

Case Study

Albania

Linking the Medium-Term Expenditure Framework and the GPRS¹

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This study forms part of a multi-country study assessing the design and application of the medium-term expenditure framework (MTEF) as a tool for poverty reduction in selected African countries.

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¹ The full version of the PRSP in Albania is called Growth and Poverty Reduction Strategy (GPRS)

Introduction

1. This case study considers the experience with the introduction of the first medium-term expenditure framework (MTEF) in Albania covering the period 2001-03. The case study is relevant since an explicit objective in introducing the MTEF was to provide a mechanism for translating policy priorities identified through the GPRS into budgetary policy and actions, while also providing a realistic macro-fiscal framework within which to develop the GPRS proposals. A further objective has been to promote greater transparency and accountability in the budget process. The development of the MTEF and the GPRS had to take place with considerable institutional capacity constraints both in the Ministry of Finance (MoF) and line ministries, which had to be taken into account in the design of the process. Despite consequent limitations in its scope and analysis, Albania's first MTEF was regarded by the MoF as a considerable success and highly influential in the setting of the 2001 Budget. Subsequent rolling forward of the MTEF in 2001 and 2002 sought to address some of the weaknesses in the initial MTEF and to make the framework a more operational instrument to support the preparation of the annual budget.

Country Context

2. *Economic context.* The economic transition in Albania has followed a somewhat different course from other transition economies, and was characterised by short-lived economic collapse followed by sustained economic recovery. During this period, the Albanian economy has gone through four distinct phases:

- The early years of transition (1991-92) were dominated by a contraction of real GDP and by high inflation. By the end of 1992, output in real terms had fallen to about 60% of its 1989 level, inflation had risen to triple digits and the fiscal deficit amounted to 25% of GDP.
- The period 1993-96 was characterised by a significant economic recovery. GDP grew by about 9% annually in real terms, inflation fell substantially, and the fiscal deficit improved significantly. However, with the slippage of stabilisation policies during 1996 the economy began to show early signs of a collapse.
- In early 1997, large pyramid investment schemes, which had been building up since 1993, collapsed, bringing the country into a state of anarchy. The resulting turmoil brought economic activity almost to a standstill, real GDP contracted by 7% and inflation more than doubled compared with the previous year.
- The new Government that came to power in the aftermath of this crisis initiated a post-crisis recovery program of structural and fiscal reforms. Implementation of the programme facilitated strong economic performance in 1998-2000. In 2000 output grew by 7.8% and inflation was 4.2%.

3. While the Government had good success in imposing fiscal discipline in the wake of the crisis in 1997, several priorities for fiscal management became clear. First, on the fiscal policy side, the reliance on domestic financing of the budget deficit needed to be reduced in order to keep inflation low and limit the level of interest payments. This, in turn, required improving the revenue base and reorienting expenditures towards the Government's objective of sustaining high rates of economic growth and achieving durable poverty reduction. Second, the process of public expenditure management needed to be changed in order to improve the incentive structure and functioning of budgetary institutions so that improvement in the technical and allocative efficiency of public expenditures could be realised. This

would also help to align the Government's overall policy objectives with its public expenditure allocations and allow for greater transparency and accountability in budgetary decision making.

4. *Public Expenditure Management system.* Albania has made substantial progress in reforming its budget management system including the introduction of a revised legal framework, improved macroeconomic and fiscal management capacities, improved budget preparation procedures, and a relatively well functioning Treasury system that has been in operation since 1993. These initial reforms have helped to establish a budget system that has managed to control and monitor revenues, expenditure aggregates, and the fiscal deficit, albeit assisted by IMF economic programs that have provided an external accountability mechanism. Consistent with these reforms, the role and functions of the Budget and Treasury Departments in the Ministry of Finance (MoF) have expanded tremendously. Today they play a central role in budget management and in the formulation of budget policies, planning, and the allocation of resources consistent with a macroeconomic framework.

5. Budget preparation begins with the formulation of the macroeconomic framework, which is agreed with the IMF and defines the aggregate resources that the Government is expected to have available for its next budget year. Allocations are distributed from the central budget department to the line ministries and other central agencies. Line ministries further allocate the budget funds to the spending units under their responsibility according to a GFS compatible budget classification.

6. The state budget covers both central and local government budgets. In recent years about 20 percent of the expenditures in the state budget were allocations for lower levels of government mostly in the form of conditional grants. Moreover, the budgets of the Social Insurance Institute (SII) and the Health Insurance Institute (HII) are consolidated with the state budget for reporting purposes.²

7. The decision making process for the budget begins with the submission to the Economic Policy Committee (EPC) of the draft annual budget prepared by the MoF.³ After being reviewed by the EPC the draft budget is sent for discussion and approval to the Cabinet. The Cabinet approves the draft budget which is then submitted to the Parliament to become the annual budget law.

