

Incentive Issues Underlying the Budget Process in Albania

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Abstract

Albania has been reforming its policy, planning and budgeting systems since the end of communism and now, in principle, has sound public expenditure management (PEM) systems and procedures within an Integrated Planning System (IPS). In practice, the PEM system has yet to operate fully as intended. Such reforms take time to implement properly, especially where incentives to implement remain weak or perverse.

The 1998 Organic Budget Law created an enabling framework for the budget process that permitted, but did not explicitly require, an output focussed system based on medium term planning. Formal rules and regulations explicitly requiring such a system now exist (under the Law on Management of the Budgetary System (LMBS)) but the budget process continues to have weak planning during budget preparation and retains excessive flexibility during budget implementation. There is a vicious circle: weak planning leads to chaotic budget implementation which requires excessive flexibility in execution to compensate; the flexibility in practice is a key disincentive for implementation of the intended PEM system. It also produces an opaque policy, planning and budgeting process.

There are four categories of incentives influencing the extent and pace of achievement of the ideal system:

Political commitment to implementing the ideal system.

Civil service commitment to implementing the ideal system.

The ability of both the political and technical strata to manage the change from the emerging system to implementation of the ideal system.

External influences on the implementation of the ideal system.

The Integrated Planning System is a sound one. If applied as intended PEM performance will be strong. Some of the incentives for application are weak. The IPS design includes the means of strengthening most of these incentives so continued implementation should bring positive results in PEM performance. The IPS design does not deal with the detail of performance management incentives (job descriptions and organisation missions reflecting service delivery performance measurement, career development, personal performance appraisal) and these need particular intention. The critical incentives are those for good management not just good budgeting. Good management will deliver good budgeting.

Keywords: Incentive Issues, Budget Process, Albania.

Introduction

The reformed started its implementation following the introduction of an Organic Budget Law in 1998 (OBL98). OBL98 provided an enabling framework for the budget process which specified two key dates for budget preparation: July 10th (issuing of the Budget Guidelines document which marked the beginning of budget preparation); and November 20th (submission of the draft Annual Budget Law to Parliament).

As a result, this *enabling framework* allowed for a range of approaches to budgeting,

including an annual inputs-focussed approach and a medium-term output-focussed approach. As demonstrated below, variants of both have operated simultaneously since the introduction of OBL98.

The net result was a budget preparation process with no planning component, as demonstrated by 28,000 budget variations (transfers) during FY2001. Although many of these would have represented transfers within the authority of a budget institution (e.g. within the same ministry, programme and article but between spending units), the volume reveals that there was effectively no planning – either in July / August or in January / February. Furthermore, a mid-term Supplementary Budget has long been a regular feature of the Government of Albania (GoA) budget process, catering for further changes, often of an ad hoc and non-transparent nature, irrespective of whether they had previously been part of the formal budget planning process.

2. Underlying Reasons for Weaknesses and the Role of Incentives

Based on the experience on implementation until now there are four categories that influence the role of incentives:

1.1 Political commitment to the emerging and ideal systems

Political commitment is the foundation upon which any successful reform process must be built. Incentive issues related to this are identified and presented below.

A standard requirement for successful PEM reform is a strong 'champion'. In most cases, this would require a strong *political* champion at Minister level or above. An obvious candidate in most cases would be the Finance Minister, although this would not necessarily be sufficient where the Ministry and/or the Minister of Finance is relatively weak, as has tended to be the case in Albania. International experience demonstrates that 'reforming from the middle' offers only limited prospects for success, with processes and procedures that are not effectively used, particularly where this requires politically difficult PEM choices to be made.

In the case of Albania, political commitment was absent for much of the period since introduction of OBL98. It was not until 2006 that an effective political leadership for the reforms materialised in the form of the Deputy Minister of Finance (Budget). One of the reasons for this was a general perception during much of the earlier period of the MTEF/MTBP as a donor exercise. Political support (to the extent that it existed at all) was limited to the production of an MTEF/MTBP *document* rather than a PEM *reform process*, largely because the document presented reforms as effective, even though the underlying processes were extremely weak at best and their connection with the budget process in practice was virtually non-existent.

In the absence of strong and active political support, technical staff in the MoF (albeit at relatively senior Budget Director and General Secretary levels) were virtually powerless to ensure effective participation from budget institutions and even from MoF institutions outside of the Budget Department.

One of the symptoms was the absence of political involvement in establishing expenditure ceilings, signalling to budget institutions that their ceilings did not represent or reflect policy as far as the CoM was concerned. This provided little incentive for them to invest time and resources in medium term planning.

The absence of an effective political champion was further reflected in substantial differences in line ministry ceilings established respectively at the start of MTEF preparation, annual budget preparation, annual budget implementation and (for the same years) at the start of the new MTEF preparation period.

A major reason for this was that the MTEF was never really regarded as an integral component of the budget process. In fact, it was largely *perceived* as a means to satisfy the international community that resource allocations and budget management were being guided by medium term policy-driven planning. This was, in fact, very effective, resulting in 2004 in Albania being included as a World Bank case study of a country that had successfully introduced an MTEF, linking budgets to policies through a medium term planning framework.

