BUDGETARY FRAMEWORKS

Objectives and lessons learned in using Medium Term Expenditure Frameworks

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Global experience and impact
WB Study “Beyond the Annual Budget”

- **MTEFs – among PFM megatrends**
  - 2/3 of all countries are known to have an MTEF in 2008
  - World Bank has been engaged with MTEF reforms in 109 LICs and MICs since the 1990s

- **MTEF still controversial among PFM practitioners**
  - Lack of quantitative analysis establishing causality

- **Questions posed…**
  - Do MTEFs work?
  - Should an MTEF be a common element of PFM systems
MTEF IS IN USE GLOBALLY – BUT IN DIFFERENT FORMS
WHAT FORMS DO MTEFS TAKE?

Medium-Term Fiscal Framework (MTFF)
- Resource envelope
- Agency ceilings
- Top down, input based

Medium-Term Budget Framework (MTBF)
- National and sector strategies, forward estimates
- Reconciliation with MTFF, agency/program ceilings
- Top down and bottom up, primarily input based

Medium-Term Performance Framework (MTPF)
- Systematic use of quantitative performance information
- Output/outcome based
- Funding linked to results
COMMON FEATURES OF MTEF

• Identification of Resource Availability
  • Economic forecasts
  • High-level fiscal rules such as aggregate revenue, expenditure, deficit/surplus and debt/assets
  • Multi-year context (3-5 years)

• Determination of Current Spending Needs
  • Baseline projections of “current policy” expenditures
  • Multi-year context (3-5 years)

• Reconciliation of the Two Determines the Future Resource Allocations for New Initiatives
ECONOMETRIC RESULTS: DO MTEFS WORK?

MTEFs have a strong, positive effect on the fiscal balance;

- The effect gets stronger with move from MTFF to MTBF to MTPF (but MTPF has too large an effect)
- Significant control variables - oil(+) , conflict(-) , aid(-)
- Significant conditioning variable - OECD(+) for MTPF only

MTEFs have a significant positive effect on total expenditure volatility, the health expenditure share and health expenditure volatility;

- The effect gets stronger with move from MTFF to MTBF to MTPF (except MTPFs have no additional effect on health expenditure volatility)
- Marginal effect of MTBF over MTFF is surprisingly small
- Significant control variables - oil, aid, inflation (all + for volatility (because they are volatile?)

Only MTPFs have a significant impact on the cost effectiveness of health expenditure

- Significant control variable - inflation(+)

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Key Objectives and Components
MTEF OBJECTIVES

Improve macro-fiscal discipline and sustainability of finances

- Lower deficits, improved economic growth
- Rational approach to retrenchment and economic stabilization

Improve the impact of government policy

- Better allocation of resources to strategic priorities between and within sectors, through better alignment with national and sectoral planning processes
- Greater predictability of both policy and funding – for both recurrent and investment spending

Improve Program Performance and Impact

- Shift bureaucracy from ‘administrative’ to ‘managerial’ culture
- Greater room for managerial flexibility and innovation
- More effective implementation through greater predictability and flexibility
MTEF OBJECTIVES

- When executed well, the MTEF helps government to extend its budgeting horizon and to consider the resource availability over the entire MTEF period when making policy.
  - *Budget decisions, influenced by the political process, tend to be short-term in focus. Sound policy decisions, however, require a medium term focus.*

- It enables government to implement structural changes and major shifts in sectoral priorities in ways that are more difficult within a single year.

- It enhances the value of the central budget office by prioritizing policy-making functions of budgeting over line-item controls. The budget office helps assess the impact of current and proposed policies on future budgets and confirm their alignment with MTEF limits and policy.

- It enhances the likelihood that policy decisions take into account the longer term cost implications, especially of capital investment.

- It helps assure that future funding commitments, notably for capital projects, are taken into account before new projects are considered.
MACRO-FISCAL CRITERIA

- **Fiscal Sustainability** which is forward looking: fiscal balance, evolution of public debt, capacity of the government to finance its budget (borrowing etc.) requirements and refinance maturing debt, assess fiscal risks, etc.

