PUBLIC EXPENDITURE MANAGEMENT AND DEVELOPING COUNTRIES
PART I: PUBLIC EXPENDITURE MANAGEMENT AND DEVELOPMENT ASSISTANCE

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CHAPTER 1 TREND TOWARDS THE INTRODUCTION OF PUBLIC EXPENDITURE MANAGEMENT IN DEVELOPMENT ASSISTANCE

For several years moves have been apparent towards the introduction of the public expenditure management in development assistance. International financial institutions such as the World Bank and the Asian Development Bank (ADB) have made it one of the points of their policy dialogs with developing countries, and they have started to implement some technical assistance and other measures which more narrowly target public expenditure management. The ADB, which is enthusiastically pursuing public expenditure management, incorporates the following measures within the concept of public expenditure management:

Revision of Public Investment Programs (PIP).
Setting three year Medium Term Expenditure Frameworks (MTEF).
Building contingent debt monitoring systems.
Drafting fiscal and finance-related laws.
Improving internal audit systems.
Introducing computerized data systems into whole government accounting system.
Introducing and enhancing computerized financial reporting within governments.

The World Bank takes a public expenditure management viewpoint in the preparation and formation of Public Expenditure Reform Loans (PERL) and Governance, Institutional Reform Loans (GIRL).[1]

The characteristic point here is that governance reform and other initiatives and operations for public sector reform are coming to be understood as integrated elements with public expenditure management. The process leading to that position begins with increased concern over the outcomes of aid, followed by consideration of "governance and institutional capability in the governments of developing countries" as a precondition for successful outcomes, and follows through to the positioning of "public expenditure management" as a means of building that capability.

The public expenditure management approach originated in reforms of the public sectors of developed countries. From the point of view of making the management of public sector funds more efficient and realizing its effects, the fiscal and budgetary targets are:

(1) Fiscal discipline.
(2) Allocation of resources based on strategic priorities (allocative efficiency).
(3) Effective and efficient use of resources (operational efficiency).

Public expenditure management is valued as a specific, basic approach for achieving those roles and targets. Its concepts and characteristics are defined by the following:

(a) System building through the introduction of sound management methods, and the use of those methods to allocate resources and improve efficiency.

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1 Arrangement of the concepts of public expenditure management is taken from the 1999 interim report entitled "Public Expenditure Management in Developing Countries and the Response of Aid Agencies" for the "Survey of Development Policy and Project Assistance" by JBIC (Consulting House Ltd. Minerva's Owl and Shinko OMC Inc). (Abbreviated below to "Interim Report") (in Japanese) .

JBIC Review No. 4 May 2001 pp 72~84

Table 1 Elements, Targets and Specific Methods for Public Expenditure Management

Element	Targets	Measures
Fiscal discipline	• Strong budgetary control • Control of off-budget funds	• Securing accountability through information disclosure • Adoption of Medium-Term Expenditure Framework (MTEF) • Clarification and evaluation of policy objectives (project evaluation, policy evaluation) = grasp of results (outcomes) • Feedback of evaluation results (fading out of incrementalism in budgeting and introduction of merit-based personnel systems) • Introduction of budgets for each area of activity and of accrual based accounting • Empowerment of audit departments
Allocative efficiency	• Budget allocation in line with priorities • Setting of objective criteria to serve as the bases of fiscal decisions	
Operational efficiency	• More efficient budget disbursement • Independence and reinforcement for the management of budget disbursement departments	

Source: Interim Report p.2-5

(b) Shifting the emphasis from the idea of due process, which holds that strict observance of rules and procedures guarantees results, to a new emphasis on output and outcomes.
(c) Information disclosure and accountability for the attainment of targets.
(d) Systematic reforms, including the introduction of budgets for each type of activity and of accrual based accounting, and the strengthening of audit departments.

These ideas are summarized in Table 1.[2]

The elements, targets and methods listed above are certainly not new inventions as individual points, and most of them have already been developed in traditional public finance or public corporation theory, but there are the following two important features:
(a) The roles and objectives of the public sector are incorporated from the point of view of new institutional economics, the above elements are collated into three groups, and fund management in the public sector as a whole is considered.
(b) The "public expenditure cycle" of planning, implementation and evaluation is emphasized.

The idea of the "project cycle"[3] has been established in the world of development assistance since the 1970s, thus the "plan - do - see" cycle is certainly nothing new, but it is notable that its application has now been extended to the entire public sectors of developing countries.

CHAPTER 2 WILL PUBLIC EXPENDITURE MANAGEMENT BECOME THE MAINSTREAM IN DEVELOPMENT ASSISTANCE?

As we saw in the preceding chapter, public expenditure management was in the forefront of the major movements in development assistance in the 1990s. There have still not been many actual records of public expenditure-type loans (GIRL, PERL etc.), but there is a strong possibility that direct support for public expenditure management could become the major trend in development assistance in the future. That is the case because public expenditure management is, by definition, a comprehensive approach, and because in recent years the World Bank and other agencies have started a succession of initiatives centering on comprehensive assistance.

The Comprehensive Development Framework (CDF) is one comprehensive approach which proposes that the World Bank should aim to encourage stronger linkages between aid agencies and countries, while respecting the ownership of aid recipient countries. It is a framework for coordination between multiple stakeholders. In the same way as the DAC International Development Strategy, it works on the basis of ownership and partnership to reduce poverty. Rather than relying solely on macroeconomics, as the structural adjustment approach did in the past, CDF conducts it in parallel with analysis of social, structural and humanistic aspects. The actions of each of

2 Interim Report p.2-5
3 Warren C. Baum, "The Project Cycle," World Bank/IMF FINANCE AND DEVELOPMENT, Vol.7, No.2, June 1970.

the domestic and foreign stakeholders contributing to development, and the actions needed to tackle each task, are arranged in a matrix, with a time frame of 10~15 years in mind, to build a comprehensive development framework[4].

