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Managing Fiscal Stress

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The phrase “economic management” might be a contradiction in terms—an oxymoron like the “crisis management” . . .

DENIS HEALEY, The Time of My Life

Fiscal stress defined as a widening gulf between resources available and needs is by no means new in the history of countries’ economic management. During prolonged or short wars, droughts, famines, and other natural disasters, expenditures tend to ratchet sharply upward, and when this increase is not matched by a corresponding increase in resources, governments are compelled either to mobilize additional revenues or to reduce expenditures from the levels they would otherwise have reached. Such measures may sometimes be needed to alleviate a short-term problem and sometimes to address a structural problem. In both cases, there is a good deal of stress on the policymakers to respond quickly. This phenomenon received fresh attention during the late fifties in industrial countries. Until then, budgets had essentially been used as vehicles for government programs and for accountability. In the fifties, however, the macroeconomic linkages of the budget with the economy began to receive greater attention. The volatility in resource availability was contributing to “stop-and-go” policies in implementing expenditure programs.

In such a context, the debate inevitably arose whether the losses to the national economy were greater than the gains from the “stop-and-go” policies. This debate led in the United Kingdom to the appointment of the Plowden Committee on control of public expenditure.¹ After a

¹A detailed discussion of the developments prior to the Plowden Committee, its main recommendations, and their impact on the tenor and content of expenditure management is provided in Premchand (1983).
detailed inquiry into the issue, the Committee concluded that a degree of continuity and stability was vital for public sector expenditure management. The events after 1973 and in the early 1980s and their impact on government budgets provided a new impetus and urgency to consideration of the role of expenditures in macroeconomic management. Inflation, unemployment, lower productivity, frequent balance of payments problems, and the associated consequences of the oil shocks, which were endemic during these years, added further stress and led to concern that public expenditure commitments made during more stable or prosperous years could no longer be continued.

In response to this concern several themes were explored to minimize or deal with the stress. The feasibility of an expanded budget process to cover taxes, tax expenditures, and credit and expenditures together was explored. Greater attention was paid to dealing with uncertainty and to formulating contingent management strategies if the situation improved or deteriorated. Expenditure controls by central agencies were strengthened, along with efforts to build enhanced financial management capability in spending agencies. Vulnerable areas such as entitlement programs, interest payments, and transfers to enterprises and other levels of government were strengthened. These and related efforts contributed a new set of tools to expenditure management. As greater efforts were made to ensure a rapid response to the changing requirements, cynicism was also growing about the futility of some of these efforts, some of which were considered (presumably for lack of clear results) simple folk rites performed annually. The view also prevailed that the approaches were more tactical than strategic, more like the operations of a fire brigade—quenching fires as and when they arose—rather than forward-looking preventive action, and that they were generally inadequate.

**What Is Fiscal Stress?**

Fiscal stress essentially refers to the options of policymakers in a context where there is a growing imbalance between revenues and expenditures over a period, or where the imbalance is short term, usually confined to a fiscal year and reflecting a situation that is different from that used as a basis for the budget. Historically, public expenditures have increased steadily, reflecting the efforts to establish a welfare state and stepping up the annual rates of economic growth. Whereas in the past government revenues had kept pace with public spending, during the more recent decades the latter began to outstrip the former, contributing to higher levels of outstanding public debt. The government budget deficit (according to available data and despite problems of comparability) widened from about 3.5 percent of GNP in developing countries in 1972 to about 6.3 percent in 1985. The deficits in industrial coun-

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tries grew in the same period from 1.8 percent to 5.1 percent. This growth in deficits contributed to an awareness of the inflationary pressures they produce and to a possible displacement of private sector activity by the public sector. As the options for raising more revenues were becoming increasingly limited because of the recognition of the distortions that such efforts could contribute, and as growing expenditure commitments were creating a difficult to displace entitlement ethic, the onus was on the policymakers to look for new approaches.

The extent of fiscal stress depends on the severity of the budget deficit problem. The deficit tends to be higher in countries where a growing share of expenditures is garnered by defense and interest payments. Defense outlays reflect a political commitment, while interest payments are a linear extension of the borrowing undertaken in previous years. This problem is particularly acute in highly indebted countries where almost half of the total expenditures represent interest payments. The policymakers in surplus countries, in addition to the difficulty of maintaining that surplus over a period, have to find quick avenues for spending it. Experience in this regard suggests that when far greater revenues are available than can be absorbed in any spending program, they will be diverted to development or investment funds (usually outside the budget), which when wisely invested, yield a reasonable return in the future. They have sometimes been used to set up more government-owned enterprises that are intended to be engines of growth. This was particularly true in countries in which a balanced budget was mandated, meaning that revenues earned in one year had to be spent in the same year. The difficulty of finding appropriate channels for spending the increased resources available, although a facet of fiscal stress, is not a focus of discussion in this chapter.

Fiscal stress can be (and often is) also a short-term phenomenon, usually when revenues are sharply reduced relative to the original budget estimates and to the scheduled outlays, and thus are likely to contribute to higher deficits. These arise largely as a result of inadequate attention to uncertainty. A decline in the prices of exports, a higher-than-estimated decline in output, a shift in the demand pattern for the country's products, and declining competitive strengths are factors that are likely to contribute to a decline in revenues. Higher deficits may also be


3An accepted notion in public finance is that a greater availability of revenues would induce higher levels of spending. Inevitably, then, and as a logical extension of this reasoning, surpluses would gradually decline.
caused by an unexpected surge in expenditures reflecting price increases that are higher than estimated, new policy initiatives, or a growth in transfer payments. The policy options may be to raise more revenues or to reduce expenditures, depending on the impact that the two types of measures have on the economy. With expenditure increases, the expenditure management processes in government envisage some routine actions aimed at dealing with them. These actions, which are common to almost all countries, usually consist of seeking accommodation within the approved budget itself to compensate for the increases in a particular sector. Savings may be found within the same chapter or in another, or special measures may be taken to procure savings in another chapter, and if none of these serve, a net additional appropriation may be sought from the legislature to cover the increases. Then, and without any increase in revenue, the budget deficit would increase.

Although short-term fiscal stress may occur in any context, evidence indicates continuation of the longer-term type of fiscal stress. Forward budgets and expenditure projections of a number of countries suggest that it would be reasonable to expect continuing pressures for spending through the changing demographic profile (increasing numbers of elderly) in terms of pensions, social safety nets and social security benefits, and greater outlays on health care and education. In countries where youth tend to dominate the population, more outlays are required for their education and eventually for the creation of an atmosphere of increased economic activity and employment opportunities. If most of the capital stock is either obsolete or has to be augmented to meet the needs of the growing population, or has to be renewed to replace worn-out stock, new investments are needed. Although in theory these investments may be financed from the peace dividend that may be available to countries, the dismantling of the existing arsenal of weapons (in particular, chemical and nuclear) also entails additional expenditures. To that extent, no respite can be expected in the near future from the type of stress experienced during the last two decades. To learn from experience, the ways in which the past crisis was dealt with have to be examined.

