

# Public Sector Financial Management

Dr. Eduardo Araral  
Assistant Dean and Assistant Professor  
Lee Kuan Yew School of Public Policy

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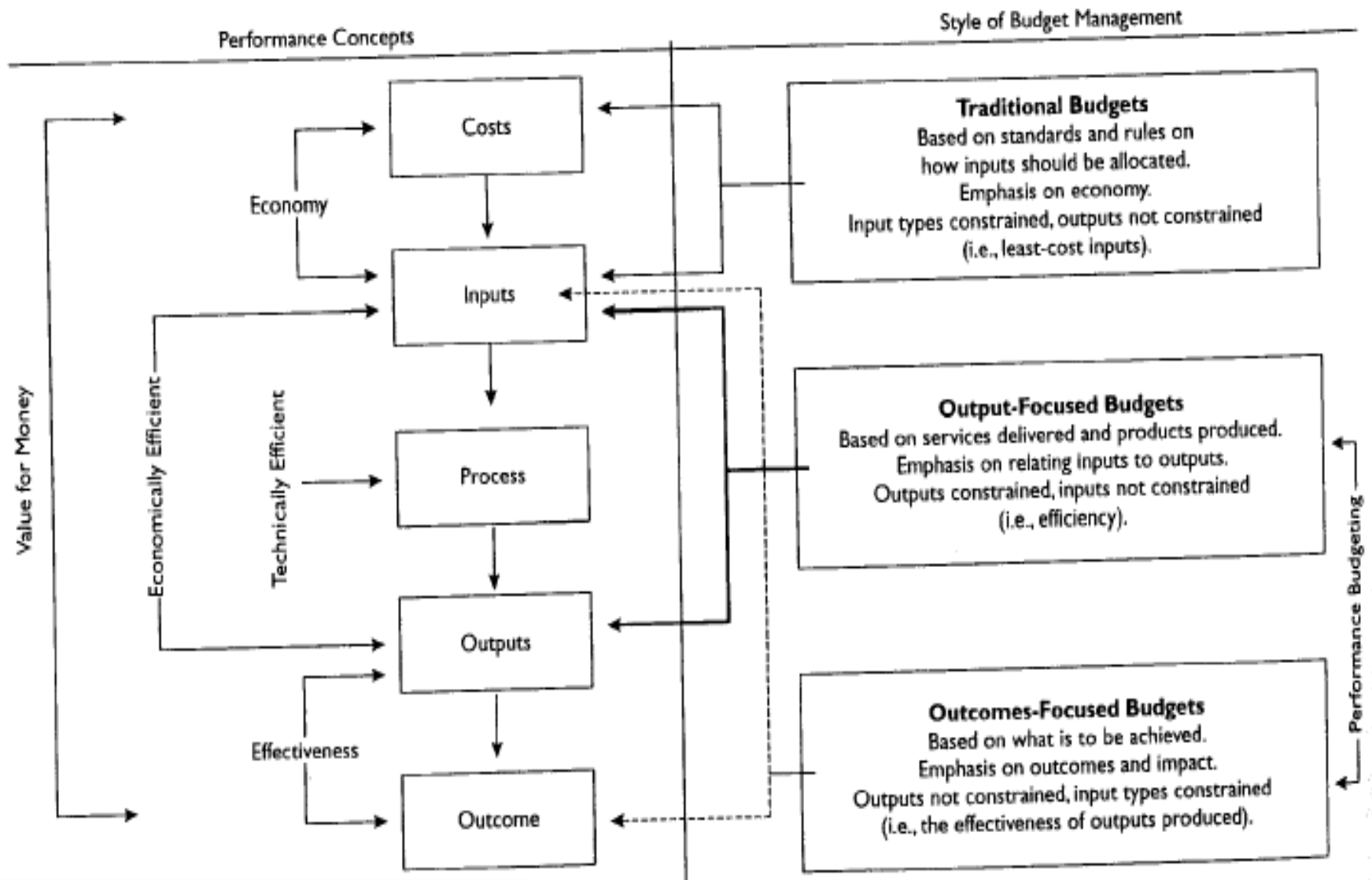
# OUTLINE

- Part 1: Scope and principles of public finance
- Part 2: Managing revenues, expenditure and debt
- Part 3: Performance based budgeting
- Part 4: Budget Execution / internal controls
- Part 5: Cost benefit analyses

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# Part 3: Performance Based Budgeting

# Concept of Performance in Different Budget Systems



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- Which of these budget systems are applied in your country?
  - What are their advantages and disadvantages?
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# Budget formats

- Line Item
- Zero based budgeting
- Program Budgeting
- OECD budget practices

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# Traditional Budgeting: Line Item Advantages

