Organising a strategic phase in the budget process

A public financial management introductory guide

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Abstract

This public financial management introductory guide discusses the strategic phase of the budget process with a focus on how it typically operates in low-capability environments. The document outlines the importance of the strategic phase in linking high-level political choices with overall spending policy and explains what distinguishes it from other parts of the budget cycle. It describes why a strategic phase of the budget is often difficult to organise in a low-capability and low-income context, and puts forward a list of options and possible tools that could be used by governments in these environments who are seeking to improve this part of the budget cycle.
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Public financial management introductory guide

This ‘Organising a strategic phase in the budget process’ paper forms part of a series of introductory guides on key topics in public financial management (PFM). They are written specifically for capacity-constrained environments and provide an overview and discussion of the main issues related to each key topic, highlighting useful literature. Each introductory guide includes practical suggestions on how capacity-constrained governments can approach reforms, together with brief outlines of other countries’ experiences of PFM reform. They are not intended to be detailed guides to the design and implementation of reforms. They are based on a review of the relevant literature and the practical experience of ODI staff working in these areas.
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1. Overview of the strategic phase of the budget process

1.1 Introducing the strategic phase of the budget process

This Public Financial Management introductory guide aims to outline a number of key points, basic concepts and possible tools for budget managers working on the strategic phase of the budget process. In line with other introductory guides in this series, the focus is on capacity-constrained contexts in which the strategic phase of the budget process is likely to be most in need of strengthening and support. The aim of this Note is to draw on the existing literature and accounts of practitioners to outline the following:

• The nature of the strategic phase of the budget process.
• Approaches to how the strategic phase can be managed effectively.
• The reasons why this part of the budget process is important.
• The challenges involved in delivering the strategic phase of the budget successfully in capacity-constrained environments.
• Tools and techniques that can be used to make the strategic phase of the budget process more effective.

In accordance with the emphasis of the introductory guides series, the detail of the discussion in this Note will focus on the strategic phase of the budget process in relation to the expenditure side of the budget. The entire strategic phase of the budget, as discussed below, must also include consideration of the revenue side of the fiscal equation in the context of overall macroeconomic strategy; however, for the purposes of this document the detailed discussion will focus more on the relationship between the strategic phase and expenditure management.

1.2 The nature and importance of the strategic phase of the budget process

1.2.1 Definitions of the strategic phase of the budget process

Although the ‘strategic phase’ of the budget process is widely recognised as a key part of the budget process, this phase is rarely defined and is sometimes referred to by different terms. Commentators may interchangeably refer to the strategic phase as the ‘planning phase’ while using the term ‘operational phase’ to describe what others refer to as the ‘preparation phase’. Others use the term ‘top-down’ budgeting to refer to the strategic phase of the budget and call the subsequent phase of detailed budget preparation the ‘bottom-up’ phase (see, for example, Potter and Diamond (1999) and Schiavo-Campo and Tommasi (1999)).

The overall aim of the strategic phase of the budget is to ensure that high-level political decisions are reflected in the detailed financial allocations that make up the budget. According to Andrews et al. (2014): ‘At its most basic, this stage involves translating broad policy goals into financial targets, given expected conditions in the economy’. These high-level policy decisions address issues such as the overall fiscal strategy, choices about the allocation of budget resources in line with politically-determined priorities, and the desired mix of different types of expenditure, such as wages and capital investment.

The strategic phase of the budget and the budget as a contract

As well as being a planning tool for achieving the government’s policy goals, the strategic phase can also support the role of the budget as a contract setting out what the government will deliver in return for taxes and funding from citizens and donors (Simson and Welham, 2014). As described by Caiden and Wildavsky (1974: p.45):

*Budgeting broadcasts […] to the extent that a budget is meaningful it communicates information about the real priorities of government [and therefore] each act in the budgetary process is important, not only for specific decisions, but for information communicated to others who alter their activities accordingly.*

A strategic phase with a transparent structure and clear outputs helps ensure that the contracting purpose of the budget is communicated effectively, both internally to government officials working on the budget and externally to other stakeholders. At the political level, a successful
strategic phase helps to determine how the budget will be ‘sold’ to the legislature.

The extent to which the strategic phase of the budget process is successful can also be important in determining whether and in what amounts external financial assistance will be provided. Donors, for example, often only consider granting financial support to governments if the strategic phase results in a budget that meets the donors’ requirements about expected levels of debt and deficit and shares of expenditure in certain sectors. Organising a strategic phase that delivers the right conditions for external financial support is challenging for many low-capacity states, however, even in spite of the potential rewards in terms of donor funding. In a review of eight fragile states engaging in PFM reform where budget support was a possibility, Fritz et al. (2012) found that improvements in strategic expenditure prioritisation would be required before significant movement towards budget support could begin.

1.2.2 Strategic budgeting in the PFM cycle

Within a standard PFM cycle, as illustrated in Figure 1 below, strategic budgeting is generally considered the first step in the budget cycle. However, the strategic phase of the budget cycle does not operate independently of the other phases; rather, it should be informed by an evaluation of the results of previous budget cycles and by the experience of the current budget being executed. The conclusions of the strategic phase should directly feed into the process of detailed budget preparation.

The starting and finishing points of the strategic phase of the budget process

Identifying the end of the strategic phase of the budget process is straightforward: typically this phase finishes with the issuing of detailed financial limits and other guidance on budget preparation to spending institutions. In many countries this guidance is usually communicated through a ‘budget call circular’ issued by the finance ministry. The budget call circular codifies the high-level political and policy decisions made during the strategic phase into expenditure limits for spending agencies, often referred to as budget ceilings. The circular may impose specific spending conditions, priorities and constraints on some or all spending institutions in order to achieve specific policy goals agreed during the strategic phase (e.g. a pay increase or a hiring freeze). Spending agencies are expected to prepare their detailed budgets within these specified constraints in the detailed budget preparation phase that follows. In some contexts, indicative budget planning ceilings may be issued in order to elicit bottom-up input into the strategic phase before final budget preparation ceilings are approved and the budget call circular is issued.

