

The Colombian Budget Process

**Ulpiano Ayala
Roberto Perotti**

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**Ulpiano Ayala, Fedesarrollo
Roberto Perotti, Columbia University**

Abstract

The rules that govern the budget process are important determinants of fiscal outcomes, with potentially important macroeconomic implications. This paper starts with a review of the theoretical underpinnings of the effects of budget processes and the main empirical evidence. After a brief institutional description of the Colombian budget process, an assessment and proposals for reform are made. The main issues analyzed here are the degree of centralization of the budget process, transparency, rules, and intertemporal links. Serious flaws have been detected: decentralization during the preparation of the budget, proliferation of budget documents, heterodox accounting standards and reporting for deficits and investment, insufficient coverage, biased forecasts and macro assumptions, unduly restrictive rules that promote creative accounting, or seemingly innocuous rules, and weak management of intertemporal links. It is recognized that better rules and institutions can be circumvented, but they can be important in realizing three conditions: allow the public a good understanding of fiscal policy and position, increase the incentives for fiscal discipline, and create an environment where a fiscally sound government can do its job more effectively, and a fiscally undisciplined government will be subject to a more informed scrutiny. These conditions can greatly enhance the scope for a more effective fiscal policy in Colombia.

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I. Introduction

In recent years the rules that govern the budget process have been recognized as important determinants of the fiscal outcome of a country, with potentially important macroeconomic implications. As a consequence, improvements in the budget process are widely considered as an important precondition for maintaining (or regaining) a responsible fiscal policy.

We believe it important to be clear and realistic at the outset about the role of the budget process. There is little defense, procedural or otherwise, against a government that is determined to run a "bad" fiscal policy without opposition from Congress. There are simply no rules that can protect a country in these circumstances. Still, a well structured budget process can fulfill an important role in the setting of fiscal policy. In particular, we believe the rules governing the formation of and the dissemination of information on fiscal policy should achieve at least three goals:

- allow a government to run a "good" fiscal policy in a transparent manner;
- make sure that fiscal policy does not get out of control in the presence of shocks of moderate to large dimensions;
- allow a person with a moderate knowledge of economics and accounting to understand the main thrust of the fiscal policy package proposed by the government, and to compare it with previous years.

This last condition is the most important one. Because, as we argue, there is no enforcement mechanism to prevent a government from running a "bad" fiscal policy, only the "market" can exert pressure on that government. A precondition for this is that the market should be able to form an independent idea on the fiscal policy run by the government. In the current Colombian situation, we believe this is unlikely: the average journalist, and even a trained economist, would have difficulties understanding the various budget documents. The Colombian budget process does not lack rules - indeed, it might have too many; what it needs is a healthy dose of transparency.

Comision de Razionalizacion del Gasto y de las Finanzas Publicas (1997) contains a thorough review of the Colombian budget process. The main difference between the two approaches is that the Comision emphasizes rules (or lack thereof), the integration of the budget in economic planning, and the control phase. As will be clear from our discussion, we place much less emphasis (or none at all) on these three aspects.

This paper is structured as follows: in section 2 we review the main theoretical underpinnings of the budget process and the main empirical evidence. In section 3 we present a brief institutional description of the budget process in Colombia. In section 4 we present our assessment of the Colombian budget process, and make our main proposals for reform. Section 5 concludes.

II. Theory and Empirical Evidence

In the last decade, a substantial body of theoretical and empirical research has investigated the effects of budget institutions on fiscal outcomes. Much of this literature can be interpreted as investigating the mechanism by which budget institutions can limit the tendency of executive or legislative bodies to overspend, relative to some benchmark. This is also the perspective that we will use when interpreting the literature and evaluating the Colombian budget process.

A. Theory

How do budget institutions affect fiscal outcomes? We discuss here a selection of the main arguments, referring the reader to Alesina and Perotti (1999) and Poterba (1996) for more complete surveys.

- **Preparation of the budget.** Schematically, one can think of two polar methods of budget preparation. In one, the Finance Minister is in charge from the start; he collects the budget requests from the individual ministries, bargains bilaterally with each minister, and puts together the totals. At the other extreme, the total budget is arrived at by a process of multilateral bargaining in which all ministries participate at the same time, with the Finance Minister as merely the organizer of the process, but with little more power than the other ministers. In the terminology of Alesina and Perotti (1999), the first method is more *hierarchical*, the second more *collegial*. From the point of view of enforcing fiscal discipline, the advantage of a hierarchical method is that it allows the Finance Minister to better internalize the effects of the overall budget. Suppose the government is composed of 10 ministers; for simplicity, assume that the budget is balanced. In a hierarchical system, if each minister spends an extra dollar, the Finance Minister, who is in charge of the whole budget, can internalize the costs of raising 10 extra dollars in taxes. In a collegial system, each minister internalizes, at most, the costs of raising "his own" extra dollar; the result is a tendency to spend more, in equilibrium. On the other hand, the costs of a more hierarchical system can be, as always in these cases, a "less democratic" budget process.
- **Presentation, discussion and approval of the budget.** A similar trade-off appears once the budget has been introduced to Parliament. In a hierarchical system, the government (usually in the person of the Finance Minister) has considerable agenda setting power during the discussion phase; and it can have strong veto power on the initiatives of Parliament tending at modifying the budget total or its components. In a collegial system, by contrast, the Parliament can amend the budget draft freely, increase or decrease its spending and revenue items and totals, and set the agenda of the discussion phase. If one accepts the premise that Parliament, because of its mere size, is likely to be more subject to many narrow interests and more prone to spending, the trade-off between these two polar systems in the discussion phase is similar to that in the preparation phase.
- **Transparency.** A budget that is difficult to read and interpret can undermine fiscal discipline for two reasons. First, lack of transparency generates incentives for the government to engage in creative accounting, i.e. in accounting practices that hide the true size of a spending item¹. Second, lack of transparency makes it difficult for interested individuals or groups to form an idea of the true size of the fiscal package, hence undermine the possibility of effective control. Transparency is greatly undermined when the budget process consists of many documents, almost always with considerable differences in presentation and coverage. The end effect is that there are as many fiscal packages as documents, so that the debate keeps shifting, often without participants realizing it, from one deficit figure to another, from one definition of the budget to another.

¹ A typical example is when a spending item is placed off the budget in order to limit the budget deficit.

- **Rules.** Budget laws and procedures frequently set specific rules that the budget must conform to: a typical example is a balanced budget rule, which prohibits budget deficits. Rules are usually meant to enforce fiscal discipline, because they constrain the possible choices of the government and legislators. Yet, there is growing recognition that they can be a double-edged sword: for instance, a government determined to run a budget deficit will try to bypass a balanced budget rule by placing several spending items off the budget. The rule is formally satisfied, but at the cost of undermining the transparency and even the transparency of the budget. Thus, one should be aware that rules are not a panacea for fiscal responsibility, a view that we will share in our discussion of the Colombian budget process.
- **Formal control.** After the budget has been approved, its implementation is monitored at several stages. Usually the actual realized revenues and expenditures must be certified by a controlling agency, to make sure they conform with the budget approved by Parliament or to discuss any discrepancy. We do not discuss this phase in this paper. The role of the controlling agency is usually merely formal, with few or no measures it can take to enforce its rulings. To the extent that the budget process has any impact on fiscal outcomes, the four aspect discussed above are much more important than formal control.

B. Empirical Evidence

Having discussed the many theoretical reasons why the budget process is important, one should be aware that the empirical evidence on the links between the budget process and fiscal outcomes is limited, particularly as concerns sovereign countries. The reason is twofold: it is difficult to measure unambiguously the different aspects of the budget process, and there is very little variation over time in budget institutions. von Hagen (1992) and von Hagen and Harden (1994) rank the budget processes in the 12 countries of the European Community along several dimensions, including the strength of the Finance Minister in the preparation phase, the strength of the Government in the discussion and approval phase, and the degree of transparency of the budget. They find evidence that more hierarchical and more transparent procedures are associated with lower average budget deficits in the eighties. de Haan, Moessen, and Volkenkirk (1999) find evidence that the role of the Finance Minister is particularly important. One limitation of these studies is the extremely small number of observations (12 countries). One study of particular interest for Colombia is Alesina et al. (1995): using responses from questionnaires sent to Finance Ministries, the authors classify the budget process in 20 Latin American countries. They find econometric evidence that countries with more hierarchical and transparent procedures tend to have lower average budget deficits during the eighties.