8. The Albanian budget is executed through the Treasury system which operates through a Treasury Single Account (TSA) that processes and records budget expenditure transactions. The Treasury exercises an effective control on budget institutions' spending limits, although challenges remain with regard to improving financial planning and cash management as well as the information technology that supports the systems.

9. The Organic Budget Law (OBL) requires that the budget accounts be audited every year. The annual audit is conducted by the Supreme Audit Institute (SAI), which is the independent external auditing body. The SAI undertakes its audit after the MoF provides it with consolidated budget expenditure accounts and reports audit results to the Parliament after the MoF reports on the actual budget accounts of the previous year. Although the audit is conducted regularly, its quality needs improvements and audit results are not published or enforced. Internal auditing is almost non-existent, but its establishment has been initiated.

² The Institutes are, however, autonomous entities and their budgets are listed separately in the Budget Document.

³ The Economic Policy Committee is chaired by the Prime Minister and is made up of a subset of Ministers. It includes the Minister of Finance, Economic Cooperation and Trade, Transport, Agriculture, Public Works, Health, and Social Protection, and the Governor of the Central Bank. Depending on the issues to be discussed other Ministers and technical staff can be called as necessary.

Institutional structure for the MTEF and GPRS

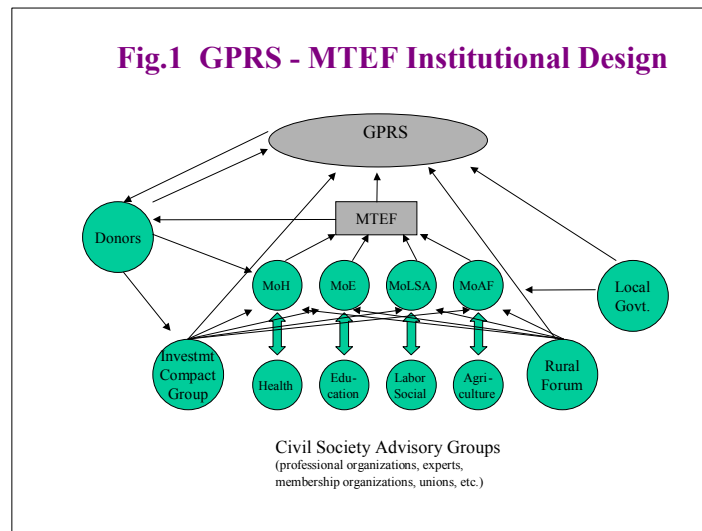
10. Against this background, the Albanian MoF took the decision, in November 1999, to proceed with a second generation of reforms for improving public expenditure management. The MoF's intention was both to provide a stronger and more predictable framework within which to plan its annual budget and to strengthen the linkages between government policies and budgetary resource allocations. Work on preparing the first MTEF commenced in February 2000 and the draft MTEF covering the 2001-03 period was completed by June. Preparation of the MTEF begun in parallel and was closely linked to the development of the Government's Interim Poverty Reduction Strategy Paper (I-PRSP) which was completed in May 2000, and later of the full PRSP completed in 2001. Thus the policies and strategies identified in the I-PRSP influenced the expenditure priorities identified in the MTEF as well as the choice of sectors for more detailed expenditure analysis in future cycles. The subsequent updates of the MTEF for 2001-2004 and 2002-2005 were also carried out in parallel with the preparation and update of the full GPRS in 2001 and 2002.

11. Joint institutional structures for coordination and management of the GPRS and the MTEF ensured close linkages, consistency of policy objectives between the GPRS and the budget, as well as consistency in decision making (Fig.1). The institutional structures for the preparation of the MTEF were a subset of the GPRS institutional structures. Both MTEF and GPRS institutional structures were composed of: (i) Steering Committee, (ii) Working Group, and (iii) Sector Technical Working Groups.

- **The Steering Committee for MTEF** is composed of the members of the Inter Ministerial Economic Policy Committee, while **the Steering Committee for the GPRS** was extended to include representatives of the Donor community and representatives of the Civil Society. They are both chaired by the Prime Minister, who guides the entire activity for the preparation and implementation of the GPRS and MTEF.

- **The Working Group**, set up by the Steering Committee, is responsible for the coordination of the operational activity of all institutional links in the process of the strategy's preparation and implementation. The composition of the Working Group for the MTEF consists of the deputy ministers and the Budget/Economic Programming department director from the Ministries of Finance, Health, Education, Labour and Social Affairs, Local Government and Decentralization, Agriculture, Public Economy and Privatization, Economic Cooperation and Trade, Transport, Public Works and Tourism. In order to utilize the existing local capacities, especially the civil society, the Working Group for the GPRS was expanded by appointing two non-government organizations as consultants for the preparation of the GPRS strategy, the Institute for Contemporary Studies, and the Institute for Fiscal Education.

