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Budget, Economic Policy, and Economic Performance in Underdeveloped Countries

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1971
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This paper served as the basis of a lecture at the "Institut fur Weltwirtschaft an der Universitat Kiel" delivered on the 10th of June 1971 under the title "Budgetpolitik als Planungsinstrument in Entwicklungsländern." It is a substantially revised version of an unpublished paper delivered at the Annual Meetings of the American Political Science Association, Chicago, 1967, under the title "Administrative Contribution to Economic Performance in Underdeveloped Countries."

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Contents

> "... das Budget [ist] das 'alles tauschenden Ideologien entkleidete Gerippe' des Staates ... — ein Gemenge harter, nackter Tatsachen ... Ein ungeheurer Einfluß auf das Volkerschicksal geht von dem wirtschaftlichen Aderlaß aus, den die Bedurfnisse des Staates erzwingen, und von der Art, wie das Ergebnis dieses Aderlasses verwendet wird ... Nicht nur hat bis zur Schwelle unseres Jahrhunderts die Wirtschaftspolitik der Staaten vor allem finanzielle Motive gehabt — ... — sondern es haben die finanziellen Maßnahmen der Staaten, auch wo es gar nicht beabsichtigt war, Industriezweige, Industrieformen, und Industriegebiete geschaffen und vernichtet ... Wessen Geist Kind ein Volk ist, auf welcher Kulturstufe es steht, wie seine soziale Struktur aussieht, was seine Politik fur Unternehmen vorbereiten mag — das und noch viel anderes steht phrasenrein darin. Wer ihre Botschaft zu horen versteht, der hört da deutlicher als irgendwo den Donner der Weltgeschichte."
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> J. A. Schumpeter, *Die Krise des Steuerstaates*, Graz u. Leipzig, 1918, pp. 6sq.

This paper tries to combine political and economic matters. It examines first the political and historical limitations which any government faces; it then examines the function of the State in a market-type economy; it questions the need as well as the possibility of setting too clearly defined targets. This leads to an examination of different types of investments, and to an examination of the major function of governmental policies in achieving growth. Investment projects and a reasonably efficient and logically organized budget are seen to be the central means of getting things done.

I. Political, Economic, and Historic Limitations

"Getting things done" involves policies and hence politics. This in turn requires some idea what one wants done and what can be done and within what time span. "Efficiency" and "Planning" can have meaning only in such a context.

The objective limitations to planning are political and economic, and both are historical. This paper will, of course, deal mostly with the economic limitations. To do so adequately, however, presupposes a brief consideration of the other two adjectives used. "Historical" means that the present state has grown in time. The major implication for the purpose of this paper is that it is impossible to explain any phenomenon merely by its relation to other phenomena at the same moment of time — the content of equilibrium theory — but that one has to see all relationships as dynamic, that is, in time. Institutions, ways of doing things have grown up, are understood without conscious effort, are felt as a burden, belong to the imponderabilia of a given situation because at one time they presented a rational reaction to a then existing situation; changing them is neither easy nor always desirable. For the cost of change can be very high. It is necessary to be alive to the dynamics of a situation, i. e. to the fact that all change takes time, and all things that *are* have *become* that way.

History presents thus serious limitations of what can be done. It means that even a discontinuous revolutionary change can be introduced only if the country can survive the chaos which must be its first effect. This is not a value judgment, but an objective fact. It may be true that only a revolutionary change can free a country from obsolete fetters. But the fact that everything takes time, that people must continue to eat if they are to continue to live, means that even in a revolutionary situation there must be somewhere some continuity if the chaos is to end. So if in a country like Ethiopia or Liberia change seems slow it may reflect the quite correct judgment of the Emperor or the President that the soil of the economy has not yet improved sufficiently to allow many, quick, and drastic changes, and that such changes would merely lead to the disappearance of the government and possibly even of the country. Economic development, being dynamic, involves a long time horizon[1].

I now turn to "political." The possible political or economic aims of a country are severely circumscribed by the fact that most, if not all underdeveloped countries (as also some developed ones) are plural societies. "Tribalism" is well-known and in general is not considered a "polite" word[2]. Pluralism involves conflicts of interest of different groups. Almost any practical decision must hurt someone. If it hurts too many groups

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[1] There is at present much talk about accelerating growth and disappointment with the results. The pessimism and the "Hilfsmudigkeit" are both inappropriate, and due to unrealistic expectations. There is much evidence that presently underdeveloped countries grow much faster than presently developed countries did in the 19th century and before. More important, Kuznets has presented convincing evidence that the presently developed countries of Europe and European origin started at substantially higher levels of living when their "take-off" (to use reluctantly this highly ambiguous phrase) occurred. Economic development has to be seen with a much longer time horizon than is customary. See Simon Kuznets, *Economic Growth of Nations. Total Output and Production Structure*, Cambridge, Mass., 1971. Of all presently developed countries, only Japan seems to have had, at the time when its modern growth began, a level of income comparable to that of India or other presently underdeveloped countries!

[2] I cannot agree, however, that the "tribal" aspects of a society automatically disqualify it from economic development. I would, on the contrary argue that "tribal" societies, provided that they are not too dishomogeneous, have a better chance to develop democratically as well as economically, than others. Only when a sense of community exists can the necessary consensus be achieved without too much trouble, a consensus which economists tend to formalize as the social welfare function. To create a nation out of many diverse tribes is yet another matter.

or people, either nothing can be done; or only a repressive regime can enforce it; or the country or economy will blow up.

Pluralism imposes two limitations on policy. It requires first, that aims not be too sharply formulated, and that not too many be set at once. Any aim can be realized only by a process of give-and-take. If too many aims are set too sharply, the process of compromise becomes impossible. In another context, Kenneth Arrow has pointed out, that it may become impossible to arrive by democratic means at a majority decision, and that ultimately the "group" decision will become the decision of a dictator[1]. But even this is possible only if the dictator has the means of suppression, and a degree of administrative efficiency not often found in underdeveloped countries. Not many African armies have turned out to have the nation-building capabilities which the example of Israel was supposed to have proved they had. A dictatorship is as likely to maintain itself at the cost of all other aims, such as economic growth, as it is to contribute to the achievement of these aims.

This conclusion runs, I believe, counter to accepted doctrine[2]. It is frequently asserted that a dictatorship or at the very least a strong central power is needed to "break the fetters of feudalism," to overcome "tribalism" or whatever the current fetishword is. This may occasionally be true when specific privileges are in the way of achieving growth. But when "tribalism" is a living force its suppression is likely to absorb all the energies of the suppressor with the result that nothing else happens[3].

Concentrating on one or a few aims at a time is more likely to achieve the ends of progress. This is not very elegant intellectually. There is no consistent "social preference function" which one tries to maximize all along the line. But the analysis of Arrow and the practice of shrewd politicians alike indicate that festina lente still gets you there fastest.

[1] Kenneth Arrow, *Social Choice and Individual Value*, Cowles Commission for Research in Economics, Monograph No. 12, New York and London, 1951.

[2] See, however, W. Arthur Lewis, *Politics in West Africa*, London, 1965.

[3] In a fascinating article on the Russian revolution, Richard Lowenthal suggests that the fascination which the Russian revolution and the Russian Communist Party has had for intellectuals in underdeveloped countries has been due to the effectiveness with which the limitless ruthlessness of the CP USSR has transformed the Russian economy. Mr. Lowenthal also stresses that the CP USSR never attempted to force the impossible: "The Bolsheviks survived in power because ... whenever they were confronted with the dilemma of choice between the needs of forced modernization and the vision of Utopia, they gave preference to the former. They succeeded in extending the range of the possible because they did not persist in attempting what was really impossible" (p. 30). Is it too much to believe that failures elsewhere, particularly in the underdeveloped world, were due to the neglect, by local dictatorships, of the objective limits to their power? See Richard Löwenthal, "1917 and After", *Encounter*, London, 1967, October, pp. 27sq.

