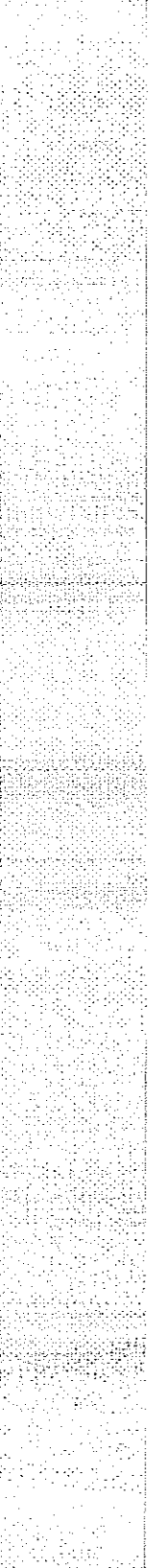


Francesco Forte

**CABINET DECISION MAKING AND THE
BUDGET**

Estratto





CABINET DECISION MAKING AND THE BUDGET

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Introduction.

The paper deals with the problems of governance in Europe after the Maastricht Treaty and the Stability Pact following the Monetary Union.

First section deals with the need of a monocratic budgetary process by the Cabinet in the « governance », as for the allocation and management of public expenditure and revenues not only of its own Budget but also and chiefly of the consolidated *General Government Budget*, inclusive of the Budgetary relevant *Public Enterprises*, of the *Non Commercial Autonomous Public Agencies and Institutions* (as those in the area of Welfare and Education) and of the *Lower Level* (regional and local) *Governments*. Limitations of *powers of making debts* and *extensive privatizations* are suggested to increase the effectiveness of governance by Cabinet.

Second section deals with the « basics of public expenditure » in relation to: a) *aggregate fiscal discipline*, b) *allocative efficiency*, c) *operational efficiency*, suggesting, to these effects, the discussion by the Cabinet and approval by its Head and then by the Parliament, *before the Budgets*, of a *Document of Financial and Economic Planning* with the macro and meso fiscal figures for the medium term. As for the deficits they shall be binding, for the entire period. For the rest of the content, they shall oblige for the first year only. The *Monocratic Budgetary Process* shall be carried on by the Head of the Cabinet and by the Minister of Treasury on the basis on that Document.

Third section focuses on the requirements of a) *Transparency*, to be reached avoiding « opportunistic behaviour » accounting practices and b) *Financial Accountability* to be reached by « prudential accounting » and by limiting the development of Central Government's contingent liabilities.

Fourth section is on the role of a *Top Level Independent Cabinet Auditing Office a)* to coordinate and standardize *the information flows* of the various entities of Central Government and of General Government *b)* to monitor the unreliable agents of the various entities relevant for the General Government Budget.

Fifth section deals with the Central Government as supplier of Budgetary and non Budgetary priorities and with how to identify the demand for *basic priorities of the country*, to make choices suitable to consensus.

Sixth section is on how the Cabinet should keep its binding priorities, by *realistic forecasts, prudential policies* and *determination in carrying on its fundamental* choices.

Final section: deals with evaluation of: *a)* implementation of strategies of the Cabinet; *b)* implementation of basic macro and allocational choices of the General Budget; *c)* public bodies performances — both by the Cabinet Auditing Office and by an external Auditing Institution reporting to the Parliament (as in Europe the Court of Accounts), comparing them with the controls of market economy corporations (1).

1. *Central Government and the « General Government's » Budget. The Monocratic Budgetary Process by the Cabinet.*

The Cabinet of the Central Government (henceforth C. Gov.) is in the core of the « fiscal governance issue ». It has, however, a sort of asymmetric situation, particularly as for the effectiveness of its policy decision making. On the one hand it is considered by the Stability Pact and by the financial markets and investors, as responsible of general fiscal governance; on the other hand, in a polycratic country, it is not the sole fiscal and budgetary power. Normally a parliamentary process is required for the approval of C Gov.'s Budget: and par-

(1) The focus is on countries, that to be able to sustain an high growth path together with domestic and foreign monetary stability, require a structural adjustment process and, more generally, an economic policy in which fiscal governance is paramount. The international perspective is necessarily that of global markets. I draw both from my personal experience as Cabinet member and Minister of Finance in the '80 and as Chairman of the Italian Senate Finance Committee, in the first years of the '90; and from my researches for International Institutions on developing countries and on European countries' problems in the adjustment processes; these last to meet the Maastricht criteria on deficit and debt and the subsequent requisites of the Stability Pact.

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liamentary amendments might challenge the fiscal discipline devised by the Cabinet, unless there are severe constitutional constraints (2). Furthermore, generally, do exist autonomous Lower Level Governments (hence forth L.L. Gov.) and quasi autonomous Public entities and Public corporations whose budgets may comprise deficits and debts not easy to be detected and controlled by the Cabinet. These « off Budget » (3) public institutions represent a big problem for the fiscal governance by the Cabinet (4).

Some of them are physiological components of a well organized pluralistic system of Government conforming to the requirements of a modern market economy, open to the global markets. Thus even if a robust executive power with a head endowed of great power, is necessary, as the « captain of the ship of the country », to guide it firmly in the open sea of contemporary global economy, important Local Governments with their autonomous Budgets are necessary for an orderly, efficient economic and civil society, in an age of expanding urban population.

