

Integrating Current and Development Budgets: A Four-Dimensional Process

by
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For most developing and transition countries, the integration of current and capital (or “development”) budgets is a major step towards improved budget management and more effective public finance institutions. Moving to a unified budget, however, can be a technically and managerially demanding task that involves legislative, institutional, budget presentation and expenditure management issues. Countries undertaking this step need to understand each of these dimensions, how they interact with each other, and how they may affect various aspects of the budget system.

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1. Introduction

Effective integration of current and development budgets is one of the hallmarks of a developed budgetary system. For this reason, presenting an integrated (or “unified”) government budget is commonly recommended by international financial institutions as a priority task for improving resource allocation and public financial management in most developing, transition and post-conflict countries.

Although the integration of the current and development budgets is sound in principle and seldom controversial, this step is often more complex in practice than is widely understood. Recommendations to governments to proceed down this path are often made without clear guidance on how and where to begin. Moreover, integration is often proposed without recognising particular institutional and policy constraints in a government’s budgeting system or without reference to the capabilities of their public finance officials for managing this important reform. For all of these reasons, the process of achieving full budget integration often proceeds more slowly and with greater difficulty than expected.

This article aims to assist governments and public finance managers in understanding the process and requirements for budgetary integration.¹ It starts by discussing how and why separate current and capital budgets have evolved and what is meant by their integration. It then describes the various “dimensions” of this task as it applies to most developing administrations. This includes identifying a number of interrelated steps and potential challenges which will need to be addressed in achieving full and successful transition to a unified budget.²

2. The origins of separate budgets

For many countries, separate current and capital budgets – i.e. a “dual budget” process – have their origins in the public financial management policies and structures established by colonial administrations. These administrations distinguished clearly between the recurring operational costs involved in maintaining a narrow range of government services and the “developmental” expenditures needed from time to time to establish new facilities or new administrative functions. Limitations on local revenue-raising capacities meant that approval for major capital expenditures often required

special budgetary provisions including referral to the home treasury or supervising colonial authority.

Dual budgeting did not disappear, however, with the departing colonial administrations. The continued separation of current and development budgets also appealed to the new administrations in that it enabled them to separate the ongoing costs of government – and the associated raising of current revenues – with ambitious new development plans and their associated financing needs. Development assistance donors have reinforced this separation over time through their traditional preference for funding of “development” activities, while at the same time shying away from the “consumption spending” usually associated with current expenditures. This traditional view of current expenditures as being of lesser economic importance, or merit, has diminished in recent years, especially within the multilateral institutions, though it is still evident in the chronic underfunding of some government services relative to more easily acquired “development” financing.

For most transition and post-conflict countries, the origins of the dual budget problem have been slightly different. In these cases, the sudden volume of financing required for reform and reconstruction – involving an almost total dependence on external sources for financing and expertise, including the detailed budget planning and reporting requirements attached to those – has mostly dictated separate budget processes. Given that unified budgets are such a widely accepted principle of good budget management, it is a reflection of the power of these practical considerations, including the demands from donors and trust fund managers, that dual budget processes have been established or maintained in several post-conflict countries, such as Afghanistan and Timor Leste, in recent years.

In defending their dual budget systems, governments sometimes point to the different skills which are required to manage current and capital expenditures. Determining the required level of current expenditures is often perceived to be a relatively formulaic task in which various “norms” may be applied annually on a volume basis, combined with the possible adjustment of input prices. Capital or investment spending, on the other hand, is perceived as a higher status activity that requires more sophisticated cost-benefit analysis and project management skills. These perceptions may not only underpin the historical preference for separate budgets, but also for separate budget management institutions.

One of the basic problems with a dual budget process is that it seldom maintains a clear or consistent separation between current and capital spending. Over time, “development” budgets tend to include many project-related expenditures that contain significant current (operational) spending

activities. Thus the dual budget process provides a separation of activities that often relates more to historical systems, political objectives, potential sources of financing and institutional capacities than to the actual nature and purpose, including correct description, of the expenditures themselves.

