

Public Expenditure Reviews: Framework and Methodology

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Context



Evolving views on development strategy

➤ Previously:

- Development planning (1960s)
- Basic Needs (1970s)
- Structural Adjustment (1980s-90s)

➤ More recently:

- N. Stern: Two pillars
 - Improve investment climate (infrastructure, regulation)
 - Empower the poor (human development)
- Ownership of poverty reduction strategy (PRSP ..)
- F. Bourguignon: Growth, Inequality -> Poverty

Two Constants: Growth, Equity

- Despite changing emphasis, two constants in objectives of development thinking
 - Growth
 - Equity and poverty reduction
- These are also the constants of public expenditure reviews – understanding how public policy affects efficiency (which stimulates growth) and equity – both of which influence poverty

Government Finances: 2002 Averages

(In Percent of GDP)

Income Level	Total Revenue		Total Expenditure	
	GG	GG	CG	CG
Low Income	25.3	30.3	20.5	
Lower Middle-Income	30.0	28.9	28.8	
Upper Middle-Income	30.4	33.9	28.6	
High Income	39.9	39.7	26.6	

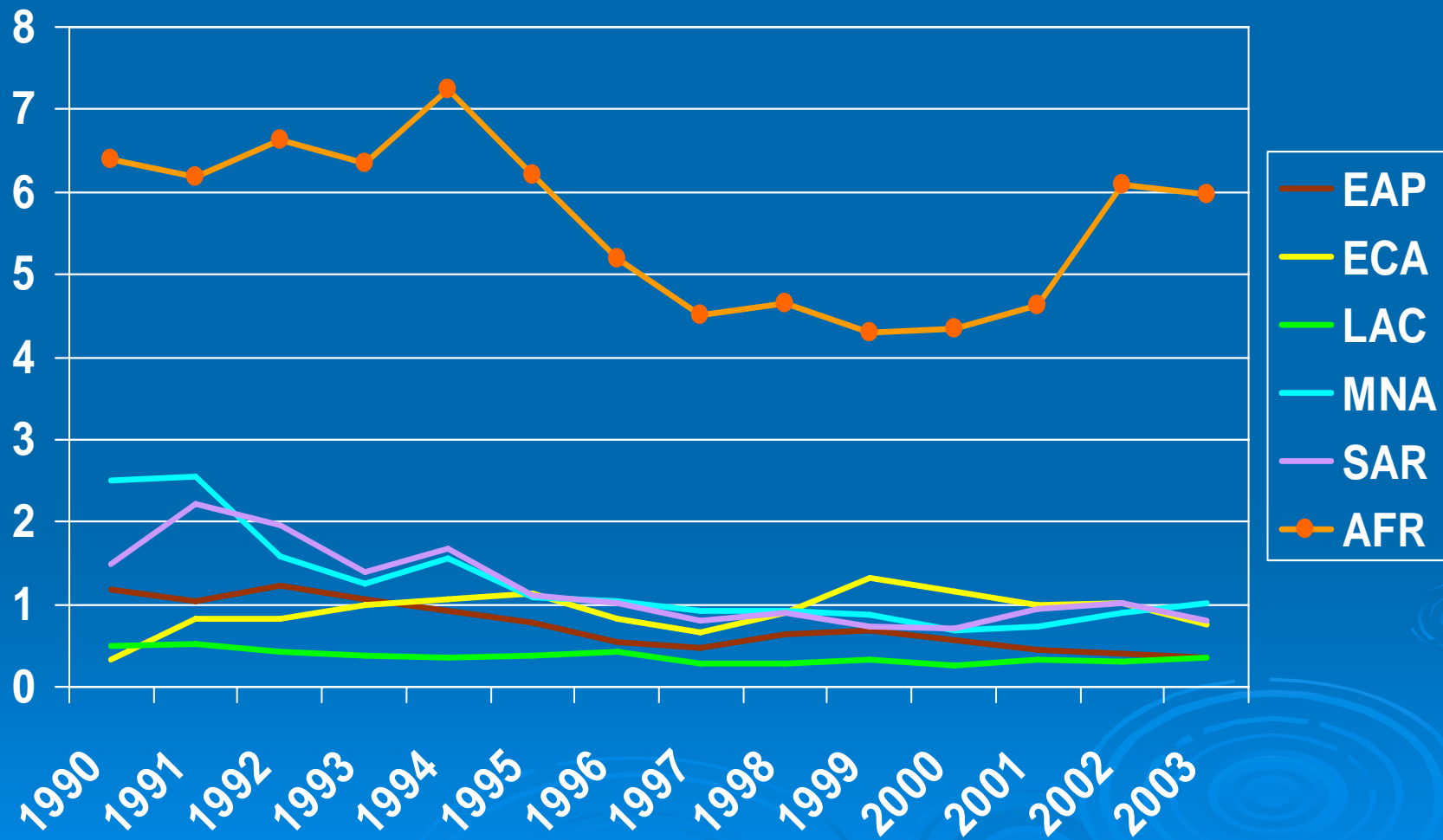
Note: Cash basis GG=General Government CG=Central Government

GDP and Pub. Exp are loosely related

- We know richer countries generally have better (financed) government but the size and role of govt. varies quite widely
 - Korea (19% of GDP) – Nordics (almost 60%)
 - On average OECD about 45% of GDP
 - High middle income countries have a wider range – 53% Hungary and 13% Mauritius
 - Low income countries, most below 30% of GDP, often supplemented by significant ODA
- Certainly no striking evidence that more public spending creates sustained development