But many other « off Budget » public or quasi public institutions, organized as non commercial or commercial autonomous entities, administering public money, have a much less dubious qualification. They often appear to be hybrid entities playing as « quasi Government institutions » vis a vis the market, to enjoy privileges of the status of « public entities » and as « quasi market » vis a vis the Government, to claim autonomy and exemptions from its fiscal discipline (5). As a general rule, a clear line should be drawn between

(2) In Italy the constitutional constraint to fiscal deficits by article 81 of the Italian postwar Constitution has not proved effective, because too vague and badly controlled. See FORTE, 1999. According to the postwar German Constitution (Grundgesetz) article: 110 and 115, in the Federal Budget, expenditures other than those for investment must be balanced by final revenues. According to article 113 amendments by the Parliament increasing, expenditures or reducing revenues immediately or in any future time need the consensus by the Federal Minister of Finance. According to article 40 of French Constitution of 1958, Parliamentary amendments are not admitted if cause a reduction of revenues or an increase of expenditures even covered by new tax burdens. According to the Gramm-Ruding-Holling Act approved by the Congress and the president of US in 1985 the Federal Budget had to be constrained to a gradual deficit reduction, to reach the balance in 1991. The new procedure initially did not prove effective (see LELOUP, LUCK GRAHAM & BARWIK 1987). However in 1999 the US federal Budget shows a surplus.

(3) The Budget I am referring to, here, it is — obviously — that of the Central Government narrowly defined.

(4) German Constitution, article 112 submits all the « off Budget » expenditures to the consensus of the Federal Minister of Finance.

(5) For the fiscal issues raised by the « blurring of the public and private sector », as for Asian (emerging) countries by these entities see HELLER, 1997.

these « off Budget » entities that may be considered as public *entreprises* (let me call them OBE) and the (often innumerable) public entities of *non commercial* nature, as those in the area of health, welfare, culture, education, recreation, research which must be considered as « non profit » public institutions and the Regulatory Agencies as well (let me call all of them OBN), whose Budgets should be consolidated within the Budget of the Government which owns or controls them. The General Government Budget (henceforth G. Gov. Budget), obtained by consolidating C. Gov. Budget, C. Gov. OBN Consolidated Budget, financial results of C. Gov. Budgets, L.L. Consolidated Gov. Budgets with their OBN and results of their OBE, shall give to the head of the Cabinet the full picture of the scope of Cabinet's Budgetary tasks. OBE, whether belonging to the C. Gov. or to L.L. Gov., and whether performing industrial, or trade' or financial services, in my opinion, should be organized as « corporations » subject to the laws of private corporations, without any privileged access to the banking system and to the financial market (6); and as far as possible also « privatized » from the point of view of the capital ownership. So that they shall be subject to the control of the market and obliged, by its constraints, to balance their current budgets and to be careful in their investment policy (7). Before a true privatization has been carried on, their current deficits should be included in the Budgets of the Governments (8) to which they belong, *in the year in which they arise*. As a rule — if a Government believes that systematic lossess of a given public enterprise, let us say the State Railways or a Municipal Bus Service, are justified in terms of public service — that Government should give an yearly grant to that OBE, obliging its management to balance the current accounts, *gross of grant* (9). As for capital expenditures of OBE, financed by debts, until they are not substantially privatized, seems to me, that these expenditures should be added to the investment expenditures of the Government to which they be-

(6) These are, actually, the rules prescribed by the Maastricht Treaty, as for public enterprises, to avoid distortion of competition and to control excessive public debts, in the European Union.

(7) In some cases the Government might simply retain a small (e.g. less than 5%) « golden share ».

(8) Frequently the lossess of OBE are temporarily financed by debts with the creditors and the banks.

(9) The European Union tries to set the rule that only exceptionally public service' public enterprises should be allowed to get transfers from Governments other than for investments. But it has not yet succeeded in enforcing this rule for State Railways and Municipal and Regional Transportation Services.

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7. *Evaluation of Implementation of the Budgets and Concluding Remarks.*

Implementation of Cabinet Budgetary choices shall be judged from two points of view: the degree of success of the *strategy* and the *performances* in the various sectors of activity at the macro and at the micro level. Two type of Institutions of controls are required and generally adopted by the most refined Budgetary legislations: the internal auditors guided by the Central Auditing Office, and an external control Institution (as in many European Countries the Court of Accounts) who exerts its control on the Central Government and its main Institutions, referring to the Parliament.

In a private corporation, internal control, is done continuously by the « Budget » office and an external control is generally done by professional auditors who certify the accounts; but above all, the main external control of a corporation is done by *the market*, through the Stock Exchange. Here actual profits and their perspectives, are the indicators of the success for the *strategy* adopted and for the *efficiency* and *effectiveness* of its implementation. As for Cabinets, there is not this specific kind of control. The Parliament and public opinion do not replace the Stock exchange. Domestic and international financial markets however judge Cabinets too. What matters for Governments Budgets, with some similarity to corporations, are

- 1) the timely implementation of the medium long term *structural strategies* to which the Cabinet is committed,
- 2) the results in terms of macro economic and fiscal parameters,
- 3) the indicators of *quality* from the point of view of *efficiency, effectiveness and equity* of fiscal action.

