Strengthening Medium Term Budget Frameworks

International Consortium on Governmental Financial Management

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Outline

• Definitions

• Medium-Term forecasting

• Institutional Challenges

• Analyzing MTBFs
Definitions

• **Medium-term budget framework (MTBF)** refers to a set of institutional arrangements for prioritizing, presenting, and managing revenue and expenditure over a period of three–five years.

• **Medium-term expenditure framework (MTEF)** is often used as a synonym of the MTBF concept, although the focus is on multi-year expenditure estimates.

• **MTBFs or MTEFs** constitute part of a wider framework of medium-term fiscal planning and view the MTEF very broadly as the integration of policy, planning, and budgeting within a medium-term perspective.

• World Bank interprets “MTEF” broadly to embrace 3 distinct frameworks:
  – *medium-term fiscal framework encompasses the top-down specification of the aggregate resource envelope and allocation of resources across spending agencies;*
  – *MTBF includes both the bottom-up determination of spending agency resource needs and a reconciliation of these requirements with the resource envelope;*
  – *Medium-term performance framework: emphasis is given to the measurement and evaluation of outputs and outcomes.*
# Key Features of MTBFs

**Advanced countries**

<table>
<thead>
<tr>
<th>Country</th>
<th>Soc</th>
<th>Sec</th>
<th>Debt</th>
<th>Interest</th>
<th>Local</th>
<th>Government</th>
<th>% of CG Spedning</th>
<th>Specificity</th>
<th>TIME HORIZON</th>
<th>DISCIPLINE</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>AGGREGATE EXPENDITURE CEILINGS</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
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<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Sweden</td>
<td>yes</td>
<td>No</td>
<td>T'fers</td>
<td>96%</td>
<td>Total Spending 27 Policy Areas</td>
<td>3</td>
<td>3-4 fixed</td>
<td>3rd- 4th year added each year</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Finland</td>
<td>Some</td>
<td>No</td>
<td>No</td>
<td>78%</td>
<td>Total Spending 13 Ministries</td>
<td>4</td>
<td>4 fixed</td>
<td>Every 4 year</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Netherlands</td>
<td>Yes</td>
<td>No</td>
<td>T'fers</td>
<td>80%</td>
<td>4 Sectors 26 Ministries</td>
<td>4</td>
<td>4 fixed</td>
<td>Every 4 year</td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>FIXED MINISTERAL PLANS</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
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<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>United Kingdom</td>
<td>No</td>
<td>No</td>
<td>T'fers</td>
<td>59%</td>
<td>25 Depts</td>
<td>3</td>
<td>3 fixed</td>
<td>Every 3 years</td>
<td></td>
<td></td>
</tr>
<tr>
<td>France</td>
<td>No</td>
<td>Yes</td>
<td>No</td>
<td>35%</td>
<td>30 Missions</td>
<td>3</td>
<td>2 fixed + 1 flexible</td>
<td>Every 2 years</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
## Coverage and characteristics of MTBFs
### African case studies: characteristics