Chronologically, the concept of public expenditure management predates the start of the CDF initiative. It is natural that public expenditure management will be taken up as an effective tool for implementing CDF, because they are both comprehensive approaches. As mentioned above, CDF is not the kind of approach that adheres to macroeconomics and market mechanisms. Instead it aims to bring the institutional and social elements, which are essential for the proper function of a modern market economy, into the framework. The public sector bears the central role in laying the social and economic foundations, and its work is achieved through public expenditure. Therefore it is reasonable to say that improved institutional capability, supported by public expenditure management, is the key to the development which CDF is intended to achieve. The process begins with evaluation of public expenditure management capacity and identification of shortcomings in each developing country. The next step is to provide support measures to improve on the identified shortcomings, thus raising the state's overall development capacity and enhancing the effectiveness of aid[5].

Alongside CDF, the relationship between public expenditure management and the Poverty Reduction Strategy Paper (PRSP) also attracted attention.The PRSP is also based on concepts of ownership and partnership and makes the judgement that developing countries should make their own economic policy decisions. On that basis they are responsible for policy making, which they carry out with support and consultation from the World Bank and the IMF, in a partnership which includes the UN, regional development banks, bilateral aid agencies, NGOs, academia, research agencies, companies and other parties. The PRSP approach is comprehensive and results-oriented. It emphasizes the setting of achievement targets, the selection of policy methods to attain those targets, and a comprehensive approach to action on poverty.

Public policy is of central importance to the reduction of poverty. As the public policy concerned is implemented through public expenditure, it is exactly the same as the CDF case. The "Source Book"[6], which is the key reference work on PRSP, includes one chapter on public expenditure. It emphasizes the establishment of public finance rules as a critical path within the budget cycle. Furthermore, the Source Book identifies certain common weaknesses suffered by developing countries in implementing policies for the reduction of poverty:

- Poor prioritization of investments.
- Unclear compartmentalization between investment (development) budgets and budgets for recurrent expenditures.
- Shortage of budget for recurrent expenditures because their budget allocations are not clearly stated in PIP.
- Inconsistency in the macroeconomic forecasting which is a precondition for the above.

The Source Book emphasizes the establishment of public expenditure management cycles, and of priority for the direction of public expenditure to poverty reduction. Thus PRSP already incorporates inherent elements of public expenditure management.

From the above one can easily infer that public expenditure management will become an important item on the agenda in development assistance in the future, as CDF and PRSP converge. There are four levels for putting it into operation:

(1) Public expenditure management is employed in policy dialogs with the developing country side alongside previous country policy (strategy) as an element in country economic sector surveys. Alternatively, it can be a added as a perspective on the preparation and formation of individual projects.

4 James D. Wolfenson (1999) "A Proposal for a Comprehensive Development Framework"
5 Interim Report pp.3-6.
6 World Bank (2000).

(2) Addition to the project appraisal items, or reflection in the implementation methods of the loans.
(3) Provision of T/A and loan, taking into account policy dialogs accompanied by country-specific aid policies and country-specific economic sector surveys, in which public expenditure management is treated as one sector.
(4) Based on the policy conditionalities on public expenditure management, aid can be provided comprehensively in the form of fiscal support in line with, or as an element of, structural adjustment facilities.

The first level is actually being carried out in Public Expenditure Reviews by the World Bank. In future, in developing countries where CDF and PRSP are used, they are expected to be merged into one. However, it is quite likely that individual bilateral donors will carry on policy dialogs from their own independent points of view, based on country-specific aid strategies. That is a valid way of applying checks and balances as well. In this survey by JBIC, multiple donors were competing to set performance indicators and displaying keen interest in providing aid, but these indicators are the basis for judging "value for money" and should be regarded as starting points. There were apparent cases of unbalance in which not enough attention was paid to raising the accuracy of costing.[7]

The World Bank is currently preparing projects based on (3) and (4) above. In these areas, Japan is handicapped in all aspects, such as skill and experience, due to the paucity of its own accumulated experience of public expenditure management, and is therefore unable to take the lead in project formation. As described below, there may be some potential for the future, but the best way for Japan to proceed for the time being would be to accumulate experience in this area by providing co-finance with other donors.

In the formation and appraisal of individual projects, in stage (2), "public expenditure management considerations" could be developed into a necessary aspect considered alongside "environmental considerations" and "social considerations". There need not be a mutually exclusive choice between the individual project approach and the fiscal support approach. Even when projects are carried out individually, public expenditure management is an extremely important element of the policy environment in which the projects are implemented. If there are elements in the public expenditure cycle which impede the implementation of a project, the remedy of such problems should be taken as a benchmark for the progress made in improving procedures. (2) is the most familiar field for Japanese ODA. Therefore we will go on to examine the key points of public expenditure management considerations in the implementation of individual projects.

CHAPTER 3 PUBLIC EXPENDITURE MANAGEMENT AND THE IMPLEMENTATION OF PROJECTS

According to a survey[8] carried out in 1997 by JBIC (then OECF), which examined the specific lessons learned from project implementation at each stage of the project cycle, the most common experience at all stages of the cycle concerned "improvement in institutional capability". The stages of the cycle were "project formation and appraisal", "management of procurement and implementation", "operation and maintenance". Of these, the most lessons were learned from "project formation and appraisal". Institutional capability could be called the ability to manage and use limited resources such as funds, personnel and information in order to carry out the project. Considering the fact that most development projects are implemented through the public sector, the issues of

7 For details, please refer to the JBIC Research Paper on this survey JBIC Research Paper (No.10 Public Expenditure Management in Developing Countries).

8 Shinya Ejima and Katsuhiko Nakadate (1998) "Lessons Learned From OECF Post-Evaluation", Journal of Development Assistance Vol.5, No.2.

organizational ability and public expenditure management are two sides of the same coin.

The problems listed below are among those generally recognized as affecting appropriate resource allocation and efficient project implementation:

(1) Weak planning capability.
(2) Weakness in the links between policy decision, plan drafting and budget making.
(3) Weak expenditure management.
(4) Inappropriate budget allocations for maintenance management (inappropriate recurrent budget allocations).
(5) Inappropriate accounting systems.
(6) Inappropriate flows of funds through governmental structures to lower-tier agencies.
(7) Inappropriate management of foreign aid.
(8) Inappropriate management of cash funds.
(9) Inadequate reporting of fiscal performance.
(10) Inadequate motivation of staff involved in public expenditure.

