

# Public Expenditure Policy and Poverty Reduction

*Has the World Bank Got it Right?*

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## 1 Introduction

In 1990 the World Bank published its **World Development Report (WDR)** on Poverty (World Bank 1990). The WDR 1990 had a powerful impact in signalling to the wider development community that structural poverty reduction had re-emerged, from a position of relative neglect in the 1980s, as a central objective of development cooperation in the 1990s. In giving this signal, the Bank was in part responding to political change in the United States, the views of other support agencies and successful campaigning pressures from (mainly Northern) NGOs. In retrospect, it seems a bold move, because it raised external expectations at the very moment when the Bank's programme (with UNDP and the African Development Bank) on Assessing the Social Dimensions of Adjustment (SDA) was in some disarray.

Did the Bank really know at this stage how structural poverty reduction was to be achieved? The WDR 1990 suggested that it did. The WDR 1990 anti-poverty strategy has three prongs. This first is the re-kindling of economic growth. This is surely right. In poor countries poverty is too pervasive for it to be reduced significantly by the redistribution of existing resources, so growth is indispensable. But it is conceivable that economic growth could affect only those at the upper end of the income distribution and thus make no impact on poverty reduction. In other words, growth may not trickle down to those at the bottom of the income distribution. The Bank's response to this possibility is to insist that growth has to be labour-intensive in character, generating strong demand for labour, on the grounds that most poor people have only their labour to sell.

The second prong, and the one that is the primary concern of this article, is change in the composition of public expenditures. The ability of the poor to participate in labour markets depends on their stock of human capital. The government can and should help poor people to add to their stock of human capital by increasing the share of total government spending that goes on education and health and by increasing the share of education and health spending that reaches the poor.

The third prong is the provision of social safety nets, that is, special government schemes targeted on the poor who are unable to enter the labour market.

Some outside observers commented that perhaps the WDR was better described as two-and-a-half pronged rather than three pronged, because of the ambivalence expressed in WDR 1990 about the appropriateness or feasibility of the social safety net prong.

Having announced its poverty-reduction strategy, the Bank proceeded to develop some basic tools to implement it in the Bank's own operations. To follow up the WDR 1990, a policy paper on **Assistance Strategies to Reduce Poverty** (World Bank 1991) recommended that Poverty Assessments (henceforth PAs) be undertaken for almost all borrowing countries within three years from 1992. The PA could act as a check on both the relation between the government's policies and the aim of poverty reduction, and the relation between the Bank's assistance strategies and the government's efforts to reduce poverty. Other donors and UN agencies were to be involved in the task of improving the reliability of poverty data, and regular reports were to be sent to the Bank's Executive Directors on the progress of poverty reduction in connection with both adjustment and ordinary project lending.

Following on from this, an **Operational Directive on Poverty Reduction** (O.D. 4.15) (World Bank 1992) provided detailed guidance on how PAs were to be prepared. This Directive also stressed that PAs were intended to mesh with the Public Expenditure Reviews (PERs), and with other country economic and sector work, including the Country Economic Memoranda (CEMs), the Country Assistance Strategies (CASs) and in the case of adjustment lending, the Policy Framework Papers (PFPs). But O.D. 4.15 allowed considerable latitude on the question of how the task of integrating the PA into existing programmes of country economic and sector work should be tackled. This was to be decided by each country desk in light of its country's circumstances.

However, it did establish some important criteria for monitoring the Bank's poverty reduction efforts through its lending operations. In order to count as part of the Programme of Targeted Interventions (PTI) to reduce poverty, projects should either contain a specific mechanism for targeting the poor, or the poor should figure disproportionately among the projects' identified beneficiaries. The poverty-reduction components of adjustment lending were

to be included in the PTI and a standard set of country poverty indicators would be given in regular Progress Reports.

Any international effort, like that of the Bank, to promote poverty reduction in particular countries must face up to the implications of one very central difficulty. It is perhaps not fully appreciated that the poverty reduction agenda has received high political priority in the now developed countries only at particular historical moments and under well-defined conditions. Research shows that the attitudes of the elite were crucial. They took action on the poverty alleviation issue because they shared a consensus around three beliefs. They were that: (a) the welfare of the elite and the welfare of the poor were interdependent, and the elite was not able to insulate itself from the living conditions of the poor; (b) the poor did in fact have the means to affect the welfare of the elite, principally by three methods, namely crime, insurrection and epidemic disease; and (c) some actions by the state would be efficacious in reducing the threat to the welfare of the elite posed by the behaviour of the poor (De Swan 1988).