3. Principal characteristics of an integrated budget

Most OECD countries have achieved a high degree of integration of their current and capital budgets. This has usually occurred through a process of development in their public administration and budgetary systems that has taken place over many years. It is the result of a growing realisation by these governments that a) the distinction between recurrent and development spending is often quite arbitrary or uncertain, and b) that better resource allocation and management decisions can often be made within a single unified framework for revenues and expenditures.

While there are now few developed countries which maintain totally separate budgets, the extent and form of budgetary integration – particularly the management of capital spending – still differ significantly in some instances. For this reason, effective integration of current and capital budgets is perhaps best measured qualitatively by the extent to which the current (operational) and investment spending decisions of the government are “well balanced” in the sense of being logically consistent with, and mutually supportive of, a given policy framework or set of policy objectives. In practice, this means that the activities and outputs, including goods and services, for which government departments and spending agencies are responsible are delivered as effectively and efficiently as possible, given the budget resources available. In particular, the operational activities and outputs of each agency are not reduced or impaired by grossly inadequate (or over-specified) capital, by technologically inappropriate facilities or equipment, by insufficient provision for maintenance costs, nor by inefficient combinations of capital and labour inputs.

Examples of an unsatisfactory balance between current and capital spending can often be found in the education sector – *e.g.* many teachers but too few or poor quality classrooms and teaching facilities. Conversely, in the health sector, there may be large new hospitals but with insufficient trained staff or inadequate maintenance and utilities funding. More general imbalances may also develop between expenditures on administrative services of government (especially salaries and allowances) and infrastructural development needs, or more specifically between large public investments in, say, electricity generation, relative to the quality of policies and regulations relating to pricing and supply (where the latter is determined

in part by current spending on the staffing and capacity of the relevant policy agencies).

Although many developed administrations may not **consciously** seek to optimise this current/capital spending balance, they nonetheless aspire to achieve consistency and efficiency within the context of their ongoing resource allocation and budget management decisions. In fact, getting the right balance between current and capital spending across the whole range of budget interventions and activities will depend substantially on the quality of financial and managerial (including budget planning) systems and capabilities – and hence their capacity to design and conduct strategic interventions. While these issues may involve a much wider range of factors than simply the extent of budgetary integration *per se*, there is no doubt that a unified budget generally makes it easier to develop better systems, policies and capabilities in these areas.

The budget systems of countries with a high degree of integration between current and capital expenditures exhibit several key features:

- a single (combined) annual budget law and appropriation process;
- clear and unified responsibilities for budgetary preparation and implementation within the relevant public sector institutions;
- a unified budget presentation, with supporting classification and accounting systems; and
- budget planning and management techniques within individual spending agencies that encourage and enable the effective use of financial resources.

Most budgetary systems incorporate some of these features. However, the full benefits of a unified budget can only be achieved where each of these conditions is present. And although each of these features is important, it is often in the last area – the budget planning and management within spending agencies – where the most challenging reform measures, and greatest gains, are to be found.

4. The four dimensions of budget integration

The features of a unified budgetary system described above provide a useful framework for designing the guidance required by most developing countries in determining how and where they should begin the task of integrating their current and capital budgets. Experience from developed country budgeting systems suggests that these attributes correspond broadly to four dimensions in which budget reforms may be required, as described below. It must be recognised, though, that a particular strategy for budget integration in any single country will depend on a range of local factors, including the stage of budget development already achieved. Finding the right

approach therefore requires careful assessment of the current political and institutional environment, including determining where the greatest or most achievable gains from budget unification can be made.

4.1. The legislative dimension

Budget laws in many developing and transition countries often require the preparation of two separate budgets – i.e. one for current expenditures and one for capital expenditures. These two budgets may be presented separately to the parliament (or supreme appropriation authority) each year under their respective budget appropriation laws or they may be presented as separate components of a single budget law. In either case, they may require annually of the parliament separate processes of consideration and debate, and possibly enactment. The specific requirements of this dual process are invariably stipulated in the country's public finance (organic budget) law. However, these organic laws are not only updated infrequently, but seldom identify, much less explain, the justification for maintaining the dual budget process.

