items above are more or less indirect because they cannot be directly attributed to each commodity X, Y and Z. In conventional costing, each cost item is allocated among the three commodities using plausible allocation criteria. The “insurance cost” may be rather reasonably allocated compared to others if the value of commodities transacted is taken as the allocation criterion. However, it is almost impossible to fix rational allocation criteria for other items especially “staff salaries”, “utilities”, and “telecommunications”. In spite of this fact, the allocation is a “must” to get the costs by commodity.

This is the process how the conventional ways make the costing ambiguous and the commodity cost unreliable under the condition in which indirect costs dominate the total cost structure.

The ABC bases its concept upon the following presumptions:

(☐) “Activity” consumes economic resources, which incurs “Costs”
(☐) “Product (Service)” consumes “Activities”

Based on the above, the ABC traces economic resources to activities which
have consumed them, and then allocates the activities to particular products or services that have consumed the activities concerned. The criteria for the allocation are called “Cost Drivers” which consist of “Resource Drivers” for the allocation of economic resources to activities, and “Activity Drivers” for the allocation of activities to products and services. The following table illustrates the ABC procedural framework which requires the two-step allocation above.

Figure A 2. Framework and Steps of ABC

<table>
<thead>
<tr>
<th>Cost Drivers</th>
<th>Consumption</th>
<th>Cost Calculation</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Economic Resources</strong></td>
<td><strong>Consumed</strong></td>
<td>Calculation of Activity Cost</td>
</tr>
<tr>
<td><strong>Activity</strong></td>
<td><strong>Consumed</strong></td>
<td>Calculation of Product or Service Cost</td>
</tr>
<tr>
<td><strong>Products or Services</strong></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

**Cost Drivers**
- Resource Drivers
- Activity Drivers
3. Steps for Implementation

(1) Identification of Necessary Activities by Analysis

What has to be firstly done is to analyze which kinds of activities must be carried out to fulfill the function of the Delivery Division (Center). Let's assume that the following are the required activities identified by the analysis.

Activities of the Delivery Division (Center)
- Recording truck movements
- Unloading commodities
- Storing
- Arranging delivery orders from each shop
- Loading commodities
- Delivery to each shop
- Using office building and warehouse

(2) Determination of Resource Drivers

Secondly, it is necessary to analyze how much respective activities consume each cost item, and fix rational Resource Drivers as the criteria to allocate the latter to the former. For example, proportions of the supervisors working hours among activities (ⅰ) to (⅝) are analyzed and standardized. Then, the standardized proportions are fixed as the Resource Driver.

The depth of the analysis varies from a detailed behavioral job analysis up to a rough estimation by staff interviews. The choice entirely depends on the entity's demand and supporting conditions. However, what is important here is that it is often more useful to utilize less precise but more appropriate information than precise but less appropriate data. That idea is also important in considering implementation of the ABC on a permanent basis growing out of a special study on an ad hoc basis.

(3) Determination of Activity Drivers

The final process is to fix attribution of activities to the products or services. This also needs analysis to grasp determinant factors or Activity Drivers of the consumption of the activities by commodities. The handling quantity of each commodity for the activities (ⅰ) to (ⅴ), and cubic meters transacted for the activities (ⅵ) and (Ⅽ) would be the appropriate Activity Drivers respectively. Applying these
Drivers, the costs of activities are allotted to the commodities X, Y and Z.

4. Concurrent Benefits of ABC

The ABC is not merely a tool for rational cost calculation, but it benefits the management of the entity in various ways. Especially from the perspective of the public sector, the following concurrent benefits are expected for the improvement of the total Public Expenditure Management.

(Ⅰ) The two-step analyses of the operational activities reveal irrational functional process such as duplicate or redundant jobs and omission of necessary activities, and facilitate drive for total management improvement.

(Ⅱ) The result of ABC gives a rational base for preparing a “Performance Statement” of a public entity.

(Ⅲ) The rationally prepared Performance Statement enhances transparency of public services, and strengthens the accountability of the public sector.

(Ⅳ) Coupled with the Activity-Based Budgeting, the ABC promotes the sense of belonging of the staff clarifying the function of their jobs.

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36 A special tool for management improvement utilizing the ABC has been developed as “Activity-Based Management (ABM).“
Appendix 3. Budget Processing in the Philippines - An Overview

1. Mechanics of Fiscal Policy Formulation and Coordination

In the first instance, budget preparation starts with the formulation of the macroeconomic framework. The purpose of the framework is to ensure that the budget is consistent with the macroeconomic policies and resource constraints. In this regard, the DBCC determines the overall budget obligation ceiling (i.e., maximum expenditures for current and capital expenditures) based on projections of central government revenues, including ODA, the fiscal deficit target and upper limit for new borrowings for the year. The DBCC focuses on the consistency of the overall budget ceiling and financing plan with projections/targets of key macroeconomic variables like GNP/GDP growth rate, inflation rate, Treasury bill rate, foreign exchange rate, and the London Inter-Bank Offered Rate (LIBOR).

In practice, the responsibility for the macroeconomic projections is fragmented. The DOF is responsible for projections of government revenue, the NEDA for projections of the real sector and prices as well as ODA flows, and the BSP for projections of monetary aggregates and balance-of-payment variables and the NEDA. In effect, the DBCC, with the DBM performing secretariat function, acts as the clearing house that evaluates the different projections. Nonetheless, this arrangement has oftentimes resulted in the lack of consistency of the projections.

In addition to the need for better coordination in the preparation of the macroeconomic projections, there is also a need for strengthening the linkage between planning, programming and budgeting. The issuance of Memorandum Order No. 295 in May 1990 calling for the adoption of the Synchronized Planning-Programming-Budgeting System (SPPBS) was meant to address the problem. It was intended to improve the coordination among the budget, planning and revenue agencies so as to ensure the consistency of budget plans with development goals and available finance. This system involves the implementation of a calendar which arranges the sequence of planning, programming and budgeting activities in harmony with the relationship between their inputs and outputs; a synchronization of procedures, and the coordination of relevant documents like the Medium Term

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37 This Appendix is a part of the draft on Public Expenditure Management in the Philippines prepared by Dr. Rosalio G. Manasan, Research Fellow at the Philippines Institute for Development Studies. The research team is to express hearty gratitude for her devotion and contribution extended during the contract with the mission.

38 Note that the completion of feasibility studies for public investment projects and their readiness for submission to lending institutions likewise represent a constraint on borrowing levels for the incoming year.
Fiscal Plan, Medium Term Public Investment Plan, the Medium Term Philippine Development Plan and the Regional Development Investment Plans.

2. Mechanism for Budget Formation: National Level

(1) Budget preparation

The aggregate level of expenditures net of debt service is then distributed to different sectoral concerns, namely: economic services, social services, defense and general public services. The procedure that is followed in determining the sectoral and sub-sectoral ceilings has changed over time. During the early part of the Aquino administration, the DBM essentially determined the sectoral allocation of the budget after a series of consultation with the heads of the different agencies. This process whereby the DBM and the agencies jointly determines spending priorities was found to be both time-consuming and acrimonious (World Bank 1992).

In 1990, the DBM first computed the baseline budget, defined as the portion of the agency budgets which is earmarked for personal services and maintenance and operating expenses of regular agency functions and for on-going foreign-assisted projects. Subsequently, the heads of the different departments agree on the distribution of the allocable component of the sub-sectoral ceilings, i.e., the difference between the sub-sectoral ceiling and the total baseline budgets of department/agencies within the sub-sector, among themselves.

In later years, the prioritization was essentially left to the Cabinet or the DBCC. Thus, during the preparation of the 1993 budget, the prioritization strategy was developed by the DBCC's Sub-committee on Prioritization that was headed by the NEDA with representatives from the DOF, DBM and the Coordinating Council for the Philippine Aid Plan (CCPAP) as members. After making provisions for personal services and maintenance expenditure requirements of all regular agency functions (or government-wide baseline budget), the Priority Projects Fund (PPF) was created and all other agency activities are lined up against the PPF.

Prioritization for the PPF then followed a two-stage process. Projects/activities with the following characteristics were given first priority and are included in the agency budget:

- On-going foreign-assisted projects with an expenditure ratio (1991 expenditure obligation over budgetary release) of 60 percent or above,
- Projects for completion in 1993,
Projects/activities tied to program loans with budget support implications, and
Positive net revenue generating activities in 1993.

In the second stage, all other projects/activities not included under first stage were prioritized based on a point system with the following criteria: development goal, regional distribution, source of finance, and implementation capability. The weight for the regional criterion was based on poverty incidence. On the other hand, the points assigned for the other criteria were determined based on a Delphi survey of the Sub-committee members.

Under the development goal criterion, social service projects/activities and physical infrastructure projects/activities received the same weight and tied for the first place. Agriculture, agrarian reform and industrial development ranked a close second. The allocable sectoral and sub-sectoral ceilings were implicitly derived as the ratio of the sum of a given sector's expenditures on projects/activities that passed the hurdle rate to the total PPF.

In the preparation of 1994 and 1995 budgets, a different prioritization strategy was followed. First, money was set aside for personal services and maintenance expenditures of regular agency functions. Budget proposals of the different agencies over and above their minimum requirements were prioritized in relation to the Medium-Term Public Investment Plan (MTPIP). Specifically, only activities included in the MTPIP were considered. In turn, the inclusion of projects/activities in the MTPIP was decided by sectoral steering committees during its yearly review. In principle, activities are ranked on the basis of their readiness for implementation and the contribution of the activity to agency efficiency and the overall streamlining effort of the government. In practice, the choice is based on the ability of agency heads to convince the sectoral or sub-sectoral committee on the advantages of his agency's proposed activity over those of other agencies. Thus, a good deal of bargaining amongst the secretaries of the line departments drives the setting of the sectoral/agency budget ceiling. To some extent, allocation decisions are made based on the political clout of the different actors than on objective indicators of needs and results.

DBM officials admit that apart from the formal procedure in setting department/agency ceilings described so far, there also exists an informal appeals process through which department heads attempt to increase their budget ceilings by asking for reconsideration from the DBM Secretary or the President prior to the Cabinet approval of the same.
Once the agency budget ceilings are set, the DBM issues a Budget Call. The Budget Call is a directive to the heads of different government agencies to prepare and submit their respective budgets in accordance with the budget ceilings and guidelines prescribed therein and consistent with the overall and sectoral objectives of the Medium-Term Philippine Development Plan (MTPDP). However, there are years when the agency ceilings are provided one-two months after its issuance. The expenditure ceilings for the agencies are meant to minimize the possibility of bloated budget proposals and to guide agencies in prioritizing their funding requirements.

Upon receipt of the department/agency ceiling, the agencies/departments require their sub-departmental units to submit their budget proposals with allocations by function/project/activity/purpose, by expense class and by regional and sub-regional areas. Typically, provisions for all mandatory requirements like personal services, retirement benefits, rent, etc. are first set aside before the balance is distributed to the different programs based on the department’s own prioritization.

Before preparing their budgets, the different departments are also expected to conduct consultations with the chairmen of the Regional Development Councils (RDC) where they present their criteria for allocating their expenditure between central and regional programs, and the subdivision of the regional budget across regions. Later, regional budget hearings in close coordination with the RDCs are held to ensure that the programs, priorities and plans of the various regions are taken into account in the agencies’ budget proposals. Regional offices submit their RDC-approved budgets to their head offices which, in turn, consolidate these into the budget proposal of the entire department.

The DBM then reviews the budget proposals of the different agencies based on the guidelines set forth in the Budget Call, the standard costing for equipment that is available from the DBM. Essentially, the evaluation of the baseline budgets of the agencies follows an incremental budget approach. However, the evaluation of the programs and projects over and above the baseline budget is based on the relationship with the development plan, agency capability as demonstrated by past performance, and complementarity with related activities of other agencies. Subsequently, the approved budget proposals of the different agencies are collated and the result is an overall budget that is presented to the Cabinet for deliberation and the President for approval.
(2) Budget legislation

The budget legislation phase begins with the submission of the President’s Budget (in the form of a detailed Expenditure Program accompanied by the Budget of Expenditures and Sources of Financing, the President’s Budget Message and the Regional Allocation of Expenditure Program) to Congress within 30 working days after the opening of its regular session.\(^39\)

In Congress, Committee on Appropriations of the House of Representatives undertakes the initial review of the proposed budget. The Committee then summons the officials of the different Departments to explain and justify their respective budgets. Based on the results of these hearings, the Committee drafts the General Appropriations Bill which is then forwarded to the Senate.

In the Senate, the Bill is referred to the Senate Finance Committee. This committee conducts its own budget hearings by calling on agency heads/officials to explain their budgets. The Senate Finance Committee then proposes amendments to the House Budget Bill for the Senate body’s approval. The differences between the House version and the Senate version of the Budget Bill are then threshed out in a Conference Committee which proposes a common budget bill. Once the House and the Senate approves this, it is submitted to the President for signing into law. It is then known as the General Appropriations Act (GAA).

The 1987 Constitution provides that “no money shall be paid out of the Treasury except in pursuance of an appropriation made by law.” This is generally interpreted to mean that the legislature has the power of the purse. However, it should be emphasized that there are statutory limitations on the extent to which the legislature may influence budget allocation.

On the one hand, Book VI Section 24 of EO 292 provides that Congress is not authorized to increase (it can only reduce) the proposed outlays for each expenditure item included in the President’s budget. Thus, many analysts express concern about the increasing incidence of Congressional cuts on certain expenditure programs and corresponding increases in other programs/projects (or insertions of

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\(^39\) The expenditure levels contained in the President’s Budget represent the actual expenditure program, proposed to be authorized by ‡ the accompanying General Appropriations Bill, ‡ the new public works act, if one is scheduled for enactment, ‡ previous years’ public works acts which by their nature continue to be in effect until exhausted, and ‡ automatic appropriations. Thus, it should be emphasized that the figures in the President’s Budget are not identical to the proposals in the General Appropriations Bill.
new programs) which are way beyond the authority of the legislative branch to do so. In reaction to this, the President's veto message for 1994 provided that increases in various expenditure items in the President's budget made by Congress shall only be implemented by the DBM upon approval of the President himself. On the other hand, Congress asserts that it is allowed by the Constitution to realign the President's budget as long as it does not increase the overall outlay. Moreover, there is growing sentiment that the legislative branch should exercise greater control over budget allocation.

Congressional insertions/substitutions come via two routes. "They may have the strong backing of local officials and the constituents of politicians. Alternatively, they may have the backing of agency officials who are, in effect, making an end run around the President's budget and appealing directly to the Congress on behalf of their own strongly felt priorities".

Congressional initiatives and insertion of new projects tends to result in an increase in the overall budget deficit. This occurs as Congress goes through the ruse of cutting debt service (even if the latter is automatically appropriated anyway). Two types of discipline are required to address this problem. First, agencies have to be disciplined so that they do not attempt to circumvent the President's Budget. Second, Congress must be willing to discipline itself. This is easier said than done.

More discipline could be introduced if budget rules were put in place that essentially force budget neutrality on each agency, i.e., new projects inserted in the budget of one agency will have to be financed by cutting the budget of other activities of said agency. In like manner, budget neutrality could be forced on a sectoral basis rather than on an agency basis.

(3) Budget execution

This calls for: ensuring that the budget will be implemented in conformity with the authorizations granted in the law, adapting the execution of the budget to changes in the macroeconomic environment, and managing the purchase and use of resources efficiently and effectively (Schiavo-Campo and Tommasi 1999). Thus, budget execution refers to the operational aspect of budgeting and involves

Note that the Constitution, by simply asserting that Congress may not increase the appropriations recommended by the President, can be interpreted as being more liberal in favor of Congress. This provision of the 1987 Constitution [Article VI, Section 25 (1)] contrasts sharply with a provision in the 1935 Constitution which included the limitation that is now provided in Book VI Section 24 of EO 292.
the utilization of the different departments of their appropriations. It is concerned 
with the release of funds, and the continuing review of the budget program in the 
light of actual revenues and borrowings, and prevailing economic conditions.

After the GAA is enacted, the DBM requires the different agencies to submit 
their respective Work and Financial Plans (WFP). The WFPs indicate various 
outputs to be accomplished every quarter, and a monthly breakdown of the agencies' financial requirements based on a schedule of program implementation. The DBM then reviews the WFPs and programs the release of government funds.

It should be noted that the policies and procedures for releasing funds (both on 
an obligation basis and on a cash basis) affects the facility of the government to 
control the fiscal deficit and, thus, achieve fiscal discipline even as it influences the 
pace at which projects are implemented as well as the manner in which resources 
are allocated. On the one hand, the DBM prepares an obligation program. In this 
regard, the DBM may apply reserves on agencies' appropriations by issuing 
obligation authorities that are less than the appropriation cover as they appear in 
the GAA. Moreover, the DBM may release the obligation authorities in 
installments over the year. On the other hand, the DBM may also pace the release 
of cash authorization in line with actual cash availability. Lastly, the procedures for 
disbursing funds may also affect the amount of fiscal control in the system.

The disbursement procedure has been revised over the years. But basically the 
DBM issues two documents to effect the release of funds: ‡@ the obligation 
authority (or allotment advice) and ‡A cash authorization (or cash allocation). The 
Advice of Allotment (AA) gives government agencies the authority to incur 
obligations and enter into contracts with suppliers and contractors, purchase 
materials or hire personnel. The AAs may be issued on a quarterly or annual basis. 
On the other hand, the cash authorizations are embodied in the Notice of Cash 
Allocation (NCA). The cash authorizations give the agency the authority to issue 
commercial checks to liquidate or pay obligations.

Between 1980 and 1985, cash authorizations were issued on a quarterly basis 
through the release of the Cash Disbursement Ceiling (CDC) which specifies the 
maximum amount that an agency can withdraw from the Bureau of Treasury (BTr) 
to pay for obligations incurred for a specific activity or project. These authorizations 
are embodied in the Notice of Cash Allocation (NCA) which allows agencies to issue 
commercial checks to liquidate or pay obligations. A weakness of this system stems 
from the considerable length of time it took the BTr to reconcile each agency's 
disbursements with set CDC limits because of the highly centralized set up.
Consequently, agencies tended to issue checks and treasury warrants in excess of the CDCs.

Another weakness of the CDC system was its rigid cash utilization procedure. Each CDC was tied to specific projects and objects of expenditures. Thus, it gave rise to the situation where some funds remained idle because the projects for which they were earmarked were not moving as fast as anticipated while other projects suffered fund shortages.

Hence, the New Disbursement System (NDS) or the Agency Warrant Funding Scheme was put in place of the CDC system with the issuance of DBM-DOF-COA Joint Circular Nos. 4-86 and 5-86 in June 1986. The NDS transferred the responsibility for monitoring agency overdrafts from the BTr to government depository banks. Deposit accounts were created in different branches of government depository banks (e.g., Philippine National Bank, Land Bank of the Philippines, Development Bank of the Philippines, Philippine Commercial and Industrial Bank, Metro Bank and Trust Company, Far East Bank and Trust Company, United Coconut Planters Bank and Bank of Philippines Islands).

The NDS also featured a Common Fund which allowed agencies to use their fund balances for any expenditure item as long as the amount of AAs issued for those items is not exceeded. Thus, the Common Fund gave the agencies greater flexibility in shifting financing during the course of the year from slow-moving to fast-moving projects.