The starting point of the strategic phase is less distinct. Given that the aim of this phase is to link high-level political priorities with the budget, it is necessary at some point in the process to obtain a political steer as to spending priorities. As a result there is usually a point in the strategic phase when the country’s president, members of the cabinet and/or other powerful figures in government receive an overview of the fiscal situation for the coming...
year’s budget and are explicitly asked to provide their input into the overall strategy. The delivery of this overview and the request for a political steer, typically issued by the finance ministry, can be seen as the formal commencement of the strategic phase. As noted in Figure 1 above, the analysis, options and recommendations presented to the political leadership in this overview should include lessons learnt from the progress of the current budget year and the experience of previous years’ budgets. Much of the technical work involved in starting the strategic phase thus needs to begin in earnest prior to its formal commencement. Given that budgets are annual and that in-year experience of the current budget will inform the forthcoming budget, some writers consider that technical inputs to the strategic phase of the budget should be a ‘permanent activity’ (Schiavo-Campo and Tommasi, 1999).

Box 1: Technical inputs to the strategic phase as a ‘permanent activity’

Schiavo-Campo and Tommasi (1999) recommend that preparing a macroeconomic framework that consolidates the key technical inputs of the strategic phase should be a permanent activity. While noting that this framework must be prepared at the start of each budget cycle, they also note that it should be updated throughout the budget process to take account of changes in the intervening period. The type of permanent activity they envisage includes taking into account the latest available economic and fiscal data and undertaking reviews of underlying assumptions in light of any changes in the external environment.

The term ‘permanent activity’ should not be confused with continuous technical inputs rather than periodic updates, however; for while policymakers value up-to-date information, they do not want to be inundated with constant minor updates that can render the budget process unmanageable. In most contexts policymakers prefer periodic updates of the macroeconomic framework – preferably coinciding with key milestones of the budget process and/or the release of important new data.

Source: Schiavo-Campo and Tommasi (1999)

1.2.3 Approaches to managing the strategic phase of the budget

Three broad overlapping activities in the strategic phase have been identified in the literature on this topic (Williamson and Wilhelm (2008) and Schiavo-Campo and Tommasi (1999)). These three activities are: (i) the top-down process of determining the resource envelope; (ii) the bottom-up process of costing key expenditure categories; and (iii) reconciling these technical inputs with political priorities in order to formulate budget ceilings and guidance.

Top-down determination of the resource envelope

Decisions on allocation must be informed initially by an estimate of the overall level of resources available for expenditure. Although the formulation of the resource envelope is largely a technical process of macroeconomic and fiscal forecasting, the envelope ultimately requires political consideration and approval. For example, although decisions as to whether to increase or reduce tax rates or to borrow more or less should be informed by appropriate technical analyses, they are nonetheless ultimately political decisions. The formulation of the resource envelope is typically the mandate of a macroeconomic department tasked with reconciling information from various departments into forecasts within a consistent macroeconomic framework. A common challenge to the effective execution of this task, however, is that politicians are often unwilling to face the short-term need for tight prioritisation of expenditure that is inevitable with finite resources and thus have a bias towards overoptimistic estimates of the resource envelope (Schiavo-Campo and Tommasi, 1999).

In countries participating in an IMF programme, the IMF may have a significant role in reviewing the resource envelope that emerges from the macroeconomic forecasting process. In these circumstances, governments must often ensure that their published fiscal forecasts for expenditure, revenue and debt are consistent with agreed IMF programme conditions. In practice this can mean that the IMF effectively approves the expenditure envelope that is ultimately adopted.

Donor funding may comprise a significant proportion of the resource envelope and this resource needs to be taken into account when drawing up top-down expenditure figures. Accurately estimating the amount of donor support that will actually be received in government accounts, as compared to the amount that is formally pledged, is a further forecasting challenge. Besides the technical difficulty of correctly estimating unpredictable donor funding, there is also a temptation to overestimate donor support to the budget, since inflating the resources available for allocation offers the opportunity to postpone difficult decisions on prioritisation.

Bottom-up determination of key expenditure categories

A key part of the technical preparation for strategic decision-making involves determining (i) what level of expenditure has already been pre-committed to existing objectives and (ii) what level of expenditure is available for allocation to new priorities. Budgets are by their nature incremental and in practice much of the budget does not change from year to year (Schick, 2002). In the words of Caiden and Wildavsky (1974): ‘drastic changes aren’t possible […] the budget has evolved from a long series of conflicts; calling them all into question at once would create political havoc’. In short, much of the budget is already pre-committed to existing objectives and therefore
that the strategic phase is intended to prevent. The strategic phase of the budget is therefore never a 'blank slate' or a fully ‘zero-based’ exercise in prioritising expenditure. This bottom-up process is a means of clarifying and quantifying exactly what commitments already exist. Once these 'fixed' items have been taken into account, the resulting margin of spending that can be reallocated can be considered discretionary. The actual amount of genuinely discretionary expenditure that can be allocated to meet political priorities may be relatively small in any one year. Political leaders often struggle to accept this constraint, however, with the result that politically-informed upward biases in the estimation of resources often go hand-in-hand with downward biases in the estimation of ongoing commitments.

Reconciling with political priorities

The reconciliation of competing top-down and bottom-up priorities is a political decision-making process that requires technocratic support. Such reconciliation is the core of the strategic phase of the budget process. Understanding the different objectives of political and technocratic motivations is an important consideration in managing the strategic phase.

Technocrats in finance ministries are often motivated by the need to obtain clear political decisions at an early stage so that the budget process can proceed in a timely and orderly fashion. They tend to be highly aware of the need for individual spending agencies to have enough time to formulate their individual budgets within legal timeframes, especially in view of the need to allow sufficient time for these spending proposals to be challenged and debated. Politicians, on the other hand, are typically more interested in the fiscal space available to deliver on the public or private promises they have made to their various constituencies. Often they wish to avoid the difficult decisions associated with finite resources. Furthermore, the political leadership may disagree between themselves on priorities, often leading to further delays in making decisions or to compromise decisions that are not expected to hold. These factors typically result in a political motivation to increase the fiscal space, even artificially so, through inflated revenue forecasts or underestimates of committed expenditures. These practices tend to undermine the credibility of the budget, which is precisely the problem that the strategic phase is intended to prevent.