ODA values by region

(In Percent of GNI)



PERs: Informing Aid Givers

- The PER provides Bank management and Board with a view on the quality of budget policy and management in a country
- Used to determine
 - Whether policies are sustainable or efficient
 - Whether the budget is aligned with policy objectives
 - Whether budgetary processes support effective implementation and policy outcomes
- Vital to Bank Country Assistance Strategy
- Provides key input to consultative group meetings and donor decisions on aid and budget support

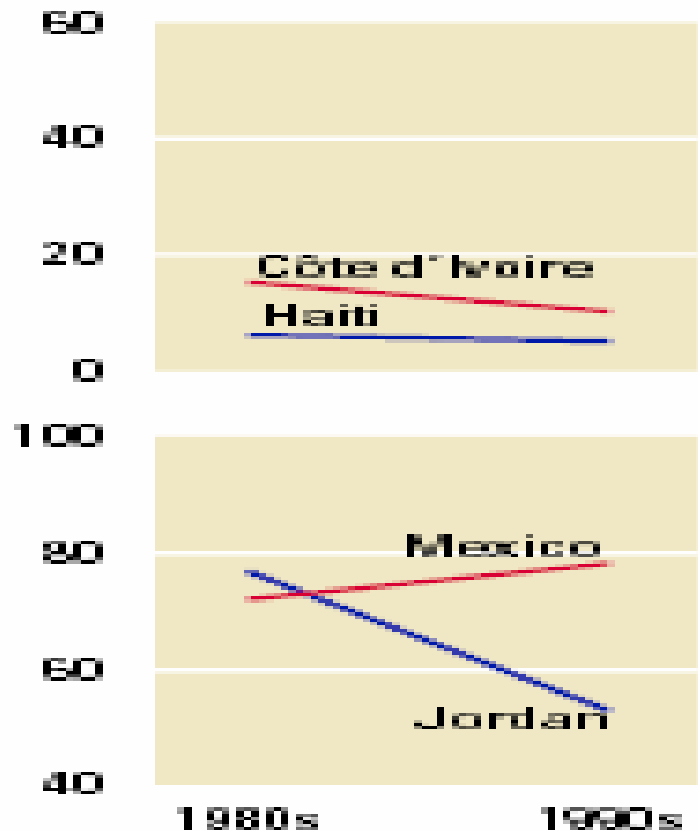
PER Process: Building government capacity

- Collaborative work between government, Bank staff and key donors
- Synchronized with govt. budget process to build capacity
- Increasingly seen as key to translating PRSP commitments into real budget implementation
- To advise the government on options for reform of policy and/or management
- Pose questions on role of state and public sector reform agenda

Public spending on directly related sectors and outcomes are often weakly related (WDR 2004)

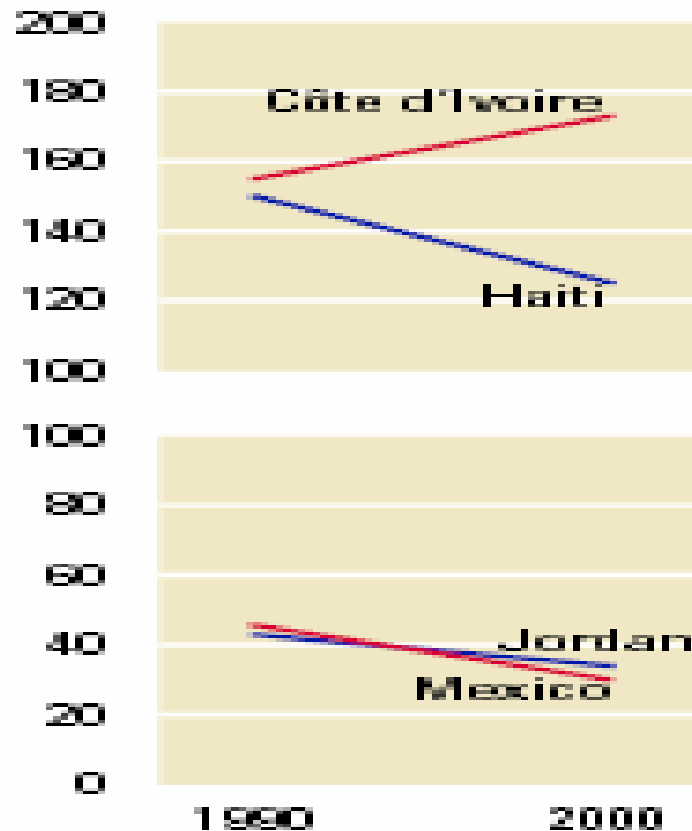
Public spending on health

Dollars



Under-five mortality

Per thousand



Missing variables

- Intuitively, differences in policies and institutions could explain the weak relationship across countries
- WDR 2004 identified some core elements:
 - Budget policy and management
 - Organization of tiers of government
 - Quality of public administration

Typical budget pathologies in LICs

- Overambitious development plans, unclear policies
- Unrealistic budgets
- No disciplined link between policy, plan and budget
- Incremental budgeting, no forward perspective
- Non-transparency - extra-budgetary funds, lack of comprehensive budget framework
- Budget execution marred by unpredictable allocations, including interruptions in flow of funds
- Symptoms of problems: arrears in payments to suppliers, unpaid bills to utilities, incomplete projects, lack of maintenance of assets, poor services
- Tax evasion

Framework for PE Analysis

- Three level framework
 - Aggregate fiscal management (Level)
 - Strategic resource allocation (Composition)
 - Operational efficiency (Efficiency)
- Institutions matter for ensuring that budget decisions integrate the 3 levels
 - Solving the collective action problem
 - Prioritizing resource demands
 - Incentives for efficiency and avoiding waste

PER analytical principles

- What are the government's objectives?
- Is it using public financing to achieve those objectives efficiently, equitably and sustainably?
 - Is aggregate fiscal policy sustainable?
 - Is it doing the right things (policy) and doing them right (management)?
 - Are key public goods and services – law and order, public infrastructure, national defense, public health – being adequately provided?
 - Are programs intended to reach the poor doing so effectively?
 - Are some programs merely crowding out private activities?
 - What are the institutional weaknesses of the budget system that need attention?