- **The Sector Technical Working Groups**, set up in the aforementioned ministries, are responsible for the elaboration of the sector issues of both poverty reduction strategy (GPRS) and budget strategy (MTEF) and for the supply of relevant information. The Sector Technical Working Groups in the Ministries of Labour and Social Affairs, Health, Agriculture, and Education and Science are composed of 9-10 members; half of the members are representatives of the ministries from the MTEF sector working groups, while the other half are representatives of the Civil Society Advisory Groups.



Approach and Integration with the Budget Process

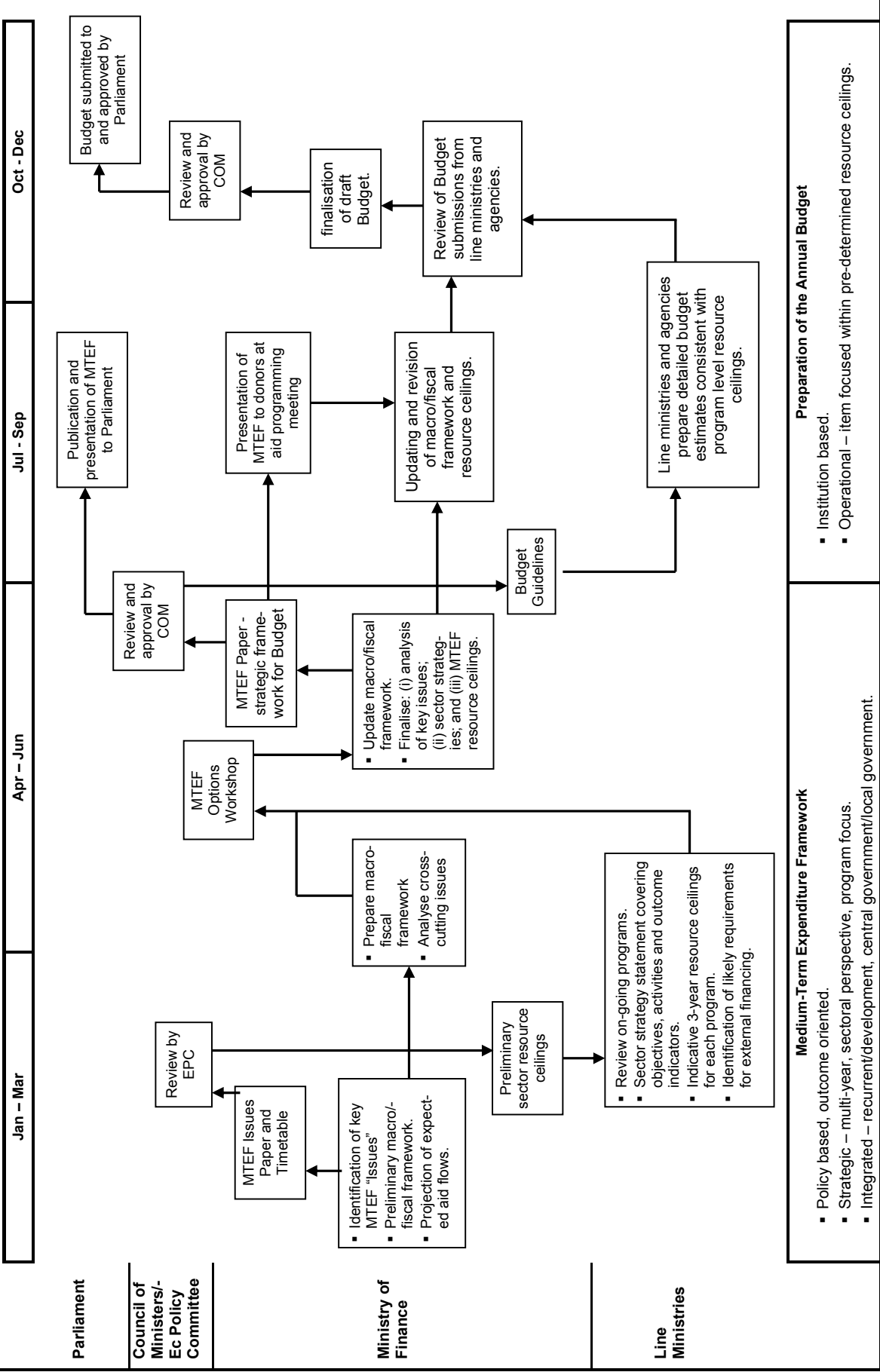
12. The approach adopted in developing the MTEF drew on international experience with the introduction of strategic expenditure planning in both OECD and developing countries. It also consolidated two previous initiatives in Albania: (i) the experiences, since 1993, with sector policy and program development under the Public Investment Programme (PIP); and (ii) an integrated exercise that was initiated on a small-scale during the Kosovo refugee crisis in 1999 to allocate additional budgetary support to priority areas. A further factor, particularly important in the Albanian context, was the very limited institutional capacities within the Albanian administration. This was both a legacy of Albania's recent past and a consequence of the high rates of loss of skilled personnel to the fast developing private sector and to emigration. It was therefore recognised that the MTEF process had to be developed in a way that limited its demands on already hard-pressed civil servants, but that allowed for its further development as institutional capacities are built up in future years.