Box 2: A frank speech on planning and budgeting by the head of a low-income country

Caiden and Wildavsky (1974) undertook an exercise of imagining the wording of a truthful presidential speech on the nature of planning and budgeting in poor countries. Although the fieldwork to support the conclusions of their research took place several decades ago, many of the issues raised in the imagined presidential speech are still valid today in low-income and low-capacity states:

The worst thing about the budget was that it kept disappearing on me. Now I had it and then I didn’t. It looked ample enough at first. Then I found out that 10 percent went to pay off foreign loans from the past, and 80 percent went for ordinary expenses that recurred every year. Most of it went for salaries, and it was all I could do to keep them from getting higher, much less lower them. At best there was 10 percent over which I had some sort of discretion. […] Moreover the 10 percent of the nation’s budget that I might actually allocate was not 10 percent of the nation’s revenue. Far from it. Some 35 percent of total revenue is controlled by organisations that are called autonomous because I can’t get hold of their money. Thus the 10 percent I might distribute was really a much smaller proportion of the nation’s total resources. It’s not so much that I minded the budget disappearing, but it began to look like I would go with it. […] Yet when a little money was available and I asked for a good project that was well thought out and would add to national income, there never seemed to be any on hand. Or else there were too many projects, each with its own advocates.

Source: Caiden and Wildavsky (1974, p. i)

1.3 Why is the strategic phase important?

A national budget aims to balance competing priorities within a context of potentially unlimited demands on finite resources. All governments have high-level national ambitions that require public spending for delivery; and in addition to their own plans, governments face (often unexpected) pressures and demands from a variety of sources. Governments also have numerous objectives that cannot be achieved within a single financial year and therefore must consider their priorities across a number of budget cycles over the medium to long-term. The strategic phase thus involves balancing a number of competing pressures for expenditure, as illustrated in Figure 2.
A strategic phase in the budget process is necessary to enable governments to trade off these competing demands in the context of finite resources. For example, governments may have to decide whether to prioritise infrastructure development or prioritise investment in social sectors, or whether to focus education policy on mass primary school enrolment or on developing elite tertiary institutions. All governments face resource constraints and this is particularly the case in poor countries, which may find they have relatively little real flexibility in budget allocations (as illustrated in the imagined presidential speech in Caiden and Wildavsky (1974), reproduced in Box 2). The strategic phase aims to provide the necessary technical inputs and to structure the required decision-making process so as to enable a reconciliation of these competing priorities at the political level.

Box 3: National development strategies and the strategic phase of the budget

Many governments of developing countries have formal published national development plans of one kind or another. These plans set out the priorities and overall policy objectives of the government for the medium term and should therefore help guide the strategic phase of the budget. In practice, however, the impact of these national development plans on actual strategic budget policy from year to year in low-income countries is often weak (Wilhelm and Krause, 2008). Nevertheless, national development plans are examples of the kind of thinking that is intended to inform the strategic phase of the budget.

In their discussion of Uganda’s approach to strategic budgeting in the 1990s, Williamson and Wilhelm (2008) outlined some of the typical challenges faced by low-income countries. Despite having a public and politically endorsed high-level strategy document in its Poverty Reduction Strategy (PRS), however, the country struggled to make the budget reflect the ambitions of this strategy.

Uganda’s PRS was overambitious for the resources available. As a result, spending ministries frequently submitted unrealistic spending proposals. Central ministries would then reduce these proposals unilaterally to make them match available resources, reducing the incentive for spending ministries to engage in the detail of the budget preparation phase.

The mismanagement of the strategic phase of the budget process often undermined the opportunity to make clear strategy and budget linkages. Insufficient time for preparation, for example, led to the late presentation of budget proposals to cabinet and parliament, thus limiting the time for meaningful discussion and debate.

The Ugandan experience, Williamson and Wilhelm conclude, suggests that the context of low-income and low-capacity countries makes it very difficult for governments to link resource allocations to specific policies, let alone to a comprehensive national development strategy.
1.4 Challenges to delivering the strategic phase of the budget in low-income and low-capacity states

Low-income and low-capacity countries face a number of institutional, economic and political constraints that make the entire process of budget preparation and execution challenging (Welham and Hadley, 2015; Allen, 2009). Some constraints are ‘technical’ in nature in that they can potentially be ameliorated through investments in capacity-building, such as the training of existing staff, the hiring of new staff and the introduction of better business processes. Other constraints relate to the nature of the political environment in which the budget operates, and these constraints are less amenable to reform and change.

While each context differs in the degree to which technical and political challenges interact in the strategic phase, two particular challenges are especially typical:

- Delays to the strategic phase. Technical difficulties in gathering and analysing necessary information, together with the political challenge of catching the attention of the political leadership, can lead to continual delays and interruptions of the formal commencement of the strategic phase of the budget, often to the extent that the strategic phase has little value.
- An ineffectual strategic phase that amounts to little more than form over function. This is common in situations where the budget as a whole does not represent a credible political commitment to a certain pattern of taxation and expenditure. In this case the relevant actors simply go through the motions of a strategic phase without actually making any decisions and/or not expecting that the government’s real strategic decisions will be reflected in the final budget proposed to Parliament.

Delays to the strategic phase of the budget process

The technical bureaucratic capacity of a finance ministry may be fully stretched by the challenges of dealing with day-to-day issues, leaving little time for the type of permanent activity by technicians that should support the strategic phase. Even in situations where a finance ministry can direct human and financial resources to such permanent activity, the technical skills needed to undertake retrospective analysis of expenditure trends and accurately forecast future expenditure levels may not be available. Nevertheless, some of these capacity gaps can potentially be overcome in the short term through external capacity supplementation, while in the long term they can be addressed through capacity development.

