Analysing Constraints: The Budgetary Nexus

(With Special Reference to the Least Developed Countries Like Nepal)

- ***Ram Prasad Ghimire***[*]

1. Introduction

Budget is an important policy instrument through which people's interests, desires and demands are transformed into financial terms. Wildavsky defines budgeting as "Transforming financial resources into human purposes". He regards budget as an attempt to allocate financial resources through political processes to serve differing human purposes (Wildavsky 1975: p. 5). Since it encompasses the political processes, it reflects the value of politics. Thus budgeting is not only a technical document but it is also a short-term manifesto of the state. Similarly, it is an incentive and engine of economic growth. Likewise, it is a tool to maintain fiscal discipline and a technique of economic redistribution.

Budgets are the links between medium and perspective plans. Long-term goals of a country are carried into effect with the help of series of budgets. Thus budgets direct the resources towards fulfilling long-term public goals.

Budgeting involves assessment of past efforts and achievements and prediction for the future; break-down of long-term objectives and strategies into short-term meaningful targets and objectives; mobilization of resources; resource allocation to various programs, projects or activities and treasury management and control.

There are three basic functions of budgeting: resource allocation; resource mobilization and utilization; and resource use accounting and evaluation. These functions are performed so as to attain aggregate fiscal discipline and, allocative and operational efficiency. For this, budgeting needs to

[*] Under Secretary, Ministry of General Administration.

embrace objectivity, enhance predictability, foster transparency, promote accountability and ensure effective control.

The concept of budgeting was developed to address the problem of resource constraints that human wants and demands often exceed the resource availability. However, budgeting itself is constrained by a number of factors like soaring public expenditure, low revenue mobilization, lack of institutional capability, multiple, diverse and sometimes conflicting objectives of budgets, poor financial management and situational constraints. Such constraints are more evident to the resource stricken poor least developed countries (LDCs).

Against this background the purpose of this article is to conduct a rigorous analysis on budgetary constraints of the least developed countries. It focuses on both substantive as well as spatial and situational constraints. It also discusses how the key actors of budgeting compete with each other to incorporate and maximize their 'stakes' through budgetary processes. It enumerates major budgetary problems of the least developed countries that are common to most of the developing countries with low per capita income and poor resource-base. It highlights on Nepal's case and finally proposes the key measures to address and mitigate the problems and constraints.

2. Changing Orientation: Shifting the Focus

In the past when governments had a limited array of activities and ample funds available to finance them, budgeting was simply a demand supply process. It was a disjointed activity rarely having policy implications. It is only in the later decades of nineteenth century when systematic budgeting approach and tools emerged. With change in the scope of government and paradigm shift in public management and the introduction of new management techniques embedded with the prevailing socio-economic context, various budgeting orientations and approaches came into existence. These can be categorised into three broad categories as:

a) **Control Orientation (1920-1935):** This approach is mainly concerned with the centralised financial control of government. This is also sometimes called regulatory budgeting. This line-item budgeting has its primary focus on traditional functions of public administration, i.e. probity and propriety. In this system, government activities are broken down into several line items to allocate budget accordingly. It facilitates comparison of estimates with actual resource utilisation in each and every item.

   However, the regulatory and control functions of line item budgeting are seen diluted in practice by corruption, incompetence and excessive political interference.

b) **Management Orientation (1935-1960):** This approach is basically concerned with the activities and performance rather than resource utilisation and control. Performance budgeting falls within this category. Unlike the line-item budgeting, it considers outputs as well as the inputs. Performance budgeting is essentially managerial in nature that exerts emphasis on efficiency and results.

However, it does not provide sufficient room for popular participation though it gives much emphasis on efficiency and cost effectiveness. Besides, it is subjective because the description of budgetary programs seems to have been primarily designed to convince legislators rather than proposing a concrete way of implementing them. Moreover, performance budgeting has a very little to do with budgetary reforms and change management.

c) **Planning Orientation (1960 to date):** This school of thought tries to integrate budgeting with medium and long-term planning and national policies. A number of approaches have been developed under this category.

i) Planning Programming Budgeting System (1961-1970): PPBS concentrates on effectiveness of budgeting. It classifies the budget in terms of programs as a technique of attaining public policy objectives. As a planning tool it defines various choices of programs along with the feasible available alternatives to these choices. It also proposes the best possible way of implementing the selected programs. It is a systems approach to budgeting.

It is analytical in nature and much more sophisticated than the previous approaches in techniques. PPBS identifies the problems, analyses various policy options to address it and puts forward the best possible and practical alternatives to the decision makers. However, it also has a number of limitations.