**Corporate Practices During Stress**

Before considering the approaches and experiences of public sector management, the experience of the corporate world in dealing with similar issues should be considered. In a competitive environment a potential crisis in the form of a loss in the market is always around the corner. Near-substitutes to a firm’s products at a lower price are always in the market. A firm’s costs may be higher than those of another firm because of higher wages, poor management practices, or obsolete ma-
chinery. In such situations, the firm enters a period of crisis. It has to reorganize itself to regain its previous identity and to secure its old market, or it has to employ other strategies to expand its share of the market. None of these approaches are valid, however, for extended periods, and they need to be constantly reviewed and updated to be relevant to the market's changing needs.

A constant for corporations in the modern era, relative to a government, is a corporate strategy. The strategy specifies the objectives and the programs to be pursued to reach those objectives. That strategy in turn forms the basis for allocating resources and for steadily implementing the approved programs. In a crisis, the first task is to determine the nature of the crisis, the factors contributing to it, whether it is short term or medium term, and whether it is a general problem afflicting the whole economy or only the firm in question. The question, in short, is whether the decline in the corporation's resources is a short-term or medium-term internal problem or whether it is a reaction to a slowdown in the economy. The strategy to be used to manage the crisis depends on this determination, which is akin to the role of an aircraft pilot who has to determine whether the turbulence is short and temporary or likely to be prolonged. If it is the latter, a decision on whether any change in the flying altitude is necessary would prove useful.

In the corporate world the decline in resources arises from loss in the market share. (For this purpose, the temporary slowdown in economic activity as a general phenomenon is not considered. Such a slowdown affects each firm differently, depending on its own capital and cost structures and the vulnerability of its products to sharp and quick changes in demand.) Such a loss in the market may be due to poor quality, higher costs caused by excess production, or profligate or poor management practices. Well-known industrial experts such as Deming⁴ have held that the absence of total quality control could be calamitous to a firm. In an expanding market, no part of this may surface upward as the flaws of management tend to be concealed. But they assume vital importance in a competitive environment. Management has traditionally sought to ensure quality in the final stages of production before the product is made available to the customer. Deming argued that it is a folly to correct defects "downstream," and the critical issue from his point of view was to address the issue "upstream" so that quality could be practiced and ensured throughout the whole process of creating a product or service.

Higher costs may be due to wage structures, obsolete production processes, or wasteful practices during production, or may reflect the uneconomic practice of excessive borrowing from the market. In such

cases, the management choices are relatively narrow. If the problems are too deep-rooted and cannot be resolved, the first alternative may be to wind up the organization or to sell it off at any price. The intent behind such an approach is to minimize the maximum losses at an appropriate time, so that they do not become an excessive burden on other items of the balance sheet. Although such an approach has obvious implications for labor and associated social welfare aspects, from the management point of view it may be the obvious and least painful solution. A more difficult challenge for corporate administrators is to pare down the excess in organization and production. This involves retrenchment in the amounts of resources used, particularly labor. The initial inclination, if the problem is temporary, may be to resort to across-the-board cuts and to defer some items of expenditure such as maintenance. But management has the obligation to demonstrate the validity of its approaches not only to its staff but also, and more important, to the bankers who are financing operations. The market will have the final word in determining the efficacy of the proposed strategy. Such cutbacks as are proposed need to have a method and a conviction behind them. As Deming (1986) aptly remarked, “goals set in the management of a company, without a method, are a burlesque” (p. 75). Because retrenchment is bound to create conflicts in the organization, the top management has to lead in persuading its employees to understand the realities and to gain a perspective of the larger stakes of survival involved. It has to specify the methods for achieving the proposed turnaround and seek cooperation for the revised corporate strategy. Its revised goals must be based on a sound analysis of the work processes and a linkage of the proposed measures with the expected results.

Otherwise, when the problem is perhaps too far in the future, the management has the obligation of communicating the constraints to all involved. Recent advances in applying management accounting in the commercial world in Japan suggest that more emphasis be laid on tightening the existing constraints than on optimizing within them. Accordingly, standard cost systems for monitoring factory performance are de-emphasized and there is a growing commitment to market-driven management in which target costs derived from estimates of a competitive market price are emphasized rather than engineering costs. In such situations, accounting systems are typically organized to influence and to motivate employees to act in accordance with long-term manufacturing strategies.6

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5See also Behn (1980).
Each of the above aspects has its counterparts in the public sector. The major features common to both relate to the identification of the nature and duration of the problem, the formulation of a corporate strategy, the assumption of leadership to gain support for implementation to ensure quality and cost control. Also, systems can and are being used to motivate and stimulate performance against tightening constraints. The major distinctions are in the type of clientele affected and the environment in which management functions. In the corporate sector, the exit of a firm and its products can be quickly compensated by the entry of another to meet the market’s needs. In the public sector, it may not always be so, as some of its products and services are unique and there is no competitive supplier. Also, some of its services may be targeted to certain social classes of the community. The community not only consumes the services but also is the one with the power to change those responsible for providing the services. Thus, in the public sector political approval and support for the proposed actions is needed. In both cases, however, the support, grudgingly given or not, depends greatly on the knowledge of the opportunity cost of not adopting the strategy proposed.

**Issues and Approaches**

The factors contributing to a crisis for a firm in the corporate sector are relatively few and lend themselves to easy, quick, empirical identification; those in the public sector are in contrast many. Some may have been long-standing, while others may have been relatively recent. Although it is debatable whether the institutional or the policy factors have the primary role in contributing to the fiscal crisis, in practice both sets seem to have contributed. The relative share depends on the economic situation and the stage of institutional development of a country.7

From an institutional angle, the following aspects have contributed, although the magnitude of their contribution is not measurable.

- Many major financial decisions are made outside the budget process;
- No explicit procedures or provisions for coordinating revenues and expenditures usually exist. In some cases, little is known about the tax

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7David Stockman holds the view that the “current fiscal disorder results from powerful, long-term, macroeconomic policy and political trends” that have tended to overwhelm the budget process in the mechanical sense. To that extent, he argued the correction of the situation requires extraordinary measures of political will and consensus. See Stockman (1986, pp. 57-58). As discussed in the text, the institutional factors have also contributed.
measures until they are announced in the legislature. No explicit machinery is present to permit the internalization of the resource constraint through all the phases of the budget process;

- No explicit linkages exist between the budget process and the macroeconomic framework. Also, there are no explicit instruments to maintain the budget deficit for specified targets. Indeed, as Lindblom (1961) pointed out, “a policy is not always a decision: it is often simply upon us without deliberate and explicit choice. A ‘decision’ to run a surplus or deficit is, for example, often not a decision at all but simply an outcome” (p. 296);

- The financial implications of decisions are not fully recognized. Cost data are generally inadequate and not integrated with monitoring systems to anticipate overruns and provide a basis for future program and budget planning;

- Procedures for reckoning with uncertainty and consequent policy formulation have not been effective. On the other side, accounting controls are too detailed, repetitive, and burdensome and have been ineffective in preventing abuses; and

- Most expenditures have tended to be inflexible over the short term and their effectiveness remains unquantified. From a policy standpoint, the pursuit of populist measures, the formulation of programs with no termination dates, and high levels of borrowing to finance new programs have contributed to steady growth in expenditures. These factors are manifested in the changing composition of expenditures.