It is beyond the scope of this presentation to examine the methodological aspects of this control. Let me end, quoting a recent J. Stiglitz « Lecture on Economics in Government » « Making Government processes more open, transparent and democratic, with more participation and more effort at consensus formation, it is likely to result not only in a process that is fairer, but one with outcomes that are more likely to be in accord with general interest ».

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long; and their debt should be accounted for as a « contingent liability », in Government's accounts.

OBN *financial autonomy should be severely limited*. They should be obliged to balance their Budgets both for the current and capital expenditures, by their revenues and transfers from C. Gov. and L.L. Gov. Budgets. They should not be allowed to have access to credit from the banks or the financial market (10).

L.L. Gov. not only should be obliged to balance their current accounts budget as OBE, in order to allow the Cabinet to be in full control of the aggregate public debt and of its management, capital investments of L.L. Gov. Budgets should be financed exclusively by their final revenues, by capital transfers from the C. Gov. and by loans from a C. Gov. specialized credit institution asking for guarantees on their revenues (11).

Many public services may be run by private enterprises under a Regulatory Authority.

I would there fore propose another general principle: privatize all the public investments that can be run with market economy resources, to save the scarce public resources for high priority investments inherently public, in the Cabinet judgement. Water supply, sewer systems, highways, telecommunications, Tv, airports, ports, airlines, many railway and bus services and postal services, ecological services and related investments may be handed over to the market economy (12), perhaps with free supply of the land on which the investment has to be made. But also schools' building, hospitals, and several other buildings destined to the provision of public goods — as justice, police and so on — can be supplied by market economy investors, to whom the Government shall pay rents and leases. In Britain, all the services of the municipality of Coventry have been leased to a private business, that runs them globally.

(10) Maastricht rules, in this respect, merely state that no public institution should have privileged access to credit. In Italy Health institution have been prevented from access to credit from credit institutions and the financial markets. However it is possible for their supplier to discount in banks their credits with them; and this possibility has created systematically a hidden amount of debts of these OBN, which the Central Gov., time to time, feels obliged to take upon itself to avoid interruption in the Health services.

(11) This system works quite well in Italy, by mean of the « Cassa Depositi e Prestiti » (Loans and Deposits Fund), a specialized Financial Corporation belonging 100% to the Treasury, instituted in the other century.

(12) This extensive privatization has been particularly done by UK. See H.M. TREASURY, 1997 and SAWKINS and McMASTER, 1997 and WORLD BANK, 1997.

To own less in order to controll *more effectively* seems to me a very important general principle for the Central Gov., in our « information era » in which information flows, technological progress and global finance grow together. We in Italy (and also in Germany) until now, have had a different idea. The result has been that many times big state corporations have conditioned the Governments, rather than the opposite.

2. *Aggregate Fiscal Discipline, Allocative Efficiency, Operational Efficiency.*

Here, drawing from the international experience and particularly from the Italian, in its recent period of successful fiscal adjustment (13), I suggest two main institutional devices, which should interact.

a) The discussion by the Cabinet — and then by the Parliament some month before the Budget discussion — of a Document of Financial and Economic Budgetary Planning for the next three or four years (14) period. I shall call this Document as DFEP (15). The DFEP should be binding, bot for the Cabinet choiches to be submitted to the Parliament and for the Parliament, for the first year and indicative for the others except for the deficit figure. It shall be prepared and up dated every year by the Minister of Treasury and Budget (or, under another terminology, Minister of Finance), under the *strict supervision by the Head of the Cabinet* (the President of the Republic or the Premier) assisted by his Council of Economic Advisers (or similar body). The DFEP shall be discussed in the Cabinet. Even if

(13) See, among others, the basic contributions of TARSCHYS (1986), SCHICK (1986), OECD (1987).

(14) Each incoming year, one new year shall be added to compensate for the year gone.

(15) This kind of Preliminary Budgetary Document, introduced in Italy with Law n. 362/1988 and made more effective in the '90, has been paramount in allowing the Italian Cabinet to cut drastically the high deficit of the C. Gov. and of the G. Gov., entering the Monetary Union in 1997, with only a 2,7% G. Gov. Budget deficit on GDP. The Italian triennial DFEP (known as « Documento di Programmazione Economica e Finanziaria » Dpef) is approved by the Cabinet in June and in September by the Parliament with a vote binding for the first of the three years. The Budget and the financial law approved by the Cabinet in September and submitted to the Parliament in October, are based on this Document. Thus the figures of the deficit and of the indebtedment of the future financial year, i.e. the next calendar year, cannot be modified by the Parliament which has already approved them. On this institution see DA EMPOLI, DE IOANNA, VEGAS (1988 and new ed.).

ditures and to increase tax revenues. The fourth, may be *lack of implementation of the legal and administrative measures* approved to reach the given targets.

A tendency of the Cabinet to be not too pessimistic about the general economic trend may be understandable: pessimistic official views may unduly depress the expectations by actors of real economy and in the financial markets. However *unrealistic* official valuations of the domestic economic trend and lack of careful consideration of the international perspectives, after a while, become falsified: and this reduces the reliability of the Cabinet also for its own committments. Revision downward of revenues and upward of some expenditures (as those for the deficits of enterprises of public services) and an increase of the expected rate of inflation may call for unpleasant corrective measures. Thus a prudent assessment should be adopted in forecasting of the domestic and of the international economic perspective. Public economy macro variable should be related to the variables of the market economy, with *prudential parameters*. The elasticity of tax revenues to the economic variables should be assessed in an *asymmetric* way: underassessing somewhat the positive elasticity of revenues to the improvement of economic conditions, while doing the opposite as for their elasticity to the worsening of the economic trends.