The inherent volatility of poor and undiversified economies, combined with persistent challenges in technical capacity, may mean that attempting to accurately forecast credible key macroeconomic variables is simply not possible. In such uncertain environments, politicians may adopt a ‘wait and see’ approach to avoid making early and firm decisions that might prove politically difficult and might later need to be reversed. Such an approach inevitably delays the point at which key decisions are made, though it should be noted that avoiding making difficult decisions due to inadequate data and analysis in a context of fractious and uncertain politics may be a rational course of action, particularly in the short term.

As a result of all these factors, procrastination about the strategic phase of the budget can become contagious and may delay the phase beyond the point at which it is no longer practical or useful. This is one reason why developing countries often end up with a condensed and/or rushed strategic phase. Given that budgets must often be submitted to legislatures by fixed dates, this can lead to the merging of the strategic and operational phases into one another. Merging these phases can entail frequent revisions of budget ceilings and other spending conditions during detailed preparation as political input is received in fits and starts. This brings a challenge in terms of coordination and logistics that reduces the likelihood either of clear political decisions being reached during the strategic decision-making process or of such decisions being reflected in the final detailed budget.

Form over function

Political factors often further exacerbate the challenge of delivering an effective strategic phase. This occurs, for example, when many of a government’s real priorities cannot be openly discussed. In this case, only some of a government’s strategic budget ambitions are made public (e.g. through national development plans or other public documents) while others are hidden from public view (Simson and Welham, 2014). The kind of strategic objectives that are typically made public include overall macroeconomic objectives (e.g. ‘to maintain a low budget deficit’), sector-level objectives (e.g. ‘to increase spending on health’) and specific project objectives (e.g. ‘to build a road between the capital city and the airport’). Strategic budget objectives that governments may not wish to make public but which they may nevertheless seek to deliver could include ensuring continued political support in key constituencies (e.g. ‘to build more infrastructure in regions of the country that support the government’), ensuring continued patronage benefits to preferred coalitions (‘to increase senior salaries in key security institutions’) and/or demonstrating compliance with donors (e.g. ‘to budget for – though not necessarily to deliver – an increase in teachers’ salaries to meet donor requirements’).

Together these factors can lead to strategic budget planning merely appearing to take place while in fact it has little bearing on the actual outcome (Pritchett et al., 2013; Rakner et al., 2004). Governments often have incentives to deliver the semblance of a formal strategic phase, particularly in countries receiving significant aid
resources where this phase may be a donor requirement. The formal undertaking of a strategic phase may involve a partly public process that includes national development plans, public consultations and seemingly open debate about what the budget should contain – a process in which the actors are often fully aware, however, that the real decisions about expenditure priorities will be made behind closed doors.

A key impact of the ‘form over function’ challenge is that government agencies may simply not bother to engage substantively in a long and detailed strategic phase of the budget when they see such engagement as having no real impact on the funding they are likely to receive. In many low-income and low-capacity countries, the process of in-year budget execution is highly uncertain and/or dominated by short-term cash rationing (i.e. releasing cash on a month-to-month basis based on what is available rather than what has been budgeted). This risks creating a situation in which actual spending bears little relationship to the agreed budget (Schick, 1998; Caiden and Wildavsky, 1974). In such a case, expending resources on detailed strategic budget planning is a less rational strategy for securing funds than investing in strategies to obtain in-year cash releases on a month-by-month basis.

1.5 What are some of the tools, frameworks and techniques that can be used to make the strategic phase effective?

The above discussion has outlined the nature and purpose of the strategic phase of the budget process and identified two key challenges that can have a negative impact on this process, especially in low-income and low-capacity states. It has further highlighted how some challenges to delivering a successful strategic phase are technical in nature and therefore open to improvement through capacity-building investments, while other challenges are political in nature and less amenable to straightforward technical reforms. This section sets out possible actions that could be taken to increase the chances of delivering a successful strategic phase.

There is a continuum of sophistication in the tools, frameworks and techniques that can be employed in the strategic phase. Budget managers thus need to choose wisely when determining the level of sophistication required for decision-makers in their particular contexts. To improve the forecasting of the resource envelope, for example, significant investment can be made in the technical quality of macro-fiscal forecasting; however, this investment may yield only a small gain in terms of precision. Similarly, as noted above, detailed and lengthy national planning documents may be of little consequence in the strategic phase if they are merely window-dressing and do not actually inform the decision-making process.

Starting the process early and using a budget calendar to set out key parts of the strategic phase

To be successful, the strategic phase should commence early in the annual budget cycle. According to Schiavo-Campo and Tommasi (1999): ‘a budget preparation period starting six months before the deadline for presentation of the budget to the legislature is appropriate in developing countries, but there is no hard rule, and no substitute for custom-tailoring the budget calendar to the specific country’. An early start allows for coordination of the various analytical inputs required to inform political priorities and ultimately for their translation into financial ceilings and targets. Failing to begin the process in good time, on the other hand, means that ‘political interference, administrative weakness, and lack of needed information often lead to postponing these hard choices until budget execution’ (Schiavo-Campo, in Shah, 2007). An early start to the process increases the probability that both the technical and political inputs required for a successful strategic phase will be realised.

In their discussion of the strategic phase, Schiavo-Campo (in Shah, 2007) and Schiavo-Campo and Tommasi (1999) set out several conditions related to timeliness and the need for orderly decision-making. Taking these conditions into consideration together with some of the structural challenges faced by low-income and low-capacity states suggests the following recommendations:

- **Obtain political decisions at an early stage in the strategic phase of the budget process.** Structuring the strategic phase so as to ensure there is a point when difficult choices are put to political leaders early on can increase the chance of obtaining a clear direction (or at least some form of direction) for budget policy through the setting of hard constraints.

- **Avoid delays in the macroeconomic and fiscal forecasting process.** As noted above, some experts consider that strategic budgeting, including macro-fiscal forecasting, needs to be a permanent activity (Schiavo-Campo and Tommasi, 1999). While this may not be possible in all circumstances, beginning the process as early as possible will reduce the risk of delays to the process stemming from a slow start to this initial activity.