The measures aimed at addressing the above and associated issues are wide ranging. For analytical purposes they are summarized in Table 3.

**Legal Powers**

Governments usually have powers to expand the budget rather than to reduce the outlays. This is particularly true in systems with an obligatory basis for budgeting and, therefore, full legal authority with the necessary funding provided from the outset. In those systems with the limiting approach—under which budget estimates are considered limits not to be violated—it is implicitly assumed that finance ministries can restrict the outlays if exceptional adverse developments occur in the economy. Even in these cases, however, the exercise of such implicit powers has generally proved controversial, as the spending agencies are reluctant to cede any claims once they have been conceded in the approved budget. The law is not free from ambiguity in this respect.

This problem has been addressed in various ways in different countries. Four approaches merit consideration: Germany, the United States,
Table 3. Approaches to Fiscal Stress

<table>
<thead>
<tr>
<th>Area</th>
<th>Problem Clusters</th>
<th>Approaches</th>
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<tbody>
<tr>
<td>Adjustment powers of central</td>
<td>Ministries of finance frequently lack powers to adjust outlays downward after</td>
<td>Provision of emergency powers to ministries of finance and introduction of</td>
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<tr>
<td>ministries</td>
<td>approval of the budget.</td>
<td>“pay-as-you-go” (PAYG) system.</td>
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<tr>
<td>Pursuit of policies to</td>
<td>Inadequate revenue efforts; extensive regulations; programs with no cut-off</td>
<td>Revenue generation through user fees; reduction in regulations; introduction</td>
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<td>achieve stability</td>
<td>dates. Considerable emphasis on public investment as primary instrument.</td>
<td>of “sunset” legislation; reallocation of tasks and functions between central</td>
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<td></td>
<td></td>
<td>and other levels of government; indefinite postponement of policy initiatives</td>
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<td></td>
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<td>and major expenditures.</td>
</tr>
<tr>
<td>Macroeconomic linkages</td>
<td>No control on deficits; future implications of current policies not available.</td>
<td>Introduction of global targets; forward expenditure planning by providing</td>
</tr>
<tr>
<td></td>
<td>Absence of cost data.</td>
<td>multiyear estimates; development of functional costing.</td>
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<tr>
<td>Budget formulation</td>
<td>Decisions taken outside the process; no explicit efforts to coordinate revenues</td>
<td>Expanded budget process; envelope or portfolio budgeting.</td>
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<tr>
<td></td>
<td>and expenditures.</td>
<td></td>
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<tr>
<td>Inadequate scrutiny of</td>
<td>Inadequate time and attention to reviewing programs and projects, resulting in</td>
<td>Scrutinies; reconsideration programs; revised budget process; association</td>
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<tr>
<td>expenditures</td>
<td>cost and time overruns.</td>
<td>of private sector; introduction of incentives for securing fiscal dividend.</td>
</tr>
<tr>
<td>Specific efforts at restraint</td>
<td>Excessive growth in personnel and associated rigidities in expenditures.</td>
<td>Freeze and restrictions on hiring; staff ceilings; retrenchment; termination;</td>
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<tr>
<td></td>
<td></td>
<td>reduction in capital outlays; across-the-board cuts.</td>
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<tr>
<td>Uncertainty</td>
<td>Volatility in budget revenues and expenditures on natural disasters create new</td>
<td>Core and noncore categories of expenditures.</td>
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<td>pressures on deficits.</td>
<td></td>
</tr>
<tr>
<td>Maintaining policy targets</td>
<td>Implementation of approved budgets difficult, particularly during inflation.</td>
<td>Cash management; cash limits; centralization of payments.</td>
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</table>

Note: The measures also include those aimed at improving productivity and performance in government and associated efficiency controls. These aspects are considered in Chapter 9.
China, and the Russian Federation. In Germany, the finance minister is authorized after passage of the budget to postpone the execution of appropriations for financial reasons. He may decide to restrict the amount of borrowing if in his opinion such borrowing may have a destabilizing impact on the economy. He also decides whether, and in what form, appropriations will be carried over to the next fiscal year. Conversely, he is also entitled to authorize new provisional appropriations in emergency situations, up to 5 percent of the budget, without waiting for the next year’s budget.8

In the United States, efforts to contain the level of budget deficits have been made by implementing what is known as Gramm-Rudman-Hollings legislation. In the eighties, the legislation aimed at securing budget implementation within specified levels of deficit. In those years, however, the limitations applied to the estimates of the budget so that there could be an agreement between the legislative and executive wings on what was aimed for during a given three-year period. To secure passage of the budget, a sequestration process under which trigger clauses would become operational to reduce expenditure estimates was also specified. But these limitations did not apply to the actual expenditures incurred. Inevitably, despite the legislation, the impact on the actual deficits was negligible, and they continued to grow unabated. By 1990, addressing the estimates of the deficit was recognized to be of little avail and if the deficits were to be tightly controlled, limitations should be on spending itself. Toward this end, the spending envisaged in the budget was divided into three categories—defense, international, and domestic—and limitations were set on all of them. Any violation of the limit triggers the operation of the sequestration process, which is legally obligatory for the executive arm of the Government. In addition, the new legislation envisaged the establishment of “pay-as-you-go” (PAYG) procedures, under which legislation aimed at proposing new direct spending or decreasing revenues must be offset so that the net deficit is not increased. This legal institutionalization of a form of restraint seeks to regulate the proclivities of a populist-oriented legislature or executive either to increase expenditures or to reduce revenues.

China, which did not have a budget law after 1949, enacted Regulations on State Budget Management in November 1991. Taking into account the growing budget deficits that had been a regular feature of the Chinese economy during the late eighties, the new regulations recognize the explicit need for budget readjustment during the year. Accordingly, Article 56 states that budgets may be readjusted within the fiscal year if

a major event happens, or if changes of policies or economic situation have a substantial impact on a budget’s execution. The regulations also state that additional expenditures should be compensated through additional revenues. More significantly, the new regulations enjoin the Government at all levels to prepare readjustment plans, thereby making obligatory the preparation of contingent adjustment plans.

Coincidentally, at the close of 1991, the new Russian Federation also prepared a budget law that is narrower in its focus. It recognizes that in the transition to a market economy, and as an independent sovereign state, swings both in revenues and expenditures are bound to occur. To prevent an excessive impact on the size of the deficit, the law envisages the division of government expenditures into “protected” and “unprotected” categories—implementation of the latter depending on adequate revenues. The law also specifies a sequestration procedure that becomes operational within a three-week period after a minimum shortfall of 20 percent in revenues has been ascertained. Although this provision has been invoked in a different way, it illustrates the readiness of governments to deal with stress inherent in fragile fiscal situations.

