

Relevance of Multi-Year in Budgeting and Public Investment Planning

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1.1 Introduction

A government budget refers to the document that includes monetary articulation of strategic plans of the government for the forthcoming financial year. In Section 33 and 78 of the Government of India Act, 1935, reference is made to the accommodation of an "Annual Financial Statement" before the Legislature. This document is an "announcement of the anticipated receipts and use for the budgetary year" and is for the most part known as the Budget. In other words, a budget sanctions planned expenditure and anticipated revenues of a government for the forthcoming accounting year. There are three types of government budget: the operating or current budget, the capital or investment budget, and the cash or cash flow budget.

The budget document of a government enunciates its financial plan as well as its intentions towards pursuance of different policies in future. The government's appropriation, tax, and other policies have consequences on both the fiscal and economic horizon long beyond the budgeting year. Hence, the consideration of the present and the future plays an inherent role in formulating a budget (McNichol, 2014). Owing to the instrumentality of the document, in matters of governance, it is subject to close public scrutiny.

The process of formulation of the budget is tedious. It involves making choices between various possible alternatives. Contingent on the government's kitty, decisions of spending have to be prioritized. The investments that promise beneficial bearings have to be favoured. The budget is conceived in the midst of myriad of insights on probable outcomes. The process invariably

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revolves around managing the resources to maximize the desirable outcomes. There are three functions of Budget Management :

1. Aggregate fiscal discipline- spending what is affordable
2. Efficient allocation- spending in proper heads or purpose
3. Operational management- making best use of allocated money

The experiences of different countries are varied. And invariably, there are issues pertaining to the budget management practice, common to countries across the world. These hurdles could be, administrative and political in nature. This, in the way that resolving conflicts between the regions and centre might prove to be a daunting task. They could also be technical in character. As the procedures for seeking approval, the rules and regulations involved, may prove to be deterrents. Furthermore, the public opinion and the pressure from the lobby groups might be at loggerheads more often than not.

In the midst of all these competing issues, linking the budget proposals to desirable outcomes becomes increasingly difficult. Particularly, if the decisions made and the outcomes sought are to be materialized in the span of just 12 months. Generally, expenditures committed in a year would show tangible developments in the forthcoming years. Thus, a financial statement that doesn't limit itself to a single year but is span across two or more years is a wise alternative.

A multiyear budget is a step in this direction.

1.2 Scope of this paper

The main focus of this paper is to elaborate on the concept of the Multi Year Budget (MYB). The paper addresses on the potential of the multiyear budget in aiding greater involvement of all the parties concerned in the process of budget formulation. The paper also elaborates the various advantages and challenges involved in the process of Multi-Year Budgeting.

1.3 Literature Review

It was in the 1970s that the concept of Multi-Year Budgeting evolved—in many OECD (Organisation for Economic Co-operation and Development) countries. Initially, in most cases, it focused on new programmes, but later it was evolved as a tool for general expenditure control.

The U.S. President Carter in 1976 during his presidential campaign had put forth the concept of Multi-Year Budgeting. The new budgetary process was aimed at reorganization and management of federal finances. The shift was to be made in a gradual manner. The Congress was supposed to make spending and taxing totals not just for the present year but for two succeeding years as well. Further, the scorekeeping of the Congressional Budget Office was to be extended to the three subsequent fiscal years. In this way, the changes were to evolve into a Multi-Year Budget instead of one giant step. (Hartman, 1977)

The interest in Multi-Year Budgeting has been kindled, in part, by the realization by governments of the difficulty in linking long-term strategic plans with financial planning processes in annual budget cycles. The difficulty associated with annual plans is its inadequacy as a tool for financial planning. These eventually result in overwhelming cyclical debts. As an alternative to this, the Multi-Year Budgeting approach has the potential to improve and enhance the annual budgets – if not replace them. Furthermore, Multi-Year Budgeting with counter-cyclical fiscal policy is contemplated as an appropriate tool to deal with economic fluctuations and act as a protective barrier against unforeseen contingencies. (Hou, 2006)

Obviously the ordeal of the developed countries will be different from what the developing countries or the states within them, that are keen in implementing a Multi-Year Budget, might realize. Nevertheless, an enquiry into the subject is indispensable. Such an enquiry has the power to assess the applicability of the concept.

