



Public expenditure reviews: progress and potential

How can the Bank use public expenditure reviews to assist its clients in ensuring that the best use is made of a country's resources?

The World Bank routinely undertakes economic and sector work—including economic memorandums, poverty assessments, and reports on specific topics such as decentralization and the environment. A public expenditure review analyzes public sector issues in general and the public budget in particular. This note looks at the role of public expenditure reviews in advancing the development agenda in client countries, examines experiences with these reviews, and sets out a three-pronged approach for improving these reviews.

Actual and potential roles

Few developing countries take a comprehensive and systematic approach to their budget process. Public resource allocation decisions rarely reflect sound economic policy, and fiscally irresponsible subsidies often account for a significant part of the public budget. In such cases a Bank-supported review of public spending often provides the only objective analysis of a country's public spending issues. Moreover, the Bank cares about its lending program—and because its lending supplements public spending in the borrower country, a public expenditure review provides valuable input to the country assistance strategy.

A public expenditure review can be used to assess the Bank's overall lending program. Funds are fungible, so Bank projects may end up financing undesirable components of a country's public spending program. Indeed, aid intended for social

and economic sectors often merely substitutes for spending that recipient governments would have undertaken anyway.

Public expenditure reviews will likely become more important as the Bank implements the Comprehensive Development Framework and moves toward budget support operations (such as the proposed public expenditure reform loans). For these lending instruments, a public expenditure review would be the most important loan appraisal document.

What do we know?

Public expenditure reviews typically analyze and project tax revenue, determine the level and composition of public spending, assess intersectoral and intrasectoral allocations (agriculture, education, health, roads), and review financial and nonfinancial public enterprises, the structure of governance, and the functioning of public institutions.

In the past 10 years studies of public expenditure reviews have suggested that, although their coverage has been comprehensive, the quality of analysis has been uneven. Findings include:

- Most public expenditure reviews define the public sector deficit as the central government deficit. The deficit of the consolidated general government (including contingent liabilities), a more relevant macroeconomic variable, has been ignored.
- Most public expenditure reviews do not examine the rationale for public inter-

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vention. Basic public economics concepts of market failure and public goods and externalities are seldom used to analyze the efficiency of the public budget allocation.

- Most public expenditure reviews do not integrate capital and recurrent expenditures, and so sidestep the issue of future recurrent cost implications of the capital budget. More important, this introduces uncertainty regarding the sustainability of policies and projects. Such a segmented analysis reinforces capital-led budgeting, which distorts public spending in favor of capital spending.
- Less than a quarter of recent public expenditure reviews adequately focused on institutional issues such as budget management or incentives in the public sector. Attention was restricted to incomplete (and often superficial) economic analysis of public expenditures.

Making better reviews

Public expenditure reviews can be made more effective through a three-pronged strategy. First, a few basic questions should be asked before undertaking a review. Second, attention should be paid to the process of the review. Third, reviewers should adopt a framework that guides policy analysis and focuses on building institutions.

Ask questions

Key stakeholders—including the government, the Bank’s country team, other donors, and nongovernmental organizations (NGOs)—need to be convinced that a review of public expenditures will add value in understanding budget problems and proposing solutions. Thus a few basic questions should be asked before initiating a public expenditure review. Why perform a review now? What will it accomplish? Who should participate in the review?

A public expenditure review is justified if a client country asks the Bank for help in evaluating its budget. Based on need, the review could coincide with the annual budget cycle and be a vital input to the budget process. Alternatively, it could address medium- to long-term strategic issues—such as reform of budget and financial management, devel-

opment of performance indicators, and so on. A public expenditure review could also be justified if it is timed to provide input to the Bank’s country assistance strategy. Finally, a public expenditure review could be important for donors before they pledge aid.

If a public expenditure review was done in the past, what impact did it have? Bank country teams should evaluate the impact of previous public expenditure reviews before commissioning new ones. Most public expenditure reviews recapitulate the recommendations made in earlier reports, but very few discuss whether the recommendations made were actually implemented.

Focus on process

The next step is to focus on the process of the review. How can country ownership be ensured? What topics should be covered? What should be done when data are poor? How should the findings of the report be disseminated? How can we build our clients’ capacity to undertake public expenditure reviews?

Reform proposals in a public expenditure review cannot be imposed on the client country. Fostering the participation of those who wield power in politics and in the civil service will likely enhance the chances for success of the proposed reforms. Follow-up training or seminars on public expenditure issues can be helpful in breaking any impasse.

Size and coverage are important issues for public expenditure reviews. A short, focused report is difficult but desirable. The most relevant and pressing public sector issues—even if unconventional or controversial (for example, military spending)—should be given priority. Next, topics covered in past public expenditure reviews and other reports (including those done by other agencies) should be reviewed. In deciding which sectors to cover in detail, a good rule of thumb is to include those—agriculture, education, health, infrastructure—that account for the bulk of the budget. Finally, coverage depends on the resources—the Bank’s as well as those of other donors—available for the review.