The operation of the NDS eliminated the voluminous cash advances that did not remain liquidated. It also facilitated the faster reconciliation of funds released with what were actually disbursed. Moreover, fiscal control was enhanced since agencies can disburse funds only to the extent of the amount deposited by the BTr in their respective bank accounts. Moreover, with the institutionalization of direct funds release to the regional offices of government agencies and local government units, the opportunity for funds diversion by central offices was minimized.

However, in 1990 it was discovered that the cash float involved in the transmittal of funds from the DBM to the spending agencies was averaging around P.10 billion, an amount that was considered excessive. It was found that this situation came about because depository banks tended to delay the actual delivery of funds to spending agencies because they wanted to take advantage of the spread between the Treasury bill (T-bill) rates and the interest rate they pay on government deposits. Moreover, some government agencies themselves were
delaying disbursements so as to be able to invest their cash in T-bills (World Bank 1992).

To address this problem, the national government moved to reduce the number of depository banks to three with the introduction of the Modified Disbursement System upon the issuance of Memorandum Order No. 276 and DOF-DBM Joint Circular 1-90 in 1990. Under this system, the DOF through the BTr also opened an MDS account with the head office of the government servicing banks. The balances of all the deposit accounts of the different agencies under the NDS were likewise deposited under the account of the Treasurer of the Philippines. Government agencies were then authorized to use a MDS check to withdraw funds from the MDS account rather than Treasury Warrants.

Under this system, the BTr maintains the minimum funding requirements for each agency in the designated government servicing bank and regularly replenishes the agency accounts to reimburse the banks for checks withdrawn by the government agencies over time. The Treasurer of the Philippines maintains the deposits and the interests earned accrue to the General Fund of the national government. The centralization of cash balances in the MDS has helped the national government economize on borrowing costs to some extent by keeping the requirements for operating cash balances to a minimum.

Since 1995, funds release follows the Simplified Funds Release System (SFRS). Under this system, the DBM issues either a General Allotment Release Order (GARO) or a Special Allotment Release Order (SARO). The GARO is a comprehensive spending authority issued to agencies to cover expenditure items that are common to most agencies. GAROs typically cover expenditures that do not require special clearance or approval from higher authorities. In contrast, the SARO refers to specific spending authority issued to one or more agencies. SAROs refer to expenditures that require specific clearance from competent authority.

Under the SFRS, the agency budget matrix (ABM) is prepared. It presents diversification of programmed appropriations for each agency by locality, program/activity, source of appropriation, fund, object of expenditure, need for clearance and specificity of appropriations. Subsequently, the allotment release program prescribes the guidelines in the prioritization of allotment releases based on policy directions/thrusts. Thus, instead of allotment advices being released on a

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41 Under the NDS, the whole amount of the CDC is deposited in the bank account of the agency. In contrast, under the MDS, the BTr only maintains a balance equal to the minimum funding requirement.
purely case-to-case and agency-to-agency basis, the SFRS stipulates that the allotment advices for a particular class of expenditures that are common to various agencies are released at the same time. That is, releases are made in line with specific policy initiatives of the government and not on the basis of individual agency requests. Thus, it standardizes releases across agencies of the government that are similarly situated. This reduces the paperwork associated with the allotment release program and facilitates the monitoring of allotment releases. However, the release of the NCAs still follow the old procedures with the exception that they are now released quarterly based on the Summary List of Checks Issued (SLCI).

Still another instrument the DBM uses to achieve fiscal control is cash programming. In this regard, the DBM in close coordination with the DOF prepares the annual program of cash expenditures, including an Annual Program of Monthly NCA Releases. This process was initiated to ensure better control over fund releases and harmonize them with revenue collections. This process was facilitated by the creation of an inter-agency committee on cash programming which is composed by representatives from the DBM, DOF, BTr and Central Bank in 1991. The committee holds regular bi-monthly meetings to assess the fiscal performance of the national government for the previous month and discuss prospects for the following month. Anticipated revenue shortfalls in original revenue projections are matched either with new revenue measures or with expenditure cuts to keep within the targeted deficit level for the period. The allowable level of disbursements determines the monthly ceilings for the issuance of NCAs. In the event that the estimated cash balance of the government reaches a level where budget cuts in the programmed releases cannot be avoided, the DBM implements across the board budget reductions. Government agencies, however, continue to determine the prioritization of disbursements provided they set aside the amount necessary for the payment of salaries and other mandates.

In 1993 (in time for the preparation of the 1994 budget), the NEDA drew up the Core Public Investment Program (CPIP) in an attempt to secure resources for essential projects even during times of fiscal restraint. The criteria for inclusion in the 1994 CPIP are:  
- foreign-assisted projects (FAPS) for completion within the year or ongoing FAPS with good implementation performance,  
- new FAPs or locally funded projects in the social sectors,  
- power projects, and  
- projects of government corporations that do not require subsidies. However, the CPIP has not been effective in protecting funding support for foreign-assisted projects. As Schiavo-Campo and Tommasi (1999) noted the CPIP has little to recommend it in practice. When applied to current expenditures, the core program generally
includes personal services while the non-core program includes maintenance and other operating expenditures. Cuts in the non-core program then leads to the reduction in the already meager operations and maintenance budgets. When applied to public investments, it is difficult to stop the implementation of a project that has already been started.

In sum, to protect the fiscal position of the central government against revenue shortfalls or unexpected expenditure requirements, the DBM may apply reserves (usually by applying a uniform rate across-the-board cut) on agencies’ appropriations thereby issuing GAROs/SAROs that are less than the appropriation cover as they appear in the GAA. Moreover, the DBM may release the GAROs/SAROs in installments over the year. The DBM may also delay or program the release of NCAs in line with actual cash availability. Thus, DBM exercises strict control over both spending obligations and cash outlays of agencies throughout the year. But this approach to controlling the cash deficit is costly.

It has been noted that across-the-board impounding (or sequestering) of appropriations leads to the inefficient dispensing of scarce resources among an excessive number of activities while selective cash rationing politicizes budget execution. On the other hand, delays in the release of the allotment advices diminish predictability and do not give the spending agencies the time to adjust their programs and their commitments (Schiavo-Campo and Tommasi 1999). Also, the mechanics of doling out the cash to the accounts of the agencies as often as once a month implies the need to implement repetitive budgeting and elaborate computations with regards to the revised allotment and cash budget each time allotments and cash releases are reduced.

In contrast, under the US system there is no direct control over cash outlays. Once Congress creates spending authority, it is allotted to the agencies quarter by quarter. In this sense, it is the obligation authorities that are controlled rigidly. No cash is transferred to agency accounts. When a payment needs to be made to settle an obligation, the agency writes an order to the Treasury stating the amount and recipient of the check. The Treasury retains central control of cash management. OMB simply provides Treasury a forecast of aggregate cash outlays likely to result from the available spending authority, but there is little attempt to exercise direct control over the timing of cash outlays.

At the same time, the cash programming procedures that have been put in place to date has been a major source of irritant between the DBM, on the one hand, and the spending agencies, on the other. The spending agencies have consistently
complained about the timeliness of the cash releases (and the resulting build-up of arrears) and about how delays in the release of NCAs despite the existence of appropriations have contributed to delays in project implementation.

In practice, cash programming has reduced the usefulness of the work plans submitted by the agencies. Also, cynicism has started to creep in the formulation and implementation of projects. For instance, implementing agencies have been observed to wait for the release of the NCAs prior to contracting out projects even if the obligation authority is already with them. They behave this way apparently as a way of protecting themselves against the possibility that cash will not be released in a timely fashion. Lastly, contractors working on government projects tend to adjust their cost estimates to take into account the greater uncertainty in timing of payments (World Bank 1992). This problem is particularly acute during times when the fiscal situation is tight. However, closer scrutiny indicates that the real problem lies in the poor revenue projections.

In the past and even up to the present, the revenue projections of the DOF are typically overestimated. In turn, the flawed revenue forecast stems from three sources: the overly optimistic macroeconomic forecast made by NEDA, the overly optimistic projections of additional revenues from new revenue measures and poor projection/forecasting methodologies. On the one hand, strong political pressures are exerted on the technicians to project a rosier picture of the overall macroeconomic situation. This tendency is exemplified by the propensity of NEDA to come up with “fighting targets” as opposed to realistic targets. On the other hand, the DOF tends to be excessively roseate in assuming that Congress will approve proposed revenue measures in a timely fashion and of the magnitude that is proposed. In reality, most of the time Congress resists legislating additional/higher taxes. Lastly, to a lesser extent, poor revenue forecast is sometimes traceable to the existence of low-level technical capability in revenue and macroeconomic forecasting.
Appendix 4. Budgeting Process in the Philippines - A Case Model of the Department of Agriculture

On the policy front, agricultural development is the centerpiece program of the government for the year 2000. Increasing productivity, efficiency, competitiveness, market adaptability, and sustainability of the country’s agro-based industries have duly been sought in the previous and under the Estrada Administration currently in place. As per the January 2000 Executive Outlook Survey recently undertaken by the influential Makati Business Club (MBC), the influential business circle in the country accorded Department of Agriculture (DA) the higher profile of 25 percent of net satisfaction in its performance, while placing DA at the highest seventh amongst 32 government agencies. Back in its July 1999 poll, the same business group gave DA a 16.7 percent net rating, representing a 49.7 percentage point improvement in seven months. This advocating perception of the business circle in the capital city is reportedly due to 6.5 percent-hike of growth in the farming and fishery sector last year, and political leadership immensely demonstrated by DA Secretary Mr. Angara in implementation of pro-agribusiness and farmer plans.  

1. Budget Call for CY2000

As regards the budgeting process at the Department level, DA was requested by DBM with the issuance of the National Budget Call CY2000 to prepare its respective three-year budget proposal for CY 2000-2002 last April. In compliance with the request, the Office of the Secretary, through the Planning Service and Financial Management Service, organized the internal planning and budgeting workshop to ensure that DA 2000-2002 budget proposals are duly in line with its thrusts and priorities as reflected in the Medium-term Philippines Development Plan 1999-2004 (MTPDP), while conforming to the DBM Guidelines. The workshop participants included the representatives of the Regional Field Units, Bureaus, attached Agencies and Corporations, Agrikulturang MakaMASA Program Directorates, FAPS, and NIA (Foreign-assisted and locally funded projects) who are respectively involved in their own budget formulation.

The Guidelines set forth for the formulation of the CY2000 budget within DA were as follows:

(1) The proposed projects/programs are to be consistent with the Food Security Covenants 1999, the Agriculture and Fisheries Modernization Act of 1997

42 The Manila Bulletin, 12 February 2000
(AFMA\textsuperscript{43}), and the Department of Agrarian Reform (DAR) Secretary’s 10-point Agenda;

(2) Budget is to be disaggregated, to the extent possible, by province, congressional district, municipality, or barangay;

(3) Programs/projects proposed are to be distinctly attributed to programs of other agencies inclusive of Comprehensive and Integrated Delivery of Social Services (CIDSS) by the Department of Social Welfare and Development, Agrarian Reform Agenda by NAPC, and Agrarian Reform Communities by DAR\textsuperscript{44}; and

(4) The proposed programs/projects are to be ensured to address the Minimum Basic Needs of the areas.

2. 1999-2002 Medium-term Public Investment Plan (MTPIP)

DA has recently submitted its Medium-term Public Investment Plan 1999-2004 (MTPIP) for the calendar years of 1999-2002 under the guidance of The National Economic and Development Authority (NEDA) with the total amount of P.26706.88 million\textsuperscript{45}. Prior to the submission of MTPIP that incorporates both the capital investment and operations programs/projects, Public Investment Program Division (PIPD), with its mandate of identifying, reviewing and prioritizing public investments in line with the sectoral and macroeconomic policy targets, issued the DA policy thrusts and priorities for the five banner programs, vis-à-vis, rice, corn, livestock, fisheries, and high-value commercial crops, to the all of the relevant budgeting bodies within DA as follows.\textsuperscript{46}

\textsuperscript{43} As a centerpiece guideline for the sector policy, AFMA was enacted in pursuance of the Republic Act 8435 that prescribes urgent measures to modernize the agriculture and fisheries sectors, with the specific policy objectives of (i) modernize these sectors by transforming from resource-based to a technology-based industry, (ii) enhancing profits and incomes with particular emphasis on small-scale farmers and fisher folk, (iii) ensuring accessibility to, availability and stability of food, (iv) promoting people’s empowerment by way of encouraging integration of the sector activities, functions, and organizations through the formulation of cooperatives, associations, and corporations, (v) pursuing market-driven approaches to enhance the comparative advantage of the sectors in the world market, (vi) upgrading the sector products to the higher value-added commodities through agro-industrial processing, (vii) adopting policies to promote further involvement of domestic and foreign resources to regional redeployment of the sector industries, (viii) providing social and economic adjustment measures to increase sector productivity and market efficiency while keeping the environmental conservation for the producers in view. DA is the lead implementing agency of AFMA, while enjoying P.21.5 billion of budget allocation in FY2000 arising from P.14.2 billion in the previous year. See DA AO 6 (1998), p.3.

\textsuperscript{44} The current institutional structure of the agriculture and fisheries sector reveals a multiplicity of national government agencies, while involving, besides DA and DAR, the Department of Environment and Natural Resources, the Department of Public Works and Highways, the Department of Science and Technology, the Department of Trade and Industry, and the Department of Interior and Local Government.

\textsuperscript{45} Of this, the annual allocation for the year 1999 of P.14343.75 million is on an actual basis, with the ensuing forward-estimates for the period of CY2000 through 2002.

\textsuperscript{46} Source: PIPD document obtained by the mission in February 2000
(1) Rice subject to the forthcoming workshop
(2) Corn with (i) marketing development and infrastructure, (ii) corn-based agribusiness systems technology demonstration, (iii) training and extension support, (iv) program management and evaluation system, (v) seed production and certification services and trichogramma production support, (vi) credit, crop insurance and guarantee mechanisms, (vii) policy and institutional reform, and (viii) program advocacy and development communication
(3) Livestock including (i) livestock enterprise development, (ii) technology, information promotion and capability building, (iii) genetic improvement program, (iv) animal health services, (v) post production, regulatory and market services, and (vi) policy, industry research and/or emergency projects
(4) Fisheries pertaining to (i) fisheries production, (ii) conservation and management, (iii) fisheries post harvest and infrastructure, (iv) fisheries training and extension services, (v) fisheries information and marketing support, (vi) fisheries research and development projects, (vii) rural finances in fisheries, and (viii) program organization and management
(5) High-Value Commercial Crops inclusive of (i) production of quality planting/genetic materials, (ii) upgrading and adoption of viable and sustainable technologies for both fresh and processed products, (iii) improvement of post harvest handling facilities, cold chain distribution system, processing and packaging technologies and facilities, (iv) expansion of protocols with foreign markets, (v) development of internationally acceptable grades and standards, (vi) focus on aggressive domestic and export market promotion, (vii) expansion and institutionalization of linkages between and among producers, financiers, processors/marketers and consumers, (viii) establishment of consumers protection policies, and (ix) designing of financial packages that are referenced on commodity requirements and market specifications.

In the meantime, NEDA had provided the general guidelines for prioritization of proposed project/programs in preparation of budgeting within the administrative branches. Priority criteria comprise the three broad categories with respective of the parameters, descriptive measures of PSAs, and parameters associated with the detailed weights in the followings. It would be noted that these criteria and parameters reflect those in MTPDP. 47

(1) Category I: Consistency with the thrusts of the Estrada Administration (20%);
Parameter: (i) poverty reduction, (ii) promoting peace and order and responsible governance, and (iii) global competitiveness

(2) Category II: Consistency with the Priority Sector Activities (PSA) – number of PSAs supported by the proposed project/program (50%);

- PSAs in support of: (i) productivity improvement and competitiveness enhancement, (ii) diversification of production and resource use, (iii) enhancing access to land and other productive resources, (iv) promoting environmental sustainability, (v) rationalizing institutional structures and empowerment of stakeholders, and (vi) others in support of five Key Result Areas (KRA), inter alia, increasing agricultural productivity, land access, diversification, environmental sustainability, and institutional reforms.

(3) Category III: Features of projects such as funding source, project performance, and so forth (30%)

- Parameters: (i) program/project status regardless of funding, (ii) type of funding, (iii) extent of GOP exposure, (iv) on-going, (v) funds utilization, (vi) proposed/pipeline, (vii) viability, (viii) governance sites, and (ix) flagship project

3. Contextual Effort for PEM – What’s going on?

(1) Agrikuturang MakaMASA Year 2000 (Action Plan) – Activity-Based Budgeting

In compliance with the sector development policy as reflected in MTPDP 1999-2004, DA prepared the Agrikuturang MakaMASA Year 2000 (Action Plan)\(^{48}\) for the respective of five banner programs inclusive of rice, corn, livestock, fisheries, and high-value commercial crops. In line with the modality of an Activity-Based Budgeting (ABB), each of the Action plan comprises (i) accomplishment in the previous 1999 calendar year period, (ii) CY2000 program thrusts, (iii) quantitative targets, (iv) program components, and (v) the budget proposed.

Specifically for corn, for instance, actions in CY2000 are set forth to include (i) production support, (ii) research and development, (iii) training and extension, (iv) market development and infrastructure support, (v) COAST (Corn-based Agribusiness Systems Technology) program, and (vi) program management and administration. With this, CY2000 President’s budget is proposed to be P.811.65 million in aggregate arising from P.422.55 million in the previous year. Of the total, the largest chunk emanates from the post harvest facilities with P.317.0 million or 39.1 percent, followed by the each actions of credit 10.0 percent, program management (9.7 percent), other infrastructure and farm machinery (9.2 percent),

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\(^{48}\) Agrikuturang MakaMASA is the banner program for DA with a budgetary allocation of P.4.8 billion in FY2000.
extension services and training (8.8 percent), technical support services (7.3 percent), research and development (6.8 percent), national information network (4.7 percent), marketing services (3.0 percent), and irrigation and water management (1.4 percent).

(2) Pilot-Testing of a Resource Allocation Scheme (PRAS) Project

Thus far, the budgeting methodology for determining the level of expenditure for endorsement by the Executive Branch has remained somewhat conventional at each of the administrative branches within the government, with line-item and incremental fund allocations for the ensuing years. Such levels of expenditure experientially proved to be a substantial divergence from the determination of growth targets and actions set by the government. Action is now in need for more strategic and rational funding framework and scheme provided that the government branches are to provide administrative supports immensely and efficiently to each of the segments of national economy.

With this in view, coupled with the government thrusts for the introduction of rational and efficient budgeting scheme both at the central and local government levels, DA is currently proposing to undertake the pilot project on its own fund in such a way to get equipped with a firmer basis for advocating the levels of allotment from DBM, and allocating such resources to the actions and programs set forth prior to budgeting. The overall objective of the Project, namely, the Pilot-Testing of a Resource Allocation Scheme (PRAS) Project, includes (i) the formulation and pilot-testing of an appropriate public investment allocation scheme for DA, and (ii) the training of concerned DA officials in the use of such a scheme. In this context, the consultants are to (i) formulate the logical framework for the econometric model to be used as basis for the public investment allocation scheme, (ii) design and devise the econometric model, (iii) formulate the allocation scheme, (iv) train DA personnel on the devised scheme, and (v) undertake pilot-testing of the scheme.