Fiscal adjustment targets may be missed because the rules introduced in the Budget legislation to limit expenditures and to raise revenues may result too optimistic: drawing from Italian experience, for instance, deficits of enterprises of public services may develop above the expectations, because the new constraints imposed to them are inefficient; improvements of tax collection may prove illusory. One should be careful in assessing the probable effects of these measures.

Ex post corrections are much better than disobedience to the binding committments. However because undertaken as urgent measures, they may lack of structural quality. And — again I draw from Italian experience — they transmitt to the citiziens and to the markets, a sense of frustration about the reliability of the Government fiscal policy and the usefulness of the sacrifices required. Thus it seems advisable to leave a certain amount of flexibility in the Budget, with some reserves on the revenues and expenditures side, so that if unforeseen deterioration in the accounts do take place, it is possible to avoids new corrective measures.

therefore the exploration of the degree of consensus on them in the society is particularly important, to avoid successive surprises.

But public services priorities do not necessarily imply more *financial resources*. The unsatisfied demand of public goods many times arises from *lack of quality* in public services. Bad quality may depend from excessive regulations, lack of clarity on the division of competences among the various authorities, duplication of administrative practices between Central government's Administrations and Regional and Local Government's Administrations, time consuming bureaucratic behaviours, corruption. Some of the remedies consist in reducing the amount of regulations, in simplifying the procedures, in obliging Public Administration to be transparent in their choices and to terminate the various practices within *defined* time spans, after whom the authorizations required are automatically given. Incentive should be employed to entice the bureaucracies to efficient behaviours.

6. *Binding Commitments in Cabinets' Budgetary Decisions.*

Not all Cabinet budgetary decisions should be conceived as binding. It is better to stick firmly to a selected list of basic commitments, than to try to be inflexible on the entire Budgetary spectrum. Within the macro fiscal constraint set by the DFEP, amendments by the Parliament may improve the quality of the allocational choices and, any way, make easier their acceptance in the country. Some flexibility, in the Parliamentary debate on the Budgets presented by the Cabinet, should also be allowed particularly as for the allocation of expenditures among the various functions, and the relative weights of the various tax burdens, provided that the broad "political" priorities agreed upon by the DFEP are respected.

Cabinet binding commitments related to the « fundamentals » should be *realistic*. There are four main reasons why targets to which a Cabinet has declared to be strongly committed may appear, in the course of time, to be unattainable under the decisions already made or even with corrective measures. A first reason may be that the *general economic picture* to which the Cabinet has related its fiscal choices, *had been wrongly assessed or has changed* because of unexpected events. A second reason may be *inaccurate assessment of the expenditure and revenue trends*, under the given general macro economic picture. A third reason, may be a *too optimistic valuation of the effects of the legal and administrative measures decided* to contain public expen-

in a Presidential System (16) it shall not need an approval by the Ministers, however it is important that the various branches of the government agree on its figures, so that it may become the rational basis of the Budget. Main feature of DFEP shall be the binding indication of the maximum deficit and net indebtedment of the Central Gov. and of the G. Gov. Budgets as percentage of GDP, for the next three (or four) years period. G. Gov. Budget, according to the system of European Accounts (SEC) that has official Status for the budgets of the Governments of the European States, member of the Monetary Union definitions, shall be the result of consolidation of the C. Gov. Budget, the OBN and the L.L. Gov. Budgets.

b) The formation by the Head of the Cabinet — (on the basis of the DFEP) — of a *unique* Budget of the C. Gov. and of a unique G. Gov. Budget to be run by the Minister of Treasury under his *monocratic responsibility vis a vis the Head of the Cabinet* (I shall call this « monocratic Budgetary procedure » as MBP) (17). The Minister of Treasury shall also be responsible of these two Budgets vis a vis the Parliament., on behalf of the Head of the Cabinet. The Minister of Treasury, shall be enabled to accept emendaments in Parliament, after consultation with the Minister responsible for the relevant expenditures and/or revenue and, in the most important cases, with the ead of the Cabinet. In case of emendaments changing the allocation of resources among branches of Government, to whom the Minister of Treasury in principle has no objection, the Head of the Cabinet shall consult the Cabinet to make the final choice.

Let me explain the logic and the contents of this « two stages » procedure-to which the present italian system only partially conforms.

DFEP shall consists both of *macroeconomic and macro and meso fiscal* figures and of the *strategic guidelines* of legislation and policy action to be set forth to attain — in the medium-long run — the quantitative targets, which, for the next three (four) years, yeld to those DFEP figures. Therefore, proposals by the Cabinet to the Parliament of new legislation to achieve the quantitative targets of the DFEP should accompany the project of Budget law. While the preliminary approval by the Parliament of the content of the DFEP constrains its *amending power* as for the subsequent discussion of the items of Bud-

(16) In the European Union, presently, only France bears a resemblance with this system.