There is more formal evidence on the effects of the budget process in US states, as opposed to foreign countries. There is a substantial variation across states in the rules governing the budget process; in particular, several states have balanced budget rules, while others have do not. Contrary to sovereign states, balanced budget rules at the state level are much more enforceable, partly because states have a more limited ability to borrow. von Hagen (1991), Poterba (1994), Alt and Lowry (1994), Bohn and Inman (1995), Alesina and Bayoumi (1996), and Inman (1996), all show that, at the state level, rules do seem to have some impact on fiscal outcomes, in the intended direction. One should be aware that these result might not hold for sovereign countries: their budgets are much more complicated, hence there is much more scope for creative accounting and therefore for rules to impact negatively on transparency and ultimately in fiscal discipline. In addition, sovereign countries engage much more actively in countercyclical fiscal policy, hence they have more incentives to circumvent rules.

III. The Budget Process in Colombia

A. Structure and Preparation of the Budget

The budget process in Colombia is summarized in Figure 1. A National Development Plan (Plan Nacional de Desarrollo, PND) is presented to Congress by every incoming administration during the first four months of its mandate. The Plan includes the National Investment Plan (Plan Nacional de Inversiones, PNI), which sets total investment spending over the four year of the Administration's mandate.

As the first step in the yearly budget process, the Finance Minister (FM), in consultation with the National Planning Department (*Departamento Nacional de Planeacion, DNP*), sets the macro guidelines and preliminary revenue and expenditure ceilings. After this, two simultaneous and relatively independent processes take place:

- Each agency elaborates their budget proposals, which are then discussed with the entities in charge of sector and global coordination: the Ministry of Finance, DNP, Sector Ministries, and the Regional Planning Councils (CORPES);
- The Ministry of Finance and DNP prepare a Financial Plan (*Plan Financiero, PF*), which must be evaluated by the Council of Fiscal Policy (CONFIS), and must be formally approved by the Council of Economic and Social Policy (CONPES). This Plan establishes the macroeconomic foundation for the Budget, and determines the compatibility between the public sector deficit and the flow of funds of the rest of the economy.

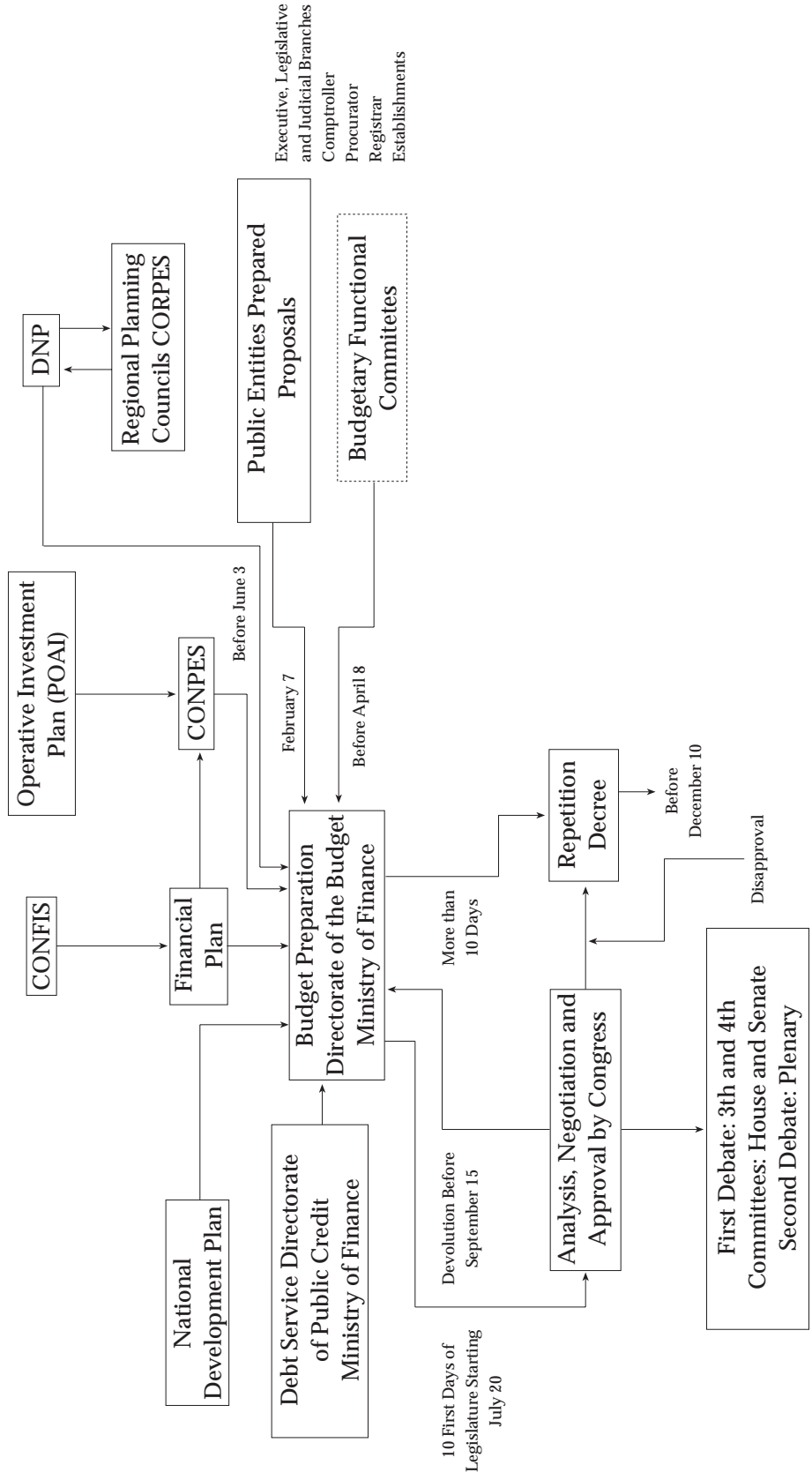
In accordance with the Financial Plan and based on the proposals made by each public agency, DNP prepares a detailed Operative Annual Investment Plan (*Plan Operativo Anual de Inversiones, POAI*), which must also take into account the framework set by the pluriannual National Development Plan. The POAI must also be approved by the Council of Economic and Social Policy (CONPES), and thereafter submitted to the Directorate of the Budget within the Ministry of Finance, to be included within the project of General Budget of the Nation (*Presupuesto General de la Nacion, PGN*), possibly after modifications following a reconciliation process with the Ministry of Finance.

The process of preparation of the budget in Colombia is relatively short. At the level of the spending agencies it starts in January and by March 15th the Directorate of the Budget at the Ministry of Finance must have received all their proposals. Bilateral committees, composed by functionaries of the agencies and the budget management units of the Ministry of Finance and DNP, discuss each agency's budget until April 15th.

The investment budget is submitted by DNP to the Ministry of Finance by June 20th, and the Government presents the whole Project of the General Budget of the Nation to Congress within the first ten days of the ordinary session, which starts on July 20th.

Meanwhile, the Directorate of the Budget collects and reviews the debt plans and requirements of the noncommercial national public agencies (Establecimientos Publicos), to be submitted to the Directorate of Public Credit at the same Ministry. This same unit prepares the plan of the whole service of the debt, to be sent by April 30 to the Directorate of the Budget, to be integrated within the project of the National Budget. Debt figures in the Budget should meet limits established by special and separate laws, the Debt Ceilings Laws, introduced by the Government whenever the corresponding authorizations expire or must be increased. These laws do not follow any established schedule related to the budget process.

Figure 1. Budget Preparation, Negotiation and Approval in Colombia



B. Budget Documents

The *Financial Plan* is a planning and management instrument for the short and medium terms, which is based on the cash operations of all those entities with relevant impact on the fiscal, monetary and exchange rate positions of the country. The cash deficit is measured and the financial requirements are stated for the Central Government as well as for the whole Nonfinancial Public Sector, which includes regional governments, the main public enterprises and noncommercial establishments, the social security sector, and the national coffee fund. The goal of the Financial Plan is to ensure the compatibility of the Annual Cash Plan (*Plan Anual de Caja, PAC*) with the external and internal credit resources as well as with the monetary and exchange targets agreed previously with the Board of the Central Bank. The Council for Fiscal Policy, CONFIS, establishes accordingly the disbursement targets for the nonfinancial public sector, and especially for the Central Government.

The *Operative Annual Investment Plan* (POAI) specifies approved investment projects classified by sectors, and executing agencies. It must comply with the investment limit set by the Financial Plan, as well as with the four-year National Investment Plan in the National Development Plan. In principle, no investment program not included in the National Investment Plan can be included in the annual budget within annual budgets, unless Congress has approved them.

The General Budget of the Nation comprises an *Income and Capital Resources Budget*, divided into i) current income revenues, ii) "parafiscal" contributions (mainly payroll taxes, accruing through specialized public institutions and enterprises), iii) capital revenues, and iv) own-resources of the non-commercial national public enterprises. On the spending side, the Appropriations Law, specifies expenditure according to three economic categories: i) operating expenses ("*gastos de funcionamiento*"), ii) investment expenses, and iii) debt service. The appropriations law establishes total amounts for each of these categories, which cannot be modified except in the cases detailed below. The PGN is followed by a Liquidation Decree (*Decreto de Liquidacion*), which prescribes more detailed allocations; these can be changed within the limits established by the Appropriations Law (i.e., without changing the totals of the three main economic categories), by permission of the Directorate of the Budget. The Budget Law also includes temporary rules to assure appropriate execution of the PGN.