Once the project commenced, the project outputs are to be concocted and submitted to DA within six months.

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49 Budget for undertaking the proposed project is presumably set at P.2.5 million (rounded) while employing two prominent domestic consultants.
Appendix 5. A Case Study: Islamic Republic of Pakistan - The Federal Government

This appendix outlines and discusses “What’s going on about PEM Cycle in Pakistan now”, while drawing a large part of attention to the new wave of Public Expenditure Management. This part also deals with the budget analysis that looks into the flow of aid funds in the country, while focusing on one of the on-going JBIC-financed projects in Pakistan, namely, On-Farm Water Management Project. At the outset of the appendix, the perceptive understanding and the direction of PEM, or Public Sector Management Reform, will be discussed, followed by the administrative environment and other issues associated with PEM.

1. PEM Cycle now in Pakistan - Its Perspective Understanding and Direction

Public Expenditure (PE) issues perceived in Pakistan are diversified to a number of segments, one of which is Public Expenditure Management. Those key substantive points expressed by the participants at the World Bank Workshops on Public Expenditure Issues\textsuperscript{50} included (i) Transparency and Communication, (ii) Ownership and Political Aspects, (iii) Role of the State, (iv) Privatization, (v) Role of NGOs, (vi) Debt and Debt Management, (vii) Quality and Implementation, (viii) Public Expenditure Management, (ix) Accountability, (x) Public Sector Development Program (PSDP), (xi) Social Action Program (SAP), (xii) Civil Service Reform, (xiii) Provincial Finances\textsuperscript{51}, (xiv) Decentralization, and (xv) Revenue Mobilization.

\textsuperscript{50} Following the completion of public expenditure review in October 1998, the World Bank organized the consultative workshops on public expenditure issues in February - March 1999, while inviting 105 participants in aggregate from different segments of civil society inclusive of government, researchers/academics, NGOs, the private sector, and press. With the overall objective to call for the attention of Pakistan’s civil society on this critical subject, the workshops took place in four cities (Islamabad, Lahore, Karachi, and Quetta), and subsequently the workshop output summarizing the views and comments made by the participants was drafted under the title of Pakistan, Consultations with Civil Society on Public Expenditure Issues. Grateful acknowledgment is made of intellectual inputs on the subject provided in various forms by Dr. Hanid Mukhtar, and Mr. William Byrd of the World Bank Resident Mission in Islamabad.

\textsuperscript{51} The World Bank last year undertook the study, namely, The Study on Provincial Finances, under the leadership of Mr. W. Byrd and Dr. H. Mukhtar with the designations as mentioned above. The report was in progress and the study team was advised that it would be submitted sometime in March 2000, with the substances therein almost same as those reflected in the previous "Findings of The Provincial Finances Study Mission". Major thrusts of the paper include: (i) over-sizing of the governments in comparison to the resources of avail, (ii) “Permanent” current budget and its Incrementalism in budget processing, (iii) Increased provincial expenditure liabilities inclusive of “unpaid” utility bills, (iv) Squeezing development budget sequential to the shortfalls in federal transfer, and (v) weak accountability and direct political interference at all levels of civil service. Of this, the largest structural problem is, among others, excessive size of workforce within governments and its negative effect on quality of civil services. Further, it was advised that the Bank did not have a clear-cut recommendation of remedial measures in this connection, while those depending on their political decision and the government’s own initiatives.
Financial authorities both at the level of Federal and Provincial Governments expressed their views in connection with PE issues as saying that the problem was not the process, procedures, and instruments, but revenue (resource) constraints and associated fiscal deficits. In this light, the Finance Ministry reportedly directed the Central Board of Revenue (CBR) to increase its sources of revenue collection within 30 months from January 2000. The measures required to undertake by CBR include, among others, imposition of income tax on agriculturalists (land owners) and general sales tax (GST) on retailers.

On the front of public expenditure, the Federal and Provincial authorities in finance also expressed their reluctance in downsizing and rightsizing of the public sector by way of retrenching “redundant” workforce. Streamlining and realignment of the roles and functions of the State and Province will be considered in tandem with diminution of public employees by retirement at age and golden handshake. Further, Finance Ministry issued the instruction at the outset of the current fiscal year of 1999/2000 that enforces the economy measures applicable to the ministries and the public sector entities. Those measures include: (i) in principle, no supplementary grant will be allowed, unless otherwise the extreme policy maker (then Prime Minister) agrees, (ii) in principle, no reappropriation from or to or within the establishment charges may be made without the prior concurrence of Finance Division, (iii) creation of new posts will remain banned, (iv) no contingent paid staff will be appointed, (v) purchase of vehicles for public employees shall remain banned, whereas that of machinery/equipment, furniture/fixture and others remain same except with the prior concurrence of Finance Division, (vi) the current instructions regarding visits abroad of government officials are strictly to be adhered to, (vii) printing of calendars, diaries, and so forth will continue to remain banned, (viii) no official meetings/functions will be held in hotels, (ix) in principle, no expenditure on decorative lights should be incurred, and (x) no honorarium granted by Ministries/Divisions.

In the meantime, the Economic Package addressed by the Chief Executive on 15 December exhibits little sign of or attention to Public Expenditure Management.

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52 While taxation on Agriculture remains a provincial subject, the Federal Government now endeavors to be empowered through the Ordinances issued by the Governors of the Provinces to collect agricultural tax on their behalf. Currently, only 1.5 million out of a population of 130 million are liable to income tax in Pakistan (The Nation, 18 January 2000). Tax collection is 10.3 percent of GDP, downsizing from 12.4 percent in the past (Source: “Chief Executive’s Speech on Economic Package”, 15 December 1999).

53 The instructions above are not applied to Defense Services and civilians paid out of Defense Estimates (Finance Division Office Memorandum, Economy in Current Expenditure for the Financial Year 1999-2000, July 1999).
Cycle except those of “Accountability” and “Debt Management”. Of this, the Accountability issues are not encountered with the budgeting process, public accounting and auditing, accountability reporting and other Public Expenditure-relevant issues, while being discussed in line with “white-collar crimes”, loan default, and corruption. In the light of the latter, the Government constituted, on 29 January 2000, the Debt Reduction and Management Committee to assess the country’s debts, review the existing framework for debt contracting, recommend the ways of debt reduction in the public and private sectors, and to specify the institutional arrangements of debt management system.55

2. Framework for Public Sector Management Reform: Budget System in Pakistan

The outline view of budgeting process and the associate issues at the Federal level are provided herewith in a bid to share the fiscal environment in Pakistan.

2.1. Legal Framework for Budgeting

In this subsection, the Constitutional arrangements for managing public finance, notably, Federal Consolidated Fund, Budget, and Supplementary Expenditure Authorization, are highlighted.

(1) Federal Consolidated Fund

In accordance with Article 78 of the Constitution, all revenues received by the Federal Government, all loans raised by that Government, and all moneys received by it in repayment of any loan, shall form part of the Federal Consolidated Fund. All other moneys received by or on behalf of the Federal Government, or received by or deposited with the Supreme Court or any other court established under the authority of the Federation, shall be credited to the Public Account of the Federation. The custody of the Federal Consolidated Fund and Public Account payment of moneys with them and withdrawals therefrom are to be regulated by an Act of Parliament or till it is legislated, by rules made by the President. The State Bank of Pakistan is the banker for the Federal Consolidated Fund and the Public Account of the Federation operated by or under authorization of the Federal Ministry of Finance. Similar provisions exist for the Provinces.

54 As previously noted in Chapter one, Accountability in the Philippines most likely denotes budgetary reporting, that takes place in the wake of budget execution.

55 ADB has since 1997 extended an Advisory TA to the Government of Pakistan, namely, Strengthening the Aid and Debt Management Capacity of the EAD, Phase II (TA 2781-PA).
(2) National Budget

Article 80, 81 and 82 of the Constitution lay down the budgetary procedure, where the Federal Government submits to the National Assembly the Annual Budget Statement, that is, a statement of estimated receipts and expenditures of the Federal Government for that year. It shows separately the followings and shall distinguish expenditure on revenue account from other expenditure.

(a) The sum required to meet expenditure described by the Constitution as expenditure charged upon the Consolidated Fund, and
(b) The sums required to meet other expenditure proposed to be made from the Federal Consolidated Fund.

The charged expenditure is discussed but not voted in the National Assembly. It is permanently protected by the Constitution and includes (i) remuneration of the President, the Judges of the Supreme Court, Chief Election Commissioner, the Chairman and Deputy Chairman of Senate, the Speaker and Deputy Speaker of the National Assembly and Auditor General, (ii) administrative and other expenditures of their offices and departments, and (iii) debt related expenditures besides some other specified obligations. The expenditure other than charged to the Federal Consolidated Fund is submitted to the National Assembly in the form of demands for grants and the Assembly has the power to assent to, or to refuse to assent to any demand or to assent to any demand subject to a reduction of the amount specified therein. The reduction is sought through a “Cut motion” to discuss the policies underlying the expenditure demand. No demand for grant shall be made except on a recommendation of the Federal Government. Hence the Cabinet approves the budgetary proposals. In the wake of clearance of the Budget by the National Assembly, the Prime Minister authenticates the Schedule of Authorized Expenditure specifying:

(a) The grants made or deemed to have been made by the National Assembly, and
(b) The several sums required to meet the expenditure charged upon the Federal Consolidated Fund but not exceeding in the statement previously laid before the National Assembly together with the demands for grant.

The authenticated Schedule of Authorized Expenditure is laid before the Assembly. The expenditure specified therein is authorized for expenditure by the Federal Ministries, Divisions, Departments and Institutions in accordance with the Financial Regulations and Rules framed by the Federal Government.
(3) Supplementary Expenditure Authorization

Article 84 of the Constitution requires that the Federal Government shall have powers to authorize expenditure from the Federal Consolidated Fund, whether the expenditure is charged by the Constitution upon that Fund or not and shall cause to be laid before the National Assembly a Supplementary Budget Statement or, as the case may be, an Excess Budget Statement, setting out the amount of that expenditure. Rest of the procedure is the same as for the Annual Budget. This is so in the cases of the followings.

(a) The amount authorized to be expended for a particular service for the current financial year is insufficient or that a need has arisen for expenditure upon some new service not included in the Annual Budget Statement for that year, or

(b) Any money has been spent on any service during a financial year in excess of the amount granted for that service for that year.

2.2. Game Players of Fiscal Operation and Macro-management of Economy

The previous section discussed the legal framework for arrangements for managing the public finance of the Federation. This section seeks to review the role of the game players at functional and institutional level, which is very significant in the context of this study. These game players have been designated and their roles assigned in the Rules of Business made by the President in terms of Article 99(3) of the Constitution for the allocation and transaction of the business of the Federal Government. These are discussed in the following.

(1) The Ministry of Finance

A. Finance Division

Key functions assigned to Finance Division in connection with the management of the economy in general and, public finance in particular, are as follows.

(a) Finances of the Federal Government and financial matters affecting the country as a whole,

(b) The Annual Budget Statement and the Supplementary and Excess Budget Statements to be laid before the National Assembly; the schedule of authorized expenditure,
(c) Accounts and Audit,
(d) Allocation of share of each Provincial Government in the proceeds of divisible Federal Taxes, National Finance Commission,
(e) Public debt of the Federation both internal and external, borrowing money on the security of the Federal Consolidated Fund,
(f) Loans and Advances by the Federal Government,
(g) Sanction of internal and external expenditure requiring concurrence of Finance Division,
(h) Advice on economic and financial policies, exchange resources,
(i) Banking, investment, financial and other corporations (including Central Banking; State Bank of Pakistan),
(j) Framing of rules on pay and allowances, retirement benefits, leave benefits and other financial terms and conditions of service,
(k) International Monetary Fund, and
(l) Negotiations with international organizations and other countries and implementation of agreements thereof.

In addition, the Rules of Business require that no Division shall, without previous consultation with Finance Division, authorize the issuance of any orders, other than orders in pursuance of any general or special delegation made by Finance Division, which will affect directly or indirectly the finances of the federation that in particular involve the followings.

(a) Relinquishment, remission or assignment of revenue, actual or potential, or grant of a guarantee against it,
(b) Expenditure for which no provision exists in the budget or for which no sanction exists,
(c) Floatation of loans,
(d) Re-appropriation within budget grant,
(e) Alteration in the method of compilation of accounts, or of the budget estimates,
(f) Receipt or expenditure of foreign exchange unless already allocated,
(g) A change in the terms and conditions of service of Government Servants, in their statutory rights and privileges, which have financial implications, and
(h) Interpretation of rules made by Finance Division.

The Rules of Business thus assign a pivotal role to Finance Division in economic management, indeed, in close collaboration with Planning and Development Division, Revenue Division, the State Bank of Pakistan and the Ministry of Commerce. As regards the public expenditure management and fiscal
management, it plays a key role with vast and exclusive powers of resource allocation, and expenditure control and a dominant role in processing of taxation policy.

Since 1989, when Pakistan initiated a series of structural adjustment programmes supported by the International Monetary Fund and the World Bank, Finance Division has also become the focal point of contact by the International Financial Institutions and the coordinator for economic policy processing and implementation. Previously, Planning and Development Division exclusively performed this function, of course in consultation with Finance Division and other economic ministries, Provincial Governments and the State Bank of Pakistan.

Meanwhile, the Revised System of Financial Control and Budgeting notified by the Ministry of Finance provides the framework of relations between Finance Division and other Ministries and Divisions. Briefly, it prescribes the following ground rules.

(a) Duties and functions of Secretary in charge as the Principal Accounting Officer in respect of expenditure incurred against the budget grants controlled by his Ministry/Division,
(b) The role of Financial Advisers (middle level officers of Finance Division) attached with Ministries/Divisions in the context of current expenditure and development schemes,
(c) Powers delegated to Ministries/Divisions/Departments,
(d) Budgetary Procedure, and
(e) Powers of sanctioning projects.

Federal Minister of Finance is also the Chairman of the Economic Coordination Committee of the Cabinet, a forum for day to day economic decisions at policy level. The Cabinet Committee meets weekly and provides a forum to Finance Division to pursue its objectives and perform its pivotal role in day to day economic decision-making. He is also Chairman of the Executive Committee of the National Economic Council (NEC), which is responsible for approval of all Federal and Provincial budgeted investments of over Rs.100 million in sectors other than National Highways, Communication, Civil Aviation and Energy for which there are special forums.

Medium Term Projections/Programs

The Finance Division does not have a regular system of medium-term fiscal
projections. These are made as and when required. Normally such projections are made on three occasions: (i) for incorporation in the macro-framework of a medium term structural adjustment program under negotiation with IMF/World Bank (ii) for the purpose of ascertaining resource availability for the next Five Year Plan and (iii) for the purposes of the National Finance Commission. There is no requirement of a formal approval of the Cabinet or Assembly. Such projections remain within the narrow circle of its users. Since ministries provide material needed by the Finance Division and P&D Division. They are not responsible for periodical forecasts on their own. There is no system either for dissemination of medium term projections to the public except to the extent included by P&D Division in the Annual and Five Year Plan. There is no system of fixing medium term fiscal targets, except to the extent included in the financial program forming the basis of medium term Structural Adjustment Program or the allocation in the Five-Year Plan. There is also no authentic statement of associated fiscal policies and programs leading to the medium term fiscal targets except in the Policy Framework Paper of the Structural Adjustment Program or the Five Year Plan. The degree of variation from targets, policies and programs is much larger in the case of Five-Year Plans than in the case of Policy Framework Paper.

These medium term projections are mainly based on historical growth rates applied to the benchmark numbers. Indeed, consistency with elements of other macro projections such as import, growth in Industry, major crops is ensured in the case of duties of custom and excise and GST. In the case of non-tax receipts, adjustments are made for foreseeable variables. In the case of current expenditure, debt service charges are based on forecast prepared by Economic Affairs Division on the basis of scheduled payments and estimates of disbursement against fresh commitments. For other categories of expenditure, historical growth rates adjusted for targeted reductions in the expenditure in real terms or in terms of percentage of GDP are used for making projections. Though Finance Division has computerized aggregation of demands for Annual Budgets, so far, there is no model in use for making a medium term projection. In this light, there would be a need for developing a model and software for making a three years roll on projections regularly on an annual basis.

B. Planning and Development Division (The Planning Commission)

The Rules of Business assign, among others, the following executive functions of the Federal Government to the Planning and Development Division.

(a) Preparation of comprehensive (medium-term) National Plan for the economic
and social development of the country,

(b) Formulation, within the framework of the National Plan, of an annual plan and an annual development program,

(c) Continuous evaluation of the economic situation and coordination of policies,

(d) Association with the Economic Affairs Division in matters pertaining to external assistance in individual projects, from the stage prior to preliminary discussion up to the stage of final signing of documents with aid giving agencies. Before project aid is negotiated with a foreign donor, the project concept must be cleared by the Concept Clearance Committee headed by the Deputy Chairman, Planning Commission or in his absence by the Secretary, Planning & Development Division, and

(e) Coordination of Social Action Program with donors, Federal Ministries and the Provincial Governments.

The assignment of the above State business, among many other related business to Planning & Development Division/Planning Commission, make them one of the top three players in the game of economic management along with Finance Division and State Bank of Pakistan. Hence it plays an important role in Public Expenditure Management along with Finance Division. Planning & Development Division/Planning Commission also functions as the technical arm of the National Economic Council and in that capacity is responsible for project scrutiny. It scrutinizes all Federal schemes/projects of Rs.20 million and above and all Provincial schemes of over Rs.100 million. It can approve Federal schemes of Rs.200 million and above up to Rs.1000 million and sends all schemes costing over Rs.100 million to the Executive Committee of the National Economic Council (NEC) for approval.

Medium-Term Projections by Planning and Development Division

The Planning Commission/P&D Division make periodical assessment of Government revenues, tax as well as non-tax, Government expenditure, current as well as development, the overall fiscal deficit and the public sector borrowing requirements, bank, non-bank and external. On the basis of its assessment, it prepares annual, three years, five years and fifteen years projections for the following purposes.

(a) Memorandum for Pakistan Development Forum (foreign Aid to Pakistan Consortium),
(b) Annual Plan,
(c) Three-Year Public Sector Development Plan supported by a medium term
fiscal framework
(d) An integrated medium term Plan (5-years), and
(e) Perspective Plan (15-years).

The annual review of the fiscal position and projections for 3, 5 and 15 years is not formally approved by Cabinet. However, these are discussed in the joint Federal-Provincial forum preparatory to the submission of Plans to NEC, and NEC itself along with other sectors of the economy. NEC approves these as part of the respective plans.

Recent erosion in the role of The Planning Commission

In the nineties there has been major erosion in the role of Planning Commission, in institutional scrutiny of investment proposals in the Public Sector. Project approval has been shifted to other forums for the following sectors.