13. Particular care was taken to ensure that the MTEF *was fully integrated into the annual budget cycle* and that the GPRS preparation also corresponded with the budget timeframe. This recognised that the MTEF, to be sustainable, would, from the outset, have to be an inseparable element of the budget process. Taking this requirement into account, it was decided that the MTEF should be prepared during the period February to May. It would then be approved by the Council of Ministers in June allowing its incorporation into the budget preparation guidelines that are required to be issued by 15th July. It was also decided that the MTEF would equate with the requirement under the 1998 Organic Budget Law for the Minister of Finance to submit to the Council of Ministers an updated budget outlook by 15th June. The Inter-Ministerial Working Group monitored the preparation of both the MTEF and the GPRS as described

above. The Deputy Minister in the MoF exercised day-to-day management of the MTEF process and co-ordination with line ministries. The strong commitment and active involvement of the Minister of Finance also facilitated co-ordination.

14. In order to emphasise the place of the MTEF within the budget cycle and the role of the different agencies in its preparation, a revised budget calendar was developed and circulated by the MoF to ministers and line ministries before preparation of the MTEF commenced (Box 1). Consistent with that calendar, the preparation of the GPRS took place during the first half of the year so that poverty reduction objectives and policy priorities identified in the GPRS could be included in the MTEF.

Box 1: ALBANIA: MEDIUM-TERM EXPENDITURE FRAMEWORK AND BUDGETING CYCLE



Stages in Preparing the MTEF and linkages with the GPRS

15. Based on the revised budget calendar, the process for the preparation of the MTEF in Albania went through the following stages.

Initiation - MTEF Issues Paper

16. Initiation of preparation of the MTEF commences in February each year, starting in 2000, with the presentation of the MTEF Issues Paper to the Economic Policy Committee (EPC) of the Council of Ministers. The paper (i) sets out the timetable for preparation of the MTEF; (ii) identifies the certain policy choices and public expenditure issues to be analysed; and (iii) provides preliminary estimates of the resource framework and its implications for sector policies and strategies. The discussion of the MTEF at this stage serves to emphasise the importance attached by the MoF to the exercise and raise awareness of ministers about its role within the budget process. This has greatly facilitated the subsequent participation of the line ministries in the development of the MTEF proposals.

Preparation - Development of the MTEF Analysis

Development of analysis for the MTEF is divided into four elements and is undertaken over a three month period, beginning mid-February:

- Elaboration of the macro-fiscal framework for public expenditure to provide the basis for projecting public expenditure allocations for. *These allocations also provide a ceiling for the poverty reduction priorities and programs identified in the GPRS to be financed from the budget.* Given the limited macro and fiscal forecasting analysis capacities, this was based on the framework provided by the IMF program⁴. Preparation of the macro-fiscal framework involved the following steps: (i) analysis of trends and developments in the real economy and their implications for public sector revenues and public expenditure demands; (ii) analysis of domestic revenue trends and issues, assessment of the likely impact of new revenue initiatives and measures, and preparation of revenue projections; (iii) assessment of trends and issues in external project financing and preparation of projections of commitments and disbursements; (iv) projections of external budgetary support and domestic borrowing; (v) assessment of foreign and domestic borrowing projections in the context of overall fiscal sustainability; and (vi) setting of the consolidated budget resource framework for the coming three-year period.
- An analysis of cross-cutting public expenditure issues. These included initiatives such as the poverty reduction strategy, public administration reform, the anti-corruption initiative, and decentralization process that involve interventions in a number of sectors. They also included an analysis of the economic categories of expenditure such as the public sector wagebill, operations and maintenance spending, entitlement program, subsidies and investment. Particularly important issues in the Albanian context are: (i) the analysis of fiscal implications of public administration reform, (ii) the impact of public sector wage settlements; (iii) the balance between wagebill and operations and maintenance expenditures; (iv) the fiscal sustainability of social protections entitlements; and (v) subsidy payments to the Albanian Energy Corporation (KESH).
- Development of sector expenditure strategies, the aim of which was to ensure that public expenditure allocations were driven by sector policies and program priorities *as identified in the GPRS*, and that resources were effectively utilised within sector programs. The MTEF

⁴ As macroeconomic analysis and forecasting capacities are built up in the MoF, the macro-fiscal framework should increasingly reflect the Government's own forecasts and analysis.

focuses on five main sectors that together account for almost two thirds of total public expenditure. These include health, education, social protection, transport and municipal infrastructure/public utilities. The initiation of these strategies was preceded by an analysis of recent expenditure trends in each sector and expenditure allocations between the main program areas (Box 2). The strategies were required to be summarised in a matrix format in order to provide a concise but rigorous analysis and to enable comparisons to be made across sectors. A four column matrix was adopted showing against each of the program areas within the sector: (i) the current situation and key budgetary issues; (ii) the role, objectives, and policies of the government; (iii) the priority actions to be taken during the 2001-03 MTEF; and (iv) the implications of these actions for public expenditure allocations.