The World Bank recognizes from its analysis that these shortcomings have their roots in structural problems in budget systems. The structural problems are as follows:[9]

(1) Achievement of the goals of budget expenditure is evaluated solely by the input side, namely how much money was spent.
(2) The above input targets only consider the short-term view, with no proper consideration for apparent or latent long-term costs. Furthermore, when choices arise between capital (development) investment and recurrent expenditure, or between financial measures and non-financial measures (regulatory improvements etc.), there is a strong bias towards short-term measures.
(3) Budget determination works on a "bottom-up" basis, which makes it difficult to coordinate between central government agencies and line-in agencies in line with policy priorities under an appropriate fiscal policy. (The costs of dealings for coordination become extremely high).
(4) Government budget setting tends to allocate any increase in revenue to new projects.
(5) Budget setting by the government, ministries and agencies tends to concentrate exclusively on fine tuning of budgets for existing projects (Reviews do not extend to comprehensive reviews of the necessity of existing projects).
(6) When expenditure is adjusted up or down partway through a financial year, there is a tendency to make sweeping, uniform cuts from all budget items.
(7) The application of uniform cuts across all budgets in mid-financial year heightens the uncertainty of policies and budgets in progress, with the result that ministries and agencies tend to chase after contingency backup sources of funding.
(8) The prospect of uniform cuts across all budgets in mid-financial year gives ministries and agencies a strong incentive to use up their budgets as early as possible.
(9) There are very few opportunities to make close inspections of existing projects and projects under way.
(10) Incrementalism in budgets results in very weak linkages (between central government ministries and agencies and between the center and the regions) between policies and resources.
(11) Policy implementation and targets lack clarity and there is a shortage of information on the performance of policies, programs and services. There is also little linkage to their costs, thus information on cost - performance is lacking.
(12) As a result of all these problems, there is very little incentive to improve performance (to use the budget to attain the objectives of the policy concerned).

To recap, the problems are concentrated in areas such as single-year budgets, line-item budgets, "Input based" budget appraisal, and incrementalism.[10] Among the available tools of public expenditure management, the single-year budget bias could be countered by the introduction of Medium-Term Expenditure Frameworks (MTEF). "Input based" budget appraisal could be countered by the introduction of per-

9 World Bank (1986)
10 Of course, these problems are not confined to developing countries. They are apparent in developed countries, including Japan.

formance budgets (necessitating performance auditing). The line-item budgets, which make it difficult to introduce performance criteria, can be tackled with the introduction of activity-based budgets. Performance budgets, zero-based budgets and other measures can be used against incrementalism.

These problems can be arranged in relation to the implementation of projects, as described below.[11]

1. GENERAL BUDGETS AND DEVELOPMENT BUDGETS

In many cases the budget provided for maintenance management is not enough to do the job properly. The World Bank's PER etc. reports that this shortage is a symptom of the common tendency in developing countries to put development (investment) budgets ahead of budgets for recurrent expenditure. Looking more deeply into the cause, they indicate problems such as the following:

- There are no policy-based comprehensive frameworks for whole sector units (such as cases where no MTEF has been drawn up).
- Cases where allocations for recurrent expenditures in the medium and long term have been considered within a Public Investment Program (PIP), but the fiscal authorities only estimate the allocations on a yearly basis (Laos PER).
- Cases where recurrent budgets are being squeezed by subsidies and interest payments on external borrowing (Indonesia PER).
- Cases where, even in traditional aid projects, the estimate made of recurrent expenditures at the financing stage was inadequate.

The PRSP Source Book emphasizes the poor linkage between individual project budgets and PIP.

At the beginning, how we can deal with the separation of the budgets for development and for recurrent expenditures? There have been arguments for and against this divided (two tier) budget method since the 1980s or even before. The argument in favor of the divided budget method is that the ways development expenditures are incoming and used are clear, and it is possible to set targets for economic policies within a balanced budget. The counterargument is that under the divided budget method, the budget puts needless emphasis on the construction of physical facilities.[12]

Where the objective of each individual project is its physical completion and the prime concern is to secure the funding for that purpose, the divided budget method would be advantageous. The upper limit on the development budget can be simply ascertained by adding the current account surplus to the amount of borrowing, thus showing the affordability of projects. However, this is only an appropriate approach where the aim is "input" in the form of construction of facilities. From a point of view which gives greater weight to output and outcomes, or from the point of view of public expenditure management, integration to PIP or MTEF is a more desirable stance. Also, the divided budget method does not easily conform to reconstruction of activity-based budgets. Even if the divided budget method is used, it is important to incorporate some kind of public expenditure management framework to secure a recurrent cost financing for operation and maintenance after the project is complete.

On the subject of recurrent expenses for projects, the PRSP Source Book supports the practice of donors incorporating recurrent cost for operation and maintenance expenses into their aid. In contrast, the traditional approach to aid, which is followed by Japan among others, holds that support for recurrent expenses, once begun, is endless and places a heavy burden on the donor in later years, as well as harming the recipient country's self-help efforts. Even supposing such assistance is provided, the traditional approach holds that the increased recurrent expenditures caused by the implementation of the project should be supported in a limited and diminishing manner (incremental cost on a declining basis, according to the World Bank). However, from a public expenditure

11 The World Bank PER summary below was a survey commissioned by Research Institute for Development and Finance, JBIC: From "Problems with Public Expenditure Management in Five Asian Countries as Seen in World Bank Public Expenditure Reviews", by Takayuki Urade, February 2000. (in Japanese)

12 W.C. Baum & S.M. Tolbert (1985) "Investing in Development: Lessons of World Bank Experience", Oxford.

management point of view, the total activity in each sector as a whole, including the kinds of activities mentioned above, including all investment expenditure and recurrent expenditure, is important and the division between investment and recurrent expenditure has no significance. The activity in a sector could be, in the example of the irrigation sector, all aspects of the building, maintenance and operation of irrigation facilities.