The late President Kennedy promised "to get American going," "to make a beginning." He was careful not to say how or where, and even precisely when.

Secondly, pluralism requires decentralization. Any heavily centralized government in an underdeveloped country is likely to be inefficient in the sense that not enough decisions get made and decisions made do not get executed; perhaps also that the wrong kind of decisions are made; certainly in that a large pool of less qualified people find no niche in the process of making and executing decisions.

The desire for a great degree of centralization seems to me "feudalism" in modern guise: One characteristic of "feudalism" of interest here is the strong structuring into "estates" with distinct functions. Society is economically not open. The often expressed desire to "involve the people" will necessarily be frustrated by centralization, because it does not allow this economic mobility.

Now obviously, a Minister of Finance has better things to do than to run a plow, and the occasional agricultural labor he performs for the photographers has mainly symbolic value if that. At the same time, it can be observed that while the Israeli type of agricultural settlement has aroused considerable admiration in many African countries and has seemed the answer to the problems of tribalism, communal landrights, and modernization of production, its imitation has not only been fabulously expensive but noticeably unsuccessful. The reason has been frequently (though not exclusively) that a "civil service" attitude developed; i. e. most farm settlers could not wait until they became persons of authority who could tell others what to do. The Israeli attitude which is so much admired in black Africa, of M. D.'s and Ph.D.'s working with their hands is all but unthinkable in practice in the same countries.

Decentralization will not only make use of minor talent while keeping the major talent for the decisions that must be made centrally; it will also act to break down the attitudes just described and force people to be executors as well as directors. It will therefore increase the decision-making and decision-executing ability of a society.

II. The State, Targets, and Investments

This brief discussion leads to somewhat unorthodox conclusions: if the government wants to get things done, it is better to be a little vague and to decentralize, rather than to concentrate power and push through one's fixed aims. In applying the ideas just sketched to the problem of economic development, it seems advisable to clear up briefly two further points, one of which is associated with Schumpeter, the other with Tinbergen.

The first, Schumpeterian, aspect deals with the role of the State in economic matters[1]. "Decentralization," vagueness of aims, etc., smacks of laissez-faire, economic liberalism, market economy and miscellaneous "Western humanist ideas" which are supposed to be inapplicable to the much different African or other underdeveloped societies. Indeed much of what has to be said will be a defense of the market. Nevertheless, the ideological parallel is faise.

In the first place, the development of the Smithian ideas came exactly when Europe was at the end of its "feudal" period, and laissez-faire was a method of getting out of feudalism's strangling effects. This alone should give one pause before one dismisses Smithian ideas out of hand as inapplicable to the problems of the presently underdeveloped countries. Nor should one underestimate the revolutionary impact these ideas are likely to have. Certainly Karl Marx understood this.

In the second place, as Schumpeter has pointed out, the State has an essential function in a market economy, and perhaps only there. The "withering away of the State" is not communist propaganda, but a precise statement that the individual is so absorbed in society that he ceases to be an individual. On the other hand, when the individual is paramount, distinct from and possibly even in opposition to society does it become necessary for some institutions to safeguard the interests of society and of the economy as a whole. There are many matters which are not well served by a market, although one neglects the market even in these cases only at grave peril.

There are two points involved, both of which involve the budget and budgetary policies which are the main concern of this paper. One relates, in general, to the discussion of "market imperfections." For various reasons which are particularly relevant and potent in underdeveloped countries markets are sufficiently imperfect, so that the market signals cannot be trusted to lead to "Pareto-optimal" decisions. It is often argued, that in these cases the budget should be used through a combination of taxes and subsidies to transform the imperfect market into improved signals for the *allocation* of resources. I will argue further on that the use of the budget for this purpose is likely to endanger economic development and should therefore be employed sparingly. (See Section IV., pp. 17sq.)

The second point involves the traditional function of the budget as a device to improve the distribution of income. As an example one might

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[1] See Joseph A. Schumpeter, "The Crisis of the Tax State", *International Economic Papers*, No. 4, London and New York, 1954, pp. 5sqq. Originally published as a monograph in 1918 as "Die Krise des Steuerstaates", *op. cit.* German version reprinted in: *Idem*, *Aufsätze zur Soziologie*, Tubingen, 1953, pp. 1sqq.

mention health care. It would be on principle possible to provide health care, as anything else, only to people who could pay the cost. Yet one would hesitate to allocate economic resources to the provision of health care and to allocate "health" to individuals, exclusively on the basis of the ability to pay. Schumpeter's important point is that, while there is nothing that could not be handled by a market, there are nevertheless many things that are better handled on a communal rather than an individual basis. The budget becomes the central document expressing the communal aspects of the economy.

Both points refer essentially to allocative functions of the State which will be central to the following remarks. They become particularly important when, as is the case in today's underdeveloped countries, the State is made responsible for economic development.

Thus the State is not an imperfection in an otherwise beautiful world, but an essential part of it. The point is so obvious that it is difficult to realize that economists have for almost 200 years since the appearance of the *Wealth of Nations* increasingly defined their pure theory in a manner which has virtually no place for the government. "Public Finance" was always a little separate from "pure theory," even in the German tradition, which at least gave *Finanzwissenschaft* an equal part with "Reine" and "Angewandte Volkswirtschaftslehre." Only relatively recently has there been a radical change through the efforts of Swedish economists, Keynes, Peacock, Musgrave and others. Even today, "government" is integrated adequately only into aggregative models!

I turn next to Tinbergen. Tinbergen's *Theory of Economic Policy*[1] is now generally used as a starting point of analyses of economic policies. Tinbergen distinguishes between target variables, instrument variables, and variables that are irrelevant for the particular purpose at hand. The names suggest their content in sufficient detail for the present purpose.

Tinbergen shows that normally one needs as many "instruments" as targets. One would prefer to have more, for neither are all instruments equally effective, nor do they all have the same side-effects. Moreover, as an economy is a very complicated interdependent system, it is very difficult to conceive of an instrument which is completely specific to one target. For these reasons one always has to be conscious of the interactions in an economy, and ought to be as clear as possible how the particular economy works.

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[1] Jan Tinbergen, *Economic Policy: Principles and Designs*, Contributions to Economic Analysis, 10, Amsterdam, 1964. — *Idem, On the Theory of Economic Policy*, Contributions to Economic Analysis, 1, Amsterdam, 1952. — *Idem, Centralization and Decentralization in Economic Policy*, Contributions to Economic Analysis, 6, Amsterdam, 1954.

The flexibility, productivity, and institutional bases of a developed economy which permit general signals, such as raising of the interest rate or an increase in the budgetary deficit, to be translated into action by thousands of businessmen, civil servants and workers are, however, missing in underdeveloped economies, where the absence of entrepreneurs so lamented in the literature is matched by the absence of a highly developed administrative apparatus and by what Myrdal has called the "Soft State"[1]. In underdeveloped countries, the required mix of general and specific policies will be different, the micro-economic aspects of decision making will loom larger than the macro-economic ones, and both are harder to execute than in developed countries. *Almost all policies require resources which flow through the budget, require budgetary decisions and are limited by budgetary means. Almost all budgetary decisions will, in turn, affect the future availability of budgetary resources.* Here, too, the micro-economic allocative aspects of budgetary policy become paramount. This is equally true for "socialist" or "private" market economies.