- **Ensure that the budget process is not open-ended.** In the absence of active management, the political leadership might issue instructions and prioritisations at unplanned points in the process or even not issue them at all. This can lead to the strategic phase and the detailed preparation phase of the budget being merged, blurring into each other.

In order to ensure adequate time is available for key activities of the strategic phase, many countries use a formal budget calendar that outlines the planned activities in the budget process. As noted by Potter and Diamond (1999): ‘budget preparation is a process with designated organizations and individuals having defined responsibilities
that must be carried out within a given timetable’. Budget calendars help finance ministry officials to manage the overall annual process internally within their institutions and make clear to external stakeholders the timing and nature of their expected inputs into the budget process.

The most significant milestones of the budget calendar are likely to be set out in a country’s PFM laws. More specific deadlines for intermediate tasks should be added by the budget department following consultation with the departments making the relevant technical inputs. Once the process becomes stable it can be formalised into budget regulations prescribed by the overarching law.

Although the budget department is the natural custodian of the budget calendar, the calendar should be developed and agreed collaboratively with the other key stakeholders, particularly those responsible for important tasks such as estimating the resource envelope (e.g. the units responsible for aid coordination, debt management and revenue collection). Developing the budget calendar in collaboration with stakeholders can improve its realism in terms of time required for certain actions, and potentially increase the buy-in from these key stakeholders. While slippages in timescales are inevitable, particularly in low-income and low-capacity states, the budget calendar can build in margins to try to accommodate these slippages.

In practice, many low-income and low-capacity states fail to adhere closely to budget calendars. Nevertheless, calendars still add value in terms of setting out expectations as to what should happen, at what time it should happen and who should be responsible for delivery. By being transparent about the calendar and staying on top of its own requirements and deadlines, a finance ministry can use the budget calendar to lead by example and drive the behaviour of others. Simple analytical exercises undertaken at the end of the budget cycle to review the extent to which actual activity matched the expectations of the budget calendar can be used to redesign and reform the calendar for the coming year so as to bring it closer to reality.

While each context and each budget calendar is unique, there are certain common experiences of low-income and low-capacity states that can inform the development of budget calendars elsewhere. From these experiences it can be concluded that a well-designed budget calendar should incorporate the following considerations:

- **The need to set aside a clear period of time for the strategic phase in the budget calendar.** As noted, the strategic phase of the budget frequently starts with analytical reviews of past and current budget experience to inform the range of decisions that political leaders can make about the coming year’s budget; and typically ends with the issuing of budget ceilings and guidance through a budget call circular. Explicitly building these points into the budget calendar will help define the time period during which the strategic phase can take place.

- **The need to ensure that the stakeholders in the strategic phase are aware of the deadlines by which their inputs are required.** The stakeholders in the strategic phase (e.g. the political leadership and the macroeconomic forecasting division) will be different from the stakeholders leading on detailed budget preparation (e.g. the budget division and the spending agencies). Ensuring that those involved in the strategic phase of the budget are aware of their roles and deadlines will increase the likelihood of their effective engagement. Establishing such clarity may also support more appropriate targeting of capacity-building efforts to improve the strategic phase.

- **The need to ensure that the political leadership (i.e. the president and/or the cabinet) are aware of when they can expect to receive updates and options.** Scheduling specific discussion periods into the cabinet meeting schedule is one way of ‘locking down’ formal discussion points in advance.

### Developing specific baseline scenarios and other options for headline macroeconomic and fiscal variables

The development of explicit scenarios for consideration can make it easier to obtain decisions from senior political leadership on the resource envelope, since politicians find it easier to choose between specified alternative options rather than being asked to put forward views from scratch. This can help reduce the potentially infinite number of possible macroeconomic and fiscal decisions to a manageable number of options. Since these options are developed by officials, moreover, it further offers the opportunity to influence the eventual outcome through careful presentation of the available options. The development of specific macro-fiscal policy options can therefore be seen as a technical tool to help overcome political constraints on the strategic phase of the budget process, such as lack of willingness or confidence to make macro-fiscal policy decisions.

A simple approach is to make the first iteration of a macroeconomic framework the baseline scenario. The baseline scenario is a forecast of what is likely to happen if there is no change in current policies (e.g. if the same spending levels, taxation and revenue policies are maintained as in the previous year) in the context of likely economic conditions. Once a baseline scenario has been developed, alternative scenarios can be produced that include changes in policy, such as: increases or decreases in taxation; higher or lower expenditure plans; and lower or higher levels of debt or deficit. The implications of these policy changes for the expenditure envelope can then be set out as explicit options for consideration at the political level. Developing such explicit options can help to guide and limit the deliberations of political decision-makers.

Decisions on macroeconomic and fiscal policy can be easier to make when there are agreed conditionality arrangements in these areas, especially through IMF
programmes. For low-income and low-capacity countries these programmes typically specify clear quantitative targets for key macroeconomic and fiscal variables. Given that these targets are set externally and often come with significant incentives for achievement, they can be used to develop the baseline scenario. Structuring and presenting the baseline scenario around previously agreed macroeconomic and fiscal policy constraints can help strengthen the hand of budget managers in their interactions with the political leadership by clearly setting out the following:

- The potential macroeconomic repercussions of failing to take the right fiscal actions to meet targets.
- The potential reactions of the IMF and/or other donors to the government's not complying with agreed overall fiscal constraints, as well as the impact such reactions would have on the resource envelope and on wider donor–government relations.
- The potential reactions of other lenders (both private and public) to the government's failure to maintain fiscal sustainability and the impact of such reactions on the resource envelope.