Firstly, it cannot make value judgements because policy options related to value choices can be settled only through political processes, not through budgetary analysis. Secondly, it is very difficult to assess the effectiveness of all programs, which are many in number, and no single indicator is applicable to quantify the effectiveness of various programs that are diverse in nature. Similarly, it is not feasible and useful to the LDCs since it is complex and too expensive. LDCs also have a very poor management information system. Likewise, these countries barely have a sustainable political commitment to implement it. Moreover, this sophisticated approach has a centralising bias because it is like a policy-making mystique to the common people.

ii) Management by Objective (1970-1976): It is a participatory management technique in which the members set organisational goals and objectives themselves in the light of desired outcomes. They evaluate their results themselves. This is a sort of self-management technique that contributes in raising the level of policy compliance among the policy actors. There is a low chance of communication lapse. It fosters individual commitment to organisational goals and objectives that promotes self-initiation and innovation.

MBO may be viewed as a more flexible budgeting technique. It emphasises on productivity, self-actualisation and greater effectiveness. However, it hardly helps in identifying and evaluating policy alternatives. It is mainly concerned with the organisational effectiveness rather than considering broader policy options of the government.

iii) Zero-based Budgeting (1976-1980): It is seen as a policy response to the unnecessary and unproductive persistence and growth of any organisation or a program. 'Sunset laws' provide a self-enforcing mechanism to mitigate such problems. Zero-based budgeting is also useful to bring major changes in financial management of an organisation or a country. Extensive reallocation of resources from a particular sector to other sector/s is possible in this system. Each programme is viewed as a part of 'decision package' and each 'decision package' is evaluated in totality to consider for further funding.

However, zero-based budgeting does not help much for the long-term investment programs, which have indivisible results to a great extent. It also involves a lot of duplication works and repetitive calculations and analyses.

iv) Budgeting as Political Management (1981 to date): Budgeting is virtually a political process, which provides values to the policies adopted by the government. The ultimate responsibility and accountability of a budget rests on political authority. Principally bureaucrats and experts are only the aids to political authority. They have only subsidiary role to play in budgeting decisions. Therefore, political acceptability is must for budget formulation and its implementation. It requires legislative approval before it comes into force. Budgeting as a political management opens the existing economic, fiscal and financial reality so as to make the budget more realistic.

There is no disagreement that budgeting is a political management process. But the model as such may not be applicable to other countries, especially the least developed ones as it is practised in the US. Similarly, there is a risk of undermining national interest by the

vested political interest. Such risks are high in the least developed countries having dominant parochial political culture.

Approaches and focus of budgeting kept on changing along with the paradigm shift in public financial management and public management as a whole in the quest of increasing efficiency and effectiveness of budgeting. However, the approaches are not unilinear and the trend differs to the countries since there is a possibility of overlap among these approaches.

3. Following Steps: Preserving the Stakes

Stages of Budgeting

The budgetary processes differ to the political regimes, budgetary approaches adopted to, level of management information system, the extent of financial and other resources available and the degree of predictability. However, in general, a budgeting process undergoes the following stages:

- initiation
- preparation
- submission and approval
- implementation
- audit, evaluation and review

The first stage involves resource forecasting, setting budgetary ceilings and general guidelines and sending call letters to the ministries and the operating agencies/offices as directives to the budgeting for the forthcoming fiscal year. The timing to submit the budget proposal may be elaborated in the law or in the budgeting circulars or guidelines.

The main responsibility for the second stage of budgeting is of the spending ministries and departments. Ministries and departments are supposed to prepare their budget proposals and submit it to the budget office (in most cases to the Ministry of Finance) within a specified time and format set by budgetary regulation or circulars from the budget office. The proposal includes reports on the budgetary performance of a certain specified period of the current fiscal year.

Once estimating revenues and expenditures is undertaken and proposed budget is fully prepared the chief executive or the Finance Minister (it depends on the form of government) submits the proposed budget to the legislature. Usually the legislature has every authority to amend or to send it back to the executive for further clarification or consideration. The proposal is discussed in different legislative committees and ultimately it is approved with or without amendments and is sent to the head of the state for formalisation.

The next stage of budgetary process is implementation. The approved budget consisting governments' short-term plans, policies and strategies is put into action at this stage. At the beginning of this stage, the competent authority sends revenue targets and expenditure authorisation letters to the concerned ministries. Concerned ministries then send a copy of it to the operating offices directly or through departments. Treasury offices are responsible for necessary fund management. They also ensure internal control in budgetary expenditure.