The Annual Cash Plan, establishes the allowable expenditure within the calendar year, according to the Financial Plan, and it also considers the execution of arrears carried over from previous years. In addition, the Monthly Cash Plan establishes the monthly resources available through the centralized account of the National Treasury, as well as the allowances established for payments financed by resources owned by the noncommercial public entities.

The Organic Statute of the Budget (*Estatuto Organico del Presupuesto, EOP*) is a high rank law, which establishes the fundamentals of the budget process. The Statute defines the General Budget of the Nation as including budgets of the national noncommercial public establishments (*Establecimientos Publicos*) and the Budget of the Nation. The latter one involves the executive branch as well as the legislative and judicial branches, the independent control agencies (Procuraduria and Contraloria), and the electoral agency, but it excludes all sorts of noncommercial decentralized entities (*Establecimientos Publicos*), commercial public enterprises, and mixed capital enterprises where the state has invested public resources.

C. CONFIS and CONPES

CONFIS, the *Consejo Superior de Política Fiscal*, is the governmental committee in charge of fiscal policy, and it coordinates the budgeting system. It is composed of the Minister of Finance, the Director

of DNP, the Economic Advisor of the President, and the Viceministers of Finance (Technical and General), as well as the Directors of the Budget, Public Credit, Taxes and Customs, and the Treasury, at the Ministry of Finance. It must approve, modify and evaluate the Financial Plan, advise on the fiscal effects of the Investment Plan, elaborate the Cash Plan (PAC), and approve the budgets of the commercial enterprises of the state.

CONPES, the *Consejo Nacional de Política Económica y Social*, is composed of the Finance Minister, 7 other ministers, representatives of DNP, and is headed by the President of the Republic. Within the budgeting process CONPES must approve the POAI as well as the Financial Plan prepared by CONFIS.

D. Presentation, negotiations and approval of the Budget

The draft of the General Budget of the Nation is submitted to Congress accompanied by a macroeconomic program, evaluating the consistency of fiscal policy with the other main policies (monetary and exchange rate), within the growth expectations and the frame of the development plan.

There may also be a "Complementary (Revenue) Budget", in case there are expenditures lacking financing at the time of the preparation of the basic budget. Once the budget project has been presented, the specialized committees of the two legislative bodies will hear the Central Bank about the macroeconomic impact of the budget and the level of public expenditure.

The committees of the Senate and the House examine jointly the Budget proposal and must reach a conclusion about the level of expenditure by September 15th. By the end of the same month the budget draft, as modified by the committee, must be introduced to the floor discussion in each chamber of Congress. The debates can be simultaneous. In case the Budget is not approved by October 20th, the Government proposal will become effective, amended by the modifications approved in the first debate.

In case the Budget proposal has not been presented to Congress within the first ten days of the legislative period, or if Congress does not approve it, the Executive must issue a Decree repeating the Budget of the previous year. However, the Government may reduce expenditures if there are not sufficient revenues for the next fiscal year.

Once the Budget is approved, by December, the Government issues a Liquidation Decree, taking into account all the modifications, and incorporating an Annex which details all appropriations for the forthcoming fiscal year. The Liquidation Decree includes "general provisions", also to be proposed by the Ministry of Finance, in order to attain adequate execution of that budget. They are temporary, and in principle should not include substantive rules, introduce new taxes or changing existing ones, or change the Organic Statute of the Budget.

E. Execution of the Budget

The execution of the budget is regulated by a new version of the Financial Plan, issued at the end of the fiscal year prior to the budget year, to be approved by CONFIS. As mentioned before, the Annual Cash Plan must also be specified in monthly terms. The Monthly Cash Plan:

- Classifies commitments by functional categories (personal services, transfers, operating expenses, investment and service of the debt
- Includes contracts in course of execution or signed during previous fiscal periods

- Includes all new programmed contracts
- Separates all current income collected through the Treasury from revenues handled directly by decentralized entities, and it projects all capital income to be received through the fiscal year, differentiating between income of the Nation and of the national establishments.

The Ministry of Finance can also arrange budget reallocations within the year. Part of such flexibility results from the inclusion of a "provisions" component, assigned to finance the fiscal cost of laws to be approved within the fiscal year.

F. Control

There are three types of control of the Budget:

- *Political Control.* To be executed by the Congress, using these instruments: a) citation of the Ministers to plenary or committee sessions, b) citation of the heads of administrative departments (depending on the Presidency), c) examination of the reports produced by the President, Ministers, and Heads of the Administrative departments, d) examination of the report on liquidation of the execution of the Budget and the report on the Treasury to be presented by the General Comptroller (Auditor) of the Republic.
- *Financial and Economic Control.* To be done by CONFIS, the Directorate of the Budget at the Ministry of Finance, and DNP, with purpose of evaluating results and to assess the process of budget management.
- *Fiscal Control.* In charge of the Office of the General Comptroller of the Republic, in order inspect the collection of resources and to verify compliance of the existing laws, norms, procedures and rules.

G. The Budget of the Commercial and Industrial Enterprises of the State

CONFIS must also review and approve the budgets of the Commercial and Industrial Enterprises of the State at the National level, which are outside the General Budget of the Nation. These are wholly owned by the State, but they have administrative autonomy. Their budgets must follow general directives and comply with coherence requirements of the Financial Plan. Their budgeting procedures follow the general principles stated by the Organic Statute of the Budget (except being subject to embargoes). Their financial surpluses, when they do not have the societary structure, belong to the Nation. CONPES determines the amounts to be transferred as capital resources of the National Budget, the date of deposit of such deposits in the National Treasury. It must leave at least 20% of such profits to the generating enterprise.

Should the public enterprises adopt the societary form, as in the case of the shares of the Nation in enterprises of mixed nature, the corresponding profits are also property of the Nation, and the representatives of the Nation in the Boards of such enterprises must follow the instructions of CONPES regarding capitalization and distribution of dividends.

IV. Problems and proposals

A. The degree of centralization of the budget process

In assessing the degree of centralization, it is useful to distinguish the three phases of preparation, discussion in Congress, and implementation of the budget.

1. The discussion and implementation phases

Although the current legislation is less clear than it could be, the Colombian budget process assigns a strong role to the Finance Minister in the last two phases. The general framework is provided by art. 60 EOP, according to which: "The FM is the organ of communication of the Government with Congress in budget matters. As a consequence, only the FM can solicit on behalf of the Government the creation of new incomes or other revenues: changes in the tax rates, changes or movements of spending items included by the government in the draft budget law, the consideration of new spending items, and the authorization of new borrowing". This article is not entirely clear on whether the FM is the only actor who can accomplish all these acts, or whether it is the only actor within the Government; but other articles of the EOP and of the Constitution help dispel many of the doubts.

During the discussion phase, the committees need a written authorization in order to modify a "partida de gasto"; Congress needs a written authorization by the Finance Minister² to increase a "partida de gasto" or introduce a new one (art. 351 Const.), while it can, with some exceptions, eliminate or reduce "partidas de gasto" by its own initiative (art. 63 EOP and art. 351 Const.).³ Regarding revenues, Congress cannot increase them without a written authorization by the FM (art. 62 of EOP), although the EOP is silent on the more important case of a reduction in revenues.

Thus, overall Congress seems to have little power to increase the deficit relative to the budget project (with the possible exception of decreasing revenues) without the approval of either the FM or the relevant ministers. Overall, we believe the spirit of the budget procedures during the discussion phase is fundamentally sound, but it could and should be stated much more clearly in one article, requiring the FM to give written authorization for any increases in spending or decreases of revenues. We do not believe a similar authorization is needed for increases in revenues or decreases in spending; in fact, the ability of Congress to decrease spending by its own initiative is a good insurance policy against the case of a spendthrift FM.

The FM has also a strong role in the implementation phase of the budget. By art. 39 of EOP, only the FM can introduce a new operating expenditure. By art. 76 EOP, the Government through the FM can at any moment reduce or postpone a budgetary appropriation under a set of conditions, including a shortfall in revenues or the need to ensure "macroeconomic coherence". The combination of articles 79, 80, 81 and 88 of EOP implies that the government only, through the FM, can introduce to Congress new spending relative to the approved Budget.⁴

² More precisely, the law requires a written authorization by the «relevant» minister; this is usually interpreted as being the Finance Minister.

³ In practice, in the very last days of the discussion in Congress, many additions to spending are passed that do not bear the written authorization of the FM. They could be declared void by the Constitutional Court, although in reality this rarely happens.

