Adopting MTEF through Fiscal Rules: Experiences of Multi-year Budget Planning in India

Pratap Ranjan Jena, Associate Professor, National Institute of Public Finance and Policy
18/2 Satsang Vihar Marg, Special Institutional Area, New Delhi 110067
Ph: 011 - 26569303, 26963421, Fax: 91-11-26852548, E-mail: pratap.jena@nipfp.org.in, prjena@yahoo.com

Abstract

The medium term expenditure framework (MTEF) has been getting renewed attention, given the preoccupation of countries to achieve fiscal consolidation and expenditure prioritization after the global fiscal crisis. With the formal adoption of MTEF in 2012 under the provisions of the fiscal rules, India had already joined a growing number of countries adopting this innovation expecting improvement in fiscal discipline, and allocative and technical efficiency in budgeting. The structure of MTEF in India suggests that it could be supportive to the fiscal rules, but its impact on medium term budget planning is uncertain. The paper makes a case for taking forward this institutional innovation forward to develop a structured medium-term framework to link policy, planning, and budgeting beyond a short horizon of annual budget.

Key words: Budgeting System, Multi-year Expenditure Framework, Fiscal Rules, Performance Budgeting, Strategic Planning

Introduction

Medium term expenditure frameworks (MTEFs) have been implemented in many countries over the last two decades, both in developed and developing world. This is considered as one of the most popular budget innovation in recent times. The need for a medium term perspective as compared to a short horizon of an annual budget was the compelling reason behind the rapid expansion of this instrument. The features of MTEF that helps in establishing fiscal discipline and providing scope for better prioritization in resource allocation increased its appeal. Initially championed by the World Bank, the MTEF became the focus of donor countries and multilateral agencies at Central and sector levels. The long-standing credibility of Australia's 'forward estimates' (David Crobett, 1998) in controlling expenditure is cited as an established process of medium term expenditure planning.

The MTEF reflects two major preoccupations of post-fiscal crisis budget reforms – fiscal consolidations and expenditure prioritization. It is a relevant budgetary institution to facilitate adherence to the fiscal rule targets as it provides a framework to take budgetary decisions over 3 to 5 years period. As the budgeting system complies with the pre-determined fiscal targets and consequent expenditure constraints under the fiscal rules, a medium term expenditure perspective of the policy decision taken in the budget becomes helpful. The MTEF, along with the annual budget contains forecasts on economic growth and revenues, targets for aggregate spending, and possibly limits for the spending departments helping them to prioritize better.

India introduced medium term expenditure framework (MTEF) in 2012 under the provisions of the fiscal rules, the fiscal responsibility and budget management act (FRBM Act). Although this is a formal adoption of the framework, the Act since its adoption in 2003 always had some medium term projections of fiscal variables, which are targeted. These are presented in a document called medium-term fiscal policy (MTFP). Two other Statements, fiscal policy strategy and macro-economic statement accompanied the MTFP. While there have been several intermittent attempts to bring in innovations in the public financial management (PFM) system, the introduction of MTEF is a significant development. The changing fiscal architecture in the country after the abolition of the five-year development planning process enhanced its appeal.

The paper, after discussing the conceptual issues in MTEF and the experience of its progress, elaborates on the emergence of a medium term framework under the fiscal rules in India. It proceeds to examine the contours of MTEF as to whether it is an adequate instrument to improve allocative and technical efficiency in addition to fiscal discipline. The paper then looks at the need for a sound medium term framework post Planning Commission fiscal scenario in India. The paper examines the opportunities to move ahead with medium term budgetary framework, the need of an effective MTEF at the sub-national level and scope for institutional support in the existing system and gives concluding remarks at the end.

MTEF: Linking Policy, Planning and Budgeting

The World Bank, in its widely referred ‘Public Expenditure Management Handbook’, held the implementation of MTEF as a central element of PEM reform to counter disconnect between policy making, planning and budget implementation, which is considered to yield poor budgeting outcome (World Bank 1998). The countries implementing MTEF expect improvement in public financial management outcomes beyond the annual budget by establishing aggregate fiscal discipline, promoting efficiency in resource allocation, and improving operational efficiency of spending agencies. With large number of countries opting for it, the MTEF emerged as an integral part of PEM solution to address broader performance problems of the governments.

The expectation of fiscal performance from the implementation of MTEF is due to its impact on budget quality and budget credibility (World Bank, 2013). The MTEF tends to reduce the tendency of ambitious annual spending plans based on blown up revenue projections to improve budget realism. The emphasis on sector priorities, based on Government objectives and policies rather than on annual increments, helps the resource allocation decisions and reduces the fiscal strain coming from politically induced resource tradeoff. The MTEF helps the spending departments to become proactive while designing and costing their programs due to increase in predictability of flow of resource in a multi-year mode. This enables them to participate in the budgeting process more meaningfully (PEFA, 2011). The focus shifts from controlling the expenditure to pragmatic spending plans and achievements of results commensurate with the objectives.