<table>
<thead>
<tr>
<th>Sector</th>
<th>New forum</th>
</tr>
</thead>
<tbody>
<tr>
<td>Telecommunication</td>
<td>PTC Board headed by Communication Minister</td>
</tr>
<tr>
<td>National Highways</td>
<td>N.H. Council headed by the Prime Minister</td>
</tr>
<tr>
<td>Energy</td>
<td>Cabinet Committee on Energy headed by the Prime Minister/Minister In-charge</td>
</tr>
<tr>
<td>Civil Aviation</td>
<td>Civil Aviation Board</td>
</tr>
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</table>

The Planning Commission is represented in all the forums either at the level of Deputy Chairman, Planning Commission or Secretary, P&D Division or both. However, their reservations on economically weak projects carry little weight in these forums. In fact, increasingly, during the nineties mega-projects with low or negligible economic return and creating unbearable burden on the fragile fiscal account and balance of payments were sponsored at the highest political level and escaped detailed scrutiny in technical sections headed by sectoral experts in the Planning Commission. In order to reinstate the effectiveness of Public Sector Development expenditure, there is strong need to reintegrate institutional scrutiny of all Public Sector development projects. Investment in some of these sectors have been made in the nineties without due regard to sponsoring agencies own cash flows or out falls on the balance of payment making both extremely fragile in the late nineties.

C. External Affairs Division (EAD)
EAD has been assigned the following business in the area of economic management, besides other associated functions.

(a) Assessment of requirements, programming and negotiation for external economic assistance from foreign Governments and organizations;
(b) External debt management, including authorization of remittances for all external debt-service, compilation and accounting and analysis of economic assistance from all foreign governments and organizations; and
(c) Review and appraisal of international and regional economic trends, and assessment of impacts on the national economy.

EAD is responsible for preparing annual estimates and projections for aid disbursements, interest payments and principal repayment for the purposes of the budget and the balance of payments.

D. Revenue Division (Central Board of Revenue)

The Revenue Division/CBR has been assigned the business relating to (i) Tax Policy and (ii) Tax Administration and all other associated matters. It is responsible for preparing annually the revised estimates of tax revenues for the current year and budget estimates of the following year, which are approved by the Cabinet after clearance from Finance Division and as included in the Federal Budget. They also prepare medium-term tax revenue projections on as required basis. Their methodology is almost identical to that of the Planning Commission, with added inputs from desegregated data available with them on tax base and tax collections for several past years.

Both the tax policy and tax administration has been a victim of fast deterioration in governance manifested in increasing political interference and poor integrity management. Urgent reforms are needed in the tax regime to increase the base and in the tax administration to improve efficiency and integrity of tax collectors. The present government has taken policy decisions to expand tax base, reform tax administration and appoint a tax ombudsman.

E. Statistics Division

The Statistics Division has a minor but significant role in economic management. It has been assigned, among other related functions, the followings

(a) Preparation, printing and release of publications on national statistics,
Undertaking national census and surveys,
(c) Population census, and
(d) National Livestock Census


Compilation of National Accounts

Statistics Division prepares and publishes (i) Annual National Accounts and (ii) Quinquennial Exercise data as indicated below.

(a) GDP/GNP Industrial Origin,
(b) Expenditure on GDP,
(c) GDP Implicit Deflator,
(d) Estimates of Gross Domestic Fixed Capital Formation by Industrial Origin, and

For compiling GDP estimates by sectoral activities (current and constant prices, Federal Bureau of Statistics utilizes all the three approaches, namely, the Production Approach, Income/Cost Approach and Expenditure Approach.

In the meantime, the Federal Bureau of Statistics prepares the revised estimates of GDP for the current year and estimates for the next year, which after approval by an inter-ministerial National Accounts Committee are included in the draft Annual Plan to be cleared by the Annual Plan Coordination Committee and approved by NEC. They also collect weekly, monthly and annual data on prices and compile Sensitive Price, Consumer Price and Wholesale Price indices, the first one on weekly basis and the others on monthly and annual basis. They also compile on monthly basis itemized foreign trade data on customs basis. The data is reconciled annually in an inter-ministerial forum before incorporation in balance of payments estimates.

F. Financial Advisors

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56 Source: Finance Division, 1981 (with later revisions), Revised System of Financial Control & Budgeting.
The system of Financial Advisers (FA) was first introduced in 1960, to complement the role of Finance and Accounts Officers (FAO). The Revised System of Financial Control and Budgeting provides that “in each Ministry/Division there shall at least be a well-trained and experienced Finance and Accounts Officer, who shall be a deputy Secretary or a Section Officer, as may be appropriate, for advising the Principal Accounting Officer on all financial, budgetary and accounting matters. “The FAO is under the administrative control of the division to which he is attached and is paid from its budget. The FAO is required to coordinate and supervise the preparation of current estimates and the Annual Development Program, ensure proper maintenance of accounts, maintain internal checks on payments, ensure compliance with Treasury Rules and Financial Instructions, etc. However, the FAO does not have to be consulted in the exercise of powers delegated to Ministries/Division/Departments.

In contrast to the FAO, the FA remains under the administrative control of Finance Division and is paid from its budget. He exercises the powers of a Joint Secretary of the Finance Division in relation to the line department(s) to which he is accredited, and, subject to appeal to the FA’s superiors in Finance Division, his advice is binding although line departments have discretion in the areas of delegated financial powers.

The intention is to expedite decision-making between Finance Division and line department by channeling such decisions through a single point of contact, the FA. It is also intended that the FA should build up a close relationship with the line department, being on hand to provide informal advice as well as making formal decisions on behalf of Finance Division. To some extent FAs have become the advocates of the line departments within Finance Division. Key areas of FAs’ involvement include reviewing proposals for supplementary grants and reappropriations, as well as proposals for development expenditures. FAs provide the first level of review of departments’ annual budget proposals. In keeping with their job title, FAs are expected to provide high-level advice to the Secretaries of the line Departments. “In all matters of payment and matters affecting the accounts or any matters touching propriety and regularity of the transactions, it is essential that the Principal Accounting Officer utilizes fully the services of the FA.”

The system of Financial Advisers does expedite financial administration, because most of the issues are referred to the FA only, without reference to other Wings of the Finance Division. His proximity to the line department helps to maintain and enforce what is, for the most part, a relatively centralized system of
financial administration.

However, it can also be argued that the FA’s role confuses accountability. The 1992 Economy Commission, discussing the problem of ensuring that expenditure do not exceed budget allocations, observed that “the Financial Advisers who are meant to advise the Ministries and Divisions in the prudent conduct of financial matters have for many reasons not been able, or perhaps not been allowed, to play their due role effectively.” At the same time, the Economy Commission observed, for a Federal Secretary “attention to his role as the Principal Accounting Officer enjoys a very low priority.” The Revised System of Financial Control and Budgeting reads “the Secretary in each Ministry will be personally answerable for laxity in matters of control over expenditures, including that on the part of his subordinates.” In practice, Secretaries are not held to this responsibility: paradoxically, the close involvement of Financial Advisers may make it harder to hold Principal Accounting Officers to account.

(2) The State Bank of Pakistan

The State Bank of Pakistan, or the Central bank, is one of the three most important players in the game of economic management. The State Bank was set up as a statutory corporation through the State Bank of Pak Act, 1956. It was nationalized in 1974 along with commercial banks. It is solely responsible for monetary management and banking control. It administers the Exchange Control Act, 1948 and the Regulations made thereunder, on behalf the Government of Pakistan, and manages the exchange rate regime. The State Bank of Pakistan Act, 1956 was amended in January 1994 and May 1997 along with other laws on banking as part of a major structural reform in the financial sector.

According to their Annual Report for 1996-97, following amendments in the State Bank Act, 1956, full and exclusive authority has been given to the State Bank to regulate the banking sector, to conduct an independent monetary policy and to set limit on government borrowings from the State Bank of Pakistan. Under the amended Act, the Central Board of the Directors is autonomous in its following functions.

(a) Formulation and monitoring of monetary and credit policy. Credit expansion plan takes into account Federal Governments targets for growth and inflation,
(b) The determination and enforcement of the limit of credit to be extended by the Bank to the Federal and Provincial Governments,
(c) Approval of the credit requirements of private sector,
(d) Advice to the Federal Government on the interaction of monetary policy with fiscal and exchange rate policy,
(e) Analysis and advice to the Federal Government on the impact of various policies on the state of economy,
(f) Submission of a quarterly report to Parliament on the state of the economy with special reference to economic growth, money supply, credit, balance of payments and price developments, and
(g) Such other functions as may be necessary for formulating monetary policy and regulating the monetary system or be assigned by the Federal Government.

Reports and Data compiled by State Bank of Pakistan

Besides the quarterly report to the Parliament on the state of the economy, the State Bank of Pakistan submits annually to the Federal Government, the Balance Sheet of the Bank and the Profit and Loss Account for the outgoing year. In addition, it submits the Annual Report of the Central Board of Directors on the working of the Bank for that year. The Annual Report provides an independent overview of economic and financial developments in the outgoing year and prospects for the new year followed by the detailed sectoral appraisal and data which are of immense value to economic managers in policy processing and policy adjustments, in particular in monetary fiscal and foreign trade areas.

The State Bank of Pakistan produces weekly, monthly and annual money and banking data besides annual balance of payments data, and its medium term projections on as required basis.

2.3. Budgetary Process

(1) An Over View of Budgeting-Philosophy of Budgeting, the 9th Five-Year Plan, and Prioritization of Projects

Philosophy of transformation of policy objectives and plan into viable budgets, programs and projects, as well as budgetary prioritization amongst the sectors, are reflected in 5-Year-Plan that comprises the qualitative policy targets and the associated list of projects. A Roll-on Plan of medium term is designed in a bid to bring flexibility into the Five-Year Plan in such a way that the sectoral and project-wise position is elastically adjustable in accordance with the financial position and progress in project implementation in the foregoing year. This represents the brainchild of Medium-Term Expenditure Framework.
As regards the current Performance Budgeting in the Province of Punjab, seemingly projects are lofty, objective is too ambitious, the budget size is too large in relation to the resources of avail, and some parts of budget allocation indicate discrepancies with those reflected in PSDP.  

World Bank has been pushing the government to draft the 2-3-year medium term Rolling Public Investment Program for the water sector in relation with their financing “National Drainage Program (NDP)” Project. While Rolling Plan is equivalent to MTEF in the government of Pakistan, it is not drafted in the Water Section yet. This is mostly because the preparation of 9th Five-Year Plan (1999/2000-2004-2005) is now underway. The medium-term plan would not be of relevance without the long-term national development framework and an indicative project list.

In this connection, Dr. M. Awan, Assistant Secretary, the Government of Pakistan informed the JBIC mission that resumption of Roll-on Plan, which was a supplementary to Five-Year Plan with a mandate of giving flexibility in implementation of the aforementioned Plan, constituted one of a set of conditionality imposed by WB. While Roll-on Plan has been discontinued since 1994/95, it essentially comprises the two parts, inter alia, (i) a list of development projects for the consecutive three years, and (ii) entire portfolio of projects with a little note of macroeconomic framework.

Also, Assistant Secretary advised that the Roll-on Plan was a medium-term development fund commitment, whereas MTEF a medium-term combination of development and recurrent funds commitment. There are some advocates of this brainchild of combination of the two categories of budget even in the Ministry of Finance of the Federal government.

Meanwhile, priority is given to the proposed projects for forthcoming budgeting in respect with the following criteria: (i) consistency with the Five-Year Plan and, specifically for the water sector, the National Agricultural Policy of 1991, (ii) consistency with PC-1 in terms of the project phasing and associated budget expenditure, (iii) foreign-aided projects due to domestic resource constraint, and (iv) nearness to completion. In line with the World Bank “Checklist of Criteria for Review of Ongoing projects” as given in their 1997 PEM paper, the Water Resources Section of the Planning Commission prioritize the proposed projects in compliance

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57 This part is based on the interview survey to Dr. M. Awan, Additional Secretary, the Planning and Development Division, the Government of Pakistan, to whom the study team is so grateful.
with some of those criteria that include (i) appropriateness, (ii) performance, (iii) nearness to completion, (iv) secured financing, (v) internal cost of project termination, and (vi) economic justification.

World Bank assisted On-Farm Water Management Project III was monitored by the Planning and Development Division, Project Wing, in 1993, whereas that financed by JBIC was carried out in 1998 focusing on the project performance in the province of Punjab. (The 1998 Monitoring Report was handed over by the Project Wing, the Planning Commission, Islamabad)

The water sector is a priority sector within the current government, thereby making it possible for the Planning Commission to confer 100 percent of development budget allocation to the proposed projects. In view that sustained operation/maintenance and costs perpetually accrued is a key element in ensuring goals, the final solution would be considered acceptable to adopt the participatory approach and associated institutional reforms in operation and maintenance. The Pakistan Irrigation and Drainage Authority (PIDA), an autonomous self-supporting body for this recurrent works, has already been set up in such a way that direct beneficiaries sustain on-farm water supply financially by themselves.

(2) Formulation of Investment Program

A. Objectives

The short term, medium term and long term objectives of the investment programs and related plans are defined by the Planning Commission in terms of sustainable growth, price stability, level of employment, internal and external balance and a degree of economic autarky. In view of the three-tier hierarchy of objectives, the time frame for planning stages is (i) annual, (ii) medium term or 5-years and (iii) long or perspective.

Till mid-eighties these objectives were achieved through government's direct role in the economy. In fact, in the seventies the direct role of the Government was expanded through nationalization of industrial and financial enterprises. Even for the areas that were left to the Private Sector, there were enforceable guidelines through Investment Schedule, detailed allocations in Credit Plan and Exchange Control Regulations. In mid-eighties there was a shift in the Government's perception of public sector role and the process of deregulation, decontrol and liberalization was started. By now Pakistan has come a long way and “State is withdrawing from direct production completely and is looking for partnerships in
physical infrastructure and social services. The Outline for the Ninth Plan states that “the nature of planning must change from dirigistic (driven by directives) to catalytic” Its continuation is necessary” for strategic thinking in a proper perspective and maintaining viability of the macroeconomic framework”.

B. Game Players in Formulation of the Public Sector Investment Programs (PSDP)

The players in the formulation of Public Investment Programs are the Planning Commission/P&D Division of the Federal Government, Finance Division, the line Ministries/Divisions and the Provincial Governments who have their own P&D Board/Department, Finance Department and line Departments. The Planning Commission, being the technical arm of the National Economic Council is the key player. The mandates and functions assigned to it have been mentioned in the previous section.

Planning Commission is responsible for defining and implementing the development strategy and for economic and technical appraisal of all Federal Government projects/schemes costing Rs 20 million and above and all Provincial Government projects costing above Rs. 100 million. Projects costing below these limits are approved by the Federal line Ministries/ Divisions and Provincial Government after clearance from their Departmental Development Working Party (DDWP) and Provincial Development Working Party (PDWP) respectively. However, they are required to send a copy of the project/scheme approved by them to Planning Commission to ensure that it is in line with the objectives of the National Plan and there is no deviation from the principles and policies laid down in the plan. The Central Development Working Party (CDWP) headed by the Deputy Chairman, Planning Commission sanctions Federal projects/schemes costing between Rs.20 million and Rs.100 million for all sectors other than Energy, Telecommunication, National Highways and Civil Aviation for which there are separate forum as mentioned in 1.3. Projects/schemes costing over Rs.100 million are sanctioned by ECNEC for sectors other than those mentioned above. The Planning Commission, in close liaison with Finance Division is also responsible for allocation of resources to individual projects/schemes.

The next most important player in preparing the plans in general and budget financed Public Sector Development Program in particular, is Finance Division. It determines the size of resource envelop for the Program as a whole as well as for the line Ministries/Divisions. Additional Finance Secretary (Budget) chairs the inter-ministerial Priorities Committee, which makes scheme by scheme allocation for various sectors and Ministries/Divisions and organizations. The Financial Advisers
assigned to line Ministries/Divisions are associated with the processing of all the
development schemes from beginning to end. While sending the schemes to
Planning Commission, line Ministries/Divisions have to mention that the Financial
Advisor has confirmed the scheme. In addition, the Development Wing of Finance
Division is responsible for policy coordination in regard to development work. This
Wing ensures that the scheme fits into the overall development plan, that it does
not clash with any scheme of other Ministries/Division and no contradictory policy
is being followed. Finance Minister, chairs ECNEC and Finance Division is
represented in all committees and councils entrusted with project approval or plan
approval. Finance Division also approves re-appropriations within the Development
budget and supplementary grant on the advice of the Planning Commission.

Line Ministries/Divisions are responsible for initiating and implementing
their own schemes and sponsoring, and supervising the implementation of the
schemes belonging to the organizations and departments under them. Each
Ministry has a planning and monitoring unit and Departmental Development
Working Party (DDWP) with representation from Finance Division and Planning
Commission for appraisal and clearance of schemes costing below Rs. 20 million
which the Ministry can sanction provided that Finance Division does not disagree
with the decision of the DDWP. In case of disagreement, the scheme has to be
submitted to CDWP. The line Ministries/Divisions are also responsible for
administering the development budget. However they can make releases to their
schemes only with the prior approval of their Financial Advisers. They can also
make re-appropriation among various schemes with the concurrence of Planning
Commission and approval of Finance Division.

Provincial P&D Departments and Finance Departments perform functions
identical to Planning Commission and Finance Division in respect of their own
schemes and provincial budgeted PSDP. Provincial Governments can sanction their
schemes costing up to and including Rs. 100 million provided the schemes
sanctioned by them are in line with the objectives of the National Plan and there is
no deviation from the principles laid down in the plan. Provincial Governments are
represented at all Federal forum on Planning. In CDWP, they are represented by
Additional Chief Secretary/Chairman P&D, in the Annual Plan Coordination
Committee by their Planning and Finance Ministers assisted by their respective
secretaries and in the National Economic Council they are represented by their
Chief Ministers assisted by the Planning Ministers and Finance Ministers and their
respective secretaries. Planning thus becomes a joint Federal-Provincial exercise.
Provincial Government not only participates in the deliberations on Provincial
schemes, and Provincial allocations but on Federal schemes, their location in
various provinces and inter-provincial, inter-sectoral and inter-regional distribution of Federal development expenditure besides the approval of Annual and Five-year Plans.

C. The PSDP Budgetary Process

Initiation

The process starts with circulation of the schedule for the preparation of the Annual Development Programs of the Provincial Governments and Federal Ministries/Divisions, and organizations and autonomous bodies under them. Their Annual Development Program has both on-going and new schemes. In the recent past, Federal Ministries/Divisions and Provincial Governments have been dissuaded from inclusion of new schemes in the annual program because of paucity of funds and a huge portfolio of on-going schemes. However, if for exceptional reasons any new scheme is to be undertaken, if has to be sent to Planning Commission or other designated forum in December to enable it to appraise it and obtain the approval of the competent authority.

Resource Envelope

On the basis of preliminary estimates of receipts and expenditures and the approved macro-economic frame, by the end of December, Finance Division conveys the preliminary assessment of availability of resources for the next years budgeted PSDP. The resource envelope is refined further as firm estimates of receipts and expenditures become available at a later stage. In the light of the resource availability, Planning Commission re-adjusts priorities and tentative allocations to various sectors for the year as indicated in the previous fiscal year’s roll on program for three years. On this basis, in January each year Planning Commission intimates to Provincial Governments and Federal Ministries/Divisions the tentative size of their investment program.