But this means that the most important "instrument" a modern government has is a productive economy. It is the absence of this instrument in underdeveloped countries which limits what government can do. It is also the creation of a productive economy that should get the highest priority as the only means of increasing the resources needed for the achievement of economic and non-economic ends alike.

III. "Investments" as Targets

The emphasis on targets and instruments suggests first, that the possible targets depend upon the available instruments. In a developed economy the major bottlenecks will be the available resources and their organization. In an underdeveloped economy resources remain to be developed and workable institutions to be created. The difference is: what can be done. It is easy enough to create institutions. It is very difficult to define precisely what they *can do* that will do any good. It is, for example, easy to pass a law setting up a central bank; it is not at all easy to make sure that the central bank will, in fact, increase the productive power of an economy. The need for agricultural credit is obvious, but the number of failures of small agricultural loans indicates the wideness of the gap between the legal creation of an institution and its proper economic working.

Whichever way one turns, therefore, increased productivity becomes central to the achievement of aims. In turn, the raising of "savings" and

[1] Gunnar Myrdal, *Asian Drama, An Inquiry into the Poverty of Nations*, A Twentieth Century Fund Study, London, 1968.

"investments" becomes one central means to raise productivity. It is, of course, generally recognized, that productivity can be raised by several means, of which investment is but one, albeit a very important one.

To outline this it is necessary first to analyze briefly the concept of investment. As the statisticians define this term it includes a hodgepodge of non-consumption items valued at cost. There are machines and factories, but also schools, hospitals, administrative buildings; roads and bridges; dams and waterworks. There are intermediate goods whose only possible use are to enter further into the process of production; others which are finished goods which only have to leave the channels of trade to become consumer goods.

For some purposes this is a perfectly good concept. It is a comparatively recent one. Its primary use has been in the context of full employment, or more generally stabilization policies. From that standpoint what matters is that total spending matches the available productive capacity. Efficiency, from the stabilization standpoint, means that there is neither too much demand nor too little. From that standpoint it matters little whether pyramids are built or children's hospitals, although no one (least of all Keynes) has preferred pyramids if it was at all possible to build something more sensible.

The stabilization aspects are never unimportant. But they are *not* the most important in underdeveloped countries. Full employment remains, of course, an important objective of both economic and social policy. Nevertheless, it must in many if not most underdeveloped countries be relegated to a secondary position. This follows from the nature of underdeveloped economies, in which even the definition of full employment is uncertain. It is not so much a question of a conflict between growth and full employment. It is rather that full employment cannot be achieved without growth[1].

Growth requires not merely the proper amount but the proper kind of spending. It must be spent so as to increase the productive capacity of the economy. The list of "investments" three paragraphs back contains much that is not necessarily "productive" in this sense. "Productive" in this sense means that the value of what is being produced is at least as great as the value of the resources used in the process of production. The

[1] Some obvious exceptions can be taken to such a bold statement on purely theoretical grounds. It may suffice here to say simply that subsistence agriculture does frequently provide substantial employment outlets at positive returns, that industrial employment must remain limited even with maximum use of labor-intensive techniques (provided any exist, or can even be defined in a practically meaningful way) and that it is very much easier to pursue full employment policies in a highly productive than in a very unproductive economy. Whatever the theoretical exceptions that can be taken, they vanish before the practical problems of increasing employment without growth.

economic value of an investment is the discounted value of what the investment produces over its lifetime. And this can be, and all too frequently is, very different from the cost of the investment: The economic value can be negative; the costs, alas, are always positive.

And this brings me to the first "target." The problem is evidently to identify and put into place as many investments as possible that have a positive economic value at a particular rate of interest, the determination of which can be left aside for the present purpose. In the absence of entrepreneurial ability this is not at all easy to do even at a zero rate of interest! Such a statement is evidently highly controversial. It is certainly true for most of Africa, perhaps less true for much of Asia; still less for Latin America[1]. There are wide variations within the continents. A reasonable discussion of this point would, itself, require a full length paper[2]. It is certainly easy to raise investments in the statistical sense, i. e. to spend money for non-consumption purposes. But this does not meet the real problems of development.

The list of "investment" contains on the one hand such things as hospitals, schools, administrative buildings, or recreation areas; on the other hand steel mills, power stations, and sausage-skin factories. It is unimportant whether they are defined as "investment" or as "consumption," to use Western terminology; or as "productive" or "unproductive," to use the terminology of the other side of the iron curtain. Neither is it suggested that one is better than the other, but rather that the two kinds of "investments" pose substantially different problems.

Both types of investments require enormous amounts of resources — this is particularly true of the investments typified by hospitals, schools, or presidential palaces — and their "outputs" (however measured) will come only with a time lag. They also have in common that they will generate not only outputs but operating cost. Because they require resources, economists must say something about them and they cannot abdicate on the grounds that the construction of a presidential palace or a school is "really" a political decision, as indeed it is.

Decisions about steel mills and schools involve inherently different considerations, which must be made in any type of economy and society. The development of the "economics of education" is intended to investigate to what extent it is possible to apply the same principles of decision

[1] Is Argentina an underdeveloped country in the same sense as India or Egypt or Nigeria? Kuznets' analysis suggests that it is not, but rather a "modern" country in which something has gone wrong. Kuznet, *op. cit.*

[2] Some of the points are discussed in Wolfgang F. Stolper, *Planning Without Facts, Lessons in Resource Allocation from Nigeria's Development*, With an Input-Output Analysis of Nigerian Economy, 1959—60, by Nicholas G. Carter, Cambridge, Mass., 1966.

making to the two types of investment. The difficulty with the "economics of health" or "of education" is first that the "product" is difficult to define and even more difficult to value in money terms, while its "production" involves very big cost. No one can doubt that health and education are means of production — but they are also valued for themselves as final "consumer goods." There is no real market for health or education, any more than there is for an army, or governmental administrative services. There *could* be such a market, and at least to some extent there is: there are private schools and hospitals, private police forces, even private armies.

On the other hand, even where it is not considered socially desirable to have private armies or schools, one can still use the market mechanism in deciding on their size or nature even though the market alone nowhere determines the extent of the demand for such services. Harvard or the University of Chicago may be "private" while the University of Michigan is "government," but neither is run either like a steel factory or a government bureau. And scientific policy is, I venture to guess, made in Russia not so differently from the United States[1].

There is another difference. Even if a factory is not run for private profit — which occasionally happens — it still must try to meet its running cost. But the running cost are, so to speak internalized. Books are set up so that one knows the cost of production, and a profit is only what is left after the cost are met. With elementary schools, or administrative buildings one also knows (or could know) the running cost, but they are normally not met out of any receipts, but are typically met by the public budget.

Thus the demand for about half of what statisticians call "investment" is not entirely determined within a market mechanism either in a socialist or a capitalist economy! Yet the fact that, given the political situation, demand is for all practical purposes limitless, while meeting this demand is extremely expensive and running cost eat into the resources available for all purposes at an alarming rate, requires some limitation on this kind of investment Social cost-benefit analysis, the attempts at developing the economies of education and health, and the development of program budgeting systems (whose French name "rationalisation des choix budgetaires" is much more to the point) all attest to the importance of this problem

For, while there can be some doubt about whether and how much education or health "pay" or even whether they should "pay," it is

[1] See, e.g. Peter L. Kapitza, "Scientific Policy in the U.S S R.: Problems of Soviet Scientific Policy", and "The Scientist and the Plans", *Minerva*, Vol. IV, London, pp. 391sqq. and pp. 555sqq., which makes this point quite clear.

perfectly possible to determine whether a textile mill pays and it evidently should do so. If it does not it should not be built. The investment is no investment but a waste. Textiles have a clear demand, they are clearly within the market nexus, they are just something to wear.