(17) In Germany, France, UK and US, within four different types of Conisutational structures, a « MBP » is clearly applied.

get, it may not *legally constrain* it to approve the related legislation, because these proposals, in the DFEP, may be indicated only by *guidelines*. The Parliamentary majority supporting the Cabinet, however shall be *politically committed* to approve that legislation, *with the timing* set in the DFEP.

The Head of the Cabinet, by the DFEP, thus shall commit its Cabinet to a medium-long term budgetary strategy supported by *structural reforms*.

Macro economic figures of the DFEP shall include expected rates of growth of GDP in real terms, inflation rates, main balance of payment figures as ratio on GDP, foreign debt as percentage of exports (18), rates of private and aggregated consumption, savings and investments percentages on GDP, level of employment and rate of unemployment.

As for the Budgetary macro figures, DFEP, both for the C.G. budget and the G.G. Budget shall give — in money terms, in constant purchasing power and as percentages on GDP and as per cent over the previous year: *aggregate current and capital final expenditures and tax and non tax (transfers and other receipts) final revenues, resulting deficit or surplus in the current accounts, in the capital account and in the aggregate final balance and aggregate public indebtedment, distinguishing domestic and foreign debt and giving this last as percentage of exports* (19). The *Primary Budget*, with the balance between expenditures different from interests on debt and all revenues shall be distinguished from the *Secondary Budget*, including the debt service. The DFEP shall also be the place where the Head of the Cabinet obtains the opinion and the consensus by the various branches of the Government's apparatus on the main budgetary allocations, both for its C. Gov. Budget and the G. Gov. Budget, with particular attention to main welfare OBN and main OBE and to the Local Gov. Budgets. To assess their broad relation with the markets, public expenditures of the Primary Budget should be distinguished in purchases of goods and services, wages and transfers to the families, to the economy and to abroad (if any).

A two stages consolidation, appears useful, to make transparent

(18) This amount shall include commercial debt without GG guarantees, commercial debt with GG guarantees and public debt.

(19) Full G. Gov. debt *liabilities* must include also Gov. guarantees on commercial foreign debt. On the other hand, the aggregate foreign debt figure inclusive of the commercial foreign debt should be given among the macro economic data of the DFEP.

functions. However misallocation may arise from the fact that some regions are undersupplied while others, for mere historical reasons, or other reasons, may be oversupplied or do not need any increase of supply.

But how to assess the allocational priorities, at the Cabinet level? Some preliminary big choices are « political decisions » on which the Head of the Cabinet has to take responsibility with the Parliament. Typically the aggregate rate of growth of public expenditure is a choice of this kind. Another broad « political » decision relates to the priorities among the four main categories of public supplies: law and order, public goods for the production, civil and social public goods (44) I would suggest a shift of emphasis in favor of the supply of goods for the production over those for social welfare (45), in a structural perspective the supply of « production » public goods may have a much higher rentability, both in terms of economic growth and of employment; so that they may provide better responses also to the demand of equity and social welfare.

Many allocational choices cannot be decided by broad political judgments: need detailed field research on the demands and supplies of public goods, which often are complemented by private supplies: as for instance, in the case of education, health services or water supplies. *Basic needs* should be assessed in terms of global needs: those currently satisfied by the Governments, by the non profit institutions and by the market, those that remain systematically unsatisfied and the hidden needs that, some time, in the area of civil needs and by welfare for the less favoured, have a higher priority.

To get consensus on its allocational choices, the Head of the Cabinet should promote hearings in Parliament on the various important needs, in the various areas of the country. The Parliament, to this effect, shall also hear organizations representing the various interests: association of entrepreneurs and of independent workers, workers Unions, cultural and social Associations and main Institution and representatives of the L.L. Gov. When fiscal discipline requires containment of expenses, choices about priorities may be hard and

(44) Some of these classes cross the functional classification of public goods: thus, typically, vocational education belongs to the category of « goods for the production » while other kinds of education' expenditures belong to the civil and social welfare.

(45) In a short run view, these may be extolled from a distributional point of view.

activity that they perform, expressed by standard indicators (for instance the average and maximum and minimum number of students per teacher in a given type of schools in the various districts, or the time lag before a patient is visited by the Public Health Service) Among the economic data, prices paid (as the unit cost of km of street built with given standards) are very important. Comparisons of prices actually paid and standard market prices may be an useful device to monitor corruption and irresponsible behaviours.

5. *Central Government as Supplier of Priorities and the Demand for Priorities in the Country.*

Public Budgets have an *inertial* tendency to increase every year in real terms. The problem of avoiding this « inertial » growth and of addressing the C. Gov. Sector Budgets and the L.L. Gov. Sector Budgets to the right priorities is thus, for the Cabinet, the *first priority* to obtain allocative efficiency and public consensus. *And, first of all, for a sustainable balance between public and market economy sectors.* Collective needs, several times, might be satisfied with a lower aggregate level of public expenditure implying a lower tax level and a reduced pressure of public debt on the interest rates. And more than often a lower percentage of public expenditure on GDP, even without reducing its aggregate level in real terms, may be a wise choice, when the real rate of growth GDP is significant.