Under the traditional approach, finance for operation and maintenance and other recurrent expenditures is impossible, while capital (development) expenditures for rehabilitation and renewal of facilities can be the subject of aid. However, if there is an adequate budget for maintenance, there is likely to be less demand for rehabilitation work. Moreover, the public expenditure management point of view points out that if aid is specialized into capital expenditure, it becomes biased towards the construction of physical facilities.

Thus it is possible that systems that would be advantageous for individual projects and would be preferable for "input" target of aid would not be supported under public expenditure management.

2. THE POSITIONS OF SINGLE-YEAR BUDGETING AND INDIVIDUAL PROJECTS WITHIN MEDIUM AND LONG-TERM PLANS

In general, even in cases where a developing country is drawing up its medium and long-term plans, it is very common for such plans to be only weakly linked to plans for single year.

The increase in BOT, BOO and other projects involving private sector activity must also be considered, In Pakistan, the Public Sector Development Program (PSDP) is prepared at the central government level within its five-year plans, while Annual Development Program (ADP) is prepared at the state level. However, the linkages between the Five Year Plans, the PSDP and the ADP is weak. Many infrastructure projects, particularly those on BOT or BOO schemes, are carried out outside the PSDP, necessitating care with the management of contingent liabilities.[13]

In addition, there are cases such as the following which are regarded as problems under PER:

- Where the PIP is merely a list of projects (Laos PER)
- Where the project selection process becomes politicized (with budget battles between ministries and agencies).
- Where the projects of some parts of the government do not require approval from the Planning Committee and lead to the risk of distortions (Pakistan PER).[14]

The last case had the advantages of simplified administrative procedures and greater speed, but would probably not be supported by public expenditure management. In cases where there is a high level of dependence on the donor side, coordination between donors in the drafting of medium and long-term plans and in setting orders of priority for investments can have a strong impact on the effectiveness of aid.

3. OFF-BUDGET FUNDS

The approach of aiding individual projects would support securing of off-budget earmarked funding. However, as a result, off-budget funds end up squeezing financial resources which should really be tax revenues. Public expenditure management, which aims to look at the public sector as a whole, would give that practice a negative evaluation for its effects on establishing fiscal norms and allocating resources efficiently. If system is transparent and accountability is guaranteed, the problems can be avoided to some extent. However, all the PERs take a negative view on off-budget funds.

In China, debt-related incomes and expenditures are accounted separately from general account budgets. As a result, the fiscal deficit figures published by the State Bureau of Statistics do not include government bond expenses and repayment of external borrowing. The figures for fiscal deficit are therefore much lower than the real situation. Debts must be handled with great care in cases where projects are carried out using off-budget funds. Furthermore, care-

13 See the above-mentioned survey by Urade.
14 ibid.

ful attention must also be paid to "tacit government guarantees" as a form of contingent liability in the implementation of BOO and BOT-type projects.

4. MANAGEMENT OF AID FUND FLOW

An on-budget/off-budget system is selected for the management of aid fund related to the previously mentioned off-budget funds. When using the on-budget method, the assistance received is calculated as revenue and its use is calculated as expenditure, and it is handled as part of the total budget (general account). On the other hand, when in the off-budget method, income and expenditure of aid fund is handled as off-budget fund. When using the off-budget method, there are general problems with the off-budget system, but there is the advantage that "fungibility" can be avoided to some extent in order to remove this from the general account. For example, China is a typical example of a country using off-budget management. Here the primary effort for receiving the aid fund (project formation, response to donor appraisal) is the responsibility of the executing agency of the project, and the central government (Ministry of Finance) has sole control over managing the debts. The central government's State Planning Commission is in charge of maintaining consistency in the nation's long-term plans. The executing agency of the project is an entity at the provincial or city level, and it is common for the relevant project to be the largest and most important project for the entity. This means that there is only a very small chance that the provided funds would be appropriated for some other purpose. The executing agency has the large "additionality" of "the project can now be executed because assistance was received". This also supports project ownership by the executing agency.

In this manner there are many advantages in using the off-budget method from the standpoint of individual project assistance. There will likely be clear differences of opinion among donors in whether an individual project aid approach should be taken or should budgetary support approach be adopted. The key points to consider for adopting either the off-budget or on-budget method are the transfer of the aid funds (how are concessions transferred and who are the beneficiaries) and, particularly in the case of loan aid (ODA loan), how will foreign exchange risks be shouldered. These and other points will be studied in section *6. Case Study.*

5. CENTRAL AND LOCAL FINANCIAL RELATIONSHIPS

The central and regional financial relationships vary widely among countries, but generally speaking local governments tend to rely heavily on the central government for financial assistance. Currently, the decentralization is being promoted, but local governments have had trouble securing their own sources of revenues and there are many cases in which they have met with financial difficulties[15]. There are also limitations as the local governments lack fiscal restraint. For example, India has a systematic mechanism for transferring development expenditures from the central government to the states. Still, losses at the State Electricity Board have weighed on state finances and have had a negative impact on the capacity to secure internal funding for development projects for power and other sectors. The financial relationship between the central and local governments will be examined in the following case study.

6. CASE OF AID FUND MANAGEMENT: INDIA[16]

In India development funds are allotted between the central and local governments with the aim of correcting disparities between the regions. Funds are transferred to the states from the central government

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15 Based on the PER (public expenditure review) for each country.

16 The following is from Kaoru Hayashi "Development Assistance Problems in India", Global Industrial and Social Progress Research Institute, "21st Century India and International Society", 1997 (in Japanese). Information on the financial relationships between India's central and local governments were referenced from Hiroshi Sato, "Financial Relationships between Central and Provincial Governments in India", Institute of Developing Economies, Ajia Keizai (Asian Economy), Vol. 29, No. 5, No. 6 (1988) (in Japanese), Hiroshi Sato "Financial Relationships between Central and Provincial Governments in India Involving Electric Power Divisions", Institute of Developing Economics, Ajia Keizai (Asian Economy), Vol. 32, No. 3 (1991) (in Japanese)

using the method and based on a fixed formula. Aid funds are also processed through this system with money being borrowed (received) by the central government and then allotted to the local governments in accordance with the planned fund transfer system. The following is a general overview of this aid fund management in the 1980s.