- Usually provides compliance control, allowing payments to be limited to voted appropriations
- Provides database for across the board cuts to control fiscal aggregates
- Uncomplicated system, easy to understand, focused on the “bottom line”
- Easy to apply in a tight time table (annual), minimizes discussion on programs/objectives

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## Traditional Line Item Budgeting: Advantages

- Adaptable to different economic conditions (incremental / decremental)
- Reporting is not demanding; accounts are prepared after year end for statutory review and audit
- Cash basis accounting is relatively easier to implement and maintain



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## Traditional Line Item Budgeting: Disadvantages

- Budget is divided by spending unit/activity centers that may have several programs
- Prepared annually with year end rush to spend
- Typical incremental approach favors existing programs, regardless of priority
- Based on line items of expenditure; control is on inputs rather than outputs or outcomes

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## Traditional Line Item Budgeting: Disadvantages

- Reports are for compliance purposes and control over aggregates need additional economic classification
- Supporting accounting system is cash based, focused only on payment stage of the spending process

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## Zero Based Budgeting (ZBB)

- Definition: a budgeting method whereby all expenditures must be justified in each new period, as opposed to only explaining the amounts requested in excess of the previous period's funding

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# Planning, Programming, Budgeting System (PPBS)

- Started in 1962 (USA DoD / Pentagon)
- Efficiencies and improvements in government operations could be achieved through a common approach for:
  - Establishing long-range planning objectives
  - Analyzing the costs and benefits of alternative programs that would meet those objectives
  - Translating programs into budget and legislative proposals and long-term projections.

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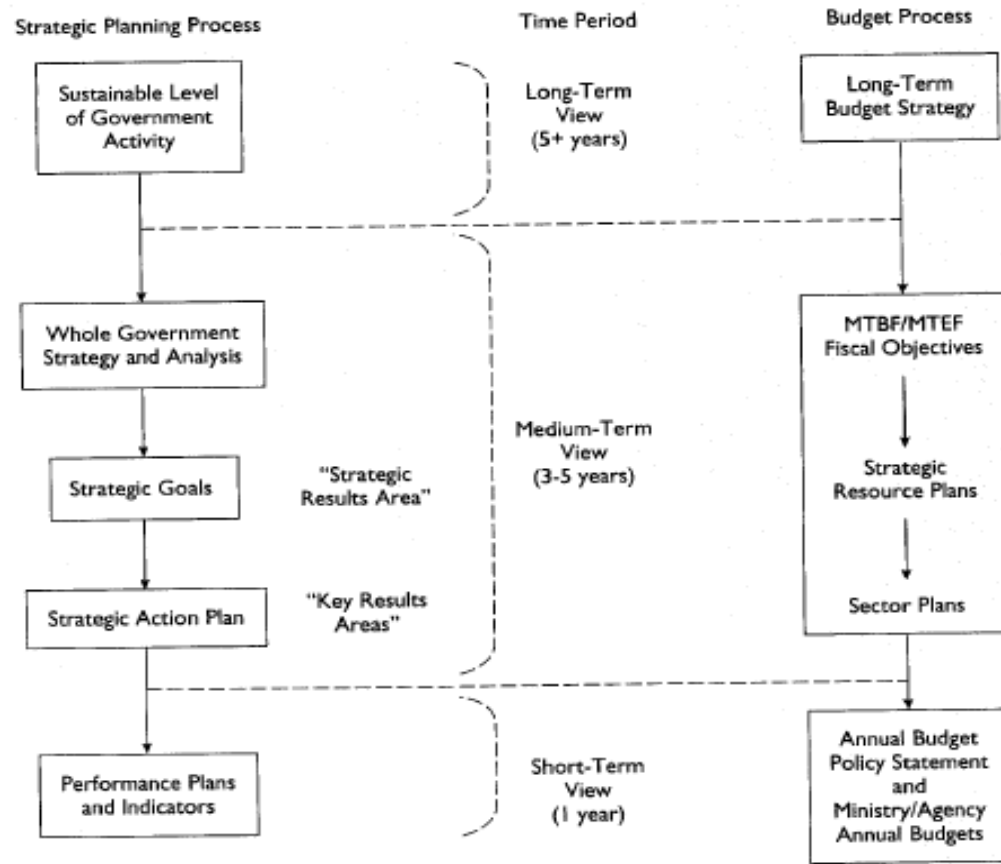
# PPBS

- **Difference with traditional budgeting**

- 1) Emphasized objectives**—PPBS focused less on the existing base and annual incremental improvements to it, and more on the objectives and long-term alternative means for achieving them.
- 2) Linked planning and budgeting**—by means of programming, PPBS instilled a process that essentially defines a procedure for distributing available resources equitably among the many competing or possible programs.

