

Public Expenditure Management Challenges in Transition

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PUBLIC FINANCE

the weak element of transition

- I. **Early stage:** liberalization and stabilization; cutting back on subsidies and increasing social assistance, deficit skyrockets reflecting output collapse
- II. **Middle stage:** erosion of tax base while introducing unemployment benefits and using early retirement instead of job creation and social safety net
- III. **Advanced stage:** assuming corporate arrears as public debt before privatization of state owned firms, bank rehabilitation with recapitalization
- IV. **Mature stage:** public finance reforms; health care, pension, education, public administration, local government finance, social transfers, etc.

Asymmetry between revenues and outlays

- Revenues correlate by and large with GDP and fluctuate with the business cycle
- Progressive scale taxes accelerate revenue growth in an inflationary environment
- Expenditures are determined in nominal terms and by individual legislation
- Making their budgeting more precise but much less flexible

Changes in deficit financing

- Early stage: monetization of deficit and debt, no independent central bank, money market
- Middle stage: central bank independence, incipient market for government securities
- Advanced stage: bank privatization, more institutional investors, foreign participation
- Mature stage: internationalization of money markets, wide variety of debt instruments

Complexity of the fiscal sector

- Proliferation of extrabudgetary funds
- Multilayering of subsovereign finance
- Mushrooming of intra-fiscal transfers
- Reduction of discretionary spending
- Intensive use of public-private partnerships
- Mixing pension and tax with social policy
- Proliferation of contingent liabilities
- Fragmentation of public debt management

Streamlining the government sector

- Maximum elimination of extrabudgetary funds, except for social security system
- Current and capital budgets to be separated
- Multipillar reforms in both pension and health care - partial privatization of finance
- Strengthening local taxing authority and assigning central transfers to specific tasks
- Introducing treasury management systems and modern asset/liability management

Modernizing the budgeting process

- Comprehensive legislation driving the budgeting process, i.e. planning, execution and control should be adopted & upgraded
- Transparency and comparability ensured by stable rules of information gathering and dissemination (independent budget office)
- Cash flow and accrual based budgeting for rolling intertemporal planning
- Responsibility defined at the lowest possible level of execution (subsidiarity)

Treasury management system

- Treasury system to include the maximum number of budgetary institutions even at regional and local level
- Appropriations for public investments to be formulated in early stages of budgeting with strictly sanctioned compliance
- Income flows to take monetary form only if and when they leave the fiscal sector (unified treasury account)
- Unified cash and asset/liability management₈

Modern asset/liability management in government sector

- Physical and financial assets of the state are to be precisely accounted for including all yields and amortization/depreciation
- Transforming financial assets into physical ones should be accounted for in the capital budget at all levels of government
- Centralized management of state debt and deficit financing (central government fiscal liabilities, including social security & health)

Eliminating quasi fiscal and contingent liabilities

- Streamline direct and eliminate indirect subsidies (tax, custom duty, social security arrears) to state owned enterprises (SOEs)
- Reduce the number of extrabudgetary funds
- Close down the development bank
- Regulate the financing of PPP-projects
- Restrict the availability of open ended state guarantee programs (e.g. student loans and mortgage lending to civil servants)

Public Finance Reforms

- Pension
- Health Care
- Labor Market
- Social Assistance
- Education & Research
- Subsovereign Finance
- Public Administration
- Legal and Judiciary
- Army and Police