If this historical interpretation is correct, then the Bank can only make progress by taking on, with the help of bilateral aid donors, a quasi-political role. The logic of the situation seems to dictate that the Bank and the members who subscribe its capital must initiate, and then carry forward as best they can, a participatory process aimed at changing elite perceptions in ways that raise the issue of poverty reduction to a much higher priority in the domestic political agenda. The best of the PAs have been conducted in an elaborately consultative manner, which is essential groundwork for doing this. However, the task now is to push the policy dialogue forward to the point where governments that have not already done so recognize and internalize the three propositions (a, b, and c given above) which should trigger their own active engagement with the conditions of the poor.

It will be essential for the Bank's own credibility in pursuing this quasi-political approach, that its own actions be seen to be in line with the policies that it is recommending to borrowing governments. The Bank's own lending programmes will have to have a clear orientation to reducing poverty. Undoubtedly,

recent decisions about the future of country lending programmes have been in the right direction. Looking at the distribution of total Bank (i.e. IBRD and IDA) lending by sector, loans for human resources development rose from 5 to 15 per cent between the early 1980s and 1991-93. For IDA lending to the poorest countries, the share was higher in 1991-93 at 26 per cent. Looking at investment lending, some 26 per cent was within the PTI (i.e. was defined as poverty-alleviating in the fiscal year 1993), compared with 24 per cent in fiscal 1992 when PTI categorization was introduced. Although it could be argued that the Bank itself should not re-focus its lending in this way, if it lacks skills in poverty-oriented projects which other donors possess, this implies a degree of donor coordination that is still all too rare.

Within the sphere of adjustment lending some 24 per cent out of 49 new loans in the fiscal year 1992-93 were defined by the Bank as poverty-focused. This means that just under half of the adjustment loans agreed in the last two years for which figures are available met at least one of the following five criteria: the loan either re-oriented public expenditure in favour of the poor; or it removed distortions or regulations that limited the poor's access to economic opportunities; or it supported safety nets for the most vulnerable; or it helped to gather data on or helped to monitor poverty; or it helped to develop poverty-focused reduction strategies (World Bank 1994: 9-12). The definition of poverty-focused loans is here evidently a broad one, and the unit is the number of loans and not the value of the loans, leaving open the possibility that the value of poverty focused loans is on average less than the value of other types of loan. Nevertheless, the statistic indicates a considerable departure from the policy concerns of adjustment lending in the 1980s and should be welcomed.

## 2 Poverty Assessment Quality

The IDS, jointly with the Institute Universitaire d'Etudes de Développement (IUED) prepared a study of the early efforts by the Bank to draw up PAs, and of their linkages with PERs, once the first round of 28 PAs had been completed. The study examined Bank PAs and PERs in eight sub-Saharan African countries (Mali, Ghana, Burkina Faso, Ethiopia, Zambia, Tanzania, Uganda and Malawi).

Examination of these eight PAs suggested that the scope and quality of the first round of PAs was significantly variable, ranging from the unsatisfactory to the excellent. Many of these early PAs were found not to be well integrated with corresponding PERs, as will be seen from our discussion in Section 3 below.

The need to promote labour-intensive growth, both to raise the average standard of living and to benefit the poor is an urgent task. However, the distributional consequences of actual economic growth in any given country remains an empirical question, which it should be the task of PAs to investigate. PAs need to focus clearly on the problems of poverty that may persist even when broad development policies succeed in promoting growth and also need to prescribe additional policies to address any such problems as are empirically identified. At present, the PAs analyse the causes of poverty in terms of the constraints that prevent the poor from participating in labour-intensive growth. This perspective needs to be supplemented by greater awareness of the social dynamics of impoverishment, focusing on those of the poor who are vulnerable to loss of their livelihoods (possibly as a consequence of economic growth elsewhere in the economy), or severe fluctuations in their standard of living because of life-cycle or seasonal reasons. Ultimately, however, as has already been emphasized, the definition of the problem of poverty has to become the responsibility of the country government, in consultation with representatives of its civil society, the Bank and other donors.

