

## Unit 3: The budget process

### Unit 3 Learning objectives What is the Budget Process for Parliamentarians?

After studying this unit you should be able to:

- Explain the different stages of the budget process
- Discuss the roles of different actors in the budget process

### **Introduction**

Understanding the way budgets are put together is a crucial first step in influencing decision making. The budget is the result of a process. The priorities and choices it embodies reflect the power of various actors in this process. Those who are effective in influencing the budget succeed in having their choices and priorities included. This chapter provides a general outline of the budget process. While the details will differ from country to country, there are also important similarities across most public budgeting systems. Based on a simplified and generalized discussion, the following sections look at the stakeholders in the budget process, stages of the budget process, and how annual budgeting can be guided by a medium-term expenditure framework.

### **Actors in the budget process**

Within the executive, the role of a finance ministry or treasury is to coordinate and drive the budget process in accordance with a schedule. The finance ministry has the economic expertise to prepare macroeconomic projections. These are important in order to assess the amount of money that will be available for spending. The finance ministry also plays a crucial role in formulating fiscal policy, guiding the drafting of the budget, and later in monitoring budget implementation. Various spending departments are ultimately responsible for expenditures within their jurisdiction, such as health,

education, agriculture and so on. Spending departments will often try to extract as many resources as possible, whereas the role of the finance ministry is that of the guardian of the public purse.

Democratic constitutions require taxation and public spending to be approved by parliament. Therefore, the role of the legislature is to scrutinize and authorize revenues and expenditures, and to ensure the budget is properly implemented. The nature and effect of legislative engagement vary. Some legislatures write the budget; others approve executive budget proposals without changes. In some legislatures most of the debate around the budget takes place on the floor of the house; elsewhere the emphasis is on discussion in committees. Some legislatures fragment decision-making power in the budget process across various committees; others have a single financial committee that dominates the process. Ultimately, the final vote takes place in the chamber. However, where committees play a strong role, the house tends to be guided by committee reports in approving financial legislation. Legislators are aware of their constituencies' priorities and needs when considering the budget.

Independent supreme audit institutions such as auditor generals or audit courts carry out an audit of government accounts in order to determine whether government did in fact implement that budget as passed by the legislature. Some of them also consider whether this was done efficiently and effectively. While this basic task is similar across different systems, there are differences in the institutional design of supreme audit institutions. For instance, some are directly linked to the legislature, while others have judicial independence. There are also differences with regard to capacity, resources, and types of audit conducted. The role of supreme audit institutions and their interaction with parliament is considered in detail in another unit.

The potential contribution to the budget process of civil society organizations, covering the full spectrum from think tanks to community-based organizations, is increasingly appreciated. Civil society organizations can provide independent research from a perspective that is not covered by conventional analyses. One example is the work on the impact of the budget on vulnerable groups such as women or children that civil

society groups have pioneered, sometimes in collaboration with the legislature. In some countries where the legislature has limited research capacity, think tanks and universities can ensure access to sound technical analysis of fiscal issues. Civil society input to the legislature is promoted when committee and chamber debates are open to the public, legislative information is freely available, and when committees conduct hearings and receive submissions on legislation and budgets.

The media has an important role to play in ensuring that the central issues in budgetary debates are widely understood. In order to play this role, journalists require full access to the legislature and its committees, and all relevant documentation should be available to them. Training and capacity building can help journalists to maximize the quality of their reporting on the budget, and there have been instances where media institutes or civil society organizations have provided such opportunities. A later unit discusses the role of civil society and the media during the budget process.

International financial institutions and donor agencies play a powerful role in the budget process of poor countries with particularly high levels of foreign debt. When international financial institutions and donors attach stringent conditions to loans, the legislature's role may be severely diminished to rubberstamping budgets that reflect prior agreements between lenders and the executive. To be supportive of sound budget practices, donor funding needs to be transparent and predictable, and full information on such funding should be given in the budget. Increasingly, the negotiations around debt and new financing involve a wider range of state and non-state actors. Consultative Group Meetings, as they are called, have become important opportunities for the private sector and civil society groups to make their voices heard on economic and budget policy issues.