The enactment of the legal powers necessary to deal with the new situation was preceded or followed by the formulation of policies to redress the impact of a widening gap between revenues and expenditures. As already noted, this gap was not unanticipated. Rather, it was the inevitable result of a number of developments. Accordingly, the policy measures were aimed at making most services recover their costs by introducing user fees. In addition, efforts were also initiated to reduce the size of the public sector by reducing its regulatory functions, by divesting state-owned enterprises, by changing the assignment of expenditure tasks and responsibilities of the various levels of government, and by initiating educational programs to usher in an age of diminished expectations. It is not the intent here to discuss the efficacy of these measures and their overall impact on the pursuit of more prudent fiscal policies or on reducing the size of the fiscal gap. Rather, they are enumerated here to serve as a preamble for a more detailed discussion of the micro-management measures taken in support of macroeconomic management policies.

**Macroeconomic Linkages**

Fiscal stress brought to the fore the importance of budget and public expenditures as instruments of macroeconomic management. In turn, this implied a continuing analysis of the expenditures in terms of their impact on the economy. Three approaches that merit consideration as part of this effort are forward expenditure planning, analysis of the
concepts of deficit and global targets as policy variables, and the treatment of uncertainty.

**Forward Expenditure Planning**

Although forward expenditure planning, or “multiyear estimates,” or “rolling expenditure planning,” as it is also known, has been an expenditure management approach for some time, the technique received added impetus recently, and some of the problems hampering its effectiveness were considered afresh. Forward expenditure planning is essentially an exercise to ascertain the future financial implications of existing policies. Each policy measure represents a commitment of future resources. So, also, as these commitments rise, little leeway exists in the budget, and a greater mobilization of resources is indicated. The system is expected to reveal to the policymaker the margins that he has, and how to explore alternatives when the resources are not adequate. It is also intended to educate the tax-paying public in how resources are utilized.

The system developed some drawbacks during the initial period, however. The estimates, which were initially made in volume terms, indicated a minimum level of services to be provided regardless of the outlays involved. In such a context, the estimates of the spending agencies became “floors” rather than ceilings. Also, carried out as an independent exercise, it built no bridges with the resources available. The “planning reserve,” intended as a contingency to meet unforeseen needs, became in some countries controversial because it shifted attention from the implications of continuing policies to the slicing of the reserve and its allocation to the agencies.9

As fiscal stress grew and became persistent, these drawbacks received attention. Thus, volume terms gave way to cash planning or estimates in cash terms. Along with this, emphasis was laid on functional costing. Although cash-based budget and accounting systems are not ideal for computing costs, the supplemental use of accrual methods helped these exercises. A notable example, despite widespread uneven application, is the computation of costs of health programs. Also, to facilitate the internalization of resource constraints, the forward expenditure planning exercises were undertaken in the context of ceilings on resources. In some cases (for example, Australia), the size of the planning or contingency reserve was reduced. More important, it was realized that leaving the exercise to the spending agencies was problematic. A central analytical

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9See, for example, Roe’s (1986) analysis of the experience of Kenya.
capability, based on facts rather than perceptions or clichés, to counter¬
vail the claims of the spending agencies was also needed. This strength­
ened analytical capability paved the way for strategic planning. Al­
though the system became a kind of “religion of feeble minds”—an
instant aspirin to policymakers who sought continuity rather than
adjustment—it was also recognized that the system by itself offered no
comfort in dealing with fiscal stress and had to be combined with other
approaches and techniques to moderate the growth of expenditures.

Global Targets

The most important element in the strategy of macroeconomic man­
agement was to reduce the size of the budget deficit. The approaches in
this regard covered two aspects—an in-depth analysis of the concept of
deficit and the ways in which it should be used as a policy variable.

In an accounting sense, there is no deficit in the transactions of any
unit if receipts are equivalent to outlays. But the effects of categories of
revenues and expenditures on the national economy vary. For example,
transfer payments have a different impact from capital outlays. Thus,
any concept of deficit involves a pattern of organization of the categories
of revenue and expenditure to facilitate the analysis and measurement
of the impact on the economy. Although, until recently, only a few con­
cepts of deficits such as current account deficit and overall deficit ex­
isted, research suggests that there are now at least 16 concepts of deficit,
shown in Table 4. Some of them illustrate conceptual advances, whereas
concepts such as operational and primary deficits reflect adjustment to
the reality of high inflation rates and highly indebted countries.10 Al­
though the range of concepts may be somewhat perplexing at first, it
also reflects the complexity of economic management and the maturity
of economics.

An associated phenomenon has been the use of the deficit and the
related borrowing program as a policy or global target. Thus, the con­
cept of the public sector borrowing requirement (which has undergone
some change in coverage in recent years) became the policy goal in the
United Kingdom. In some cases, it has been replaced by governments
endeavoring to achieve a surplus, a policy goal of public sector debt
repayment. Elsewhere, in Germany, for example, the net borrowing of
the federal and Länder governments is not allowed to exceed net

10The content of capital or investment budgets was also debated. Should they, for
example, include intangible capital outlays (research and development outlays) and
human capital outlays in the defense sector? See United States, Congressional Budget
Office (1987). For a previous discussion of this subject, see Premchand (1983).
Table 4. Budget Balance Concepts

<table>
<thead>
<tr>
<th>Concept</th>
<th>Formula</th>
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<tbody>
<tr>
<td>1. Overall balance</td>
<td>Government expenditure – government revenue + grants</td>
</tr>
<tr>
<td>2. Overall balance without grants</td>
<td>Overall balance – grants</td>
</tr>
<tr>
<td>3. Foreign balance</td>
<td>Government foreign expenditure – government revenue from foreign sources</td>
</tr>
<tr>
<td>4. Domestic balance</td>
<td>Overall balance – foreign balance</td>
</tr>
<tr>
<td>5. Operational deficit</td>
<td>Overall balance – inflationary part of interest payments</td>
</tr>
<tr>
<td>6. Primary deficit</td>
<td>Overall balance – all interest payments</td>
</tr>
<tr>
<td>8. Consolidated coverage</td>
<td>(a) With rest of public sector</td>
</tr>
<tr>
<td></td>
<td>(b) With quasi-fiscal accounts of central bank</td>
</tr>
<tr>
<td>9. Cyclically neutral balance</td>
<td>Government expenditure – cyclically corrected government revenue</td>
</tr>
<tr>
<td>10. Cyclic effect of the budget</td>
<td>Overall balance – cyclical neutral balance</td>
</tr>
<tr>
<td>11. Base-year balance</td>
<td>Normative year balance</td>
</tr>
<tr>
<td>12. Structural budget</td>
<td>Cyclic effect of budget + base-year balance</td>
</tr>
<tr>
<td>13. Full employment balance</td>
<td>Full employment government expenditure – full employment revenue</td>
</tr>
<tr>
<td>15. Permanent balance</td>
<td>Present value of all government liabilities – present value of all sources of government assets (assets, taxes, etc.)</td>
</tr>
<tr>
<td>16. Generational balance</td>
<td>Present value of taxes of an average member of his generation for the remainder of his life – present value of transfers he will receive</td>
</tr>
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investment expenditure,\textsuperscript{11} except to correct a recognized disturbance in the macroeconomic equilibrium. Most countries have a limitation of maintaining a debt-to-GDP ratio. In some cases, the rate of growth of expenditures is targeted to be maintained at the same rate as the rate of growth of GDP. These and similar goals have, in several cases, had a