Linking policy, planning, and budgeting under MTEF is conceptualized by determining the available resource envelope to the government and allocating these resources in line with government priorities in a multi-year budgeting framework. To complement top-down resource envelope, bottom-up estimate of the current and medium term costs of the policy initiatives are estimated by developing spending plans for the sectors. Sector studies consist of strategies for the sectors and the estimated costs of running and new programs. The expenditure implications of the sector policies are estimated by using costing techniques. The MTEF can be used to highlight the opportunity costs of various policies and programmes that need to be foregone if additional resources are allocated to a particular programme.

The MTEF is often considered as an umbrella framework with interconnected frameworks or sequence of stages (Castro and Dorotinsky, 2008, OPM Review, 2000, and World Bank, 2013). A medium term fiscal framework (MTFF) constitutes specifying a top-down aggregate resource envelope and allocation to major category of expenditure items. It shows the fiscal stance of the Government through a set of integrated medium-term macroeconomic and fiscal targets and projections. The medium term budgeting framework (MTBF), more popular variant of the medium term frameworks, develops further by including bottom-up resource requirements prepared by the spending departments and reconciling with the resource envelope available to the Government. In this framework, budget estimates for individual spending departments indicated in a medium term and resource allocation follows the strategic priorities. The medium term performance framework (MTPF) takes this process further by shifting the focus from inputs to outputs. This is basically output-outcome type budget in which performance indicators can be worked out for each sector programmes and through them sector outputs are defined.

The early experience from the implementation of MTEFs in developing countries, particularly from African region, showed several weaknesses (Le Houerou and Taliercio 2002, Homes and Evans 2003). The MTEF was found to be ineffective in influencing environment of the annual budget due to lack of political ownership and often resulted in unrealistic projections (Jim Brumby 2008). Discouraging experience from the implementation of MTEF, however, did not repudiate the idea of formulating a medium term perspective for the annual budget. The consistent use of MTEF in Australia to plan and finance spending initiatives and positive experiences from other industrial countries sent out positive signals (Brumby and Hemming, 2013). The efforts to strengthen public financial management systems both in developed and emerging markets to successfully address the fiscal policy challenges in a more integrated world economy included MTEF as one of the important instruments to modernize budget planning process.

A recent study by the World Bank (World Bank 2013) over a period 1990-2008, shows there has been widespread adoption of MTEF and shifting from basic MTFF to MTBF and MTPF among the advanced countries. The study steering though cross-country data found strong evidence that the variants of MTEF promote fiscal discipline. While the impact of efficiency gains in allocation of resources and operations are not conclusive, there are instances of improvement.

The budgeting System and Policy Making in India

While the overarching five-year development planning system influenced the economic decisions in the country, the budgetary system remained the most visible face of the policymaking. The budget continues to be financial instrument showing annual revenue and spending plans and a place of assessment of Government’s policies. The annual budget presented in the Parliament is conventional input based. However, it is consistent with accounting, audit, and legislative control systems (Swarup, 1990). Some of the government initiatives to improve the budgeting systems and processes over the years yielded many enduring changes[1]. However, bringing in efficiency and effectiveness to the decision making and implementing the policies remains concerns, more so when the Government has been expanding the key central programs in the area of building rural infrastructure, eradication of poverty and creation of employment, and social sector spending. Taking a medium terms perspective of policies while building the programs and determining cost is one such crucial change on the way of budgetary transformation.

The budgeting system in India is similar in form at both union and State levels. The functional responsibilities and financial powers of the Union and states and the relationship between them following the Constitutional provisions (Seventh Schedule, Article 246) define their contents. The States’ tax powers are inadequate to meet their expenditure needs and therefore, the Constitution provides for the sharing of revenues from central taxes and provision of grants by the Union Government. The budget outcomes of the States many a times become affected by the

[1] Outcome budget is one such innovation.

uncertainties and discretions in the fund-flow from the Central Government. A longer-term perspective in building programs for service delivery at State level would depend upon the effectiveness of a medium-term approach at the Union level.

The development planning process in India was stated to have provided a multi-year perspective to the planning and budgeting systems. The five-year plan was close to the concept behind the MTEF as the plan (investment) and non-plan (spending on existing programs and recurrent expenditure) expenditure is planned based on projected resources. The integration of annual plans to the budget was considered as an innovation (Thimmaiah 1984).

The divergences between plan and budget were evident in the resource mobilization, allocation, and organizational structures (Premchand 1983). The practice of making distinction between plan and non-plan expenditures, an accounting development to keep a tab on plan investment, led to expanding the plans beyond the resource limits and resulted in neglect of existing assets both at Central and sub-national levels (Ministry of Finance 2008). The economy and sector wide plan consisting of both private and public sectors was not adequately linked to the annual budget. Planned goals, objectives, outputs, and resources allocated to achieve them were not adequately integrated into the annual budgets (Planning Commission, Expert Committee on Expenditure Management 2011). The plan budget linkage was not smooth and there were several disconnects in practice (Jena 2016).