The basic allocation of authority in the implementation phase is also, in our view, fundamentally sound. Here too, however, we believe it could be stated in much clearer terms; in particular, the wording of articles 79, 80 and 81 of EOP does not exclude a role for Congress to introduce new spending; in practice, however, these articles (together with article 88) are interpreted as reserving this role to the FM.

2. The Preparation Phase and the Plan Nacional de Desarrollo

The Colombian budget process is much less centralized in the preparation phase. The root of the problem is the emphasis on planning that permeates all economic policy in Colombia, and which manifests itself in the key role attributed to the Plan Nacional de Desarrollo (PND) in the political rhetoric. This has two consequences: it dilutes the powers of the FM, and it decreases the transparency of the whole Budget process.

As in all plans, investment is the key tool for the implementation of the PND; and like in many countries with a planning tradition, this leads to a separation of the current and the investment budget, the former attributed to the FM, the latter to the planning agency, in the Colombian case DNP. This separation of the current and capital budgets undermines the very reason for centralizing the preparation of the budget in one entity, namely ensuring that someone can internalize the whole budget. The FM has a strong role in the very first phase, since it decides the aggregates for investment and gasto de funcionamiento which become part of the June Plan Financero.⁵ The two aggregates must then be allocated to Ministries; but very little bargaining occurs on operating expenditures, which are mostly set for each Ministry incrementally relative to the previous year's figures. Virtually all the bargaining on allocations occurs on investment spending, which implies it is conducted bilaterally by DNP through the "comites funcionales". As we discuss later, bargaining on appropriations might be of little significance when -as in recent years- arrears amount to about the same size as new appropriations; but even the cash allocations in the PAC are divided between the FM and DNP. And in this case DNP has the prominent role, since for obvious reasons most of the cuts in the cash allocations relative to appropriations occurs in investment spending.⁶

Thus, the separation of the current and investment budgets imply a considerable dilution of the powers of the FM, and of its ability to direct the process of allocations of spending between ministries. As IMF (1999) emphasizes, this separation of roles could also undermine the intertemporal coherence of fiscal policy, as it can easily generate underprovision of maintenance spending for investment projects, or overprovision of investment given the budgeted level of maintenance expenditure.

But there are even more fundamental reasons why the emphasis on planning undermines the centralization of the budget process. By its nature, the PND itself is a hodge-pot of good intentions, to which virtually all institutions and interest groups in the country contribute with their own preferred investment project. According to the Constitution, the PND is elaborated by the Government

⁴ The Government need not go to Congress if it just reshuffles spending within operating expenses or investment spending; but it must have Congress' approval if it modifies the total appropriations for these two aggregates.

⁵ Formally, the Plan Financero must be approved by CONFIS, but historically the FM has had a prominent role in setting these aggregates.

⁶ Cash cuts in gasto de funcionamiento would largely imply that the Government is not paying wages.

with the "active participation of the planning authorities, the territorial entities, and the Consejo Superior de la Judicatura". The Draft Plan must be submitted to the Consejo Nacional de Planeacion, which is formed by "representatives of the territorial entities, and of the economic, social, ecological, community, and cultural sectors" (art. 340 Const.). To all this, one must add the Departmental Consejos de Planeacion, each of which elaborates their own Plan de Desarrollo.

But the dilution of the centralization of the process goes further. By its very nature, a plan generates a multitude of documents, which have to be consistent, at least formally, with each other and with the plan. Each of the other documents is prepared by a different entity, and often must be approved by yet a different one. Table 1 summarizes these features of the different budget documents

The problem is that CONFIS and especially CONPES are collegial bodies, where the FM is at best a *primus inter pares*.⁷ One could view this arrangement as a legitimate -although flawed in our view- design of the legislator to limit the powers of the FM; in reality, there is little doubt that this arrangement is rather the result of a planning mentality that feeds on ever more agencies and institutions, and of the uncontrolled growth of claims on the budget process by interest groups within the bureaucracy. The result is, in the best scenario, dilution of the centralization of the process; in the worst scenario, confusion.

Alternative: The PND should just become a political document, where the Government states the main guidelines of its program, but without any legal or formal implication for the budget process. The Budget process need to be centralized, so the Planning Department staff in charge of Investment should be integrated in the Office of the Budget of the Finance Ministry, which should prepare both the current and the capital budgets. The Plan Financero should also be prepared by the same agency. An implication of our proposal is that the Consejo Nacional de Planeacion, the analogous bodies at the Departmental level, CONFIS, should play no direct and authoritative role in the Budget. In addition, CONPES should have no direct role in the budget process.

It is certainly legitimate of the Government to collect the concerns and the problems of the country by giving voice to all actors in society. But this should be a political process, not an institutional one, and should not generate an official document with the status of a law, like the PND. The current framework is too unwieldy, and inevitably generates a document where everything is included, thus discouraging rather than encouraging the discussion of the trade-offs that fiscal policy must face.

Table 1. The Colombian Budget Documents

| | PND | PF | POAI | Budget | |
|--------------------------------|------------------|--------------------------|------------------|---------------------|------|
| | | | | Func. | Inv. |
| Preparation | Govt | MH (DNP) ¹ | DNP (MH) | MH | DNP |
| Non-binding Advice Approval | CNP ³ | CONFIS CONPES | CONFIS CONPES | CONFIS ² | |

¹ "Coordination"

² CONFIS authorizes obligaciones on future years that do not have appropriation in current budget year (art. 24 EOP).

³ "Consejo Nacional de Planeacion".

⁷ While CONFIS includes mostly Finance Minister officials, CONPES includes 7 other ministers and a host of other officials.

Exactly for this reason, it ends up having very little operational content. But perhaps the most fundamental reason why the PND should have no place in the Colombian budget process is that a plan should have no place in a market economy.

B. Transparency

1. The Proliferation of Budget Documents

The second negative effect of the proliferation of budget documents is on transparency. Several budget documents can be useful if they fulfill clearly differentiated functions, and if it is easy to go from one document to the other. Neither condition is satisfied in the Colombian budget process. By art. 13 EOP, the Budget must be consistent with the Plan Nacional de Desarrollo, the Plan Nacional de Inversiones, the Plan Financiero, and the Plan Operativo Anual de Inversiones. Is this consistency requirement satisfied in practice? And how?

Consider first the relation between the Budget and the PND. The key feature of the PND is the Plan de Inversiones, which specifies the total investment spending, in real terms, of the Central Administration, the Establecimientos Especiales, the Departments and Municipalities, and the NFPE's, over the four years of the plan. Its link with the yearly budget is the Plan Operativo Anual de Inversiones, which specifies the investment projects to be included in the Budget, and the yearly amounts to be appropriated. The investment figures in the POAI will then be part of the draft Investment Budget (art. 36 EOP). By art. 8 EOP, the annual amounts in the POAI and in the Budget must be consistent with the figures in the Plan Nacional de Inversiones.

But what does this consistency requirement mean in practice? Virtually any investment spending set in the Budgets of the first three years of the Plan de Desarrollo can be claimed to be consistent with the PNI, because one could always argue that investment in the fourth year will adjust residually. However, even this is a very loose constraint: we are not aware of any request ever being made that investment in the Budget be consistent, over a four year horizon, with the Plan de Inversiones; nor are we aware of any official analysis ever being made to check this simple adding constraint *ex post*. But this exercise can easily be done on the four years covered by the 1995-1998 Plan "El Salto Social", as shown in Table 2.⁸

Thus, appropriations and compromisos during the last years of "El Salto Social" were only 85% and 69% of PNI figures, respectively. The opposite phenomenon will likely occur in the current Plan, "Cambio Para Construir la Paz". Its PNI implies an average share of Central Government investment in GDP of .5% over the 1999-2002 period; because this share was about 2% in both 1999 and 2000, the PNI target is guaranteed to be unattainable, and by a large amount. Furthermore, the current size of (one version of) Plan Colombia alone is roughly equal to the total investment in the PNI for the 1999-2002 period. All this is hardly surprising: many shocks can occur over a four-year horizon that can change the picture entirely; there is absolutely no reason why a document written in 1998 should bind the actions of the government in the year 2000. And of course it does not, in practice.

To complicate things further, it is not even clear what the consistency between the PNI and the yearly investment budget means in theory: by art. 341 Const, "the annual budget law can increase or decrease the partidas and recursos approved in the PND". Thus, the requirement that the annual

⁸ We thank Maria Alejandra Ojeda Ortiz of DNP for providing us with these data.

Table 2. Investment in PNI and Outturn, 1995-1998, General Budget

| | PNI | Aprr. | Compr. |
|-------|--------|--------|--------|
| 1995 | 3,515 | 3,908 | 3,473 |
| 1996 | 5,123 | 4,610 | 4,336 |
| 1997 | 5,439 | 4,643 | 4,307 |
| 1998 | 5,890 | 3,802 | 1,587 |
| Total | 19,948 | 16,963 | 13,703 |
| % | | 85.0 | 68.7 |

Thousands of millions of 1994 pesos

Yearly figures for PNI are internal DNP figures: they do not appear in any official document and do not have any official status.

