



THE ROLE OF LOCAL BUDGETS IN THE ECONOMY AND THEIR USE

Hashemy Sayed Shir Shah¹

¹Termez State University

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ABSTRACT

The present paper considers the theoretical and practical aspects of local budgets as well as their role in financial support for the implementation of state tasks of Afghanistan. The essence of the local budget is revealed in the context of interbudgetary relations. The paper presents an analysis of the economic mechanism for the formation of local budgets, namely the dynamics of the formation of the local budget of Pavlodar city. The authors consider the development trends of interbudgetary relations based on greater independence of local authorities and analyze modern models and methods of local budget management. The paper addresses problems associated with assessing the efficiency of local budget management and shows how to solve them.

Introduction

Afghanistan is one of the poorest countries in the world, with a poverty rate of 36 percent and an unemployment rate of around 40 percent at its highest level.^{2, 3} The country also suffers from widespread corruption, including the embezzlement of public resources, domestic revenue, and foreign aid. According to Transparency International (TI), after Myanmar, North Korea, and Somalia, Afghanistan is ranked as the most corrupt country in the world.⁴

Prior to 2008 the efforts to reform the budget system in Afghanistan largely focused on internal documentation, improving fiduciary controls, and making data available to donors and those responsible for making decisions about the country. Very little attention was paid to whether or not budget documents were

accessible to the public. Even international financial institutions paid more attention to the fiduciary controls of the financial system than to whether or not the public had access to budget documents or were able to engage in the budget process.¹⁹ The Open Budget Survey 2008 evaluation of budget transparency in Afghanistan found that the Afghan government was providing the public with “scant” information on its budget documents during the year. This situation, along with most aid being off-budget, made it difficult for Afghan citizens to hold the government to account with regard to how it manages public funds. While the Ministry of Finance was producing most of the necessary budgetary documents, it was not making all of them public. As the Deputy Minister of Finance, Mustafa Mastoor, put it: “Previously, we did not publish these



documents although we had them available, because we were not aware of the international budget ... [transparency measures].”²⁰

After the collapse of the Taliban regime in 2001, a significant amount of foreign aid — the result of the Bonn Agreement of 2001 and the new political setting — flowed into the country to fund reconstruction and stabilization efforts. The government, hoping to earn the trust of the international community and to reignite public confidence in the Afghan state, introduced a number of reforms in the area of public financial management.¹¹ The primary motivation behind these reforms was to assure donors that their aid money would be channeled through a credible budget system. The government further hoped to differentiate itself from former regimes that had kept the budget a secret and based expenditure on political agendas and the self-interest of public officials.¹²

Budget transparency was not approached in a systematic manner, and there were no universal indicators against which to measure budget transparency. Although the enacted budget, mid-year budget review, and information about donors were made available online through the Ministry of Finance’s website, the content and format of these documents changed regularly, and there were no standards for the quality of the content and no firm deadlines about when the information should be posted. The budget department also embarked on a process of raising budget awareness among CSOs at the provincial level. An important initiative launched in 2004 when the first Civil Society and Budget National Conference was held in Kabul. Additionally the first

Public Financial Report was prepared and first made public in 2004. The follow up on these initiatives, however, was poor.¹⁴ When the new parliament was established in 2005, it stipulated that budgetary information must be shared with members of parliament prior to budget hearings. Unfortunately the capacity of the parliament to conduct in-depth analyses of the budget was limited. The convening of the new parliament in January 2011, however, led to improvements in the content of the budget documents as well as their availability in local languages.

What’s the Local Government Budgeting?

A local government’s annual (or in some cases biennial) budget indicates a community’s civic priorities, projected revenue and costs, and plan for the future—what revenue will pay for which departmental services and for whom those services exist. Development of the annual budget in the public sector is more than just number crunching; the budget reflects a strategic plan and its conception should consider the needs and priorities of all stakeholders, from government administrators and employees to citizens and business leaders. The development, approval, and implementation of a public agency’s budget are all critical steps of the budget process.

Budget Development

The first step of the budget preparation process is identifying budget objectives and operating budget requests. The chief executive or local government CEO (e.g., city manager, town manager, county



manager) drafts a recommended budget through their budget office. Department directors solicit input from program managers within their department. These budget requests are submitted to the budget office for review. The chief executive reviews the budget requests (typically submitted by mid-March if the fiscal year begins July 1) with the finance director. Meetings are held with the department directors and budget staff to go over requests. Once the chief executive drafts a proposed budget, it goes to the legislative body (e.g. city council, county council, or county board) for approval. This process can take up to six months.

Budget Approval, Adoption & Implementation

When the proposed budget goes to the legislative body for review, depending on the size of the group, there may be committees that oversee various portions of the budget. Each member of the legislative body reviews the budget in detail (during what are known as work sessions) and hosts a public budget hearing and information session for public input. After community input and review, the local legislative will adopt the budget. Typically, this takes place one or two months before the fiscal year begins.