A major and essential step in budget integration therefore involves moving to an appropriation process that requires all expenditures to be unified within one budget document and presented and approved under a **single budget appropriation law**. This step is likely to require an amendment to the public finance legislation and may require significant consultation (and explanation of purpose) within the parliament. The basic provisions of the amended law are, however, unlikely to be complex: as a first step, the law should simply require that all of the budgetary operations of the government (revenues and expenditures) are presented within a single appropriation. The detailed format of this presentation within a single appropriation will depend on the approach to other dimensions of budget integration as discussed below.

Amending any law, especially an organic budget law, may take considerable time and it is therefore desirable that at least some of the other dimensions of the budget integration task are advanced during this period. While a single unified budget appropriation law and approval process often represents a necessary and highly visible step towards budget integration, this achievement on its own can only bring limited improvements in the quality of fiscal management.

4.2. The institutional dimension

4.2.1. Central agency level

Separation of responsibility for current and development expenditures between two ministries – typically the ministry of finance and the ministry of planning (or economy) respectively – is often a major obstacle to effective

budget integration. This arrangement is generally more common in developing and transition countries than in post-conflict administrations and, again, may have its origins primarily in donor interests and/or colonial administration systems. Nonetheless, a long history of institutional separation of budgetary responsibilities can make these structures politically resistant to change.

Internationally, there is increasing recognition and acceptance of the principle that budget planning, presentation, management and accounting and control functions can be conducted more effectively within one central agency: typically a ministry of finance. In practice, however, ministries of planning often have greater power and capability with regard to economic analysis and policy development, including especially the design and management of public investment policies. Traditionally, these ministries are often more effective in securing technical assistance to support their role in the planning and management of the development budget. As a result, they tend to possess superior capacity for analysing and managing public expenditures, especially investment programmes, and for negotiating the required financing with donors and lenders. In many cases, they may be unwilling to concede these functions – including the power and career opportunities that accompany them – to another ministry.

Common strategies for relaxing the grip of planning ministries on their development budget responsibilities involve either amalgamating with the ministry of finance or re-defining their functions to focus on higher level economic policy analysis and advice, including the design and implementation of economic regulations. These strategies have been employed in many transition countries over the last two decades. At the same time, the budget management capacities of these ministries of finance have needed to be strengthened, often with substantial support from donors, to enable them to assume their increased functions and responsibilities for capital expenditures.

In many developing countries, however, ministries of finance remain weak and under-resourced. The speed at which they should be encouraged to absorb new responsibilities for development expenditures is therefore a matter for careful judgment. In some cases, many of the more effective expenditures of the government are contained within projects administered under the development budget, and it is important that these are not jeopardised by rapid change in institutional mandates.

Apart from supporting long-term capacity building in the ministry of finance, there may be relatively little that international agencies or external advisers can do in the short term to hasten this institutional dimension of budget integration. Political factors, including portfolio responsibilities of

ministers, may simply override consideration of these changes for improving budget management. At the very least, however, it is often possible to establish a broadly agreed timetable for the consolidation of budget management functions within the finance ministry and to define the transfer of resources and capability that will be required to achieve this. Moving to a single annual budget appropriation law, as described above, may also be a necessary step in encouraging and facilitating this process.

4.2.2. Budget department level

In parallel with the consolidation of budget management functions within the finance ministry, it is crucial that the “budget department” within that ministry is re-organised in a way that supports the integration of financial planning and monitoring for both current and capital spending. In practical terms, this will require that the budget officers responsible for designated spending agencies, or sectors, have budget oversight responsibility for **both** forms of expenditure. Any internal separation of responsibility for current and capital expenditures between budget office staff – despite the internal and external pressures that may be applied to maintain this distinction – can only impede the integration process. The logic of this consolidation of budget responsibilities becomes further evident as the various spending departments move towards greater use of the kind of policy-based expenditure programmes described below.

4.2.3. Spending agency level

The institutional dimension for budgetary integration extends beyond the role and structure of central agencies and their budget-related responsibilities. Within line ministries and other spending agencies, the establishment of separate management units for the execution of current and capital (development project) budgets has also created problems.