Reviewing expenditure policy

- At the program level, an expenditure review will have to assess the program's efficiency or incidence impact
- Efficiency: Govt. intervention is justified as efficiency improving if there is a market failure or if the objective is to redistribute resources
- Equity: Incidence analysis can reveal who really benefits from programs

Some caveats

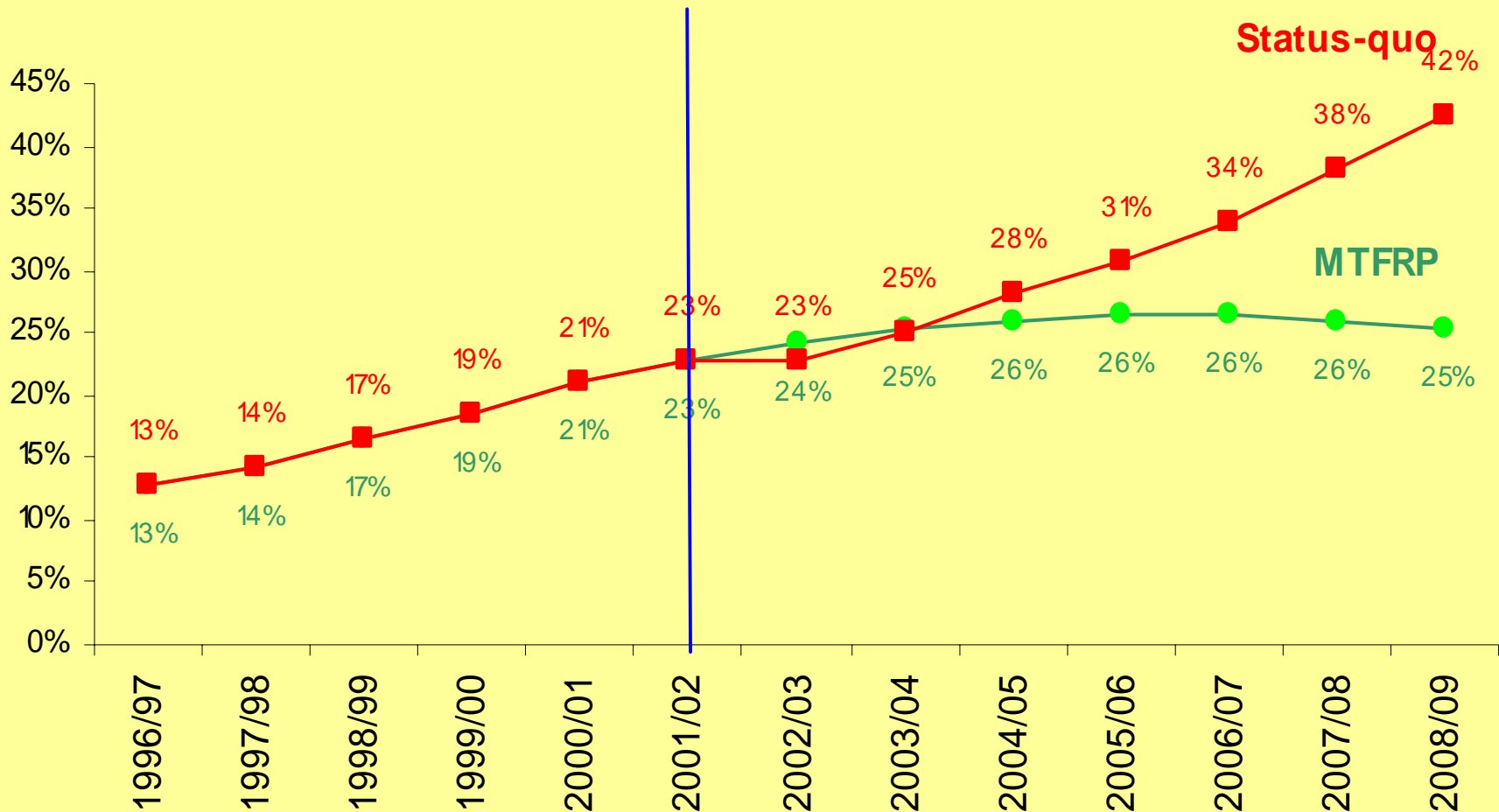
- Public expenditure is only one of a number of possible policy responses to market failure – regulation and tax policy are other possible responses
- Scope for government failure must also be considered, given evidence of problems of service delivery in the public sector
- Even where public financing is justified, the provision of the service may be through private, not public, providers

