Budget methods of financial planning

Prof.Asoc.Dr. Etleva Bajrami

Co-funded by the European Union

"Funded by the European Union. Views and opinions expressed are however those of the author(s) only and do not necessarily reflect those of the European Union or EACEA. Neither the European Union nor the granting authority can be held responsible for them

- The process of budget preparation and expenditure and income planning is a very important process for the adequate implementation of government policies.

- Policy proposals should be developed independently of the annual budget process so that the core of the budget process is not current financial considerations but medium-term strategic objectives.

The overall strategic planning

- Although almost all government budgets are prepared on an annual cycle, they must also consider events outside the annual cycle.
- A medium-term view is necessary because the one-year budget period is too short for the purpose of adjusting spending priorities.
- Forecasts should cover the current year and a forecast period of three or four years.

- In order for the projected budget to match the actual budget, during the preparation of the budget, important multi-year factors should be taken into account, such as:

- Future expenditures of ongoing investment projects and programs.
- Future program funding needs, because spending levels may change.
- Political events and commitments such as parliamentary elections, etc., or various uncertainties must be considered in the budget.
- The existence of the budget deficit and its impact on public debt service costs in the following years.

Government policies and fiscal goals

- In the European Union, the Maastricht Treaty defined specific criteria regarding fiscal convergence, the fiscal deficit to GDP ratio and the debt/GDP ratio.
- These criteria are very important for EU countries and candidate countries in the context of European integration
- Two of the criteria of the Maastricht Treaty are directly related to public finances.
- The first criterion is that the total public debt should not exceed 60% of GDP, while the second criterion is for the budget deficit, which for a given year cannot exceed 3% of GDP.

Basic rules of the budgeting process

- The beginnings of the budget preparation work are the clear definition of fiscal objectives and priorities.
- The basic rules of the budget process derive from the goals of the budget and the stages in which the budget process passes and detail the budgeting process.

1. First, statements of government policy priorities are drawn up. Interest groups must have an important place in the process in order to identify the most important priorities.

2. Fiscal objectives and goals are set, spending levels in accordance with them and in harmony with the fiscal policy.

- The budget must be managed respecting the fiscal goals and avoiding the increase of the public debt in a continuous and unsustainable manner.

3. Detailed assumptions or events outside the budget cycle are considered. At this stage, the strategic planning that has been carried out is taken into account and analyzed for the year that is being predicted.

4. Budgeting should be based on the needs for national development, focus on all sectors, not only priority ones, industries or aspects that will affect future economic development such as infrastructure, development projects, etc.

5. The budget process reflected in budget documents should be transparent. The documents must be public, both projected and actual budgets, various financial reports, etc.

6. The distribution of funds or budget allocations must be fully and faithfully implemented by government ministries and agencies, which have limited authority to reallocate funds during the year.

7. Performance related information must be provided. The performance of budget expenditures is difficult to calculate.

8. Auditing ensures smooth running and transparency. Independent auditing is an essential guarantee for the quality of the integrity of budget processes and financial management within all ministries and public agencies.

9. One-year budget term. An important reason is the fact that many national and international statistical reports are published based on the calendar year.

Methods of setting the budget ceilings

1. Governments in developing countries are often portrayed as hierarchical, centralized and top-down.

However, developed countries like Germany also use this approach. Such structures emphasize control over the governance process and require that representatives of all agencies adhere to the process.

- The preparation of the initial ceiling amounts is very important as a first step.

- In some countries, line ministries are notified of sectoral ceilings at the beginning of the budget preparation process.

- In this case, the Ministry of Finance defines as efficient the method of setting the ceiling amounts at the beginning.

- Budget requests of line ministries should clearly specify the amount needed to maintain the current level of activity and proposals for cost changes to the level of activity or policy changes.

- The main requirement must be in accordance with the notified ceilings or guidelines, and then the full cost of the programs involved is calculated so that the funds are sufficient for the full implementation of the programs in question.
- Due to greater authority in this case, line ministries are free to reallocate savings to ongoing programs, within the limits of sectoral ceilings.

BUDGET PLANNING

- In order to achieve the objectives, tax and non-tax public revenues and expenditures should be planned as well.

- The most accurate forecasts result in clearly designed and feasible strategies.

- But the forecast is made for the future which, despite the efforts, has economic and financial uncertainty.

- Forecasts for the purpose of the budget should be based on the country's economic forecast.
- Forecasting economic parameters is essential. One of the most important elements of the forecast of public revenues is the forecast of the GDP growth rate.

- Forecasting GDP is very important, so depending on the structural composition of each economy, different models are used by governments.

- In general, fiscal indicators such as the level of debt and fiscal deficit are reported depending on the GDP.
- For example, the 2017-2021 governance program of the Albanian government aimed at fiscal consolidation and was committed to the gradual reduction of public debt to around 60% of GDP.
- Public investments financed from the state budget in the program were estimated at around 5% of GDP, while income assurance at the level of 28% of GDP.

- The GDP forecast is not separated from the performance of other fiscal and economic indicators.
- For this reason, the forecast of public revenues, the number of existing businesses and the number of new ones that will be opened, is of particular importance, predicting according to the divisions of large, medium or small business.
- The prediction of their number provides valuable data not only for the tax revenues that will be predicted but also for the number of employees in the private sector, which together with the public sector provides the possibility of predicting:

✓ employment level,

✓ personal income tax

✓ social and health insurance contributions.

Planning process

- The forecasting models are different, the financial statements declared by the businesses to the tax authorities can also be used for business income.

- Forecasting public revenues are always a priority but require high consistency in the context of a deficit budget.
- More accurate forecasts are needed on current and capital expenses, interest expenses, social security scheme expenses, etc.

- In the event that the forecast and the reality have not produced the same results in the past, it is important to understand the reason, and to avoid future mistakes in planning.
- The analysis is detailed by determining the events that caused the differences in the previous schedules.

- It is determined from which sectors or categories of businesses the forecasts were not realized. It must be understood if the changes are real or if the changes are the result of mistakes in the interpretation of the laws by the taxpayer.

Decision making under conditions of uncertainty

- Accurate forecasting of GDP and other economic indicators, under conditions of uncertainty, is a must for budget administrators.
- It is almost impossible to have complete certainty in the predicted values of the parameters of the economy. The data used in forecasting can change unexpectedly in the event of a natural disaster, financial crisis, the start of a war, etc.
- The same can be said in cases of financial crises of stock exchanges or the banking system.
- The financial crisis of one country is very easily transferred to other countries.

Predicting the results

- In the case of a fiscal reform, with changes in tax rates and with changes in taxable bases of various taxes, the financial effects or results must be calculated in advance.
- The financial effects should be calculated for the category of businesses that will be affected by the change and what impact it will have on their finances.
- In general, reforms in modern countries aim to increase the number of businesses and the number of employees.
- The reforms aim to positively change the fiscal parameters of the economy as well as macroeconomic indicators.

- The indicators that are predicted every year and, in every mid-term, or long-term forecast are:

I. Increase in revenues from taxes and fees
II. The necessary level of public spending
III. Public borrowing and interest costs