Theoretical and Applied Economics
Volume XXI (2014), No. 1(590), pp. 131-140

Budgeting mechanisms in public administration – meeting today's and tomorrow's development challenges

Adelina DUMITRESCU
National School of Political Studies and Public Administration of Bucharest
adelinad@snspa.ro
Tatiana-Camelia DOGARU
National School of Political Studies and Public Administration of Bucharest
dogaru_tatiana@yahoo.com

Abstract. *The efficiency of the rational allocation process of public resources represents a constant issue for both scholars and practitioners, under the European and global requirements set up by International Monetary Fund, European Commission and OECD agendas. In Romania, among the objectives of local government reforms, the rational allocation of public resources can also be identified. Influenced by changes induced by the global economic crisis, achieving this objective became a requirement for the administration of public institutions. From an economics and legal perspective, budgets increasingly came to be used as an instrument for public intervention.*
The goal of this paper is to identify budgeting mechanisms used at local public administration level in order to determine the main interest factors for the approached subject. In this context, our research is based on an analytical method of collecting information from existing written sources, legal analyses and strategic documents. Therefore, the research aims to outline the positive and negative aspects of budgeting processes in the public administration. The results of the research will help us to draw some conclusions which will be integrated into a project concerning the rational resource allocation processes in territorial administrative units.

Keywords: local government reform, budgeting mechanism, rational allocation.

JEL Classification: B26, D61, H61, H68, H72.
REL Classification: 8B, 13C, 13G, 16H.

1. Introduction

The paper analyzes the budgeting tools and mechanisms of public administration at a local level, being developed under the scope of a two year research project investigating the rational allocation process of public institutions at administrative - territorial units level. In this paper, by mechanisms we understand the policies, rules, procedures, systems, organizational structures that govern the budgeting process. Having responsibilities in areas such as education, social services, and environmental well-being, local government is a major player in the delivery of public services. The financing for current and capital expenses of local interest is ensured: (1) entirely from the local budget (depending on subordination); (2) extra budgetary incomes and subsidies granted from the local budget, and (3) entirely from extra budgetary incomes (Matei, 2009). Therefore, public sector budgeting in Romania has changed radically in recent years due to global economic crisis and reforms of public administration.

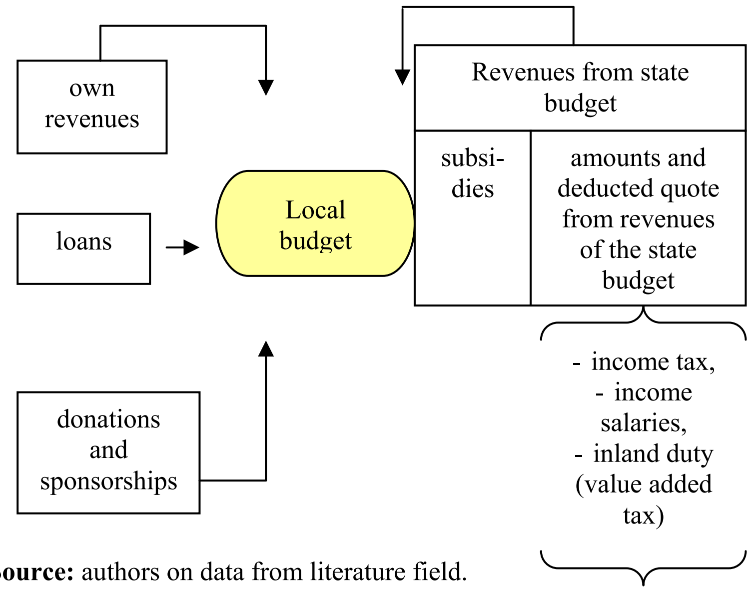
Budgeting mechanisms help the leaders of local public administration to restrict managerial discretion and therefore to mitigate the public administration's problems. The budget must be made to ensure that it fits the government policies and priorities. The budget is both an instrument of economic and financial management and an implicit policy statement, as it sets relative levels of spending for different programs and activities (Dumitrescu, 2012, pp. 23-26). A good budget process is not an exercise in balancing revenues and expenditures for one year period, but it is a plan that allocates resources on the basis of identified goals. According to Government Finance Officers Association (1998, p. 3) a good budget process is characterized by several essential features, namely: (1) incorporates a long-term perspective, (2) establishes linkages to broad organizational goals, (3) focuses budget decisions on results and outcomes, (4) involves and promotes effective communication with stakeholders and (4) provide incentives to government management and employees.