\textsuperscript{11}Tarschys (1985) and Premchand (1990) describe the global targets in the countries covered by the Organization for Economic Cooperation and Development (OECD).
desirable impact on the community because they served as an educational process. In some cases, they have also had a beneficial impact on the expectations of the spending agencies, which recognized the futility of demanding more resources. Also, they served as a signal of a government's intention for the direction of the economy. But these advantages have also to be weighed against the disadvantages. Adherence to the level of deficits has sometimes contributed to the adoption of strategies aimed at doctoring the estimates and circumventing the specified budgetary procedures; adoption of the global targets strategy was not always accompanied by the necessary political and administrative support; and the enthusiasm shown in articulating the strategy did not translate itself into administrative action. But those that believe in counterfactual logic could argue that without such targets, the actual level of deficits could have been far worse.

**Uncertainty**

All plans are subject to change, and plans for expenditure management cannot be considered exceptions. As Keynes wrote in one of his earlier tracts, there are always "the dark forces of time and ignorance" that affect the economy, in turn affecting the outlook and operations of government. Some of these can be forecast, although an error of estimation is inevitable. In some cases, even the least statistically significant may have a "butterfly effect." Anticipating these effects and including them as variables affecting policies are formidable tasks. Fiscal stress amplifies these factors and makes the policymaker recognize them in earnest.

The response has been in the form of forecasts and formulation of scenarios. Such forecasts depend on observed relationships among variables in the economy and typically take into account the categories of revenue and expenditure and their reciprocal relationships with the economy. These forecasts have become integral parts of expenditure management. In fact, one of the enduring impacts of fiscal stress is the integration of economic analysis with expenditure management. Formulation of these scenarios is not always scientific or objective, and political considerations have clearly had their share of influence. Thus, some scenarios were made rosier than warranted to serve political purposes. But such manipulation cannot be maintained for long as the increasing

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13A mathematically rigorous theorem shows that a butterfly flapping its wings in the Amazon rain forest can and does control the weather in Chicago a few weeks later. See Drucker (1989), p. 165.
divergence between forecast and actual developments tends to discredit the system itself.\textsuperscript{14} Forecasts are not adequate substitutes for judgments; but judgments tend to be sharper and less subjective when grounded in empirical roots.

**Budget Formulation**

The major innovation in budget formulation was the introduction of a system of envelope budgeting in Canada, which in due course yielded to portfolio budgeting, as practiced in Australia.\textsuperscript{15} The introduction of envelope budgeting in Canada had its origins in two recognized weaknesses of the previous system. First, no adequate linkage existed between policy determination and resource allocation. Second, decisions by departments on their own budgets and for coordinating policy with resource allocation were barely controlled. The envelope system therefore envisaged integrating policy and expenditure decision making to ensure that the former was undertaken in the context of expenditure limits, and to decentralize decision making to committees of the Cabinet. The system was to operate jointly with the longer-term fiscal plans that provided the expenditure limits (or envelopes) for various policy sectors consistent with the longer-term plan. The underlying principle behind the formulation of envelopes is that all programs are collected into categories that belong to a broad policy sector. To enable comprehensive consideration, expenditures were interpreted broadly and included alternative forms such as lending programs, tax expenditures (included in the envelopes only in one year), and guarantees. The entire government was divided into eleven policy sectors and each envelope consisted of two elements—operational planning and a policy reserve. The reserves were of two types—an operating reserve used to reflect cost adjustments from inflation and a policy reserve intended to fund new initiatives. The policy fund was in principle a kind of revolving fund that could be renewed by giving up some old programs from the operating base. Its significance was that it brought together four major elements—

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\textsuperscript{14}Reflecting on his experience as Chancellor of the Exchequer, Denis Healey wrote, “Like long-term weather forecasts they are better than nothing . . . But their origin lies in the extrapolation from a partially known past through an unknown present, to an unknowable future according to theories about the causal relationships between certain economic variables which are hotly disputed by academic economists, and may in fact change from country to country or from decade to decade.” Healey (1989), p. 381.

\textsuperscript{15}For Canada, see the case studies in Premchand and Burkhead (1984) and Premchand (1990) and McCaffery (1984). For Australia, see the case study in Premchand (1990).
macroeconomic fiscal framework, ongoing budget base, new program initiatives, and a mechanism for setting priorities within a comprehensive framework of resources and expenditures or their alternative forms.

Despite the recognized strengths and the considerable advances it offered over the prevailing systems, it was given up after a decade, for political and systemic reasons. Politically, the shift of the focus of decision making from the Cabinet to the Cabinet subcommittees did not please many. Also, the anonymity of the Cabinet was preferable to the hard and direct choices made in a subcommittee atmosphere, and from a systemic point of view, a reduction in the base became a formidable and therefore less successful task. Instead of concentrating on the adjustments needed, emphasis shifted to the allocation of the policy reserve. In the circumstances, the policy reserve ceased to be revolving and became a net additional claim on available resources.

A similar approach, known as portfolio management, was introduced in 1987/88, in Australia. It was recognized that the best way to appraise and reappraise priorities is to entrust them to the agencies responsible and therefore also the most knowledgeable. Another objective was to provide an opportunity to reduce outlays with relatively non-controversial changes. Major allocation decisions, particularly on new policy initiatives, continued to be vested in the Cabinet. This system still operates in Australia.

Despite the differences in the life cycle of the approaches, they have provided new instruments to those involved in expenditure management—an expanded budget process and an explicit opportunity to internalize the resource constraint.

**Expenditure Reviews**

The fiscal crisis was also responsible for reorienting energies to review expenditures. What were the factors responsible for their growth? How could they be ascertained and brought under control? These questions elicited several responses from governments but four of them are considered here because of their past and potential impact on the expenditure management system.

One approach was the scrutinies program that was initiated in the United Kingdom in the early eighties. The intent was to introduce a

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16 The effort behind this approach was to bring many complementary program areas under one portfolio for which credible and realistic resource targets were set, so that high-priority new policies could be financed through offsetting savings.

17 The new system reduced the demands on Cabinet time.
series of scrutinies of various expenditure programs designed to produce results quickly so that the serious weaknesses of expenditure management could be identified and addressed. This program encouraged officials to identify areas of duplication, waste, and inefficiency and was to be internal. Suggestions for improvement were invited, and after discussion, new policy initiatives to correct the areas of waste were launched. Since it was internal, the process generated a good deal of self-examination leading to a commitment to improvement. An incidental benefit, in addition to the direct economies stemming from reorganization, was that the consolidated evidence from the scrutinies reemphasized the need for long-term improvement in the design of the expenditure management process itself. This recognition ushered in a series of efforts that are described in Chapter 4.

