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AN AGENDA FOR BUDGETING

A Concept Paper for Establishing a Budget Network in the LAC Region

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Since 1980, senior budget officials of OECD countries have met annually to discuss common issues and interests. Under OECD auspices, they also have established a network for exchanging information and ideas, and for keeping abreast of recent developments in budgeting. This paper proposes that budget officials of Latin American and Caribbean countries (LAC) make use of the IADB dialogue process to convene periodically and discuss means of improving budget practices in the region. The paper surveys contemporary issues that may warrant consideration during the formative years of the contemplated LAC network.

A LAC-centered network would address somewhat different issues than those discussed at OECD meetings. It would have to view budgeting in a much broader perspective, not only as a means of allocating financial resources to government programs and agencies, but also as a critical instrument for promoting economic and social development, stabilizing financial conditions and reducing exposure to various risks and shocks, improving public governance and overall managerial capacity in the public service, building political legitimacy and making national governments and their budgets more responsive to democratic will, and encouraging a fundamental shift in the relationship between LAC countries and international financial institutions (IFIs) from conditionalities to dialogue. This is an overflowing agenda, but its scope speaks to the important issues that governments in the region must deal with in developing their societies. In the OECD community, the typical agenda focuses on recent innovations in budget practice; in LAC, the agenda will have to concentrate on fundamental developmental and governance issues. The ambitious scope of a budget agenda bolsters

the case for a LAC network that serves as an ongoing clearinghouse for the many countries in the region that need to upgrade their management of public finances.

Two considerations add to the argument for a budget network linking practitioners in the region. One is the habitual insularity of budgeting, the other is the apparent preference of LAC governments to adopt practices applied in advanced countries rather than from countries in the region.

In my view, LAC countries would greatly benefit from an international forum because budgeting is an insular process that encourages communication within, but not between governments. When they prepare and administer spending plans, practitioners continually deal with budget and program officials, both at the center of government and in government ministries and agencies. But they are acculturated not to discuss these matters with outsiders beyond the boundaries of their own government. In contrast to professionals in education, health, environment, transport and other government responsibilities, budgeters do not regularly interact with counterparts from other countries. For the most part, the conduct of budgeting is government talking to itself, with outsiders eavesdropping and occasionally joining in. This village quality of budgeting was well described by Hecló and Wildavsky a generation ago in their splendid study of Britain's budgeting practices. The Whitehall village that they characterized in Britain has parallels in the Hacienda culture of many LAC countries. Within the village, participants—both politicians and managers—interact regularly with one another, but they are guarded in dealing with others. Each government has its particular language, embedded in the forms, rules and classifications of the budgeting process, as well as in the behavior, roles and relationships of those who construct and manage government

budgets. There are universal elements in the language of budgeting, but every country has its distinctive ways and terminology that reinforce the insularity of budgeting. It is a private language, crisp and mannered by generations of experience, that is readily understood by insiders but a puzzle to those not connected to the process.

A LAC network would help break down the insularity of budgeters by encouraging them to learn and adapt from different venues and experiences. For example, a government contemplating a shift from the annual budget to a medium-term framework would have access to the experiences of neighboring countries that have sought to lengthen the time frame of budgeting. In this writer's observation, LAC governments often are more captivated by faraway developments than by what is happening in their own region. They prefer the state-of-the-art innovations of Western countries to the basic systems found in the area. This preference may propel LAC countries to favor avant garde reforms rather than "good enough" practices that have stood the test of time. Of course, LAC countries should actively search Western experiences and adapt practices that can enhance public management, but they may gain more from exchanging views and information with countries in the region than by reaching afar for the latest fashions.

This paper surveys some of the issues that are likely to be of continuing interest to budget officials in the region. The large number and variety of issues make a strong case for IADB to promote the launch of a regional budget network. The issues are organized into four categories: social and economic development, democratic governance, financial capacity, and budget practices. Although budgeting is the final category, all the issues presented here impinge on the conduct of budgeting. Budgeting is listed last so as to

frame the challenges LAC governments face in broad terms, not just as procedural questions. We want to discuss what how budgeting can be reshaped to stimulate developments, enhance governance, and strengthen the financial position of national governments. If budgeting does not address these larger issues, LAC countries may end up with sound budget systems on paper but poor budget outcomes.

### 1. Social and Economic Development

All LAC countries are, in varying degrees, works in progress. None is fully developed, and most have an urgent need to boost economic output, promote social integration, improve basic public services, develop internal capital markets, and formalize labor markets and business activity. As underdeveloped countries, most are vulnerable to capital flight, have elevated poverty rates and wider income disparities than is the norm in Western countries, and low mobilization of tax revenue. Cyclical disturbances tend to be more severe than in developed countries, and shocks from shifts in exchange or interest rates or from a fall in commodity prices often dislodge government from intended budgeting policy.