2. Budgeting mechanisms in Romania

2.1. Economics perspective on budgeting

Financing the economic and social activities on a central or local governance level is mainly performed through public budgets (Matei and Dinu, 2009, p. 1). A budget is defined as the formal expression of plans, goals, and objectives of management that covers all aspects of operations for a designated time period (Shim and Siegel, 2008, p. 1).

From an economic perspective, the budget is a financial tool providing targets and directions, but in order to carry out relevant results and to help managers for achieving their activities it must operate effectively and efficiently. According to Matei and Dinu (2009, p. 1) the public budget, no matter the level at which it is constituted, becomes a tool of economic and social policy with multiple attributes, the most important one being the balance between two components: revenues and expenditures. On the one hand (Matei, 2009, p. 24), the revenues of local budgets comprise: (1) own revenues from: taxes, charges, contributions, other payments, other revenues and shared amounts from the income tax; (2) shared amounts from some revenues of the state budget; (3) subsidies from state budget and other budgets; (4) donations and sponsorships. On the other hand, local public expenditure represents „the ensemble of annual expenditure with public nature of a country, financed on the basis of public budgetary resources (Dobrotă, 1999, p. 98). So, from and economic perspective we can draw the following structure of local budget:



Source: authors on data from literature field.

Figure 1. *The structure of local budget*

In the specialized literature (Matei and Săvulescu, 2009, p. 7; Matei and Săvulescu, 2009, p. 7) public expenditures are grouped depending on different administrative or economic criteria. An administrative classification of expenditures could be as follows: (1) organic, when expenditures are grouped depending on institutions: ministries and other central bodies, administrative - territorial units, other public institutions, and (2) functional, when expenditures are grouped depending on the profile of the activity of public institutions: public power and general administration, justice and police, international relations, army, culture, education, social actions, economic actions. From economic criteria, the classification is: operational expenditure, transfer expenditure and investment expenditure.

In this context, public budgeting is a mechanism within government that seeks to allocate resources. It is a technique resulting in systematic management in order to achieve the established objectives. In other words, budgeting is a complete expression of the planning operations of the organization for a specific period.

Budgeting is a form of planning and policy development considering resource constraints. It is a planning mechanism and may look at "what - if" scenarios (Shim and Siegel, 2008, p. 23). Budgeting has been described as being "at the core of the financial process within a local authority" (Hale and Capaldi, 2003, p. 309). Many of economic perspectives on budgeting are based on traditional rational model of decision-making, characterized by the immense calculative complexity of alternative, a rigorous cost-benefit analysis, with a strong planning and programming system. In practice this model has been very difficult to implement determining the local reforms to take into consideration the changing of this. Thus, for a long time, budgeting has been dominated by the practice of incrementalism (Seal and Ball, 2008, p. 5), but starting with the middle of 1990s, a new paradigm arises, called New Public Management. This new paradigm picks holes in incrementalism, providing a new alternative to the managerial approach of public administration, but concentrated mainly to performance improvement and budgetary sustainability.

2.2. Legal perspective on budgeting

From the state budget by the budgets of main credit release authority transfers an amount of money to local budgets in order to finance some development or social programs of national, county or local interest, which are approved, annually, in global form, by the Law on state budget. The local public finances have been reshaped starting with Romania's Integration in the European Union by the entrance in force of the local public finances' Law. The elaboration of a new law on local public finance has been also determined by the requirement of improvement the principles and budgetary procedures relying on the European countries' experience and, particularly on the financial rules applied to the European Union's budget. In this way, four new principles were introduced: the principle of local financial autonomy, the principle of consultancy, the principle of proportionality and the principle of solidarity (Ichim, 2007, pp. 57-58).