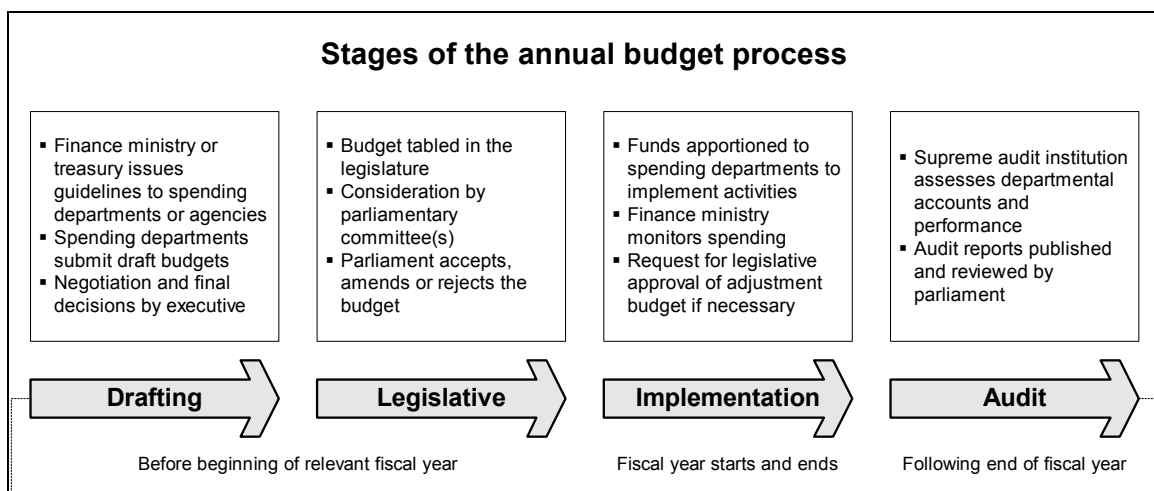
### **Stages of the budget process**

Budgets have to be passed regularly, usually on an annual basis, in order to ensure that the government continues to operate. The budget process is governed by a timeline that typically can be separated into four different stages:

- Drafting
- Legislative
- Implementation
- Audit and evaluation

This basic sequence is applicable for many if not most countries whose governments are built on democratic principles. But across countries there are many differences in the influence of various actors and the timing of the process. The following paragraphs look at a simplified version of public budgeting in the form of a generalized overview of the process of preparing, approving, implementing and auditing a single budget.

It is important to remember, however, that in real life budget cycles overlap. At any one time a number of different budgets are at different stages of the budget process. For example, while one budget is being drafted, another budget might be awaiting legislative approval, yet another might be in the process of being implemented, and a fourth one that has already been implemented might be subject to audit and evaluation. This means that the legislature concurrently has to deal with several different budgets at different stages in their process. The overlapping nature of budgeting means that the maintenance of fiscal oversight can be a complex challenge.



The drafting stage is concerned with compiling a draft budget that can be submitted to the legislature. This stage is mostly internal to the executive, but it does not have to be a secretive affair. The first step is to set fiscal policy and estimate available revenues in order to establish the total resource envelope that will be available for spending. Based on the policy framework of the government the finance ministry issues indicative expenditure ceilings for each department. This leads up to negotiations between spending departments and the finance ministry about the allocation of funds across different functions. A consolidated draft budget has to be reviewed and approved at the highest political level, such as the president or cabinet, which will also make final decisions on especially contentious issues that could not be resolved before.

Once a comprehensive budget has been drafted, it has to be approved by the legislature to become effective. During the legislative stage, parliament scrutinizes the expenditure and revenue proposals of the executive. Its options are to approve or reject the budget, to amend it, or, in a few cases, to substitute the draft tabled by the executive with its own budget. In some countries, the legislature passes separate legislation for appropriations and changes to the tax code; in others it considers a unified budget bill. The exact form of legislative approval is less important than the fact that it must be comprehensive. Legislative authorization of all public spending and taxation ensures the rule of law in public finance.

The duration of the legislative stage is an important element of variation between budget processes of different countries. The United States Congress spends about eight months and sometimes more on deciding the budget, while some legislatures only have about a month. Budget scrutiny takes time. A good rule of thumb, therefore, is that the more time the legislature has to review the draft budget, the greater its overall potential influence. A national legislature requires a minimum of three months for effective consideration of the annual state budget.