This is not a full account of the pathologies associated with underdevelopment, but it suffices to indicate that budgeting is adversely impacted by both structural and cyclical risks. Structural problems are rooted in depressed growth rates (which until recently have been lower for many LAC countries than in previous decades) that provide an inadequate revenue base to finance expected public services, undermine the legitimacy of democratic institutions, and breed inefficiency and corruption. Low growth is not just an economic condition; it also gives rise to behavior that weakens governance. Moreover, the problems do not respect national boundaries, for contagion from financial crisis in

one country ripples across the region, destabilizing business and government plans. When capital flees, inflation soars and currency depreciates, it is of no avail that the country has a good budget process that supposedly lives up to international standards. Budgeting is always among the first casualties of economic disarray.

International financial organizations often take the position that underdeveloped countries are poor because they have inadequate public institutions. But the reverse is closer to the truth: entrenched gaps between social needs and fiscal capacity induce beleaguered politicians to play fast and loose with the rules, compel the government to shorten its time horizon, and put a premium on muddling through. Budget systems cannot withstand the perverse behavior (including corruption) bred by inadequate revenue, no access to capital markets, and the need to roll over short term debt at extremely high interest rates. In pointing to the budget implications of being an underdeveloped country, it is not my intention to argue that nothing can be done by governments in these countries to uplift themselves. They are neither blameless nor helpless, but improvements in financial management must unfold a space with development.

An LAC budget network would not be an appropriate forum for discussing overall development strategies, but it would be for exploring how the budget contributes to or retards economic development and for examining means of buffering budget policies and processes against severe economic reversals. The argument advanced here is that making the budget a more effective instrument of national development requires that certain features differ from Western practice. Specifically, budgeting in LAC countries must be less incremental and more strategic, linked to national planning or other means of

defining objectives and priorities, and sensitive to the developmental consequences of tax and spending policies.

Of course, certain routines of budgeting tend to be similar in all countries, regardless of their stage of development. These universal features revolve around procedures for submitting and reviewing spending requests, the role of the central budget office in managing the process, and an accounting system for recording public expenditure. Countries differ in how they carry out these basic chores, but all build them into the machinery of budgeting. In devising an agenda for the contemplated network, it is important to focus on those aspects of budgeting that distinguish underdeveloped countries from those that are developed.

Incremental versus strategic budgeting. Budgeting is not an instrument of development in Western countries. As befits affluent, stable democracies which have little difficulty financing established programs (even when they have deficits), budgeting throughout the developed world is principally a process of continuing government on the path it already is on, while making small adjustments in spending for price and workload changes and to finance program initiatives. The typical budget in these countries also makes marginal cutbacks in some inefficient or outdated programs. The process is incremental, not developmental or strategic: each budget is compiled largely on the basis of decisions made in previous budgets. Moreover, in allocating resources, the government does not give sustained consideration to building markets, strengthening public institutions, bringing basic services to backward communities, and other developmental policies. This generalization does not give due consideration to occasional non-

incremental decisions, but it does accurately characterize the dominant tendency in Western budgeting.

Governments in some developed countries have waged a 50-year war against incrementalism by introducing a series of reforms aimed at making the process more strategic. From performance budgeting in the 1950s, program budgeting and planning-programming-budgeting systems (PPBS) in the 1960s, zero-base budgeting in the 1970s, and budgeting for results in the 1980s and 1990s, governments have sought to make the process somewhat less incremental and more responsive to changes in national priorities. Each failure sets the stage for the next reform. Nowadays, the anti-incrementalists put their stock in performance-based budgeting and medium-term expenditure frameworks (MTEF). Even failed reforms deposit some of their procedures and orientation onto the practice of budgeting. Yet it is fair to conclude that incrementalism has triumphed in the West, despite the vast increase in data on programs and performance. The outcome of this battle was foreordained by the advanced state of developed countries. Incrementalism fits them well, they can afford it, and citizens seem reasonably satisfied with what they get from government. Perhaps Western countries will not be able to afford the comforts of incrementalism in the future, if growth slows and populations age, but they can now.

LAC countries also budget incrementally, but few can afford to do so, for they have unmet social needs and inadequate revenues. Incrementalism condemns many to an underdeveloped future, or to slow, halting growth that widens the gap between them and rich countries. Yet, these countries also must contend with the allure of incrementalism. But compared to developed countries, they labor under much greater obstacles. For one thing, the increments available to them tend to be much more meager, for another, their



budgets often are beholden to legally (or constitutionally) mandated expenditures for pensions, public employee wages, and other entitlements. Lengthening the time frame of budgeting or injecting more performance data into the process will not uproot incrementalism or make sufficient room in the budget for development initiatives.