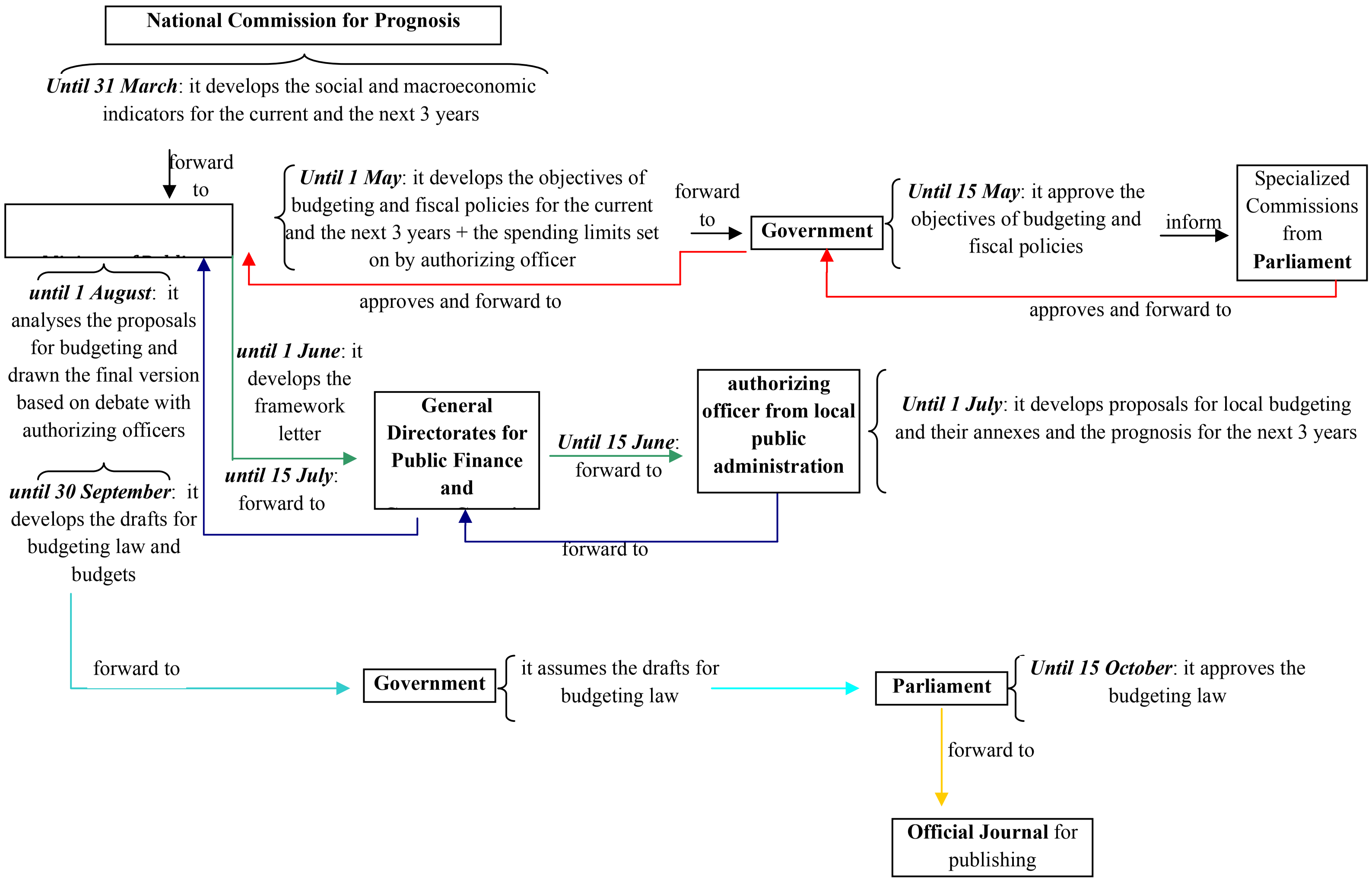
The legislation in this area comprises the following: (1) Law no.215/2001 on local public administration; (2) Law no. 273/2006 on local public finance; (3) Law no. 500/2002 on public finance; (4) Government Ordinance no. 92/2003 on the Fiscal Procedure Code; (5) Law no. 92/2003 on the Fiscal Code, and (6) Annual budget law (see Figure 2).