The final stage of the process involves auditing and review. In most of the countries there is an independent audit office to examine consistencies between the programs and objectives and actual budget operations. It examines the accuracy of accounts and also evaluates performance standard through performance audit. The auditing office submits its annual reports to the legislature for review and necessary action.

The Budgetary Process

The budgetary process under scarcity of resources can be described in terms of state centric models of social causation. The least developed countries are characterised by scarcity of resources with the persistent vicious circle of poverty. Thus state-centric models are quite relevant in analysing budgetary process in LDCs under severe financial constraints.

Rational Actor Model seeks to maximise values and solutions in decision making. A rational actor is presumed to have ability and access to all types of information and its analysis. He can evaluate the best possible alternative and he always uses his non-perversive choice. However, Herbert Simon's bounded rational model postulates that the rational actor does not always reach at the best alternative due to inadequate information, time and resources. Thus in practice they adopt 'satisficing' solution to policy problems.

According to the Political Bargaining Model a budget can be treated as an outcome of competition and negotiation among the bureaucratic entities. They compete with each other and hold negotiations to allocate maximum budget to the organisation in which they are attached with. Bureaucrats can influence public policies by the use of their strategic position to use resources at their disposal, and their control over information as well as their political connection and by the use of their expertise.

Organisational Process Model assumes the government, being a huge organisation, has a definite sets of rules and structures with its own procedures. These standard operating procedures solve the routine problems. In case new typical non-routine problems are cropped-up new organisations are created to solve these problems. This model may be more useful for allocating resources to routine recurrent expenditures. But it does

not seem conducive for economic transformation and development and change management.

It is obvious that the key actors of budgeting influence structure and content of a budget in the way they interact with each other. Actors in the budgetary process are either the spenders or the savers. That is why budgeting involves bargaining between the spending agencies and the treasury guardians. On the other hand, the spenders compete with each other to maximize their share of budget. Similarly, all the actors of budgeting strive their best to maximize their stakes through various stages of the budgetary process. These actors perform different roles in order to accomplish their respective goals. The actors can be listed as below:

- legislature and its committees
- cabinet
- auditing office
- planning authority
- ministry of finance/budget office
- line ministries
- treasury offices
- donor community
- local government
- field offices
- civil society
- interest groups

The budgeting process and its stages vary to the countries. In China fiscal year starts without an approved budget. In Indonesia and Saudi Arabia development budgets do not lapse at the end of fiscal year. In the UK supplementary budget is submitted thrice during a year. Some countries take quite a long time for budget formulation and approval. For example in the US it takes about 16 months for the preparation and approval of a budget whereas many countries complete this process within 6-9 months.

Despite the logical sequence of formal steps of budgeting, most of the LDCs are seen to have adopted adhoc approaches and steps in formulating annual budgets. In some cases informal power structure play dominant role than the formal legitimate process. Formal process in most of the cases is based on bottom-up approach. However, the operating agencies/ offices do not have much knowledge and information on the nexus of budgeting. So they just compile the incremental budget estimates. Thus they can hardly have meaningful contribution in dealing with budgetary constraints. Moreover, most of the populist programmes do not come through this channel. It is realised that in practice Political Bargaining Model has been playing dominant role in most of the LDCs' budgetary process though Organisational Process Model has been applied in connection with most of

the recurrent expenditure estimates. If we look at the equity side, we find that those who are well to do and well organised have dominant saying in the budget than the poor and unorganised people. On the whole the budgetary process has a very little impact in dealing with the budgetary problems and constraints of LDCs since the financial position and state of development is not significantly improved in most of these countries.

4. Dealing with the Constraints: Major Problems, Small Steps

An Overview

Budgeting has to encounter with the scarcity of resources and complexity of issues. Managing public expenditure in the resource stricken least developed countries is still a daunting task. Revenue base is very low in these countries. Paradoxically they have very high aspirations and expectations. A large number of people in the LDCs are deprived of even the basics of human life. With a limited capacity of resource mobilisation these countries are heavily dependent on external assistance and other forms of capital inflows. These countries have an alarming debt burden that are also marred by high corruption.

Realistic and meaningful budgeting needs sound financial management system. It requires adequate knowledge, expertise and information base. However, most of the LDCs do not have integrated financial information system.

Budgets are also the statements about future. Future is uncertain and the uncertainty is much more prevalent in LDCs since their socio-economic and political condition is highly unstable. In such a situation budgeting requires expertise and professionalism, which LDCs lack.