This structural separation of budget execution functions at the spending agency level is in some cases a direct result of donors seeking greater assurances of administrative capability before committing their funds to development activities. Newly created units responsible for development budgets generally offer significantly higher rates of remuneration and therefore have the ability to attract superior quality and better motivated staff. As a result, the resources and capability of these units may greatly exceed those of their current (operational) budget colleagues “down the hall”. This phenomenon has been particularly evident in many developing and transition countries where line ministries have established “project implementation units” (PIUs), in some cases ostensibly for procurement purposes, as a means for ensuring more effective management of donor-financed projects or sector

loan operations. These PIUs invariably present a long-term obstacle to more integrated and effective budget management.

Separation of current and capital expenditure management functions within departments also raises the potential for an increasing proportion of financial resources to flow into so-called “development expenditures”. To the extent that even core operational activities become increasingly dependent on this funding source, this may further drive down the quality, effectiveness and relative priority of these activities. In the medium term, if not sooner, separate budget management entities within spending agencies tend to lower and distort the overall performance of the organisation and the quality or impact of its expenditure activities.

There can be situations, however, where distinct funding and payments processes **necessitate** some separation of budget implementation responsibilities at this level. In these cases, it is important that the management capacity for both categories of expenditures receives the same or very similar levels of donor support, especially in the form of administrative facilities and resources and staff training and remuneration. Where possible, though, donors should be actively discouraged from establishing or supporting these dual structures and should focus instead on helping to equip a unified budget management structure in each line agency with capable and effective staff.

Finally, it is sometimes argued that budget integration objectives relate primarily to **budget policy and planning** tasks and do not necessarily require the consolidation of **budget execution** responsibilities within a spending agency. The problem here is that many important budget allocation priorities are actually established during the execution process. A much higher degree of co-ordination and consistency in current and capital expenditure rationing decisions is therefore likely under a unified management structure, compared to a situation in which institutional structures reinforce competing budget units, policies and individuals.³

4.3. The presentational dimension

4.3.1. Budget summary tables

A basic but visible and readily achievable step towards integrating current and capital budgets involves the combined presentation, or consolidation, of aggregate budget data in a “budget summary table”. This table should present a summary of the total planned (current plus capital) fiscal operations – i.e. cash flows⁴ – of the government for the next budget year, plus for at least a further two years. Although current and capital revenues and expenditures may be presented as separate lines within the consolidated summary table, they should sum to a **single fiscal balance** – i.e. to a net surplus or net

financing requirement.⁵ Sources of financing for a budget deficit – i.e. expected “below the line” financing flows – will typically include a mix of domestic borrowing and external grants and loans.

The main purpose of a unified budget summary table is to show all planned fiscal operations for the year and their associated financing implications. As such, the table is a small but important step in presenting a consolidated or integrated picture of all current and capital spending, plus the associated financing decisions. It is likely that at least some of the planned external financing shown in this table may be tied to, or conditional on, approval and implementation of specific “development” projects or capital spending activities.

The exact format of a consolidated budget table, as outlined above, will depend on existing conventions and procedures for the presentation and appropriation of public revenues and expenditures, including budget classifications, as understood and approved by the parliament. However, the table can and should be formulated and presented routinely with the annual budget documents, **even where separate current and capital budgets have been prepared, and even if they remain subject to separate appropriation laws**. Although, in the latter case, the summary table may have no specific legislative standing or approval function, it may still assist the authorities to understand and manage better some of the macroeconomic and total debt servicing implications of their planned fiscal actions.

4.3.2. Budget classifications

Notwithstanding the importance of the legislative, institutional and budget presentation steps outlined above, effective integration of current and capital budgets in an **operational** sense really only begins to occur at the next level down: i.e. in the detailed classification of budget revenues and expenditure. The choice of budget classification structure is therefore important since it provides the budgetary framework for integrated planning and management of current and capital spending as discussed under the final dimension below.

Budget classifications assist governments to present, manage and report their fiscal activities in terms of a range of fiscal objectives and management needs. Typically, the most important classifications for meeting these objectives are:

- **Legislative:** a breakdown of the total budget into separate appropriations (or votes), usually, though not necessarily, aligned with administrative agency mandates.
- **Administrative:** this defines responsibilities and accountability for managing these appropriations according to administrative (spending)

agency, typically line ministries and sub-agency units, but including regional or local government authorities and other budgetary entities, as appropriate.