Box 2: Preparation of the Sector Expenditure Strategies

The MoF guidelines stated that the preparation and updating of sector expenditure strategies was an integral part of the annual MTEF/Budget cycle to be undertaken during February to April. The guidelines identified a sequence of four distinct stages in the preparation of the sector expenditure strategies:

Stage 1. Setting indicative resource guidelines which indicate the expected order of magnitude of future public spending in the sector and which also show how existing resources are allocated between the key programs areas within the sector. The guidelines envisaged that this analysis would be contained in a short background note prepared by the MoF for each of the sectors in which strategies were to be prepared.

Stage 2. Summarising the overall policy objectives for the sector and identifying the main programs areas through which these objectives would be achieved.

Stage 3. Carrying out for each of these program areas:

- an assessment of the current situation and key issues to be addressed, focused on the way in which resources are currently utilised;
- a statement of the specific objectives and policies to be pursued;
- an analysis of the role of government distinguishing: (i) between central and local government responsibilities; and (ii) between those areas in which the government plays a regulatory or facilitating role and those in which it is responsible public service delivery.
- an assessment of the implications for future public expenditure allocations both in terms of the share of total sector resources and the measures necessary to ensure more effective use of existing resources;
- a presentation of the priority measures to be taken over the coming three years and the changes in resource allocations necessary to realise these measures.

Stage 4. Providing recommendations for how allocations should change over the coming three year period, taking into account existing patterns of resource use as well as the results of the analysis from the previous stages.

The preparation of the sector expenditure strategies was co-ordinated by sector working groups (SWGs) chaired by the line ministry and including representatives of other ministries and line agencies involved in the sector as well as of the MoF. In the context of the GPRS preparation, sector strategies were then discussed with the Civil Society Advisory groups, in order to get their opinion and feedback on the issues and priorities identified (Box 3). This process culminated in a sector strategy workshop to agree on: (i) the priorities between the program areas consistent with sector policies; and (ii) recommendations for future budgetary allocations. Thereafter, the sector strategy was finalised and formally submitted to the MoF. The MoF then consolidated the sector strategies and set out its proposals for sector resource allocations under the MTEF.

- Development of expenditure plans consistent with both the macro-fiscal framework and the sector expenditure strategies. These comprised two principal components:
 - ◊ Planned allocations for each of the main components of public expenditure covering recent trends and projections for (i) statutory and discretionary expenditure broken down

between the main economic categories of public spending; (ii) central and local government spending; and (iii) budgetary and extra-budgetary spending.

- ◇ Sector expenditure plans showing past and projected spending across all sectors. In the sectors for which expenditure strategies had been prepared, guidelines were also provided as to how resources should be allocated between the main program areas.

Box 3: Consultations with the Civil Society Advisory Groups

The GPRS/MTEF Working Groups held a number of meetings with the Civil Society Advisory Groups to make an accurate assessment of poverty issues and the potential for growth in the relevant sectors as well as to identify possible solutions and the way they could be reflected in the GPRS/MTEF. After becoming familiar with the nature and character of the GPRS/MTEF and having a clear idea about their contribution, each of the Civil Society Advisory Groups appointed 4-5 members to represent the group on the Technical Sector Groups, which had a combined staff with members from the ministries and the civil society. The groups conducted 37 meetings during January-June 2000 period, including the meetings of the Civil Society Advisory Groups and the meetings of the Technical Sector Groups with the high officials of the Ministries. This process culminated with a one-day workshop that took place in mid-April. In the workshop the representatives of the civil society coordinated their efforts with the officials of the Ministry of Agriculture, Ministry of Labor and Social Affairs, Ministry of Education and Science, and the Ministry of Health to prepare the final declarations on the strategic priorities of the relevant sectors.

Budget Options Workshop

17. Once the technical work in developing the MTEF analysis is completed, a “Budget Options Workshop” is organised to review the draft MTEF proposals and planned resource allocations. This is usually held at the end of May with over 50 participants attending comprising deputy ministers, senior ministry officials and representatives of civil society. The discussions tend to highlight a number of important public expenditure issues where further analysis is needed.

18. By bringing the discussion of sector expenditure programs into a common forum, the Budget Options Workshops have succeeded in highlighting the trade-offs that should be made between sectors in establishing appropriate budgetary resource ceilings. It thereby considerably facilitated subsequent discussion of the MTEF and GPRS in the Steering Committees, especially the Economic Policy Committee.