Interdisciplinarity in the assessment of poverty was one of the requirements laid down by O.D. 4.15. The Directive states that 'analyses of the cultural constraints, sociological context, and/or political dynamics within which poverty persists contribute to understanding the process of poverty in a particular country and to evaluating the full costs and likely benefits of alternative measures to reduce poverty'. (Paragraph 8). In fact the analysis of the process of poverty, as contrasted with the state of poverty, and in particular the political dynamics of this process, has been the major weak point of the Bank's poverty assessment efforts to date. The explanation for this may lie in inhibitions arising from the non-political nature of the Bank's Charter, or in the under-representation of social and political

analysts among the Bank's staff compared with economists, or in a combination of both. Whatever the causes, it is a critical area of weakness, given the boldness and ambition of the new poverty agenda. For the heart of the matter is that poverty reduction has been low on the domestic political agenda of many poor countries. Moreover, this low priority is often not a mere matter of oversight or neglect. It often is a result of the political and social arrangements inherited at independence from the colonial elite being deliberately retained and expanded as sources of rents for the indigenous elites who currently exercise power. This poses a very difficult problem for a Bank now committed to a poverty reduction agenda.

The sociological and political factors that lie behind the institutional constraints on poverty reduction get very little mention, if any, in the PAs. The rare glimpses of pro-poor schemes being subverted by political corruption tend to be anecdotal, rather than analytical. Areas of policy discussion which will remain weak without more socio-political analysis are the strategy of decentralization, particularly of the location responsibility for provision of health and education, and the reform of extension services so that they better address, amongst other things, the needs of women farmers. Moreover, assessing the prospects for eventual government ownership of the whole poverty agenda depends on these kinds of analyses. More explicit stakeholder analysis, coupled with BAs (Beneficial Assessments), is vital.

In some PAs, a poverty reduction strategy is not sufficiently distinguished from the existing agenda of stabilization and structural adjustment. It is implied that the combination of labour-extensive growth plus improved expenditure allocations to the social sectors will be sufficient to protect the interests of the poor. However, although this may be true, it should not be endorsed as an appropriate poverty reduction strategy without a close examination in the PA of how existing policies, including fiscal policies, impact on the identified poverty groups.

Of the eight PAs examined in the IDS/IUED study, most concentrated their quantitative analysis on trying to measure poverty solely in terms of private consumption. But public expenditure and taxation also affect the standard of living. Thus an important

task for the PA is to investigate the incidence of public expenditure as it affects poverty groups, along with that of taxation issues, including recoveries and charges. The appropriate level of this analysis is below both sector and sub-sector, which are the main categories on which the PER normally operates. As is explained further below, good BAs of health and education expenditure can thus provide a key link in integrating the PA with the PER.

### **3 The Public Expenditure Reviews**

To date the PERs have focused on public expenditure policy at two levels – the macroeconomic and meso-level. At the macroeconomic level, the issue has been the reduction of the overall deficit of revenue compared with expenditure. In the African context, large budget deficits are closely linked to large increases in the money supply and to accelerating inflation. Inflation is equivalent to a tax on money holders. As Keynes once remarked: inflation is 'the form of taxation which the public find hardest to evade and even the weakest government can enforce when it can enforce nothing else.' To the extent to which the poor hold money, so they will be impoverished further by inflation. The impact of the inflation tax on the poor is, however, rarely analysed.

At the meso-level, PERs have generally concentrated on three issues. The first is the percentage of total public spending on the social sectors (usually health and education). The aim here is to ensure that any compression of total spending arising from reducing the budget deficit falls less than proportionately on the social sectors, which are seen as benefiting – at least potentially – the poor. This objective thus implies a more than proportionate compression of spending on foreign representation, the military budget and subsidies to parastatals, all of which are an important source of rents for the elite.

The second meso-level issue is intra-sectoral. The PERs indicate that within the social sectors spending priorities need to be changed if they are to become pro-poor in reality, and not just potentially. Within education, for example, the balance of spending as between tertiary and primary is shown grossly to favour the former, from which the children of the poor are virtually excluded. Within

health, for example, the balance between curative medicine in hospitals in large towns and primary health care clinics is again shown heavily to favour the former to which the poor rarely gain access. The PERs recommend substantial changes of intra-sectoral priorities in favour of pro-poor social sector spending.

The third meso-level issue is the input-composition of budgets. At present up to 80 per cent or more of budget expenditure in many SSA countries is programmed for staff emoluments. The purchase of equipment and materials is disproportionately small in its share. To some extent the budget figures are misleading, because they fail to include some items of equipment and materials financed by aid that are distributed directly to the local users. Even so, there is plenty of evidence that health services are suffering because doctors and nurses lack drugs and medical instruments, and education is of low quality because teachers lack books and papers and pencils. The PERs therefore often underline the need to re-balance spending between staff and other types of input.