Preparation of PSDP by line Ministries/Divisions

The line Ministries/Divisions have to observe inter-sectoral and intra-sectoral priorities with the resource envelope indicated to them. Foreign aided projects are required to be given the highest priority and adequately funded. Foreign aid for import of goods and services and for local expenditure has to be indicated separately. Where disbursement of foreign aid is not a priori and but as reimbursement of actual expenditure, estimates of reimbursement have to be given. Next in priority
are the projects likely to be completed in the program year. It is to be ensured that schemes which have a direct bearing on targets to be achieved during the period get due priority. To facilitate efficient resource allocation, schemes proposed for inclusion in the program are required to be arranged in order of priority within each sector/sub-sector so that if resources fall short of requirements, low priority schemes could be dropped or their allocation curtailed.

Public sector enterprises have to prepare their investment programs within the resources available to them. The entire program of National Highway Authority is financed through the Budget. A ceiling is, therefore, indicated to NHA. The total resources available to Power Wing of the Water and Power Development Authority (WAPDA) and Oil and Gas Development Corporation (OGDC) are the foreign aid, which passes through the Federal Budget and for which a ceiling is indicated, plus bank credit for which a ceiling is indicated in consultation with Finance Division, which in turn, consults with State Bank of Pakistan, plus their own internal cash generation. The entire investment program of WAPDA (Water Wing) passes through the Budget.

**Process in Planning Commission**

Sector chiefs in the Planning Commission closely examine the sectoral programs prepared by the line Ministries/Divisions and autonomous bodies. They make needed adjustments in proposed allocations to tailor the program according to available resource envelop and enforce the pre-ordained priorities. Sectoral programs as recommended by sector chiefs are consolidated with the approval of respective members of Planning Commission. The Planning Commission then transmits the tentative Federal Development Program to Finance Division and line Ministries/Divisions as a working paper for the Priorities Committees.

**Inter-Ministerial Priorities Committee**

The Priorities Committee is an inter-ministerial committee represented by the Planning Commission, Finance Division, Economic Affairs Division and the administrative Ministry/Division and other agencies concerned, whose program is under discussion. The committee meets for 4 to 5 weeks commencing from the second week of March and reviews item by item for each Ministry/Division/Organization according to a schedule already notified. The Additional Finance Secretary (Budget) chairs the meetings. The over-riding concern of the chairman is to fit the program of each organization within the resource envelop nationally determined by Finance Division but not formally notified to
Planning or administrative Ministry. There is item by item discussion but the whole exercise is carried out in such a hurry that it is quite a formidable task for Planning Commission representatives to protect the inter and intra sectoral priorities. Finance Division generally plays safe and retains within overall resource envelop for the Program, some space for schemes inducted in the program as a result of directives from political levels or modifications in allocations as result of consideration of appeals at higher forum of Annual Plan Coordination Committee and National Economic Council. Within two days of award by the Priorities Committee, the administrative Ministry/Division sends the New Item Statement showing allocation approved item by item indicating, inter alia, foreign exchange required from foreign aid and own resources both for imports and consultancy and other services duly verified by the technical section concerned in the Planning Commission. No re-appropriation can take place between rupee and foreign exchange allocations. Quite often appeals are against excessive foreign aid included in limited total allocation for a scheme. Occasionally, the tangle of intra-sectoral priorities remains unresolved in the Priorities Committee and lump sum allocation is made with the direction to the Administrative Ministry concerned to make detailed scheme wise distribution in consultation with the Planning Commission.

Annual Plan Coordination Committee (APCC)

After the completion of deliberations of the Priorities Committee, Planning Commission finalizes the Provincial Development Program in consultation with the Ministry of Finance and Provincial Governments. On receipt of the firm figures of allocations from Finance Division, Planning Commission incorporates the Public Sector Development Programs of the Federal Government, the Provinces and Public Sector Enterprises in the Annual Plan and prepares the working paper for the APCC in two parts. Part-I of the working paper presents the review of the Annual Plan for the outgoing year and the prospects for the next fiscal year bringing out in sufficient details, the performance of various sectors of the economy as well as all areas of macro-economic framework. Part-II of the working paper contains itemized details of proposed allocation to the Public Sector Development Program.

The APCC finalizes the macro and sectoral targets and reviews the allocations. This is the occasion for the Provincial Ministers to press their demand for higher allocation for their own PSDP and for Federal projects in their Province. Federal Ministries also appeal to this forum when there is a gap between the funds allocated and the demand, if Planning Commission has not already responded to their appeals in the working paper. More thorny issue is the balance between the Federal and Provincial programs. It is customary to seek direction from the Prime
Minister/Chief Executive on the differences with the Provinces before going to NEC. Occasionally, he also reviews the entire Federal Program, mainly to ensure that political priorities have been adequately protected in the program.

National Economic Council

By the middle of May, Planning Commission is in a position to submit its summaries for NEC on Annual Plan and the Public Sector Development Program. NEC meeting is generally convened in the last week of May. While considering the summaries, it also functions as the highest appellate forum in case any Federal Minister or Provincial Chief Minister is not satisfied with the allocation recommended by the APCC. However, the modifications are very few and can easily be accommodated in the Federal and Provincial budgets and PSDPs which, by that time, are ready for submission to respective cabinets. For this purpose, the line Ministries have to send immediately the revised New Item Statements for the projects affected by the modifications approved by NEC.

(3) Formulation of Current Expenditure

A. Objectives and Profile of Budget in the Past

The primary objective of the Recurrent Budget is to raise resources and allocate funds for the functioning of the Organs of State and its institutions for general administration, maintaining internal and external security, running community services and providing economic and social services to its people in accordance with the Principles of Policy enshrined in the Constitution and the political commitments on public wants. An associated objective of the recurrent budget is to generate enough public savings to finance public investment in community, economic and social services to meet the demands of the growing population in a manner that maintains the viability of internal and external balances.

Since mid-eighties, the budget contributed negative savings and the Government started borrowing not only for the entire development expenditure but also marginally for meeting current expenditure. The total borrowing for the budget ranged between six to eight percent of GDP for most of the nineties. As a result the debt servicing which was 4.4 percent of GDP in 1990/91 rose to 6.2 percent of GDP in 1999/2000 creating immense pressure both on the budget as well as balance of payments. Apart from contributing to imbalances in the economy, this development has also constrained the capacity of the State to maintain the quality of services.
provided by it. Thus fiscal imbalance has caused failures and shortcomings in the achievement of the objectives mentioned above. Concurrent deterioration in governance in the nineties has also undermined the effectiveness of expenditure.

Major failure has occurred in revenue collection. Total revenues declined in the nineties from 19.1 percent of the GDP in 1991/92 to 16.8 percent of the GDP in 1999/2000. Tax revenue has come down from 13.6 percent of the GDP in 1991/92 to 13.1 percent of GDP. The performance of taxes collected by CBR has been unimpressive stagnating at a level of 10.7 to 10.8 percent of the GDP despite major expansion of GST network in 1994/95 and again in 1999/2000. Due to lack of political will the nineties could not witness the extension of GST to retails and the direct taxes to agricultural sector. Consequently, throughout nineties direct controls on expenditure took precedence over resource management.

Apart from structural problems in the taxation system and tax administration, due to lack of documentation of the economy, especially at the down stream levels of economic activities, tax evasion through collusion and corruption has a high incidence. Moreover search for quick fix as a substitute for structural reforms has proliferated withholding taxes so much so that about 97 percent of taxes on income is collected through withholding taxes giving a free hand to tax payers to pass it on to the consumers as indirect tax. Thus direct tax has abdicated its role of redistribution of income. This, combined with waning capacity of the fiscal system to maintain the quality of service to the growing population, has aggravated poverty in the nineties.

It is in this background that all governments in the nineties focused their reform programs on the budget and committed to achieve a significant enhancement of revenue effort and improving efficiency and effectiveness of expenditure.

(3) Game Players in the Formulation of Recurrent Budget

Receipts

Central Board of Revenue is a major player in so far as revenue estimates are concerned. It collects direct taxes, customs duties, excise duties and GST. It collects 10.8 percent of GDP out of the total revenue of 16.8 percent of GDP. Provinces have an insignificant role. They collect only 0.7 percent of GDP. The Ministry of Petroleum is the next most important player in tax collection. In 1998/99 it collected 2.6 percent of GDP as surcharges on natural gas and P.O.L. In 1999/2000 these
receipts may decline to less than 1.5 percent of GDP due to rise in petroleum prices. Line Ministries/ Divisions/Departments are responsible for collecting dividends on Government investments in undertakings under them, receipts from economic, social and community services and fees and charges for services rendered.

Expenditure

Main players in expenditure budgeting are cost centers/units under departments and organizations, the departments and organizations themselves, the line Ministries and Finance Division. Planning & Development Division have little say in budgeting of recurrent expenditures except to the extent of their own budget. Finance Division plays through their Financial Advisers the most dominant role of distributing funds to organizations under Additional Finance Secretary (Expenditure) and Additional Secretary, or Military Finance. Each cost center having independent billing system is responsible for preparing expenditure estimates, with documented calculations by detail heads under functional and object classification. These are consolidated by each Department/Organization and sent to line Ministry/Division for approval and transmission to Finance Division along with its own expenditure estimates.

In Finance Division, its Financial Advisors Organization and Budget Wing share the responsibility for current expenditure budget. All proposals for inclusion in the budget prepared by the line Ministries/Divisions are required to be transmitted to Financial Adviser for examination and clearance. They have full access to documents having detailed calculations supporting budgetary demands. Once the Financial Adviser has given his clearance, the demand for grants and appropriations made by the line Ministry/Division for each activity are eligible for inclusion in the budget and are transmitted to Budget Wing for consolidation and inclusion in the Budget documents to be presented to the Cabinet and the National Assembly for legislative approval. After the budget has been approved and expenditure authorized, the line Ministries/Divisions can incur expenditure to the extent of powers delegated to them under the Revised System of Financial Control and Budgeting without reference to Financial Advisers. In other matters, Financial Advisers exercise the powers of Ministry of Finance as Joint Secretaries to sanction expenditure.

Normally, lump sum provisions are not allowed in the budget. However, where such provisions is admitted for exceptional reasons, proposals which are intended to be financed from lump sum provision are finally examined and disposed of by the Financial Adviser. They also exercise the powers of appropriation and re-
appropriation vested in Finance Division. Moreover, they examine proposals for supplementary grants. Additional Secretary, Military Finance has his own team of Financial Advisers, who perform similar functions in relation to Defense expenditure. He receives the Defense budget proposals in sufficient details according to object classification to enable him to exercise his judgment. The budget as cleared by him is submitted to Finance Secretary for approval before it is passed on to Additional Finance Secretary (Budget) for inclusion in the Federal budget, as a line item for security reasons.

The Budget Wing of Finance Division is responsible for compilation of the Federal budget demands for grants and appropriations from the budgetary estimates cleared by the Financial Advisers Organization. The whole process is computerized. They keep preparing the overall budgetary position with revenue and capital receipts estimates and with the approval of senior management allocate responsibility to CBR and other Ministries administering Federal receipts, for additional resource mobilization. They are responsible for securing political level approval to receipts and expenditure proposals and submission of budget to Cabinet for approval before the Finance Minister introduces the budget in the National Assembly. They are also responsible for ways and means management and release of funds for payments above Rs.1 million is referred to them for clearance. They are also responsible for managing Federal-Provincial fiscal relationship.

C. Budgetary Process

Initiation

The budget year in Pakistan is 1st July to 30th June. The procedure and time schedule for preparation, its clearance from the respective Financial Advisers and submission to Budget Wing is prescribed in a “Budget Call Circular” issued by Finance Division each year in early October. The process of budget starts with the lowest functional unit of the Government and the consolidation and flow of estimates is hierarchical till it reaches the line Ministry/Division for making budgetary demands for grants and appropriations and seeking clearance from the Financial Adviser.

Resource Envelope

There is no strategic framework for allocation of resources for current expenditure. There are also no medium term projections for current expenditure except as appended to a structural adjustment program supported by IMF and
World Bank. Finance Division tries to work within the revenue, expenditure and overall deficit target in a medium term macro-framework. However, budgets have seldom been in conformity with these targets except to the extent of overall fiscal deficit. Consequently, there is no resource envelope given to line Ministries and Divisions within which they can order their priorities. The functional units of the Government and the hierarchy above it up to the line Ministry/Division/Department prepare their budget estimates with incremental approach often bidding for excessive demands and ending up in failure to meet full cost of activities. The demands are based on the past actual results, approved additions and deletions in their activities and obligations, policy responses and any other factor bearing on these estimates.

Process in Financial Advisers Organization

The line Ministries/Divisions have to prepare their estimates in two parts; Part-I-Standing Charges in respect of permanent expenditures and Part-II-Fresh Charges in respect of temporary and new expenditures. (See Box laid down below). Part-I of the budget and Part-II estimates are scrutinized by the Financial Adviser concerned who issues to the Budget Wing of Finance Division and the Accountant General Pakistan Revenues Budget Orders (B.O) in respect of Part-I estimates and verified copies of New Item Statements (N.I.S) in respect of Part II estimates in accordance with the instructions contained in Budget Call Circular. The scrutiny by Financial Advisers is not based on any strategic planning or guidelines but maximum ceilings handed down to him for increments on establishment charges and other categories of expenditure. The admitted Part-I and Part-II estimates are also compiled together by the Finance and Accounts Officer of the line Ministry/Division, into Demands of the Ministry to be included in the “Book of Demands for Grants and Appropriations”. These “Demands” are sent through the Financial Adviser to the Budget Wing of Finance Division for aggregation.

Aggregation by Budget Wing

The Budget Wing aggregates all the Budget Orders and NISs forwarded by the Financial Advisers through computerized process at various levels, namely:

(a) Division-wise Demands for grants,
(b) Sections comprising group of Demands for Grants for a Ministry,
(c) Current Expenditure on Revenue Account,
(d) Current Expenditure on Capital Account,
(e) Development Expenditure on Revenue Account,
(f) Development Expenditure on Capital Account, and
(g) Division and Section wise Appropriations for expenditures charged upon the Federal Consolidated Fund.

These aggregations are organized in three parts of “Demand for Grants and Appropriations”, namely,

Part I Demand for Current Expenditure,
Part II Demand for Development Expenditure, and
Part III Appropriations Charged upon the Federal Consolidated Fund

Preparation of Schedule of Authorized Expenditure

On the basis of aggregation done in the manner indicated above, the following three schedules are compiled and appended to the “Demands for Grants and Appropriations”:

Schedule I Demands for Grants and Appropriations for Expenditure met from the Federal Consolidated Fund for the financial year (of the budget commencing from July 1 and ending on 30th June of the following calendar year)
Schedule II Expenditure estimates according to functional classification on account of the financial year commencing on 1st July and ending on 30th June
Schedule III Expenditure Estimates according to object classification on account for the financial year commencing on 1st July and ending on 30th June

Schedule I facilitate the preparation of Schedule of Authorized Expenditure authenticated by the Prime Minister/Chief Executive after passage of the Demands for Grants and Appropriations from the National Assembly. Schedules II and III together with approved estimates of revenue and capital receipts, including foreign assistance and estimates of domestic bank and non-bank borrowings, facilitate preparation of the Annual Budget Statement required to be presented to the National Assembly along with the book of ‘Demands for Grants and Appropriations’.  

Authority for expenditure

There is no system of issue of a warrant of sanctioned budget to each Ministry/Division/Department. Each Demand for Grants and Appropriations included in the book of “Demands for Grants and Appropriations” submitted to the National Assembly for legislative approval is desegregated detailed head wise, for each functional unit; grouped together according to Audit Circles and included in a book entitled “Details of Demands for Grants and Appropriations”, popularly known as “Pink Book”. All Ministries, Divisions, and Departments in the government are authorized to draw upon the Federal Consolidated Fund and Public Account of the Federation by submitting bills and vouchers to their Audit Officers for pre-audit and issue of checks. Finance Division circulates the authenticated Schedule of Authorized Expenditure together with the “Pink Book” to all Ministries, Divisions and Departments as well as to Audit authorities. These documents constitute the authority to incur expenditure within the budgetary allocations shown in the Pink Book.

Releases of funds

No formal release order is required for incurring expenditure on pay, allowances, etc. However, all payments of over Rs.1 million to third party are required to be referred to Budget Wing for ways and means clearance. Financial Advisors, who have to send a monthly statement of releases to Budget Wing and to P&D Division in case of development expenditure, can approve payments up to Rs.1 million. In addition, even in the delegated field, prior consultation with Finance Division has recently been made obligatory for certain types of expenditure. Creation of posts and purchase of transport have been totally banned. Releases are made on monthly basis to organizations and agencies whose accounts are separate from those of the government.

Appropriations

There are certain restrictions on reappropriation those inclusive of:

(a) From one grant to another,
(b) After the expiry of the financial year,
(c) Between funds authorized for expenditure charged on the Federal Consolidated Fund and other expenditure,
(d) For any expenditure not sanctioned by the competent authority,
(e) For any purpose specifically refused or reduced by National Assembly,
(f) From lump sum provision made in a grant, and
(g) From budget provisions specifically made for payment to other Government agencies/departments.

Subject to these restrictions, the Ministries have full powers of re-appropriation within a grant in accordance with the Revised System of Financial Control and Budgeting. Recently some restrictions have been imposed on grounds of economy. No re-appropriation for or to or within the establishment charges may be made without the prior concurrence of Finance Division. Reappropriations in excess of Rs.0.5 million have to be referred to Finance Division. Restrictions on re-appropriations from establishment charges create difficulties in making more productive use of resources, in particular in research organizations whose budget hardly allows 15 to 20 percent for operational expenditure against a norm of 50 to 60 percent.

Supplementary Grants

Financial Advisors and senior management in Finance Division rigorously scrutinize the supplementary demands for grants and appropriations. Annexure III to the Revised System of Financial Control and Budgeting describes the procedure for examination of proposals and for obtaining approval of the Prime Minister. Procedures for aggregation in Budget Wing and legislative approval are the same as for annual budget. While the administrative approval to supplementary grants and appropriations are made during the course of the year on the basis of assessed needs, legislative approval is obtained traditionally along with the annual budget. The book of Supplementary Demands for Grants and Appropriations and authenticated Supplementary Schedule of Authorized Expenditure constitute legal sanction for such expenditure.

Parliamentary Control over Expenditure

The Accountant General, Pakistan Revenues (AGPR), who works under the direction of Auditor-General of Pakistan maintains accounts of all Federal transactions. AGPRs end copies of monthly accounts to Finance Division for purposes of expenditure control and reviewing budgetary position. After final closing of Annual Accounts, the Auditor-General submits to the Government, the Appropriation Accounts showing expenditure against budgetary grants, as modified by supplementary grants to and surrenders from the grants and appropriations. The Appropriation Accounts are accompanied by Audit Report containing his observations on excesses and savings against appropriations and on the regularity
and propriety of expenditure incurred against these grants and appropriations. The Appropriation Accounts and the Audit Reports are prepared before the National Assembly and its Public Accounts Committee carries out detailed examination of the Accounts and the Report and submits its report to the Assembly after hearing the representatives of Ministries/Divisions.

2.4. Project Evaluation by the Federal Government-Cases of WB and J BIC-financed OFWM Projects

World Bank has been pushing the government to draft the 2-3-year medium term Rolling Public Investment Program for the water sector in relation with their financing “National Drainage Program (NDP)” Project. While Rolling Plan is equivalent to MTEF in the government of Pakistan, it is not drafted in the Water Section yet. This is mostly because the preparation of 9th Five-Year Plan (1999/2000-2004-2005) is now underway. The medium-term plan would not be of relevance without the long-term national development framework and an indicative project list.