Doing a public expenditure review is much more difficult when the quantity or quality of data are poor. A proper evalua-

tion of public expenditures requires focusing on outputs and outcomes rather than inputs. But in most developing countries data are sketchy and incomplete. Few developing countries have well-functioning public accounts systems, and information on actual spending (as opposed to the budgeted amount) is available only after a considerable lag. Inadequate and outdated data preclude a rigorous analysis of links between public spending and outputs and outcomes.

In most cases a reasonable amount of information on intermediate inputs is available. This information should be supplemented with information obtained from a few onsite project inspections. When making judgments based on such anecdotal evidence, due qualifications need to be made. One possible solution to the data scarcity problem is to undertake field surveys to find out which public resources actually reach the intended facilities and beneficiaries. But this approach has limitations: because of its limited coverage, it cannot be a substitute for the country's public accounts system.

Once public expenditure reviews are approved for publication, the public officials (and private participants) who spent considerable time and energy providing information to the public expenditure review team often never hear again about the review. To make the public expenditure review process complete, informative, and transparent, an effective dissemination strategy is needed—along with a budget to support it. The main findings of public expenditure reviews—if they can be made public—should be shared with all stakeholders if possible.

Finally, the Bank cannot continue to have client governments merely provide information for public expenditure reviews. Governments need to do their own public sector analysis and the Bank needs to help them do it. In cases where there is little or no capacity to undertake such analysis, the wait will be long and the work likely difficult. In other cases a bit of knowledge sharing, supplemented with technical assistance, could do the job. Encouraged by the Bank, a few member countries—Argentina, Ghana, Vietnam—have conducted their own public

expenditure reviews. Preliminary evidence indicates that this approach has worked well.

Develop a framework

The primary objective of analyzing public expenditures in a client country should be to help establish a transparent budget mechanism that allocates, executes, and manages public resources to promote private sector-led growth and reduce poverty. This analysis should be based on two complementary themes: getting policies right and building well-functioning institutions.

The best practice in public sector budget reform starts by identifying three areas where governments can improve their performance: macroeconomic discipline, strategic priority setting, and efficient public service delivery. Reforms in these areas involve principles of political economy, public economics, budgetary and financial management, and other institutional and regulatory reforms. These principles, along with lessons of experience from public expenditure reviews, provide a framework for public expenditure analysis.

To ensure macroeconomic stability, public spending should be kept at a level consistent with the country's long-run financing ability. Where appropriate, the cost of public services should be recovered by levying user charges.

Strategic priority setting requires a technocratic approach that gives policymakers the information they need—such as the tradeoffs between competing claims on the budget—to make informed decisions. Expenditures should first be evaluated in terms of the rationale for public intervention in a particular activity. This involves asking two questions. First, if market-generated allocation of resources leads to efficiency losses, would public sector intervention enhance efficiency? Second, could the public sector activity be justified because it contributes to a more desirable distribution of income? If the answer to these questions is no, the public sector activity should be carefully reviewed or, failing adequate justification, be cut.

In practice there is no optimal allocation of public resources. Beyond the core public sector activities, the design and imple-

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mentation of public expenditure priorities require detailed assessment and careful tailoring country by country. A comparison of expected outputs and outcomes resulting from different budgetary allocations could provide useful tradeoffs.

While a balanced aggregate sectoral allocation of resources is necessary, it is equally important that there are no egregious biases in the composition of intrasectoral expenditures. Governments in developing countries tend to undertake new (mostly donor-funded) investment projects without adequately considering their future stream of recurrent costs. The underfunding of recurrent expenses—mainly nonwage operations and maintenance—leads to inefficient service provision and the often premature death of public assets. In other cases a perpetually rising wage bill crowds out nonwage operations and maintenance and even investment spending to the point of seriously reducing the effectiveness of public programs. An integrated analysis of capital and recurrent expenditures serves as a check on distortionary and ineffective intrasectoral expenditure composition.

Redefining the role of the state from public provider to regulator in certain infrastructure areas (such as electricity, telecommunications) requires expanding the opportunity and capacity of the private sector. Moreover, improvements in property rights and private contracts, efficient and impartial regulation, and other public activities are necessary—though not sufficient—for the private sector to serve as the engine of growth.

Having the right budget allocation is essential for meaningful public expenditure reform. But focusing on allocative policies alone will do little unless such policies are efficiently executed and effectively managed. Achieving efficiency in the delivery of public services requires well-functioning institutions—more of an exception than a rule in developing countries.

Public institutions—tax collection agen-

cies, law enforcement agencies, regulatory bodies, accounting and auditing units—lacking proper incentives (low pay, unfair recruitment and promotion) often become a breeding ground for corruption and low morale, eroding the effectiveness of public institutions. The oft-prescribed technocratic approach of capacity building may not be an adequate solution to deep-rooted problems such as lack of incentives and bad governance.

The key to achieving efficient delivery of public services is to reform the incentives in the public sector. Examples of such reforms—initiated by New Zealand and emulated by other industrial countries—include performance-based budgeting and client surveys. But reforming public institutions takes time and depends on a country's initial conditions—including capacity and political readiness.

Further reading

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