At present there seems to be little connection between the processes of preparing the new PAs and other tasks of country documentation, including the preparation of PERs. It appears that, until recently, the process of preparing country PERs has continued without being synchronized with the preparation of PAs. The determination of work programmes by Bank country teams seems to have proceeded much as before, without any particular sensitivity to the logical links between the attempt to achieve a new anti-poverty emphasis in country policies and the implications of this for changes in their public expenditure management. However, on matters of public expenditure policy, the PAs have tended to follow the lead of pre-existing PERs, by centring their attention on changing the allocations of public expenditure to, and within, the social sectors.

Although this approach is correct as far as it goes, and should be sustained, it does not go far enough. The fact that the same prescriptions are repeated in successive PERs for the same country with little evidence of amelioration should lead to a more searching analysis of their limitations. Despite the fact that in recent years a rapidly increasing share of the Bank's adjustment lending has included social

sector loans, and that such loans have involved conditionalities based on analyses identical to those found in the PERs, the prescriptions still have to be repeated. Naive statements of optimism that radical change is just around the corner should be abandoned unless there has been adequate prior progress in establishing control over public expenditure.

One major reason for the frequent repetition of the above prescriptions has been that loan conditionalities have focused much too exclusively on expenditure allocations, i.e. the estimates in the budget for the following year of what can be spent under particular budget heads. Unfortunately, in many borrowing countries these tend to be symbolic figures. One might venture to put it even more strongly: in many cases expenditure allocation figures are pure fiction. The appropriate budget estimate to satisfy the conditionality can easily be written into the budget and approved by the legislature. But there are many reasons why the budget estimate does not in the end govern what actually gets spent. These include unauthorized spending, and the fact that some public expenditure (including some donor funds) is not channelled through the budget. Furthermore, mid-year variations between estimates and out-turn tend to be very large, as supplementary estimates are passed for some budget heads, while at the same time release of funds for other heads does not take place even after the budget which includes them has been approved. For all of these reasons, the good intentions towards the social sectors embodied in the budget estimate may not, and very often do not get translated into reality.

The problem of large discrepancies between budget estimates (or allocations) and budget out-turn is intensified when countries formally adopt a cash budgeting system. Cash budgeting is a system which makes the release of funds for expenditure conditional on the inflow of sufficient cash into the Treasury to finance the amounts released. The reason for adopting such a system is to prevent the emergence of a gap between total expenditures and total revenues which would have to be financed by borrowing or simply by the printing of money. When strictly implemented, cash budgeting is a very effective method of eliminating a fiscal deficit. The imperative to eliminate the fiscal deficit arises

from the need to maintain macroeconomic stability. The size of the fiscal deficit is usually one of the economic indicators that is subject to the macro-economic conditionality of the IMF. This is 'hard' conditionality: its breach is followed swiftly and certainly by a disruption of Fund assistance. The pressure to resort to cash budgeting is, therefore, very strong.

The ill effects of cash budgeting arise because there is no necessary connection between the phasing of the collection of revenues over a year and the desired time phasing of expenditure outflows. The actual pattern of revenue inflows is determined by the detail of existing tax legislation, and, within that, by factors like harvest times and the accounting periods used by private firms. The extent of tax evasion is also relevant, as are the periodic shocks (like droughts or bankruptcies) which prevent those who try to comply with the tax rules from doing so. Cash budgeting has the effect of subordinating the time pattern of public spending to these irrelevant, and often arbitrary, determinants.

The distortions thus generated in public expenditure are illustrative of a serious conflict between sound policy at the macroeconomic and at the microeconomic level. In practice, the latter has generally been sacrificed to the former. Compared with the 'hard' conditionality of the IMF, the Bank's conditionality on expenditure allocations is relatively 'soft' – and in any case, as we have argued, it is ineffective. The Bank's response has been to negotiate arrangements designed to 'ring fence' specific elements within social sector public expenditure budgets, that is to allow them to proceed according to plan, come what may in terms of revenue fluctuations. Given the large scale of the periodic collapses of revenues in some sub-Saharan African countries, the share of expenditures which can be 'ring-fenced' in this way is obviously limited.