The abolition of the Planning Commission in 2014 formally put to rest any misgivings regarding scope for a perceived multi-year budget planning within the five-year development planning process. The Planning Commission was considered to be not suitable to India's economic aspirations in a more globally integrated environment with higher participation of private sector. The capacity of the Commission to make an economy wide investment plan involving the Centre, States and the private sector was believed to be limited. The NITI Aayog, constituted as successor to the Commission in 2015, was given the responsibility of long term strategic planning and to provide technical support to the Central and State Government in different areas[2].

Fiscal rules adopted in the form of Fiscal Responsibility and Budget Management Act (FRBM Act) in 2003 proved to be a strong anchor for budget making and public policy. The objective of achieving fiscal targets over a period required projecting macro variables under a framework, called medium term fiscal policy (MTFP). The MTFP contained projection of the fiscal variables like revenue deficit[3], fiscal deficit[4], tax revenue, and outstanding liabilities relative to GDP as targets for three years in a rolling manner. The MTFP also contained a macro-framework and fiscal stance of the Government aligned with the budget[5]. Over the years, the

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[2] The National Institution for Transforming India, NITI Aayog, was established in 2015. NITI Aayog, considered as premier policy 'Think Tank' of the Government of India, will design strategic and long term policies and programs and provide both directional and policy inputs.. NITI Aayog is not meant to engage in approving or funding the plans prepared by the sub-national governments like the Planning Commission.

[3] Revenue deficit in the Indian budget classification refers to recurrent deficit. It is the difference between revenue receipts and revenue expenditure, which increases the liabilities without corresponding increase in assets.

[4] Fiscal deficit is the excess of total disbursements (excluding debt repayments) over the total receipts (excluding debt receipts) during a fiscal eyar.

[5] The MTFP sets forth a three-year rolling target for prescribed fiscal indicators like deficits and debt. As these are fiscal outcomes projected for a medium-term, the fiscal strategy of the Government to achieve them is elaborated in another statement called 'Fiscal Policy Strategy Statement'. It is supposed to give strategic priorities for the ensuing budget year. To provide a macro-economic background to the fiscal stance, the fiscal rule also stipulated to present a 'Macro-economic Framework Statement' containing assessment of the growth prospects.

projection of the target fiscal variables became the core activity of the MTFP facilitating tracking of macro numbers and did not develop into any kind of any expenditure planning. The preparation of MTFP and progress towards achieving the fiscal targets are all monitored by the Ministry of Finance.

The MTFP, however, remained as a supporting document describing the fiscal stance of the Government. It did not develop into a system to prepare top-down resource envelope through an unbiased projection process and to allocate resources to major spending categories. Although, the MTFP elaborates on macroeconomic challenges and prospects, it lacks a medium-term macro-fiscal framework for improving efficiency of the budgeting system. It was not upgraded to contain the assessment of future year fiscal impact of the Government policies. The State Governments in India, depending heavily on Centre for funds, have to deal with the unpredictability of fund-flows while formulating their MTFPs[6].

It was contended that the effectiveness of the fiscal rules could be enhanced by stretching the annual budget from one year to three years with an effective MTEF or its variant MTBF (Holger van Eden et al, 2013). The usefulness of the MTEF will depend upon its capacity to establish a hard constraint on future expenditures (Allen Schick, 2013). A well-formulated medium term strategy in budgeting depicting budget impact of policy changes considered as a key element in this regard.

The Indian Variant of MTEF

The country adopted a formal MTEF in 2012, which was anchored in the fiscal rules with the rationale that it would support achieving the desired fiscal targets set under the FRBM Act. This reflects the growing focus on fiscal discipline in the budget reforms across the countries after the global fiscal crisis. The recommendations of the Thirteenth Finance Commission (TFC) to provide a detailed framework containing three-year forward estimates of revenues and expenditures formed the background for this decision (Govt. of India 2009, Report of the TFC, pg. 132). The objective was to provide a fiscal roadmap for three years into future and use it as an operational policy document. However, there was not much elaboration on how the MTEF would strengthen prioritization in resource allocation when the MTEF was adopted in India

This version of MTEF contains forward estimate of expenditure commitments in various Sectors viz. Education, Health, Rural Development, Energy, Subsidies, and Pension etc. (Tables 1 and 2). Expenditure commitments are shown separately for Revenue and Capital expenditure. The MTEF is designed based on broad functional categories of expenditure and does not contain the schemes and programs run by the departments[7]. It shows the expenditure indicators projected for three years in a rolling manner, which includes the budget year and two outward years. The MTEF consists of descriptions relating to the assumptions while making the projections.

The assumptions relating to projections do not give a clear insight to the derivation of the numbers and their utility. It was prescribed that the projections should be made taking into

[6] The State Governments receive share in Central taxes, grants from the Centre, and funds for several centrally sponsored schemes. The tax devolution is s predictable source of revenue as the share of the States are determined by the Central Finance Commission. The discretionary elements are high in other sources of funds and many a times depends on the fiscal health of the Central Government. The fund flows for several Central schemes implemented at State level also does not follow a predictable pattern affecting the ability of the States to implement them in time.