Even in a socialist society, textiles ought to pay and even in a capitalist socie y one likes to heal people because they are sick, and to educate them because they are human and have a mind, even though it remains of course true that healthy and (properly!) educated people are more productive than sick and uneducated (or miseducated) citizens. In all types of societies these two kinds of decisions have to be made, and they are made on different though overlapping principles. And this is the point where the budget and budgetary policy come in.

IV. The Budget as the Central Document

Thus the government has a positive role. This does not mean that the government has to do everything. The border between what is public and what is private is, as indicated, not logically fixed but determined by convenience. One can give almost unlimited examples. Business can by legislation be forced to train people. This involves cost which in due course will be reflected in prices and in real incomes of consumers. The government might wish to provide the training directly. Depending on where taxes are raised prices might rise or disposable incomes fall. Government can protect businesses by tariffs or go in for direct production — with budgetary effects in both cases.

The point to be stressed is that the government has an immense influence on the *allocation of resources* directly and indirectly; and that *almost everything the government does has a direct reflection in the budget. The budget is the central document for economic policy; and it is the major policy instrument*

It is at this point essential to safeguard against misunderstanding. As long as we do not specify further, "Government" and "the budget" seem straightforward concepts. The brief discussion of what is private and what public, and of the wide margins within which a society can decide to use its governmental powers in such a manner that direct governmental expenditures arise or do not arise, was intended to suggest that this is not so. It is conceivable that Government exerts enormous powers on the allocation of resources through policies, yet has only a minimal budget.

At the same time, in most countries, the document that goes by the name of a "budget" is a most inadequate and occasionally almost accidental expression of Governmental activities. In francophone African countries, the sums spent "hors du budget" are substantial. And practically nowhere is it possible to get an accurate picture of the public sector and its relation to the economy as a whole. When Government is decentralized, information on local authorities is scant. And differences in the treatment of such essentially marketable services as electricity, railways or the telephone make not only international comparison difficult, but may lead to inefficient policies.

Because of this arbitrary nature of budget documents, criticisms of "fiscal planning," as voiced for example by Myrdal[1] are quite just. But they do not affect the point which I am trying to make: in the budget as the picture of the public sector as a whole are reflected the choices open to the community and the effects of past choices.

What are the major functions and means of the Government? Assuming that the overriding aim of society is to eliminate its poverty, "growth" becomes the central aim This growth can only be achieved by changes that allow a better allocation of resources and by making the best allocation possible. The former will include a great number of policies that may or may not have budgetary implications. The latter involves primarily the question of savings and investments, both as to extent and efficiency. And, in economics, everything is interrelated with everything else.

The traditional functions of the "government" are to provide law and order, and efficient administration, both aims that even developed countries find at times difficult to achieve. It is also accepted that Government should affect income distribution in a more equitable manner. Even before the Keynesian revolution was government expected to combat cycles and to stabilize the economy. But in developed countries, growth as such was not a major aim — it was in the context of full employment policies however — nor does in developed countries the problem arise that Government should be the major saver as well as investor. Even in developed countries much of this is changing as government plays an increasing role in the economy.

Both equity and stabilization consideration apply to underdeveloped countries to a much lesser degree, not because they are less desirable but because the absence of productive economies sets serious objective limitations to their execution. There may well be many unemployed and underemployed people, but budgetary deficits will not necessarily employ them.

The problem of equity with its immediate budgetary reflection is politically tremendously important. The pluralism of societies exacerbates the problem because different groups will have very different ideas about what is equitable and the lack of productivity and flexibility makes effective policies extremely difficult to formulate.

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[1] Myrdal, *op. cit.*, Appendix 4.

This means that the allocation aspects of Government policies as well as of the budget become of paramount importance. All Government expenditures in so far as they are not essential to hold the country together must in some way be justified by the effects they have on making the economy more productive. (It will not be repeated in the future that increased productivity is not an aim in itself but is seen as a means to achieve other higher goals.) At this stage, a separation of budgets into current and capital, or ordinary and developmental would be quite misleading and dangerous. Not even the size of the budget could at this stage be determined in a rational manner.

It would be particularly dangerous at this stage to view development problems essentially as how to maximize savings and investments. For, investment expenditures are only one, albeit a very important means of raising production and productive capacity. Furthermore, the ambivalence about the definition of investments tends to lead to attempts at solutions by definition.

Instead, at this stage the problem is for Government to develop specific actions, of which investment programs may be one type. Normally, these actions will be formulated inside the operating (or "technical") ministries and the various autonomous or semi-autonomous agencies and authorities. If well done, they will be formulated in "physical" terms for inputs and outputs, will be realistically costed so as to allow an assessment of (social) cost-benefits, and will contain suggestions for policies of implementation. There will be also a phased realistic statement of financing requirements, and in particular a justification for proposed subsidies. At the same time, there will be only few such actions that can be implemented without some financial resources which usually will come from the budget.

What has been sketched is the beginning of the normal process of planning. It is also what is at the heart of "program" budgeting. Note, however, that the early introduction of (social) benefit-cost ideas is essential to ensure that the purpose of economic activities becomes output- rather than input-directed. Note further that the justification will clearly be different for "steel mill"-type programs and "health"-type programs. Note also that programs that are not in the nature of investments can be treated equally with those that are. And note finally, that when the programs are put together, the options for policy become apparent.

Each of the programs must have a time horizon, when it will be discontinued, or when its cost reach a maximum level, or when it begins to produce benefits. The benefits may be in the nature of final consumption or even in the nature of Government receipts. What is essential is to develop streams of cost and benefits, and their budgetary implications.

In this manner investment-type, "current"-type (e. g. agricultural extension services, but also improved tax collection services) and pure "policy" programs (e. g. a proposed land reform program) can be put on equal footing as far as their claims on budgetary resources are concerned. In this manner, too, the extent to which "health"-type investments may be allowed to compete with future savings may be determined. This itself has important implications for wage and interest rate policy. For, one important manner in which resources can be stretched, as it were, is by ensuring that wages and salaries are not too much out of line with the productivity of the economy.

A consideration of these budgetary implications, would have shown at an early time why, for example, the frequently heard call for extremely low, even zero "shadow" wages were unsound from an allocation point of view. The proposition more recently put forward by Little and Mirrlees[1] to set shadow wages high and shadow rates of interest low in the interest of growth would have become obvious once it is realized that any difference between actual wages paid and "shadow" wages involves net budgetary subsidies[2]. The need to avoid such subsidies would at the same time point to a control of wages and salaries actually paid, i. e. to the necessity of using wages policies to make "shadow" wages real — a point not lost on many Governments faced with controlling expanding budgets[3].

If the budget, then, is to be used for the formulation of policies, it must be used to coordinate the plans as they emerge from the technical ministries. In turn, these plans — and with them the final Plan — can be formulated in a meaningful way only when the budgetary implications have forced an analysis of alternative ways of achieving the desired goals. "The Plan" may be conceived as much of a justification of "The Budget," as "The Budget" as "financial" expression of "The Plan."

To illustrate with two examples: the difference of steel-type and health-type "investments" and wage policy. The allocation effects do not

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[1] Ian M. D. Little and James A. Mirrlees, *Manual of Industrial Project Analysis in Developing Countries*, Vol. II: *Social Cost Benefit Analysis*, OECD, Development Centre Studies, Paris, 1969, pp. 157sqq. "... the shadow wage rate is greater, the more distant is the date when investment is expected to be satisfactory. Roughly speaking, the shadow wage rate is greater, the less developed is the country" (p. 165). "The general conclusion to be drawn is that countries should avoid assuming that the shadow wage rate is low" (p. 169).