But apart from that, there is a serious problem of expenditure monitoring. It is often quite difficult to be sure what is happening to the expenditure budget during the year, and indeed for a long time afterwards. In the worst cases, the true situation may never be established at all. Because of differences in format between the relevant documents, the reconciliation of budget heads with the heads of the government accounts may not be possible

without extensive research. Moreover, the accounts themselves may be unable to satisfy the criteria for an audit certificate. It has to be said that the failure to gain an audit certificate is a failure that is especially characteristic of government departments spending on the social sectors. The reason for this is simple. Unlike some other ministries, their expenditures are spread throughout the country and pass through the hands of several intermediary bodies on their journey to the ultimate spenders, the local schools and health clinics. In some countries, like Uganda and Ghana, these issues have already been acknowledged and are at last being addressed explicitly and centrally in the PER.

The PER should in future provide more analysis of the interactions between the effects of policies at the macroeconomic level and the spending reallocation policies being pursued at the meso-level. This analysis should include the question of how inflation affects the poor, given that at present so little is known of the money holding habits of the poor. Another macro-meso link which needs further analysis is that between cash budgeting and the maintenance of approved budget allocations. Questions to be addressed are: the relationship between the proportion of expenditures that can feasibly be subject to 'ring-fencing' and the degree of likely variation in revenues; and the relation between the extent to which expenditures are decentralized and the ability of departments to maintain budgetary allocations.

Without abandoning its focus on allocations, the PER should also include a much more substantial focus on budget management and accounting and auditing than can be found in the existing versions. Particular attention needs to be paid to the institutional intricacies of the existing system in borrowing countries, because it is that fine-grained detail which creates the room for manoeuvre by governments who wish to avoid the effect of the present allocation-based conditionalities. This will almost certainly require the acquisition by the Bank of more expertise in African systems of government accounting and auditing than seems to be available to it at present. Such expertise as there is of this kind seems to be located in the Fund rather than in the Bank and seems to be dedicated to the production of handbooks and manuals on the subject (for example, Premchand 1993 and 1995).

As a central aim of the broad process of dialogue, the PER should ultimately be transferred to the government of the borrowing country, with the aim that it should evolve from an advisory document to a central document in the improved system of public expenditure management. All parties to the dialogue should be encouraged to view it as a prototype for a Public Expenditure Survey, which provides the comprehensive controlling document to which budget estimates then have to conform. Aid donors, for their part, should renew their efforts to ensure that all their financial and in kind assistance is included in the government budget. This is a separate requirement from (although a precondition for) the need to coordinate their investments in a given sector.

Although the setting of public expenditure priorities is inevitably concerned with resolving conflicts over the public use of scarce resources, the task may be made easier by greater transparency, provided that these conflicts are situated within an established political process. A special committee of the legislature could be charged with examining the PER in draft form, and hearing submissions both from government ministers and from NGOs. These may be either on issues of general public expenditure management or the expenditure bids of sectoral programmes. Its report could be taken into account by the government before a final version of the fiscal framework is determined. In the first instance, the aim should be to encourage a public debate about expenditure priorities, to involve a wide spectrum of informed public opinion (from churches, universities, professional groups) as well as government ministers and officials, and to provide a public forum where well-planned and integrated sector programmes can gather public endorsement.

#### **4 Measuring Net Fiscal Incidence**

The procedure of measuring poverty by estimating the number of households whose private consumption falls below a designated poverty line (as is done in most PAs) is really much too narrow, even when the household's own produce and its off-take of free natural resources are included. The distribution of poverty is the combined resultant of the distribution of private consumption and of the social dividend. The social dividend is the difference between the publicly provided consumption available to

households and the taxes plus any cost recovery and other charges which they pay. Very few PERs attempt to analyse the net incidence of taxes and charges and the benefits of public expenditure. The assignment of the benefits of public expenditure is intrinsically difficult, as is the determination of the actual incidence of taxes and charges.

We do know that the impact of the system of taxes and charges in sub-Saharan African countries is at present far from distributionally neutral, because for example farmers who produce cash crops for export continue to be taxed very heavily in many countries. At the same time it is very unlikely that many households will receive in public benefits an amount exactly equivalent to the value of what is paid in taxes and charges. So that it cannot be assumed that the net social dividend (even at the level of the direct impact of expenditures and taxes) is zero. Logically, therefore, some attempt should be made to try to measure net fiscal incidence. It would be a major step forward for the PERs to include an analysis of the distribution of the benefits of public expenditure and the disbenefits of taxes and charges. However, as already noted, the attempt to do this runs into quite severe methodological problems.