Finalisation and Approval of the MTEF Document

19. Immediately following the Budget Options Workshop and the consultations with the Civil Society Advisory groups, the MoF tried to incorporate the revised proposals into the draft MTEF document. The MTEF document is submitted through the Economic Policy Committee and to the full Council of Ministers in June. The MTEF is then used as the basis for developing the detailed guidelines for the preparation of the 2001 Budget that are issued in July. Specifically, the guidelines required that line ministries reflected the MTEF spending priorities and resource ceilings in their budget submissions and indicated that MoF would be evaluating budget requests for consistency with the MTEF/GPRS policy objectives. The first full GPRS slipped the mid-year schedule for approval. It was presented to a wider forum of civil society in September 2001 and sent for final approval to the Council of Ministers in December. However, given the common institutional arrangements and the close cooperation between of the MTEF and GPRS working groups, the MTEF for 2001-2003 was able to reflect the priorities identified in the GPRS.

Preparation of the 2001 Budget

20. Following approval by the Council of Ministers, the MTEF is used as the basis for preparing the guidelines for the 2001 Budget which are issued by the MoF at the beginning of July. These emphasise that line ministry budgets would have to be prepared in conformity with the policy directions and sector resource ceilings contained in the MTEF. They also required that budget proposals in the five pilot sectors be consistent with the sector strategies prepared under the GPRS. Policy priorities are further emphasised in a public statement made by the Prime Minister regarding the spending priorities for the annual budget.

21. The draft Budgets that were presented to Parliament for the last two years followed closely the recommendations of the MTEF and were considered by the MoF to be consistent with the framework. Where variations occurred these were mainly attributable to subsequent updating of the macro-fiscal framework as well to changes in the budget classification system. Variations tended to be greater for investment expenditures than for recurrent expenditures. This reflected both the “lumpiness” of expenditures on major public investment projects as well as the difficulties that the MoF had encountered in projecting forward planned expenditures on externally financed projects.

Presentation of the MTEF to Parliament and to Donor Agencies

22. The original timetable for the MTEF included provision for it to be presented to and discussed in Parliament, with the aim of allowing Parliament the opportunity to review the government’s overall public expenditure strategy prior to considering the detailed proposals for the 2001 Budget. It was considered that this two-step approach would enable Parliament to consider the draft Budget in a more strategic policy context than had previously been the case. In practice, the MoF decided not to present the initial MTEF to Parliament since it wanted first to consolidate understanding within the Government of the role and importance of the MTEF. However, through the GPRS consultations with the Parliament, members of various sectoral committees became familiar with the main policy directions to be included in the MTEF.

23. Because of the important role played by donor financing in Albania⁵, it was also decided to present the MTEF at a conference with Albania’s principal donor partners. The objective of this consultation was to emphasise to donor agencies that their assistance was part of the overall strategy for poverty reduction presented in the GPRS and public expenditure program. Therefore needed to be planned within the context of the MTEF. In the event, this consultation took place somewhat later than originally planned, in December after the 2001 Budget had been finalised. The Conference Declaration emphasised the role of the MTEF in translating sector policy objectives and the poverty strategy into public expenditure allocations and in providing a framework for aid co-ordination. It also signalled strong donor support for the initiative. Annex 1 presents a summary of the Albania’s MTEF for 2001-2003. Since then, the MTEF has been rolled over for 2002-2004 and is currently being prepared for 2003-2005.

Assessment of the experience for linking the GPRS and the MTEF

24. Despite the tight timetable, the fundamental changes implied for the budget process, and the limited capacities in both the MoF and the line ministries, the initial MTEF exercises have achieved considerable success.

- **The MTEF brought a much sharper focus to the preparation of the annual budgets**, it increased the level of analysis in the preparation of the budget and there was strong political

⁵ Aid flows were equivalent to round 4.6% of GDP in 2000.

endorsement for the proposals to increase spending on education, transport, and infrastructure maintenance.

- **The MTEF opened the budget process to a broader constituency within the government** and increased cooperation between the Ministry of Finance and line ministries. This increases transparency in the formulation of budget policies and decision making and can be used as a platform for increasing demand for better budget performance in the public sector and better accountability. The budget is no more a taboo of the MOF.
- **The MTEF provided a regular forum for discussing systematically cross-cutting expenditure policy issues** such as those for poverty reduction, pay and employment, fiscal decentralization, public investment and presenting various policy options and their cost estimates for inclusion in the annual budgets.
- **The MTEF provided a possibility for increasing ownership of the GPRS** since poverty reduction policies were reflected in the MTEF and therefore in the annual budgets. This also creates a possibility for securing adequate financing through the regular channels of government activity and creates a forum for better coordination of donor activities.
- **The MTEF provided a systematic forum and the discipline imposed by the budget for prioritization and costing of the GPRS programs.** By bringing poverty reduction policies and programs into the regular decision making channels of the government there is more likely to reach and sustain consensus on policy priorities and improve predictability in funding different programs, while achieving realism on their cost implications.
- **The MTEF/GPRS created an opportunity for improving the classification of budget expenditures** and using a program classification (in addition to the functional and economic) for identifying programs and their objectives as well as making possible their costing in the medium term. This program structure was used to further disaggregate sector resource ceilings in the MTEF and annual budget, during 2002 and especially for setting meaningful outcome indicators and performance targets.