The following ideas for countering budgetary incrementalism might be studied by the new network. It would be foolhardy to expect that these tactics would transform budgeting into a zero-base process, but they might expand the margin for developmental initiatives.

(1) Some governments (particularly in Africa) set aside a portion of the budget in a social fund that is reserved for investment in activities that directly enhance the wellbeing of disadvantaged communities or people. In order to preserve the comprehensiveness of the budget, these may be “virtual” funds that are separately accounted for but are included in the budget. It would be useful to examine experience with these funds to determine whether they contribute to national development.

(2) Bidding funds, such as the one established in Chile, reserve money for competition among spending units for additional resources. Units bid for these resources by proposing initiatives that serve the government’s development priorities. To have a significant development impact, a bidding fund would have to comprise a larger share of the budget than in Chile. Enlarging the fund would probably require cutbacks in some existing programs. Bidding funds work best when they provide seed money that impels agencies to change their own spending patterns and priorities. Their impact is likely to be limited when they are viewed as a source of additional money.

(3) An LAC network could take the initiative in assisting member countries establish strategic development objectives (consistent with millennium development goals) that are linked to country budgets, influence the allocation of resources, and enable the government to monitor progress in developing society. Strategic objectives would differ from conventional output and outcome in that they would be government-wide, not program or agency specific. They would measure change in social well-being, and serve as directional signals to spur development.

(4) Separate development or investment funds have been abandoned in Western countries and are generally frowned upon by international organizations. In almost all Western countries recurring and investment expenditure are consolidated. In developed countries, public investment typically totals only about 1-2 percent of GDP, far lower than is needed to build social and economic infrastructure in underdeveloped countries. For this reason, it may be a good idea to separate the development budget, but to ensure that it is not unduly curtailed when governments face financial difficulty and to monitor the flow of money for development. Of course, the recurring and investment budgets should be combined in managing aggregate spending. Moreover, when funding development projects, it is essential that downstream operating expenditures are taken into account.

(5) The capacity of a government to generate tax revenue correlates with a country's development. The less developed a country is, the smaller that internal tax revenue are as a share of GDP. One explanation of this pattern is that under developed countries generally have large informal sectors that escape taxation; another is that government may lack sufficient legitimacy to boost tax rates and collect what is due to it;

a third is that powerful interests use their influence to block changes in the tax code that would produce additional revenue; a fourth is that tax administration often is inefficient or corrupt in poor countries.

Whatever the reasons, it is important that revenue be accorded prominent attention in LAC budget discussions. IADB has undertaken an 8-country study to determine whether improvements in expenditure management would pave the way for national governments to raise taxes as part of a “social contract” in which firms and households pay more in exchange for obtaining better public services. An explicit understanding that links the two sides of the budget is especially important to enable underdeveloped countries to escape the fiscal trap that denies them adequate resources and assures inferior services. Without more money, these countries cannot improve services, but without better services, they cannot extract more money from taxpayers. In view of the salience of this problem on the IADB agenda, it warrants high priority in budget dialogues.

Planning-Budgeting Interface. National planning was once a key tool of development, but it has long been out of favor in the West and discredited in many transitional countries. Nevertheless, countries in need of development have to plan for their future in ways that Western countries don't. They cannot merely assume that socioeconomic conditions will be better in the future, or that budgeting one year at a time will enable them to reshape their economies. Within the LAC region, there are two main models for injecting planning into the allocation of resources. Countries may be differentiated in terms of whether they have planning-centered or budget-centered allocation processes. In some, multi-year development plans drive the budget by defining

the national priorities that strongly influence medium-term spending decisions. In others, budgeting is the dominant process and allocations made through it are not encumbered by preset plans. Regardless of their orientation; however, countries that rely on planning must have effective means of connecting them to annual budgets; and countries that base allocations on the budget must have the capacity to assess spending options in the light of expected impacts on future development.

National planning has a tendency to ignore fiscal realities, with the result that the ambitions of the plan after are thwarted by a lack of resources. The indifference of planners to budget constraints is reciprocated by the indifference of budgeters to the promises made in plans. This is an old problem, for which Brazil has forged a new solution. Brazil's pluroannual is prepared early in the term of each president and covers the next four years. Although it is structured by the programs of government, the plan aims to remake society. As envisioned by the Constitution, the plan is intended to strongly guide preparation of each of the next four annual budgets. Toward this end, the plan is comprehensive; it covers all programs for which public expenditures are made. In effect, the plan is a multi-year budget that is oriented to national development, not just the financing of ongoing programs.

