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Cash Planning and Management

As an integral element of public expenditure management, governments need to develop cash planning and management to keep within budgeted expenditure in cash terms; to prevent unanticipated borrowing that might disrupt monetary policies; and to help identify the need for in-year remedial fiscal action. Variations in in-year actual versus planned patterns of expenditure are not without cost. Even if the total limit on borrowing were not exceeded over a fiscal year, higher-than-planned expenditures within a short period may lead to a surge in borrowing and can disrupt the achievement of monetary policy objectives.

The ability to adjust central government spending, both in the *timing* as well as the *amount*, is of strategic importance in any budget system. Careful financial planning and efficient in-year management of budget delivery are essential, but both planning and management will work well only if the budget information systems are comprehensive, timely, accurate, and reliable—and if all the departments involved, both inside and outside the ministry of finance, cooperate closely. These conditions are rarely fulfilled in developing countries, thus making monitoring of the fiscal program difficult and cash management more challenging. This section will outline the main cash planning requirements for ensuring that expenditures are smoothly financed throughout the year and that overall fiscal targets are met.

The main questions are:

- What are the essential features of cash planning?
- Who is responsible for preparing and monitoring the cash plan?
- What are the main constraints that disrupt smooth financing of expenditure plans and how can these be overcome?

What are the essential features of cash planning?

Cash planning has three main objectives: (1) to ensure that expenditures are smoothly financed during the year, so as to minimize borrowing costs; (2) to enable the initial budget policy targets, especially the surplus or deficit,

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to be met; and (3) to contribute to the smooth implementation of both fiscal and monetary policy. An effective cash planning and management system should:

- recognize the time value and the opportunity cost of cash;
- enable line ministries to plan expenditure effectively;
- be forward-looking—anticipating macroeconomic developments while accommodating significant economic changes and minimizing the adverse effects on budget execution;
- be responsive to the cash needs of line ministries;
- be comprehensive, covering all inflows of cash resources; and
- plan for the liquidation of both short- and long-term cash liabilities.

Even if a budget is realistic in the sense of having well-prepared and objective aggregate revenue and expenditure estimates, this does not mean that budget execution will be smooth. Timing problems can be expected between payments coming due and the availability of the cash necessary to discharge them.

Ideally, a cash plan for central government expenditures should include, for the month ahead, a daily forecast of cash outflows (i.e., mainly expenditures) and cash inflows (receipts from tax and nontax revenues and also from borrowing, including issues of government securities as well as other external and domestic borrowing).[35]

But some such daily systems found in developing countries are essentially misdirected and represent "emergency" cash budget regimes that pay out tomorrow what flowed in today. Where such cash planning systems do exist, they are rudimentary, *dirigiste,* and unresponsive in practice, to unanticipated shortfalls in revenues or borrowings. They have many drawbacks. While they can be broadly effective in limiting cash payments to available cash inflows, they often do so at considerable cost to the effective allocation of resources (sudden cuts in cash provision relative to budget appropriation) and to the timely delivery of services (because there is insufficient information on the likely flow of cash available to enable managers in line ministries to plan their delivery of services). Moreover, such systems are often associated with a buildup of payment arrears. Governments need to pursue a more sophisticated approach to cash management.

Developing countries should aim to deliver their budget by adopting a monthly cash plan, based on projected aggregate cash inflows and limits on cash outflows. The principal components should be as follows:

- The starting point should be an *annual cash plan,* prepared in advance of the fiscal year, setting out projected cash inflows and cash outflows month by month.
- Past patterns can help establish likely month-to-month inflows of tax and nontax revenue receipts. The likely timing of external borrowing is also often partly known in advance, so that total inflows can be projected. Past patterns of expenditures can usually be a guide to the cash outflows each month.

[35]Except where state expenditures are very large, the macroeconomic focus on financial management is on the central government level. State and local governments, however, have the same incentives to manage their finances efficiently by following the same cash planning and management practices recommended here (see B. Potter in T. Ter-Minassian, *Fiscal Federalism in Theory and Practice* (Washington: International Monetary Fund, 1997).