Source: DNP.

Table 3. Investment in the Budget Documents

| | POAI | Draf Budget | PF, appropriations | PF, Cash Anexo |
|----------------------------------|-------|-------------|-----------------------|-------------------|
| Total investment | 5,600 | 6,400 | | |
| Central Administration | 3,300 | 4,065 | 4,046 | 2,000 |
| Fondos Especiales | 1,400 | 1,148 | | |
| Vigencias Futuras | 860 | 1,000 | | |
| Resto | 1,000 | | | |
| Formacion Bruta de Capital | | | 2,375 | 2,000 |
| Reclasificado | | | 663 | |
| Sin Situacion de Fondo | | | 1,010 | |
| Establecimientos Publicos | 2,300 | 2,300 | | |

budgets be consistent with the four-year plan does not have any bite in practice and possibly even in theory, but it introduces a host of totally unnecessary complications in the process.

Consider now the relations between the annual budget document, starting with the investment figures in the POAI, the Plan Financero, and the draft Budget, as displayed in the following table.

After reading the fine print, one discovers two differences between the POAI and the Budget figures for the Central Administration: the latter includes \$517mn of investment by Forex, and about \$600mn of "reservas", the former does not. But even these do not explain the difference between the totals for the Central Administration. Also, no table in the budget gives figures for Establecimientos Publicos: one has to read attentively the text on page 73 of the Budget Message to get this figure. Although the total appropriations in the budget and the Plan Financero are close, note that the presentation and breakdown is very different. Finally, the cash figures in the Annex table of the Plan Financero include only fixed capital formation, about half of total investment in the appropriation figure of the same document.

Consider next the Plan Financero. As we know from section 3, its main purpose is to set the goals for cash spending by the Central Government and the NFPS that are compatible with the availability of credit and the macroeconomic developments. Its importance has grown pari passu with the growing importance of budget arrears: if there were no arrears, the Central Government figures in the Plan Financero and in the Budget would be identical. It is therefore understandable that a government should aspire to showing a good deal of consistency between the total revenues in the Plan

Table 4. Revenues, Plan Financiero and Draft Budget

| | Plan Financiero, July 1999 | Draft Budget, July 1999 |
|----------------------------|----------------------------|-------------------------|
| Ingresos Corrientes | 21,110 | 21,305 |
| Recursos de Capital | 1,777 | 18,957 |
| Rendimientos Financieros | 494 | 494 |
| Excedentes Financieros | 1,065 | 1,065 |
| Privatizations | 2,489 | |
| Credito Total | 13,874 | |
| Otros | 218 | 1,085 |
| Rentas Parafiscales | 640 | |
| Fondos Especiales | 637 | 2,214 |
| Total | 23,524 | 43,116 |

Financiero and in the Draft Budget; a large discrepancy between the two would imply that the Budget is overestimating revenues relative to the Plan Financiero.⁹ Indeed, the 2000 Budget message states that "for the first time, the total figure of the budgeted revenues of the Presupuesto Nacional is the same as that of the Plan Financiero" (p. 10), at \$43.1bn.

It is instructive to compare the revenue figures in Plan Financiero and in the draft Budget, both of which were issued in July of 1999. Besides differences in individual items like Rentas Parafiscales and Fondos Especiales, the Draft budget includes above the line two items, Privatizations and Credito Total, that are recorded below the line in the Plan Financiero. Credito Total is gross of amortizations, i.e. it includes both past debt that comes due and new net issue of debt. However, even after including these two items in the Plan Financiero, it still yields a total of \$39,987bn, still far from the Budget figure. In fact, we could find no way to reconcile the two figures, given the information available in the two documents.

Thus, either the requirement of consistency does not have any apparent bite, or it is satisfied by resorting to creative accounting practices. Certainly, the existence of these multiple documents generates considerable ambiguity regarding the definition of budget items, their amounts, and the aggregate figures for revenues and spending; ultimately, this has a large negative impact on the transparency of the budget.

Ideally, the whole budget process should consist of just one document. But at the moment there are large differences between the semi-accrual figures of the Budget and the cash figures imposed by reality, and it would not be realistic to impose a move to an exclusively accrual or cash basis.¹⁰ Hence, two documents are required: the Budget and a Plan Financiero. The two documents should have exactly the same structure, and should provide a table of reconciliation - essentially, the magnitude of budget arrears (see section 4.4) in the budget year and the previous year.¹¹

⁹ Recall that, for revenues, there is little difference between accrual and cash figures.

¹⁰ As we will see later, some actions are being taken to get closer to an "obligation" budget.

¹¹ In several countries, like New Zealand, the government is required to publish a few months before the Budget a document containing the expected macroeconomic developments and the aggregate figures for the coming fiscal manoeuvre. The goal is to provide all the agents involved in the process a framework for the budget negotiations. We believe that, at this stage, it would not be wise to apply this model to Colombia as well, because it would reintroduce the multiplicity of documents that we are trying to eliminate.

2. Accounting standards and reporting: the definition of investment

As we have seen, investment is a magic word in the Colombian budget process (and it becomes even more magical when combined with "social"). This is largely a reflection of the emphasis on planning, of which investment is the key instrument. The assumption underlying all the budget documents is that only investment has any social value, all other expenditures are necessary evils. This, together with the prohibition to cut the share of social investment spending in the budget, is an open invitation to use a very liberal notion of investment, and one that is at odds with any conventional usage of the term in the macroeconomic and accounting professions. Thus, the most important notion in the budget process becomes extremely difficult to interpret.

In macroeconomics and accounting, investment is the addition to the stock of physical capital. The room for controversy in this definition is extremely small. But in Colombia several current expenditures that are deemed to contribute to the formation of human capital are included in the figures for investment. Thus, for instance, the Manual de Programacion de la Inversion Publica of DNP states that Investment is the sum of "those expenditures that are capable of causing income or of being in any way economically productive...[and] those expenditures with the purpose of creating social infrastructure. The main feature of this expenditure is that it should increase the capacity to produce and the productivity in the fields of physical, economic and social infrastructure" (page 12). There is very little that could *not* fit into this definition.

Not surprisingly, in the 2000 Budget about 60% of expenditure by the Red de Solidaridad Social, all the spending by the (yet to be created) Red de Apoyo Social, and 90% of expenditure by SENA and ICBF are considered capital expenditure!¹² It is doubtful whether, under proper accounting rules, any expenditure by these agencies would be considered investment.¹³ Most revenues of Fondos Especiales are automatically recorded as investment expenditure on the spending side: thus, in the 2000 Budget all the revenues of the Fondo de Solidaridad Pensional, of FOSYGA, and of the Fondo de Solidaridad del Sector Electrico are recorded as investment expenditure!

Outside the Central Government, the definition of investment seems to become even more non-standard. The budget does not detail the criteria for the computation of public investment by local governments and NFPE, but a large part or even all of the Situado Fiscal is automatically considered investment.¹⁴ In fact, according to the Draft Budget, in 2000 investment by Territorial Entities will amount to 9.8% of GDP, against 3.4% by the Central Administration and Establecimientos Publicos. Of this investment by Territorial Entities, most is social investment according to the Budget: Territorial Entities contribute to 74.2% of social investment by the NFPS, which in turn represents 50.8% of all public investment. (see Cuadro 38 p. 77)!¹⁵

¹² The Red de Solidaridad Social is a system of about 16 different programs on subsidized housing, social assistance pensions, public employment creation, feeding program, and family assistance (see Perotti (2000) for a discussion of the Red). The Red de Apoyo Social is the complex of emergency programs (mostly public employment creation and conditional cash subsidies to families with children) put in place by the administration to cope with the recession. SENA is the agency in charge of training programs. ICBF is the agency in charge of family assistance and all the programs of child care and school restaurants. SENA and ICBF are not part of the Central Administration budget, but they are part of "Establecimientos Publicos". Spending on the Red de Apoyo Social is included in the December 1999 revision to the PF, but had not been decided at the time the budget project was published (July 1999).

¹³ It appears that programs 310 ("Divulgacion, Asistencia tecnica, y Capacitacion del Recurso Humano") and at least subprograms 1302 ("Bienestar Social a Trabajadores") and 1501 ("Asistencia Directa a la Comunidad") of program 320 ("Proteccion y Bienestar Social del Recurso Humano") are automatically treated as investment.

¹⁴ The Situado Fiscal is the automatic transfer from the CG to the LG, with mandatory destination health and education expenditure, with a small residual item on water and sanitation.