Maharashtra Fiscal Study

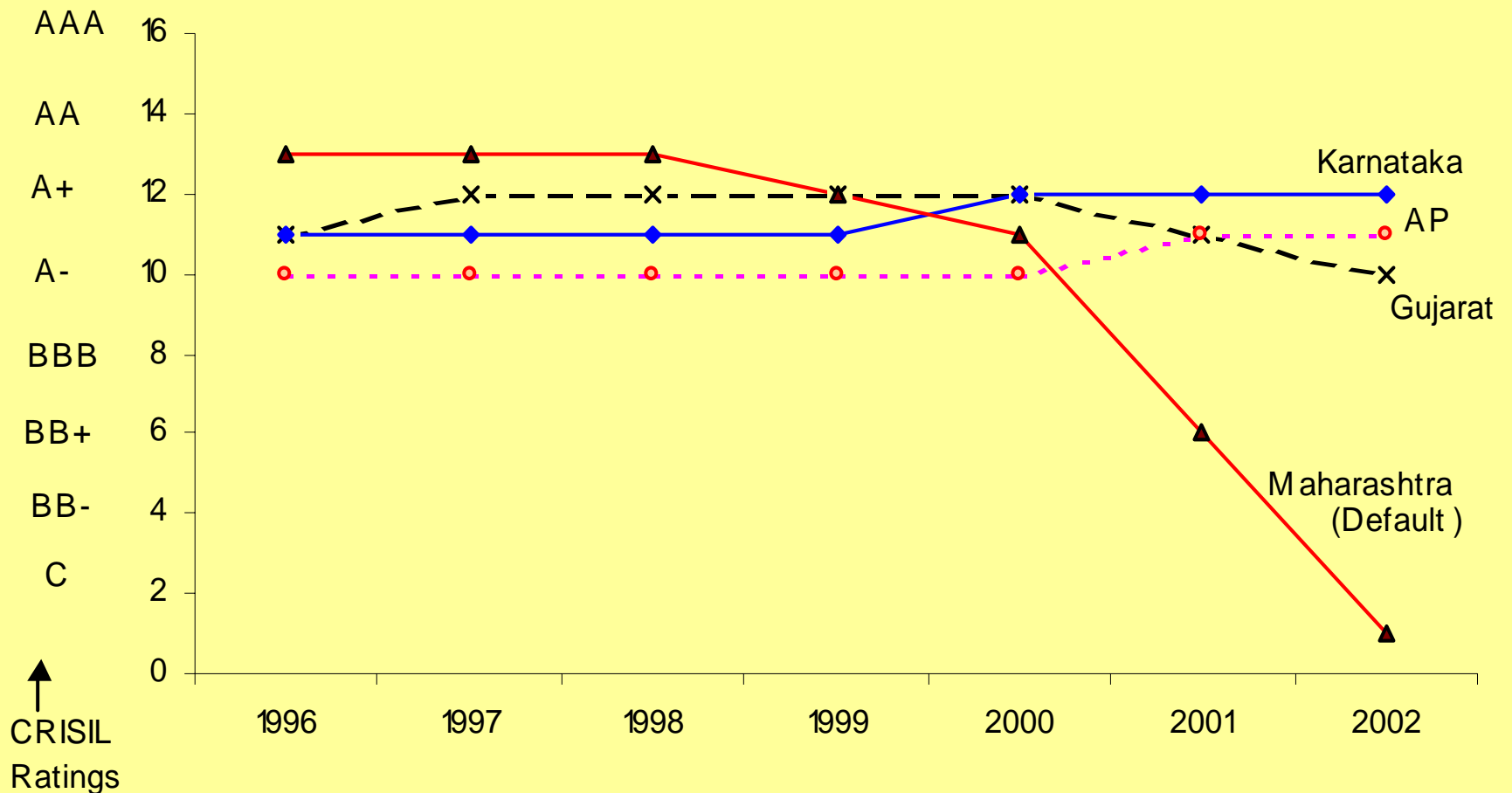
- Historically one of the better managed states in India
- But sharp decline in the late 1990s
 - Growing fiscal deficits (level problem)
 - Low power sector tariffs and leakages caused MSEB losses and constrained investment
 - Irrigation subsidies
 - Losses on cotton procurement scheme

Ratio of debt to GSDP would explode under status quo...

