The role of Budget Classifications in budgetary reforms

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Why are Budget Classifications Systems Important?

- One of the fundamental building blocks of a sound budget management system.
- Provides a normative framework for both policy decision-making and accountability.
- Classifying expenditures and revenues correctly is important for:
  - policy formulation and performance analysis.
  - allocating resources efficiently among sectors.
  - ensuring compliance with the budgetary resources approved by the legislature.
  - day-to-day administration of the budget.
Main Principles of Budget Classification Systems

- **The principle of comprehensiveness**
  - Requires that the budget cover all government entities and institutions undertaking government operations, present a consolidated and complete view of these operations.

- **The principle of unity**
  - Requires that the budget include all revenues and expenditures of all government entities undertaking government operations. This principle is important to ensure that the budget is effective in constraining total and sectoral government expenditure, and in promoting greater efficiency in the allocation of resources.

- **The principle of internal consistency**
  - Requires consistency between different components of the budget. In particular, current expenditure needed for the operations and maintenance of past investment projects be fully reflected in the budget. Moreover, this principle implies that there should not be a dual budget system in which responsibilities among ministries, institutions, or entities in preparing and executing current and capital (or development) spending are fragmented.

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1/ Source Public Financial Management Technical Guidance Note, IMF Fiscal Affairs Department Budget Classification Daviina Jacobs, Jean-Luc Hélis, and Dominique Bouley
What should a Budget Classification System Contain?

- A sound system of budget classification should, at a minimum, comprise a classification of:
  - revenues into various categories.
  - an administrative, economic, and functional classifications of expenditures.

- However, increasingly focus is on classification system capable of linking funding to results rather than inputs.
  - Increase transparency and accountability and increase information to enable better management of the public finances.
  - In particular, program classification.
Program Classifications

- The programmatic classification of expenditure—that is, the grouping of expenditure by common objective for budgeting purposes—is a basic information tool used by most contemporary performance budgeting systems.

- The program classification of expenditure is intended to introduce clarity about the objectives being pursued through public expenditure, the government activities aimed at achieving these, and about the amounts being spent on them.

- The classification of expenditure by objectives is not intended only for budgetary planning and reporting purposes. The aim is, rather, that it should serve to promote budgetary decision-making which more closely aligns government activities with political priorities, and contributes to better public sector performance.

Source: Public Sector Performance Budgeting: Linking Funding to Results: IMF 2007, Marc Robinson Ed.
Functional/program classification

- In many cases programs can be linked directly to functions.
  - Functional classification does not need to be identical to COFOG.
  - But must be able to produce GFS/ESA reports.

- Links to sub-functions are more difficult.
  - May need separate bridging tables.
Organizational/program classification

- Combine organizational and program classification?
  - Reasonable for top level.
  - Programs usually related to only one ministry (more discussion on this later).

- What about lower levels?
  - Over time, lower organizational structure should converge towards program structure.
  - Difficult to impose at beginning – rapid organizational change not easy in large bureaucratic structures.
  - Should lead to activity-driven output and outcome definitions.

- In transition economies organizational and program classifications should usually be separate, at least below top level.
Economic classification still needed with programmatic structure

- Program classifications should be capable of being broken down into relevant inputs for analysis purposes.

- Separate from program classification.

- Programs should include both current and capital elements.
  - economic classification identifies different categories of inputs.

- Must be able to link economic inputs to programs results.
Source of Fund classification

- Tempting to combine with programs.
  - Some donor-financed activities coincide with programs (for instance debt relief).
  - Special financing for priority programs.
  - Will simplify structure.

- However may undermine ability to fully integrate all sources of funding in budget.
  - May result in being unable to track funds channeled to different programs.

- Need separate classification.
Separate within the same overall classification system

<table>
<thead>
<tr>
<th>Organization</th>
<th>Function</th>
<th>Program</th>
<th>Economic</th>
<th>Funding</th>
</tr>
</thead>
<tbody>
<tr>
<td>Ministry</td>
<td>Function</td>
<td>Program</td>
<td>Type</td>
<td>Type</td>
</tr>
<tr>
<td>Agency</td>
<td>Sub-function</td>
<td>Sub-program</td>
<td>Head</td>
<td>Organization</td>
</tr>
<tr>
<td>Department</td>
<td></td>
<td>Activity</td>
<td>Item</td>
<td></td>
</tr>
<tr>
<td>Division</td>
<td></td>
<td></td>
<td>Detail</td>
<td>Project</td>
</tr>
</tbody>
</table>
Combining functions/programs

<table>
<thead>
<tr>
<th>Option 1</th>
<th>Option 2</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Function</strong></td>
<td><strong>Program</strong></td>
</tr>
<tr>
<td>Function</td>
<td>Function</td>
</tr>
<tr>
<td>Sub-function</td>
<td>Program</td>
</tr>
<tr>
<td>Sub-program</td>
<td>Activity</td>
</tr>
</tbody>
</table>
Option 1

**Organization**  **Program**

<table>
<thead>
<tr>
<th>Ministry</th>
</tr>
</thead>
<tbody>
<tr>
<td>Agency</td>
</tr>
<tr>
<td>Department</td>
</tr>
<tr>
<td>Division</td>
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</tbody>
</table>

<table>
<thead>
<tr>
<th>Program</th>
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</thead>
<tbody>
<tr>
<td>Sub-program</td>
</tr>
<tr>
<td>Activity</td>
</tr>
</tbody>
</table>

Option 2? Very difficult in practice.