Priority is given to the proposed projects for forthcoming budgeting in respect with the following criteria: (i) consistency with the Five-Year Plan and, specifically for the water sector, the National Agricultural Policy of 1991, (ii) consistency with PC-1 in terms of the project phasing and associated budget expenditure, (iii) foreign-aided projects due to domestic resource constraint, and (iv) nearness to completion. In line with the World Bank “Checklist of Criteria for Review of Ongoing projects” as given in their 1997 PEM paper, the Water Resources Section of the Planning Commission prioritize the proposed projects in compliance with some of those criteria that include (i) appropriateness, (ii) performance, (iii) nearness to completion, (iv) secured financing, (v) internal cost of project termination, and (vi) economic justification.

World Bank assisted On-Farm Water Management Project III was monitored by the Planning and Development Division, Project Wing, in 1993, whereas that financed by OECF was carried out in 1998 focusing on the project performance in the province of Punjab. The water sector is a priority sector within the government, thereby making it possible for the Planning Commission to confer 100 percent of development budget allocation to the proposed projects.

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59 Grateful acknowledgement is made of the close cooperation provided by Messrs. Abdul Hafez Qaiser, Chief, and Dr. Munnawer H. Shah, Deputy Chief, Water and Resources Section, Planning Commission, in the form of intellectual inputs and advise on this issue.
In view that sustained operation/maintenance and costs perpetually accrued is a key element in ensuring goals, the final solution would be considered acceptable to adopt the participatory approach and associated institutional reforms in operation and maintenance. The Pakistan Irrigation and Drainage Authority (PIDA), an autonomous self-supporting body for this recurrent works, has already been set up in such a way that direct beneficiaries sustain on-farm water supply financially by themselves.

2.5. Integration of Investment and Recurrent Budgets

As indicated in Appendix 1, channels for budgeting of recurrent and development expenditures are parallel but separate from the stage of preliminary estimates to admitting final budgetary allocations and preparing Budget Orders and New Item Statements i.e. warrants for aggregation and inclusion in the Demand for Grants and Appropriations to be submitted to Cabinet for executive approval and to the National Assembly for legislature approval. Of course, some of the same officials, i.e. Finance and Accounts Officers and Principal Accounting Officers of line Ministries and Financial Advisers and Budget Wing officials of Finance Division participate to some degrees in both the processes. In Finance Division, Budget Wing does not play any significant role in allocation process of current expenditure but they are intensely involved in scheme-wise allocation for development expenditure.

The water-tight compartmentalization of recurrent and development budgets have a number of implications for expenditure management that include:

(a) Recurrent costs of completed schemes are an essential part of project planning and project appraisal process. However, there is no mechanism for automatic transfer of these costs to the current budget. It has to be re-justified after completion of schemes and included in the recurrent budget as “fresh charges” through New Item Statement (NIS) at the Center and Schedule of New Expenditure (SNE) in the Provinces,

(b) P&D is not involved in the allocation for O&M completed schemes,

(c) There is no system of sectoral resource envelopes within which the line Ministries/Divisions responsible for the sector can optimally arrange their priorities,

(d) There is a direct pressure on current budget to expand room for development. This causes twin problems; on the one hand there is inadequate allocation for O&M, on the other there is an over commitment in total expenditures building up fiscal imbalances in future and impairing the effectiveness of resource use,
There is fragmentation of budgetary decisions. Examination of budgetary demands is uncoordinated. Permanent expenditures are rarely reviewed and redundant activities remain on board by inertia, and

(f) Decision on a trade off between incremental investment with continuing and aggravating inefficiency and improvement of service delivery can not be actualized in a system of highly compartmentalized budgeting for current and development expenditures.

Pakistan has recently experimented on integration of planning and budgeting in the social sector through the Social Action Program. The program combines development budgeting, recurrent budgeting and institutional and policy reforms. This integrated approach has enabled line departments to secure higher non-wage allocations for O&M improving efficiency of resource use and service delivery in basic education, basic health, family welfare and rural drinking water supply and drainage.

2.6. Flexibility-Budget Approval and Amendment Procedures

(1) Budget Approval

Section 2.1 articulated in detail the legal framework for approval of the Budget by the Executive and the National Assembly, while Section 2.3 and 2.5 discussed the review on the institutional arrangements for processing of investment and recurrent budgets. Subsequently, this section seeks to recapitulate the procedures for approval and amendment of the budget. There are four stages of approval of the budget: administrative approval, financial approval, executive approval, and legislative approval. These are dealt with in the ensuing subsections

A. Administrative Approval

All the departments, agencies and organizations working under an administrative Ministry/Division have to prepare their revised estimates for the outgoing year and budget estimates for the following year in accordance with the procedure prescribed by Finance Division. These estimates are required to be submitted to their Ministry/Division for scrutiny, consolidation and approval before transmission to Finance Division. The Finance and Accounts Officer of the Ministry/Division, scrutinizes the estimates and consolidates them. These estimates are then submitted to the Secretary, who is the Principal Accounting Officer of the Ministry/Division. The Administrative Secretary seldom makes any major modification. Secretary’s approval is on incremental basis and without information
on the resource envelope for the Ministry/Division. The estimates are now ready for transmission to Finance Division as far as recurrent expenditure is concerned and both Finance and P&D as far as development expenditure is concerned.

B. Financial Approval

The Financial Advisor examines the estimates of recurrent expenditure. And the Financial Advisor and P&D examine those in respect of development expenditure. Approval of recurrent expenditure is conveyed to Budget Wing of Finance Division through budget order (BO) for permanent expenditure and new item statement (NIS) for fresh charges. In the case of development expenditure, scheme-wise demands are sent to P&D, which prepares on the basis of these estimates, the Public Sector Development Program and working paper for the inter-ministerial Priorities Committee, headed by Additional Finance Secretary (Budget). The allocation made by the Priorities Committee constitutes the authority for the Financial Adviser to admit New Item Statements and countersign them before transmission to Budget Wing for inclusion in the budget documents.

C. Executive Approval by the Cabinet

The Public Sector Development Program that is the basis of budgetary provisions for development expenditure is reviewed by the Annual Plan Coordination Committee and approved by the National Economic Council before its submission to the Cabinet. Finance Division (Budget Wing) incorporates the changes approved at these forums through amending new item statements (NIS) prepared by the administrative Ministries/Divisions and verified by the Financial Adviser.

Budget Wing, which carries out aggregation and prepares “Demands for Grants and Appropriations” and functional and objective classification wise schedules of these demands, submits these estimates to the Cabinet. However, before the budget is formally presented to the cabinet, it is discussed in a smaller forum presided over by the Chief Executive/Prime Minister. This forum is overwhelmingly concerned with the political feasibility of various resource mobilization measures. There is little discussion on resource use as only a summary of allocations by functions is presented to this forum. There is no economic analysis of proposed allocation, or object-wise classification. This forum or the Cabinet does not discuss expenditure policy or the impact of budgetary allocations on the quality of public service. There is also no discussion on macro-economic framework except the target for the overall fiscal deficit, which is intended to be achieved through the
The Cabinet sees the budget and the budgetary proposals for the first time on the day of the presentation of the budget. The limited time it has, is devoted to discussion of new measures and by tradition, amendments proposed by the Cabinet are very few. The Cabinet is not presented with any macro-economic framework within which the budget has been framed, nor is it presented with any medium term expenditure framework. There is need for greater involvement of the Cabinet in order to earn political ownership to the macro-economic framework, a medium term expenditure strategy and the related fiscal reforms.

D. Legislative Approval

The Constitutional arrangements for the legislative approval of the budget have been reviewed in Section 2.1. The Finance Minister, with the approval of the Cabinet presents the budget in the National Assembly through his budget speech, which reviews the performance of the economy in the outgoing year, targets for the next fiscal year, the policies and programs incorporated in the budget, salient features of the public sector development program, revised estimates for the outgoing year and budget estimates for the next financial year without new measures. This is called part-one of the budget speech. Part-two of the budget speech outlining new measures is distributed in the House after the Finance Minister has started proposing the new measures.

The following documents are placed on the table of the House.

(a) Budget speech Part One and Part Two
(b) Demand for Grants and Appropriations
(c) Details of Demands for Grants and Appropriations
(d) Annual Budget Statement
(e) Finance Bill
(f) Budget - in - Brief, a brief description of receipts and expenditures
(g) Explanatory Memorandum on Federal Receipts
(h) Estimates of Foreign Assistance
(i) Public Sector Development Program

After passage of Demands and Appropriations and the Finance Bill the authenticated Schedule of Authorized Expenditure is also placed on the table of the House and this completes the process of legislative approval of the budget.
There is general discussion on the budget covering performance of the economy, policies and programs. The opposition uses this time for criticism of government policies and performance and the treasury bench for defending them. There is also intensive discussion on new measures. Modifications, if any, are announced through the winding up speech of the Finance Minister. Demand for Grants are discussed and voted one by one. Cut motions can be introduced to discuss policies and performance of the ministry. The discussion by members generally hovers around constituency interests. Under the parliamentary system there is no possibility of passage of a cut motion so long as the government commands a majority in the House.

There is a general discussion on Finance Bill to give effect to the new measures proposed by the Finance Minister. Clause-by-clause reading and passage follow this. After its passage the Bill is sent with Speaker’s certificate of passage for the Presidents assent, after which it becomes law. There is no possibility of any amendment in the Finance Bill except those proposed by Finance Minister in the light of the debate and response of the general public.

In practice, though the budget session of the House continues for about three weeks, the whole process of legislative approval is void of any serious deliberation on macro-framework or strategic policy of resource allocation. To give substance to legislative approval, the National Assembly should get an opportunity to look into the macro-economic framework and the strategic policy on resource allocation as a framework for preparing the budget much ahead of the presentation of the Budget.

(2) Budget Amendment

Amendment to the budget can be effected through the following three instruments. Each of the three instruments has separate procedure and forum for approval.

A. Surrender Order

The Principal Accounting Officers are supposed to review the progress of expenditure periodically and anticipate savings and surrender them by 31st May at the latest. The administrative Secretary is empowered to approve surrender order. However, partly due to deficiencies in financial reporting, this function is routinely treated and provisions are retained right up to the fag end of the fiscal year. There is a strong case for streamlining the surrender procedure to minimize the incidence of ad hoc cuts in the budgetary allocations distorting relative priorities.
B. Reappropriation Order

The procedure and the recent restrictions on the powers of Ministries/Divisions have been discussed in Section 2.3. Secretaries are empowered to approve re-appropriations within a grant except to and from a within establishment charges. Moreover, for any reappropriation in excess of Rs.0.5 million clearance of Finance Division is a pre-requisite.

C. Supplementary Grant

The line Ministry/Division concerned initiates proposals for supplementary grants. A detailed Proforma has been prescribed to provide information supporting the proposal. Financial Advisers scrutinize the justification and verify the inability to meet the expenditure through re-appropriation or surrender from another demand. For executive approval, a summary has to be submitted by the Secretary concerned to the Prime Minister through Finance Secretary. Till recently supplementary grant proposals escaped stringent scrutiny. Paradoxically, majority of supplementary grant proposals emanated from Prime Minister’s directives making extra-budgetary commitments both on development and recurrent expenditures without adequate institutional scrutiny. It would facilitate better expenditure management, if even proposals sponsored by the Chief Executive were deferred to the next budget if institutional scrutiny can establish that this is possible without hurting policy objectives.

The procedure for approval by the Cabinet and the National Assembly is the same as aforementioned in the context of the annual budget. In fact, while supplementary grants are sanctioned throughout the year, the “Supplementary Demands for Grants and Appropriations” are submitted to the Cabinet and the National Assembly along with the annual budget.⁶⁰

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⁶⁰ Source: Finance Division, 1999, Information collected from Budget Wing
2.7. Points of Discussions

Against the background of Budget System in Pakistan, a couple of issues to be discussed have been identified by the local expert engaged in the current study and the consultants. Some of those are summarized, for readers’ kind reference, in this subsection.

(1) Fiscal Policy Formulation and Coordination

A. Savings and investment imbalance

While in the national accounts deterioration in the savings and investment balance was witnessed in the nineties, on the budgetary side this imbalance started appearing in the mid eighties, though the position became acute in the nineties as would be seen from the following table:

Table 1: Fiscal Imbalance

<table>
<thead>
<tr>
<th>Year</th>
<th>Investment</th>
<th>Overall fiscal deficit</th>
<th>Savings</th>
</tr>
</thead>
<tbody>
<tr>
<td>1980/81</td>
<td>9.3</td>
<td>5.3</td>
<td>+ 4.0</td>
</tr>
<tr>
<td>1984/85</td>
<td>7.0</td>
<td>7.7</td>
<td>- 0.7</td>
</tr>
<tr>
<td>1990/91</td>
<td>6.4</td>
<td>8.7</td>
<td>- 2.3</td>
</tr>
<tr>
<td>1995/96</td>
<td>4.8</td>
<td>6.3</td>
<td>- 1.5</td>
</tr>
<tr>
<td>1997/98</td>
<td>3.2</td>
<td>5.4</td>
<td>- 2.2</td>
</tr>
<tr>
<td>1998/99(RE)</td>
<td>3.0</td>
<td>3.4</td>
<td>- 0.4</td>
</tr>
<tr>
<td>1999/2000(BE)</td>
<td>3.4</td>
<td>3.3</td>
<td>+ 0.1</td>
</tr>
</tbody>
</table>


It will be seen that some improvement has taken place since 1998/99, though it is yet fragile and predicated on a drastic cut in budgeted investment.

B. Fiscal Consolidation - Expenditure cut vs. Resource expansion

A major issue in fiscal policy response to fiscal deterioration is the right mix of expenditure contraction and resource expansion. While there is a strong case for expenditure control, efficiency of resource allocation and underpinnings for effectiveness of expenditure, fiscal consolidation must be largely predicated on

\[\text{This part owes to Dr. M. Z. Khan, a former IMF professional staff and currently an independent consultant mostly working for the international financing institutions. The study team is so grateful for his intellectual supports and inputs.}\]
resource expansion specially when many economic activities and incomes are exempt from taxation and evasion and collusion is rampant facilitated by complicated procedures and insufficient documentation of the economy. In recent years, due to lack of political will to carry out difficult but necessary tax reforms and expansion of tax base, almost the entire burden of fiscal consolidation has been on development expenditure and, in terms of percentage of GDP, it is now one third of the level in 1980/81 as will be seen from the following table.

Table: 2

<table>
<thead>
<tr>
<th>Year</th>
<th>Total Revenue</th>
<th>Total Current Expenditure</th>
<th>Defense</th>
<th>Debt Servicing</th>
<th>Revenue Surplus/deficit</th>
<th>Overall Deficit</th>
<th>Development Expenditure</th>
</tr>
</thead>
<tbody>
<tr>
<td>1980-81</td>
<td>37.7</td>
<td>31.9</td>
<td>15.3</td>
<td>7.9</td>
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<td>247.7</td>
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<td>1998-99 (RE)</td>
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<td>478.4</td>
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<td>270.3</td>
<td>-98.0</td>
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<td>1999-2000 (BE)</td>
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<td>525.9</td>
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<td>287.4</td>
<td>-103.0</td>
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Source: Ministry of Finance data

The strategy of fiscal consolidation largely via investment curtailment is questionable on many scores. In Pakistan it has triggered recession and consequential stagnation in exports. Public sector development expenditure performs the locomotive function in economies like that of Pakistan. It is intended to accumulate physical and human capital by developing physical and social infrastructure. A drastic cut in budgeted development expenditure constrains the capacity of the infrastructure to support even a modest growth of two to three percent in per capita income. Combined with a miniscule tax-transfer budget, it has accentuated incidence of poverty. It has constrained the capacity to invest in quality of life projects to ameliorate poverty. There is, therefore, a strong case to tilt the strategy for fiscal consolidation towards tax reforms and resource expansion.

C. Lack of a Strategic Framework for Resource Allocation for Current Expenditure

There is no strategic plan for resource allocation for current expenditure, though some sort of strategic plan does exist for development expenditure through the instrument of Medium Term Plan. As a percentage of GDP, current expenditure has declined from 18.7 percent in 93/94 to 17 percent in 1999/2000. This is the
period during which there has been a rapid rise in debt servicing expenditure. Its share in current expenditure has risen from 31 percent in 1993/94 to 37 percent in 1999/2000. It now claims 71 percent of Federal revenues compared to 59 percent in 1993/94. Consequently, the share of expenditure on social, community and economic services in the current expenditure has only marginally moved from 19.2 percent in 1993/94 to 19.7 percent in 1999/2000, despite huge claim for allocation for O&M of completed projects since 1993/94 and quantum jump in allocation to basic social services under the SAP. In the absence of a strategic plan for resource allocation and due to the practice of incremental budgeting within the ranges indicated in guidelines to financial advisers, the O&M of productive assets has been seriously affected by fiscal consolidation with inadequate efforts for expansion of resource base. Quite often the demand for O&M of newly completed schemes is tossed between current and development budget.

(2) Formulation of Public Sector Investment Programs (PSDP)

A. Unwieldy Investment Portfolio

The public sector investment portfolio has become unwieldy due to continuous process of addition of newly approved schemes. Quite often new additions are politically sponsored regardless of their relative importance in increasing the productivity of the economy. Occasionally projects started by the previous government are stopped at an advanced stage making investment infractions. Pakistan has seen lot of political instability during the last 12 years. Each change of government has meant addition of many politically sponsored and constituency building projects. With ever declining allocations in real terms for development, the available resources are thinly spread over a large number of on-going schemes extending far beyond their scheduled completion year. This demands a moratorium on sanction of new projects, unless there is strong economic justification for immediate inclusion in the program. In addition, the annual screening should be a serious exercise. The position is more acute in research organizations that have a large list of research schemes with thoroughly inadequate allocations. About 75 percent of their allocation is pre-empted by establishment charges leaving little for research equipment and operational expenditure. Thinly spread allocations have undermined the productivity of investment by postponing the pay-off of even those projects which could be completed earlier.

B. Erosion of Institutional Role of Planning Commission

One of the important functions of the Planning Commission has been to
ensure the efficiency of resource allocation through a process of thorough economic, financial and technical appraisal of all projects Federal and Provincial, as even those projects that are within the sanctioning powers. The Federal Ministries and Provincial governments are docketed to Planning Commission. During the first thirty years of its existence, Planning Commission had acquired a prestige and authority that would eliminate the possibility of its recommendations on the feasibility of a project being disregarded at any forum. However, there has been a serious erosion of their institutional authority in the nineties. Quite a few mega projects have been included in the PSDP despite serious reservations by Planning Commission squeezing the space for more productive projects, with softer institutional financing. Besides mega projects, low priority constituency programs, such as Peoples Works Program and Tameer-e-Watan Program claimed sizable resources. Responsibility for sanctioning projects in some sector was transferred from Planning Commission to other institutions. This facilitated passage of less efficient projects. There is a strong case for reunifying the institutional arrangements for approval of projects to ensure consistency with sectoral priorities, efficiency of resource allocation and fiscal and balance of payments stability.