The IMF's Public Expenditure Handbook (1991: 122, Chart 1) relies on a stylized presentation of net fiscal incidence. It asserts that 'the combination of taxes and cash transfers is fairly progressive at low levels of income, reflecting largely the impact of transfers, and is then more or less proportional – or mildly progressive – over the range of the income distribution where most individuals are located.' This statement is said to be based on numerous empirical studies. But there is no further reference to these studies, or to how many of them, if any, use data from SSA. Since in most SSA countries cash transfers are minuscule, the assertion of a progressive net fiscal incidence at low levels of income does not seem to be reliable in that particular geographical context.

Empirical estimates of direct 'tax and transfer incidence' as well as of direct 'benefit incidence' are only necessary first steps towards a theoretically valid measurement of the distribution of the public dividend. In future it would be valuable to try and include such studies within the PERs. But at this stage it would be necessary to avoid drawing from them

strong implications for the welfare of the poor. The households concerned might be facing a new and different set of relative prices in the post-tax-and-spending situation than they did in the pre-tax-and-spending position. Some might have been better off with lower incomes at the old, pre-tax and pre-spending set of relative prices: only with relative prices constant is higher income unambiguously preferable.

Practically speaking, one can approach the question of the impact of public expenditure on income distribution in two different ways: one can ask who receives transfer payments from the government and one can ask who gains the benefits of the services which government expenditure provides. In principle, expenditure incidence studies should cover both. Transfer payments are not any more intermediate, and therefore excludable, than the tax payments which are the object of tax incidence studies; they are, in fact, merely 'negative taxes'. If they are omitted from the expenditure side, they should be treated as deductions from taxes in the tax incidence analysis. This is not a major problem if (as suggested above) formal public transfer systems make up only a very small part of public spending in sub-Saharan economies.

How should the benefits of expenditures on goods and services be valued? Governments typically provide free (private) goods and services to households, and ration output by non-market mechanisms. The value to the marginal recipient of such goods and services equals its marginal cost of production only if private and public sector resources are optimally allocated, which is unlikely. In any case, for intra-marginal recipients, there are additional benefits analogous to consumer's surplus, and these are rarely measurable or measured. The typical method of measuring benefits from public expenditure 'assumes that all relative prices and real incomes are fixed, and benefits are not shifted, marginal benefits are equal to average benefits, and average cost is a good proxy for marginal benefits' (Selden and Wasylenko 1992: 4). From an economic viewpoint, these are very crude assumptions, and results derived from using them can be only a crude first approximation.

How should the benefits (however valued) of general government expenditure be apportioned

between different groups of the population? Spending on defence, justice, diplomacy and general administration is often treated by allocating benefits of it in proportion to income or expenditure, on the argument that this indicates their relative share of that which needs state protection. Other assumptions are either allocation as an equal per capita lump sum, on the argument that the government benefits all citizens alike regardless of how much they possess; or that the benefits accrue exclusively to the upper 10 per cent of income earners, on the argument that wealth is distributed very much more unequally than income. The point is that these are very different methods of apportionment; they affect the distribution of what is usually a large share of expenditure; the resulting measured incidence is therefore very sensitive to which assumption is used. Given the use of these categories of expenditure for rent seeking by the elite in many sub-Saharan African countries, one must surely hesitate long before crediting any part of this expenditure as a contribution to the social dividend of the poor. Indeed, the whole problem can be set aside, confining the analysis to that of the distribution of expenditure on specific goods and services, such as health services education services and infrastructure services, in the manner of Selowsky (1979).

Decisions on how the benefits of public expenditure on the social sectors (physical infrastructure, education, health) are distributed should not be made either on the basis of legislative intentions or by making assumptions which are not subsequently tested. Both of these procedures merely beg the question at issue. Household surveys of consumption of publicly provided goods and services can be a starting point for analysis. But given the weaknesses of household surveys even for private consumption, survey results would need to be tested against information emanating from BAs or PPAs. It is particularly important to use these methods to establish whether low consumption of such services by the poor, where it occurs, is caused by absence of need, or by discouraged demand, and the factors that are responsible for any discouragement. In addition, household surveys rarely distinguish between benefits from public spending that accrue to men and to women (although the Bank has done some work of this type in Ghana). There seem to be gender differences in benefit impact



within the social sectors on the poor, in education more notably than in health. Further investigation of these differences is necessary, particularly in the light of what is said below on the subject of externalities.