A related approach, the “reconsideration procedure,” was introduced in the Netherlands during the eighties primarily to alleviate the politically inflexible elements of the budget and to assess the efficacy of expenditure programs. After a comprehensive inquiry into the inflexibility of expenditures, the authorities found that the factors contributing to that inflexibility were two: programs were structured by law, therefore became obligatory, and amending the law proved difficult; and programs based on political agreements or politically approved estimates (such as multiyear estimates) were not easy to reduce. The latter was due to the type of forward expenditure planning, which, while it clarified the draft expenditure programs on future resources, also assured continuation and expansion of the programs. To mitigate the impact of these programs, the reconsideration procedure (which was adapted from zero-based budgeting) sought to analyze policy from a zero-based perspective. On the basis of that analysis, three decision variants were developed. These were variations in input while maintaining output, allocation variants that sought improved pricing or divestiture to the private sector, and output variations that sought reductions in output. The analyses were carried out by interdepartmental groups at official level (avoiding political involvement and maintaining the technical objectivity of those engaged in the reconsideration), and their findings were integrated into the budget process and used to determine the allocations to agencies.

A third approach was the introduction of a new budget process in Sweden in the early nineties. The annual framework of budget making created its own momentum that did not permit a detailed review of the effectiveness of programs. Accordingly, a new budget process was intro-

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19See the case study on Sweden in Premchand (1990).
duced under which the activities of all agencies and the results achieved are reviewed once every three years. The agencies are divided into three groups so that approximately a third of all agencies are examined each year according to a rolling three-year schedule. The appropriations for an agency for the next three-year period are then determined in the light of this review of the purposes and the results achieved, as well as the costs of achieving them.

A fourth approach was to involve the private sector in examining the activities, identify redundancy, and suggest measures to eliminate waste. The implicit assumption behind this rather infrequently applied technique is that the government has a vested interest in continuing the existing program and would at least be reluctant to admit poor management or inappropriate choices. This attitude contributes to complacency and continuing efforts at self-preservation. Bringing in the private sector is like bringing in a much-needed whiff of fresh air or like shock therapy. The utility of this approach depends on the level of expertise that is brought to bear on the analysis. The three approaches outlined above recognize that ideas for improvement should come from within, from those who are managing the activities, for they are the most knowledgeable about their operations. Bringing in outside experts could be problematic, as their access to information would be limited and their purview restricted therefore to the more obvious programs rather than covering the whole gamut of operations. On the other hand, the association of the private sector, if judiciously chosen, could pave the way for a greater acceptance of the retrenchment programs by the public. It also has the potential for becoming mired in the self-defensive posturing of those managing programs and those evaluating them.

**Efforts at Restraint**

The measures described above are frequently combined with other specific restraint measures aimed at curbing growth in specific areas. These measures are considered in terms of three categories—personnel restraint, across-the-board cuts, and specific sectoral cuts.

**Personnel Restraint**

Control of personnel expenditures has often been vexatious. It is an area where a steady growth in numbers and in gross outlays is not

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20 The private sector has been associated in several instances, albeit in the form of government commissions, with efforts to reduce expenditures: for example, the Royal Commission on Expenditure in India in the late nineteenth century; the Hoover Commission in the late forties in the United States; and the Nielsen Committee (Canada) in the eighties.
always matched by an increase in productivity. There is also the age-old perception that public agencies are usually overstaffed. When confronted with the medium-term structural and short-term imbalances in the overall fiscal situation, measures are taken to reduce the number of posts in agencies. For this purpose, a target for reduction and a ceiling on the permissible number of staff are notified to the spending agencies by the central agencies. If pressures persist, a freeze on recruitment (which will result in vacancies remaining unfilled) is imposed, and, in some cases, retrenchment is also resorted to by providing incentives for early retirement. Where increases in staff are found to be justified, these are then adjusted against savings in other sectors. Thus, the efficacy of these measures depends very much on judging the global situation, as well as on identifying the specific areas where growth is indicated and where reductions are feasible.

The experience of a wide spectrum of countries that have implemented the above approaches reveals several problem areas. Any effort aimed at reducing the number of people employed is viewed as touching only the surface of the problem. The factors that contribute to personnel growth are the growth in programs and their tendency to be labor intensive. If the properties of the programs are not examined, measures such as freezing or holding in abeyance the number of vacant posts may have only a short-term effect. Indeed, if the problem is primarily short term, these approaches may even be considered the ideal solution. In reality, however, the staff increases reflect a structural problem that needs a more detailed response. Thus, in some cases (for example Ghana), efforts have been made to reduce employment in government through a massive effort at retrenchment.\footnote{See Kapur and others (1991), pp. 34–35, for a discussion of these efforts.} There was an explicit recognition that it was a structural long-term issue. Exit from government was facilitated by providing termination benefits and training programs to equip those retrenched with technical skills. Thereafter, efforts were also made to investigate how these social safety nets affected retrenchment. Although outlays on rehabilitation contribute to increased expenditures in the short term, they also have the potential to change their composition.

Another problem that can reduce or even nullify the effect of any retrenchment is the phenomenon of ghost employees. This phenomenon, prevalent in several African countries, shows the number of employees on the payroll as much larger than it really is. This problem reflects the state of overall expenditure control rather than efforts to relieve fiscal stress. It represents, in effect, a major leakage of expendi-
ture control and portends the probable lack of impact of a freeze and associated efforts.

As an integral part of the control strategy, however, personnel controls no longer enjoy the primacy they had in the past. Emphasis has moved over the years, in response to the new tasks and duties of management, from reducing targets to providing an appropriation for a wage bill within which managers have flexibility either to employ more people at low wages or fewer people at higher wages. Also, as attention is moving to the control of the running or operational cost profiles, personnel is subsumed into the global targets for such costs rather than considered an independent entity. The choice among the approaches depends on the stage of development. Some countries emphasize running costs. Developing countries, handicapped as they are by lack of cost information, rely more on personnel costs.

Across-the-Board Cuts

These cuts may be indicated before a budget is formulated and can represent a percentage of outlays to be reduced in the following year’s budget. Or, when confronted by a major shortfall in revenues during the year, a cut by a specified percentage may be made to prevent excessive credit expansion and to achieve stabilization. The cuts, which are imposed unilaterally, represent a decision-making convenience for the central agencies. Cuts can be quickly determined and implemented and are generally fair because the amount of hardship is the same percentage for all, and they meet stabilization requirements. On the other hand, cuts represent a lack of priorities or a lack of method. Agencies are unequal, and the degree of slack is bound to be uneven among them, so that cuts may affect some more than others. Also, a cut exercised without taking into account the inner dynamics of the programs may only be sowing the seeds for future problems. A more troubling aspect is that when across-the-board cuts are utilized too frequently, they can paralyze program managers.22 As an instrument, it negates all that management stands for because it induces a permanent state of expectation in the agencies, which will keep on second-guessing when the next blow will be delivered. Thus, instead of promoting orderliness, it engenders short-term solutions to long-term structural problems.