(1) The aid fund (both loan and grant aid) is received by the central government and then transferred to the state governments and other project executing organizations.
(2) The transfer from the central government to the state government is conducted within the "Transfer of Planned Expenditures". The conditions are that 70% of the funds are a loan and 30% are a grant, regardless of the conditions placed on the original fund (for backward regions only 10% is a loan and 90% is a grant).
(3) The transfer of funds is in accordance with the system mentioned in (2) and therefore the funds are temporarily placed within the general account to combine it with other "fund allotments" and then the funds are distributed.
(4) For the target project the state government must also calculate the receipt and use of aid fund within the state and central governments' planned expenditure budget.
(5) The aid fund is converted into rupees by the central government. Therefore, there are no exchange risks for the state governments.

The following summarizes the rationale behind this system and shows the general merits for this type of on-budget management.

(1) Aid fund and development strategies can be easily aligned because aid projects are included in the general planned budget allotments. This is especially true for budget allotments with the aim of correcting disparities between regions. It is also possible to have the central government monitoring the progress of the project as part of the budget process.
(2) Unfairness resulting from the different conditions of the original aid fund can be avoided. For example, within the same sector, say irrigation or afforestation, differences in the levels for executing agencies and the beneficiaries, as well as unfair burdens, can be avoided by providing grant aid in some area and loan aid in other area.
(3) Support can be given to development projects carried out by the local governments and their public corporations under local governments, which tend to be weaker financially, as the foreign exchange risks associated with the loan assistance are shouldered by the central government.

Taking another look at this on-budget management from the point of view of public spending management from the 1990s, it can be highly praised for helping to plan effective allotment of development funds. From the point of view of implementing individual projects, especially in the case of loan assistance, this system was quite effective in handling foreign exchange risks. In other words, the yen loans are transferred into rupees at the central bank. The yen is then managed within the central bank's portfolio. China had adopted an off-budget management system in which foreign exchange risks were shouldered by the executing agency and eventually the beneficiaries, and this resulted in the big problem for them having to repay much larger amounts due to appreciation of yen since 1993. This is why India chose a different method.

However, this on-budget management system used by India has resulted in some problems on the donor side. It goes without saying that the main problem has been "fungibility". The following describes some of the criticisms that have arisen.

(1) When aid fund is lumped in with the funds being allotted from the central government to the local government, there are cases in which funds originally intended to be grant aid are provided to the local government and executing agencies in the form of loans. In other words, the grant aid is turned into loans (cross subsidization). Some of the donors providing mostly grant aid are finding this hard to accept.
(2) Because the aid fund is transferred to general account, it is difficult to track the flow of the aid, even if the accounts all balance (fungible in practice). Furthermore, there is low level of awareness among the executing agency and the

beneficiaries that "projects are using aid funds" = "additionality", and this can hamper incentives to effectively use the aid funds.

(3) Foreign exchange risks handled by the central government can result in a type of "hidden subsidy" for the local governments and executing agencies.

These arguments summarize the problems with on-budget management of aid funds from the viewpoint of assisting individual projects. From the public expenditure management approach, these may be used as a means for discussing and supporting mid-term public spending plans and other public spending cycles targeting the overall development budget. However, India covers such a large area and has such a large population, and considering the scale of its economy, it may be difficult to introduce public expenditure management at the national level. The Indian government has hammered out a form of "disintermediation" in which off-budget system is used for a portion of the aid fund management in response to the problems caused on the donor side[17].

The main points of this disintermediation are:

(1) Public corporations under the central government are seen as direct borrowers of the loan aid (guaranteed by the central government).

(2) In other cases the central government receives the aid fund and then transfers it with the same terms and conditions. This includes transfer of foreign exchange risks.

Soon after this partial off-budget system was proposed, there were debates both for and against it. It goes without saying that donors that provide mostly grant aid were in full support of this proposal. However, Japan, Germany and other donors that offer a high percentage of loan aid were quick to point out problems such as foreign exchange risks. Some of these points are summarized in the following.

(1) This would effectively close the path to borrowing loan assistance for local executing agencies that do not have the capabilities to handle foreign exchange risks.

(2) This would result in larger disparities between states with strong financial bases and those with weaker financial bases.

(3) It would be difficult to apply financial aid in areas such as major infrastructure projects with long gestation periods for the capital and in environments where there is invested poor capacity to generate direct cash flows. This would all likely have a negative impact on India's economic development.

(4) Narrowing of the scope of the responsibility of the central government could undermined monitoring functions of the aided project.

In addition to these problems, there are also issues that were initially overlooked (not seen as main issues). These are related to debt management. By making many public corporations direct borrowers through the off-budget method, government debts on the balance sheet are changed to contingent debts. This all makes the management of debts even more difficult. When there are guarantees from the government, and even when there aren't, many public corporations will operate public utilities that can not easily bankrupt as this results in a type of "tacit guarantee". Power sector is a typical example where many of the Public Sector Units (State Electricity Boards) are in deficit due to the politically constrained tariff structure. These public sector units are "too big to fail" cycle, and therefore state governments have to continue huge amount of subsidies to these units.

Clearly there are various practical problems with budget systems, management of aid fund, off-budget funds and the financial relationships between the central government and local governments. There are no simple solutions, but it will be necessary to in the future address these problems within the framework of the public expenditure cycle and analysis.

17 "Proposals for Promoting Aid Project Implementation" presented by the Indian Finance Ministry for the June 1993 at India Development Forum

CHAPTER 4 CHALLENGES FOR INTRODUCING PUBLIC EXPENDITURE MANAGEMENT INTO DEVELOPMENT ASSISTANCE

Until now the argument has been along the lines that "public expenditure management will become the mainstream for future development assistance", but the problems and risks involved in introducing public expenditure management into development assistance, as well as mitigation strategies, must also be addressed.