Not surprisingly, there were a number of weaknesses in the exercise that will need to be addressed in future years. These included:

- **The lack of clear prioritisation within sector expenditure programs**, which limited the operational usefulness of the sector expenditure plans. This highlighted weaknesses in policy, planning and budgeting capacities in line ministries. Addressing these will be essential to the further development of the MTEF exercise and has been identified as a priority area for additional technical assistance in the context of the Government's public administration reform programme.
- **The limited progress toward an integrated approach to the analysis and budgeting of recurrent and investment spending.** This was reflected in the failure in the sector expenditure strategies to break investment spending down by the main program areas and the continued separation of responsibilities between the MoF and the Ministry of Economic Co-operation and Trade for preparation of the recurrent and investment components of the annual budget.
- **The limited extent to which some line ministries took account of the MTEF/GPRS proposals in their initial budget submissions**, which then had to be referred back for revision. This was probably due to their insufficient engagement in the preparation of the

sector expenditure strategies as well as to the lack of integration between the policy and programming and the budgeting functions in some ministries.

- **The limited extent to which the sector expenditure strategies identified budget outputs and monitorable indicators against which to monitor implementation performance.** This will take some time to address and will need to be done in the context of initiatives to improve programme design and monitoring in the line ministries.

25. A further issue was the extent to which the MTEF led to real changes in the budget preparation process. Here the results were mixed. In education, transport, and public works the quality of the budget presentations was considerably improved and clearly reflected the expenditure strategies. In health and social protection, little change was evident, with budget ceilings significantly exceeding resource ceilings and little attempt to reflect the program priorities contained in the MTEF. The Government fully recognised these limitations and the need to address them. In its planning for preparation subsequent 2002-04 MTEF, it: (i) sought additional technical assistance to assist line ministries with the development of their MTEF strategies to allow for more detailed analysis of resource allocations by sub-function/programme area; (ii) identified wagebill reform and fiscal decentralisation as key cross-cutting policy issues for which more detailed analysis is being undertaken; (iii) signalled its intention to further disaggregate sector resource ceilings by line ministry agency so that these could be incorporated into the guidelines for the preparation of the 2002 budget.

Lessons learned

A number of lessons have emerged from the experience of introducing a more strategic approach to budgeting and trying to link it with the GPRS in Albania.

- **Institutional arrangements** for the preparation of the sectoral strategies should be consistent in both exercises and part of the regular governing structures rather than ad hoc arrangements. Otherwise, there is a risk of creating unhealthy competition among various institutions and working groups, which could result in weak coordination and fragmentation of policy and decision making in the country. The central role of the Ministry of Finance and the budget system has to be recognized and used upfront.
- **Linkages with the budget cycle** are essential to ensure that poverty reduction priorities identified in the PRSP are reflected in the MTEF and ultimately in the annual budget. The timetables, therefore, for the preparation of the MTEF and PRSP should be very closely coordinated.
- **The openness of the MTEF to a participatory process associated with the PRSP** ought to be approached with caution and gradualism. It should be recognised that increasing transparency of the budget policies and decision making entails a change in mentality and behaviour, which if it is not approached gradually can turn into a chaotic situation that undermines the participation itself.
- **Decision making on the budget** should rest with the government and the government should ultimately have some space for internal consultations and decisions within its central bodies. If there is no space for the central executive to take decisions on priorities or various policy options, the credibility of the MTEF and the GPRS could be undermined by the inability of the government to act on its promises and implement policies. This can also create a very distorted accountability framework for achieving performance targets and good policy outcomes.
- **Sequencing the introduction of the MTEF** and applying it creatively in specific country circumstances is essential for its successful introduction and, especially, its sustainability. Such sequencing should not be rushed by institutional requirements for finalizing the PRSP document.

- **Prioritization and costing** will only be possible if the PRSP is linked to the budget and becomes an integral part of regular structures for policy formulation and decision making. It is the rigor of resource constraints and contestability of the budget process that forces prioritization.
- **Donor buy-in early in the process** can give a very positive push to the government's initiatives and create healthy external accountability mechanism for gradual improvements, where internal accountability environments are weak.

Summary of Albanian MTEF Proposals

26. The final MTEF proposals presented to the Council of Ministers comprised five principal elements. These were:

- the macroeconomic outlook and its expected impact both on the resources available to the budget and on public expenditure demands;
- the resource framework for the MTEF covering projections of government revenues, external financing and domestic financing;
- the expenditure framework for 2001-03 and issues related to the major economic categories of public expenditure;
- the analysis of sector expenditure priorities and resource allocations, with particular emphasis on the five pilot sectors; and
- the proposed sector resource ceilings for 2001-03.