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- However, factors such as irregular capital expenditure patterns, variations in the timing of donor grant receipts (whether for specific capital projects or general budgetary support), and the precise timing of new borrowing (which may have to await a conjunction of beneficial market conditions) are likely to mean variation from year to year in monthly patterns of cash inflows and outflows.
- When it appears from the initial projections that there might not be enough cash available within a given month to cover expenditures falling due, a government can delay the planned commitment of the expenditure; speed up the collection of revenue; or borrow. The choice among the three options will depend on feasibility and costs.

Once the annual plan is established, it should become the basis for rolling three-month projections, and within that projection an *operational cash management plan* for the month ahead. These should operate as follows:

- The three-month projections and monthly plans need to be revised each month on a rolling basis in the light of actual revenues and expenditures (and often experience in borrowing domestically and externally).
- When the three-month rolling projections indicate there may not be enough cash available within one or more of the three forward months to cover expenditures, action can be taken to delay expenditure commitments, accelerate revenue collection, or borrow, with the choice depending on feasibility, costs, and borrowing constraints.
- The operational cash management plan for central government expenditure for the month ahead should, ideally, include a daily (or at least weekly) forecast of cash outflows and inflows. This cash management plan should be prepared and updated at least every week.

The operational monthly cash management plan is often translated into a monthly cash limit set on some, or all, expenditures of individual ministries or spending agencies. In some instances—and not just in post-chaos situations or as a temporary means of reimposing control—there can be cash limits on economic categories of spending or even individual line items. Some industrial countries have put limits on certain subaggregates like "running costs"—wages, utilities, and residence costs for individual spending agencies. These cash limits are often seen as being the way in which a "hard" budget constraint operates. But, as noted, as a means of *expenditure* rather than *cash* control, cash plans on their own are ineffective when there is no separate control over commitments, and often lead to a buildup of (unpaid) liabilities.

The cash plan assists in determining the realism of fiscal criteria or benchmarks for each month/quarter. It can engender a sense of confidence among the authorities that they have cash control and give them greater confidence that other important fiscal and monetary targets (e.g., credit ceilings) will be respected. Thus, to be viable, the targets included in an adjustment program should always be supported by a cash plan that is updated to take into account the latest available information on revenues collected, other receipts (including borrowing), and expenditure committed and paid.

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The continuous monthly updating of the cash plan should help in ensuring that the initial budget targets will be met. When it is clear from the latest forecast available that targets may not be met in the future or at the end of the year, measures will have to be taken to constrain expenditure or to increase revenues. The cash plan can contribute to the decisions on the size, type, and targeting of the measures required. (See the previous section for a discussion of such measures.)

Who is responsible for preparing and monitoring the cash plan?

As noted, in principle, within the monthly cash management plan for the central government budget, the figures should be *prepared and updated at least every week* by the treasury or cash management department of the ministry of finance, as the government's financial manager. This often does not occur in developing countries—although sometimes the central bank may undertake all or part of such an exercise. The budget advisor should encourage the creation of some kind of cash management unit within the ministry of finance (typically as one of the components of the treasury department) to prepare and maintain cash plans and monitor outcomes.

To monitor delivery of the cash budget, the treasury department must get all the necessary information as quickly as possible from all the departments involved—not only from the ministry of finance departments, (e.g., the tax and customs administration and budget department) but also from the planning ministry, the line ministries, the spending agencies, and the central bank. This task is often not adequately carried out because, among other reasons, the reporting system is not fully networked. As a first step, before more lasting comprehensive reforms are put in place, a provisional monitoring system may have to be introduced.

For this purpose, one approach is to set up a small team, headed by someone with enough authority to obtain information from the various departments. For example, in some francophone African countries, the *Direction de la Prévision* or *Cabinet du Ministre des Finances* are already operational in coordinating budget execution and cash planning. In Latin American countries, the unit in charge of monitoring is either in the central bank or within the ministry of finance under the supervision of its minister. The functions of this unit should be to:

- prepare a monthly cash plan;
- keep an inventory of the existing in-year fiscal reports, on the revenue side of the budget as well as on the expenditure side, and propose the preparation of new reports if those existing do not fulfill their requirements;
- centralize the outturn revenue and expenditure information in "flash reports," summarizing main developments with minimum lags;
- analyze the reports, and update cash forecasts on the basis of these flash reports;

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- make proposals for adjusting cash flows if the need arises; and
- keep the central bank fully informed (because government operations can have important consequences for bank liquidity).