- **Fiscal Space**: additional expenditure needed to promote development, stimulate growth, increase gov. revenue, etc. – create fiscal space to finance increasing demands (health, education, etc.)

*These two objectives are better incorporated in a multi-year framework as opposed to an annual budgeting framework.*
CORE ELEMENTS OF AN MTEF

• Explicit fiscal targets (such as the deficit or total spending) for each of the next 3-5 years

• Baseline (forward) estimates of the future costs of existing policies

• Procedures for proposing policy initiatives

• Medium-Term projections of the cost of proposed and approved policy changes

• Allocation of a budget margin (positive or negative) to each sector or department

• Rules for assuring that the budget complies with fiscal targets

• Procedures for updating the baseline projections and rolling the MTEF forward
CONSIDERATIONS FOR THE MACRO-FISCAL FRAMEWORK

• Predictions of main macroeconomic indicators (GDP, inflation, balance of payments, employment, wages, etc.)
• Conservative macro estimates to avoid cut-backs during the fiscal year
• Take into account fiscal policy objectives and their impact on the economy (real and monetary sector)
• Some countries develop multiple scenarios for revenue and expenditure estimates, to complement the baseline estimate, e.g., one assuming macro stability and another with more uncertain macro environment with lower estimates.
DEVELOPING THE MTEF BASELINE (1)

• The baseline is a projection of future budget amounts (revenues, expenditures, and the fiscal balance) if current policies are continued without change.

• The baseline is constructed for each year covered by MTEF. Some governments prepare baseline projections that extend beyond the medium-term.

• **Fiscal space** is the arithmetic difference between baseline projections and the government’s fiscal target.

• The baseline takes account of medium term economic forecasts and demographic changes, as well as approved policy changes.
• The central budget office maintains the baseline and estimates the budget impact of proposed and approved policy changes.

• Lapsing programs are removed from baseline; “sunset clauses” can help reduce baseline

• Considerations include: Can the same outputs be achieved more economically in the future; what is the impact of demography/aging on social benefits, schooling, health care, etc.
• Policy priorities (by sector) are decided by the Cabinet, reflecting national development priorities
• Different expenditure growth rates (or reductions) are attributed to different sectors/ministries (i.e., top-down guidance)
• Sector strategies should link budget allocations with expected policy achievements at each sectoral level.
• Sector spending: mandatory (usually defined by law: transfers, wages, etc.) vs. discretionary, must be consistent with sector ceilings
• Sector strategies can in theory provide an opportunity for input (voice) into ceilings (as ministries have the best data on future needs). But there is a risk they become used as “fundraising” documents or wish lists to increase funding (via donors)
Key Success Drivers for MTEFs
LINK BETWEEN THE MTEF AND ANNUAL BUDGET

- The annual budget should not be a separate process: it should be fully integrated into the MTEF.
- While the approved budget authorizes expenditure for the next year, the MTEF only provides “indicative” expenditure for future years.
- The MTEF is rolled forward each year by dropping the first (budget) year and adding a year at the end.
- The first step in rolling MTEF forward is to update baseline projections to take account of the latest economic forecasts, policy changes, and other factors that affect spending levels.
- Once the baseline is updated, government estimates the fiscal space available in the next budget for policy changes over the medium term.
- Countries differ in how “firm” to make the “indicative” ceilings of the MTEF years, but year 1 of the MTEF should be the starting point of the annual budget process.
CONTRIBUTORS TO AN INEFFECTIVE MTEF

MTEFs experience problems when there is:

• Lack of reliable data for fiscal estimates or developing the baseline

• Weak political support to abide by agreed targets or capital project commitments.

• No linkage to the annual budget process or to the sector strategies (i.e., it’s seen only as a MOF exercise)

• No tracking of policy commitments made for the outer years of the MTEF

• Inability to keep baselines up-to-date

• Lack of control or predictability over external resourcing (donor funds) or high sensitivity to global commodity prices
ENABLING CONDITIONS FOR AN EFFECTIVE MTEF (1)

MTEFs are more likely to be effective when:

• The annual budget allocations are a reliable predictor of year-end spending, i.e., there’s little variance between plan and actual expenditure.