In the Brazilian model, the plan should drive annual budgets, that is, each budget is supposed to be consistent with the priorities and allocations in the multi-year plan. Integration of the two processes has been facilitated by merger of planning, budgeting and management in a single ministry, though with a separate secretariat for each. As a consequence, plans appear to be more realistic than if they were entrusted to a ministry whose only portfolio was a production of a medium-term plan every 4-5 years. There is a

tendency, however, for Brazil's plan and budget to diverge as a presidential term nears a conclusion and attention turns to the next election.

In some countries (such as Chile and Uruguay), budgeting is the dominant process and allocations made through it are not encumbered by previously-approved plans. But in these and other budget-oriented countries, significant efforts have been made to lengthen the time frame of budgeting. Uruguay adopts a 5-year budget (subject to annual adjustment at the start of each presidential term; Chile has moved toward a medium-term expenditure framework.

The variety of approaches provides fertile opportunity for exploring several issues that are important for development in the region. One is the planning-budgeting interface itself. Does one type of arrangement lead to a tighter, more consistent linkage of planning and budgeting? In particular, has Brazil's novel approach overcome the habitual unrealism of national plans and to what extent is the plan adhered to in budget allocations? How do countries that have a medium-term budget or planning horizon deal with the cyclical disturbances or shocks that dislodge the economy and government from the expected path? Finally, how do budget-dominant countries inject strategic considerations into resource allocations and other policies?

One aspect of development that is likely to gain prominence in the years ahead is the establishment of new regional institutions that link or integrate the economies of participating countries. Mercosur may be the forerunner of a larger union of countries in the Americas whose interests extend beyond purely economic matters to social, environmental and other issues. It will likely take considerable time for new regional institutions to grow to the scope and salience of the European Community, but the

inevitable push toward integration will propel LAC countries to take greater interest in each other's budget practices and policies. In the decades ahead, this development will almost certainly affect the mission and operations of IADB, and give it fresh opportunities to influence the shape and work of new international institutions. Even if IADB is not directly involved, it will be impacted by fundamental changes in relations among countries in the region. It can be either a bystander or facilitator: the latter posture would enable a LAC-based budget network to promote harmonization of budget procedures, accounting standards, transparency rules, and other important features of public sector financial management.

In itemizing various areas of potential interest, my aim is not to compile an agenda, but to urge that budgeting be seen as an engine of development, not only as a cog in each government's administrative apparatus. On paper, many-perhaps most-countries in the region already have reasonably good budget processes. What they do not have are well-developed societies. Because they don't, actual budget practices stray from the sound procedures they have adopted. Reforming the machinery of budgeting will make a difference only if countries in the region advance.

Democratic Governance. The same considerations pertain to use of the budget process to strengthen democratic governance. Budgeting is only a part of governance, but it influences the full array of public management capacities, including the performance of public employees, accountability in spending appropriated funds, the quality of public services, and fundamental relations between citizens and government. In addition, budget issues are embedded in the roles and relationships of vital national institutions: political executives and managers, the legislature, and the judiciary. A

budget dialogue should deal with governance issues only to the extent that they materially relate to raising and spending public money. The central idea is to leverage budget power to enhance the legitimacy and effectiveness of government.

Budgeting for Services. Improvements in democratic governance are utterly depending on the quantity and quality of public service. Citizens experience government through the services they receive (or fail to receive) from it. Few people know whether the budget covers one year or extends to the medium-term, or whether the budget is oriented to inputs or outputs, but parents do know whether textbooks and classrooms are available for their children, and patients know whether the health clinic has bandages and medicines. Democratic institutions wither when public services are unavailable or inadequate, and popular support for government ebbs. In this writer's view, focusing the budget on the services provided by government may be an effective means of improving both public services and overall governance. When it budgets, government should be able to tell citizens: "This is the number of villages that will have health clinics next year, and this will increase the number of villages with clinics by the following amount over the previous year". It should be able to issue similar statements with respect to all key services that are delivered directly to citizens.

Some may regard this as performance budgeting, but what is contemplated here is simpler and more basic. In contrast to contemporary performance measurement, which typically focuses on outputs and outcomes, a service-oriented budget process would allocate resources on the basis of the tasks and activities carried out by government entities. Many countries seeking to introduce performance budgeting have been stalled by sterile debates as to whether particular measures are outputs or outcomes, or whether

they measure impacts or effectiveness. The idea expressed here is predicated on the notion that the best way to link resources and services is to specify in the budget the activities that will be undertaken if money were forthcoming. Activities are what public agencies do and what they spend their money on. Activities are directly controlled by spending agencies; they are the meeting grounds between citizens and government. Students get educated when government builds schools, places qualified teachers in classrooms, provides textbooks and supplies, and so on. Some would argue that these are inputs and what matters are the results. But there are no results when there are no inputs.