[7] The system of Government accounts in India contains elaborate details of the financial transactions, which sometimes considered as excessive.

account the expenditure commitments of policy changes, contingent liabilities, and grants given for capital assets. Leaving aside the committed expenditures like salary, pension, and interest payments, where guidance has been given for their estimation and projection, there is hardly any clarity on the assumptions behind the projections of other spending items. The assumptions regarding these spending innocuously indicate that the projections have been carried out 'keeping in view the availability of resources and financing requirement for various programs of Government in line with various decisions and commitments' (Medium-term Expenditure Framework Statement, 2015, pg. 6). The document does not elaborate on the linkages between the spending commitments and the policy decisions.

Table 1 Revenue Expenditure (Recurrent) Part of the MTEF

Rs.Billion

Heads	**BE**	**Projections**		**BE**	**Projections**		**BE**	**Projections**	
	2013-14	**2014-15**	**2015-16**	**2014-15**	**2015-16**	**2016-17**	**2015-16**	**2016-17**	**2017-18**
Revenue Expenditure									
1. Salary	789	866	951	906	996	1196	1006	1165	1282
2. Interest	3707	4144	4576	4270	4684	5153	4561	4960	5390
3. Pension	707	778	856	820	902	1082	885	1026	1129
4. Subsidy	2210	2173	2186	2514	2460	2550	2274	2390	2550
a. Fertiliser	660	623	636	730	760	850	730	750	800
b. Food	900	1200	1350	1150	1200	1300	1244	1320	1410
c. Petroleum	650	350	200	634	500	400	300	320	340
5. Grants to States	1544	1687	1878	1253	1279	1295	1127	1066	1061
6. Defence	1169	1251	1339	1344	1479	1774	1551	1799	1979
7. Postal Deficit	67	62	58	69	69	69	67	67	67
8. External Affairs	88	95	101	100	100	101	96	108	119
9. Home Affairs	157	168	178	165	168	170	158	170	184
10. Tax Administration	120	129	137	30	130	130	186	145	43
11. Finance	152	164	174	223	225	227	309	331	355
12. Education	697	814	902	720	768	800	559	604	646
13. Health	295	336	394	316	343	355	261	290	309
14. Social Welfare	343	376	421	353	387	401	251	270	289
15. Agriculture and Allied	276	301	336	288	304	313	222	240	263
16. Commerce and Industry	140	157	173	164	162	165	140	151	165
17. Urban Development	28	30	33	152	156	159	133	147	162
18. Rural Development	1024	1120	1245	1060	1153	1196	796	844	898
19. Dev. of North East	18	20	21	21	23	26	22	24	26
20. Planning and Statistics	117	74	80	62	64	66	61	65	70
21. Scientific Departments	97	104	112	101	104	106	108	114	123
22. Energy	124	123	145	112	120	124	93	100	114
23. Transport	153	163	175	178	181	184	143	151	163
24. IT and Telecom	61	64	67	72	81	85	56	61	72
25. UT	64	68	73	62	63	64	63	69	76
26. Others	215	229	246	325	342	350	231	245	261
Total-Revenue Expenditure	14362	15496	16860	15681	16744	18139	15360	16605	17796
of which,	0	0	0	0	0	0	0	0	0
Grants for Capital Assets	1747	2333	3042	1681	3016	2535	1106	1496	3168

Source: MTEF Statements, Relevant Years, Government of India

Note: BE is budget Estimates

Table 2 Capital Expenditure Part of the MTEF

Rs.Billion

Heads	BE	Projections		BE	Projections		BE	Projections	
	2013-14	2014-15	2015-16	2014-15	2015-16	2016-17	2015-16	2016-17	2017-18
Capital Expenditure									
1. Defence	867	945	1031	946	1088	1164	982	1070	1177
2. Home Affairs	93	99	109	102	143	156	93	98	103
3. Finance	380	236	261	161	219	228	111	127	148
4. Education	0	0	0	0	0	0	0	0	0
5. Health	29	33	39	21	35	38	9	11	12
6. Commerce and Industry	22	24	26	12	16	18	17	19	22
7. Urban Development	75	84	96	98	119	124	101	121	147
8. Planning and Statistics	9	10	11	8	11	12	4	4	4
9. Scientific Departments	40	44	49	39	53	56	36	41	45
10. Energy	67	76	86	71	99	109	61	66	73
11. Transport	489	529	636	548	698	739	759	795	844
12. IT and Telecom	27	28	30	40	54	57	27	33	35
13. Loans to States	110	119	133	120	132	140	125	131	138
14. UT	19	21	24	17	22	24	19	21	23
15. Others	64	67	72	85	109	118	70	72	74
Total-Capital Expenditure	2291	2315	2602	2268	2797	2981	2414	2610	2845
Total Expenditure	16653	17811	19461	17949	19541	21120	17775	19214	20642

Source: MTEF Statements, Relevant Years, Government of India
Note: BE is budget Estimates

The projections are usually prepared after the budget was presented. This shows a strong annual budget bias, where the spending on development and capital outlay become residual after meeting the committed spending[8]. Bulk of the spending, to the tune of 87 percent, in Government goes toward revenue expenditure. Nearly two-third of this is spent on grants to States, interest payments and subsidies. The other major components are spending on defense, railways, salaries, pensions, and others (Report of the CAG 2015). The large committed expenditure in this projections show an increasing trend. The projected expenditure trends in social and economic sectors and in capital outlay do not show a consistent behavior vis-à-vis the earlier years.