[2] See my *Planning Without Facts* (*op. cit.*), on this point, which is logically different from arguments that "capital-intensive" investments which high shadow wages and low shadow interest favor, are more conducive to the generation of savings than labor-intensive investments. For reasons analyzed in *Planning Without Facts*, I see little merit in the last argument.

[3] I am discussing the problem of wage policy in another context, in a forthcoming publication.

exhaust themselves in deciding to put up factories or schools, government or private. Every government as every private expenditure has effects on future budgets in that it either does or does not improve productive and taxable capacity, and that it does or does not affect future government expenditures. This means that every government action today has effects on the mobilization as well as the allocation of resources in the future, and it affects the future ability of government to act. It does so not only by making more resources available but, if successful, by also having increased the flexibility of the economy.

The distinction between the two types of investments made suggests over-all guidelines for policy. Tax levies should not reduce the tax base, for example, by dis-incentives — an important limitation with, incidentally, a strong equity bias on the taxation of farmers. Expenditures on textile mill-types of investments should not be made if they do not add to productive and taxable capacity, for if they do not the government will get into a fiscal bind which will simply reflect the mis-allocation of resources. There is, incidentally, nothing to the argument that such investments may be "needed" for balance of payments reasons. If they are not productive, they will necessarily create or aggravate balance of payments problems, or at the least waste foreign exchange. Expenditures on social investments should not be carried beyond the point where they threaten the necessary savings to carry on the directly productive investments, though they should be carried to that point. Education expenditures in particular threaten to become self-defeating. The recurrent budgetary cost rise long after the investments have ceased. The "product," even assuming that the education is worthwhile and "functional," becomes available only after a long time lag. Hence for a number of years the capacity of an economy to save can be seriously threatened by too ambitious an educational program. Mutatis mutandis, this is true for health or administrative services. "Technically" speaking, it is essential to be aware of these "dynamic" effects, i. e. of the relationships involving the lapse of time.

If the budget is set up so as to yield the information on taxable capacity and future budgetary charges it becomes a powerful instrument in *doing* things as well as in *formulating* policies. To give a different example: how many people does the government need for administrative purposes? This question is usually answered by pointing to the manifest understaffing in most of the countries. Next an analysis is made of what it takes to get certain jobs done and the number of people needed is then determined from some semi-magical numbers derived from some other economy. There is usually also some idea about what is right in relative salary scales within the hierarchy, modified here by what degree a man has, there by how many years of experience, and elsewhere by a military dictatorship of sergeants who do not like it that all the good jobs go to colonels. But it does not take any genius to see that a government could use all the skilled people it can lay its hands on. It should not take a genius to see, but it apparently does, that how many skilled people a government, or any economy can *afford* to employ will depend very much on salary scales.

The issue is not, that the existing civil servants are useless. Nor is it that they are paid exorbitant sums. The issue is that, given the salary scales on the one hand and the low productivity of the economy on the other, the budget can't stand as many and that the problem is not seen in the proper context of the budget and the economy, which means the allocation of resources. The efficiency is low even if the individuals are excellent, because the budget allocates so much to salaries that not enough is left for the means needed for civil servants to do their job, e. g. to maintain roads. If taxes are raised, production falls, as farmers withdraw again into their subsistence shells.

Similarly, only when an economic plan is related to the budget will the relevant policy question come out. As an ex-Planner, I have no intention to minimize the importance of a Plan. But as an ex-Planner I am also quite conscious of where the weak spots are likely to be. Plans are supposed to be consistent. The trouble is that it is quite easy to adjust numbers to come out with a consistent set of figures. Not enough savings? We just assume a slightly larger growth rate. The budget in trouble? We just assume that taxes can be raised a little while growth of expenditures can be held at x%. Even quite small adjustments in the numbers can achieve major "results," given the workings of compound interest over a few years.

All of these planning procedures I hint at are quite legitimate and necessary. The trouble begins when the budget is seen as purely financial device instead of an allocation device, and when the link between the contemplated investments and the contemplated governmental policies on the one hand, and the expected growth in the economy on the other is inadequately established; when it is assumed rather than shown to exist by careful specific analyses. What is required is a careful analysis, year by year, of what inputs are likely to be required; when the outputs are likely to come and at what rate; whether the manpower needed will be available; what provision there is to ensure the training of the necessary manpower. This will quickly reveal whether an inordinate amount is planned, for example, on primary school education because the budgetary effects will be all on the expenditure side for many years to come, and will wipe out rapidly any budgetary surplus. It will also quickly suggest what tax levels should be aimed at when the difficulties of investing in sufficient textile mill-types of investment with positive returns will become apparent. Policies in giving tariff protection or tax holidays immediately become analyzed for the effect on the budget in a context which not only allows a more rational decision but an actual execution i. e. it becomes quickly apparent whether or not *all* contemplated decisions are feasible.

Return for a moment to the distinction between the textile mill-type and the hospital-type investments Clearly both are urgently needed. Now make the mental experiment: suppose we cut out *all* "investments" in health or education that are not made on strictly economic grounds. How scarce would capital then be? I venture to say that in many, if not most underdeveloped countries, interest rates would in such a case rapidly converge to zero; that is, I believe that in many of them the available savings would be sufficient to put up virtually any type of investment that is clearly within the money and market nexus that does not make actual losses at a zero or a rather low rate of interest[1].

Suppose now we contemplate a particular government program, say roads. Techniques of studying road programs are well developed. The roads will cost a certain amount. The capital cost and the maintenance cost are within wide limits substitutes for each other. The cost of roads and the cost of maintaining trucks are also to a certain extent substitutes for each other, the maintenance cost of providing truck transport falling substantially as the quality (and hence capital cost) of the road increases. There is therefore a first willingness to pay taxes just to get a better road. The road should obviously go somewhere. The potential traffic will depend on whether areas of production are opened up. If they are they will raise taxable capacity. Export products will become available, and export taxes are important in underdeveloped countries. Markets are established. But roads have to be maintained, hence operating cost also will rise. Now, clearly there are numerous problems of how to evaluate all the different influences on the receipts and the cost side which we can leave to the specialists. The important point is that the calculations must be made at least roughly, and the essential point for the present purpose

[1] This opinion is apparently shared by Little and Mirrlees, *op. cit.* "If a country is large enough, and economically sufficiently advanced, to be able to contemplate setting up a large-scale industrial plant, and if it can expect to operate a modern industrial plant quite efficiently, it would be surprising if the ARI [accounting rate of interest] were less than 10 per cent. ... But others, ... less efficient in their industrial operations, may well find that they have to set interest rates as low as 6 or 7 per cent." p. 184. — See also my *Planning Without Facts* (*op. cit.*), on these points. To avoid any misunderstanding, I am of course not advocating the elimination of all "health"-type investments. The point is rather that, to use a different terminology, the budget is the obvious place that allows a community to decide rationally between "present" and "future" consumption.

is that the place where the final decision will and must be made, is the budget[1].

The reason is simply that the budget will be affected. A politician has a certain choice. He can insist that the road from his palace to his fellow politician's chateau be paved even if the economic cost vastly exceeds the economic gains, but if he overdoes this sort of thing he will run out of budgetary means. He will, after all, have more pet projects than the dust-free road to his friend. He will want to give his village a school or a water-point, and perhaps even locate a factory there. All of his pet projects require budgetary resources. So do all the pet projects of his friends and rivals.