A LAC budgeting network could pioneer new concepts and applications in services-centered budgeting. It may be sensible for the network to sponsor experiments and research on different approaches to implementing a service strategy. One idea would be for government to develop a service baseline (parallel to the financial baselines that are widely used in MTEF systems) that shows the types and volumes of services provided under current budget allocations and the changes that would occur if allocations were increased or decreased. A services baseline would target key activities, not every task carried out by government. When a budget change is proposed, the budget would disclose the number of schools/classrooms operated under current policies and the additional schools and classrooms to be built and operated under proposed or adopted policy changes. The budget would show baseline and proposed activities for all services provided directly to citizens. These measures should also have a qualitative dimension, such as the preparedness and motivation of teachers.

Services-centered budgeting requires significant capacity in government, including timely and accurate reporting on activities, linkage of resources and services,



comparison of target and actual services, and (most difficult of all) a committed civil service that fulfills assigned responsibilities. One of the tasks of a LAC budget network would be to encourage the exchange of ideas and experiences on actualizing budget reforms that aim to improve public services.

Productivity of public employees. Most public services are provided by public employees. Their performance is a critical determinant of the quality of public services. Government cannot perform if those it employs don't. Building classrooms and equipping them with books and supplies does not produce effective education if the teachers are unskilled, fail to show up for work, or do not care whether students are learning.

The wage bill is a prominent component of national budgets throughout the region, and is generally a higher proportion of total spending than in the OECD community. Although conditions differ across the region, quite a few LAC countries are afflicted with clientilism that has left them with an oversize, poor performing, unresponsive civil service, along with unqualified managers and staff, low pay and low morale. The remedy often demanded by IFIs is that countries facing severe fiscal imbalances should pare the wage bill. But from the perspective of the service strategy outlined above, it may be misguided and almost always unpopular. In some LAC countries, high profile efforts to modernize the state have been blocked by opposition from workers threatened with a loss of jobs and by politically-connected unions.

Trimming payrolls may free up money for salary increases for those remaining on the job. But it will not itself remedy deficiencies in public services, and might actually worsen these problems. If health clinics are understaffed, having fewer nurses will surely

make matter worse. Much the same applies to the maintenance of law and order by police, the education of school children by teachers, on down the roster of public employment.

The budgeting network can assist LAC countries in dealing with this difficult issue by sponsoring research and disseminating data on staffing and pay levels, and by examining pay-for-performance schemes and other contemporary innovations in human resource management. But it is important to recognize that rooting out pervasive pathologies in civil service behavior and performance lies mostly beyond the pale of the budget process and goes to core political and social values. Yet it is also evident that the budgets of many LAC countries cannot be repaired if inefficiencies persist in staffing public services. The main cost of an underperforming civil service is an underperforming government that fails to meet basic social needs because those who are entrusted with delivering them don't care, fail to show up for work, or see their job as a sinecure or reward for party loyalty.

Budgetary institutions. Budgeting runs through the institutional fabric of government, for example, as regards the role of the national legislature and courts. In quite a few LAC countries, the legislature exercises budgetary independence and is free to amend the tax and spending policies proposed to it. Expansion of the legislature's budget power is a worldwide trend, even in parliamentary regimes which give the government overwhelming advantage in revenue and spending matters. Growing legislative power has coincided with efforts to lengthen the time horizon of the budget and to strengthen control over fiscal aggregates. In most countries, legislators are habituated to consider only the year immediately ahead when they vote appropriations.

Modern budget systems impel them to assess the impacts of their actions within a medium-term framework, and to be mindful of the effects on budget totals when they act on particular revenue or spending measures. It would be useful for the budget network to survey the legislature's role in reviewing and amending the budget, the use it makes of reports and evaluations prepared by audit authorities, and the impact of legislative action on fiscal policy.

Courts have a prominent influence in some LAC countries on public spending. In some courts have interpreted constitutional or statutory language in ways that compel the earmarking of funds for particular purposes; in others they have upheld claims on the government. This is a sensitive issue in affected countries, but it cannot be ignored if national governments are to retain (or regain) control of public finance.

Democratizing the budget process. In its early stages centuries ago, budgeting emerged as a means of democratizing government by limiting the amounts it spent and holding leaders accountable for their actions. In recent times, budgeting has tended to retard democratic expression because it is a closed, technocratic process. This generalization applies to democracies throughout the world; it is not addressed specifically to LAC countries. Efforts to make the management of public finance more transparent aim to redemocratize the process. One should not be surprised if this trend were to gain force in the decades ahead, and will command the attention of politicians and budgetcrats in developed and underdeveloped countries. It will likely find a niche on OECD and budget agendas.