# Connecting Planning and Budgeting

**Box 12. Connecting Planning with Budgeting**



# Budgeting problems in practice - 1

<b>problem</b>	<b>practice</b>
unrealistic budgeting	the budget cannot be implemented budgeting as approved because it authorizes more spending than the government can pay for
hidden budgeting	the 'real' budget (actual revenues and spending), is known only to a small circle of insiders, or only in retrospect-after the fiscal year has ended
escapist budgeting	the process feeds on itself and unrealistic budgets beget escapist budgeting: the government knowingly authorizes significant public spending that will not occur so as to create the impression that it is responding to demands for social improvement

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## Budgeting problems in practice - 2

<b>problem</b>	<b>practice</b>
repetitive budgeting	the budget is remade frequently during the year, in response to economic or political shocks
cashbox budgeting	government pays bills or spends as cash becomes available, not according to a preset budget
deferred budgeting	budget may be "balanced" only because some needs (e.g. maintenance) or liabilities (e.g. bills due) are deferred. Deferred expenditures tend to escalate from year to year.

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## Budgeting problems in practice - 3

<b>problem</b>	<b>practice</b>
escapist planning	planning is politically important in developing countries, because the government promises in the plan what it cannot pay for in the budget
distorted priorities	spending on showcase projects that produce meager social return, while underspending on human capital (health, education, etc.)
"enclave" budgeting	efforts (often by international organizations) to protect certain priorities by establishing special funds, separate investment budgets, social (or physical) investment programs, and other devices that wall off the "enclaves" from the rest of the budget.

## Budgeting problems in practice - 4

<b>problem</b>	<b>practice</b>
'Compensatory` spending	To ameliorate unemployment, size of civil service balloons, but real public wages decline
Declining productivity	"Ghost" workers, underinvestment in training and information technology, poor working conditions and other practices degrade operational efficiency.
Disappearing budgets	Resources available for operations are uncertain, even after budget has been approved and fiscal year has commenced. Managers operate hand-to-mouth without knowing what resources they will have for the next month or quarter

## Budgeting problems in practice - 5

<b>problem</b>	<b>practice</b>
Detailed, rigid rules	On paper, spending control is highly centralized, with detailed rules concerning civil service (numerous classifications and grades), external control of procurement and other items of expenditure. Paper controls often violated in practice.
Informal management	Informal arrangements coexist the formal rules. Extralegal arrangements dictate how government operates: civil servants jobs or promotions, pay scale, procurement, etc.
Corruption	When formal rules are unworkable, and government operates through extra legal means, corruption rises. Corruption though widespread is often undetected or unreported

# Case study: Singapore

(source: “Budgeting Principles for Public Release”, Ministry of Finance, Singapore)

- Line Item Budgeting (up to 1977-78)
- Programme Budgeting (up to 1987-88)
- Block Vote Budgeting (up to 1995-96)
- Budgeting for Results, *BFR* (up to 1999-2000)
- Budgeting 21 (up to 2002-03)
  - MOF: macro and inter-ministry block allocations.
  - Macro-Incremental Factor (MIF) funding framework
  - 3 year Development Block Vote System for development expenditure
- Resource Management (from 2003)
  - “Resource” (accrual) accounting and budgeting to capture full costs of government services
  - ~~*Net Economic Value* to foster cost consciousness~~

# Singapore: Budget management framework

**Desired Outcomes**

**Principles, Policies & Processes**

**Secure Singapore**  
 • Long-term fiscal sustainability

**Responsible Government**  
 • Efficient & effective public service

**Establish Limits**

Sectoral Caps  
 Block Budget Caps  
 Reinvestment Fund  
 Budget Utilisation Framework  
 DPC process  
 Cost norms for government buildings

**Monitoring & Evaluation**

**Maximise Discretion**

Block budget system  
 Net Budgeting Framework  
 Budget Flexibility Frameworks

**Annual Strategic Reviews**  
 (Are we doing the right things?)

**Measure Costs**

Resource Accounting  
 Resource Budgeting  
 Net Economic Value  
 Interdepartmental charging framework

**Sectoral Budget Meetings**  
 (What are our sectoral priorities?)

**Achieve Value for Money**

Best Sourcing, PPP  
 Demand Aggregation/  
 Reverse Auctions  
 Economy Drive  
 Manpower Management  
 Debt-equity & capital restructuring for SBs

**Budget Review Meetings**  
 (Are we doing the right things correctly?)

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# Discussion Question

- Which of these budgeting problems are common in your country?
  - What can be done about them?
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