The problem of valuing and allocating the benefits of public investment in the social sectors also arises. Current investment expenditure generates no current benefits, but should do so in the future. Even if both the level and composition of public investment spending are constant (rather unlikely if a country is either declining or developing), it is misleading to value the future benefits of an investment as equal to its cost over the relevant pay-back period, because good investment yields a substantial positive return over and above cost, while the benefits of loss-making investments are smaller than their costs. It is thus almost impossible to avoid the arbitrary attribution of the future benefits of public investment in the social service sectors whatever a *a priori* rule is used to impose adjustments on the underlying investment expenditure figures. But it may be possible to speculate intelligently on whether the level and composition of past public investment is likely to shift the benefits of government activity in the social sectors to be more or less pro-poor in its future impact.

Certain expenditures yield 'external' benefits or costs. For example, education may not only confer benefits directly on the educated (which are reflected in wage and salary levels which they can then obtain) it may also contribute to the efficiency and performance of the economy more generally, by improving the mobility and adaptability of labour. A specific example is the externalities that arise from the education of girls, in terms of improvements in fertility behaviour, child care, public health and environmental protection. We note that many studies have established their importance, but because of the difficulty of quantification, they will probably have to be omitted from the formal results of the analysis of expenditure benefits. They can be taken into account only as a qualitative add-on.

One further methodological problem is that the resource diversions caused by taxes and expenditures not only have direct impacts, but also have consequential indirect effects. Changes in spending and taxes, even when there is no fiscal deficit and the

budget is balanced, can have an inflationary or a deflationary impact on the economy, depending on the share of transfers in public spending. Second, the relative prices of goods and services in the economy may change as a result of the taxes and expenditures undertaken: this will alter the demand for labour and other inputs and so cause wage and profit incomes to alter. Third, changes in taxes and expenditures may cause changes in the technology of production and the supply of labour and investible funds. These three types of consequential indirect effects on income distribution would, in theory, have to be worked out before one has a comprehensive picture of the income distribution that results from a balanced budget tax/expenditure change.

Most empirical studies of net fiscal incidence simply assume that the indirect effects of the tax and expenditure system are zero. The assumption of zero indirect effects may well be justified when one is assessing the incidence of a small, marginal tax expenditure change. But it is not justified if one wants to know the incidence of the fiscal system as a whole, when as is usual in sub-Saharan African countries some 10 - 25 per cent of national income flows through the fiscal system. Without a general equilibrium model of the economy, one cannot measure the net incidence of the whole fiscal system. Because of the problem of indirect effects of the fiscal system, it is desirable to use, when feasible, the more elaborate methodology of the social accounting matrix (SAM). The SAM is simply a generic name for a class of analytic instruments which combine a Keynesian-type matrix of national accounts with an input-output table that describes the interdependencies between all the different production activities in the economy. SAMs may be used on their own for relatively simple manipulations or may be connected to more elaborate models which incorporate detailed specifications of economic behaviour and feedback effects affecting relative prices.

The precise analyses which can be performed with a SAM will depend on the details of the classifications that it uses and the disaggregations of the data which it employs. There is not, and because the economic structure of countries differs there should not be, any general format of classifications and disaggregations. This has to remain a matter for the judgement of the analyst, in which the availability

or not of reliable data sets will inevitably force some compromises on what might ideally be desirable. When SAMs are used in conjunction with economic models, a more general trade-off exists between the effort devoted to data acquisition and reconciliation for the SAM and the elaboration of the economic (cum demographic, cum educational, cum whatever) model in which it is nested.

Obviously, however, in order to be useful for investigating the effects of anti-poverty policy, the classification of both the household sector and the government sector needs to be fairly refined. Taking the household sector first, rural and urban households are distinguished. Within each sector, major sub-types can then be distinguished – say, subsistence from commercial farmers in the rural sector, or whatever the major lines of socioeconomic division happen to be. Within each sub-type, rich, middle and poor households can then be separately identified. Taking the government sector, both expenditures and revenues would need to be distinguished in some detail. Expenditures need to be shown separately under the major functional spending heads plus transfer payment by main type, while taxes need to be separately identified, plus off-setting subsidies and the profits/losses of state enterprises. What the SAM does, in principle, is to calculate the effect of a specific change in one of the government's fiscal instruments on the income of particular types of household.