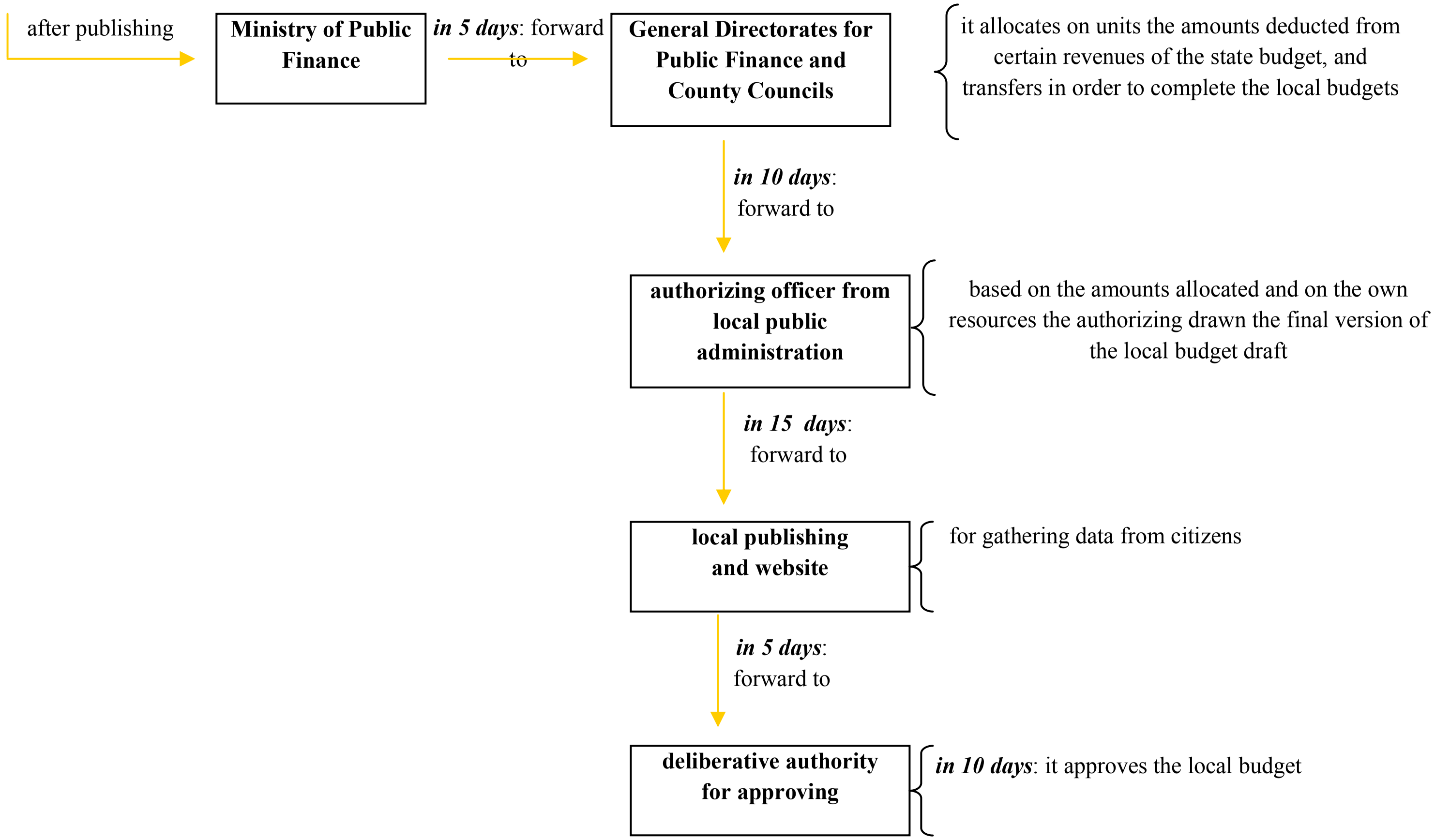
Law no. 273/2006 takes most of the provisions of the old law, clarifies many aspects and introduces clear rules (a formula, a mechanism) to allocate resources in a balancing way from state budget to local budgets (transfer) cutting out a part of the county councils' influence, more often a political one. Articles no. 32 and 33 comprise the main provisions regarding the allocation of resources towards local public administration, drawing two important budgeting mechanisms.

The first mechanism (art. 32) defines how to directly share the income tax (revenue paid on earnings) based on collection area. Thus, from the income collected to the state budget at each administrative-territorial unit's level is monthly transferred within 5 working days after the end of the month in which income has been collected, a quota of 44% to the local budgets of communes, towns and municipalities whose territory operate the taxpayer, a quota of 12% to the budget of county and a quota of 21% in a separate account, opened on behalf of General Directorates of County Public Finance for balancing the local budgets of communes, towns and municipalities, respectively the budget of county. So, a quota of 77% from income tax collected at administrative - territorial units' level is allocated directly as shared income to local and county councils' budgets.