The Government revised the MTEF in 2016-17 following the inputs provided by the Expenditure Management Commission (EMC).[9] The MTEF was expanded consistent with the Demand for Grants[10] of the Expenditure Budget and it contains demand wise projections of revenue and capital expenditure for the two outward years (Govt. of India, MTEF Circular

[8] The MTEF comes after four to five months after the budget, which is usually presented in February.

[9] The Government constituted the Expenditure Management Commission (EMC) in 2014 to suggest major expenditure reforms that will enable the government to reduce and manage its fiscal deficit at more sustainable levels. The EMC was supposed to make recommendations on institutional changes relating to budgeting process, fiscal rules, and fiscal discipline.

[10] Demand for Grants is the part of the budget documents and shows the estimates of expenditure from the Consolidated Fund, included in the annual financial statement and required to be voted upon in the Parliament. Generally, one demand for grant is presented in respect of each ministry or department. However, for large ministries and departments, more than one demand is presented.

2016-17). The existing aggregate spending wise information also continues to exist. The initial projections are taken from the ministries and departments with a growth factor in the range of 5 to 10 percent; a higher growth factor should be accompanied by reasons for it. These inputs and fiscal stance taken in MTFP is used by the Ministry of Finance to finalize a demand wise projection of revenue expenditure and capital expenditure. The ministries and departments are communicated with the approved spending projections. This data after being categorized into a format based on schemes is to be used in the interaction between the departments and the Ministry of Finance for resource allocation.

The MTEF revision shows positive intents. The proposed changes in the projections indicate features of both the MTFF and MTBF. In the revision plan, the role of the administrative departments in developing a multi-year expenditure plan has been acknowledged. The second round changes in the projections by the Ministry of finance based on the fiscal stance of the MTFP and communicating this back to the departments is like preparing expenditure ceilings under the MTBF. This exercise will be of use for expenditure control and will serve the purposes of the fiscal rules. The medium term projections at department level and an aggregate view taken at the Ministry of Finance level will facilitate expenditure control.

The revision in MTEF also makes it a work in progress. It still does not shed light on whether the spending departments will prepare a medium-term sector plan, negotiate for resources for the budget based on this plan, and prioritize the programs based on the spending limit. The projections of aggregate departmental spending are not the same as giving a ceiling to the departments and allow them the flexibility of choosing their programs to achieve the sector Goals of the Government. The MTEF will remain as an instrument to serve the objectives of the expenditure control.

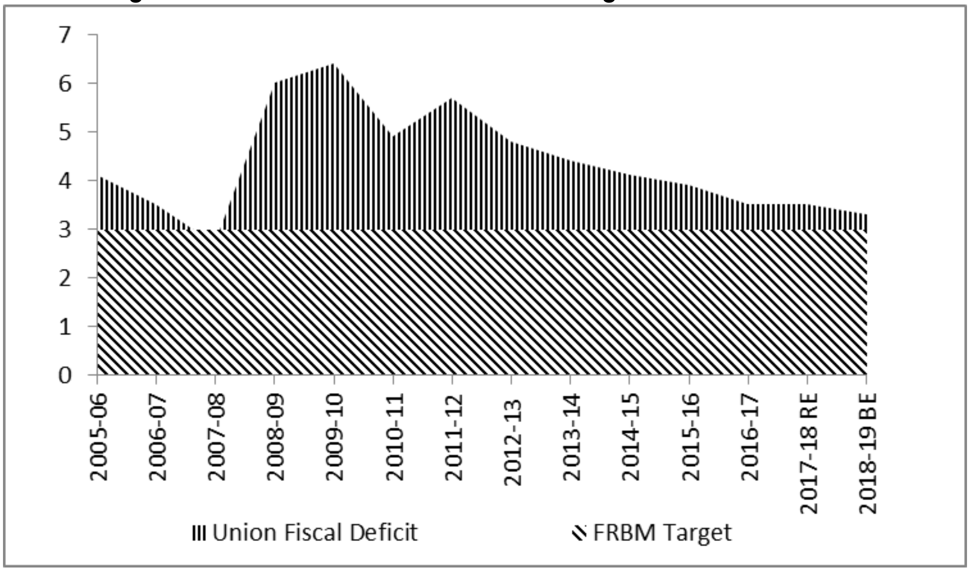
The MTEF, structured around department wise revenue and capital expenditure, is not an outcome of prioritized spending preferences revealed by the departments and constrained by accompanying resource forecast. The departments do not get an indication of availability aggregate resources early in the budget making process during their negotiation for funds (Ghosh and Jena 2008). The projections are suggestive and are framed on annual budget estimates. They do not necessarily show the medium term implications of policy decisions taken in the budget. Probably, some of the committed spending items like salary, pension, and interest payments would follow the path.