The history of budgeting and the development of modern democracy are closely intertwined. It is no exaggeration to say that the emergence of democratic legislatures

was propelled by pressure to give citizens, through elected representatives, a voice in tax and spending actions. Budgeting emerged as a means of requiring government to present a financial plan to the legislature specifying its revenue and spending intentions for the period ahead. But despite its origins as a democratizing institution, nowadays budgeting is rarely seen in this light. For most citizens and many legislatures, it is a closed, intimidating process that is transparent only in the technical sense that planned and actual spending is published in annual budgets and financial statements. The process by which spending amounts are decided is walled off from public participation. The budget discloses the decisions flowing from the process, but says little about underlying assumptions, alternatives, and program implications. To budget is to draw civil society into the process after the work has been done, when it usually is too late to have much of an impact. This is an impoverished form of democracy that induces passivity and compliance, and makes the process more authoritative but less participatory.

In LAC and other regions, international organizations have promoted engagement of civil society as a means of opening up political institutions, addressing critical problems of social development and equity, and strengthening accountability regimes. One can envision a leadership role for the budget network in devising and testing new means of opening up the budget process while maintaining fiscal discipline and improving the effectiveness of expenditures. E-budgeting is one such initiative; it enables citizens to access budget data through the internet. Plebiscitary budgeting goes a big step further by giving citizens a voice before decisions are made. My point is not to promote a particular innovation, but to indicate that the march of democracy will deeply affect government-citizen relations.

Financial Capacity. LAC countries generally have a much smaller margin for coping with financial disturbances than do most developed countries. Because of high debt burdens and exposure to fluctuations in interest and exchange rates, they have little room for fiscal missteps and must give sustained attention to external factors (regional and global) that impinge on their financial wellbeing. For these reasons, there is considerable urgency in defining standards and practices that balance development needs and fiscal risks. This is likely to be a prominent, recurring issue on budget network agendas. It is also an issue which requires both country discipline and international cooperation.

Debt Burdens. It is not uncommon for countries in the region to experience periods of economic growth and financial stability, followed by periods of crisis and collapse in which the currency plummets, interest rates soar, and budget deficits spin out of control. One of the main causes of this pattern is heavy debt accumulation in good times which cannot be service of in bad times. The shallowness of internal capital markets compels LAC governments to borrow abroad, and lack of investor confidence impels them to borrow short-term. When economic conditions deteriorate, the government must rollover maturing debt at much higher, sometimes usurious, interest rates, and has difficulty meeting its obligations. Rising interest changes crowd out social needs, and public spending contracts at the same time that economic output is declining.

This is an issue that demands urgent attention in the LAC community, not only in the budget network but in other regional and international forums as well. Stabilizing the debt burden requires that governments run substantial primary surpluses, as Brazil has done in recent years. But this may be beyond the reach of poor countries that rarely

experience robust growth and have difficulty financing unmet social needs. Insisting that these countries adopt contractionary policies to constrain deficits during downturns is questionable on moral and economic grounds. Doing so deepens the impoverishment of disadvantaged people and robs the country of investment that would give it a brighter future.

Developed and underdeveloped countries respond to economic adversity in fundamentally different ways. When a developed country experiences economic weakness, the government typically runs a larger deficit, borrows more to cover revenue shortfalls, and keeps on the spending course authorized in the budget. But many LAC countries face similar adversity by redoing the budget and trimming discretionary investment and maintenance expenditures. The main reason for this double standard is that affluent countries have no difficulty borrowing money to cover their deficit, while poorer countries risk capital outflows. But the international community also reinforces this double standard by insisting that dependent countries tighten their belts, thereby adding to contractionary pressures.

I believe that one of a budget dialogue's most valuable roles would be to encourage rethinking of government (and IFI) responses to fiscal stress by devising appropriate fiscal rules for good and bad times. There is a compelling need for new rules and instruments to cope with fiscal disturbances and to provide early warning of stress. LAC countries and the international community have a role in confining the financial contagion that often spreads to countries that have managed their finances prudently, and in establishing conditions that enable economic growth to be sustained.

Fiscal Rules. Stabilizing public debt would be facilitated by fiscal rules that limit public sector debt and debt burdens. These rules come in several varieties. Some (such as Chile's structural deficit rule) are self-imposed; others (such as IMF conditionalities) are imposed by outside authorities. Some have fixed targets that do not distinguish between expansionary and contractionary periods; others differentiate between structural and cyclical deficits. All fiscal rules depend on means of enforcement; these include accounting standards, reporting requirements, and response to actual or projected breaches. Perhaps the most important element is the determination of government to abide by the rules. Often, however, enforcement is subject to negotiation between the affected government and the entity responsible for enforcement. The enforcers may have the weaker hand in this relationship, especially when the economy is weak. Judging from Europe's experience with the Stability Pact, it appears that enforcers retreat when economic weakness causes fixed rules to be breached.