But the Cabinet must also be able to react to inertial tendencies to differential increases of public expenditures in some sectors of the public economy at expense of others, to strike a *right balance between functions.* Somebody, to react to the differential tendency of the various sector of public spending to inertially grow, suggests a *zero point* budgetary procedure. This seems to be an unnecessarily drastic change in budgetary practices, which risks to fail for lack of operational consensus by the various bureaucracies concerned. Inside any great function of public expenditure, shifts among subclasses may improve the quality (e.g. shifts from secondary to vocational education, in the education function). On the other hand, the *geographical* allocation too should be systematically considered. Normally Cabinets produce only functional classifications of public expenditures among the various branches of the Public Administration, at the Central and Local level, rarely Cabinets produce and propose to the Parliament, in their Budgets, the *geographical distribution* of expenditures by

operational choices. In the first stage the C. Gov. *Sector Budget* — should be formed by consolidating among themselves all OBN and adding this aggregate and the deficits and liabilities relating to the OBI of the C. Gov. Budget. To this first stage also belongs the consolidation of all the L.L. Gov. Budgets in a L.L. Gov. *Sector Budget*. Then the G. Gov. Budget shall be obtained by consolidating the C. Gov. Sector Budget with the L.L. Gov. Sector Budget. Clearly, among its allocational choices, the Cabinet has to decide the amount of transfers to the OBE, to the OBN and to the L.L. Gov. Sector Budget, in relation to their needs and to the overall constraints to the G. Gov. Budget balances. It has also to decide the interventions on the expenditure and on the revenue side to be done by legislation or otherwise to meet these targets.

To allow the Cabinet to discuss on the main allocational choices both for its own branches and for the other entities of the C. Gov. Sector, for the L.L. Gov. Sector and for the aggregate G. Gov. Budget — expenditures, current and capital, shall be distinguished by main *functions* and revenues by main *categories* (direct taxes, domestic indirect taxes, indirect taxes on international affairs, social security contributions, transfers, other revenues (20)). They shall be given in monetary terms and in constant purchasing power amounts, as percentage of GDP and as percentages of the C. Gov. Sector Budget, of the L.L. Gov. Sector Budget and of the G. Gov. Budget. Real rates of increase or decrease of expenditures by functions and revenues by classes over the the past years and in the medium term shall also be given.

The standard classification by « *functions* » on the expenditure side (21) crosses that of the Ministries of the Government and may be too general. Four or five *Subclasses* for any of the *main functions* shall be given to provide a less global picture and allow more and better allocational choices (22).

(20) The WORLD BANK, in its « World Development Report » classifies the (Central) Government revenues in Taxes on income, profit and capital gains (i.e. direct taxes), Social Security Contributions, Domestic Taxes on goods and services (i.e. domestic indirect taxes), Taxes on international trade and transactions (i.e. indirect taxes on international affairs), other taxes and non tax revenues.

(21) As given by the World Bank, in its annual « World Development Report »: Defense, Education, Health Housing and amenities, Social Security and Welfare, Economic Services, Others.

(22) WORLD BANK in its « World Reports », for instance, classifies « expenditure on education (inclusive of both public and private education) in « primary », « secondary » and « tertiary ». To them one should add « vocational education » and « pre-scholar education ».

The Head of the Cabinet and the Minister of Treasury (or Finance), as seen, have a paramount task in the preparation and discussion by the Cabinet of the DFEP. This discussion, in turn, gives them the full support of the various branches of the Government' apparatus to carry the Defp to the approval by the Parliament. Thus the Minister of Treasury shall be able to manage the approval of the C. Gov. Budget, the C. Gov. Sector Budget and the G. Gov. Budget and the financial legislation accompanying them in the parliamentary debate, *within the constraint of the DFEP*. But to be able to keep firm the right figures for these Budgets, the Head of the Cabinet assisted by the Minister of Treasury must have a monocratic power in the Budget. This Monocratic Budgetary procedure (MBP), clearly, is not sustainable economically and operationally if its allocation of resources is not inserted in the frame of macroeconomic fiscal discipline obtained by a macro medium term structural program. Thus a combination of DFEP and of MBP seems necessary to get *the basics right* from the point of view both of fiscal discipline and allocation of resources (23) Operational efficiency both in the parliamentary process and in the execution of the Budget shall benefit from this combination of institutions (24).

3. *Transparent Budget and Fiscal Accountability.*

A policy of fiscal discipline carries, as an inherent risk, the tendency to distort the budgetary concepts by « opportunistic accounting » to reduce the official deficit and debts of the C. Gov. Budget, to shift deficits and debts « off budgets » and to move from true budgetary obligations to non budgetary commitments (25). In a sense

(23) Italian experience in this area provides a « negative » evidence of the validity of the combination of a DFEP with a MBP. Indeed, because of lack of MBP, fiscal discipline to meet Maastricht criteria has been achieved chiefly increasing the tax burden and reducing the public expenditure in investments, while particularly generous schemes of old age pension have allowed these current expenditure to soar as percentages of GDP. On the other hand the Italian DFEP does not present any allocation of expenditure by functions for the C. Gov. Budget or for the G. Gov. Budget, nor includes any important OBE and the OBN Sector Budget. Thus the huge deficits of the State Railways and of the Old Age Social Security Institutions escape the attention that they should deserve from the point of view of « keeping the basics right ». On the question of the quality of fiscal adjustment and fiscal deficits see Selowsky, 1999.

(24) In a « Presidential Republic » the MBP rests on the President's budgetary power while something like the DFEP rests on the cooperation between his Offices and those of the Treasury.