After the budget is implemented, the budget office's duties include monitoring expenditures and ensuring that funds are spent as intended. At the end of the fiscal year, the legislative body will approve a final budget reconciliation, among other year-end accounting modifications to the budget. An independent auditor will review the Comprehensive Annual Financial Report (CAFR) reviewed by an

independent auditor and determine compliance.

Strengthening the Effectiveness of Public Finances

The national budget is the primary tool for implementing the priorities and policies of the Government.

In recent years, considerable efforts have been made by the Ministry of Finance to implement a number of reforms in order to improve the quality and effectiveness of the budget process. These reforms are aimed at ensuring Government priorities for economic development and poverty reduction are implemented through the budget, addressing the needs of people across all provinces and ensuring the gender differentiated needs of women and men are met.

Several important reforms have been implemented by the Government in the past few years, including (i) Program Budgeting, (ii) Gender Responsive Budgeting reform (iii) Pro-Poor Budgeting and (iv) Provincial Budgeting. These reform initiatives are expected to improve the effectiveness of public finances.

(a) Program Budgeting

Program budget reform was initiated by the Ministry of Finance in 1385, when it was introduced on a pilot basis. The overall goal of program budget reform in Afghanistan is to link budgets to Government priorities and the results it wants to achieve. In the first year MoPH, MRRD and MoE were identified as pilot ministries to implement the program budget. Reform was subsequently rolled out to seven, eleven and nineteen



ministries in 1386, 1387 and 1388 respectively and, finally, to all budgetary units in 1389. The Ministry of Finance provided technical support to all line-ministries as they entered the reform process.

(b) Gender Responsive Budgeting

To facilitate better analysis of specific needs and the adequate allocation of resources to both genders, facilitating measurable improvements in women's lives and status, the Ministry of Finance has commenced Gender Responsive Budgeting reform. At the first stage, MoF identified seven pilot ministries and provided technical support and advice to line-ministries. Gender commitments have been integrated into the design of the development programs and projects of these ministries. The budget submission of all 7 ministries has been analyzed and reports have been prepared which will be discussed in detail in this chapter.

© Pro-Poor Budgeting

The Ministry of Finance started its initial work on pro-poor budgeting during 1389. MoE, MoLSA and MoPH have been identified as pilot ministries for the implementation of pro-poor budgeting reform. The objective is to identify, track and report on the pro-poor expenditure of these 3 ministries, in order to better integrate poverty reduction policies within their programs. For all 3 ministries, the MoF has provided technical support. The expenditure of the ministries has been analyzed to assess its impact on poor people; this is discussed in detail later in this chapter.

(c) Provincial Budgeting

To enable provincial authorities to plan, formulate, execute, monitor and improve budgeting processes in their area of jurisdiction, the Ministry of Finance initiated provincial budgeting reform in 1385. Provincial budgeting reform was started in three ministries (MAIL, MRRD and MoE) and three provinces (Balkh, Punisher and Kandahar) on a pilot basis. The reform comprises two components: (i) provincial capacity building and (ii) a provincial consultation and coordination process. In addition, a provincial resource allocation pilot project was initiated in the Ministry of Education in 1389.

(A) Program Budgeting

Introduction

Traditionally, the National Budget was prepared on the basis of allocating resources to particular economic categories: wages, goods and services, and capital expenditure. Little information was made available on what was to be produced, what services were to be delivered or what results were to be achieved.

In recent years, the Government of Afghanistan (GoA) has introduced a number of budget process reforms designed to strengthen public financial management. These reforms have two key objectives:

- Develop medium term budget plans and expenditure priorities.
- Link budget allocation decisions more closely to the nation's economic and social priorities.

The most important of these reforms is the introduction of program budgeting, a tool used to link budget resource allocation to



the outputs generated from those resources. As the Government is now able to link public expenditure to ANDS priorities, it is able to measure progress towards the achievement of Government policies and priorities.

Because Program Budgeting is new in Afghanistan, it has been introduced across line ministries and budget units on a phased basis from 1385 to 1389. The roll-out to all budget units was approved by the Cabinet in July 2010. Hence, the 1390 budget is the first to be prepared in a program format by all budget units.

Aligning Budget Allocation with ANDS Priorities

The National Budget is recognized as the central tool for addressing government priorities and is central to the implementation of the Afghanistan National Development Strategy (ANDS).