Many countries are obliged to pay certain amounts or bound to finance certain activities due to their prior commitments and agreements. Law often backs such payments. LDCs have huge amount of such 'uncontrollable'. These items are referred as 'uncontrollable' because they cannot be easily changed. Such items are debt servicing, contractual payments, counterpart funds and entitlements. They are not absolutely uncontrollable but they cannot be changed easily without amending laws or without renegotiations with the concerned parties. There is a high risk of loosing political image and credibility if such items are bluntly changed.

Even the so-called 'controllable' cannot be easily changed. Most of the recurrent expenditures, though there is no contractual liability or obligation and legal compulsion, are also not fully controllable. A government cannot deny paying salary and benefits to its employees. It also cannot easily eliminate minimum general operating expenses, as it cannot repudiate

external debt liabilities in normal situation. Therefore, there is no clear-cut demarcation between controllable and uncontrollable but they can be helpful while ranking the priorities to different expenditure items.

Budgeting Practices in the Least Developed Countries

There is often no explicit link between medium-term plan and annual budgets in most of LDCs. Budgets are rarely linked with the results or goal achievement. Mostly the percentage of expenditure spent on particular item or items determines efficiency.

Budget requests from the operating offices and line ministries are deliberately inflated in expectation of cuts. Demands often exceed the resource availability. On the other hand, budget authorities hardly look on the rationality of program and funding while cutting the size of expenditure in particular item to fit it with their revenue estimates, and other sources of financing.

Political authorities and representatives are more concentrated on their respective constituencies. Budget approval is often mechanistic. No meaningful discussion takes place. Attention is focused on how to get the proposal approved rather than how to make it better. Alternatives are rarely entertained for serious discussion.

A large number of projects are proposed every year, which is beyond their capacity to implement in terms of institutional capacity and resource availability. Feasibility study is often not carried out to the project funded by the governments' internal resources.

Financial management is weak in these countries. Foreign aid disbursement especially the grant portion is very low due to low absorptive capacity. Budget release is too slow. The governments are often unable to provide counterpart funds in time. Since there is no standard time-bound operating procedure with clear and direct accountability assigned with, administrative discretion plays vital role. Initial policy statements and goals are sometimes distorted and even displaced due to frequent transfer of funds from one budget head to another. In some countries law does not allow budget transfer but bureaucrats manage it somehow so long as it serves their personal interests.

The entire public expenditure management is suffered with the pathologies in each of its dimensions; i.e., fiscal discipline, allocative efficiency and operational efficiency. These pathologies are the product of short-sighted behaviour, domination of informal power structure and pessimistic and uncertain financial outlook (Allen Schick 1998/35). At the end of a fiscal year budget estimates for revenue mobilisation is often proved to be too ambitious and unrealistic. Percentage of recurrent spending is generally higher than the development expenditure if we compare it with their respective estimates. Similarly, there are many off-budgeting expenses.

Budget amounts are also scattered to a large number of activities to incorporate political demands and interests.

Although most of these countries have very low spending on social securities, other mandatory and transfer payments like external debt servicing occupy large proportions of current revenue. However, revenue base is considerably narrow. Governments' revenue heavily relies on custom duties and commodity taxes. Revenue administration is too weak.

Scope and size of the government is too big to the size of geography, population and economy. A large sum of money is invested in state owned enterprises, which are in most of the cases living monuments of mismanagement and misutilisation of states' resources.

Due attention has not been paid on sustainability issues while investing money, especially in the large and multiyear projects. Some of such projects are seen crumbled like the houses of cards. With a low societal participation, many investment programs lack public ownership.

Accounting system is old –fashioned in most of the cases. Management accounting system is rarely introduced. Capacity and morale of accounting and auditing human resources is seen generally weak. Controlling agencies and oversight mechanisms are not efficient and effective. They themselves are to be guided and controlled.

Some Reflections on Nepal

The LDCs' budgeting practices as mentioned above truly reflect Nepal's scenario. This sub-section reinforces the arguments with some data and information from Nepal's case. Similarly, this sub-section also enumerates some peculiar situational budgetary constraints of Nepal.

Like in most of LDCs', budgets in Nepal are highly populist as they are too comprehensive to implement successfully. For instance the budget for FY 2004/05 is populist and ambitious with multitude of objectives. It seems to be a perspective plan. Objectives of the budget extends from the restoration of peace, relief, rehabilitation and reconstruction and social and economic transformation and progression to the judicious access to resources and opportunities, and devolution of authority and additional support to poverty alleviation program by enhancing economic activities and creating mass employment opportunities through economic reforms and investment promotion (MoF: 2004a).