(25) On the « opportunistic accounting » or « creative accounting » practices

the Head of the Cabinet (39) or from his Minister of Treasury responding to him (40), but must be organized as an autonomous Agency, with officials scattered in the various branches of the Central Government and in its main « off Budget » commercial and non commercial entities, to assist and supervise the auditors of each administration.

A primary task of CAO is to provide a standardized system of accounts to be employed to assemble *omogeneous data*, to prepare the C. Gov. Sector and the L.L. Gov. Sector Budgets. Normally the system of accounts of the Public Institutions entering these two grand Consolidated Sectors' Budgets differ. Some of the differences are unnecessary and should be eliminated by imposing standardized accounting rules (41). However the approval and implementation of this reform may take time, particularly because requires a learning process and changes in the informatic networks. On the other hand, some differences in the accounting rules are unavoidable, because the Budgets of public enterprises should follow the rules of accounting of the market economy corporations (42), while the Budgets of the Gov. at the various levels and of their non commercial Agencies and Institutions need to follow the general criteria adopted for the Governmental Institutions. Prudentail accounting shall differ for the two kinds of Budgets, particularly in areas as that of purchase of assets and of contingent liabilities. Thus, to avoid the risk of assembling heterogeneous data, CAO should prepare standardized forms for the reconciliation of the accounting criteria of the different branches of the various Governments, Agencies, Institutions and Public service enterprises.

Auditing shall not be limited to mere collection of *ex ante* and *ex post financial* data of expenditures and revenues. It seems very important to collect *economic* and *resourceist* informations (43). Among the last is quite important to know the amount and type of personnel employed in the various Institutions and offices and the amount of

(39) The President of the Republic, in a system where he is also the Head of the Government as in Usa or in France.

(40) In the Presidential Federal System of US, this task is performed by the OMB (Office of Management and Budget).

(41) Preferably those adopted by the Official International Institutions as EUROSTAT, 1996 and IMF, 1996.

(42) See for instance INTERNATIONAL ACCOUNTING STANDARD COMMITTEE, 1997.

(43) See on this theme the basic paper of POLIVKA and STRYKER (1983) on the experience of the PRE (Evaluation and Program Review Unit) in the Office of Planning and Budgeting (OPB) of the Governor.

ernments should finance themselves only by bonds and other certificates, *issued on the market* (36).

Accountability of the Budget and therefore effective governance by the Head of the Cabinet upon the G. Gov. Budget and particularly upon its own Budget, implies, generally speaking, a situation that, in the terminology of derivatives, is of « put options » not of « call options ». In other words, the Cabinet must be in the position of « asking » the others to conform to the prescribed behaviours not of « being asked » and constrained to intervene in their favour, when they need money.

Thus, preferably, public debt should not be short term debt. Contingent liabilities should be minimized, being a « hidden risk to fiscal stability » (Polackowa, 1999) and, any way, should be accounted for in some Official Document Annex to the C. Gov. Budget. According to the German Constitution, in so far as they might give origin to future debts, they must be authorized by a law (37). Governance by the Cabinet implies that it should be very careful in providing guarantees for the debts of other entities. Obviously they, when given, may be a nice way to avoid more expensive interventions as loans or straight transfers to these entities. But they create an uncontrolled hidden burden for the C. Gov. Budget (38).

4. *Top Level Cabinet Auditing Office to Coordinate the Budgetary Information Flows and to Monitor Unreliable Agents.*

The collection of informations from the various branches of the C. Gov., from the OBN, from the L.L. Gov. and from the OBE, in order to prepare the DFER, to write the proposals of C. Gov. Budget, of C. Gov. Sector Budget and the L.L. Gov. Sector Budget, to be consolidated in the document the G. Gov. Budget and to follow their implementation and prepare the final statements, is a gigantic task: which informatization may greatly ease but cannot solve without a top level coordination. Experience shows that to accomplish this task a specialized Central Office of Auditing is needed. This Office, which I shall call CAO (Central Auditing Office) may depend directly from

(36) This is one of the main rules of the Maastricht Treaty for the fiscal discipline. It may be eluded by issuance of debts by OBN and OBE.

(37) See article 115 of the GrundGesetz.

(38) See POLACKOWA, 1999 and FORTE, 1999 in the same Volume.

deficits and debts are similar to the dust on the floor of an apartment of several rooms: those in charge of cleaning, rather than remove the dust by an exacting work, may take the easier way to hide it below the carpets and the furnitures. Thus one may cut transfers to Welfare institutions from the C. Gov. Budget allowing these institution to accumulate debts with the beneficiaries or with their suppliers (for instance suppliers of farmaceuticels and of food to hospitals who, as in Italy, may discount in banks their credits).