The experiences of other countries in this regard are insightful. Austria's Multi-Year budget details a three year estimate for expenditures and revenues in addition to the current year. The system is an aid to the annual budgeting exercise. The annual budget is put out in October. The estimates of the Multi-Year Budget are put forth in June. The difference in the two is representative of the fact that they are prepared by separate divisions of the Budget Division of Ministry of Finance. Austria's implementation of the Multi-Year Budget is insightful as it did not entail an excessive increase in administrative expenses. These estimates are aimed at portraying the medium term fiscal consequences of the policies already enforced by the government. Furthermore, they aid in the government's planning purposes.

Germany's tryst with the MYB stands in stark contrast with the simple framework of Austria. A medium term financial plan is formulated which encompasses the MYB. The estimates put forth by MYB assess the compatibility of the current policies with the government's medium

term fiscal strategy. If they seem to be in conflict, immediate corrective measures are listed out. The fiscal approach thus, becomes consistent and responsible in character. The annual budget formulation is an exhaustive process. A Financial Council, with the Federal Minister of Finance and Government's representatives, is at the centre of the process. Pre-budget consultations are carried out with various advisory councils in close association with the states and their local governments. Efforts aiming at arriving at consensus on various matters of importance ensue. Division of resources between three tiers of the government, the level of aggregate expenditure growth and the quantum of borrowing to be pursued are some of the deliberations worked upon. The decisions of the Financial Council aren't legally binding in nature. But political and professional credibility ensure cogency. The formulation of the federal budget requires all spending agencies to put in their spending demands for the current year and their estimates of budget for the three forthcoming years. All instructions are listed. Thereafter, a budget negotiation process ensues. Comparison of the budget requests with the Government's medium term fiscal strategy are carried out. On matching the two, divergences might surface. In situations where expenditure target is greater than the demanded level, surplus is assigned as a 'reserve' which is meant to be used later, as and when required. In situations where expenditure sought exceeds the expenditure target, the deficit is to be addressed through budget cuts. 8000 expenditure items and 1200 revenue items, are estimated in the MYB. However, in the final MYB component submitted along with the annual budget, only 40 functional spending categories are made public.

Having implemented the MYB in early sixties; Great Britain stands a pioneer in the field. As this scheme is also followed by the UK and the members of Commonwealth, it is otherwise christened as the "Commonwealth" approach to Multi-Year Budgeting. The crux of the Commonwealth approach is that, by putting decisions concerning expenditure in a multiyear framework, budgetary restraint is implemented, policies are rationalized and efficiency in expenditure is ensured. At the outset, the MYB provides the government a perspective on medium term budgetary policies. The MYB is mostly calibrated towards the expenditure side of the budget. The expenditure plan is stipulated for a period of three years whereas the tax policies are just annual in nature. Nevertheless, revenue estimates are projected for the three year period. It is officially published along with the annual budget in November. The treasury sets limits within which adhered to by the line departments, entrusted with the responsibility of chalking program priorities. The line departments play a significant role in the process of budget formulation.

Australia introduced the medium term fiscal strategy in the eighties in the backdrop of high level government spending and consequent higher tax burden. Objectives of medium term fiscal strategy were to reduce increasing government spending and to put a check on the rising tax levels. Australia has a central system, Finance Information on Resource Management, which brings out forward estimates for three years along with the current year. The estimates are inclusive of only those allowances that have already been announced by the government. The forward estimates are updated and the expenditure baseline becomes the base for the next year's budget proposal. The concentration of the budget is on the increments in the expenditure that match the medium term fiscal strategy and policy initiatives of the government. The Australian Government circulates four budget related documents, *The Budget Strategy and Outlook*, *Budget Measures*, *Federal Fiscal Relations* and *Commonwealth Public Account*. All these documents are based on multi-year and medium term frameworks.