The second mechanism (art. 33, paragraphs 1-7) defines the allocation's way of balancing transfers for local budgets. The main goal of this mechanism is allocation of some deducted amounts for financing the public expenditures, as well as the balancing of local budget of administrative-territorial units. The mechanism consists on two stages: (1) transfer from central to territorial (county) level and (2) from county to local level. Balancing the allocation to counties is made through annual budget law using two criteria: (1) fiscal capacity per person at county level, based on income tax, weighted 70%; (2) area of county, weighted 30%. The last mechanism presented has the scope to make more predictable and transparent the allocation process of budget balancing.

Taking a look to the provisions of annual budget laws after the entrance into force of the law no 273/2006 until now, we will remark significant changes of the amount and the rules from one year to other. Although, the legislative accountability has continued to govern the administration of budgets today, in addition, budgeting has acquired dimensions of economic planning and key instrument of national policy-making worldwide.


National Commission for Prognosis
Until 31 March: it develops the social and macroeconomic indicators for the current and the next 3 years
forward to
until 1 August: it analyses the proposals for budgeting and drawn the final version based on debate with authorizing officers
until 30 September: it develops the drafts for budgeting law and budgets
Until 1 May: it develops the objectives of budgeting and fiscal policies for the current and the next 3 years + the spending limits set on by authorizing officer
forward to
Government
Until 15 May: it approve the objectives of budgeting and fiscal policies
inform
Specialized Commissions from Parliament
approves and forward to
approves and forward to
until 1 June: it develops the framework letter
until 15 July: forward to
General Directorates for Public Finance and
Until 15 June: forward to
authorizing officer from local public administration
Until 1 July: it develops proposals for local budgeting and their annexes and the prognosis for the next 3 years
forward to
forward to
Government
it assumes the drafts for budgeting law
Parliament
Until 15 October: it approves the budgeting law
forward to
Official Journal for publishing



Source: authors on legal framework regarding public finance.

Figure 2. *Planning and budgeting process*

3. Advantages and short comings of budgetary mechanisms

Looking at the budgetary mechanisms presented above, we can observe a series of advantages and disadvantages of the budgeting process. Since budgeting is a future-oriented activity, it relies mainly on prognosis, which is always corrupted by a degree of mathematical uncertainty. This uncertainty derives from the statistical model used, but also from the validity of the mathematical assumptions that are the basis of the forecast.

Also, prognosis is subject to interpretation, which is prone to blur its accuracy. Interpretations can disturb the meaning of the figures calculated within the forecast, but also, can corrupt the mathematical assumptions on which it relies (Popa, 2010, pp. 17-23).

There are two ways of diminishing the negative influence of mathematical uncertainty and of the errors induced by faulty interpretations of figures: (1) setting up scenarios (as in worst and best case scenario, what if analysis and so on) (King, 2005, pp. 123-141), which will determine the acceptable margins of variation, or, if these are established by law, will determine to see, whether the budget is well within these margins, and (2) orientation of the budget towards activities, and rely less on the figures of past years.

Another sensible issue of budgetary processes refers to transfers from the state budget to the local budget. In principle it is a very simple method for local communities to fill out the deficits between incomes and expenditures, which almost every time will affect local public investments. By subsidizing some activities, certain amounts of the local revenues can be transferred to other activities, such as financing investments.

However, there can be several problems, especially if the governmental development strategy differs from the local one. Local communities in Romania, for example, have accused in the last years a significant drop in allocations from the state budget. It is not necessary for the two strategies to be coherent, since communities do not develop at the same pace and in the same direction as the state (usually, communities develop faster than nations) (Klimovsky, 2013, pp. 15-17). Lacking coherence to the state development, local communities must match some aspects of their development strategies (Iancu, 2013, pp. 73-86) according to the variations in budgetary allocations by the state.

Also, there might be issues with the criteria used to distribute the money. As a rule, communities that contribute with higher amounts per capita to the local budget, will get more funds allocated by the state. Also, the allocation is made in accordance to the area of that community. It must be said, that these criteria of allocation show a great degree of objectivity, which makes them suited to be written down in the form of laws, making them comprehensible on one hand, and applicable on the other.

This is a problem especially for the poorer communities, which do not contribute per capita as much to the state budget. It is, however, usually these communities who are in need of greater allocations from the state budget, in order to sustain their own development programs. Given this, poorer communities rely more on government programs of regional development, since they are not able to sustain investments themselves.