In Table 5, we compare public investment according to the Budget definition to public investment according to the even more liberal DNP definition and to the National Income Accounts definitions, which is in principle the correct one of fixed capital formation; as a comparison, we also display the average general government investment spending in OECD countries, all as shares of GDP in 1998. As one can see the Budget definition is more than double the National Income Account figure for capital formation at the Central Government level; the DNP definition is more than 3 times the figure at both the Central and Local Government levels; and all are vastly superior to the OECD average.¹⁶

Why is this latitude in the definition of investment dangerous? First, it prevents an understanding of the budget. Very little of macroeconomic significance can be inferred with the current use of the term "investment" in Colombian budget documents. Second, it undermines the comparability of different figures and budget documents: one is never quite sure what definition a budget document is using, and we have seen above an example of highly different definitions. Third, it invites creating accounting.

There are several reasons why individuals agencies and the FM might want to exploit the latitude in the definition of investment. At a general level, investment "looks good" in the political rhetoric; knowing this, agencies have an incentive to classify as much as possible of their expenditure as investment.¹⁷ Second, only investment projects are entitled to specific external financing. Third, an agency that wants to hire new public servants must go through a very complicated administrative process, which in some cases can last up to one year; the process is much simpler and shorter in the case of investment spending. For instance, when recently the railway system decided to hire some temporary workers, the expenditure was classified entirely as investment.¹⁸ Note that DNP merely records the investment figures submitted by the individual agencies in its Banco de Proyectos; it does not enter into the legitimacy of the definition of investment used by the agency. On the other hand, there is at least one powerful incentive working in the opposite direction: the PAC cash allocations are much more likely to cut investment spending than gasto de funcionamiento.

Table 5. Investment in Budget, DNP, NIA, and OECD General Government, 1998

| | Budget (1) | DNP (2) | NIA (3) | OECD (4) |
|-----------------------|---------------|------------|------------|-------------|
| General Government | | 13.9 | 3.8 | 2.7 |
| Central Government | 3.5 | 4.6 | 1.7 | |
| Other Public Entities | | 2.0 | | |
| Local Governments | | 7.3 | 2.1 | |

Central Government: Aportes Nacion and Recursos Proprios.
Sources: (1): Budget Message 2000, from Direccion General de Presupuesto Nacional, appropriations; (2): DNP; (3): DANE; (4): OECD.

¹⁵ This fundamental ambiguity in the definition of investment spending has gone so far that it is occasionally enshrined in the law. Thus, art. 2 of Law 358 1997 states that: "To this effect [the determination of the creditworthiness of Territorial Entities], the salaries, honoraria, social security spending and social security contributions are considered as "gasto de funcionamiento" even when they are budgeted as investment spending".

¹⁶ A further difficulty in interpreting the notion of investment in budget documents is the tendency to switch back and forth between the two different notions of capital expenditure and of fixed capital formation. Thus, Cuadro 5 in Plan Financero gives total capital expenditure at \$3,844mn, the sum of \$2,000mn of fixed capital formation and \$1,744mn of other capital spending. The Annex table to the Plan Financero gives only fixed capital formation for \$2,000mn.

¹⁷ DNP merely records investment expenditure in the Banco de Proyectos; it does not change the classification of spending it receives from the agencies.

¹⁸ DNP, personal communication.

We propose that the definition of investment used in the budget, in all other budget documents and by DNP, should conform to the international standards and definitions. How should this proposal be applied? The New Zealand Fiscal Responsibility Act forced the Government to conform to GAAP, a set of accounting rules approved by an independent body, the New Zealand Accounting Standard Reviews Board, and applying to both the public and private sector. Colombia need not go this far. It could adopt the rules set in the Government Finance Statistics Manual (currently under revision). For accrual accounting, the Public Sector Committee of IFAC (the International Federation of Accountants) is developing a standard, and has already issued a draft on "Guidelines for Government Financial Reporting". In Colombia, the "Contador General" has recently set accounting standards for public sector income and expense accounts, and for balance sheets. They could also provide alternative sources of accounting standards for the Budget.

3. Accounting Standards and Reporting: the Treatment of the Deficit

The problems with the definition of investment are a manifestation of a more general one: the frequent use of non-standard accounting practices. Particularly troublesome is the inclusion of gross debt issues¹⁹ (both amortization and new) and of proceeds from asset sales and amortization as a "recurso de capital" (art 31 EOP), hence above the line. That is, the structure of the Budget presentation is:

Revenues = Current revenues + new emission of debt + proceeds from asset sales and privatization + other capital spending + other revenues

Spending = Current spending + capital spending + interest + amortization of debt come due

This classification hides the deficit. Properly speaking, the most common definition of the deficit is (see IMF 1999): New emission of debt - Amortization of existing debt + Proceeds from asset sales and privatization (plus some quasi-fiscal operations, of limited size); without a long and detailed analysis of both the revenue and spending sides of the budget it is impossible to form an idea of the deficit. And without that, it is difficult to form an idea of the budget.

Including new emission of debt in revenues could have some meaning if this amount was predetermined and taken as given by the FM and Congress when deciding on the Budget. But this is not the case. The authorization to incur debt that Congress votes periodically are maximum amounts, which are always larger than the new emission of debt (also called "maximo endeudamiento posible") in the Budget. Moreover, authorizations to incur debt are voted whenever needed, and their timing is not tied to that of the Budget process. Finally, and perhaps most importantly, the "Disposiciones Generales" in the Budget Law every year authorize the Government to issue TES (government bonds) outside the debt authorization law (see art. 60 in the 2000 Budget Law).

Of course, having debt issues above the line makes several budget rules meaningless. For instance, by art. 347 Const. "if the revenues legally authorized are not enough to cover the projected expenditure... the Government will propose ... the creation of new rentas or the modification of existing ones..."; clearly such a rule has no teeth if the deficit is part of "recursos de capital" and one can issue TES at will.

This practice is engrained in the parlance of the budget. Thus, the 2000 Budget Message states on page 8 that "the draft budget amounts to \$46.6bn, financed as follows: \$21.3bn, with current revenues; \$19bn, with "recursos de capital"; \$2.8bn, with "rentas parafiscales" and "fondos especiales"; and \$3.5bn, with recursos propios of the Establecimientos Publicos". As one can see, there is no way from

¹⁹ Only debt with expiration at issue above 1 year is recorded under "recursos de capital".

this wording to infer the size of the deficit, and not even the usual definition of total spending (that is, net of amortization). In fact, except for a line in a summary table, there is no mention of the notion of deficit in the whole chapter 1 of the Budget Message, precisely in the chapter that should summarize the fiscal manoeuvre proposed by the Government.

Other items included under "recursos de capital" should also be recorded below the line, such as proceeds from privatizations. As we have seen, the 2000 Plan Financero is immune from this practice; indeed, under pressure from the IMF, the December 2000 Plan Financero even includes a reconciliation table to take care of a few smaller remaining differences with the IMF definition.

We believe the Budget too should conform to international standards in this area as well. The Colombian Budget should also conform to the standard classification of revenues and spending; the latter in particular should be reported broken down according to both the economic (that is, mainly into government consumption, public investment, transfers, and subsidies) and the functional classifications (that is, by the function fulfilled by each expenditure: health, defense, public services, etc.). Here too international standards are available: by the IMF for the economic classification and by the United Nations for the functional classification. In fact, work is under way to reclassify the Budget according to these two classifications; this is a highly commendable enterprise, and one that should be adopted permanently as part of the budget.

4. Coverage

The main function of the Budget is to provide an idea of the role of the intervention of the State in the economy. To fulfill this role, the Budget should have as wide a coverage as possible. Ideally one would like to include all the Territorial Entities and the rest of the Non-Financial Public Sector. There are obvious legal obstacles that prevent this, but unfortunately the Colombia Budget does not provide a complete picture even of the Central Government.

As it is well known, currently pensions are among the most momentous fiscal policy problems, and a whole chapter of the Budget Message is devoted to the implicit liabilities of the pension system. Yet, the Budget currently covers only a part of the pensions paid by the Central Government, namely public sector pensions at the Central Government level: all the pension (and health) expenditure by ISS (about half of total pension expenditure) is outside the Budget. This is so because the ISS is, formally, a commercial public enterprise; but the legal obstacles for its inclusion in the Budget should not be unsurmountable. At a minimum, ISS and all the other pension funds outside the Budget should be included in a separate chapter, with an informational role.

The Government is doing a good job in the Plan Financero to cover all the components of the NFPS. This should be extended to the Budget. Presently, the Budget does include information on the Territorial Entities and Non Financial Public Enterprises. But this information should be provided using the same scheme and classification as for the Central Government, and indicating clearly the flows from and to the Central Government. This way, one can form an opinion of the own operations of TE's and NFPE's, of their financial relations with the Central Government, and of their deficits.