- **Economic:** application of an economic classification⁶ structure for supporting improved analysis, in particular, of the economic nature and impact of budgetary decisions.
- **Functional:** application of a functional classification⁷ for assessing the volume and composition of revenues and expenditures across the core functions of government compared with previous years and with other countries.
- **Policy, or programme, management:** for preparing and implementing budgetary activities within the relevant administrative agency and sub-units in relation to ongoing or new policy objectives and functions of the government. (Increasingly, specific programmes, or other policy-based groupings of expenditure within this classification, tend to be supported by performance objectives and indicators.)

Budget classifications even in developing countries vary considerably in structure, comprehensiveness, and quality of design and implementation.⁸ Most countries have developed classifications of budget revenues and expenditures that support existing administrative structures and basic operational and reporting requirements for line item (object code) expenditures. However, the introduction of economic, functional and performance management classifications is necessary to support more sophisticated levels of budget analysis, preparation and policy implementation. Steps for integrating current and capital budgets in any country will need to be carefully formulated and aligned with the existing classification systems and capabilities, but also with a longer-term view to the future development of budget management capabilities, including the range and structure of classifications needed to support a more sophisticated policy environment.

Most developing and transition countries have already embarked on the implementation of improved budget classification structures. These new classifications should enable their fiscal activities to be analysed, managed and reported in terms of the five budget management categories listed above. For some countries, further classifications may also be appropriate where there are other, possibly more sophisticated, budget management objectives or where there is a need to recognise other federal, state or local budget activities and accounting frameworks. Examples of the former may include cross-agency budget appropriations – including a variety of budget programmes – that are focused on **outputs** and/or specific policy **outcomes**.⁹ Of course, reporting of actual expenditures against each budget classification

implies a supporting expenditure coding and accounting system that provides the required structure and level of detail in each case.¹⁰

4.4. The managerial dimension

Development of the budget classification system to include the economic and functional categories outlined above is an important step in helping the authorities move towards better analysis and reporting of current and capital spending activities. However, truly effective integration of current and capital budgets can only occur through co-ordinated resourcing and management of expenditure policies by each spending agency. Most international experience suggests that this integration objective can seldom be achieved by leaving it to donors to decide where development activity is needed and what level of current or other budget resourcing should accompany it. Rather, spending agencies themselves need to develop budget programmes that explicitly combine current and capital spending decisions within a single policy-based implementation framework. The development of these programmes within each appropriation is probably the most important task, but also the most institutionally demanding one, that these governments face in strengthening their budget management capabilities. It is also the key to full and effective budgetary integration.

The development of a **basic** programmatic framework for budget management in spending agencies is not a difficult technical exercise – at least in principle. There is ample guidance and experience internationally on how major “expenditure programmes” can be formulated around key policy objectives within each of the major sectors. However, the development of these programmes, including appropriate sub-programmes, cannot simply be imposed. An effective structure must be achieved in consultation with budget managers in each of the respective line agencies. This enables the rationale behind their financing and implementation – and the measurement of their achievement – to be embedded within day-to-day expenditure management decisions.

In practice, implementing detailed, effective and integrated programme-based budgets has proved difficult in many of the countries of the former Soviet Union, for example, where line ministry staff have had little experience in managing policy-oriented or results-based budgeting. Over time, these problems are gradually being overcome. As a result, well-designed programmatic frameworks have assisted line agency staff to comprehend better the linkages between current and capital spending and to begin to see that effective policy implementation requires a careful, strategic balance between the two. This understanding is much more difficult to achieve within a dual budgeting framework.

In practical terms, policy-based programmes should be designed so as to incorporate capital expenditure needs immediately alongside related current activities and outputs. For example, a programme for secondary level education – within an overall education sector appropriation – should incorporate capital needs within the objectives and resources assigned to individual sub-programmes. Thus, the capital spending requirements for, say, rural (public) secondary schools should be specifically identified and budgeted under that sub-programme. This differentiates it from the capital spending required within other sub-programmes – such as urban schools, mixed public/private schools or special needs schools, etc. – and will help to ensure that decisions about the required level of capital spending are considered in relation to parallel current expenditures on rural secondary teacher salaries, classroom materials, utilities and maintenance needs.