It is often assumed that fixed rules are essential for fiscal discipline because they do not vary with the preferences of politicians. In some circumstances, however, pliable rules that are set and can be changed by political leaders may be more effective. New Zealand's Fiscal Responsibility Act, which does not bind the government to a present target, has been a model for other countries, including some in LAC. The fiscal responsibility model requires the government to formally announce targets and explain changes or deviations from them. Similar arrangements have been implemented through Australia's Charter of Budget Honesty and coalition agreements in the Netherlands. Although these types of arrangements have been in effect for barely a decade or less, they

show considerable promise may it be that rules which are grounded in strong political commitment are sturdier than those which are imposed on reluctant politicians.

A number of LAC countries have recently adopted variants of the fiscal responsibility model, including Argentina, Brazil, Columbia, and PERU. An important feature of these arrangements is that they cover both the national and sub national governments. In effect, governments at all levels negotiate a contract specifying the fiscal limits by which they will operate. The multi-level concept is necessary because of the prominent role of sub national governments in the overall finances of these countries. It may be premature to assess these arrangements, which have typically been in effect only a few years, but it certainly is ripe for a budget network to monitor them and disseminate information on various types of fiscal rules.

Fiscal risks. In developed countries, government is the holder of financial risk for society. It indemnifies workers against loss of jobs, ill people against the cost of health care, elderly people against loss of income, and so on. Some risks are direct liabilities of government; others are contingent liabilities that come due only pursuant to certain events. When government underwrites fiscal risk, it tends to weaken control of its finances because risks generally come due in the future, not in the period during which they are taken up. There is an inclination to underestimate future budget costs, or even to regard some risks as costless (as, for example, when the government guarantees private loans).

Many, perhaps most, national governments do not have a full accounting of the risks they are exposed to. It would be highly valuable for the budget network to assist countries inventory the risks they have assumed though the issuance of guarantees,



insurance schemes and other direct or contingent obligations. Few national governments make provision for these risks, in their budgets, but they often come due during stressful times, when the government's budget position has eroded because of adverse economic conditions and related factors. For example, a government might indemnify businesses against changes in interest or exchange rates. These contingent obligations are more likely to come due when the economy is depressed.

It would also be helpful for the network, possibly in cooperation with IFIs, to develop standards and criteria for taking on risk and for assessing prospective costs before the obligations are taken on. One active policy area which has attracted international interest is the use of public-private partnerships for expensive infrastructure projects. In these partnerships, the government often guarantees a return on investment, thereby taking on new risks that might compel payments 10-or more years ahead. The attractiveness of partnerships may induce participating governments to disregard downstream risks. The budget network would provide valuable service by calling attention to the risks embedded in these arrangements.

Budget Practices. Many LAC countries have “textbook” budget systems on paper, but deficient systems in practice. The chief culprits include excessive earmarking, which drains the budget of incremental resources for new spending priorities, chronic variance between authorized and actual expenditures, which drains the budget of legitimacy, and inadequate data on program results, which drains the budget effectiveness. In many LAC countries, there persists a gap between formal and informal budget processes, between the way the process is supposed to work and the way it actually does. Informality in governance parallels informality in the economy and

society, and affects public employment procurement, and other administrative processes in addition to budgeting. In countries where informality predominates, reform of the budget process does not produce the expected improvement, for changes in formal procedures often are disregarded in allocating resources.

Earmarking. In almost all countries, the textbook description of budgeting as a process for deciding among competing claims on limited resources runs up against the reality that most spending is mandated before a single decision is taken. The proportion of the budget that is precommitted tends to be somewhat higher in LAC than in other regions, but the main difference is that incremental resources are more meager in underdeveloped countries than in developed ones. Moreover, various transfer payments are constitutionally earmarked in some LAC countries, making it exceedingly difficult for the government to make even marginal adjustments. Earmarking is particularly harmful when the government is compelled by economic force majeure to curtail the small portion of the budget that remains in its discretion, such as investment expenditures and school supplies. This is a sensitive issue and a frontal attack on earmarking would likely fail. The budget dialogue cannot avoid this issue, but it should tread carefully, surveying the types and extent of earmarking and investigating successful efforts to ameliorate the problem.

Variance of actual and approved expenditure. In developed countries, spending allocations made during compilation of the budget generally are implemented during execution of the budget; in poor countries, spending decisions are revised, sometimes several times during the year to accommodate changes in the government's cash flow. The more it rebudgets during the year, the less incentive a government has to prepare a

realistic budget at the start of the year. Some underdeveloped countries routinely produce unrealistic budgets in the expectation that actual spending will be decided behind closed doors by power brokers who are not accountable to the public or the legislature for their actions. This practice may help countries maintain fiscal discipline, but it impairs the transparency of the budget and opens the door to corruption.