The first engagement with the political leadership in the strategic phase of the budget process may therefore simply seek consensus on what the high-level fiscal constraints for the upcoming budget year should be, thus closing down discussions of alternative scenarios. Discussions about allocation may come later, once the implications of the agreed budget ceiling are clear. There may be further merit in holding separate discussions about the macroeconomic and fiscal framework that determines the overall expenditure envelope prior to discussing precise allocations. As heads of spending agencies, ministers have a strong incentive to maximise their own share of the budget and only a relatively weak incentive as part of a collective government to restrain overall expenditure. Separating decisions on the aggregate expenditure envelope for the whole of the government from subsequent decisions on sectoral or agency-level allocations can help reduce the temptation for ministers to begin trying to maximise their share of the budget at the point of discussion of the overall envelope.

Explicitly forming a technical working group to support macroeconomic and resource envelope forecasting

Forming a technical working group explicitly dedicated to producing the macroeconomic framework and the resulting expenditure envelope can help ease the coordination of the various actors involved in the process. As noted, achieving even basic coordination and agreement between all parties in low-income and low-capacity states can be challenging. In countries where one function is performed by a small number, or indeed just one individual, personalities matter and need to be managed. The creation of a formal technical working group may assist in establishing the information flows and working relationships required to maintain the macroeconomic and fiscal forecast at a standard that ensures it is a useful input into the strategic phase. It can also help formalise and institutionalise the process of producing these forecasts, further allowing for targeted capacity-building efforts.

The lead institution in producing the macroeconomic framework and resource envelope is typically a department within the finance ministry, usually the macroeconomic department. However, it is likely that this department will require inputs from a number of stakeholders, including:

- The Treasury/Accountant General and budget departments. These institutions provide up-to-date information on budget execution in order to determine the current fiscal balance as well as forward projections of expenditure aggregates such as the wage bill, major capital outlays, etc.
- Revenue-collecting agencies. While the macroeconomic department will likely forecast revenue at the aggregate level based on forecasts of economic growth, the views of revenue-collecting agencies are also important. This is particularly the case in low-income countries where the tax base may rely on a relatively small number of firms and industries, or where efficiency gains in tax collection through administrative reforms can yield substantial returns. Representatives of these agencies are also more likely to be able to explain recent trends in individual revenue lines.
- The central bank. The involvement of the central bank helps strengthen the links between fiscal, monetary and external sectors, particularly in relation to inflation and foreign reserves.
- The IMF. As noted, in many low-income and low-capacity states, adherence to an IMF programme and associated fiscal policy targets means the IMF has extensive influence over the outcomes of the macro framework. Early engagement with IMF representatives and mission staff can help ensure consistency with the requirements of the country programme and/or provide opportunities to access IMF technical assistance and quality assurance.

Introducing a medium-term macroeconomic and fiscal perspective into the strategic phase of the budget process is often presented as a solution to the problem of political short-termism. The introduction of such a perspective needs to be considered carefully, however. On the one hand, a genuine medium-term perspective on macroeconomic and fiscal policy will improve policy-making to some degree, and some constituencies in government may have an interest in this kind of longer-term thinking. On the other hand, and in reality, rent-seeking short-termism is a rational approach for many in the political leadership, especially if they suspect they
may not be in post very long. This can seriously undermine the efforts invested in producing complex medium-term frameworks and may mean it is not worth the costs in resources. Time may be better spent on investing in a more accurate one-year forecast.

Producing a set of specific analytical options papers for consideration by the political leadership

The methods by which analytical products are communicated to the political leadership for consideration vary between countries. In all contexts, however, engaging with the political leadership in such a way as to ensure that hard choices are made and adhered to in the strategic phase is highly challenging. To improve the chances of successful engagement, certain specific analytical products can be produced to help stimulate discussion and decisions on the part of the political leadership. This is a further example of using a technical tool (i.e. the production of analytical options) to help overcome a political constraint (i.e. a lack of decisions on key issues). Such analytical products can further serve as a means of disciplining internal thinking within finance ministries. They can also be explicitly built into the budget calendar as a way of clearly structuring the analytical work needed to produce them.

A range of possible ‘options papers’ on various topics could be produced according to local needs. The following are examples of the kinds of analytically-supported options papers that could usefully be provided at key points in the strategic phase of the budget process:

- A short ‘narrative’ paper on the overall context of the budget. Politicians often have limited time, interest and ability to engage with anything more than the headlines of the coming budget year, which may be many months away. Early on in the process, therefore, the finance ministry could produce an overall summary of the direction of the budget for the coming year, containing key messages on the macroeconomic context, the revenue forecast, the ongoing commitments forecast and the implications of these forecasts for debt and donor/IMF relations.
- A ‘Budget Framework’ paper setting out more detailed options on the macroeconomic framework and resulting resource envelope. A budget framework paper could include the baseline scenario and other scenarios identifying ways in which various political commitments and donor conditions can be accommodated within the forecasted framework for the following year and the implications for overall budget aggregates.

Box 4: Macroeconomic frameworks: a continuum of sophistication or of complication?

Globally there has been a great deal of policy reform focused on improving and strengthening macroeconomic frameworks and resulting fiscal policy options. Often these have focused on building a greater multi-year and/or medium-term awareness into fiscal policymaking (World Bank, 2013). Schiavo-Campo and Tommasi (1999) identify the following continuum of sophistication in introducing a macroeconomic framework with a medium-term perspective into the budget process:

- **Minimum level of sophistication**: aggregate expenditure estimates by function and broad economic category; forward costs of programmes.
- **Intermediate level of sophistication**: preparing multiyear expenditure programmes framed by a macroeconomic framework and strictly linked with budget preparation; including only programmes/projects for which financing is certain; ensuring that the multiyear programmes focus on ongoing policies and that new policies are decided only during the preparation of the annual budget.
- **Final level of sophistication**: preparing a formal medium-term expenditure framework with the same coverage and the same level of detail as the budget (at least by programme and projects and broad economic categories).

Incorrectly determining the appropriate level of sophistication of the macroeconomic framework may render the framework impractical for the purposes of the strategic phase. Identifying the appropriate level of sophistication involves a trade-off between the information needed to make good decisions and the resources required for the preparation of the framework, as well as determining whether the outputs of the framework can be communicated meaningfully to policymakers.