The Fiscal Experience and Enabling Factors

The fiscal outcome since 2008-09 shows the overarching macroeconomic stabilization process, strengths, and weaknesses of the PFM system and its impact on fiscal discipline in the country. The introduction of MTEF may not be a factor in this. The targets of balancing the current account and attaining a sustainable fiscal deficit of 3 percent of GDP were achieved by 2007-08 as against the FRBM Act timeline of 2008-09. High growth of the economy at about 9 percent and consequent rise in revenue collection contributed to this early success. Post global fiscal crisis, when the national economy declined sharply, the Government decided to put on hold the process of fiscal consolidation and amended the Act only in 2012 with a time line of 2017. Latter the targets were further postponed and in 2018-19 budgets, the timeline to achieve FRBM target was extended by three years. The fiscal outcome has to be assessed on its trend without comparing with the budget targets due to the intermittent deferral of target dates.

The fiscal deficit, which increased sharply in 2008-09 and crossed 6 percent of GDP in the next year, has shown a declining trend since then. (Figure 1) While achieving the FRBM target of 3 percent of GDP remains the target, the declining fiscal deficit indicates the strengthening of the fiscal consolidation process. An efficient medium term framework will be helpful now to give impetus to the fiscal consolidation. The budgeting system needs to go beyond the short horizon of annual budget by empowering the departments to make their medium-term plan within the budget constraint. Indicating a growth factor in the range of 5 to 10 percent to project aggregate department spending makes it an incremental process.

Figure 1. Fiscal Deficit: FRBM Target and Outcomes



The credibility of the annual budget, accuracy in medium-term macroeconomic and demographic projections, established fiscal objectives and rules, and a comprehensive, unified top-down budget process are considered as pre-conditions to build a successful medium-term framework (Harris et al 2013). In addition to declining fiscal deficit, many of these features of PFM system in India look favorable.

A credible annual budget, enabling the Government to implement the policies voted in the Parliament in a predictable manner, forms the basis for the multi-year decision making process. The aggregate revenue receipt performance during 2011-12 to 2016-17 remains good with the actual revenue remaining between 93 to 105 percent (Table 3). During the last three years, while the overall revenue receipts reached the targets in 2016-17, it exceeded the target by 4.68 percent in 2015-17. This gets a rank of 'A' following PEFA methodology. The PEFA ranking on budget credibility for India for the period 2007 to 2009 was also very high (Jena 2010 – PEFA India)[11]. Expenditure outturn as compared to the budget estimates shows that the actual revenue expenditure (current expenditure) was between 94 to 104 percent during this period, which gets top ranking. This was an improvement over the last PEFA assessment. The capital expenditure seems to have become residual in the system and takes a setback depending upon the demands of committed spending. During last two years, the spending in capital account has remained more than the budget estimates. This was mostly due to budget amendments during the fiscal year.

[11] The aggregate revenue collection during the period from 2006.07 to 2008.09 exceeded 97 percent of the budget estimates in two of the three years for which the PEFA ranking for revenue outturn was a high of 'A'.

Table 3 Deviation from Budget Estimates

Percent

	2011-12	2012-13	2013-14	2014-15	2015-16	2015-16
Revenue Receipts	-4.87	-6.03	-3.94	-7.43	4.68	-0.20
Tax Revenue	-5.23	-3.79	-7.72	-7.54	2.60	4.48
Non-Tax Receipts	-3.00	-16.56	15.45	-6.94	13.32	-15.51
Revenue Expenditure	4.43	-3.31	-4.48	-6.45	0.11	-2.34
Capital Expenditure	-1.24	-18.53	-18.09	-13.27	4.80	15.22

Source: Budget documents, relevant years, Government of India

To build a successful MTEF, the basics of PFM institutional structure and macro management needs to be on strong footing. The macroeconomic and fiscal management in India has been showing stability in recent years despite the presence of considerable volatility in the international economic environment. The GDP growth for the country was 7.9 per cent in 2015-16 and the expected growth during 2016-17 is 7.1 percent. The task, however, is to maintain the momentum in a difficult global environment. A stable macroeconomic environment helps preparing realistic forecasting to apply in the medium term budget framework.

Fiscal rule for the country defines the stance of the Government in the medium term with regard to key variables like deficit, tax, and debt. The target fiscal outcomes in the medium terms put a limit on the fiscal behavior of the Government. When the MTEF is built, its contours in terms of program financing are accommodated within such limits. Post fiscal crisis in 2008-09, the country has been trying to strengthen fiscal consolidation[12] and a major revision to the fiscal rules is made[13].

A unified top-down budgeting process is the crucial element of budgeting process, which facilitates expenditure discipline and helps the spending departments prioritizing within their limits. The abolition of Planning Commission in India has ensured a unified decision making process to the Ministry of Finance. As the fiscal architecture has been evolving with several changes, the need for taking a comprehensive view of budget process and making all expenditure decisions at one time has become necessary.