Similarly, New Zealand, with the objective of enforcing fiscal rigor and introducing transparency and accountability in the budget formulation process, moved to a multi-year framework. The multi-year framework has ensured that government policies that have a tendency to diverge from the fiscal objectives are corrected immediately. The systematic reporting requirement increases efficiency of the framework. Flexibility is ensured by the fact that no numerical targets are stipulated to be achieved. Thus, government has greater degree of freedom to respond to economic fluctuations. Multi-year estimates are prepared by the line ministries in the form of incremental budgeting. The departments are expected to adhere to the guidelines put forth by the Treasury. Often they are encouraged to raise their own funds for sponsoring new initiatives. Three budget documents are published over the year: *The Budget Policy Statement*, *the Fiscal Strategy Report* and *Budget Economic and Fiscal Updates*, within the multi-year framework.

The United States' federal budget consists of various multi-year elements. The estimates are put forth for the current year plus four more years. It serves two prime objectives. On one hand it weighs current fiscal policy decisions with respect to the medium term fiscal strategy of the government to check fiscal deficit, on the other hand it provides the starting point for the forthcoming year's budget. The Multi-Year Budget of the US has a demarcation between *Budget authority* and *Outlays*. Budget Authority empowers the line departments to engage in obligations that will result in immediate or future outlays of the government. Outlays are actual expenditures made from government resources. The budget authority is what the Congress votes on. The budget

authority normally expires after one year but sometimes the unused balance of the budget authority is carried forward to the next year. The Office of Management and Budget (OMB) and the Congressional Budget Office are entrusted with the responsibility of formulating revenue estimates and projecting required revenues. The OMB is required to explain differences, if any, in the set of estimates. (Boex, Martinez-Vazquez, & McNab, 1999)

Denmark has multi-year investment budgets, enabling carry-over of funds from one budgeting year to the next.

1.4 Multi-Year Budget Defined

A multi-year operating budget is defined as the development and formal adoption of an expenditure and revenue document that spans two or more years (Guajardo, 1999). In other words, it is a document that shows detailed forward estimates of expenditure and revenue for the spans of two or more years. Contrary to the annual budget, a multiyear budget details appropriations and revenues for two or more budgetary periods. Annual budgets, otherwise, provide details of the appropriations and revenues of the government for a period of 12-months.

A piecemeal approach to sanctioning of funds and schemes leads to loss of considerable time and delays in the realization of objectives. Multi-year budgeting offers governments the opportunity to reduce work hours dedicated to budget development. It helps them reallocate that effort toward monitoring, analysis, and innovation.

Most governments have implemented a relatively comprehensive multi-year fiscal planning framework, as encouraged by the Government Finance Officers Association (GFOA), rather than practicing multi-year projections for the general fund alone.

In recent years, multi-year framework is being adopted by many developed countries to formulate their annual budget process. Multi-year budget practices vary substantially between countries. However, a feature common to all is the including the forecasts of revenue and estimates for expenditure for two or three years beyond the current year.

The rationale for making the transition from an annual budget to a Multi-Year Budget (Blom & Guajardo, 2000) includes:

- Greater emphasis on management and service delivery
- Greater emphasis on program evaluation and monitoring

- Improved long-term planning
- Redeployment of human resources to activities other than budget preparation
- Reduction in staff time spent on budget development

Experience of other countries with the Multi-year Budget Scheme has shown its effectiveness in reinforcing the fiscal discipline in public sectors. The fact that the MYB has been instrumental in making public expenditures more efficient is also well documented. Thus, the overall response to the MYB in the developed countries has been positive mostly. Now, developing annual budgets in developing countries is in itself a herculean task. In this setting, it becomes crucial to verify whether a multi-year framework is in fact feasible for them. And if it is feasible, one needs to enquire into how far it will be favorable for them.

1.5 Advantages of Multi-Year Budgeting for a Developing Country

Given the state of fiscal distress that these developing countries are constantly mired in, MYB has potential to ease these exigencies. However, a simple framework is warranted.