**Organization/program**

<table>
<thead>
<tr>
<th>Ministry</th>
</tr>
</thead>
<tbody>
<tr>
<td>Agency/Program</td>
</tr>
</tbody>
</table>

| Department/Sub-program |

| Division/Activity |
## UK – Program structure

<table>
<thead>
<tr>
<th>Directorate</th>
<th>Main programs</th>
<th>Targets</th>
</tr>
</thead>
<tbody>
<tr>
<td>Children, young people and families</td>
<td>Every child matters</td>
<td>1 and 2</td>
</tr>
<tr>
<td></td>
<td>Sure start, Extended schools</td>
<td>3 and 12</td>
</tr>
<tr>
<td></td>
<td>Youth</td>
<td>5</td>
</tr>
<tr>
<td></td>
<td>Safeguarding</td>
<td></td>
</tr>
<tr>
<td>Schools</td>
<td>Primary, 11 – 19</td>
<td>4, 6 and 9</td>
</tr>
<tr>
<td>Lifelong learning</td>
<td>11 – 19</td>
<td>7, 8, 10 and 11</td>
</tr>
<tr>
<td></td>
<td>Success for all</td>
<td>13</td>
</tr>
<tr>
<td></td>
<td>Adult skills</td>
<td></td>
</tr>
<tr>
<td>Higher education</td>
<td>Higher education</td>
<td>14</td>
</tr>
</tbody>
</table>

Appropriations are mainly done by Department (Ministry)
Program classifications and the link to outcomes

- The programmatic classification of expenditure should be *combined with good information about the results delivered by programs* (performance measures, evaluations etc).
  - Only then can it assist decision-makers to make more informed judgments on competing policy objectives.

- Program classification of expenditure is also widely seen as contributing to improved productive efficiency.
  - Relaxation of line-item controls gives managers greater flexibility in the choice of the mix of inputs used to produce outputs, which can potentially result in substantially improved productivity.
  - Increased freedom to function without externally imposed line item controls, however, carries with it an obligation by these managers to track accurately the costs associated with pursuing various outcomes and outputs.
Legal requirements for successful implementation of programmatic classification

- Budget to be prepared in programmatic format by Spending Units.

- For multi annual budgeting purposes forward estimates to be compiled on a program by program basis.

- Legislative body should be prepared to appropriate expenditures by program rather than line item.
  - Estonia is an example where a de-linkage between budgetary planning documents (programmatic) and budget appropriations (organizational and economic based) has led to proposals to change to program based appropriations.¹/

- Budget documentation should be in programmatic format.
  - Statement of program objective
  - Description of program activities and outputs.
  - Indicators to be used to measure program performance (outputs/outcomes).
  - Possibly program performance targets (if feasible).

¹/ Source OECD Journal on Budgeting Volume 2008/02
Appropriate appropriation level using a programmatic classification

- Countries with mature program structures tend to use the first level of the program hierarchy as the basis of allocative decision-making by cabinet or legislature.
  - Legislature typically appropriates at level of program
- Should legislature have the right to amend program structures presented by parliament.
  - In UK legislature has not got that power-most power vested in cabinet.
  - US congress has unlimited power.
  - France limited power to vary programs (a second tier appropriation but not missions (higher level program appropriations).
- No correct solution-very much dependent on political system in operation.
  - Westminster systems offer limited power to legislature to amend details of the budget. Government is key decision maker particularly in non-coalition environments.
  - US congress has wide ranging powers.
Appropriate appropriation level using a programmatic classification – Government decision making

- Cabinet should not in general concern themselves with the lower levels of the program hierarchy.
- This should largely be left to the line ministries and MoF to discuss in the agreement of more detailed planning of the budget.
- MoFs generally would want information on the use of inputs at all levels of the program structure, to verify costing assumptions.
Some lessons to be learned from country experiences

- Classification system should strike the right balance between detail and aggregation.

- Should be in sufficient detail to ensure that analysis of each major source and use of funds is possible.

- Should not however be so detailed that flood of information masks the ability to categorize revenues and expenditures into meaningful categories.
  - Recent conclusion of OECD review of budget practices in Russia recommended creation of a more aggregate classification system with not more that 10 programmatic line items per ministry and not more than 2000 in all (as opposed to existing 3,800 line items).\(^1\)

\(^1\) Source OECD Journal on Budgeting Volume 2008/02
Should programs be classified under single organizational unit

- Government strategic policy objectives can be implemented across organizational units.
  - However, experience suggests that individual programs need to be rooted within single organizational units.
  - Practical problems are too great to make the exercise worthwhile.
  - Existence of pools of ‘shared’ funds without clear ownership rights can be a source of inter-agency conflict and also to reduce accountability.

- Not a universal view. Arguments against
  - Can promote silo approach whereby agencies promote own objectives as opposed to overall policy objectives.
  - Makes reallocation of resources across agencies with similar objectives more difficult – less competition for resources.

- Some experiments with inter-ministerial appropriations disappointing largely due to lack of clear accountability for use of resources.
  - Largely abandoned in 2007 UK spending review.
  - Rationalized in France from 11 to 8 inter-ministerial “missions” to reinforce ministerial responsibility for program implementation.
Need to link input costs to outcomes

- Program budget classification need to reflect input costs associated with meeting program objectives

- Program concept should integrate recurrent and capital budgets.
  - Need to identify all factors contributing to meeting program objectives.

- Program budgeting does not exclude some input controls. Virement limits often imposed for sub-program and activity levels on line ministry managers.
  - Input reallocation can be limited to the identified main economic categories or more simply personnel expenditure and capital expenditure may be controlled within the program structure.
  - Enables control over levels of employment and can act to protect capital expenditure in times of fiscal pressure.
Thank You