1. FROM OUTPUT EVALUATIONS TO OVERCOME EVALUATIONS

Each donor is focusing on the problem of outcome evaluations and the making of these indexes, which are directly linked to policy evaluations. However, the relationship between output and outcome is not a simple problem. The relationship is shown by the ADB divisions in Table 2. Outcomes should be grasped quantitatively, however, it is difficult to make concrete indexes. One example is poverty reduction through the DAC new "International Development Strategy". In order to achieve this outcome, poverty being limited to "income poverty", it is indispensable to obtain data. However in almost cases it is very difficult. Where is the poverty line to be drawn and how is the poverty of particular social groups to be handled[18]? It is also difficult to evaluate the results of the assistance segregated from total outcome of macroeconomic policies. As a result, even if we try to grasp the actual outcome of poverty reduction, it is assumed that we will only be able to make an approximation with the accumulated output. There has been a great deal of effort in trying to make outcome indicators, however, many feel that they are still a proxy for the true outcome.[19]

It is important to grasp outcomes and create indexes, but this will all be meaningless unless importance is also placed on grasping the outputs as well. Even if the output is not necessarily always linked to the outcome, there will be no outcome if there is no output. Emphasis must be placed on outcomes that are formed by accumulating outputs through the steady execution of individual projects. We are now waiting for actual research to uncover the missing link between output and outcome.

2. INSTITUTIONAL CAPABILITIES OF DEVELOPING COUNTRIES

Public expenditure management has the aim of improving the institutional capabilities of developing countries, but its introduction also limits the country's institutional capabilities. When introducing public expenditure management into a developing country, the country's stage of development and other conditions, especially its institutional capabilities, must be taken into consideration and the advisability and procedures for such an introduction must also be studied. This study includes case studies and seminars in the Punjab Province of Pakistan and in the Philippines as per Part II, two developing countries that have made considerable progress in introducing public expenditure management. Through this study many problems where uncovered in both cases.

Even in these two cases, which have made comparative advances for developing nations, it is difficult to say that public expenditure management has been fully developed. In particular, the cycle based on the premise of a performance budget is still far from being fully developed. If the advanced systems of the developed nations are simply introduced, it will be difficult for these systems to become firmly established.

The most important point for the introduction of public expenditure management in both countries is that they both had the strong leadership needed for introducing such a system.

The following are general points of consideration for introducing public expenditure management into developing countries, based on the case studies and seminars.

18 For difficulties with poverty project formation, see; Hideki Esho, "Development and Poverty", Journal of Development Assistance, Vol. 5 No. 4, pp. 46-48, Institute of Development Assistance

19 Interim Report, pp. 2-9

Table 2 Examples of Performance Indicators

Sector	Type of Indicator			
	Input	*Output*	*Outcome*	*Process*
Administration	No. of staff	No. of policy papers	Better decisions	Openness of debate
Education	Student/teacher ratio	Retention rates	Higher literacy	Encouragement of student expression
Judicial system	Budget	Cases heard	Low appeal rate	Assistance for indigent defendants
Police	No. of police cars	No. of arrests	Decline in crime rate	Respect for rights
Corrections	Cost per prisoner	No. of prisoners	Recidivism rate	Prevention of abuse
Health	Nurses per population	No. of vaccinations	Lower morbidity	"Bedside manners"
Social welfare	Social workers	Persons assisted	Exits from system	Dignified treatment

Source: ADB 1999 p.334

(1) Government leaders who have strong will to improve the public expenditure management need to be supported in the developing countries.
(2) The introduction of an "Activity Based Budget" is very useful for identifying the costs of the relevant projects and policies.
(3) Consideration must be given to the tradeoff between the transfer of authority and accountability. Monitoring must be improved.
(4) Policy changes based on feedback from the results and the accompanying changes in the budget allotment are very difficult areas.

CHAPTER 5 JAPAN'S DEVELOPMENT ASSISTANCE AND TACKLING WITH PUBLIC EXPENDITURE MANAGEMENT

This final section will address public expenditure management in Japan's development assistance, focusing mainly on ODA loans. Public expenditure management is basically part of the trend towards budget support, and has been made apparent by looking at this background. However, as mentioned earlier, this is not simply the problem of choosing between supporting individual projects or providing budget support. Even when executing an individual project, public expenditure management is important in the total process to implement the project and realize effectiveness. Even from the point of view of securing the domestic currency budget, there must be a strong link between the Medium Term Expenditure Framework (MTEF) based on the macro-sector comprehensive framework, annual budget and individual project. Emphasis should be given to public expenditure management in the management of financial assistance, and efforts should be made to avoid off-budget financing or use of earmarking.

Support for public expenditure management is possible, but Japan does not have advanced experience in this field and thus may have difficulty in leading such projects at this stage. However, local governments in Japan have very strong interest in public expenditure management and new public management[20]. In the future, the expertise now being gained by these local government will be mobilized.

There is also the possibility of projects that take into consideration public expenditure management reforms in the assistance for individual projects. For example, there are methods for promoting assistance and for drafting, integrating capital expenditures and

20 Ohsumi (1999)

current expenditures, mid-term action plans and financing plans based on budgets for each action item in the sector loan. Proto-type of these loans are already being implemented[21]. Monitoring function in developing countries should be strengthened through project execution. The World Bank is providing LACI (Loan Administrative Change Initiative)-type cooperation and similar methods are used with its yen loans (checks expenditure-related documents provided by the developing country's auditing organization). There is room for further expansion in this area, including training and other components in the future.

It is important to offer active cooperation in creating performance standards for developing countries. Specifically, there must be a shared understanding of operational and effectiveness standards. Dialog and improvements are possible in coordination with other donors.

In this manner, support for individual projects are consistent with public expenditure management. It is possible to provide support for public expenditure management as an extension of existing assistance tools.