5. Macro Assumptions and Fiscal Forecasts

There is increasing recognition that the yearly fiscal manoeuvre embodied in the Budget is not independent of the macroeconomic environment and is part of a longer-term fiscal policy. The practical implication of this recognition is twofold. First, the budget should include forecasts of the

macroeconomic developments, i.e. of variables like GDP growth and inflation; the presentation should include an explanation of how these forecasts are obtained and of how the Government believes they will affect and will be affected by fiscal policy. Second, the current Budget should include a medium or even a long-term scenario for fiscal policy, so as to be able to set the current manoeuvre in the context of the whole medium-term policy of the government.

We agree entirely with the first implication. Indeed, the recent Budget message contains a good presentation of the expected macroeconomic developments. But the question remains how reliable these forecasts are. The accusation is frequently made that governments, including the Colombian government, systematically overestimate GDP growth, in order to justify higher revenues than it is reasonable to assume for the budget year. This is indeed the case for the last four years (see Table 6), which exhibit a vast overprediction of GDP growth; but, interestingly, this has not been associated with gross errors in predicting revenues. In the previous four years the opposite pattern emerges: a good record in predicting GDP growth, but a tendency to overpredict revenues.²⁰ This table illustrates why macroeconomic forecasts are less important in Colombia than in other countries: revenue projections in Colombia are not based on an econometric model, but are mostly the result of an empirical approach. Hence, the connection between revenue projections and GDP growth is probably not very tight.

Nevertheless, we believe the Budget should provide up-to-standard projections on future macroeconomic developments. In fact, we think the Budget should take two steps further in this respect, by outsourcing its forecasts to one or more independent entities,²¹ in Colombia or outside, and by presenting a table with the recent track record of the budget forecasts of macroeconomic variables and revenues. Outsourcing macro forecasts will do away with any controversy about the strategic incentives of the government to manipulate them, and will thus enhance the credibility of the Budget. Still, since revenue projections are not based mechanically on GDP growth projections, nothing can prevent the government from overestimating revenues even in the presence of more realistic GDP growth figures; presenting a table with a comparison of forecasts and outturns can provide some idea about the track record and therefore the credibility of the present Budget forecasts.²²

Table 6. Macroeconomic and Budget Forecasts and Realizations

| | 1991 | 1992 | 1993 | 1994 | 1995 | 1996 | 1997 | 1998 |
|------------------------|-------|-------|-------|-------|-------|--------|--------|--------|
| GDP growth | | | | | | | | |
| PF ¹ | 3.0 | 3.0 | 4.5 | 5.0 | 5.6 | 5.1 | 5.3 | 4.5 |
| Actual | 2.1 | 3.5 | 5.2 | 5.7 | 5.4 | 2.0 | 3.0 | 0.6 |
| Revenues (bn\$) | | | | | | | | |
| PF1 | 3,000 | 3,995 | 5,954 | 7,728 | 9,926 | 12,531 | 14,505 | 18,299 |
| Actual ² | 3,164 | 4,207 | 5,908 | 7,700 | 9,524 | 12,049 | 15,283 | 16,957 |

¹ December of year t-1.

² December of year t+1.

Source: Planes Financieros and DNP, from Asquerria, Arangieron and Ayala (2000).

²⁰ These overpredictions of revenues are due mostly to a tendency to overestimate the effects of tax reforms yet to be approved.

²¹ Canada recently has taken such a step.

²² The IMF Transparency Guidelines (IMF (1999)) go further, and recommend that the Budget provide an assessment of the macroeconomic and fiscal "risks" surrounding the estimates. We believe this assessment is bound to be controversial and of dubious informative value, and should only be tried in advanced countries with more tested budget processes and more sophisticated forecasting approaches.

Concerning the use of a medium-term fiscal outlook, we believe that it can be a double-edged sword. True, this year's fiscal policy is presumably part of a longer term approach on the part of the administration. But no government or entity can predict with any confidence what will happen more than two years from now, and the current government cannot bind its own future policies, let alone those of its successors. Most importantly, in some circumstances a medium-term fiscal plan would provide the Government with a perverse strategic incentive when some fiscal adjustment is needed. The Government can always claim that, although it cannot be done this year due to unfavorable macro circumstances, it will be done the next few years, as the medium term fiscal plan shows.²³ Thus, the medium-term fiscal plan can be used as an excuse for postponing needed but unpopular choices, without at the same time losing credibility or appearing fiscally irresponsible. Finally, a medium-term fiscal plan in a country like Colombia would resurrect, albeit in a milder form, the Development Plan that we have advocated should be eliminated. Thus, we are not convinced that a medium-term fiscal plan should be institutionalized in a country like Colombia.

C. Rules

For expositional purposes, it is useful to distinguish between **procedural** rules, establishing the procedures for, say, changing budget appropriations; **numerical** rules, establishing numerical values or limits for certain budget magnitudes; and **accounting** rules, establishing how certain items should be recorded.

As we argued in section 2, theoretically it is not obvious what the end effect of rules might be. On one hand, they are usually intended to ensure a "sound" fiscal policy and to limit the powers of the executive and the legislator to engage in budget gimmicks. Yet, even the best intentioned rules can obtain exactly the opposite effect, by inviting creating accounting in order to bypass them. For instance, a prohibition of budget deficits will probably result, sooner or later, in more and more items being placed off the budget. The end result is less, rather than more, transparency.

Thus, we take the view that only those rules that are enforceable with a reasonable probability and effort should be imposed. A key prerequisite for enforceability is simplicity: complicated rules lend themselves more easily to budget gimmicks that are difficult to verify.

We have dealt with **procedural rules** in section 4.1, where we argued that, although basically sound, they could be stated more clearly.

Some **numerical rules** are best interpreted as enforcing a constitutional mandate or, more generally, some general principle that is the object of wide agreement. Perhaps the best known such rule is the requirement that public social spending as a share of total spending should not decrease from year to year.²⁴ This provision can only invite budget gimmicks. Indeed, in this particular case bypassing this requirement is a trivial exercise, since the definition of social spending is so loose that virtually anything can fit in it: "any expenditure whose objective is the satisfaction of unsatisfied basic needs in health, education, environment, drinkable water, housing, and those aiming at the general

²³ There is evidence of this behavior in the Budgets of some advanced countries, like Italy and even the United States.

²⁴ Note that this rule is subject to some confusion. Art. 41 EOP states that the share of social investment spending cannot decrease from year to year; but it is not clear whether the notion of social investment spending, which appears in other parts of art 40 and of the EOP, is to be considered distinct from that of social spending. To complicate matters, art. 350 Const. states that the share of investment spending in total spending cannot decrease from year to year: the qualification "social" does not appear there.

well-being and the improvement of the quality of life of the population" (art. 41 EOP). As in the case of investment, it is difficult to see any operational content in such a definition; in fact, it might not be surprising that in the 2000 budget the share of social spending in total spending is 45.4%, and this without including pension and health spending by ISS and several off-budget pension funds!

Interestingly, in the 2000 Budget the share of social public spending in total spending is .2 percentage points higher than in 1999, thus barely satisfying the constitutional requirement. In fact, not only is the definition of social spending very loose, but also nothing ensures its consistency over time. Indeed, over time it has included more and more budget items, precisely in order to satisfy the constitutional constraint. Currently, it includes items pertaining to culture, recreation, parks, contribution to religious events, concerts, and virtually all expenditure on education and health, including wages (see Perotti (2000) for a discussion).

Other types of numerical rules can best be interpreted as enforcing some principle of "sound" fiscal policy. It is typical of countries that experience fiscal problems to try and solve them by imposing more and more rules. This is understandable, and not always unproductive (see Poterba (1996)). But it is difficult to point out a single numerical rule in the Colombian budget process that has not gone unfulfilled from the very beginning, and predictably so. Art. 78 of EOP states that the government must reduce the *gasto de funcionamiento* for year t when reserves created in $t-1$ for year t exceed 2% of the *gasto de funcionamiento* in year $t-1$. A similar procedure (with a 15% threshold) holds for investment spending. How would one go about enforcing this rule? The government can always claim that any given level of expenditure is consistent with it.

Similarly, the rule that does not allow Territorial Entities to increase the *presupuesto de gasto*, in real terms, relative to the previous year is virtually unobservable and unenforceable, and again operates as a powerful incentive to reclassify items as investment expenditure. Moreover, if taken literally it implies a continuously falling share of *gasto de funcionamiento* of local governments in GDP - most likely not what the legislator had in mind. In any event, to our knowledge this rule is not enforced.

No budget can be made without some **accounting rules**. But here too it is important to conform to accepted international practices. Some accounting rules in the Colombian budget process simply do not seem to have any apparent rationale. Art. 46 EOP states that, if there is a deficit in $t-1$, there should be a provision in the draft budget for year $t+1$ for an equal amount. In its absence, the committees can reject the budget outright. If the law prohibited budget deficits in $t+1$, this rule would amount to a reduction in debt in $t+1$ equal to the increase in debt in $t-1$ (notice, however, that this would not stop the accumulation of debt because it does not take into account the interests accrued in the meantime). But since there is no limit on the deficit of year $t+1$, the government can always claim that a certain part of the year $t+1$ revenues are to be set against the year $t-1$ deficit. Notice that in the budget total issues of debt (new and amortization) are recorded above the line; hence, this would amount to recording a decrease in new issues or in amortization equal to the year $t-1$ deficit, and at the same time an increase in new issues by the same amount. The net effect is 0.