The place where all these choices become evident first is in the budget. The most ingenious defense of individual expenditures will, for better or for worse, show up its true worth when pitted against all other claims on resources. And the Minister of Finance with the Minister of Economics or of Planning, or in cases of important conflicts the Prime Minister is the proper authority to see the picture as a whole and to make the final decisions. The final decisions reflect what in analogy to Samuelson's phrase may be called the "revealed political preferences." But these decisions are now made, at least potentially, in a rational way, and the limitations on all purely political decisions inherent in the structure of the economy are inescapably made manifest[2].

A road is, or could be reasonably clearly within the market nexus. For an elementary school this is not so clear. Again the choices come out first

[1] It may be worthwhile to dwell on this a little longer. It is not too difficult to fake figures in a reasonable way. Change the cost slightly here, assume the benefits to be slightly bigger there, and it is not too difficult to make even quite shaky propositions look economically sound and rational. I have heard participants of the IBRD's Economic Developement Institute's courses on project evaluation make quite scathing remarks about the course on these grounds. One of the participants, an engineer (not from the US Corps of Engineers!) once put it bluntly over a cup of coffee: "I can make any one project look good." This is true, but it is not a generalizable point. That is, it is *not* possible to make all or even many projects look good simultaneously

[2] This point has been forcefully made in the American context by Kermit Gordon, "Reflections on Spending", *Public Policy*, Vol. XV, Cambridge, Mass., 1966, p. 11: "The budget is the President's budget, in a real as well as in a formal sense." Mentioning of a Prime Minister as the final arbiter might suggest a strong centralizing bias of the sketched approach. This is, however, not necessarily the case. It is quite easy to imagine a federal government which agrees to complete freedom of movement of goods and people within its area, but leaves large areas of the economy (such as agriculture) as well as strong taxing powers to the individual members. There could be substantial transfers of funds between members. Factories could still be located, and roads built, on economic grounds with compensating transfers agreed upon in horsetrading. Obviously, someone has to make a final decision. But in plural societies it is, I believe, essential to establish firmly what the areas in which *no* decisions must be imposed are. In plural societies, a certain self-restraint is essential to survival; in others it may be desirable in the interest of decency.

in the budget. Is there money to build the school? Can the budget be relieved, for example, by community action? This is a static problem of a once-and-for-all nature and quite easy to solve. But then come the questions of the maintenance cost, the teacher salaries, school fees, as well as the quality of education, which relate both to the cost and the employability of the end product. This involves future budgets in a double way. There will be operating cost, and questions have to be asked whether school fees can be levied to relieve the budget, etc. There will be effects on future savings. Thus through the budget the politicians can be put into a position where they must answer such questions: Will there be enough savings (i. e. real resources) to allow me to give to my community next year and the next other projects they need and want? In underdeveloped countries, too, people have a way of asking: "What have you done for me lately?"

No matter what it is desired to do, it is always possible to answer the question: What does it cost now? What is it likely to cost in the future? What do I get for it now? What do I get for it in the future? Are there alternative ways to achieve the goal? The essential point is to see all the individual cost and benefits in a context — and the best context where one meets the really hard facts of life is the budget. And it is always essential to see "cost" both in terms of charges against resources *and* in terms of the effect of present decisions on future resource availabilities. Just as it is essential to see the benefits both as so and so many people healed and educated, so and so many yards of cloth or sausage-skins produced, as well as so and so many resources provided in the future for further allocation.

This, of course, is the idea of program budgeting. The problem in underdeveloped countries is first of all to make them aware of the problem as well as of the possibilities. It is in some respects a problem of getting the Ministries of Finance — which have a not always deserved reputation as "no-Ministries" — to see the problems of the operating Ministries, and to get the operating Ministries to see their problems in the context of mobilizing and allocating resources for growth, as well as in a more specific technical context. The operation of the Central Bank, or of any institution, always can be put into such a context.

Now, obviously "program budgeting" by any name or with any gadgetry does not solve political problems. But it can make policy decisions rational by formulating them in ways that require as well as allow solutions. The reputation of Finance Ministries as "no-Ministries" may be deserved if it is simply due to inertia and lack of imagination.

But at one point they must be "no" Ministries. For, if there is no choice between proposals to be made, one has not yet reached the optimum.

It is characteristic of an optimum that there are costs of alternatives foregone.

Similarly, the "yes-Ministries," the operating Ministries, will be on much safer grounds, if they can show that what they want to do will add to the flexibility of the economy, will achieve ends at minimum cost, will add to taxable capacity and future savings capabilities. And planners will be on much safer grounds if their proposals, both positive and negative, will be seen in the context of making people better off in the future as well as the present, of raising consumption levels as well as savings capacity. This requires a careful correlation of detailed analyses in a consistent framework. The most powerful such framework is the budget[1].

This does not belittle the importance of aggregative national income analysis. But the latter is the more useful the more data there are and the more flexible the economy is. The national accounts are an important tool at a very high level of abstraction. Taxes, government expenditures both present and future are tangible. There is nothing abstract about them. To raise savings is a rather abstract concept which becomes operational only when a tax is to be raised here or cost cut there, or a loan floated from a private saver. Investment in education is a wonderful idea, but it has to be worked out for its impact on cost streams and savings potential and their cost in terms of alternatives foregone. Without the budget, almost all other policies simply hang in the air, are at best unconnected with each other and for this reason in grave danger of being irrational (in the sense of being neither the best choice possible under the circumstances nor suitable to achieve their avowed ends); at worst they cannot be executed at all and remain expressions of pious hopes.

[1] The comment has been made by Professor Wildavsky that the reasons so many countries love plans but hate budgets are that plans commit you to nothing while budgets do; that plans have something for everyone if only after a few years while budgets, being essentially short-term affairs, must necessarily deny the requests of many people.

This is, of course, true, and it neither exhausts the reasons for the proliferation of plans — Professor Wildavsky himself has no difficulty in augmenting a list of reasons to at least ten — nor does it mean that plans are useless, even when they are essentially exhortative documents or prepared bargaining positions rather than orderly statements of planned and feasible action. I have argued elsewhere that bargaining plans are dangerous politically and economically. But for the present purpose I assume — which is often also true — that governments really want to modernize and plan and that they have the political will to carry through reasonably well thought out plans.

To the extent to which there is a political will, the budget becomes a major planning and executing device — and again I prefer to think of reasonable plans and as documents of intentions that can, in fact, be acted upon. A plan that assumes a political will to exist which in fact does not is as uninteresting a document as a Plan that ignores economic or social impediments that cannot be overcome when the Plan is to be translated into action.

Under these assumptions, Ministries of Finance are "no" Ministries only because real resources are scarce. They may nevertheless prod lethargic operating Ministries into more action as often as they may hold back enthusiastic Ministries in other directions.

V. Suggested Budget Format for Policy Purposes

The efficiency of government in underdeveloped countries with respect to economic development can be judged by how well the government understands its policy tasks as well as the limitations under which it labors; and by what it does to overcome the limitations. It makes as little sense to criticize a Government for not undertaking the impossible as to make the mechanics of government more efficient without clearing up the direction in which the efficiency is to be used, i. e. without clearing up the policy goals. Rent control enforced by an efficient civil service kept house building at a minimum in France or Austria in the inter-war period. India or Egypt could furnish quite a few additional examples for the economic damage which an "efficient" civil service can cause.

The example of rent control underlines why it is necessary to go into economic reasoning. The problems of administrative efficiency per se are, of course, important; but they are outside my interest, except insofar as they contribute to the formulation and execution of economic policies. A government may therefore act efficiently if it tries *not* to interfere, if it is aware of the absence of policy instruments, the difficulties of creating them, and the difficulties of formulating alternative policies. With tribally split pluralistic societies such caution may be much the best part of valor.