In recent years, the Government's fiscal strategy has been modified to improve budget performance and support poverty reduction:

- Through its Medium Term Fiscal Framework (MTFF), the Government has strengthened its budget formulation within available fiscal envelope to assist sustainable implementation of the ANDS.
- A Medium Term Budget Framework (MTBF) specifies expenditure priorities and allocates spending envelopes by budget unit. This allows line ministries and agencies to prioritize their needs, based on their sector strategies and

the country's overall development priorities, as described in the ANDS.

The 1390 program budget formulation process will enable all ministries and agencies to more effectively plan their allocation of resources and enable donors to commit financial resources to programs and projects that are more clearly aligned with the ANDS sector results frameworks.

- Analysis of the local budgets in connection with the state budget

The adequate management of the present development of the Romanian economy is linked with the national and local administration responsibilities regarding the dimension of the sources for the budget income and its redistribution in order to cover the needs for the development of the national and local economy. For the local administration that have autonomy to redistribute the revenue at the local level, the expenditure should be established not only based on the local capacity to produce revenue, which – considering the condition of the real equilibrium – could have a negative impact on the sustainable development of the communities. The local administrations have four sources to cover the expenditure: their own resources, the transfers and subsidies from the central budget and the loans. What is very important is how they use all these resources, for current consumption or for investments, and how they harmonized the local taxes with the general level of taxation in order to stimulate the investors' interest in their region. They must know that an increase in local taxes over the central ones could have negative effects. And that if they appeal to loans, these are to be paid by future generations by



imposing new taxes. Moreover, the costs afferent to these loans can determine the creation of the so-called snowball effect, when a loan determines a new one, and so on. Thus, a better synchronization of the central and local decision is necessary in order to coordinate the orientation of the aggregate demand.

The ways of presenting the budgets of the European Union countries are in accordance with the rules of budgetary equilibrium, observing the protocol No. 5 annexed to Article 104 C of the European Union Treaty. This protocol stipulates that the deficit of a budget should correspond to the net financing need it generates, that is to the net debt flow that is contracted loans and debentures and granted needs, respectively, assuming the equilibrium of accounts. This equilibrium is not reached, all the European Union countries presenting negative balances of their national budgets.

Four factors influencing local government financial decisions

1. Political (Citizen) Involvement

What appears to be occurring at the local level is that city and county managers and their legislative boards are increasingly using the budget to better understand how citizens, rather than internal participants, see government. Such a transformation will have a major effect on budget allocations and the relative size of city and county agencies.

In fact, we should anticipate greater diversity among local governments in type and quality of services provided,

particularly as communities develop reputations for having strengths in particular services. And given the powerful differences in service preferences that have been documented among age groups, we should also anticipate further segmentation of communities along generational lines.

Types of citizen involvement to obtain citizen feedback: citizen surveys; neighborhood forums; town hall meetings; and interactive websites.

2. Economic Influences

A number of factors can influence the economic environment of local government budgeting, including:

- **Economic cycles.** Economic downturns affect local budgets in two main ways. First, revenues may decline, especially such revenue as sales or income taxes, which are more sensitive to economic cycles. Second, during a recession, state and federal revenues are often hit hard, which means that intergovernmental aid to local governments may decline.
- **Inflation.** Inflation creates uncertainty in local government revenue and expenditure forecasts. When the cost of living increases rapidly, organized labor experts pressure to keep wages current with inflation.
- **Interest rates.** Changes in interest rates can also affect the budget, although their effects are not as great at the local level as they are at the national level, where the federal



deficit requires continual borrowing.

- **Competition among local governments.** Because it affects taxation decisions, competition among local governments for new residents or business investment also exerts an economic influence on local budgeting.

You can prepare for economic influences by (1) prohibiting departments from spending all their allocations, holding back on permission to hire new staff or make other contractual commitments, building reserves or rainy day funds; and (2) obtaining a competitive advantage over other jurisdictions is to export the tax burden, lifting it from residents to nonresidents. Such action reduces taxes on residents while allowing service levels to be maintained.

3. Social and Demographic Change

Changes in three social and demographic factors – population, age distribution, and personal income – have significant and lasting effects on local budgets.

- **Population.** As population increases and fixed costs are divided among more households, the resulting economies of scale will mean lower per-unit costs. Because financial obligations do not decline in proportion to population loss, communities with declining populations have difficulty reducing spending.
- **Age distribution.** Spending for public education, public safety, and recreational services are the budget

categories most likely to be affected by the age distribution of the population.

- **Personal income.** Research consistently shows that growth in personal income significantly affects the size of local government budgets. Higher-income households often demand more and better services from government, although these same households are more likely to advocate limited government, especially at the state and federal levels.

4. Legal and Intergovernmental Matters

Legal and intergovernmental factors shape local budgets in three principal ways:

- **Budgetary balance.** The legal environment in which state and local budgeting operates typically requires budgetary balance – that is, current revenues must equal current expenditures. Requirements for budgetary balance are complicated by a technical question: Is the budget balanced on a cash basis (i.e.; revenues are recorded when cash is received, and expenditures recorded when disbursed) or on a modified accrual basis (i.e., liabilities are recognized at the time they are incurred, and revenues are recognized when they are available for budgeted purposes)?