Higher levels of sophistication (e.g. the use of complex macroeconomic models) may require data that often might not readily exist or which is simply not credible in low-capability contexts. As Schiavo-Campo and Tommasi (1999) note: ‘the importance of good data cannot be underestimated. Without reliable information, the macroeconomic framework is literally not worth the paper it is written on’.

In practice, in many low-capacity environments sophisticated models are often developed by external advisors who operate with little regard for the quality or quantity of the supporting data systems and a weak understanding of local capacity to maintain the model after the advisor departs. Even where the technical capacity does exist to maintain a more sophisticated macroeconomic framework, budget managers should engage in a careful evaluation of the costs and benefits of investing significant resources in complicated models.
• An ‘Expenditure Options’ paper that relates an agreed macroeconomic framework and resulting resource envelope (or assumes the baseline or medium assumption) to spending priorities. This options paper could contain more detail on the discretionary margin in the budget once all commitments have been adhered to. It could also outline how the likely shape of the budget relates to both national development plans and commitments made to donors or other external funders.

Developing clear spending options and choices can help guard against over-reliance on incremental budgeting, another risk identified in the literature as arising from a weak strategic phase of the budget process (Schiavo-Campo and Tommasi, 1999; Schiavo-Campo in Shah, 2007). Incremental budgeting refers to the practice of rolling over the current budget to the following year with relatively little adjustment. In practice all national budgets involve a greater or lesser degree of straightforward incremental adjustments alongside more proactive changes (Schick, 1983). However, over-reliance on simple across-the-board incremental adjustments for each budget line leads to a situation in which no strategic and/or fundamental change of expenditure policy is possible. Developing specific options papers outlining the expenditure choices available during the strategic phase of the budget can help ensure that incremental increases are actively managed to deliver specific budget goals.

Ensuring that donor involvement and requirements are accounted for in the strategic phase of the budget

Donors often provide substantial resources to low-income and low-capacity states. The strategic phase of the budget therefore needs to build in an awareness of what donor activity means for the budget as a whole. Ensuring that donor financing and associated conditionality are accurately reflected in decisions made in the strategic phase is a technical challenge. Although the precise nature of donor involvement in a government’s financial and budgetary affairs varies between countries, the following are some of the key issues that typically need to be considered in the strategic phase:

• Expected levels of direct financial aid. The amount of financial aid that governments receive in the form of general budget support or sector budget support has a direct impact on governments’ macroeconomic and fiscal forecasts. Budget managers should carefully consider – drawing on experience from previous years – the difference between the amount of direct financial aid pledged by donors and the amount that tends to actually be delivered. This may involve applying a straightforward ‘discount rate’ to aid that has been pledged.

• Progress in meeting financial aid performance conditionality frameworks. Donors usually insist on governments meeting a range of targets and benchmarks as a condition for providing funding. Budget managers can use the strategic phase of the budget to review progress in meeting these conditions and, if necessary, to inform the political leadership as to whether they are going off track and the reasons why they are doing so.

• Requirements regarding spending shares of the budget. In sector budget support operations, donors frequently require that a certain percentage of government spending be allocated to certain sectors. The strategic phase of the budget is an opportunity to ensure that expenditure options presented to the political leadership accommodate these donor requirements.

• Expected counterpart-funding for infrastructure projects. Donor projects may require some degree of co-funding. Without this funding the projects may stall, leading to higher costs and delays in delivery. The strategic phase is an opportunity to review, catalogue and include these costs in the expenditure options presented.

‘Sector working groups’ are often employed to facilitate government-donor engagement in specific sectors. In contexts where sector working groups are in place, they may draft ‘Budget Sector Plans’ setting out the strategic priorities of the budget for a specific sector as part of the strategic phase. In some circumstances these sector working groups may be able to conduct some of the analytical work that budget managers need in order to present options to the political leadership.

1.5.1 Approaches to obtaining a political steer in the process

Getting politicians in low-income countries to take early decisions on expenditure priorities and set hard constraints is not an easy task. National development planning is an activity that is often popular with political elites because it provides a formal mechanism for outlining ambitions and dreams. Annual budgeting, by contrast, is typically far less popular, since it reminds the political leadership of how limited the resources of their country are and how difficult it is to satisfy all of their constituencies. Annual budgeting, moreover, relies on complicated technical procedures that political elites may not understand, or in some cases refuse to understand, and requires hard decisions that potentially store up trouble for the future (Caiden and Wildavsky, 1974). While investment in capacity-building can help reduce technical constraints on achieving a successful strategic phase, the options to reduce political constraints on the process are less clear. The ability of finance ministries to navigate these difficult constraints is a real test of the political and coordination skills of senior officials.
Building key events into the political decision-making process

Although each context is unique, certain techniques and tools can serve to kick-start the engagement of the political leadership in the budget process, or at least help to get the issue on the agenda of the political leadership. In addition to the tools mentioned in the discussion above, the following techniques and tools could usefully be adopted:

- **Budget conferences.** Budget conferences can be public or internal events at which the prospects for the coming year’s budget are outlined to a wide range of stakeholders, including members of the cabinet. A budget conference can begin the process of communicating the core ‘narrative’ that might affect subsequent strategic decisions on the budget (e.g. ‘the higher commodity price forecast means we have more resources’ or ‘the deficit targets of our IMF programme require cuts this year’).

- **Cabinet retreats.** The entire political leadership could spend time – perhaps outside of the capital city – dedicated to focusing on the coming year’s budget. Such retreats are a key opportunity for budget managers to present key narratives on the budget and to outline the timeline for the production of the budget (i.e. the budget calendar). Retreats may also provide an opportunity to reiterate to members of the cabinet their roles and responsibilities vis-à-vis the budget process more generally.

- **Prescheduled budget discussions on the cabinet agenda.** Cabinets often meet once a week and these meetings include some degree of forward agenda planning. The points at which political engagement in the budget process is needed can be pre-planned into the cabinet’s calendar, potentially months in advance.