What are the main constraints that disrupt smooth financing of expenditure plans?

In OECD countries, cash plans are typically prepared within the ministry of finance for year ($t + 1$) on the basis of estimated revenue and expenditure profiles for year ($t - 1$), and the information being collected, as the budget year (t) unfolds, from the tax and customs administrations and from the treasury department or line ministries (at least for large expenditure items). In many industrial countries with well-developed capital markets, the ministry of finance can readily borrow the amount necessary to meet both temporary shortfalls, when timing problems occur, and to finance the deficits. When there are temporary surpluses, these can be invested in the money markets, even overnight, to earn a return.

In contrast, many non-OECD countries do not have access to a well-functioning capital market. Either the ministry of finance cannot borrow easily, or it is not permitted to borrow from the central bank[36] or the money market to finance short-term shortages of cash. In these cases, cash plans have a more fundamental importance. Unanticipated expenditures cannot simply be passed on to the ministry of finance for payment. The cash expenditure forecast for a given month then becomes a real limit that should not be overshot.

There are five prerequisites for good cash management: (1) a realistic budget, (2) clear procedures for the release of appropriations, (3) strict observance of the budget execution rules, (4) experienced and skilled staff to prepare and monitor the cash plans, and (5) clear borrowing rules.

What are the typical questions?

Is the budget realistic?

A good cash plan cannot compensate for an unrealistic budget. Indeed, the cash plan—and any monthly cash limits typically derived from it—must not become substitutes for the budget itself. The budget preparation procedure is the prioritization process within specific financial constraints, and this prioritization process should be fully in place before expenditure is broken down into monthly cash limits.

Yet the reverse is often the experience—for example, in a number of economies in transition and some African countries. Decisions about expenditure priorities are not adequately discussed or settled at budget preparation time by the line ministries and the ministry of finance, or the budget avoids hard decisions to appease the parliament. Then, it is the ministry of finance

[36]For example, under a currency board arrangement.

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that has to exercise the real prioritization and expenditure cuts through cash allocations. This can strain budget execution beyond its breaking point.

Are the procedures for the release of appropriations adequate?

The way appropriations are released is also important because it defines how much may be spent in a given month or quarter. Three systems are possible, depending on the legal framework (usually the organic budget law), and/or the country's situation.

In most *industrial countries,* budgetary appropriations are available to the spending ministries as soon as the budget is approved. The spending ministries are free to commit their expenditures and issue payment orders when they wish, and the treasury will borrow on the market if necessary. This is possible because the profile of expenditure is relatively stable, and because the government can borrow easily from a well-established capital market.

In some *less developed countries,* fixed amounts are released for a specific period of time (month or quarter)—for example, ⅟12 of appropriations is released at the beginning of each month. If the situation does not change, ⅟12 of the appropriations will be released every month. If, however, the situation worsens, the release of appropriations can be slowed down.

In many *developing countries,* particularly Commonwealth countries, formal warrants can be issued by the ministry of finance to spending agencies that control specific categories of spending, and budgetary allocations can be made available only in part, again for various periods of time—monthly, quarterly, or even by special request. This allows fine-tuning of the release of appropriations.

In all cases, when the appropriations are released, the line ministry or spending agency has authorization to commit the expenditure. But additional controls on cash releases (e.g., monthly cash limits) can be an effective method of controlling the rate at which appropriations are used. In a very few countries with severe cash shortages, commitments and payments have to be almost simultaneous, because suppliers will not accept an order nor deliver unless payment is assured.

Are there adequate experienced and skilled staff to carry out this task?

The preparation and the maintenance of cash plans require some financial skill. Officials have to analyze the available information, make judgments as to its reliability, and, based on this information and their past experience, make realistic projections. In particular, they have to regulate the flow of commitments with all the instruments available to make sure the cash necessary to cover the expenditure, when due, will be available and thus avoid payment arrears. This is not easy—depending on the type of expenditure, there may be a lag of months, or only a few days, between the commitment stage of the expenditure and the payment.

