Linking Policy, Planning and Budgeting in a Medium-Term Framework

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Abstract—This research deals with linking policy, planning and budgeting across the whole of government and at a sectoral level. The chapter provides guidance on institutional mechanisms that facilitate the allocation of resources to achieve strategic objectives. Affordability must influence policy making and planning at the point when the decision is made. Where adjustment is required to deal with changing macroeconomic conditions and, even more particularly, changing priorities, that adjustment needs to take place through policy change to be sustainable. A medium-term approach that encompasses all expenditure provides a linking framework and facilitates the management of policies and budget realities to reduce pressure throughout the whole budget cycle. The result is better control of expenditure and greater efficiency and effectiveness in implementing policies, programs and projects. This chapter provides guidance on approaches to some of these issues and improving these linkages throughout the full cycle of policy, planning and budgeting.

Keywords—Policy making, Planning, Budgeting, Medium-Term Framework.

I. INTRODUCTION

The reasons for adopting a MTEF were numerous:

- To facilitate political decision making,
- To develop cooperative governance,
- To improve the efficiency of the public sector,
- To create a more predictable environment within which public sector organizations could raise the quality of their services to citizens.

Key mechanisms that promote strategic decision making by core decision making bodies are those that:

- promote consultation and debate on policy issues;
- promote transparency and accountability;
- promote decision making that is underpinned by resource availability;
- help manage and sequence the process for policy considerations by Cabinet.

II. DEVELOPING AND IMPLEMENTING A MEDIUM-TERM FRAMEWORK

Developing and implementing a medium-term framework for linking policy, planning and budgeting can be accomplished progressively at a pace that fits a country’s capacities. Some countries (e.g., South Africa, Uganda) began by developing an overall medium-term framework for allocating resources between sectors through a top-down approach carried out by the Ministry of Finance. Others (e.g., Malawi) began with a more bottom-up approach, focusing first on developing MTEFs at the sector level to govern resource allocation within individual sectors.

Many of the potential gains at the sector level, however, cannot be realized until the sector approach is combined with a central overall planning, resource allocation and budgeting system that supports a better balance between policies and resources at the intersectoral level. Furthermore, too much dependence on a sector focus can limit opportunities for responses that go beyond the sector. For example, the most effective health sector response might lie in the water sector, yet consideration of this could be excluded through a sector approach confined to health.

Similarly, a framework to allocate resources between sectors can only be fully effective when it is complemented by a similar system for resource allocation within sectors and by information generated by sector ministries themselves. The ideal, therefore, is to develop a medium-term approach to decision making and resource allocation across the whole of government that combines top-down and bottom-up decision making for expenditure allocation. Clearly, medium-term expenditure planning at the sector and government-wide level are linked. Necessary components of government-wide planning include sector (and program) information, a sense of what is affordable, and a mechanism to resolve the tension between the two and to set priorities inter- and intrasectorally. For either form of MTEF, development will take a number of years because the MTEF needs to encompass all expenditure.
III. The Objectives of an MTEF Are To

- improve macroeconomic balance by developing a consistent and realistic resource framework;
- improve the allocation of resources to strategic priorities between and within sectors;
- increase commitment to predictability of both policy and funding so that ministries can plan ahead and programs can be sustained;
- provide line agencies with a hard budget constraint and increased autonomy, thereby increasing incentives for efficient and effective use of funds.

IV. Stages of a Comprehensive MTEF1

Preparation and implementation of an MTEF takes place through an integrated, bottom-up/top-down strategic planning process consisting of seven main steps, each of which feeds into the next. Figure 1 provides a schematic representation of the stages, drawing in particular on the Malawian experience.

Stage 1. This stage involves developing the macroeconomic framework, which will be used to make projections of revenues and expenditures for three years. The key activity here is macroanalysis and modeling, a necessary step in achieving aggregate fiscal discipline. Information on what is fiscally affordable and sound is required for restrained decision making. In this exercise, the importance of linking economic projections to fiscal targets and the requirements for constructing and using models must be kept in mind.

Linking economic projections to fiscal targets. The transition from planning to budgeting often suffers from inconsistencies such as overcommitment. This occurs when decisions do not take into consideration the aggregate resource constraint or their ongoing costs. Models can assist in identifying problems by checking the internal consistency of proposals and by generating accurate forecasts. Models can also illustrate trade-offs between alternative uses of resources and can make explicit the underlying assumptions about relationships and priorities.

Constructing a model can expose differences in assumptions about what drives decisions or relationships and reveals deficiencies in data. Personal computers and software have increased the scope for using models for analysis and explanation.

Constructing and using models. The value of model building stems from involving the interested parties in reviewing data, discussing different perceptions about the relevant relationships, and identifying data requirements. A working group on a macroeconomic model may be the first occasion that technical staff of finance, planning and statistics agencies, together with the central bank, have collaborated directly. This coming together can be used as a basis for more systematic coordination in the future.

Stage 2. This stage can proceed in parallel with stage one and involves a sector review process through which sector/ministry objectives and activities are agreed and then costed. The sector review process consists of three stages:

- agreeing on objectives, outputs and activities;
- reviewing/developing agreed programs and subprograms; and
- costing agreed programs.