Financing for each of these elements within the rural secondary schools sub-programme should of course be determined on the basis of relevant government policies, competing education priorities, and forecasts of rural demographic trends, etc. This kind of programme (and performance) approach may also help to define better the specific expenditure responsibilities under local and central government fiscal mandates within a given area of public policy. In this way, both current and capital expenditures will contribute jointly to the achievement of the government's policy goals and performance indicators in this area.

Exceptions to the programme-based approach described above are possible, but preferably rare. Occasionally, capital expenditures may involve substantial donor-funded projects that focus on a dominant facility or activity that affects, or supports, a wide range of economic activities, possibly extending beyond any one sub-sector, or even one sector. The size, complexity and limited time duration of these investments may argue for special project management structures. Examples include the construction of major infrastructural facilities, such as ports or airports, a teaching hospital, or perhaps a network of courthouses which are substantially different or additional to any existing facilities.

In such cases, and for sector-wide projects, it may be desirable to create a special budget programme, within the relevant sector appropriation, that comprises all of this developmental expenditure. However, the format should be similar to other programmes in that it is assigned unique objectives and performance criteria for the period of its duration within the budget. Any local operational costs and non-capital items associated with such investment “programmes” should be correctly identified and classified accordingly.

The decision on which of these two approaches should be used to ensure effective operational integration of current and capital spending within a

programmatic framework will depend on a number of programme-specific considerations. However, capital expenditures should, wherever possible, be contained within the appropriate policy-based programmes. This will help to ensure that current *versus* capital resource allocation decisions are more consistent and complementary over the longer term.

5. Conclusions

The integration of current and development budgets is a necessary and important step towards improving budget management. However, the technical and managerial complexity of this step tends to be underestimated, leading in many cases to disappointment with the speed and quality of this reform. These challenges can be overcome successfully by addressing each of the legislative, institutional, presentational and managerial dimensions of budgetary integration. To achieve this, public finance officials and advisers must first be willing to consult carefully with ministers and parliament on the benefits of budget integration and on the need to adjust financial laws and organisational mandates and structures to support it. Officials in line ministries must also be trained and engaged in the design of new budget management methods that will support improved analysis of needs and more detailed reporting of current and capital expenditures. Only then can a unified budget process fully contribute to better budget allocation and management decisions.

Notes

1. Budget integration usually refers to both revenues and expenditures, though it is in the management of public expenditures that the most important gains from this development are usually expected to occur.
2. "Development budgets" are mostly composed of capital expenditures, but they may include operational costs associated with capital items. In this article, the terms "development budget" and "capital budget" are used interchangeably, as are the terms "current", "recurrent" and "operational" expenditures.
3. In practice, the management structures within some spending agencies may be a little more complex than implied by this discussion on "dual administrative units". In most cases, management structures are likely to be aligned with policy or programme activities, or sub-sector organisations, within which there may be separate management units for current and development expenditures. However, the desirability of combining the management of both types of expenditure within these programme-based structures remains.
4. The discussion in these paragraphs refers particularly to a cash accounting environment.
5. The exact presentation of revenue, expenditure and net lending aggregates within the summary table may vary significantly between countries depending, for

example, on the structure of their fiscal activities, their budget appropriation requirements and their public sector accounting methods.

6. Such as the government finance statistics standard as described in IMF (2001).
7. Typically also on a GFS basis; see IMF (2001).
8. For a more detailed discussion of classification issues, see Chapter 4 in OECD (2001).
9. For example, the more output/outcome-based budgeting and accounting frameworks used by Australia and New Zealand.
10. Transition, developing and post-conflict countries may also require a facility within the budget classification system for **donor reporting**, i.e. an ability to present budgets and financial statements that show how the financial assistance received from various donors has been committed to – and expended on – the agreed items, projects or policy objectives.

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