C. On the Course Expansion in the Scope of Large Projects

Once a large project has been started, there is no effort for its completion within the original time and cost framework. The scope, cost, and time frame continue to be expanded and the projects are dragged on for many years, beyond the original date of completion vitiating not only their own already weak economic feasibility but also inflating the list of on-going schemes. Recent examples are Pakistan Steel Mills, Saindak Copper, and Chashma Nuclear Power Plant. Such projects should be closed with their original scope of work and additions should be appraised as independent projects in the light of sectoral and intra-sectoral priorities.

D. Over-Commitment and Distortion in Sectoral Balance

In the nineties there has been over-commitment of resources to the Transport and Power sub-sector. The share of roads and bridges in the total expenditure on Transport and Communication in the Federal PSDP has risen from less than 12 percent in 90/91 to 32 percent in 1999/2000. The NHA now has an investment portfolio of over Rs.161 billion against which an allocation of Rs.19 billion has been made in the PSDP for 1999/2000. In order to complete these projects in time NHA would need an annual allocation of Rs.40 billion per annum in the next two years, which will be impossible to accommodate. In the power sector huge commitments
were made to purchase at relatively high price, along with pass-through provisions for increases in various elements of production costs, even though it had become apparent that future demand would contract due to slow economic growth in the nineties. This has created serious financial problems for WAPDA and disputes with foreign investors destroying climate for foreign investment. WAPDA’s financial difficulties have constrained implementation of their own PSDP. There is need for reinstating the sectoral balance in the PSDP and restraining growth in investment portfolio for one sector. On the other hand, concern for poverty amelioration should demand higher allocation for water resources development, agricultural research and upgrade of social services.

E. Declining Share of Physical Capital in Foreign-Aided Projects

In the nineties, it has been observed that the share of consultancy, in particular, foreign consultancy in the scope of the projects/programs financed by foreign donor has been rising fast giving an impression that a substantial share of the foreign assistance is being siphoned off as service payments right in the beginning of the project cycle having little for capital formation. In some projects, the consultancy component is as high as 60 percent of the project costs.

F. Budgeting of Recurrent Costs

There is a requirement of calculating and reviewing recurrent cost at the stages of project formulation, development, appraisal and approval. However, thereafter the development budget and recurrent budgets are in two watertight compartments. Planning Commission and P&D Departments in the Provinces are not associated with the process of allocation of resources for O&M from the current budget.

G. Uncertainty about Resource Availability

The uncertainty about the resource availability continues not only till the last stages of budgeting but also throughout the year. This is so because it is not certain that the preliminary indication of resource envelope would actualize in the final budget. Finance Division itself is not sure if political approval would ultimately be secured for the new measures needed to reach the revenue target. Even the budgeted target for revenue collection has not been met in the nineties. During the last three years there have been heavy short falls in revenue and this shortfall translated into drastic cut in development spending. Even during the fiscal 1999/2000, against the total budgeted PSDP of Rs. 116 billion, actual releases are
not likely to exceed Rs.93 billion. As a result, the line departments, organizations, Ministries and Divisions make a bid for a much bigger program than the likely resource availability. The aggregate demand for Federal and Provincial programs is 60 percent to 80 percent higher than the preliminary indications of resource availability from Finance Division. This makes the job of Planning Commission and Finance Division all the more difficult. The existing system distorts priorities, increases the size of on-going schemes and delays completion of schemes. It would be preferable to hand down to them their resource envelopes right in the beginning with elaborate guidelines for itemized allocation.

(3) Formulation of Recurrent Budget

A. Control vs. Management

The system of allocation, disbursement, and accountability to Government and legislature is control oriented rather than management oriented. At all levels the emphasis is on control over the volume of expenditure, hierarchical delegation of powers to spend and its regularity rather than efficiency or effectiveness of resource use. The Financial Advisers, while approving budgetary allocations for a Ministry/Division or its Department or organization are overwhelmingly concerned with the level of growth in expenditures at micro-levels rather than quantity and quality of services produced by the resources allocated. The audit authorities are mainly concerned with regularity of expenditure in terms of admissibility of a charge or the competence of the functionary making the charge rather than its productivity in terms of service delivery. On a macro-level, they are concerned with the level of use of resources against allocations. Though the Auditor-General has started performance audit, it is mainly confined to some public sector enterprises. Similar is the orientation of the legislative procedure for resource allocation and accountability for actual resource use. There is hardly any nexus between the resource allocation and political and strategic objectives of the sector.

B. Strategy vs. Incrementalism

Resource allocation and resource use are not regulated by political and operational objectives and strategies. In the recent past, expenditure cuts under the pressures of sound macro-management of the economy have generally resulted in squeeze on development and non-wage operational expenditures. In the absence of a strategy for efficient resource use, in a situation of fiscal constraints, the balance between wage and non-wage expenditures further deteriorates. There are rigidities both in the level of employment as well as remuneration structure. In the absence of
strategy or framework for expenditure management, allocations are made on the basis of notionally determined limits for increments over the benchmark i.e. the estimated actual expenditure of the preceding year. This system of incremental budgeting has promoted a tendency of making initially inflated demands, which may be even for strategically least important or productive activity.

The existing system does not transmit the signal of performance within the resource constraint. Efficient and inefficient activities get equal treatment and many obsolescent activities just continue for years by inertia. Consideration of efficiency and effectiveness in public expenditure management would demand that, where operations and maintenance coefficients exist, these should be updated. In other cases, input and output coefficients should be determined for all strategic activities, and proper ranking should be made of all activities in terms of their relevance to political policies and socio-economic strategies. Resource allocation would then depend on recent performance on assigned targets, input-output coefficients and the strategic ranking of various activities.

At present while resource allocation for development is made on the basis of a three year roll-on projections of development expenditure, the current expenditure is planned only on annual basis. The existing pattern of current expenditure management does not permit capturing liabilities in immediate future on account of operation and maintenance. Incremental budgeting for existing activities makes provision of O&M for new activities extremely difficult particularly in a situation of fiscal constraints. It is therefore, imperative that there is a medium term strategic framework for public expenditure, which is consistent with a viable macroeconomic framework as well as the strategic objectives of the various sector of the economy in the light of the roles of various levels of government, the private sector and the civil society.

C. Separation versus Integration of Recurrent and Development Budget

Another important issue in Pakistan’s expenditure management is integration of recurrent and development budget. Though the time frame for preparation of the two budgets is the same, and there is some what legal integration inasmuch as the Demands for Grants and Appropriations for both the current and development expenditures, are presented in a single document and both the categories of expenditures are reflected in the same Annual Budget Statement, there is no sector wise integration of the two budgets. In fact the channels for current and development expenditure are not only parallel and separate but also watertight. While Finance does have a say in the budgeting of development expenditure, P&D
Division does not have any say in the budgeting of current expenditure though development expenditure has a spill over effect on the recurrent expenditure. This arrangement creates many difficulties. The line Ministries/Division responsible for sector management does not have the advantage of decisions on trade off between expansion of inefficient services and improvement in the efficiency of existing services.

D. Centralization vs. Devolution of Authority

At policy level, Pakistan has already moved away from direct controls to arms length management through regulatory instruments and institutions. However, the Civil Service is not yet trained for this change in the role. This phenomenon has become more glaring in fiscal management. Instead of developing modern instruments of expenditure management, giving flexibility to line Ministries/Division to adjust their priorities within limited resources, with enforceable document based checks and balances predicated on information flows, Finance Division has centralized powers. Indulging in micro-management of expenditure. The devolution of authority to line Ministries/Divisions that was effected through the Revised System of Financial Control and Budgeting in the sixties has been reversed in the nineties, under the pressures of tighter fiscal management demanded by growing imbalances in the economy. Till recently the line Ministries/Divisions had full powers of re-appropriations within a grant subject to prescribed controls. Now no re-appropriation from or to or within establishment charges can be made without the prior concurrence of Finance Division. It has taken away the incentive to save on wages to deficient allocation for non-wage O&M expenditure. This has hurt most the research organizations, in particular, the agricultural research, crucial for poverty alleviation and import containment where the wage component is 80 percent of total expenditure compared to a norm of 40 to 50 percent. Thus effectiveness of expenditure has been sacrificed for an illusion of control over expenditure. Another example of micro-management affecting efficiency is that now budgeted purchase of machinery/equipment and furniture and fixture cannot be made except with the prior concurrence of Finance Division. Moreover the age-honored schedule for releases was one-fifth in the first quarter, one-fourth in the second, three-tenth in the third and one-fourth in the last quarter subject to utilization report for the first three quarters. This flexibility has been taken away and now releases are made monthly subject to submission of detailed utilization report each month. In Agricultural Sector major non-wage expenditures are in summer and winter sowing seasons. The newly introduced system of monthly releases disrupts the operations in this sector. Centralized micro-management must give way to information based strategic management of expenditure. Line
Ministries/Divisions need to be given more flexibility in fixing their priorities with an early indication of availability of resources.

E. The Pakistan Improvement of Financial Reporting and Auditing Project (PIFRA)

The Government has been cognizant of the deficiencies in the system of accounting and expenditure control leading to uncertainties about fiscal outcome that remains even after the close of the financial year. It has undertaken “Pakistan Improvement of Financial Reporting and Auditing Project (PIFRA)” under IDA funding. The Project seeks to develop and implement computer based financial applications systems in various areas of Government accounting and financial reporting, strengthen audit standards and techniques with automated audit tools and strengthen human resource management. The Project is very promising but it needs strong political and financial support, in particular, from Finance Division itself. The outline of PIFRA is given as follows.

This IDA-funded project provides assistance to the Pakistan Audit Department; it became effective in 1997.

Objectives

The overall objectives of the project are:
(a) To improve public sector accounting and financial systems,
(b) To provide the basis for enhancing public sector accountability, and
(c) To support improved institutional capacity for economic policy-making and management.

Project Component

PIFRA components include:
(a) Government Accounting and Financial Reporting:
    Development and implementation of computer-based financial applications systems (to supersede existing manual systems) covering:
    - The core accounting and reporting system
    - Payroll and pension systems
    - Cash flow forecasting and financial analysis systems
(b) Government Auditing:
    - Consultant services to assist in strengthening audit standards and techniques
    - Provision of hardware and software for introduction of automated audit
tools
- Training and capacity development
- Supporting the use of private sector firms in government audit

(c) Institutional Development: strengthening human resource management in PAD, provision of training, and development of Management Information Systems wing of PAD.

(d) Policy Studies in support of improved economic management:
During project preparation, PAD prepared a Vision Statement with, inter alia, states government’s intention to separate its accounting auditing functions.

F. Regularity vs. Efficiency and Effectiveness of Expenditure

The whole system of expenditure management is biased towards regularity rather than efficiency and effectiveness of the expenditure. Lack of institutional capacity and political interference in resource allocation has affected the efficiency of expenditure. Deterioration in governance, inefficiency of civil servants and poor integrity management have affected the effectiveness of expenditure. There is a strong case for institutional development, in particular, in the Financial Advisers organization, which applies ad hoc and out-dated techniques of quantitative control over expenditure. They should be trained to apply strategic criteria for resource allocation based on scientifically determined coefficients, redefined roles of various tiers of government and various levels of organizational structures, and, strategic plan for various sector. The civil service reforms need to be undertaken to improve institutional capacity, and efficiency and institutionalize across the board concurrent accountability.

(4) Integration of Investment and Recurrent Budgets

A. Lack of Strategic Planning of Expenditures

The line Ministries/Divisions/Departments do not get a composite resource envelope within which to order their priorities. The compartmentalized budgeting does not lend support to a system of integrated sectoral strategy as in the Social Action Program. Consequently, they not only continue with existing inefficiencies but these are getting accentuated with the passage of time. This performance weakens political involvement and commitment to sectoral priorities. It is difficult to actualize political policy objectives or perform on public commitments for improving public services.
B. Inadequate Funding for Operations & Maintenance

Pakistan’s assets and quality of public services have been affected by inadequate allocations for upkeep and repair of capital assets and the operational expenditures of service networks (O&M). Even though assessment of recurrent expenditures of schemes after completion of the project/scheme is part of project development, appraisal and approval, entry of recurrent expenditures of newly completed schemes in the current expenditure budget is difficult and time consuming. P&D has no say in this matter. Even high profile projects like Sandak Copper Mining and Processing and Gawadar Fish Harbor encountered difficulties in funding of operating expenses. Agricultural research and irrigation net works are other glaring examples.

The disjointed planning and budgeting system are biased against adequate budgeting of O&M. Lack of integration of the development and recurrent budgets and the separation of functions between Planning and Finance adversely affect O&M. New projects are initiated without ensuring recurrent budgets of newly completed projects. Consequently, in many sector, there has been over extension of infrastructure beyond the capacity of fiscal system to service them.

Recent centralization of powers by Finance Ministry has further exacerbated the situation. Sectoral line agencies cannot re-appropriate savings in their salary budgets to meet other pressing needs of O&M. Under the Constitution, the receipts from user charges must be credited to the Consolidated Fund. There is, therefore, no incentive for improving receipts from user charges to cover O&M needs. The political authorities have been reluctant to correct growing imbalance between receipts from service charges and O&M costs.

Fiscal constraints are translated into disproportionate squeeze on O&M budget. Since establishment structures cannot be easily adjusted, wage components of O&M budget is always protected at the expense of non-wage component of O&M budget.

The public works departments responsible for O&M of publicly owned infrastructures networks have disproportionately high level of bad governance, because of political interference in contracting, employment and rewards and punishments. This undermines the effectiveness of O&M spending.

Technical capacity is limited in the specialized agencies of the Federal Government such as Railways, Pakistan Telecommunications, Pakistan Public
Works Department and Provincial Communications and Works (C&W) and Public Health and Engineering (PHE) departments. However, government departments that are over loaded with work-charged staff rotated on different works are required to utilize their own services rather than outsourcing it to private sector. Even departments with their own engineering cells are forced to entrust the maintenance to these departments.

3. Budget Flow Analysis

The section provides an overview of the procedures of operation and maintenance of loan accounts opened for donor financing agencies. The underlying issue herewith is the shortage of counterpart fund from the Federal Government during and after the completion of development project under the finance of JBIC, or whatever the donor agency may be. It also looks into the reasons possibly laid down behind the current structure of budget flow within the government of Pakistan. Further, the financial process currently ongoing with the JBIC-financed water management project will be briefly depicted in the following subsection to make it somewhat lively.

3.1. Mechanism of Budget Flow Process for Foreign-assisted Development Projects

As previously noted, the major game players and their respective roles and functions in the scrutiny of budgeting (budget flow process), vis-à-vis, (i) budget preparation, (ii) budget approval, (iii) budget appropriation, and (iv) budget sanction and release, in Pakistan include the followings.

(1) Budget Preparation and Approval (Annual Development Plan, Standing and new Recurrent Expenditures)

A. Finance Division, Ministry of Finance (MOF) - prepares Budget Circular for non-Development Budget
B. Planning and Development Division, Ministry of Finance (MOF) - prepares Budget Circular for Development Budget
C. Drawing and Disbursing Officers (DDO) - preparation of ADP and recurrent expenditures in each of the ministry/departments/agencies

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63 Grateful acknowledge is made of the close cooperation provided by Mr. K. Matsunami, Senior Project Implementation Officer, and Mr. T. R. Anwar, Senior Control Officer, both gentlemen at the Asian Development Bank Islamabad resident Mission, in the form of kind assistance inclusive of the provision of guidance, intellectual inputs and precious documents of most relevance.
D. Project Directors—in the case of Foreign-Assisted Projects—preparation of ADP
E. The Accountant General (AG)—verification of the past schedules of expenditures of each ministries/divisions at the time of submission of non-development budget estimates to Finance ministry
F. Financial Advisors for review and approval
G. Principal Accounting Officers (PAO) for final approval of budget estimates
H. Central/Provincial Development Working Parties (CDWP, PDWP)

(2) Budget Approval

A. Finance Division, Ministry of Finance (MOF)—prepare the Annual Budget Statements
B. Planning and Development Division, Ministry of Finance (MOF)—prepare the Public Sector Development Program (PSDP)
C. Central/Provincial Development Working Parties (CDWP, PDWP)—approval of CP-1s for Development Budget
D. The Inter Ministerial Priority Committee
E. The Annual Plan Coordination Committee
F. The Executive Committee of the National Economic Council (ECNEC)
G. The Cabinet
H. (The Congress)
I. Chief Executive

(3) Budget Appropriation

A. Finance Division, Ministry of Finance (MOF)—lump sum provision of approved budget (called “Primary Units of Appropriation”) to PAOs
B. Principal Accounting Officers (PAO) at ministries/divisions/departments/agencies—distribute sanctioned or approved funds to DDOs
C. Drawing and Disbursing Officers (DDO)

64 Non-development budget estimates for operation and maintenance of completed projects are called “the schedule of new expenditure (SNE)”.
65 As noted, Financial Advisors, normally assigned to the officials of Joint Secretary level with the grade 19-20, are posted in all ministries/divisions, but under the administrative control of Finance Ministry.
66 The Congress has been suspended since last September.
67 As the budgetary allocation are already in ADPs, approved budget will be allocated to EAs in full amount without discretionary power of PAOs to distribute in the case of development budget for foreign-assisted projects.
(4) Budget Sanction and Release

A. Line Ministries/Departments—at the request of their respective ministry/departments for approval of fund release, and submit proposals for fund release to MOF

B. Finance Ministry (MOF)/Departments—approve, prepares sanction order, and send fund release orders (called “Sealed Authority”) to (i) the State Bank of Pakistan (SBP) and (ii) the Accountant General’s Office in the cases of (i) development budget transfer from the federal to Provinces (Federally funded projects with Provincial Government branch as Executing Agency), and (ii) no fiscal transactions between the Federal and Provinces with the Federal or Provinicial government branches as EAs, respectively

C. The Central Directorate of the State Bank of Pakistan (SBP), Karachi—in the case of (i) in B. above, credits the accounts of the respective Provincial Government, and credit advise (Authority to Pay) to the Finance Department (FD) in Provinces

D. Finance Department at the Provincial Government—send sealed authority to AG offices to credit amount to the EA’s Personal Ledger Account (PLA)

E. Accountant General—in the case of (ii) in B. above, issue release order to (a) DDOs, and authorize the concerned branch of the National Bank of Pakistan to honor payments claims of EAs, if Assignment Accounts is opened by EAs, or to (b) District Account Officer when EAs have project director’s Personal Ledger Account (PLA) with the Government’s Treasury Office

F. The National Bank of Pakistan—in the case of (a) in E. above, claims on everyday-basis reimbursement of the amount paid out of the Assignment Accounts by EAs

G. District Account Officer (DAO)—credit the project director’s Personal Ledger Account (PLA) to let EAs draw funds to the equivalent amount for meeting expenditures

H. Drawing and Disbursing Officers DDOs—issues payment claims to NBP by checks or DAO by withdrawal claims co-signed by Project Director

3.2. The Financial Process in the light of JBIC-Financed OFWM Project

(1) Project Approval

The overall controlling documents of projects are the Project PC-1 Documents.