1.2 Civil service commitment to the emerging and ideal systems

In Albania, civil servants will often look directly to legislation for guidance on day-to-day management issues, particularly when confronted with a reform process that requires changes in management practices, roles and responsibilities. Under these circumstances, civil servants will often discount regulations and procedure if they do not emanate directly from legislation or, alternatively, if they are not issued directly from a sufficiently high political level. In the case of MTBP regulations and procedure, these have been established with the status of a Ministry of Finance instruction. In practice, this alone has represented insufficient authority.

This weakness was anticipated by MoF staff when they¹ began the drafting of the LMBS. A strong message at that time from within the government was that catering for the *possibility* of an outputs-based performance budgeting system in legislation (OBL98) is insufficient – legislation must *require* such a system for it to be effectively implemented.

The LMBS explicitly caters for the architecture, scheduling and delivery of the MTBP. The basis of this legislation has been more or less in place for most of the last three years. The required process of review, finalisation and participatory approval of the content and detail, however, was delayed for a variety of reasons, including the absence of a political champion actively pushing for the LMBS and the weakness of both the political and technical strata in managing the process. As a result, there has been no legislative requirement to date for individuals and institutions in the GoA to undertake and implement MTBP tasks. Given the nature of the rules-based environment of the GoA, this effectively means that there has been no government-wide incentive to undertake and implement the MTBP.

One means of addressing this would have been to incorporate the architecture, roles and responsibilities for the MTBP into the wider regulatory environment (job descriptions, departmental responsibilities, etc.). This would also have required strong political leadership to widen the institutional ownership of MTBP change management responsibilities.

1.3 The ability of both the political and technical strata to manage the emerging and ideal systems

The general lack of transparency and accountability in the budget process in practice means that there is no incentive for senior party managers to ensure unrealistic

¹ With external consulting assistance.

policy commitments are not announced. The short-term political gains from making new policy announcements outweigh the cost of not following through properly on these. Ministers have a strong incentive to 'cut the ribbon' on new projects (through announcing new projects and engaging in groundbreaking in their constituencies). Being seen to deliver new initiatives to solve constituent problems is a very powerful motivating factor. By way of contrast, providing adequate funds to deliver existing projects or providing the requisite operations and maintenance for other activities does not result in the kind of attention that is attractive to an ambitious politician. The operational incentive in this case, is to provide just sufficient resources to keep existing projects and other operational activities functioning whilst using the balance of resources on newer initiatives.

This is a feasible *modus operandi* if the budget process is, in effect, non-transparent. Whilst constituents may be *aware* that particular outputs are to be produced, they remain broadly *unaware* of when they are meant to be delivered. The situation is analogous to a jobbing builder whose incentive is to maximise the number of jobs he/she has at any one time and to worry about delivery of each once the contract has been signed. A drip-feeding of inputs into each job is often required when the number of contracts obtained exceeds the capacity of the builder to deliver.

1.4 External influences on the effectiveness and sustainability of the emerging and ideal systems

Whilst the MTEF document up to 2003 included information on general policy issues and some costing implications of these, information on specific delivery of outputs has only recently been included. Timeliness of policy delivery, however, has still to be incorporated.

The logic of the MTBP process, however, is to facilitate the development of precisely this kind of information and to present it in a transparent manner to Parliament and the general public. At present, though, there is a straightforward absence of transparency in the Albania PEM system and it is not clear to the general public what the government has contracted to deliver and *when* this delivery is intended to occur and be completed (notwithstanding political announcements) and therefore little political accountability associated with them.

This enables politicians to intervene directly in budget implementation by moving resources into areas deemed to be of high political import, with little or no knowledge from the general public of the likely impact on other policy areas. A full commitment to the MTBP, however, would ultimately lead to a situation of transparency over such decisions, with the media, general public and Parliament having a much greater understanding of the impact of moving resources around in this way during budget implementation. Whilst transparency would not necessarily prevent the government from intervening, it would weaken its ability to do so in an arbitrary manner, as there would be a calculation to be made in relation to the political cost from the perceived impact on other policies. Transparency represents a potentially strong disincentive to a full commitment to the MTBP.

Conclusions

The failure to properly address the incentives that underlie the emerging budget system are reasonably clear from the above discussion. Policies will continue to be planned 'on the hoof', arbitrary interventions during budget implementation will tend to be the norm, resource allocations will link poorly to policy requirements and there will be a much lower economy, efficiency and effectiveness in resource usage than would otherwise be the case. The net result of this will be a missed opportunity in terms of public service delivery to the people of Albania.

Whether a failure to address underlying incentives will materially impact upon Albania's ambitions for European Integration is somewhat debatable. The fact is that Albania has ostensibly fulfilled the requirements of the EC to date and (apparently) continues to do so. Should the budget process remain somewhat dysfunctional at the time scheduled for Accession, it is unlikely to be the case that this by itself would hinder Accession. Other (political) factors are likely to weigh much more heavily, as was the case with Romania which achieved EU status with a largely unreconstructed budget process.

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