Once ministries have reviewed and costed programs and subprograms, they also need to go through a process of prioritization to make program costs fit within available resources. This involves agreeing on which activities are to be scaled back, postponed until the following year or dropped altogether. The impact of these reductions on targets such as pupil-teacher ratios or kilometers of roads rehabilitated will also need to be identified. This information is provided to the Ministry of Finance and used to develop the expenditure framework and ceilings. During this stage, ministries can also develop performance indicators for agreed programs and subprograms so that, over time, there can be greater emphasis on what ministries are achieving with the resources they are given.

Stage 3. This stage involves a series of hearings between the Ministry of Finance and sector ministries to go over the outputs of the sector review (Stage 2).
Stage 4. With the macroeconomic framework and the sector review output in hand, the Ministry of Finance now develops a strategic expenditure framework. This framework enables the analysis of the trade-offs between and within sectors of certain funding decisions and is the basis for the establishment of sector expenditure ceilings for the upcoming budget year as well as the two outer years.

This framework should be used to guide the deliberations of the decision making body (usually Cabinet or the Council of Ministers) that makes strategic resource allocation decisions. The policy framework must enforce aggregate fiscal discipline, which demands a high-level of consensus among the key players. This consensus is essential to ensure that there is discipline in adhering to expenditure targets and to the procedures that have been agreed for adjusting them. The framework needs to cover a medium-term time frame (three to five years) and must include clear statements on the following:

- the broad objectives of policy and the role of government in the economy;
- the need for discipline in macroeconomic management;
- targets for broad aggregates of public revenue and expenditure;
- procedures for setting and revising the expenditure framework;
- the responsibilities of key agencies.

The consensus that emerges must include political and technical levels and, where aid is significant, major donors as well. However, leadership must come from within the government if improvements in planning and budgeting are to be durable.

Stage 5. This is a crucial stage of the MTEF process and requires the main decision-making body in government (Cabinet or Council of Ministers) to make medium-term sectoral resources allocations on the basis of affordability and intersectoral priorities. This is done by defining sector resource envelopes (budget ceilings) for the next three years. The more out of balance are policies and resources, the more likely indicative resource envelopes beyond the budget year will be valuable. However, the poorer the balance, the more difficult it will be to deliver on these ceilings when the forward year becomes the budget year. The test of these envelopes is their credibility, i.e., they do not change so much during the cycle as to become meaningless.
It would be expected that they would become tighter through the cycle, i.e., from indicative in the outer years, to reasonably firm for formulation of the annual budget, to very tight during budget execution.

Top-down sector resource envelopes with a medium-term horizon are a basis for predictability so that appropriate strategic and efficient operational decisions can be made and implemented. Restraint and discipline in defining the sector resource envelope increases predictability of resource flows, thereby increasing operational efficiency, and permits greater flexibility in the management of the resources that are defined by the sector envelope (e.g., by devolving authority for lower level resource allocation decisions within the tight aggregate constraint). Sector resource envelopes can be derived by establishing a sustainable macro ceiling for government expenditures over the medium term, then breaking it down. A division between discretionary and nondiscretionary expenditures should be made. A medium-term perspective increases the scope of effective discretion, e.g., over staffing levels and salary obligations. An unallocated contingency can be withheld to cope with uncertainties and to allow for adjustments for unanticipated expenditures, but this should be kept to a minimum as it can easily become a "slush" fund.

The political aspect of resource allocation makes it wise to reach agreement on the criteria to be applied to allocations. Agreement on criteria provides guidance on how to adjust to new or altered circumstances and can increase discipline and predictability.

Stage 6. At this stage, ministries make revisions to the budget estimates to make them fit within the approved ceilings.

Stage 7. The revised ministerial budget estimates are reviewed again by the Ministry of Finance and presented to the Cabinet and the Parliament for final approval.

V. RESULTS

Implementing an MTEF is a complex task requiring a radical shift in perspective and the way in which business is done. Success hinges on a variety of factors, which include:

- political commitment and endorsement at the highest level to make and abide by the difficult decisions involved in the restructuring of expenditures (Some ministries may need to scale back their activities so that more resources can be directed to higher priority sectors);
- strong management of donors to ensure that they operate within the framework of the MTEF;
- willingness to subject policy decisions with financial implications, made outside the budget process, to the discipline of the MTEF;
- understanding of, and commitment to, the difficult decisions at the sector ministry level;
- commitment at all levels to abide by the budget decision so that new expenditure decisions are not introduced during budget implementation that would require reallocation of resources (These new decisions mean that the priorities set when the budget is approved by Parliament are often overturned);
- improvements in expenditure control so that the decisions are not undermined by overexpenditures and reallocation of funds during budget implementation;
- improved macroeconomic management and revenue collection so that revenue shortfalls do not necessitate adjustments to the budget estimates;
- briefings of politicians and senior management during implementation;
- improvements to expenditure reporting on results;
- development of a computerized accounting system.

But one of the important factors in the success of MTEF its integration into the budgeting process. In other words, a mechanism should be designed so that when it became clear strategies and plans, the annual budget on the strategies and plans to achieve them and be prepared.

In other words, the main point is that the process of consolidation of the strategic decisions taken to result in major policy debates and in the beginning of the process, at the end of the annual allocation provided in the budget result.

The experience in implementing MTEF countries, also shows that in some countries, this model carried out for all sectors and in some countries, these patterns is carried out only for selected segments of decision-making in this area, the state and organizational policy.

REFERENCES