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Asian Development Bank 1999 "Managing Government Expenditure"

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21 One example from Pakistan "On Farm Water Management Project" (1992)

PUBLIC EXPENDITURE MANAGEMENT AND DEVELOPING COUNTRIES PART II: CASE STUDIES[22]

Taichi Sakano*
Masashi Aoki**

CHAPTER I THE PHILIPPINES

1. BUDGET FORMULATION PROCESS

(1) An Overview

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

In the Philippines, a number of administrative bodies are individually and interchangeably play key roles in the preparation and implementation of the budget. These are (i) Development Budget Coordinating Committee (DBCC), (ii) Department of Budget and Management (DBM)[23], (iii) National Economic and Development Authority (NEDA), (iv) Department of Finance (DOF), (v) Bangko Sentral ng Pilipinas (BSP), (vi) Congress and Commission on Audit (COA), (vii) LEDAC and (viii) Regional level Institutions.

At the national level, the President steers the fiscal policy formulation process through DBCC that comprises the Secretary of DBM as chairman, with the Secretaries of NEDA and DOF) and the Governor of BSP as members. 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:

1) budget operations , 2) accounting and financial services, 3) management services, 4) support services - involving support to DOF's units in area of internal management and logistics. NEDA is the economic planning agency, with the responsibility of formulating the medium-term development plan. It also coordinates the preparation of development plans in line agencies. The Department of Finance is the institution charged with ensuring sound and efficient generation and management of the fiscal and financial resources of Government. An important link between the legislative and executive branches of government is provided by the Legislative-Executive Development Advisory Council (LEDAC) with a major objective of achieving consistency between development plans deemed at the executive branches and law making priorities at the legislative branch.

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

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22 This part is written mainly on case studies consigned to the study team consisting of Consulting House the Minerva's Oul and SHINKO Overseas Management Consulting, Inc.
23 NEDA-ISP (1997), pp.16-19.

JBIC Review No. 4 May 2001 pp 85~92

is to be spent without legislative authorization (i.e., appropriation), thus by 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).

(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, 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. In practice, the responsibility for the macroeconomic projections is fragmented. DOF is responsible for projections of government revenue, whereas NEDA for projections of the real sector and prices as well as ODA flows. 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, (i) limited issuance of obligation authorities and other measures to keep on the track of fiscal discipline, and (ii) 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. 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.

(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 paper works. 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 needs for the issuance of the General Allotment Release Order (GARO). Further, the Notice of Cash Allocations (NCA) to facilitate payment of due and demandable Accounts Payables (A/Ps) has since 1999 Budget been released quarterly in lieu of monthly rations imposed by DBM.

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

(a) SPPBS

The Synchronized Planning-Programming-Budgeting System (SPPBS) in 1990 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. The concept dates back to the late 1980s. After a decade, the general assessment has to be that, in its own terms, it failed[24]. 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.

(b) MTEF (1) Fiscal level and ceiling

These problems was expected to be addressed in the context of a Medium Term Expenditure Framework

24 NEDA-ISP (1997), p.45.

(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 the budgetary reform in the Budget Call for the FY2000 that signaled the implementation of MTEF. The overall objective of MTEF is perceived in the country to include (i) enhancing planning and budgeting linkages, (ii) strengthening fiscal discipline, (iii) improving allocation of budgetary resources, and (iv) enhancing agency in program implementation.

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.

MTEF also divides agency's budget into two parts, that is, (i) the baseline (or operating) budget, and (ii) 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.

3. ALLOCATIVE EFFICIENCY

(1) Prioritalization Procedure

During the preparation of the 1993 budget, the prioritization strategy was developed by DBCC's Subcommittee on Prioritization that was headed by NEDA, with representatives from DOF, DBM and the Coordinating Council for the Philippine Aid Plan (CCPAP) as members. After making provisions for 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. They are (i) On-going foreign-assisted projects with an expenditure ratio (1991 expenditure obligation over budgetary release) of 60 percent or above; (ii) Projects for completion in 1993; (iii) Projects/activities tied to program loans with budget support implications; and (iv) 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.

(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." 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, Congress is not authorized to increase the proposed outlays for each expenditure item included in the President's budget. It can only reduce them.

(3) MTEF and Forward Estimates (FE)

(a) MTEF (2) Allocation level

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

1) The Medium-Term Philippine Development Plan (MTPDP) 1999-2004,
2) The Medium-Term Public Investment Plan (MTPIP),
3) The Medium-Term Macroeconomic Framework (MTMF),
4) The Medium-Term Fiscal Plan (MTFP), and
5) The Medium-Term Expenditure Plan (MTEP)

The full MTEF implementation mechanism comprises the four components, vis-a-vis, (i) budget preparation, (ii) budget release for major capital expenditures and auxiliaries chargeable against special purpose funds, (iii) contingent liabilities, and (iv) Congressional bills with fund requirements. As noted above, the transitional MTEF mechanism for the CY2001 budget requires that (i) the above-the-baseline proposals include augmentations for existing programs/projects, and (ii) no saving proposals being embodied in the light of underestimation of baseline expenditure.

(b) Forward Estimates (FE)
The purpose of forward estimates is rather the determination of the block allocation for increased managerial flexibility. In the Philippines, experience of baseline budget is a good basis for Forward Estimate.

(4) Performance Indicators
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 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 NOCCs 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.[25]

4. OPERATIONAL EFFICIENCY

(1) Reengineering Bureaucracy
As dignified in the Budget Call 2000, the government stressed to improve productivity through the proper management of the bureaucracy, while recognizing the urgent need for responsive, streamlined and efficient public service undertaking[26]. To this end, the proposed measure gave the President authority to reorganize 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.

(2) Performance Evaluation and Costing
(a) 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 private and public sectors. In the Philippines, the "Performance" side involving also the argument which to take "Output" or "Outcome" is now discussed with foreign technical assistance. To cope with the enforcement of new budget regulation to impose each agency to submit performance targets at the time of their budget request and quarterly reporting of the target achievements.