An accounting change in expenditure classification to remove plan and non-plan distinction expected to improve taking a holistic view of the program expenditure and provide comprehensives idea about resource availability for programs. This artificial distinction distinguishing desirable spending on development from unproductive spending had lost the clarity (Expert Committee on Expenditure Management 2011). It created a fragmented budgetary allocation involving two different authorities like Planning Commission and the Ministry of Finance (Ghosh and Jena 2008). The tendency to favor the plan spending has created a situation in which the assets already created are neglected for funds to maintain them. With the demise of Planning Commission, the distinction lost its usefulness.

The change in expenditure classification is stated to facilitate better formulation of MTEF and performance budget. The policy decisions, particularly relating to investments, will be based on both capital and operating costs together in a unified manner by the spending departments.

[12] See the report of the Comptroller and Auditor general of India 2016 on compliance of FRBM Act

[13] The government formed a committee in 2016 to review the working of the 12-year old FRBM Act and suggest changes.

While the rearrangement in expenditure classification and unifying the resource allocation decisions in the hand of the Ministry of Finance provides opportunities to further the MTEF process, firming up the resource envelope and provide ceilings to spending departments should be given priority. To projections of expenditure variables under the existing MTEF are adequate to provide the spending departments with indications regarding resource availability.

Building on the Existing Institutions and Moving Ahead

The MTEF in India need to transform from supporting instrument for fiscal rules to an efficient instrument for budget planning. The medium term expenditure framework should move towards adopting the features of the medium term budgeting framework (MTBF). Nomenclature should not be a hindrance; it can continue to be named as MTEF. The core theme of this should be to build on a sound macroeconomic framework with unbiased estimates of availability of resource, improve predictability of flow funds, reflect the future costs of policy decisions adopted in the annual budget through multi-year revenue and expenditure estimates, and improve service delivery mechanism.

Progress has already been made in terms of preparing medium term fiscal policy, projecting aggregate department wise spending, and operating under fiscal rules. The existing institutions and experiences should be put to use to build a more efficient MTEF or MTBF. First, providing strong indication of resource allocation to spending departments for the outward years with a realistic picture of resource envelope should be focused. Second, it is important to make distinction between ongoing and new programs and providing higher fiscal space to priority programs in a politically influenced resource trade-off situation. Third, the spending departments need to overcome the challenges of conflicting pressures to prepare a sector plan and prioritize within the resource limit.

The idea of giving ceilings to the spending departments indicates certainty about their budgets over a medium term that permits them better planning. However, the commitment for resources may create conflict due to problems in realizing the revenues (Robinson Mark 2016). The decline in growth of countries leading to slow growth of revenues and firmer fiscal rule regimes created doubt on committing resource ceilings for next three years. As MTEF is designed to be a rolling system, which will be revised, based on the economic situation and revenue projection, the potential conflict could be avoided.

Unlike an incremental system, the departments have to focus on government policies and cost of the programs as the basis for prioritizing. The programs have to be identified, which will outline the contours of the medium term planning (Schiavo-Campo 2009). Major divisions in a ministry like primary education or secondary education can be considered as broad programs to define the objectives and indicators. Such broad definition of programs to ensure accountability is appropriate in a government where the autonomy and flexibility to design and implement the budget is high for departments and ministries. In the Indian budgetary system, the functional classification of expenditure is elaborate and the flexibility to re-appropriate is limited[14]. This level of budget classification is not necessary for a functional MTEF. At the same time, the expenditure categories included in the existing MTEF do not reflect the program structure. The program classification for MTEF has to be judicious so that prioritizing them for resource allocation, monitoring, and evaluating the program implementation will be feasible.

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[14] The functional classification shows the functions and activities of the Government for which the expenditure has been incurred. The functional classification system comprises of a six-tier structure with a hierarchy that explains the major functions, objectives of spending, specific activities, details components of the schemes, and the object head of the expenditure.

Further Progress: Aiming at MTPF

The MTEF or MTBF can be taken forward using the output type budgeting with performance indicators to prepare what is known as medium-term performance framework (MTPF). This will shift the focus from inputs to outputs and facilitate evaluating the performance. Although, the MTEF does not specifically need a performance budget and can be adopted in a cash based line item budgeting environment, promoting results and encouraging better performance from the sector programs is always considered as improvements in the system. The MTPF design includes program outputs, and performance indicators of the sector strategies. The performance indicators are considered while taking resource allocation decisions and form the basis of evaluating the effectiveness of the programs.

The performance budget adopted in 1968, failed to make any impact, and remained a routine document without being able to link the budget decisions to the performance indicators (Premchand 1969, Cutt 1972, Toye 1981). Dismal run of this early innovation prompted the Central Government to adopt a revised version called outcome budget in 2005. The outcome budget is yet to emerge as a useful instrument to influence the budgetary decisions in both program formulation and resource allocation. The factors like lack of appropriate and acceptable performance- indicators focus on quantifiable outcomes instead of more acceptable outputs, inadequacies in costing process, stretched performance chain with gaps in information with regard to Central schemes, absence of an effective monitoring system to evaluate the results proved obstacles (Jena, 2012). The inclusion of performance indicators in the sector strategies to transform the MTEF to MTPF will depend upon strengthening of the outcome budget.