Nepal's recent budgets are characterised by swelling 'uncontrollable'. For example, pension liability increased by 1649 percent for the period between 1990 to 2002. Similarly, debt service payments went up by 572 percent during the same period. In the FY 2002/03 it was about 30 percent of regular budget. (MoF: 2004 a&b).

Given the initial stage of development, financial requirements are very high to catch up economic development of the country. Similarly, Nepal still has bleak social indicators. The situation of infrastructure development is still poor. For example, only 26 percent of the total irrigable land has year-round irrigational facilities. This situation has posed serious challenges to budgeting in Nepal.

A large chunk of development expenditure (about 73%) is financed by foreign aid. However, a huge amount of foreign aid reimbursement is yet to be settled. Similarly, revenue forecasting has been consistently over estimated. Due to the lack of reliable resource forecast and excessive political pressure, a number of projects are created without a firm backing of resources.

There is a weak public sector capacity because of the lack of competency, discipline, sense of responsibility, accountability and transparency. Governance is weak and poor. The problem has been identified but no rigorous and logical response to the problem has been employed so far.

The language of budgets itself indicates the budgetary constraints of Nepal. The terms like 'due importance shall be accorded' and 'special attention will be paid' clearly denotes the lack of specificity in the budget.

At present, Nepal is marred with mass poverty, Similarly, population growth has contributed in deepening the budgetary constraints.

To sum up, swelling 'uncontrollable', foreign aid dependency, management deficiency, political instability and insensitivity and situational and revenue constraints are the major budgetary constraints in Nepal.

Addressing the Problems and Constraints

Problems and constraints of budgeting can be minimised by enforcing fiscal discipline, ensuring timely and proper implementation, focusing on results (achievements) and enhancing efficiency, effectiveness and equity.

Given the resource constraints and low level of efficiency as basic problems, the strategies should broadly include restructuring expenditure; finding a way of increasing resources; cutting programs or activities by prioritising it and concentrating on efficiency and productivity enhancement. These strategies depend on multitude of factors. The following activities are proposed as parts of these strategies:

- Redefining the role of government and right sizing it.
- Linking budgets with macro-economic management and medium-term and perspective plans.

- Cutting expenditure with the help of medium term expenditure framework (MTEF).
- Defining the role, scope and relationship of central government with local government.
- Concentrating public resources on the most critical activities to maximise the return on investment.
- Introducing performancebased management system in public organizations.
- Improving expenditure management by linking it with the objectives and performance.
- Improving financial planning and ensuring better management of user's fees.
- Adopting new debt management techniques and strategies.
- Promoting capacity support not expansion of activities.
- Introducing budgetary operational plan.
- Discouraging extra budgetary accounts.
- Making public enterprises and local governments more accountable.
- Speeding up privatisation process with a clear post-privatisation measures and a strong regulatory mechanism.
- Conducting continuous assessment of short-term and long-term liabilities and rescheduling it for repayment.
- Introducing new public management techniques in government agencies to enhance operational efficiency.
- Introducing resultbased management for effective monitoring, evaluation and feedback system.
- Preparing budget on multiyear perspectives.
- Incorporating all projects including the technical assistance projects funded by external sources under the domain of national budget.
- Broadening the revenue base.
- Improving the administrative capacity.
- Investing on income generating activities and high yielding projects.
- Introducing contributionbased budgeting, i.e., pension fund.
- Designing self-operating mechanism for completed development projects.
- Rejecting the programs or projects having no measurable goals, objectives and targets.
- Making budgetary process more transparent.
- Making budget implementation report public.
- Improving fund management and ensuring sound financial management information system.
- Making feasibility study compulsory to all projects.
- Establishing long-term budgeting capability at various levels of government.

- Keeping budget deficit at prudent level.
- Minimising the 'uncontrollable'.
- Making the budget a strategic development tool.

5. Concluding Remarks

Budget is an operational plan. It gives direction to the medium and long-term plans and policies. All public policies are concerned with budgeting decisions one way or another. Budgets play key role in public policy implementation. However, budgeting has constraints of scarcity of resources and time limitations as well as inadequacy of knowledge and information to address complexity of multidisciplinary issues. Nevertheless, the problems and constraints can be addressed or minimised by revitalising budgetary process incorporating economies of expenditure, output orientation, recognition of constraints and fiscal discipline.

Sound accounting and auditing systems and effective oversight mechanism can lead to streamlining budgetary process towards successful policy implementation. Similarly, effective monitoring and evaluation system can have significant contribution on establishing congruence and coherence among periodic plans, policies and annual budgets.

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