22The important issue for expenditure management is, as Keating and Rosalky (1990) stated, “how, for example, does one ensure that the advantages of greater stability for program managers are not thwarted by the need for budget flexibility at the political level, including the need to be able to shift priorities from one budget to the next?” (p. 73). An associated management issue is how the twin objectives of fiscal restraint (associated with stabilization) and devolution are to be achieved. For a discussion of the Australian experience in this respect, see Keating and Rosalky (1990).
Specific Sectoral Cuts

Often, where the magnitude of the problem is severe, the across-the-board cuts may not be adequate and therefore have to be supplemented by larger reductions in specific areas. From a systemic point of view, however, fiscal stress has contributed to the specific formulation of spending priorities into those to be implemented with available resources and those that can be given up if resources are scarce. Thus, expenditures are divided into “core” and “noncore” projects, or into “protected” and “unprotected” expenditures. These unprotected categories may sometimes not be adequate, however, and more substantial reductions in expenditures may be needed elsewhere. Experience shows that governments tend to defer capital outlays and some social outlays to the future. Operation and maintenance expenditures may also be deferred to better times. All these approaches will have the effect of reducing the rate of development, forgoing social welfare, and adding to the future costs of maintenance or replacement of assets. If these choices are made deliberately, they may reflect an explicit consideration of the opportunity cost of alternative policies. Each approach has its costs and the one that is chosen may be the least costly in the circumstances. These considerations add a new dimension to the approaches of the expenditure manager.

MAINTAINING POLICY TARGETS

The choice of the global targets discussed earlier presupposes the existence of adequate machinery to ensure their achievement. But as these targets were somewhat novel and related to areas that had not been addressed before, new management systems had to be introduced to deal with them. One such approach is cash management.

In theory and in scope, cash management is a simple concept and covers the process of conserving cash, optimizing its flow so that the specified levels of deficit are not exceeded, and restricting borrowing to the indicated levels. Inflows and outflows are forecast and methods that reduce the divergence between the two are specified. Revenues and expenditures have their own periodicity. Revenues tend to be higher during the second quarter, whereas expenditures tend to be higher during the first month of the fiscal year (when any pending payments are cleared) and progressively higher from the last month of the third quarter to the end of the last quarter. In developing countries, the flows of foreign aid are another important factor whose timing may add to or reduce the divergence between receipts and expenditures. To manage

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23 A detailed discussion of the concept and the way in which it is implemented is provided in Chapter 8 of Premchand (1990).
Managing Fiscal Stress

this volatility and to forestall an excessive rush of expenditures during the last quarter, a procedure for quarterly, monthly, or ad hoc releases is adopted as part of the cash management system. Although the programs are already included in the budget and adequate authority has been provided in the form of legally voted or approved appropriations, actual spending for them would be subject to the release of authority to spend. Such authority usually covers items of expenditure other than payroll (which is usually centralized, and also regular in its flow), debt service payments, and entitlements, or social security payments that are demand determined. This approach of phasing the release of authority enables the central agencies to relate the outflows to the inflows and to minimize the costs of borrowing or to invest resources when they tend to be idle. The device provides a net addition to the arsenal of the expenditure managers in assessing the flows of expenditure in a broader perspective.

An associated technique is cash limits. Although variously interpreted, these limits refer to budgets expressed as final cash requirements and represent the aggregate of an implied level of spending set at a fixed and known price base, and an allowance for price changes for the specified fiscal year over the fixed price. Its origins are in the adjustment of budgetary outlays to inflation. If outlays are to be adjusted to neutralize the full effect of inflation, they may be far higher than the inflation-adjusted revenues and, thus, may contribute to higher deficits. To control such expanding deficits, cash limits were introduced as an administrative device to supplement and regulate the budgeted outlays. These limits are based on cash-based planning and take into account the predicted inflation rate. As they are deliberately set lower than the full rate of inflation, they force the spending agencies to reappraise their expenses (and quantities) and to limit them to the specified levels. They thus represent a final limit beyond which no spending is to occur.

In practice, however, both these techniques contributed to various problems. In several countries, particularly those with both a high level of indebtedness and an obligation to maintain controls on credit expansion, governments have resorted to monthly releases of authority. These releases are somewhat lower than those implicit in the budget estimates, but they do not have any impact on the commitments of the agencies that are made with reference to the budget. Meanwhile, however, the monthly releases have effectively replaced the budget itself and its credibility, while inducing an uncertainty in the spending agencies about the allocations to come in the following months. Their response to reduced allocations is usually to delay payments rather than to adjust policy.

24A discussion of these aspects is provided in Chapter 8 of Premchand (1990).
In some countries, the monthly releases, while fully honoring the payroll, reduce the allotments for other purchases and related expenditures. People were as a result sometimes underemployed for as long as three months a year, contributing in turn to higher costs. It also illustrates that the stabilization goal is being pursued without due regard to economy and efficiency. The two goals are not mutually exclusive, and the pursuit of economy and efficiency is even more important when stabilization is sought. The objective of stabilization implies the conservation and not the misuse of resources.

Releases are sometimes deferred during the earlier parts of the year and are fully compensated for (to be equivalent to the total approved estimates) during the last month of the year. This deferment adds an element of urgency to spending, and the higher levels of spending are financed by borrowing from the organized financial sectors. Such borrowing (in particular from those banks owned by government) is undertaken at a cost in the sense that the financial institutions unload the borrowing instruments (treasury bills and bonds) into the secondary market, after the appropriate credit ceilings have been met. These extremely short-term techniques do not even qualify as "Band-Aid" approaches, for a Band-Aid has the virtue of helping to heal some types of injuries.

In a few other cases, to obtain more control of them, payments are centralized and are directly controlled by the ministries of finance. In addition to converting a policy arm of the government into a cashier, this centralization contributes to delays, to payment of interest on delayed bills, and to needless politicization of the payment process. Such centralization is questionable when a substantial portion of the outlays is spent in the last quarter. Decentralized payments offer the prospect of applying a degree of internal audit before payments are made, whereas when centralized, the rush of work prevents the specified process from being observed.

Countries have sometimes built up enormous domestic and external arrears to ensure a technical observance of credit goals. Although some involuntary arrears in payments (arising largely from transit delays) are inevitable, these arrears reflect a deliberate policy decision to defer payments. Since commitments have already been made and goods delivered, the build-up in arrears reflects a leakage from the system and a distortion of the control process. The benefits, such as they are, have to be weighed against public awareness of such arrears and the consequent decline in the creditworthiness of the government. The vendors will also demand additional premiums to compensate for the delays in payment or will demand advance payments before delivery of goods.