Obviously if the accounting is transparent and the obligations are correctly accounted for, the consolidation of the OBN with the C. Gov. Budget shall show the dust that has gone below the carpet and it is still in the room. But the consolidation might be done improperly. Some time *Cash Budgets* and not *Budgets in terms of obligations* of non governmental-public institutions are consolidated with the C. Gov. Budget. On the other hand, even under a consolidation of the Budgets of the C. Gov. Sector and of the L.L. Gov. Sector in terms of obligations, legal devices may be employed to conceal debts. A typical fix consists in accounting, as obligations, on the expenditure side, the amounts *actually credited*, i.e. *credits payable* — a spurious concept of credits which is close to the cash concept. By opportunistic accounting rules credits payable may be made greatly different from the obligations *matured*. To narrow the credits for expenditures to *credits payable* — norms, accompanying the Budgetary Law, may limit the Public Administrations spending capacity in the next year, to a given percentage of their total appropriations, expressed as a ratio over the expenditure of a past period (26). By this rule, a host of pending obligations may be postponed to the future, without giving origin to present “credits” on the expenditure side of the Budget some time this practice may be welcome to reduce the impact of the cash flow from the G. Gov. Budget on the monetary circulation (27). The question, however, is whether these temporal adjustments represent *true savings* for the Budget or only a *temporary relief* which merely shifts problems to the future, aggravating the future liabilities.

adopted in the European Countries to ease their accomplishment of the Maastricht deficit and debt rules see FORTE (1997).

(26) This procedure has been extensively applied by Italy to meet the Maastricht parameters on deficit and debt.

(27) In some circumstance, this kind of manouvres has been useful, in Italy, to combat inflation. But the damages to the functioning of public economy and to the market economy of delayed payments of Budgetary obligations may be substantial.

In principle, even if one may not include these obligations in the Budget and hence in the deficit of the year of maturity, they should be included in the new indebtedment of that year, thus adding to the aggregate amount of the public debt of that year. But another opportunistic accounting practice is that of including in public debt only the public debts issued on the markets plus the debts pertaining to C.G. and to L.L. G *payable* (28).

Generally speaking a Budget to be transparent and fiscally accountable should follow a line of prudential accounting. By a prudential system of public accounts (29), I mean a sort of asymmetric methodology by which, on the expenditure side, in the dubious cases, *prudentially* one adopts an extensive view while on the revenue side, *prudentially*, adopts a restrictive view.

Following this prudential methodology, on the expenditure side, shall be included all the obligations, in the year in which they are completely formed, even if not payable in that year. This shall be done both for real expenditures and for transfer expenditures. In the first case one shall adopt the criterion of reference to the time when good or service pertaining to that obligation are actually supplied (30). In the second case, the criterion of the year for which the transfer is due (31) shall be applicable (32).

Often purchases of assets of other entities, public, quasi public, domestic and international, and particularly of assets of public financial institutions, are written in the Gov. Budgets *below the line*, assuming that they do not create a *net expenditure*. But prudential accounting implies that if these assets do not give to the Government

(28) Excluding the debts of OBN and the deficits of OBE.

(29) I have dealt with these issues in a paper presented to the Workshop on « EU Accession and Sovereign Debt Management », subsequently published in EUROPEAN COMMISSION and WORLD BANK, *European Union Accession. The Challenge for Public Liability Management in Central Europe*, 1998.

(30) This principle and most of the other above mentioned should be now adopted by the European countries member of the European Union, under ESA 95 (in EUROSTAT, 1996) which is applied from the 1999 Budgets on. See FORTE (1997).

(31) See the previous note.

(32) Credits for new old age pensions or for wage increases of public employees or for public works already executed might be postponed, not because of cash constraints in Budgetary management, but because of the need of time to determine the amounts actually due. But if the persons to which the new pensions are due, have a right to the status of pensioners, if the employees to whom the wage increases are due have already given their services and if the public works have been executed in part, the obligations pertaining to these events, under prudential accounting, must be entered in the public Budget, even if the *credits* are not entirely mature.

any revenue, they could be considered as transfers to be entered *above the line* (33). On the revenue side, the revenues to be entered, in the Gov. Budget of a given year, under a prudential accounting methodology, should be merely those whose obligation have been generated in that year, and only if they have the real possibility of being cashed in some not too distant future (not necessarily in that year); and only by the percentage may be cashed, discounted for the postponement of the payment, if this is supposed to legally take place in installments (34).

Obviously the above prudential accounting is meant for the objective of an effective fiscal discipline. However in addition to the Budget in terms of obligations, to be approved by the Parliament, a Cash Budget may prove useful, for *monetary policy* objectives, particularly in an inflationary period.

Cash Budgets of the various Governments and Gov. Sectors may be also useful to provide a transparent quick, rough picture of the impact of them on the aggregate demand and on the monetary flow. Periodic Reports to the Head of the Cabinet by the Treasury on Budgetary Cash flows and deficits thus may improve its fiscal governance (35). However, in order to avoid confusions, under a prudential accounting methodology, these Documents should carefully distinguish operations above the line and below the line. Above the line one shall enter, on the revenue side, only tax revenues, transfers, receipts from sales of services and goods other than public assets. Receipts; from the sale of public real and financial assets should be written below the line. On the expenditure side, above the line one shall enter all the payments for current and capital expenditures inclusive of the purchase of assets of public or quasi public entities that are not expected to give a market revenue; below the line disbursements for obligations of the past and purchases of assets giving a market revenue. The balance of the two side of the cash budget is the amount of cash that the Treasury needs to get by new public debts.

Transparency in the area of public debt requires that the Gov-

(33) On this principle see BLEJER and CHEASTY, 1991.

(34) ESA 95 on this important issue is less clear.

(35) The Italian basic Budgetary reform by Law n.468, 1978 requires a periodic Budgetary Cash Statement to be presented by the Treasury to the Parliament, for information purposes. On the relevance of « cash deficit » in fiscal management see BALLASSONE & FRANCO, 1996.