Implementation of the budget commences with the beginning of the fiscal year. The execution or implementation stage of the budget process is mainly in the hands of the

executive. The finance ministry or treasury usually plays a leading role in assuring that funds are apportioned to spending departments in line with the approved budget. Sometimes, however, in many developing countries, cash constraints lead to certain expenditures being cut below voted and other unplanned adjustments to approved spending. Funds might be shifted to purposes other than those that were approved. Improvised budget cuts tend to adversely affect vulnerable groups that have a weak political voice, and who are most dependent on government initiatives. Frequent adjustments to budgets can reflect the uncertainties that are characteristic of the macroeconomic environment, but 'continuous' or 'repetitive budgeting' is also a symptom of a weak and ill-disciplined budget system. To ensure that its authority is not undermined by excessive adjustments, the legislature might find it useful to keep a close eye on implementation through scrutiny of actual spending during the fiscal year. Any significant adjustments to the budget should be captured in adjustment or supplemental appropriations that are tabled in the legislature for approval. In-year adjustment decisions need to be made in a transparent manner and should be subject to the same scrutiny carried out at the budget formulation stages.

All countries are exposed to fiscal risks inherent in a continuously changing economic environment and even with high quality forecasting many new and urgent pressures on public spending are impossible to anticipate and can emerge suddenly. For instance, infrastructure reconstruction might unexpectedly become necessary due to natural disasters such as floods or storms. To ensure that the budget remains authoritative even during difficult economic times, a budgeting system needs to cope with uncertainty (Crippen 2003). This is the function of contingency reserves, which set aside an amount for adapting the budget to changing circumstances or emergencies. However, contingency reserves need to be clearly accounted, decisions about their use should be a transparent and approved by the legislature, and they should not be excessive in size. Otherwise, they can easily deteriorate into 'slush funds.'

There are other potential challenges to the proper implementation of annual budgets. Ordinary legislation introduced during the course of a financial year can have budgetary implications, for example by creating or increasing entitlements such as social grants.

This might bring such legislation into conflict with the constraints of the approved budget or medium term expenditure plans. For this reason, the process of drafting ordinary legislation should include a consideration of its implications on the budget in both the short and medium to long term. This information should be available to the legislature during the law-making process, so that it can be subjected to independent and open scrutiny.

During the audit and evaluation stage, an independent audit institution, such as an audit court or auditor general, analyses government accounts and financial statements. In most countries, the audit of accounts is followed by the consideration of audit findings by the legislature. If the process is effective, any recommendations based on audit findings are reflected in future budgets, which allows for continuous improvements in public spending and generally public financial management. Audit reports need to be produced and tabled in the legislature as speedily as possible to ensure their relevance and accuracy. Long delays undermine accountability, because officials who are responsible for a loss of public money may have moved on or retired by the time an incident receives attention. Delays may make it more difficult to pursue disciplinary measures. The interest of the public is also likely to focus on more current matters. The timely submission of audit reports requires that departments produce their financial statements in time for the audit institution to meet the deadline. The relevant financial management legislation usually prescribes when and in what form the necessary information has to be submitted by departments to the auditors.

Budgeting is a process rather than an event, and budget cycles are ongoing and interconnected. The role of parliament should not be restricted to budget approval and the review of audit findings. For instance, in a number of countries parliamentary committees ask government to report on the process of drafting an upcoming budget yet to be tabled, and legislators might request certain documentation that is used in the drafting process. During budget execution, the legislature should have access to actual revenue and expenditure data on an ongoing basis. In this way, it will be able to keep track of the progress that is being made in implementing the approved budget. This provides an opportunity to pick up problems at an early stage, before they result in

significant deviations between the approved budget and actual revenues and spending. When parliamentarians follow the entire budget process as it unfolds they will be in a position to acquire relevant expertise and to keep track of emerging issues. Legislative effectiveness in budget scrutiny is enhanced by continuous oversight.

### **Budgeting for the medium term**

With budgeting on a year by year basis, new policy initiatives stand little chance of being sufficiently accommodated because there is a bias towards existing programs. Since the need for particular programs can shift over time, unnecessary expenditures may be carried over year after year, leaving insufficient funds to address more pressing *new* needs and priorities. Also, many aspects of budgeting require more than an annual time horizon. For instance, when planning for large scale capital expenditure projects or substantial restructuring of service-delivery agencies, the planning period stretches over a number of years. Many countries have introduced a medium-term expenditure framework (MTEF) to support strategic prioritization and sustainable fiscal planning beyond the horizon of annual budgets.