Debt to GSDP ratio : Status-quo versus Reforms

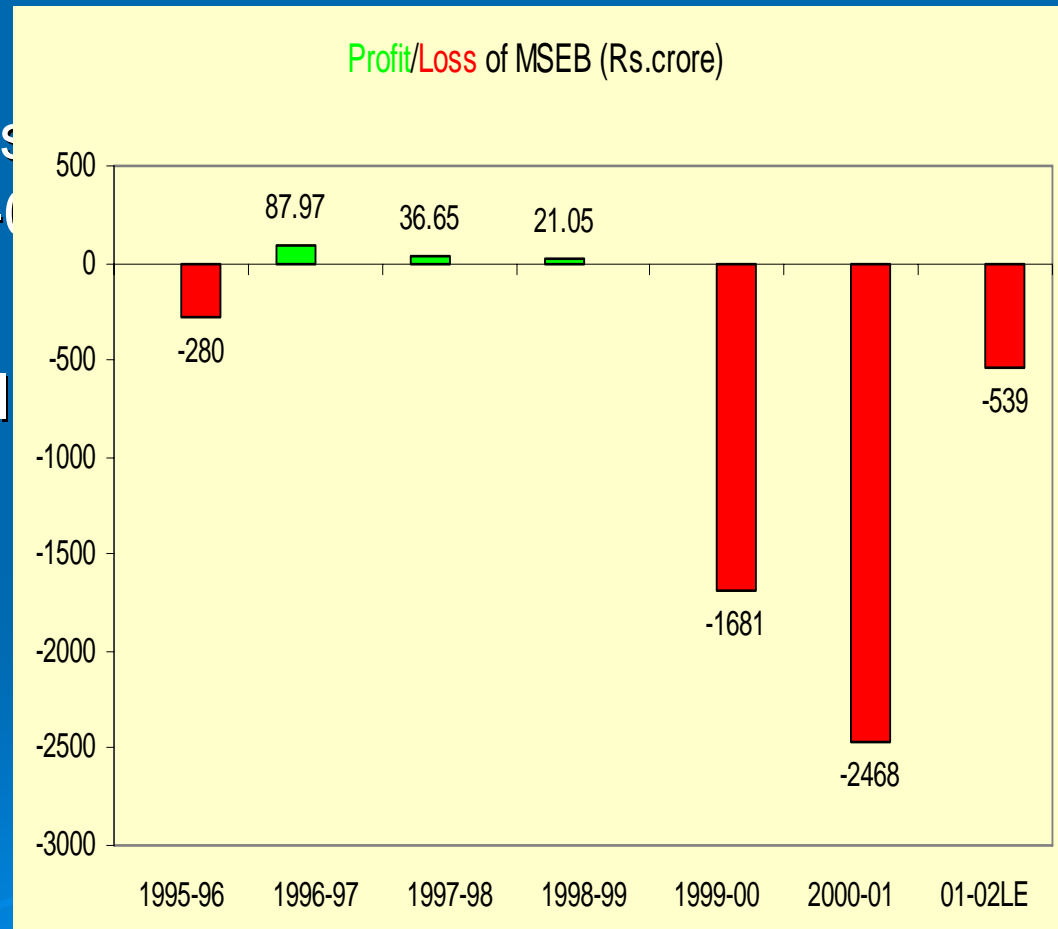


Credit Ratings: Selected Indian States, 1996 - 2002



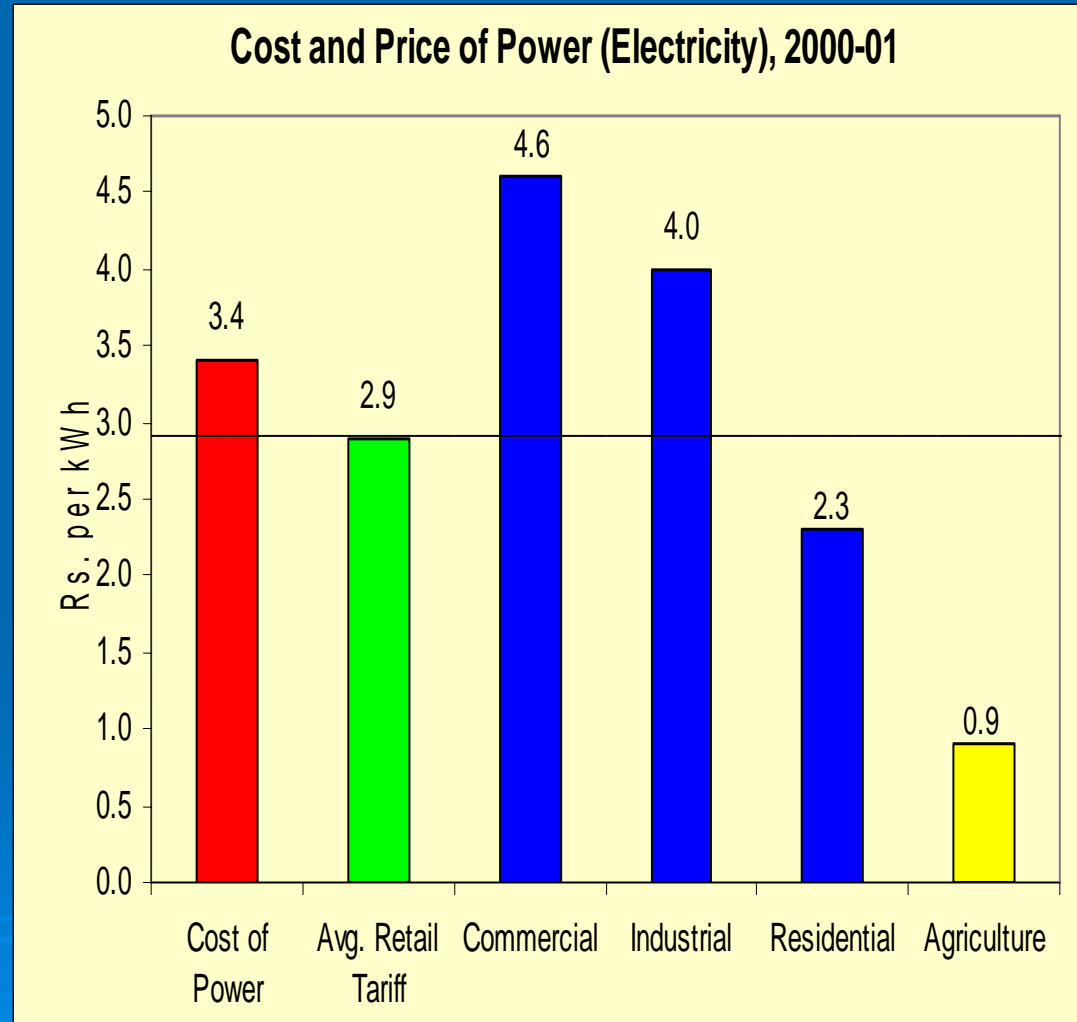
Power: MSEB was incurring huge losses

- ❖ Sharp increase in power purchase cost in 1999-00 & 2000-01
- ❖ Low tariffs
- ❖ Poor recovery of bill
- ❖ High T&D Losses
- ❖ Inability to invest