Given the characteristics of underdeveloped countries sketched before, what can the government do, and how can the budget (in the widest sense) be used to achieve the government's aim? What a government wants to know for economic policy purposes is, first, whether its actions contribute to growth: hence the need for cost-benefit or cost-effectiveness studies; secondly, how the pattern of taxing and spending is likely to affect directly and indirectly the savings of the economy: hence the need for a multi-year approach; thirdly, what effect the combined tax and expenditure pattern has on achieving *all* its aims (i. e. equity effects, growth effects, effects on savings); fourth, how it can in general involve as many people as possible into moving the economy; finally, what can be done to stabilize the economy.

Because in developed countries the economy has a great deal of flexibility and there are large numbers of people who can translate general signals into specific action it is, on the whole, sufficient if the cash budget and perhaps the national income budget is known. Distinctions between recurrent and capital budgets, or between ordinary and extraordinary budgets, found in some countries, are essentially gimmicks which may or may not fulfill particular political functions. In developed countries there is little to be said for such distinctions. The essential policy problems there concern the necessity to keep overall taxing and spending at economically desirable levels; to determine the "monetary" impact of the whole budget on the economy; to ensure that specific spending decisions achieve their intended aims and to develop some notion of the impact of present programs on future receipts and expenditures. A single unified budget is obviously much the best format for a developed country[1].

All of this is equally important in underdeveloped countries. But few of them have budgetary systems that can even begin to give the answers to these questions. It would be extremely difficult in any of them to construct a consolidated cash budget for the public sector as a whole. The budget procedures are designed essentially for accounting convenience to permit control of the honesty of spending. The budget was not designed to allow the policy-maker to find out what, if anything, the government contributed to savings in the economic sense; it was not designed to permit the gauging of the budget's inflationary or deflationary impact. Least of all was it designed to allow a Bureau of the Budget to question individual programs or to compare them with alternative demands for funds.

Indeed, the notion of a staff agency with the function of the Bureau of the Budget is all but unknown. Planning ministries fulfil part of the function. But even when they go beyond the aggregative frameworks, they in fact but seldom work out the detailed budgetary implications. The antagonism that all too frequently exists between Planning and Finance is in part due to the fact that Planning tends to look at the budget as purely financial, while Finance is likely to stick to an administrative budget: that Finance tends to stick to line item budgets, with or without a functional classification, while Planning tends to forget about the "program budget" aspects of its proposals.

In planned underdeveloped economies the budget was (and often still is) not designed to allow any projection of future revenues and expenditures, which in turn means that it is not designed to allow an orderly execution of economic policy in time. The budget is, in short, not designed to be a policy instrument, or to allow the Prime Minister or President or whoever has the ultimate decision-making power to see clearly the choices before him.

The concluding remarks will attempt to develop a general form in which a budget might be presented together with the economic reasons for doing so; and will then ask: what are the questions, what is the information needed to make economic policy in detail? Needless to say, only general answers can be given in this context, since specific answers can

[1] See on this point, Gordon, *op. cit.*, and more recently, *The Report of the President's Commission on Budget Concepts*, Washington, D.C., October 1967 (Report of a Committee under the chairmanship of David M. Kennedy).

be given only to specific questions, i. e. in the context of a particular economy at a particular time.

First, in several countries it is not possible to say whether or not the government has savings or runs deficits. In several it is not even possible to find out, without engaging in a major piece of research, what spending or receipts actually were during a given period.

There is lack of clarity as to what is meant by "savings," what is meant by a "deficit" or a "surplus." Even though the particular form in which the information is presented will always be essentially arbitrary, it is essential to present a total picture for a number of years into the future, as well as information on budgeted and actual expenditures for at least one year in the past, so as to bring the basic policy questions into focus. The general form which brings out some of the information might be as follows:

A. Ordinary Budget

Receipts	Expenditures
1. Tax receipts only	3. Expenditures on running Government only. (Classification by Function, and within Function by Administrative unit; including current transfers)
2. Fees and other regular government income	4b. Operating subsidies to public enterprises
4a. Operating surpluses of public enterprises transferred to budget	5b. Surplus
5a. Deficit	

B. Investment Budget

Receipts	Expenditures
5b. Surplus transferred from ordinary budget	6. Projects and Programs by Function, and within Function by Administrative Unit
7a. Deficit	7b. Surplus

C. Means of Financing the Deficit

Receipts	Expenditures
9. Borrowing a) Domestic non Bank b) Foreign	7a. Deficit
10. Use of cash balances	8. Transfers to autonomous public agencies)
11. Bank borrowing	
12. Money creation	

A few comments are necessary. Each item is, of course, intended to be only a heading, not a complete set of proposals. The suggested format is intended to permit the Government to assess: (a) savings (item 5b); (b) the degree to which its investment program is domestically financed from ordinary government resources; (c) investment programs; (d) the inflationary impact, if any. It also permits Government to relate the investment expenditures to future operating expenditures, drawing the Governments attention to the efficiency of public enterprises and it allows therefore to do some forward planning. Forward planning means in this instance to decide what should be done *now*, and in what order future investments should proceed. The latter is done by assessing the effect of different time streams of investments on both sides of the ordinary budget, and hence on future surpluses. Without the "program" analyses suggested in the preceding section there is danger in this format that Government policy will be directed to maximize savings and investment, instead of maximizing the total impact of the unified budget. This danger should, of course, be avoided. Obviously, no budget format exists which *forces* Government to make rational decisions.

Tax receipts should not include budget support by Foreign Governments, or proceeds from borrowing, as is done in some countries. On the "ordinary" expenditure side, all expenditures to which Government is committed year after year should be included. Investments which have future cost implications should, as far as possible, be excluded. Other "investments" can stay in for policy purposes, though for other purposes they might also be excluded. This somewhat cryptic remark refers to the definition of "investment" in the national income sense which includes a great deal that is "ordinary" governmental expenditure, e. g. the purchase of desks, typewriters, and cars. It includes, however, also practically the whole public works department whose entire maintenance activity is "gross investment" in the national income sense. Separating out operating subsidies forces attention to the efficiencies of past investments, and to the price policies of public enterprises as alternatives to tax policies.

Since ordinary expenditures are made "per unit of time," the budget ought to refer to a series of clear time periods. For various reasons, many budgets do not. Administrative budgets give the expected cost of a program, not what has actually been spent on it during the year. There are differences between commitments and payments, and in some countries, expenditures committed in year X but spent as much as a year later are still put into the books as referring to year X. The suggested format (with the proper precautions) would allow the government, therefore, to know what it saves in the sense of what resources it could use for investment purposes. It would allow it, therefore, also to formulate policies about spending more or less on "current" purposes as well as about increasing or decreasing the fraction of investments to be financed out of government savings.

The major function of the investment budget ought to be to allow it to be linked to the ordinary budget. It can in this way become a major instrument in deciding the size and the time rate of the health-education-type investments. For this reason, too, a multi-year Plan is no substitute for a multi-year budget, unless the Plan itself assumes this major function of the budget.

By separating out the "means of financing the deficit" (or the use to be made of surplus funds, a much less likely contingency), monetary and credit policies, as well as balance of payments problems can be linked to the budgetary and planning process. This again forces the government to make relevant policy decisions.

If it is remembered that virtually all underdeveloped countries desire capital inflows; that virtually all have actual or potential balance of payments limitations to what they would like to do; that major aid givers such as US AID or the IBRD, or the United Nations normally require as a condition for giving aid that the receiving country make a local contribution, the formulation of the budget in a manner that actually clarifies whether a local contribution can be expected (i.e. whether there are potential budgetary savings); how many foreign loans are bearable, has obvious policy advantages.