The Subnational Context

The States have traversed a long way from the late nineties and early 2000s (Rao and Jena,2009) when fiscal reforms were undertaken to stave off the imbalance and mounting debt burden. The States have shown fiscal discipline, particularly after adopting the fiscal rules in the form of fiscal responsibility and budget management (FRBM) Act. The compliance to the targets of fiscal rules to contain fiscal deficit and stabilizing debt overhang underpinned the trust over the ability of the States for the fiscal consolidation and a broad spectrum of political commitment to the fiscal rules. There are, however, concerns in the public financial management processes relating to resource allocations in the budget, predictability of fund flows, and efficiency in use of public resources. There is a need to move forward building upon the early successes to improve social and physical infrastructure for overall development, creating enabling environment for investments, reducing poverty and other deprivations in laggard States, improving employment and so on.

The abolition of Planning Commission and cessation of Central plan grants to the States after the recommendation of 14th Finance Commission (FFC) left the States with a crucial need for a medium-term budget planning process[15]. As the practice of plan approval from the Planning Commission ended, the focus has shifted to the ability of the State Governments to manage their own development path. Given the large functional responsibilities, consequent expenditure requirements, and the resource constraint, a multi-year expenditure plan with clear priorities

[15] The 14th Finance Commission (FFC) considered tax devolution to be the primary route of transfer of resources to States. The FFC enhanced the States' share in central taxes (untied transfers) to 42 percent from present 32 percent to enhance the flexibility of the States to take expenditure decisions based on their own priorities. Consequent to the enhancement of share of the states in the divisible pool of Central taxes, the Central Government has discontinued the central assistance to the State plans.

with budget constraint is necessary[16]. The indicators of sustainable development goals (SDGs) have been emerging as the new focus of development in the Government policies. The spending departments need effective medium terms spending plan to integrate the long-term SDG indicators into their sector strategies.

MTEF will be a useful instrument for the States to address some of the basic PFM issues at sub-national level[17]. The contemporary challenges faced by the States, judged from the basic objectives of the PEM system, are the issues related to the allocative and operational efficiency. Ensuring value for money and effective utilization of public resources to achieve desired results remained as the problem areas. The tendency of expanding the budget size, spreading resources thinly, and bias towards short-term goals adversely affected resource allocation in a prioritized manner. The issues relating to inadequacies in designing and implementing the programs, project appraisal and approval processes, and planning and monitoring mechanism remained as common themes across the States affecting the operational efficiency in service delivery. Post fiscal rules[18], the State Governments have improved their fiscal position and are in a stronger position to adoption budget reforms (Rao and Jena, 2009).

With the removal of plan and non-plan distinction, some uncertainty has arisen over the future role of the State-level planning bodies, usually the planning departments. These bodies should be effectively used as coordinating agencies among the departments to formulate appropriate strategies, policies and processes in a medium term. The planning departments can become repository of knowledge regarding public policies to facilitate capacity building of the spending departments in the areas of sector planning and performance management. They can help the spending departments in project appraisal to select the programs, costing, and strategies to achieve the program goals.

Concluding Remarks

The medium term expenditure framework in India needs to shed the mechanical approach to make it an efficient budgetary instrument. Decades of development plan and medium-term projections of fiscal variables under years of fiscal rules could not change the short horizon of the annual budget. The formal adoption of MTEF with projection of expenditure variables does not sufficiently inform the budgetary implications of policy changes. The need for investment and development of human and physical infrastructure many a times leads the governments both at the Central and State levels to plan more than they could support. The Government needs strengthen the MTEF process to establish a hard budget constraint in the budgeting process, improve the predictability in the flow of resources to ministries and departments, and improve the strategic priorities in resource allocation. With the end of the planning era, the Governments at national and sub-national level require a credible medium-term framework.

The Government should move ahead with the MTEF (or MTBF) by indicating availability of resources to the departments in a medium term to provide them the flexibility of prioritizing their expenditure plans to achieve the sector goals. This should be a forward-looking process

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[16] The State governments in India bear major portion of expenditure responsibilities and provide basic services in the field of health, education, water supply and sanitary services, electricity, transport and communication, agriculture and also have the responsibility of maintaining law and order and provide wide range of judicial services. The Constitution of India demarcates the functional responsibilities between the Central and the State Governments.

[17] For some of the expenditure management issues at the State level, see Jena, 2016 and Jena et al , 2016

[18] The State Governments adopted FRBM Act separately through their own State Acts. Central Government incentivized the States through debt restructuring facilities to adopt the fiscal rules.

where the medium term expenditure projection is updated consistent with the resource availability. Both the Ministry of Finance and the spending departments need to coordinate for resource allocation and program management within a medium-term framework. The MTEF can further develop into Medium-term Performance Framework (MTPF) by including performance indicators in the sector programs, if the output and outcome type budget get renewed attention. It is important, however, to allow the MTEF to stabilize and show positive impact on fiscal discipline, resource allocation, and service delivery.

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