A last aspect refers to the approach used in order to set up yearly budgets. The preferred method of budget setup is taking the budget from past periods and weighting it with forecasted figures. There are two main advantages to this method: (1) it is the most simple method of budget setup and (2) the method offers coherent budgets from one year to the other, which can be easily justified and asserted.

There are also some downsides to this method: (1) by using this method it is very difficult to correlate the budget to the local strategies; (2) a budgetary execution based on such a budget is very rigid and interferes with the reaction capability of the community to various stimuli coming from the its environment and (3) the budget is susceptible to the uncertainty of the predictions, as mentioned at the beginning of this chapter.

A local community must take into account existing needs of its citizens and correlate them with what local authorities can offer in matter of public services (Mulgan, 2009, pp. 234-235). That is why a budget must offer a certain degree of flexibility, and at the same time, must respect the legal framework that defines it.

4. Conclusion

"To be strategic is to take the future seriously, and to resist the myopia that particularly affects institutions facing intense pressures to be accountable for present actions" (Mulgan, 2009, p. 235). In this regard, budgets are an important tool of the public sector, at local and central level, for modeling the future. Budgets are no less that a mirror of the strategy of an entity, institution, state or even a supranational organization. They reflect tendencies, and make statements on the health of local, regional, national or even European organizations.

Acknowledgements

This paper has been presented at the 3rd *International Symposium "Shaping Europe 2020: socio-economic challenges", Bucharest, 15th-16th November 2013,* organized by Pro Global Science Association, and is a part of a greater research within the Exploratory Research Project no. R 932/20/12/2012, "Instruments and Mechanisms for Evaluation and Efficiency Growth of Rational Resource Allocation Processes in Territorial Administrative Units".

References

Dobrotă, N. (coord.) (1999). *Dicționar de economie*, Editura Economică, Bucureşti

Dumitrescu, A. (2012). *Audit şi contabilitate. Baze ale performanței în administrația publică*, Editura Economică, Bucureşti

Hale, R., Capaldi, A. (2003). *Councillors' Guide to Local Government Finance*. London: CIPFA

Iancu, D. (2013), "Local reforms by political conditionality: trials and errors in Central and Eastern Europe", *Theoretical and Applied Economics,* vol. XX, no. 1 (578), pp. 73-86

Ichim, C. (2007). "The principles of the local budgetary process in the light of the new law of local public finances, in Romania's Integration in the European Union. Opportunities & Challenges", *Theoretical and Applied Economics. Supplement*, vol. II

King, R.F. (2005). *Strategia cercetării*, Editura Polirom, Iaşi

Klimovsky, D. (2013). "Local Public Reforms in Central and Eastern Europe: Agendas for the Future?", in Iancu, D.C. (ed.), *Local Reforms in Transition Democracies*, Institutul European, Iaşi, pp. 15-17

Matei, A., Dinu, T. (2009). "Improvement of Government Financing through Non-Conventional Methods: Reducing the Administrative Costs in the Public Sector", *MPRA, no. 18905, online at* http://mpra.ub.uni-muenchen.de/18905

Matei, A., Săvulescu, C. (2009). "Enhancing the efficiency of local government in the context of reducing the administrative expenditures", *MPRA*, no. 17640, online at http://mpra.ub.uni-muenchen.de/17640/

Matei, A., Săvulescu, C. (2009). "The Impact of Reducing the Administrative Costs on the Efficiency in the Public Sector", *MPRA*, no. 19018, online at http://mpra.ub.uni-muenchen.de/19018/

Matei, L. (2009). *Romanian Public Management Reform Theoretical and Empirical Studies*, vol. 1, Editura Economică, Bucureşti

Mulgan, G. (2009). *The Art of Public Strategy. Mobilizing Power and Knowledge for the Common Good,* Oxford University Press, New York

Popa, M. (2010). *Statistici multivariate aplicate în psihologie*, Editura Polirom, Iaşi

Seal, W.B., Ball, A. (2008). *Reinventing Budgeting: The Impact of Third Way Modernisation on Local Government Budgeting*. Great Britain: Elsevier Ltd.

Shim, J.K., Siegel, J.G. (2009). *Budgeting basics and beyond*, 3rd edition USA, John Wiley & Sons, Inc.

Government Finance Officers Association (1998). *Recommended Budget Practices: A Framework For Improved State and Local Government Budgeting*. USA: GFOA