The proposal to separate a capital from a recurrent budget within a unified budget is made with the consciousness that it is essentially a gimmick. In the United States or other developed countries, such a separation would have undesirable policy implications, and it would be unnecessary as well as harmful[1]. The budget of the government has to be seen in the context of the mobilization and allocation of resources as a whole regardless of whether they are for current or capital purposes. Normally, however, developed economies are not called upon to provide the bulk of savings through the public sector, nor do they have a major burden for the detailed allocation of resources which proceedes largely privately through the action of the market.

All this is very different in most underdeveloped economies even where they do not call themselves "socialist." The government is counted upon to provide a major part of savings. This means that an "ordinary" budget which is presented merely as balanced is already in trouble:

[1] David J. Ott and Attiat F. Ott, *Federal Budget Policy*, Rev. Ed., Studies of Government Finance, Washington, D.C., 1969.

it should have a hefty surplus. The government is supposed to affect the allocation of resources directly. It can do so only if it is aware of the implications of its investment decisions on future savings. The Government is *a* if not *the* major recipient of foreign aid; it cannot absorb capital inflows without providing local funds. And it should not accept even "free" foreign aid without justifying the use to itself in terms of the overall utilization of resources The policy questions the Government has to solve are therefore somewhat different, and the organization of the budget suggested is intended to focus on the major policy problems and to facilitate their solution.

There exists a considerable literature on the functional and economic classification of government expenditures which has begun to bring order into the presentation of budgetary data for purposes of analysis. Needless to say, in any given real situation, a great number of arbitrary decisions have to be made. For this reason, international comparisons are apt to be exceedingly misleading without a great deal of trouble to ensure comparability of data. Thus, in some countries electricity generation, or railways are private activities, in others governmental, in others (wholly or partially government owned) public corporations. The differences this can make to the "functional" or "economic" classifications are enormous. Or, to give an example from Francophone African practice, there is occasionally the appearance of much more decentralization than in former British territories. Thus, elementary schools may be set up as independent units on principle — probably an excellent idea — with the school or hospital getting an annual allocation from the central budget, in which it appears as a subsidy ("interventions d'Etat"). At the same time, the budget title "Interventions" may include scholarships, and operating subsidies to a government-owned factory that should never have been built in the first place.

These examples emphasize mainly that it is difficult to make a sensible classification useful for all purposes. The problems go, however, beyond it. The difficulties of interpreting fiscal data even when classified sensibly by function is that what is being measured is the *cost* of getting things done, not what the cost will achieve. This is a serious matter because the advisor or planner is all too frequently asked what percentage of the budget "should" be spent on administration or roads or schools. He is not only under pressure to come up with some magic number to increase certain expenditures and decrease others without a thorough analysis of the particular case; measuring "efficiency" by *cost* clearly encourages inefficiency.

The basic idea behind "program budgeting" and planning is to avoid this kind of inefficiency, and to focus policy making on the essential problem: how to get things done with a minimum of cost (or alternatively how to achieve the most with a given cost). For this reason, I would prefer — sometimes in addition to the usual functional distribution, sometimes in its place — to start with a distinction between those expenditures which are clearly within the market nexus and those that are not. I would include among the former all those that *could* be, even if they are not in practice. This includes not only the provision of roads but also water, sewerage, markets, public housing, in fact a great deal that is frequently classified as "social infrastructure." I have pointed out elsewhere that such calculations were made in the Nigerian Plan with important political considerations and social policy reasons in mind, although the reasons were, of course, not spelled out in the Plan document itself[1].

Those "programs" for which the results can be measured in money terms, should be so evaluated, with no distinction being made between the current or the capital budget. At the same time, the evaluation must always be made over a number of years. For example, agricultural extension agents (who are invariably in the "current" budget) should have an effect on agricultural output, usually after a year's lag; sometimes after a longer one, e.g. when we deal with treecrops, or with new programs that take years to become fully developed. Once it can be shown that the employment of agricultural extension agents will lead to an (economic) increase in output, it can usually also be worked out what else is needed to make this program effective: transport for the agents; training for more agents; marketing for the output; roads to get the product out. Thus looking at an expenditure as something to achieve an end, focuses consideration on interactions and other related programs and thereby brings into the open the essential problems of choice. It also brings out immediately the crucial problem of time sequences.

For investment programs it becomes essential to get a notion of how long the budget will be burdened with input-payments until the outputs arrive to add available resources. In fact it becomes essential to find out first whether there will ever be any net resources as the result of the expenditure, and if so when. Ghana or Indonesia furnish obvious examples of expenditure patterns that have not led to a long-term addition of resources.

When planning in an underdeveloped country, it is defensible to start briefly with an aggregative framework in national income terms in order to get a rough idea of orders of magnitude and of the problems of changing

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[1] See Wolfgang F. Stolper, "Social Factors in Economic Planning, with Special Reference to Nigeria", *The East African Economics Review*, Vol. XI, Nairobi, 1964, No. 1, pp. 1sqq.

these orders. But if a country does not have a set of national accounts this does not mean that there can be no meaningful planning. A "minimum system," as G. C. Billington[1] has called it, can be developed quickly *if* a country has a budget and some notion of its foreign trade, since the external and the government sectors are likely to be the most important ones. But even if the minimum system is not developed this is no major tragedy[2]. In any case, it cannot be developed unless there has been previously developed a decent system of budgeting.

Once the aggregative exercise has been brought to a conclusion — if it started at all — the *real* planning begins: what can be done in detail. As sketched, planning is seen as the combination of the functions of a Bureau of the Budget and a Council of Economic Advisors to use the American analogy. The real planning will start with the question how many resources can be raised by government without reducing agricultural production which is likely to be the mainstay of the economy in the early stages of development. The next step — which will take considerable time and effort — is to get everyone in the operating ministries, the public corporations, the private businesses — both foreign and domestic —, to say what they want to do, why and what the obstacles to their doing it are. The point of this exercise is twofold. First, it forces people to develop rational programs. They must explain what they want to do, how many people will be healed, whether they can lay their hands on doctors or teachers or foremen, what they do about training people, and whether and why they think the costs are worth the results. Forcing the development of a program will usually change it radically, as reasoning will show a better way of doing things than originally foreseen, or alternative aims.

More important, however, is that the development of the program will bring out both the time streams of inputs and outputs, and the relation to other programs. This permits the development of a rational overall picture in which costs are linked to achievements, and alternative claims on resources are evaluated. It will also bring out weaknesses in the governmental organization. It will quickly make clear who is capable

[1] G. C. Billington, "A Minimum System of National Accounts for Use by African Countries and Some Related Problems", in: *African Studies in Income and Wealth*, Ed. by L. H. Samuels, International Association for Research in Income and Wealth, London, 1963.

[2] As W. Arthur Lewis puts it: "... *a government's most important planning measure is to raise a large budget surplus.* A Plan without a large budget surplus will get nowhere; whereas a large budget surplus can work wonders even without a Plan." *Reflections on Nigeria's Economic Growth.* OECD, Development Centre Studies, Paris, 1967, pp. 36sq. (Italics in the original.)

of developing a rational program and who is not, where assistance is needed to get projects going. This, in turn, will have a very healthy effect on policy-making. One alternative that will appear is the encouragement of the private sector to satisfy certain needs, or at least a better division of labor between the private and public satisfaction of particular wants. It will prevent the governn nt from trying to do what it cannot, though it may of course induce government to improve itself to the point where it can. Most important it will show up quickly the narrow limits within which purely political decisions without regard to economic consequences can be made.

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