The purpose of an MTEF is to indicate the size of the financial resources needed during the medium term, usually between three to five years, in order to carry out existing policy. The MTEF concept differs from multiyear budgeting, which involves fixed appropriations for a certain number of fiscal years. Usually, only the first year of an MTEF is approved by the legislature as the annual budget, whereas the outer years are nonbinding projections of the future cost of existing policy. The firmer these projections become, the more they move to the centre stage of the budget process and form the basis for the annual negotiation of allocations, resulting in a system of 'rolling budgets.' All OECD countries have medium term frameworks, and many developing countries have implemented, or are in the process of implementing, similar tools.

While the details will differ, there are some basic steps that need to be carried out in the process of compiling an MTEF. The first step involves the setting of aggregate and

sectoral spending ceilings, based on realistic revenue projections and fiscal policy. The guidance of the finance ministry is important at this stage. The second step involves policy planning within the spending ceilings that have been established. This requires departments to cost programs and consider their linkage to strategic objectives. There will always be contentious issues and difficult trade-offs that have to be negotiated. The third step, therefore, is to make a binding political decision involving final negotiations and the approval of medium term spending choices by cabinet.

Medium term budgeting has been implemented in many countries, but with varying degrees of success. Highest level political commitment is crucial in ensuring that such a reform takes root. When medium term planning is widely considered to be a 'technical' exercise for bureaucrats, and politicians do not buy into the process, the framework is unlikely to acquire the status and authority that it needs in order to become entrenched and deliver improvements. To enhance debate on public spending MTEFs should be tabled and discussed in parliament. Another ingredient of success is to clearly link medium term spending and revenue figures to government policy, for instance by linking the MTEF with a medium term budget policy statement. It is only with narrative information on the content and direction of budget policy that the medium-term figures can be adequately interpreted and assessed by parliament.

<b>Table 2</b>		
<b>Does the annual central government budget documentation submitted to the legislature contain multi-year expenditure estimates?</b>		
	<b>Number of countries</b>	<b>Percentage of total</b>
Yes	28	70%
No	12	30%
<b>Total</b>	<b>40</b>	<b>100%</b>

Source: OECD (2003), <http://ocde.dyndns.org/>

## **Conclusion**

For parliamentary budget researchers and committee staff thorough acquaintance with the actors and process of budgeting is essential. This unit looked at a simplified and generalized summary of budgeting in the public sector. Core participants in a typical budget process are the executive, including finance ministries and spending

departments; the legislature and its committees; and supreme audit institutions. Media reporting and civil society participation enhance transparency and public debate. Most budget processes in the public sector go through drafting, legislative, implementation, and audit stages. Medium-term budgeting frameworks are increasingly used to guide annual budgeting and to provide a broader planning horizon that is necessary for many tasks in budgeting. Successful medium term planning requires political commitment to the framework, rather than being a technocratic add-on to the budget process.

### Unit 3 Questions

Please answer each of the following questions. If you are taking this course in a group you may then meet to discuss your answers.

- Why do budget cycles overlap?
- Who plays a role in the budget process in your country?
- Draw a timeline of the budget process in your country. In what way does it differ from the generalized version discussed here?
- Is an MTEF part of the budget system in your country? If so, is it effective?

### Relevant internet resources

Health Systems Trust:

*The Budget Process: A Guide for South African Legislators*

<http://www.hst.org.za/hlink/budget/default.asp>

Institute of Public Finance:

*A Citizen's Guide to the Budget*

[http://www.ijf.hr/eng/budget\\_guide/proen.pdf](http://www.ijf.hr/eng/budget_guide/proen.pdf)

New Zealand Treasury:

*The Budget Process*

<http://www.treasury.govt.nz/budgets/process/>

Organisation for Economic Co-operation and Development:

*Results of the survey on Budget Practices and Procedures*

<http://ocde.dyndns.org/>

World Bank:

*Medium Term Expenditure Framework*

<http://www1.worldbank.org/publicsector/pe/mtef.htm>

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