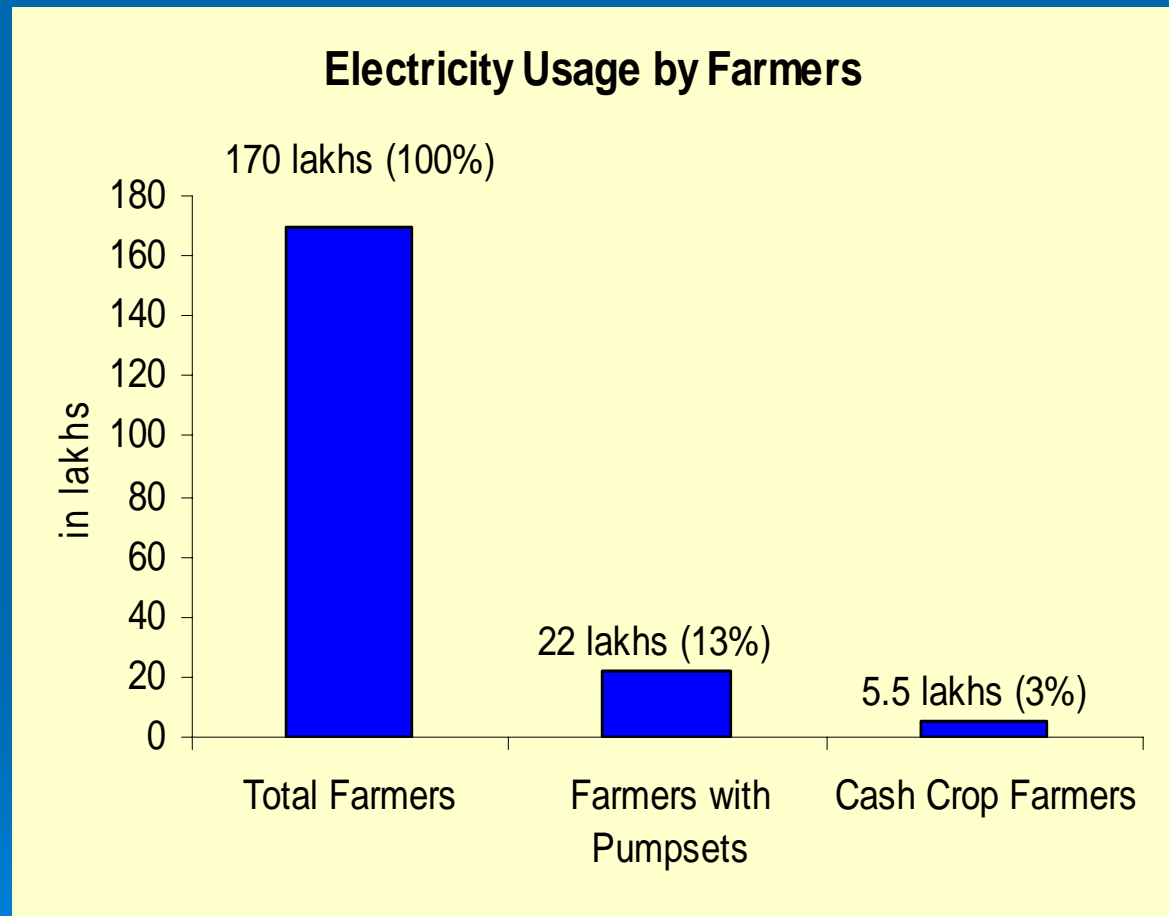
Power: Pattern of Cross Subsidies

- ❖ Nine out of ten MSEB customers are subsidized
- ❖ Actual cost of supply to agriculture is higher than the average
- ❖ Increasing number of industrial consumers are looking for alternative sources of power