When the official budget authorizes unrealistically high spending that cannot be finance with available resources, it is of little avail to extend the time horizon of the process by adopting a medium-term framework. If the budget does not govern the year underway (or immediately ahead), it certainly will not be authoritative for future years. Restoring the habit and norm of realistic budgeting warrants highest priority. The budget dialogue should shed light on this problem and assist governments striving to stabilize public finance in developing realistic spending plans.

Time horizon of budgeting. Countries that have implementable annual budgets may be ripe for moving to a medium-term (typically 3-5 years) for measuring the future fiscal impact of current budget decisions. Quite a few countries, in the region and worldwide, have formally adopted a medium-term expenditure framework (MTEF), but (in my view) few countries have made effective use of this innovation. In many, the MTEF is a separate document (or process) that parallels the annual budget, projects future revenue and spending, but is not the real basis for current budget decisions. In others, MTEF is a technical exercise, an additional thing that government has to produce in budgeting annually.

A government can have only one budget at a time. For MTEF to be effective, it must become the annual budget, that is, the means of deciding how much to spend in

each of the next 3-5 years. The next year's budget should be the first year of the MTEF, not a separate exercise. Moreover, the MTEF should be the responsibility of the core budget staff, not of a separate entity which is walled off from ongoing budget work. Assisting governments in implementing MTEF or other reforms that lengthen the time frame would be an excellent use of budget network resources. Many governments want an MTEF; they need to be guided on doing it right.

Information on Results. Along with MTEF, performance budgeting ranks among the most popular contemporary reforms. Because performance budgeting comes in so many varieties, ranging from including information on workload to explicit linkage of resources and results, the term used here (information on results) covers a broad range of practices. Moreover, as discussed earlier, this writer believes that budgeting for services and activities would be the most fruitful way of sensitizing budget makers to the substantive impacts of their decisions.

In government, it is far easier to measure performances than to act on the basis of performance information. The true test of a performance system is not whether data are produced, but whether they are used, especially in budgeting and other critical processes. OECD's SBO network came to the conclusion that governments cannot budget for results if they do not manage for results. That is, the culture of public management must be oriented to the purpose of government agencies and to the organized means by which they produce (or fail to produce) results. Isolating budget procedures from the rest of public management will not advance the cause of performance. An important implication of this is that a LAC budget network will have to broaden its perspective to consider an array of management issues.

Integrated financial information systems. To a far greater extent than in any other region, LAC countries have invested in integrated financial information systems that link a broad range of accounting budgeting and other financial management processes. These systems have been running for more than a decade in some countries, and it appears they have produced significant efficiencies in routine financial operations. It is an open question, however, whether they have changed the ways governments manage public money, especially during implementation of the budget. Integrated systems can spur decentralization of financial management and give line managers greater discretion in implementing their budget. Alternatively, they can enable central officials to more closely monitor and control operational decisions. Properly used, and integrated system changes relations between spending units and central controllers.

Despite investment in these systems, international organizations have not systematically evaluated how they have been used and their impacts on public management. This would be a fertile area for study by the budget network.

Getting Started. This is an overflowing agenda that can occupy the budget network for many years. It is also an agenda that will change from one year to the next, as interests and opportunities shift and as budget officials gain confidence in the network. I would urge that to get started, the network proceed on two tracks, one centered around an annual meeting, the other based on research in the region. Both would require substantial support and leadership from IADB. It would have the lead role in organizing the meetings and in setting the agenda, and it would also have to actively solicit participation of the member countries.

If a LAC SBO were to follow the OECD formula, much of the research would be drawn from reports and case studies prepared by participating countries. Obviously, this data base would not be as rigorous or objective as one compiled by IADB specialists, but it would more likely motivate countries to participate than one prepared by IADB itself. Moreover, to the extent that the aim of the network is to encourage countries to learn from one another, this type of research may be more productive. Of course, IADB would still have its own research program (as the OECD Secretariat has), but a good deal of the exchange at meetings would revolve around country experiences.

It may take a few years for budget officials to warm up to annual meetings at which their own systems are under discussion. In its early years, SBO encouraged dialogue by beginning each annual meeting with a “round of the table”, which invited delegates to present interesting developments in their own countries. This typically consumed half a day of each 2-day meeting. The remainder of the program was devoted to discussion of prepared papers, often drawn from country case studies.

OECD has completed 25 years of annual meetings, and attendance is now more robust than before. SBO has added various meetings during the year on current topics, such as accrual budgeting and accounting and performance management, as well as a journal that publishes its research. By all accounts this is a worthwhile, valued program that is likely to grow in prominence in the decades ahead. One looks forward to similar success in a LAC network.