(b) Costing
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 more accurate budget estimation based on rational and justifiable method. This inevitably requires each agency to improve their prevailing budget or cost estimation procedures.

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

(i) Auditorial 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, municipalities, including government-owned or-controlled corporations. Types of audit that COA

25 DBM (1999a)
26 DBM (1999), p.16

performs are as follows[27]:
1) Compliance Audit
2) Financial Audit
3) Performance or Value-for-Money (VFM) Audit
Other functions are:
(ii) Rule-making Function; (iii) Reporting Function; (iv) Recommendatory Function; (v) Limited Accounting Function; and (vi) Custodial or Archival Function

(4) Public Accounting Practices

The public accounting system of the Philippines would 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 "Obligation Accounting System" in which expenditures are recorded when incurred regardless the accompanied cash payment, and the "incurrence" is recognized when "Obligation" arises.

However, the accrual accounting is not applied to the Revenue side[28]. 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 consolidate 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[29].
(i) Balance Sheet (Statements of Financial Position)
(ii) Statement of Operations (Statement of Financial Position)
(iii) Cumulative Results of Operation

(5) Strength of the Philippine System in Feedback Function

The important function in the PEM Cycle that is to be performed is 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.
1) The first strength is the "Resident Auditor System" stated above functioning as day-to-day monitoring and fostering corrective actions.
2) 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.

CHAPTER 2 THE PROVINCE OF PUNJAB, PAKISTAN

1. BUDGET FORMULATION PROCESS

(1) An Overview

The Province of Punjab has started introducing the "Performance Budget", which is an ambitious attempt to apply "Activity-Based Budget", getting rid of their conventional "incrementalism" under the "Line-Item Budget" system. The Province is also leading 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 introduced and thus far tried to mainly improve Operational Efficiency, How Allocative Efficiency will be tackled on provincial level and Fiscal Efficiency can be achieved is the next step for the reform.

(2) Key Institutions and Organizations

(a) Finance Department
On the introduction of Performance budget, Punjab

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27 COA, "What you need to know about COA"
28 "Accounts Receivables of taxes and other government revenue" do not appear in the Current Assets of the Balance Sheet.
29 This is based on the Financial Statements of FY 1997.

provincial financial department played an important role. Punjab provincial financial department advised all provincial departments to prepare their 1999/2000 budgets as per the revised format, outputs, and inputs. Moreover, the financial department planned to remove from the budget books and process all unfilled sanctioned posts.

(b) Office of Director General Performance Audit Wing, Lahore
The Office of Director General Performance Audit Wing is the development center of Performance Audit and conducts comprehensive training for internal staff as well as for key officials of whole governmental sector throughout the country to be involved in performance evaluation.

(c) 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.

2. AGGREGATE FISCAL DISCIPLINE AND ALLOCATIVE EFFICIENCY

The principle of the Punjabi budgeting which keeps the 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. OPERATIONAL EFFICIENCY

(1) Retrenching Redundant Workforce

On the front of public expenditure, the biggest structural problem faced by the provisional governance is the excessive size of their civil service to the resources available.

(2) Introduction of Public Expenditure Reform

The efforts were materialized as the "Performance Audit Guidelines" in 1986, which comprises 12 volumes covering auditing procedures for 9 economic sectors, and the practice commenced. Until last year (1999), Directorate General Audit, Punjab had performed more than five hundred cases of performance audit with a wide range. The Directorate General Performance Audit Wing is conducting the training inviting not only auditors and other key officials throughout the country. Along this advanced steps toward Public Expenditure Management in the auditing aspect, a new initiative in the budgeting side, "Performance Budgeting", was launched in 1999.

Thus the move toward Public Expenditure Management, even it is still at an infant stage except for the area of Performance Auditing, has been proceeding actively leading rest of the country. The Province has been positively taking 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, those momenta seem spontaneous rather than imposed and has been led by internal initiatives as mentioned above.

(3) Performance Budgeting

(a) 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) the "Performance Budgeting", which is a drastic change from their conventional "Line-Item Budgeting". The "Performance Budgeting" was applied to the following six departments to pilot the rest of the Provincial Government.

The underlined phrases clearly depicts that (1) every department shall specify and propose quantified performance targets for each activity, and (2) the budgets are estimated and allocated for these activities to achieve the targets proposed.

(b) Weaknesses in Punjab Performance Budgeting

i) Imperfect integration of costs under an objective of an activity.

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 the minor activities; Reconciliation of expenditure/receipt, Collection of receipts and Monitoring of audit paras. 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.

ii) Budget estimation with lack of accurate costing procedures.

The budget estimation is merely based on a rough percentage allocation of the manpower cost. To improve this situation, the introduction of accurate costing system is needed.

iii) 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 the 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 who has been leading the Performance Budgeting to involve the Department of Auditor General in the region.

(4) Performance Auditing

(a) Framework of Performance Auditing

The Performance Audit Guidelines issued in 1986 was further enriched into the new Performance Audit Guidelines in 1993 absorbing the results and lessons of the practical performances in this field.

The new Guidelines have been enriched in terms of its comprehensive coverage, principle and practical auditing procedures, expanding its 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.

(b) Practice of Performance Audit

The auditors of the Office, together with consultants hired to evaluate technical issues and project evaluation. Conducting a) review of project documents completion and evaluation reports by various agencies, b) interviews with the beneficiaries and c) 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 their 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 the later section.

(c) Project Evaluation by the Provincial Government

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

In due course of evaluation, the criteria are usually applied which include, among others, (i) compliance with PC-1utilization of funds allocated, (ii) physical achievements, (iii) compliance with the policy objectives of the project, and (iv) 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.

(5) Multi-Layered Evaluation System

A well organized multi-layered control system was observed for its performance evaluation. The following is the system from internal control within the Office of Director General Agriculture (Water Management) Punjab, to the Office of Director General Audit.

(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 functioning. 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 the public accountability.

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 the double-entry and accrual accounting, however it has a weakness as public accounting in a sense that it only covers financial statements and omits preparation of a Performance Statement.

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