As for cash limits, experience shows that the primary problem relates to the timing of their announcement. If they are announced with a
pronounced lag from the rate of inflation, they will induce an element of panic into the managers' approaches, and, depending on the preparedness of the agency, could have an uneven impact on the volume of services provided. In any event, cash limits should not be viewed as a durable solution to persistent inflation or to structural imbalances. They are most effective in the short term while the policymakers are exploring other courses of action.

**Assessment**

The preceding discussion illustrates the range and diversity of approaches that governments have adopted to deal with both a short-term and a more lasting fiscal crisis. The evolution of these approaches demonstrates that expenditure management can no longer be considered an isolated phenomenon but has to be fully integrated with macroeconomic management with a capability fully reflecting its dynamics and its frequently changing requirements. On the positive side, the new techniques suggest a heavy investment in analysis. Forward expenditure planning, formulation of scenarios, and the explicit recognition of resource constraints in the management process have become durable parts of the public managers' stock. The authority of the management systems in central and spending agencies has also been substantially strengthened.

Experience shows also a number of problems in these approaches. Some of these arise from the perception (and occasional empirical verification) that their impact has been less than expected and in general minimal. Organizations seem to have been more skillful in preserving the cherished programs and in circumventing them than in adhering to them. In comparison with commercial sector experience, public organizations have been unable to build a consensus both within and outside the government and to evolve an implementation strategy. Far too often, resource ceilings are not communicated, or are changed with little explanation, and new approaches are instituted without the previous approaches being fully explored. Such inconsistency hardly inspires confidence in the managers or outside. Cutback management requires the full support and participation of the field agencies. Overuse of tactical approaches undermines confidence in the goals as well as in the central policymakers.

Also, when controls change from being a hands-off practice to a command system, to frequent intervention and interference, and finally to

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the centralization of certain functions (such as payment), cutback management seems to become the responsibility of a few. In reality the success of any cutback management depends crucially on the approach proposed being validated by consensus.26

**Removal of Drawbacks**

If fiscal crisis continues to be a major theme also in the future, it is imperative that the drawbacks discussed above are addressed. First, a strategy aimed at minimizing the crisis and at facilitating the pursuit of stabilization should be developed.27 Such a strategy should recognize that economies cannot be procured uniformly from all areas and that reductions have to be specific. Thus, a modular approach that views expenditures in clusters of common features needs to be formulated. For example, transfer payments, particularly debt servicing, tend to be inflexible. On the other hand, subsidies, entitlements, and other social welfare payments, which are primarily money-intensive transactions, have to be addressed at the policy rather than at the payments level. In other areas, such as administrative and social services, transactions tend to be labor intensive and therefore need to be considered for potential reductions in manpower. In development areas, the transactions are likely to be capital intensive, and more emphasis may have to be placed on streamlining procurement and contracting out and reaping the relative price-effect advantage.

Because the frequent changes in approaches are attributed to uncertainty, the areas where uncertainty is large should be targeted at an aggregate level. There is always some degree of uncertainty associated with the projections of revenues, expenditures, amounts of foreign aid, and the extent of financing. Given the interplay of forces between the budget and the economy, and vice versa, it is only appropriate that the central agencies responsible for specifying the economic parameters

26Although recent improvements in the average fiscal situation, which reflect the ongoing adjustment effort at the policy level, are comforting, they should not be considered an incentive for relaxing any resolve to strengthen the public expenditure management system. Recent evidence suggests (see International Monetary Fund, 1992, p. 72) that for the aggregate of developing countries significant changes occurred in central government expenditures in that they declined from an average of 29 percent of GDP in 1981-85 to 27 percent in 1986-88 and to 25 percent thereafter. These declines were largely attributable to cuts in current expenditures, mainly subsidies and wages. There were also a number of countries where expenditure increases continued, thereby contributing to higher deficits.

27The term “strategy” is used here in the managerial sense—to lay out a plan of action. Economists—in particular those firmly rooted in the theory of games—tend to view strategy as the art of outdoing an adversary, knowing that the adversary is trying to do the same. See, for example, Dixit and Nalebuff (1991).
should also reveal and clarify the extent of uncertainty implicit in the projections. Such an indication would enable the spending agencies to assess the uncertainty associated with economic forecasts and to internalize part of that uncertainty by providing a contingency reserve in their own expenditure plans. This effort needs to be complemented by a similar effort at a program level. Each major program of expenditure has its own internal dynamics that are mostly known and therefore quantified, but if detailed information is not available, it is presumed. If the various components of a decision package are arranged in terms of those known or presumed, the extent of the “unclear” factors affecting the degree of uncertainty would be known. This procedure, illustrated in Table 5, can be carried out at various levels of program aggregation, and the profile of expenditures of the agency as a whole would indicate the extent to which the projections of outlays are likely to be sustainable. The analyses would also indicate those programs that are more affected by external factors, and those that are relatively constant.

Table 5. Uncertainty Matrix: An Illustration of Elementary Education

<table>
<thead>
<tr>
<th>Groups of Factors</th>
<th>Factors Affecting Expenditure Estimates and Outcome</th>
</tr>
</thead>
<tbody>
<tr>
<td>Known</td>
<td>Internal dynamics: Improved teacher/pupil ratio</td>
</tr>
<tr>
<td></td>
<td>Replacement of obsolete equipment</td>
</tr>
<tr>
<td></td>
<td>Employment of substitute teachers</td>
</tr>
<tr>
<td></td>
<td>Improved nutrition program for pupils</td>
</tr>
<tr>
<td>Presumed</td>
<td>Internal reorganization to improve teacher/pupil ratio</td>
</tr>
<tr>
<td></td>
<td>Selective redeployment of equipment</td>
</tr>
<tr>
<td>Unclear</td>
<td>Possible influx of refugees from contiguous countries</td>
</tr>
<tr>
<td></td>
<td>Introduction of new syllabuses and standards</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Factors Affecting Expenditure Estimates and Outcome</th>
</tr>
</thead>
<tbody>
<tr>
<td>Changes in syllabus</td>
</tr>
<tr>
<td>Community pressure for improved quality of services</td>
</tr>
<tr>
<td>Competition from private educational institutions</td>
</tr>
<tr>
<td>Prices of inputs—books, stationery, etc.</td>
</tr>
<tr>
<td>Shift of pupils to and from private sector institutions</td>
</tr>
<tr>
<td>Contracts for provision of midday meal program</td>
</tr>
<tr>
<td>Contracts for additional construction</td>
</tr>
</tbody>
</table>
This type of analysis, while clarifying the causation and outcome process, also helps in considering solutions in terms of their relative impact on the outcome, which will also be helpful in determining the contingency amount. Any approach drawn from this methodology cannot be unilaterally determined by the central agencies, but needs to be jointly undertaken in consultation with the spending agencies.

The central agencies, as leaders of cutback management and as agencies responsible for macroeconomic management, must demonstrate that the strategy proposed is the only viable one and that it is superior to any alternatives. Deep-rooted structural problems cannot be either wished away or resolved through ad hoc approaches that lack conviction.