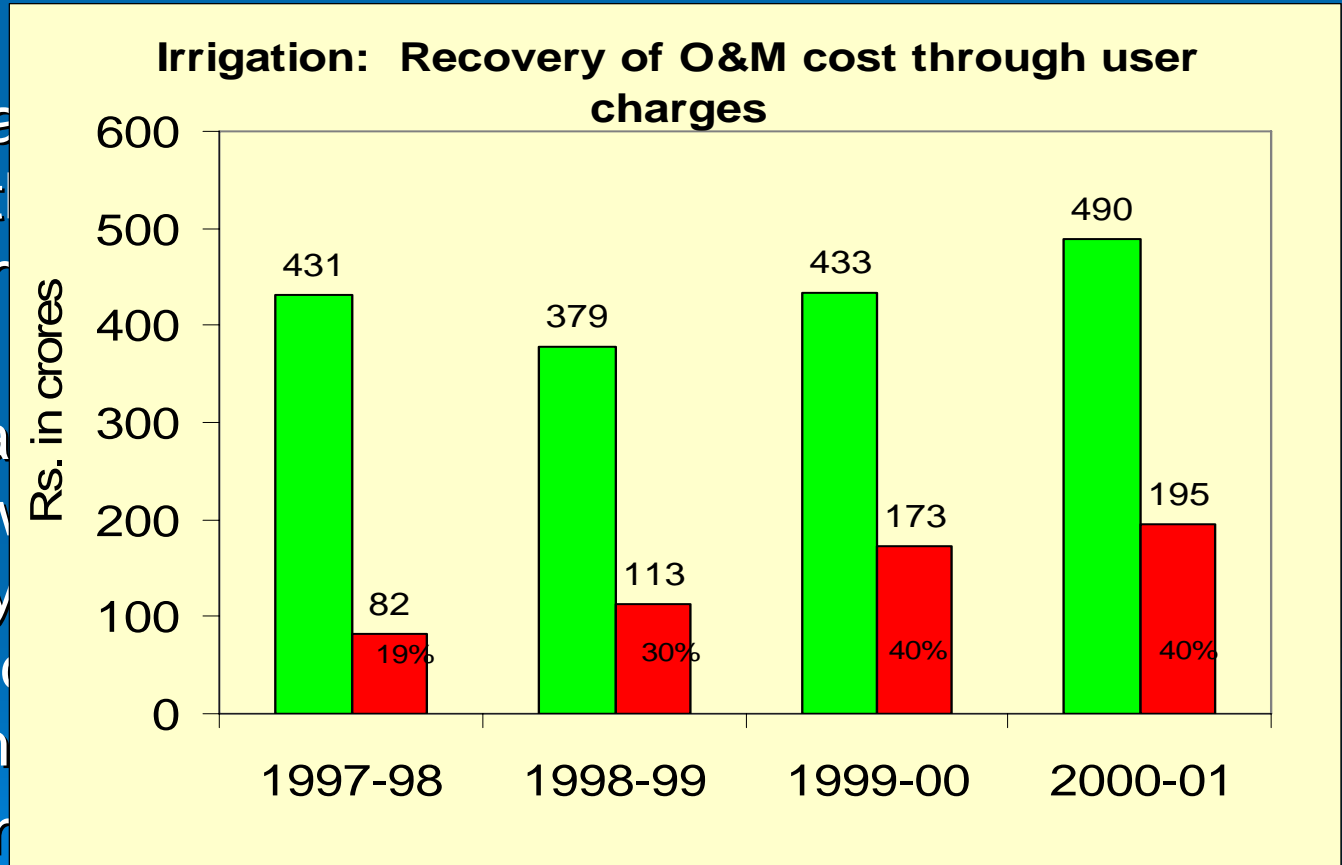
Power Subsidies: Who are the beneficiaries?

- ❖ Subsidy primarily accrues to farmers with pump-sets
- ❖ Rich sugar farmers are the prime beneficiaries



Irrigation Subsidies

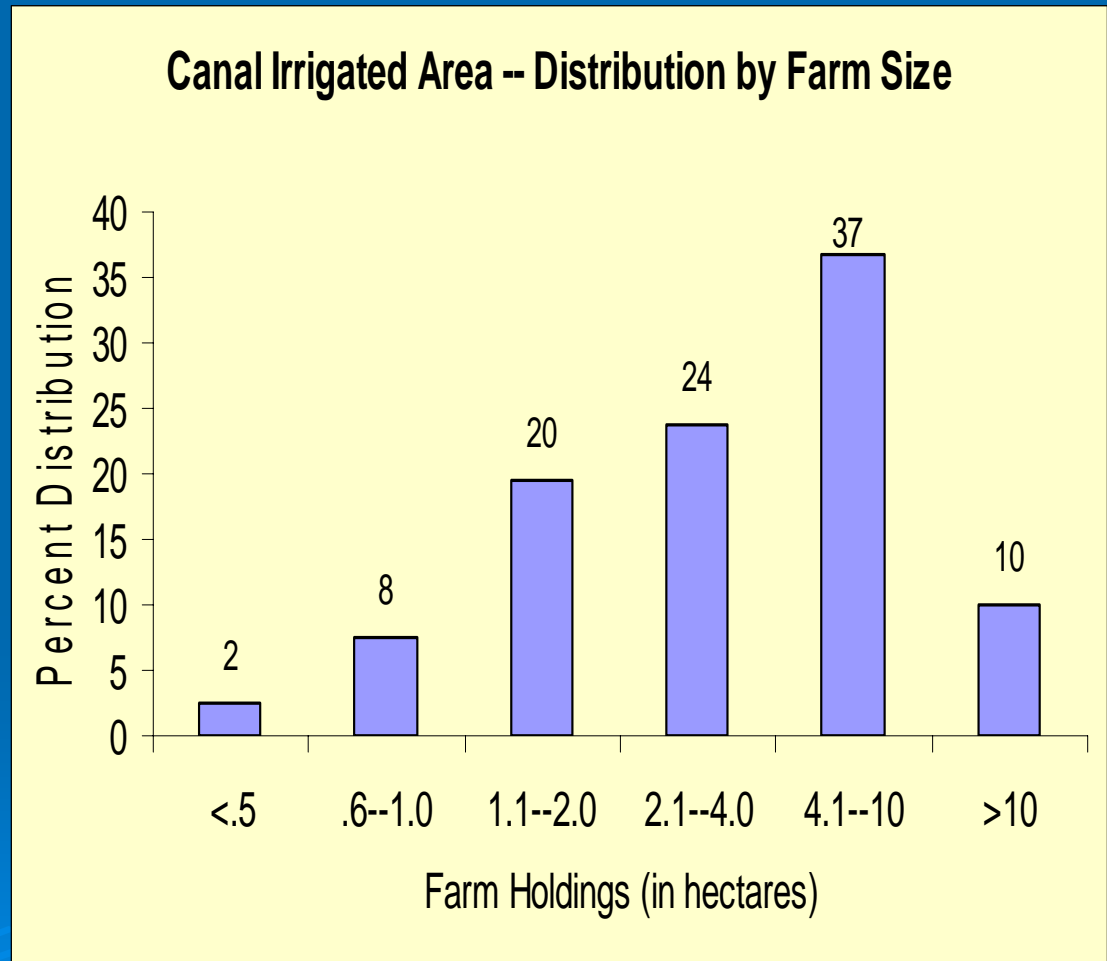
- ❖ While cost recovery has improved, there is still a big shortfall
- ❖ The shortfall looks much worse if interest payments on loans are included
- ❖ In 2001-02, the total budgeted irrigation subsidy is Rs. 1,200 crores



Canal Irrigation: Who are the beneficiaries?