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*This part mostly owes to Mr. W. Newcombe, Team Leader of OFWMP Consultant Team from Harlcrow Rural Management, for which the study team is so grateful.*
These establish the reasons why the projects are needed, the objectives, project components and the physical targets, institutional arrangements and staffing, project costs and budgets, financing arrangements and the economic viability. The project and the PC-1 is approved firstly by the Central Development Working Party (CDWP), and finally by the Executive Committee of the National Economic Council (ECNEC). On approval the project is included in the Public Sector Development Programme (PSDP), which allocates finances to the project.

For a project such as the OECF OFWM project each province has to prepare a PC-1 for approval of the respective provincial government, to obtain funds from the provincial budget. FWMC then prepares an umbrella PC-1, incorporating each provincial PC-1, for approval of the Federal Government for approval of ECNEC and inclusion in the PSDP.

(2) Release of Funds

With approval of the project PC-1 and inclusion in the PSDP, funds are allocated to the project. Annual budgets are prepared by the Provincial OFWM Directorate staff and finalized by the Directors and Director Generals. These budgets are then submitted to the provincial governments through the Ministries of Agriculture. The provincial governments then make due allocation of resources to the project in the annual PSDP.

The funds are then release to the executing agencies by the Ministry of Finance. In turn the executing agencies provide funds to the project management staff to implement the project works.

(3) Obligations

Financial and physical obligations are incurred in accordance with the PC-1 and Loan Agreement, or as agreed during project implementation. As regards JBIC-financed project in concern, the OFWM Directorates identify works and make preliminary selection based on the agreed scheme criteria either set in the PC-1 or as developed by the project management. These are subsequently passed to the consultant for checking compliance with the criteria and review of the feasibility and design. When the checks and review are complete if there are no problems the scheme design files are approved. At this stage the Directorates commence the works and incur costs.

Material supplies are made on the basis of tenders. At the beginning of a
season the Directorates will call tenders for the supply of materials. These are assessed and one company awarded the contract for supply of specified materials. This fixes the price of materials for the season.

(4) Verification of Delivery of Goods/Services

Verification is undertaken on behalf of the FWMC by the consultant. Field staffs make supervision visits to the works under construction and when they are complete verify quality and quantity. All works are measured and the quantities for payment calculated. This is, in effect, a physical audit.

The consultant’s performance is monitored and verified by the Federal Water management Cell (WMC) currently headed by Mr. N. A. Gillani, Director General.

(5) Payment Authorization and Financial Audit

The Directorates make payments to the suppliers. For reimbursement of costs, the directorate submits all claims to the consultant’s staff. The claims are verified and the consultant prepares the application for submission to the DG OFWMC. Upon receipt, DG OFWMC then checks and makes the formal request to JBIC for replenishment/reimbursement of the funds. Consequently, the financer releases the funds to the DG OFWMC who then disburses these funds to the provinces.

Audit is conducted in accordance with the Government Regulations. Staff of the Auditor General of Pakistan conduct audit. These procedures are time consuming and often result in delays in submission of the audit reports.

3.3. Issues - Counterpart Fund Shortage - Structural Impediments and Others

Against the background of Budget flow as articulated in Appendix 3.1, some of the issues to be highlighted are sorted out through discussions with concerned officials in the government, as well as development professionals at the international financing institutions. Those include:

(1) Structural Impediments to Sufficient flow of Counterpart Funds

In the estimation of newly proposed investment projects, discrepancy between PC-1 and Loan Agreement are often identified, where in PC-1, the local cost portion/OM costs are in most cases intentionally underestimated because of preference on “cheaper local cost” projects by competent authorities in the scrutiny
of budgeting. Behind the scene is “a bunch of investment portfolio and NEC’s preference on “on-going Projects” rather than newly coming-up projects with “Fresh money”.

As regards the ongoing Projects, income tax payable by executing agency (EA) to all suppliers in procurement of goods and services regardless of source countries can not be dispensable from PC-1 budget allocation even for foreign cost components covered 100 percent covered by donor fund. Line item of “Duties and Taxes” in PC-1 (L/A) is provided only for import duties, thereby making it impossible to provide, by the government rules, income taxes accruable to procurements.

Also, Security Deposit, amounting to around 5-10 percent of the gross value of a contractor’s invoice, has to be paid in advance by EA during the construction period. This cost item is not included in budget, or cost estimates in PC-1, thereby making it impossible, by the Financial Rules of the Government, to withdraw from the counterpart fund appropriated to EA.

(2) CDWP/PDWP

Central Development Working Party (CDWP)/Provincial Development Working Party (PDWP) are to be convened every month to discuss and select the approved investment projects newly incorporated to PSDP on the basis of PC-1 document. With this, PC-1 documents are submitted and approved on ad hoc basis, time by time, thus making it almost impossible to prioritize all the proposed projects in an integrated manner.

(3) Funding Crises Experienced at JBIC-Financed OFWM Project

It was pointed out by the consultants assigned to the JBIC-financed On-Farm Water Management Project that the executing agency (EA) had experienced a serious crisis of fund shortage during the loan period. This happened because EA have not submitted their reimburse application on time. By the end of September 1998, only 35 percent of project management costs had been claimed whereas the planned reimbursement standing at 88 percent.

In order for EA not to encounter this fund flow difficulty, the consultant stressed that this type of loan should be in compliance with “revolving fund” with the initial deposit equivalent to the costs accrued to management and operation for the period of three to four months. This would give a kind of incentive for project staff to expeditiously proceed with their processing work for reimbursement. As
noted in Appendix 4.1, the initial deposit was JY 1230 million that accounted for 14.9 percent of the aggregate loan amount.

(4) Misconduct by Project Director

In the case where skeptical shadow is cast over some payments by Project director, it would mostly be impossible to prove the misconduct when (i) Tender, (ii) Procurement, (iii) Verification, and (iv) Payment procedures are supervised and controlled by one person or a couple of specific persons in the organization. Should the occasion arise, it would be far better for quick solution to undertake timely JBIC-financed TA while sending project administration specialists to look into the matter than asking consultants assigned to the project in concern. While the consultants are to be neutral and in a position to verify the actions taken by EA, vested interest asking the consultants for favor is in the hand of the consultants’ employer, inter alia, EA.

4. JBIC Financed On-Farm Water Management Project (PK-P32)

In carrying out the study, it had been discussed to pick up one specific project under the finance of JBIC in Pakistan to look into the budget flow process currently in place at the micro-level. In so doing, it was also intended to draw some implications for JBIC to support lending operations of project/program processing and administration in the days to come.

In the previous subsection, the in- and out-flows of fund committed to development projects have been outlined. Immediately following the issues of counterpart fund shortage as well as mismanagement of funds during and possibly after the loan period. This subsection highlights one of the JBIC-financed projects in a bid to look into the financial process and fund management mechanism that have been actually in place. With this in view, the On-Farm Water Management Project (OFWMP, PK-P32) was selected among others, while taking due consideration on projects being implemented by provincial government agency, specifically in Punjab province where the JBIC mission was to undertake an extensive study on its Performance Budgeting.

Alternatively in the Philippine, budget flow analysis that focused on the specific project was not undertaken due largely to the mission’s intensive work on PEM or the public sector management reform currently ongoing at the Central Government level as well as on a bunch of assistance efforts extended by donor agencies and countries.
4.1. Project Profile

In the past 20 years, nineteen On-farm water management projects have been completed in all over the country. Besides, another seven donor-aided projects are in progress, one of which is the one under the auspices of JBIC. The Project’s PC-1 was originally approved in 1992 prior to the signing of Loan Agreement\(^{70}\). Subsequent to the physical and institutional works duly undertaken, the revised Umbrella PC-1 was approved by ECNEC in the middle of 1998 in the wake of almost-two-year-long scrutiny in the administrative procedure. The revision of the original PC-1 took place due to the expansion of the scope and the associated cost increase, with an extension of loan period for one and three-quarter years, that is the end of March 2000, due to the delay at the outset of the Project. \(^{71}\)

The overall objective of the project was to increase agricultural production through efficient water use at farm level in aggregate of 25 eligible districts in the provinces of Punjab, Sindh, Balochistan, NWFP, and those special districts under the Islamabad Capital Territory Administration (ICTA) and the Federally Administered Tribal areas (FATA). Loan amount was JY8,230 million, of which JY1,230 million, then equivalent to Rs.362,225,710, or 14.9 percent of the aggregate, was initially disbursed and deposited, through credit advise from the Sate Bank of Pakistan in Karachi, in the foreign exchange and rupee accounts (matching fund accounts) opened at the National Bank of Pakistan in Islamabad\(^{72}\). The physical progress of core activities, vis-à-vis, construction of watercourses was 117 percent of the target number of watercourses in 82 percent of the target command area by the end of September 1999, while the financial utilization accounting for 77.0 percent of the total costs as of the end of November 1999.\(^{73}\)

\(^{70}\) This is evidently in a violation of the Government rules. See Planning and Development Division (1997). In this connection, the high-ranking government official is quoted as saying that there was a dispute on this issue within the government at the time of PC-1 approval at ECNEC.

\(^{71}\) The cohesiveness and camaraderie have been among a corps of the project team inclusive of Mr. Bill Newcombe, OFWMP consultant team leader in particular and all those well equipped with professional knowledge and willingness in his team, as well as those at the Federal Water Management Cell headed by Mr. N. A. Gillani, Director General.

\(^{72}\) Of this, disbursement to the initial advance by province and executing agency accounted for 33.7 percent, 24.0 percent, 14.0 percent, 10.9 percent, 3.0 percent, 1.0 percent, and 13.7 percent for Punjab, Sindh, NWFP, Balochistan, FATA, ACT, and the Federal Water Management Cell (WFMC), respectively. (Source: WFMC document)

\(^{73}\) See Harlcrow Rural Management (1999) and JBIC Islamabad Resident Office (2000).
The Project Wing of the Planning Commission monitored this OECF-financed Project in progress in Punjab in 1998, with the major findings and recommendation as follows: (i) The executing agency revised the project scope, one of which was an expansion of Precision Land Leveling, without the approval of the competent authority, (ii) discrepancy in physical progress was found amongst the reports submitted by the executing agency and the consultants, (iii) the expansion of Precision Land Leveling under the revised PC-1 was redundant and consequently shriveled the financial resource for watercourse improvement, (iv) in this connection, the Project should expeditiously be carried out to complete the remaining part of watercourse improvement in lieu of diversifying the scope, and (v) consultancy services by expatriates would be minimized in future, while confining to the areas where local expertise are not of avail.

4.2. “What-If” Game in the Face of Counterpart Fund Shortage-The Mechanism of Budget Adjustment within the Federal Government

(1) An Overview

To begin with the budget play for any development projects, administrative Ministries/Divisions and Departments of the Federal Government, at the request of the Planning and Development Division, are to submit their budget estimates to Finance Ministry, with “Proforma” of each of the standing and fresh projects as attached to the “Budget Call Circular”. In tandem with the submission of budget request for the ensuing fiscal year, the revised estimates for the current fiscal years are also to be put forward. Should the case happen where the revised estimates and the authorized grants and appropriation deviate each other, documentary evidence indicating both approvals of the competent authority and source of reappropriation are to be submitted from the concerned Ministries/Divisions and Departments.

Should the case of cost-overrun take place and the budget request for the ensuing year exceed the cost estimate given in the PC-1, new budget allocation to the project concerned would meet the request for proliferation, strictly subject to the resource availability in the year concerned, with the conditions, notably, (i) fulfillment of authorized grants and appropriation (budgets) in the previous year,

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74 Planning and Development Division (1998). Close cooperation from Mr. Abdul H. Chaudhly, then Joint Secretary, and Dr. A. Kalim, both gentlemen at the Project Wing, the Planning and Development Commission, is gratefully acknowledged.

75 In carrying out the interview survey regarding the budget mechanism and so many other issues of relevance, an intellectual inputs and supports willingly provided by Dr. M. Awan, Assistant Secretary at the Planning and Development Commission are gratefully acknowledged.
(ii) a kind of force majeurs incidents such as natural disaster or else that are not liable to the concerned project executing bodies did take place during that fiscal year, and unexpected costs such as import duties, warehouse charges, or transportation of equipment/machinery for the use of the project construction and operation, did take place. Likewise, if the occasion arises and the cost of project overruns during the project implementation, supplementary grants and appropriation would be utilized if (i) that excess use of funds are inevitable due to incidents not liable to the implementing body, or (ii) the project in concern was highly important and its completion was considered nearly “A MUST”. (Ghazi Brotha Hydropower Project is the case, for example) In the event the change in budget or scope of work did inevitably take place, PC-1, a prescribed document of project proposal, should be revised and submitted to Planning and Development Division whenever the case took place during the project implementation, vis-à-vis, (i) there happened (a) major change(s) in project scope of work of the project, and (ii) the estimated total cost exceeds that of the original PC-1 by 15 percent or more. The Executive Committee of National Economic and Council should also approve the revised PC-1 eventually through the technical scrutiny by Planning and Development Division.

Meanwhile, an incremental budget would be appropriated in Public Sector Development Plan (PSDP) with somewhat priority to the project whose implementation period elongated and went beyond the original duration given in PC-1 (like OFWM Project) so that the project is to be spurred for completion. Should the case occur where costs incurred exceeded the original fund allotment and the no incremental budget from the Supplementary Grants and Appropriation or the war chest of Provincial government is of avail, project implementing body could resort funds from foreign donor(s) subject to the consent of financier with respect to an amendment to Loan Agreement, so that the project could be kept on the track. In this case, there needs no consultation with or approval from competent authority, and the Budget Proforma to be submitted by the concerned executing body for the ensuing year only will reveal its excess use of funds under the auspices of foreign donor(s) during the current year.

What happens if there remained unutilized fund at the end of the fiscal year. Simply, the fund that was not withdrawn from the Federal Consolidated Fund in the annual Budget Statement during the fiscal year should be surrendered to the financial authority on 30 June, the closing date of fiscal year. This means the budget allocated to an executing agency of a certain project in principle can not be carried over to the following fiscal year.
(2) Scenario of Budget Adjustment in the Face of Cost Overrun

In View of the above, it would be helpful to articulate the case of “project cost overrun” in such a way to draw the scenario of “Budget Adjustment” as follows.

Scene I: There is an acute shortage of recurrent/development budgets for the continuation of project during a current year.

ACT I: What’s next for A Project Director?
(a) Only quit to keep going with the project,
(b) Go to the Finance Division of the Allocation of Supplementary Grants,
(c) Go to the Planning Commission for the revision of PC-1 and get more fund in the ensuing year, or
(d) Go to donor institution, if any, and ask for amendment to Loan Agreement and reallocation of fund in advance.

Scene II: When the fund is in need even in the wake of the original loan period and construction works still in progress.

ACT II: Rush to the Planning Commission (PC) and ask for budget allocation for the year after the original loan period. The request would be taken up primarily by PC in a bid to have the project in concern complete as soonest.

4.3. Prospective Ninth-Five Year Plan for the Water Management Sector

(1) Draft Ninth-Five Year Plan for the Water Management Sector

While the preparation of the 9th Five-Year Plan is around two years behind the schedule, a draft for the water management sector has been submitted to the Planning Commission for consideration and comments. Little either development or modification has been seen in the draft compared to the previous 8th Five-Year Plan, except that the draft emphasized social change and institutional reforms.

Problems identified during the past Five-Year Plan period include: (i) late award of contracts and the associated delay in construction, (ii) deteriorated Law

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Grateful acknowledgement is made of the close cooperation and the documents provided by Mr. Naseer Gillani, Director General, Water Management Cell, the Ministry of Food, Agriculture and Livestock, and Dr. Munnawar Shah, Deputy Chief (Water), Planning Commission. The study team’s output as reflected in this subsection has extensively benefited from their kind support during the assignment.
and Order, (iii) Improperly prepared PC-1s and associated changes in design and delay in project implementation, (iv) land acquisition, and (v) political interference. On the financial front, problems identified are (i) too many projects, or investment portfolio, for too little resources available, (ii) inefficient use of resources due to bureaucracy and less incentives for smoother allocation of fund within the organization such as WAPDA, and (iii) a paucity of recurrent budget for operation and maintenance. In this connection, Provincial Irrigation Development Authority (PIDA), farmer’s Organizations, and Farmer’s Association were set up in each of the provinces and currently in work in a bid for water management on site to be financially self-sustainable. Beneficiaries’ contribution (user’s pay), privatization, private-public partnership, disinvestment or dilution of public fund, and economic use of water are newly in view. A set of performance indicators attributable to the economic use of water, for example, output in monetary term per unit of water used will be introduced in this light.

New initiatives are place on (i) construction/rehabilitation of water reservoirs and dams of the n-going projects, (ii) good governance, human capacity building and institutional reforms, and (iii) water resources development and information system. In the 9th Five-Year Plan, no foreign-aided new projects are presumed. The aggregate budget allocation is set at Rs.236 billion for the actual 1998/99 and 1999/2000 budgets plus ensuing three-year budgets, arising from Rs.83 billion in the previous 8th Five-Year Plan.

(2) Guiding Policy for Budget Allocation to the Water Management Sector

World Bank has been pushing the government to draft the 2-3-year medium term Rolling Public Investment Program for the water sector in relation with their financing “National Drainage Program (NDP)” Project. While Rolling Plan is equivalent to MTEF in the government of Pakistan, it is not drafted in the Water Section yet. This is mostly because the preparation of 9th Five-Year Plan (1999/2000-2004-2005) is now underway as such the medium-term plan would not be of relevance without the long-term national development framework and a indicative project list.

The current government puts high priority on the water sector, as reflected in the Chief Executive’s address in last December in such a way that “Water conservation is a very high priority for this Government both in terms of

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Hearty gratitude is due to Mr. Abdul Hafez Qaiser, Chief, and Dr. Munnawer H. Shah, Deputy Chief, both gentlemen at the Water and Resources Section, Planning Commission.
rehabilitation of the irrigation system and for the revitalization of the farm water management projects in all provinces”78. In the light of this, policy priority will be given to the proposed projects for forthcoming budgeting in line with the following criteria: (i) consistency with the Five-Year Plan and, specifically for the water sector, the National Agricultural Policy of 1991, (ii) consistency with PC-1 in terms of the project phasing and associated budget expenditure, (iii) foreign-aided projects due to domestic resource constraint, and (iv) nearness to completion. In line with the World Bank “Checklist of Criteria for Review of Ongoing projects” as given in their 1997 PEM paper, the Water Resources Section of the Planning Commission prioritize the proposed projects in compliance with some of those criteria that include (i) appropriateness, (ii) performance, (iii) nearness to completion, (iv) secured financing, (v) internal cost of project termination, and (vi) economic justification.

World Bank assisted On-Farm Water Management Project III was monitored by the Planning and Development Division, Project Wing, in 1993, whereas that financed by JBIC was carried out in 1998 focusing on the project performance in the province of Punjab. The water sector is a priority sector within the government, thereby making it possible for the Planning Commission to confer 100 percent of development budget allocation to the proposed projects.

In view that sustained operation/maintenance and costs perpetually accrued is a key element in ensuring goals, the final solution would be in such a way to adopt the participatory approach and associated institutional reforms in operation and maintenance. The Provincial Irrigation and Drainage Authority (PIDA), an autonomous self-supporting body for this recurrent works, has already been set up in such a way that direct beneficiaries sustain on-farm water supply financially by themselves.

78 “Chief Executive’s Speech on Economic Package”, 15 December 1999
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