Another important task is to liaise with the central bank to ensure that financing requirements can be met and will not cause adverse monetary

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repercussions. The scope for borrowing from different sources, and the terms of such borrowing, will also be matters of concern, since the future debt service implications of present borrowing will also have to be factored into spending plans. Officials executing the budget should possess adequate skills and technical capacity. Sometimes fiscal economists and general budget advisors need to identify where training is necessary.

Are there clear borrowing rules?

Government borrowing quickly leads into wider questions of monetary policy. In this publication, only two aspects are considered: are the institutional arrangements sufficiently robust to permit effective cash planning for government and to facilitate short-term borrowing?

As noted earlier, it is all too common for the government's monies to be held on deposit in a number of different bank accounts—some in the central bank and some in commercial banks. Ideally, the government should have all its resources either in a single account—such as the Treasury Single Account as established in a number of transition economies—or in accounts that can be consolidated every night. If a consolidated balance rather than some subset of bank accounts can be drawn upon, that may prevent the government from borrowing when it does not need to do so. (There are many occasions when government deposits in a commercial bank are used by that bank to purchase treasury bill issues. The government is literally borrowing its own money and paying interest for the privilege.)

Thus, all government deposits in the banking system should be consolidated overnight so as to ensure that government borrowing requirements are minimized. This can be more problematic than first appears—common difficulties include:

- hypothecated funds such as health, road, and even social security funds may be established by separate legislation. The money in these funds is often not available to the government, even on a short-term borrowing basis; privatization funds have often been established on this same basis in some East European and other transition economies;
- donors may regard money committed to a government and held on deposit in the central or a commercial bank, but not yet disbursed, as theirs (the donors)—not the government's; and
- there may be a lack of transparency between monetary and fiscal instruments; thus large government deposits in the commercial banking sector may be serving a secondary monetary role (e.g., providing liquidity needs for the banking system).

In this area, the basic principles are that:

- government money belongs to the government;
- money in different accounts is usually fungible and should be consolidated;
- the government has a right and a duty to make effective use of its own funds; and

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- the government should earn a market rate of interest on its deposits, while paying overdraft rates on its borrowing and a negotiated service fee to banks that conduct transactions for it.

Where the government is budgeting for a deficit, planning for the financing of that deficit is a major task—outside the scope of this publication. Governments need to have an annual borrowing strategy implemented in close coordination with the central bank and in line with monetary policy. But for efficient cash management, within that borrowing strategy, the government also needs a mechanism for dealing with unanticipated day-to-day or week-to-week cash shortfalls in the least-cost way, and without unnecessary disruption to the delivery of public services.

How then is a temporary shortfall to be met? First, great care should be taken in attributing an unanticipated borrowing need to temporary causes. Poor revenue performance or sudden increases in expenditure above plan are very often *not* temporary factors; rather, any temporary causes should be tracked down, and the authorities must be convinced that this cause will unwind within a short interval. Only then will any associated borrowing be genuinely temporary (and readily repaid).

Once it is clear that the country is facing a temporary cash shortfall, there may be scope for postponing some payments. But this can damage the government's financial credibility and is normally best avoided. As noted earlier, if the government does not hold all its deposits in a single account, the scope for financing a temporary cash shortfall on the main treasury account by borrowing from other government funds should always be investigated. Some countries maintain a separate "stabilization fund," into which windfalls, donations, etc., are directed, that can be used in such circumstances. This is (or should be) the least-cost option in terms of interest forgone, being less than the cost of an overdraft facility.

Finally, many countries have an automatic overdraft facility (sometimes called a "ways and means advance" in Commonwealth countries) at the central bank. Clear rules must govern the use of such overdraft facilities:

- the size of the overdraft facility should be limited (preferably in statute);
- the duration of any overdraft should be limited (again preferably in statute);
- to avoid monetization of the deficit, any short-term borrowing that is not quickly repaid (through the arrival of delayed inflows into the treasury account) should be transformed into a treasury bill or bond issue and sold (ideally to the nonbank public) by the central bank; and
- the cost of the overdraft facility should be transparent and be paid by the ministry of finance.

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