The PAs have, at least in their best examples, succeeded in identifying a number of different poverty groups. These groups are not necessarily just based on the simple rural/urban, higher income/lower income classifications cited above. The PAs mostly recognize that current income is not the most reliable indicator of poverty, and that current consumption is a better guide to permanent income. Poverty groups have been identified according to whether consumption invariably exceeds income (the destitute), falls short of income (surplus households or the self-improving poor) or fluctuates above and below income (deficit households or the precarious poor). By adding 'other households', this generates a particular disaggregation of consumer expenditure which can then be incorporated into the SAM. Thus a formal link can be forged between poverty groups identified in PAs and the remainder of the SAM.

Where a SAM is already in existence for a borrowing country, it would take relatively little time and effort to adjust it in the manner outlined. We note that the work done by the Cornell team for USAID was based on a series of computable general equilibrium models (Sahn, Van Frausum and Shively 1994). The possibility could be investigated, on a pilot basis, of adapting these models to incorporate the poverty groups identified in the relevant country PA, while recognizing that it has limitations which mean that issues of assets, seasonality and intra-household distribution will have to be investigated by other means.

## 5 Conclusions

The PERs have generally concentrated their attention on three meso-level issues, the percentage share of the education and health sectors in total expenditure, the composition of spending within each of these sectors and the balance between staff and non-staff costs. Increased percentage shares for health and education have been recommended, along with substantial changes in intra-sector priorities to favour pro-poor types of spending and a rebalancing of spending in favour of non-staff costs. The IDS/IUED study found that despite the conditionalities in an increased number of Bank social sector loans, on these three issues progress has been very slow. It furthermore found that the introduction of PERs had not occurred on a consistent footing.

Attention to budget allocation needs to be supplemented by a much more substantial focus on budget management and government accounting and auditing. Until public expenditure is better managed and accounted for, conditionalities based on allocation figures are not likely to be fully monitorable. Improvement in management requires donors to ensure that all their assistance is recorded in the budget, as well as that their investments in a given sector are coordinated according to an agreed sector strategy.

Apart from the familiar meso-level issues, the PERs could usefully examine two issues of macro-meso linkage. One is the effects of inflation and additional formal taxation on the poor. The other is the link between cash budgeting and the ability to 'ring-fence' specific expenditure allocations.

That some PERs are now being prepared by country governments, rather than within the Bank, is extremely welcome. Since a broad process of dialogue between government, NGOs and independent authorities is vital for creating a constituency for poverty reduction policies, and PERs have the potential to become a central focus of such a dialogue, more PERs should be transferred in this way. The ultimate aim should be to evolve the PER from an advisory document to the central document of an improved system of public expenditure management. But, for this to happen, a process of consensus-building around public expenditure decisions is required, perhaps with a special committee of the legislature hearing submissions both from government ministers and representatives of civil society about the content of a draft PER.

The integration of PAs with PERs could be achieved by the introduction into the latter of some forms of the distributional analysis of public expenditure. There are many methodological problems in this area. Some points, however, are clear. The aim should be to gauge net fiscal incidence, i.e. the impact on the poor of both government expenditure and taxation and other charges. The assumptions usually used in incidence analysis would have to be carefully cross-checked by PRA or by BA methods.

A familiar technique that allows the exploration of the impact of specific policy changes on the income

of poverty groups is the Social Accounting Matrix (SAM). Because SAMs are expensive to construct, it may only be feasible to adapt existing SAMs in countries for which they have already been constructed. In any case, the important issues of asset-holding, seasonality and intra-household distribution would need to be explored outside this framework.

To sum up, the Bank's revived poverty agenda which has been pursued since the publication of the 1990 'World Development Report' must count as the Bank's most heartening initiative of late. During the Presidency of Lewis Preston, the Bank has transformed itself from a tardy follower (or sometimes outright critic) of the poverty agenda into a clear leader of important initiatives being taken worldwide to combat both long-term structural poverty and the conjunctural poverty which arises from public sector restructuring and other adverse effects of structural adjustment policies. At the level of inputs, the Bank's project design and use of policy conditions is now much better attuned to the relief of poverty than they ever were before.

However, as the discussion of the Bank's PAs and PERs suggests, immediate improvements are needed in both the methodological and analytical approaches to poverty analysis and the identification of poverty issues to be addressed. The standard of PAs can be levelled up and PERs can become key planning tools for countries themselves. This is the challenge which the Bank has still to meet.

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