• There is capacity to produce reliable macro-fiscal forecasts beyond the budget year.

• There is accurate financial reporting with which to confirm adherence to the MTEF and update baselines.

• There is ability to hold ministries accountability for future policy commitments.
MTEFs are more likely to be effective when:

- There is capacity to assess and quantify the future budgetary impacts of future policy decisions.
- There is stability in the country’s overall economic environment, i.e., not easily disturbed by external pressures or commodity prices.
- There is political will among ministers and parliamentarians (a) to use it to set fiscal policy and spending priorities and (b) to respect past policy commitments made through it.
Insights from the PEFA framework
Medium Term Perspective in Expenditure Budgeting

16.1. Medium-term expenditure estimates

A The annual budget presents estimates of expenditure for the budget year and the two following fiscal years allocated by administrative, economic, and program (or functional) classification.

16.2. Medium-term expenditure ceilings

A Aggregate and ministry-level expenditure ceilings for the budget year and the two following fiscal years are approved by government before the first budget circular is issued.
16.3. Alignment of strategic plans and medium-term budgets

**A** Medium-term strategic plans are prepared and costed for *most* ministries. *Most* expenditure policy proposals

16.4. Consistency of budgets with previous year’s estimates

**A** The budget documents provide an explanation of *all* changes to expenditure estimates between the last medium-term budget and the current medium-term budget at the ministry level.
PEFA INDICATOR 15: FISCAL STRATEGY

This PEFA indicator is closely linked to PI-16

“This indicator provides an analysis of the capacity to develop and implement a clear fiscal strategy. It also measures the ability to develop and assess the fiscal impact of revenue and expenditure policy proposals that support the achievement of the government’s fiscal goals.”

15.1. Fiscal impact of policy proposals

15.2. Fiscal strategy adoption

15.3. Reporting on fiscal outcomes
TWO COMPLEMENTARY INSTRUMENTS: THE MTEF & FISCAL STRATEGY PAPER

3. Review of 2014 Budget Performance
   3.1. Revenue Outturns
   3.2. Expenditure Outturns
   3.3. Fiscal Deficit
4. Review of the 2015 Budget Implementation
   4.1. Revenue Outturns
   4.2. Expenditure Outturns
5. Assumptions Underlying Projections of Oil and Non-Oil Revenues In 2016
   5.1. Oil production
   5.2. Oil Price Benchmark
   5.3. Non-oil Revenue Baseline Assumptions
6. Fiscal Strategy for 2016-2018
   6.1. Macroeconomic Stability and Efficient Resource Allocation
      6.1.1. Zero-Based Budgeting
      6.1.2. Oil sector Management
      6.1.3. Increasing Economic Diversification & Strengthening Linkages in the Economy
   6.2. Social Development
   6.3. Infrastructure for Development
   6.4. Improving Governance
      6.4.1. Good Governance
      6.4.2. Improving Revenue Generation and collecting-plugging leakages
      6.4.3. Size of Government
      6.4.4. Managing Expenditure
7. Policy Thrust of Fiscal Year 2016 Budget
   7.1. Guiding Principles of 2016 Budget
   7.2. Policy Objective of Budget 2016: Macroeconomic Policies
   7.3. Macroeconomic Parameters and Targets for 2016-2018 Medium Term
   7.4. Strategies for achieving the Instrument and Outcome Targets
By integrating the fiscal strategy paper/statement with the MTEF, governments may be able to better engage Parliament around the big-picture national strategic directions.

In some countries, the fiscal strategy and fiscal framework proceed the submission of the detailed budget in the budget cycle.

Political agreement on the overall level of revenue, expenditure, and financing are critical prerequisites for having effective dialogue on sectoral or intra-sectoral spending.

National strategic planning documents continue to be used in much of Asia. But the credibility and usefulness of such plans is impacted in part on whether they are rooted in realistic medium term fiscal envelopes.