This question is important because cash balances can be easily manipulated: to make the budget look more balanced than it is, payments can be delayed until the



following fiscal year and revenue collections can be accelerated for credit to the current year.

- **Mandates.** A mandate involves one level of government requiring another level to provide particular services or follow certain procedures, as well as specifying the quality or frequency of service provision. Both the federal and state government imposes mandates on local governments.

The problem: Unless the federal or state government also provides full funding to implement the mandates, local officials may have to cut other services to comply. Communities suffering the effects of recessions have sometimes been hit simultaneously by unfunded mandates and cutbacks in state spending.

- **A combined effect.** Forbidding particular revenue sources, constraining tax increases, requiring balance, and mandating some services and service levels, are a combination of factors that has created enormous fiscal stress at the local level during the past three decades.

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expenditure should be established not only based on the local capacity to produce revenue, which - considering the condition of the real equilibrium - could have a negative impact on the sustainable development of the communities. The local administrations have four sources to cover the expenditure: their own resources, the transfers and subsidies from the central budget and the loans. What is very important

is how they use all these resources, for current consumption or for investments, and

how they harmonized the local taxes with the general level of taxation in order to stimulate the investors' interest in their region. They must know that an increase in local taxes over the central ones could have negative effects, and that if they appeal to loans, these are to be paid by future generations by imposing new taxes. Moreover,

the costs afferent to these loans can determine the creation of the so-called snowball

effect, when a loan determines a new one, and so on. Thus, a better synchronization of the central and local decision is necessary in order to coordinate the orientation of

the aggregate demand.

The ways of presenting the budgets of the European Union countries are in accordance with the rules of budgetary equilibrium, observing the Protocol No. 5 annexed to Article 104 C of the European Union Treaty. This protocol stipulates that the deficit of a budget should correspond to the net financing need it generates, that is



to the net debt flow, that is contracted loans and debentures and granted needs, respectively, assuring the equilibrium of accounts. This equilibrium is not reached, all the European Union countries presenting negative balances of their na Even the local budgets are neutral in comparison with budgetary equilibrium rules and certain basic principles are established. Consequently, a series of differences between local communities may appear. Therefore, besides the territorial and demographic differences 4 , other factors may appear as well, such as the status of local communities, the number of local public administration levels, the repartition of competences and the system of public finances. Voted, mainly, in real equilibrium, all local communities must observe a budgetary equilibrium norm as stipulated by law. Also, the two sections (functional and capital) of a local budget allow for a real balancing of the accounts. Therefore, the functional section needs to generate a surplus able to cover the repayment of contracted loans. It is obvious that this structural principle of equilibrium valid for all local communities is broken, sending disturbances to a global level. This happens when the budgetary policy for the stabilization of the economic activity intervenes with effects on the local functional expenses, particularly those related to education, health system and social security.

According to the legal regulation, local authorities can decide only on a small part of the budget revenue, namely their own revenue that usually does not exceed 50% of the total revenue, as shown in Figure 1. The adequate management of the present development of the Romanian economy is linked with the national and local administration responsibilities regarding the dimension of the sources for the budget income and its redistribution in order to cover the needs for development of the national and local economy. For the local administration that have autonomy to redistribute the revenue at the local level, the expenditure should be established not only based on the local capacity to produce revenue, which - considering the condition of the real equilibrium - could have a negative impact on the sustainable development of the communities. The local administrations have four sources to cover the expenditure: their own resources, the transfers and subsidies from the central budget and the loans. What is very important is how they use all these resources, for current consumption or for investments, and how they harmonized the local taxes with the general level of taxation in order to stimulate the investors' interest in their region. They must know that an increase in local taxes over the central ones could have negative effects, and that if they appeal to loans, these are to be paid by future generations by imposing new taxes. Moreover,



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Conclusion: As it's known budget reflects the government strategic plan and its conception considering the priorities in different skateboards. Hence, budget highly needs into some basic developments strategies. If a budget does not contain them then it cannot levels up soon. Although, Afghanistan is accosting along with budget deficit, but it can promote its budget by implementing some substantial

plans. For instance: political (citizen) involvement, economic influences, social and demographic change, and legal and intergovernmental matters. Furthermore, history of budget in Afghanistan was involved with different challenges in applying them into local stages. But during the time and by experiencing new governmental systems it shifted itself somehow in the right path.

As well as, there are some fundamental reforms that they are done in budget implementation in different periods. Develop medium term budget plans and expenditure priorities. Link budget allocation decisions more closely to the nation's economic and social priorities.

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