27. The proposals presented against each of these elements are summarised in Box 3. These emphasised continued strong economic growth, improved revenue performance and reduced reliance on external budgetary support allowing overall public spending to increase by around 12% per year. On the expenditure side the share of GDP allocated to wagebill expenses was projected to increase allowing for substantial real increases in government salaries. Operations and maintenance allocations were also to be substantially increased in order to ensure that infrastructure was better maintained and public services better resourced. Social assistance transfers were to be sustained at the current levels of GDP with measures to be introduced to improve targeting. At the sector level, priority was to be given to increasing expenditures as a share of GDP in education and health, with substantially increased funding for road maintenance. Defence spending was to be further cut back, but at a more gradual pace than in previous years.

Box 3: Summary of 2001-03 MTEF Proposals	
Element	Projections and Proposals in 2001-03 MTEF
Macroeconomic Outlook	<ul style="list-style-type: none"> ▪ Economic growth of around 8% per year during 2001-03. ▪ Inflation controlled within the range of 2%-4%. ▪ Gradual reduction in the current account deficit. ▪ Rapid increase in public investment based on implementation of projects for which external financing has already been committed. ▪ Debt-service payments to remain at less than 10% of annual exports, foreign debt as share of GDP to remain unchanged.
Resource Framework	<ul style="list-style-type: none"> ▪ Balance to be struck between increases in public spending necessary to improve public infrastructure and services and achieving greater fiscal sustainability through reduced domestically financed budget deficit. ▪ Domestic revenues projected to increase from 22.5% of GDP in 2000 to 23.6% in 2003 linked to: <ul style="list-style-type: none"> (i) further improvements in VAT administration; (ii) enactment of the law on taxation of income; and (iii) expanded participation in the social insurance scheme and reduced evasion of contributions. ▪ External budgetary support to fall from 2.8% of GDP in 1999 to 0.6% in 2001 and be eliminated by 2003. ▪ Externally financed public investment to increase from 3.7% of GDP in 2000 to 5.7% in 2003 driven by the large carry forward of undisbursed commitments in the infrastructure sectors. ▪ Domestic financing projected to fall from 5.0% of GDP in 2000 to 3.1% in 2003.
Expenditure Framework for 2001-03	<ul style="list-style-type: none"> ▪ Spending projected to increase by 41% from Lek 172 billion in 2000 to Lek 242 billion in 2003. ▪ Central government spending to increase from 22.1% of GDP in 2000 to 23.9% in 2003 with: <ul style="list-style-type: none"> ◊ wagebill allocations increasing from 5.9% to 6.1% of GDP during 2001-03. Substantial increases in salaries linked to further reductions in public employment and decompression of salary scales; ◊ operations and maintenance spending to increase from 4.3% of GDP in 2000 to 5.3% in 2003 to support better maintenance of public infrastructure and improvements in public services; ◊ transfers from the Budget to the Social Insurance Institute declining from 2002 following an actuarial review of the social insurance program; this reduction to be offset by improved collection of social insurance contributions. ◊ social assistance transfers maintained at 1.2% of GDP, linked to better targeting of benefits. ◊ public investment increased from 6.5% of GDP in 2000 to 8.4% in 2003 reflecting due to increased disbursement of external project financing, domestically funded investment unchanged as share of GDP. ▪ Outlays from extra-budgetary funds (health and social insurance) projected to increase by 61% from Lek 19.6 billion in 2000 (3.6% of GDP), to Lek 31.6 billion in 2003. ▪ Revenues assigned to local governments to increase by 92% from Lek 1.3 billion in 2000 to Lek 2.4 billion in 2003.
Sector Expenditure Priorities	<ul style="list-style-type: none"> ▪ Review of expenditure programs in pilot sectors highlighted; <ul style="list-style-type: none"> ◊ health and education spending that in GDP terms was well below other countries in the Region; ◊ insufficient targeting of social protection expenditures towards poverty alleviation; ◊ insufficient spending on primary level services in health; ◊ inadequate provision for road maintenance; and ◊ the need for improved sector program management.
Sector Resource Ceilings for 2001-03	<ul style="list-style-type: none"> ▪ MTEF proposals for the distribution of recurrent spending involved: <ul style="list-style-type: none"> ◊ sustaining, as a share of GDP, the enhanced levels of spending in recent years on public order; ◊ continuing cutbacks in defence spending, but at a more gradual pace than in recent years; ◊ significantly increasing spending on health and education consistent with a gradually increasing share of GDP allocated to these sectors; ◊ maintaining the share of GDP allocated to social security and welfare, but with increased spending concentrated on social assistance programs that benefit the poor; and ◊ maintaining the share of GDP allocated to economic services (primarily transport) but with increases concentrated on operations and maintenance allocations. ▪ MTEF proposals for public investment spending reflected the priorities set out in the 2000-03 PIP and took account of the substantial carry forward of donor commitments. Investment in infrastructure was projected to increase rapidly. New funding there would be oriented more toward public service reform.