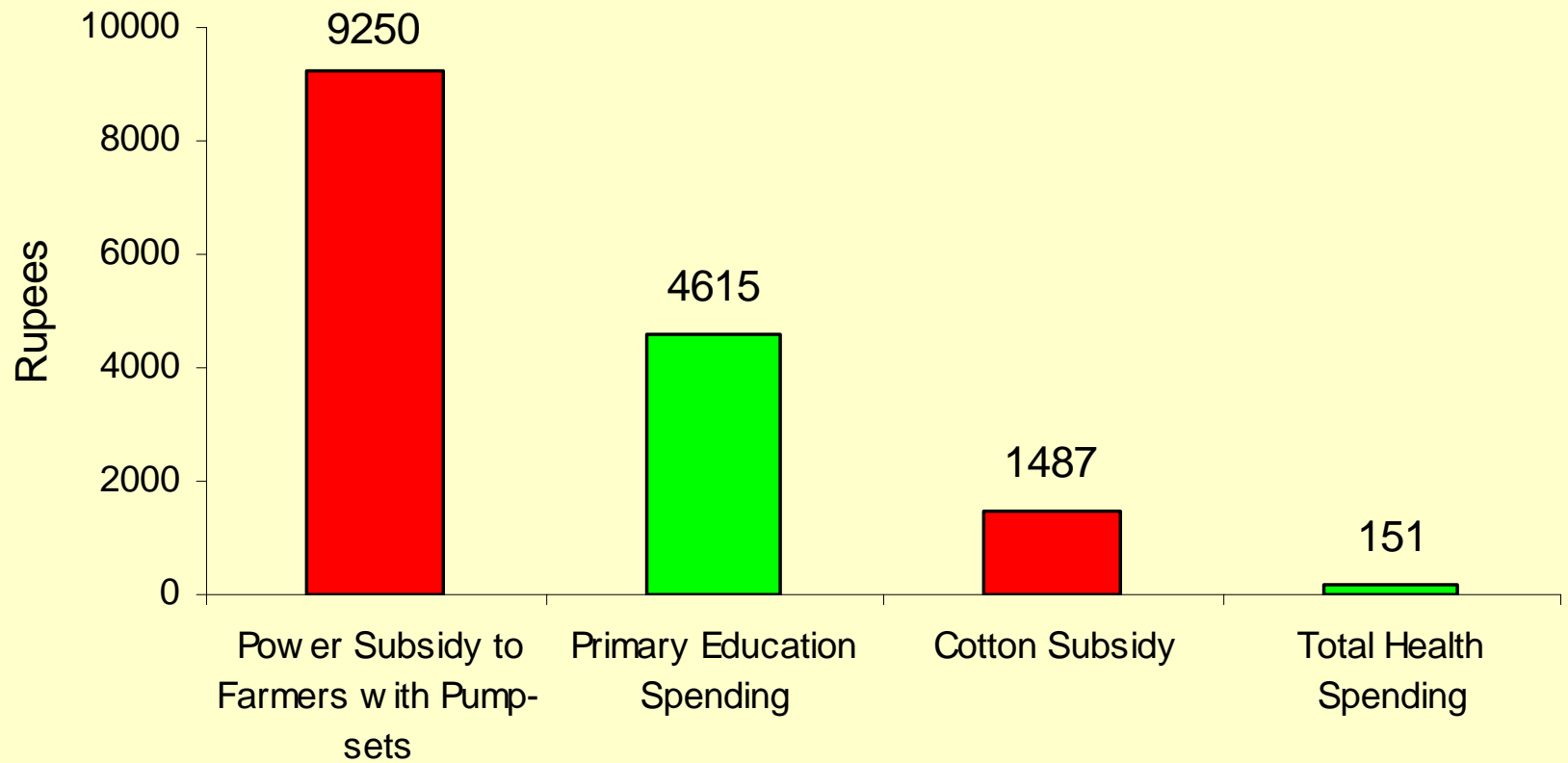
- Seventy percent of canal irrigation benefits accrue to farmers with average farm holding of > 2 ha
- Ten percent of canal irrigation benefits accrue to farmers with average farm holding of < 1 ha

Source: NSS 48th round



Forgone Opportunities

Subsidies & Other Spending (Per Beneficiary), 2000-01



Government Perspective

- A few Governments undertake their own PER.
- UK Spending Review.
 - Comprehensive Spending Review in 1998
 - Sets expenditure limits
 - Pub. Service Agreements
 - Dept. Investment strategies
 - Spending Reviews every two years
- Objectives
 - Sustainable growth
 - Fairness and Opportunity
 - Efficient public services
- Methods
 - Independent reviews of spending efficiencies
 - Target reductions in administrative costs