It is interesting to follow the destiny of this rule in the 2000 Draft Budget. The Government argues that it took care of the 1998 deficit in the 1999 fiscal year, through the mechanism of budget arrears, so it does not have to have a provision for it in the 2000 budget. As we have seen, this justification is entirely unnecessary, but it is interesting that the committees did not reject the Draft Budget, even though by law (art. 46 EOP) they were required to do so.

The recent legislation has seen a proliferation of a final type of rules, one that for lack of a better name could be called "**seemingly innocuous**" rules. These are rules that give only very generic indi-

cations, mostly to address a widespread concern or to make a theoretical point, but without providing any clear indication. In the best scenario, these rules only clutter the budget legislation; but in many cases they have a more tangible negative effect, reducing the transparency of the budget process.

We make three examples of rules with no teeth, in descending order of legislative rank. By art. 350 Const., "public social spending will have priority over any other spending". This is yet another manifestation of the Constitutional emphasis on social spending; we doubt it has ever been invoked, but if this rule can indeed have any practical consequence, it can only be by inviting creative accounting.

According to the principle of "Coherencia Macroeconomica" of art. 20 EOP, "the budget must be compatible with the macroeconomic goals" set by the Government and the Central Bank; according to the principle of "Homeostasis Presupuestal" of art. 21 EOP, "the increase in real revenues must be compatible with the growth of the economy, so as not to generate macroeconomic disequilibrium". Although these are worthy goals, it is difficult to imagine any government that will claim it is deliberately ignoring them; conversely, it is difficult to imagine how to conclusively prove the budget is not fulfilling these principles.

We propose to eliminate all the rules that we have mentioned. They are either irrelevant or counterproductive. In particular, we propose to do away with the Constitutional mandate on social spending. Besides being unenforceable and counterproductive, it encourages a culture of rhetorical discussion dissociated from reality.

D. Intertemporal links

The budget for a given fiscal year must deal with appropriations that, for several reasons, straddle over different fiscal years. In recent years, these items have created considered problems to the management of fiscal policy. To understand them and their effects, it is useful to start with a brief description of the process leading from appropriations to cash disbursement and its terminology. This process involves the following steps:

Appropriations²⁵

Commitments: contracts are signed

Obligations: work is completed and goods and services are delivered; bills are issued

Payment: Treasury issues checks

Cash: checks are cashed

A payment can take place only if its resources are included in the Monthly Cash Plan, in order to meet the financial and macro constraints specified by the Financial Plan.

At the end of the fiscal year, not all work has been completed: the appropriation has generated a commitment, but not an obligation. This type of appropriations are called "appropriation reserves": commitments which have not created obligations. These appropriations remain alive. In other cases, by the end of the year the work might have been completed and the goods and services delivered, but checks have not been issued. This type of appropriations is called "accounts payable": obligations that have not been paid. These appropriations too remain alive. The sum of reserves and accounts payable is the "budgetary arrears".²⁶

²⁵ Appropriations can be modified through the fiscal year: they can be increased, cut, and shifted between items. We deal here with final appropriations.

A third type of intertemporal linkage is created by "vigencias futuras", an authorization to make a commitment extending to the year following the budget year.

PAC restrictions are the main proximate cause of budget arrears.²⁷ But the underlying cause is usually assumed to be the frequent overestimation of government revenues, leading to inflated appropriations, which in turn have to be cut by PAC during the year. The size of recent and expected arrears is shown in Table 7. Total arrears transferred from 1999 into 2000 may reach 18% of programmed expenditures for the Central Government, and almost 85% in the case of investment. For this type of expenditure, there were almost no arrears in 1990.

Arrears may have significant economic effects: since they constitute a "forced credit" to the public sector, they may induce increase in costs, and even bribes and corruption. They reduce transparency: in the presence of substantial arrears, it is more difficult for Congress and the public opinion to appreciate adequately a given year's fiscal manoeuvre, since much of it is constrained by the need to make room for arrears and "vigencias futuras". On the other hand, the cash interventions that generate arrears concentrate on investment, thus inducing a strategic classification of expenditures that has nothing to do with their true economic nature.

A transitory rule, incorporated in the Law of the Budget for year 2000 (Art. 33), has been widely interpreted²⁸ as ordering all appropriations which have not been executed during that year to be incorporated in the budget for year 2001. This will leave room only for arrears from year 2000 budget which arise from accounts payable. By art. 34, if the execution of an appropriation (i.e., the delivery of goods and services) must go beyond the current fiscal year, a "vigencia futura" must be used. This requires the special approval of the Director of the Budget, which should ensure more control than was possible with reserves.

These two provisions should clean the budget of accumulated arrears due to PAC restrictions and overbudgeting of previous periods. But, if taken literally, they will also imply almost no room for new investments in year 2001; in year 2000 the execution of programmed investment should amount to no more than 15%.

While we agree with the intentions of these two articles, we doubt they will provide a lasting solution to the problem of arrears. First, they do not tackle the underlying problem, namely the excessive appropriations relative to reasonable forecasts of revenues. Second, although "vigencias fu-

Table 7. Arrears as % of GDP, Central Government

| | From 1997 to 1998 | From 1998 to 1999 | From 1999 to 2000 | From 2000 to 2001 |
|-----------------|-------------------|-------------------|-------------------|-------------------|
| Funcionamiento | 0.97 | 1.30 | 1.42 | 1.59 |
| Debt | 0.11 | 0.71 | 0.04 | 0.00 |
| Investment | 1.37 | 1.21 | 1.63 | 1.05 |
| Total with debt | 2.45 | 3.22 | 3.09 | 2.64 |
| Total w/o debt | 2.34 | 2.51 | 3.05 | 2.64 |

Source: Mensaje del Presidente y del Ministro de Hacienda, presenting the Proyecto de Presupuesto para el Año 2000, page 84.

²⁶ There may also exist revenue arrears- for example; taxes levied but not collected and uncollected loan repayments due to the government. They will not be discussed here.

²⁷ Some accounts payable may be due to ordinary commercial credit and billing practices.

²⁸ Art. 33 is an interesting piece of legislation, in that it is, by generalized consent, of a remarkable lack of clarity.

turas" are, in principle, the proper way to handle activities and projects lasting more than one year, one should be aware that they also create inflexibilities for the future budgets. In addition, the process does not have a clear regulation, and the Directorate of the Budget at the Ministry of Finance has almost unlimited powers in this area.

Third, the articles still allow not only for "vigencias futuras", but also for accounts payable; it is then easy to foresee a large strategic use of "vigencias futuras" and accounts payable to overcome controls imposed on reserves. A parallel budget thus arises, based on commitments of "vigencias futuras", as well as other mechanisms generating accounts payable, in order to assume obligations or make expenditures not allowed by the revenues programmed for each year, or to permit expenditures to be executed through several periods.

There is little doubt that the accrual basis of the Colombian budget, in addition to the common practice of overbudgeting relative to available resources, combine to produce such high levels of arrears and non transparency. The arrears problem thus seems to arise more from basic budget policy failures than from accounting weaknesses.

Still, improvements in accounting may help. The IMF Code of Good Practice on Fiscal Transparency provides accounting procedures to provide reliable information on arrears, in order to improve transparency and to control them. Such data does not result from simple cash accounting, and must be supplemented with modified accrual statements, such as developed by the International Federation of Accountants, IFAC (see IMF (1999), p. 57).

But perhaps the only real defense against arrears is a more rigorous process of forecasting revenues. To this effect, our proposal of outsourcing these forecasts, and subjecting them to external control, could go a long way in limiting future arrears.

V. Conclusions

After making several criticisms of the Colombian budget process, we want to reiterate a point we made in the Introduction: better budget institutions will not automatically solve all Colombian fiscal problems. One has to be realistic: any rule and regulation can be circumvented, sooner or later. Casual observation and common sense suggest that, if the government and Parliament of a sovereign country were to agree on a given fiscal policy, there are no budget institutions that can effectively constrain them in the long run. But better budget institutions can be important in realizing three conditions:

- allow the media, interest groups, members of Parliament, and any interest individual, a better understanding of the fiscal policy proposed by the Government, and therefore allow a more effective control on fiscal policy;
- increase the incentives for fiscal discipline;
- create an environment where a fiscally sound government can do its job more effectively, and a fiscally undisciplined government will be subject to a more informed scrutiny.

We believe these three conditions, as limited as they may appear, can greatly enhance the scope for a more effective fiscal policy in Colombia.

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