- ❖ **Efficiency in Public Resource Allocation:** The developing countries often face a myriad of budgetary problems. Issues like fund-starved government programmes, chronic budget deficits and rising debt burdens are common place. An MYB, instead of revamping the annual budgetary process shows more potential. An MYB is unique because it allows long term interlinking of current year budgets with future years' expenditure requirements. Thus, it would provide a platform whereby perennial fiscal problems could be resolved by matching the government's expenditure commitments to the resources available. It improves long-range and strategic planning. Introducing the medium term approach to budget formulation would help prioritizing expenditure commitments in line with the fiscal strategies. This would improve resource allocation.
- ❖ **Fiscal Sustainability:** Improves financial management by identifying structural imbalances between revenues and expenditure. Further, by providing estimates for certain forthcoming years, MYB could help generate fiscal outcomes in different economic conditions. This could function as an early warning system to flag off policies incompatible medium term fiscal objectives of the government. In an MYB, the current year's expenditure forecasts are

used as base for the forthcoming year's annual budget. By maintaining stability and continuity, it brings about fiscal sustainability.

- ❖ **Improvement in Department Involvement:** In most of the countries, the approach involves empowering the line ministries to put forth their budget demands. And often, they are also asked to raise revenues from within the department to cater to the requirement of new programmes and policies. Thus, the approach invariably increases the constructive involvement of the line ministries in the budget process.

1.6 Challenges of preparing a Multi-Year Budget

On the outset it has to be acknowledged that a single scheme of MYB doesn't cater to all nations. It has to be tailored, keeping in mind the country's policy purposes, unique budget institutions and traditions, constraints of available resources and administrative capacities.

Many changes have to be spun around before an MYB can be implemented comprehensively. An unstable local economy may present difficulties in forecasting revenues and expenditures.

Legislative acts and resolutions may be needed to accommodate Multi-Year Budgeting. The budget process may need to incorporate new policies and processes. Efforts have to be made to ensure that the legislative bodies do not perceive a loss of budgetary control and oversight. The process has to provide aid to some departments/divisions that might find it difficult to project expenditures and revenues.

Deliberations around MYB should also incorporate economic and environmental changes.

Forecasts of governments tend to reflect their political aspirations. Moreover, ministries might start looking at budgetary allocation projections for future years as their political entitlements. Efforts are to be made to ensure that these conflicts do not blossom into hurdles.

1.7 Essential Requirements of the MYB

It is indispensable to conducting an analysis of the existing revenue structure. The changes in the budget process are to be reflected comprehensively in the budget manual. Further, the key stake holders should be taken into consultation when deliberating on the MYB. An efficient budget review process has to be put in place to ensure compliance with budget policies, processes, and targets. The MYB has to be effectively linked with the strategic plan, long-range financial plan and revenue forecast, and financial and budgetary policies. Lastly, the budget staff is to be prepped in advance regarding the implementation of the multi-year budget.

1.8 Implementing Multi-Year Budgeting

There is always a less likelihood that the long-term financial stability goal would be achieved through annual plans or annual budgeting. Mostly because linking the budget proposals to desirable outcomes becomes increasingly difficult in annual budgeting process. Also, budget issues and problems are not limited to a single fiscal year. Thus, there is a need for the introduction of multi-year budgeting in order to attain long-term financial stability.

Multi-year budget process needs clear understanding of current fiscal reality of an economy (revenue generation capacity, tax base, fund balance, cost drivers including all forms of compensation, retiree health care etc.). So that proper strategic responses can be developed. Proper strategic responses requires focus on goals and priorities of the implementing organization, its organizational capacity and necessary steps to increase its capacity, appropriate visualization of short-term and long-term objectives etc.

Strategic responses in a multi-year budget process of an economy might take into account adoption of ongoing activities, monitoring through monthly reports, multi-year amendments, transparency through evaluation and adjustments in forecasting through quarterly forecasting. This is because the process of producing revenue estimates and expenditure allocation should not be simply a forecast (repeat of previous year's budget into the next year with inflation) in out-years, but an actual appropriation.

1.9 Conclusion

The experience of the developed countries serves as a starting point for the developing countries. This enhances or aids the already existing budget process. Processes that require great upheaval of administrative machinery are unwelcome.

The MYB is introduced gradually. In the sense that it is first developed as a simple scheme which evolves into an integrated and ambitious project over time. Irrespective of the approach, the MYB documents provide policy inputs to government officials, lawmakers and the general public to frame realistic and responsible budgets. Improved decision making in such a background leads to desirable policy outcomes.

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