Budget managers require certain political decisions to be made at different times in the budget process. These different points of consultation can be built explicitly into the budget calendar. For example, the engagement process may begin with an introductory discussion as part of a regular cabinet meeting in which the political leadership are given formal notice that the budget process – and therefore the strategic phase of the budget – is beginning, and it may end with a ‘formal confirmation’ point on the cabinet agenda at which the long list of individual agency ceilings are formally agreed. The presentation of the baseline scenario and other options for the macroeconomic and fiscal forecasts, as well as the discussion of an ‘expenditure options’ paper, could take place at points in between, at which points the political leadership would be explicitly asked to make decisions.

**Figure 3: Diagrammatic representation of major steps in the strategic budget phase**

- “Technical Working Groups” set up to manage the overall process and key subprocesses
- Use of ‘baseline model’ and other scenarios to clarify high-level choices
- ‘Budget Conference’ or other set-piece event(s) scheduled to focus minds on decisions
- Use of ‘Options Papers’ to clarify in more detail the trade-offs and choices available to Cabinet / President
- Cabinet / President provide further steer on high-level policy choices
- Final budget ceilings issued to spending agencies alongside detailed budget guidance in the ‘Budget Call Circular’ or similar
- Final fiscal and budget totals sent to Cabinet / President for formal approval
- Detailed budget sent to Parliament for approval
- Detailed budget preparation undertaken by spending agencies to take high-level budget totals and policy decisions and reflect this in allocations to lower-level budget lines
- The ‘permanent activity’
- The strategic phase of the budget
- The detailed budget preparation phase

*Source: authors’ representation*
Choosing the right language in presenting options and choices

An important skill for budget managers is that of knowing the context and audience and choosing the right technique in which to frame trade-offs. This is an area where careful presentation of technical information can be used to prompt political decisions and reduce political constraints on the delivery of the strategic phase of the budget process. Cabinet ministers may neither understand nor be impressed by graphs and tables showing expanding or shrinking deficits, rates of inflation and debt levels. In difficult political situations, moreover, individual cabinet members may regard these collective problems as irrelevant to their individual interests in the short term. In seeking to convince the executive to set a hard constraint, the finance ministry itself therefore needs to think politically to ensure the correct balance is struck in the use of technical information and the way this information is framed.

The way in which choices are presented can be instrumental in determining whether and to what extent decisions are made. If politicians are to make tough decisions they need accompanying political narratives with which to explain their decisions to their constituencies. Examples of how choices can be framed more effectively for politicians include:

- ‘Fiscal austerity to head off rising debt levels’ might be better conveyed in terms of ‘avoiding a future bailout’.
- Expressing the effect of inflation in dollar terms in relation to wages might be a more appropriate means of conveying key economic messages than relying on local currency units.
- Highlighting the potential impact of certain decisions on the timeliness of salary payments may carry more weight than discussing the mechanics of cash management.
- Budget managers can try to be clear on the trade-offs between the various options, noting that if the political leadership want one budget increased then they will need to consider where corresponding cuts can be made.
- Being careful to show consistency between what the cabinet agreed to in a previous engagement and what is being presented to them now, so that previous decisions remain locked in and the whole process retains credibility.

Box 5: Obtaining a political steer: an example from South Sudan

During a peer learning visit to Kampala conducted shortly after South Sudan’s independence in 2011, officials from Uganda’s Ministry of Finance impressed upon their South Sudanese counterparts the value of obtaining a political steer from the President early on in the budget process.

Following the oil shutdown of 2012 and the austerity measures of the 2012/13 budget, the 2013/14 budget offered the prospect of increased resources due to the combined prospects of a resumption of oil production and budget support from donors. Recognising that demands for increased spending were likely to be open-ended, South Sudan’s then Finance Minister approached the President to determine his spending priorities, with the assistance of the Presidential Economic Adviser. The President’s articulated prioritisation of increased spending on service delivery sectors and infrastructure was then reconciled with the bottom-up spending plans submitted by the relevant sectors. In particular, the ‘Local Service Support Agenda’, initially an aid instrument designed to facilitate greater donor use of government systems, was redesigned as a budget proposal for government to start releasing operating and capital funding to local governments.

Although budget execution on infrastructure was overtaken by the outbreak of civil war in December 2013, public service delivery grants nevertheless began to be released in the latter half of 2013/14, including a capitation grant for education.

A key factor in this success in delivering local services in the health, education and water sectors in the midst of a civil war was the Finance Minister’s management of political priorities, in particular through obtaining a political steer from the President on this issue early on. The provision of South Sudan’s basic services is an example of how an effective strategic phase of the budget process can play a key role in determining outcomes.

Source: Hart et al. (2015)
1.6 Conclusions

The strategic phase of the budget process is a period of time that allows budget managers to orientate the emerging budget around politically-determined priorities. A key aim of this phase is to enable budget managers to actively encourage the political leadership to establish priorities, make trade-offs and jointly determine which activities are to be funded by the coming year’s budget. The strategic phase is a vehicle for improved budget-policy linkage, beginning with analytical work to support the development of high-level fiscal and expenditure options and ending with the issuing of detailed ceilings and guidance to spending agencies. Successful delivery of the strategic phase requires a politically-informed reconciliation of expenditure aggregates to be determined by top-down macro-fiscal analysis with bottom-up consideration of pre-existing spending commitments.

In practice such successful delivery is hard to achieve in low-income and low-capacity states. Numerous structural factors make it difficult to generate accurate and timely information with which to inform the strategic phase of the budget process. Aside from technical challenges in gathering the right information, a major risk in these contexts relates to the willingness of the political leadership to engage with, make and adhere to difficult budgetary decisions. The strategic phase inevitably involves political leaders responding to the fact that the discretionary resources available will not be sufficient to achieve their spending wishes.

There are a number of tools, techniques and approaches that can be used to support an effective strategic budget policy process. These include starting the process early, outlining planned steps in a budget calendar and investing in producing high-quality analytical options papers for political decisions. The ability of budget managers to coordinate and bring parts of government together and to ensure the delivery of key products is crucial to obtaining value from the strategic phase.
2. Annotated bibliography of key sources

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