<table>
<thead>
<tr>
<th></th>
<th>Kenya</th>
<th>Namibia</th>
<th>S. Africa</th>
<th>Tanzania</th>
<th>Uganda</th>
<th>Zambia</th>
<th>Advanced Countries*</th>
</tr>
</thead>
<tbody>
<tr>
<td>Lead ministry**</td>
<td>National Treasury and MoP</td>
<td>MoF</td>
<td>NT</td>
<td>MoF and Planning Commission</td>
<td>MoFP</td>
<td>MoFP</td>
<td>Usually MoF</td>
</tr>
<tr>
<td>Characteristics and Coverage</td>
<td>BCG</td>
<td>BCG</td>
<td>GG</td>
<td>BCG</td>
<td>BCG</td>
<td>BCG</td>
<td>CG or GG</td>
</tr>
<tr>
<td>Excluded transactions</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
<td>Varied practices</td>
</tr>
<tr>
<td>Social security</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
<td></td>
</tr>
<tr>
<td>Debt interest</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
<td></td>
</tr>
<tr>
<td>Time frame</td>
<td>3 years</td>
<td>3 years</td>
<td>3 years</td>
<td>5 years</td>
<td>5 years</td>
<td>3 years</td>
<td>3-4 years</td>
</tr>
<tr>
<td>Fixed or flexible framework</td>
<td>Rolling</td>
<td>Rolling</td>
<td>Rolling</td>
<td>Rolling</td>
<td>Rolling</td>
<td>Rolling</td>
<td>Rolling or flexible</td>
</tr>
<tr>
<td>Binding or indicative ceilings</td>
<td>Indicative</td>
<td>Indicative</td>
<td>Indicative</td>
<td>Indicative</td>
<td>Indicative</td>
<td>Indicative</td>
<td>Indicative or binding</td>
</tr>
<tr>
<td>Ceilings approved by legislature</td>
<td>Yes</td>
<td>No</td>
<td>Yes</td>
<td>No</td>
<td>Yes</td>
<td>No</td>
<td>In some cases</td>
</tr>
<tr>
<td>External aid included</td>
<td>Yes</td>
<td>No</td>
<td>No</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
<td>Not relevant</td>
</tr>
<tr>
<td>Publication of MTEF</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
<td>No</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
</tr>
<tr>
<td>Share of external aid****</td>
<td>8%</td>
<td>&lt;1%</td>
<td>&lt;1%</td>
<td>39%</td>
<td>39%</td>
<td>10%</td>
<td>N.A.</td>
</tr>
</tbody>
</table>

Notes: BCG = budgetary central government; CG = central government; GG = general government. In the case countries, transfers to local governments are included in the budget.
Figure 4. Annual and Medium-Term Forecast Errors in Revenue, 2000-12
(Percent of Outturn)

Average Forecast Errors in Revenue

Revenue Forecast Error in t and t+2

Source: FAD staff calculations.
Medium-Term Forecasting
Expenditure

Figure 5. Annual and Medium-Term Expenditure Forecast Errors, 2000-12
(Percent of Outturn)

Average Forecast Errors for Expenditure

Expenditure Forecast Error in t and t+2

Source: FAD staff calculations.
Medium-Term Forecasting

Expenditure: components

Figure 6. Annual and Medium Expenditure Forecast Errors, 2000-12

a. Development Expenditure
   (Percent of Outturn)

b. Efficiency of Capital Spending
   (Hybrid Indicator)

C. Recurrent Expenditure
   (Percent of Outturn)

d. Wage Expenditure
   (Percent of Outturn)

Source: FAD staff calculations.
Medium-Term Forecasting
Budget Deficit

Figure 8. Budget Deficit: Annual and Medium-Term Forecast Errors, 2000-12
(Percent of Outturn)

Average Forecast Errors for Budget Deficit

Source: FAD staff calculations.

1 The average error on the forecasts of the budget deficit in advanced countries is -0.06 in year $t$, -0.09 in year $t+1$, and -0.20 in year $t+2$, and is not visible due to the scale of the chart.
Challenges to adopting MTBFs

Institutional weaknesses

- Weak role of the cabinet in budgetary decision-making
- Limited impact of national development plans on budgetary decisions
- Improving public investment management
- Inefficient planning and monitoring of external aid
- Inadequate institutions for executing the budget
- Underdeveloped parliamentary involvement and oversight
Analyzing MTBFs
Prerequisites of the MTBFs

- **Clarity and transparency of the MTBF**
  - Does the country have a clear and predictable fiscal outlook over the medium term, and a longer-term vision for some advanced economies.
  - Existence of a credible fiscal strategy, based on accurate and coherent macroeconomic forecasts.
  - A set of binding fiscal rules is another characteristic of an advanced MTBF

- **Credibility of the budget process**
  - How well does the budget reflect national priorities
  - Reliability of spending estimates
  - Nature of spending ceilings
  - Integrity of the budget
Analyzing MTBFs
Prerequisites of the MTBFs

- **Appropriation and budget classification**
  - Appropriation structure of the budget
  - Classification of the budget
  - Chart of accounts compliance with international standards

- **Institutional characteristics of the budget process**
  - Nature of engagement between key players in the budget
  - Challenge function of the Ministry of Finance
  - Cabinet involvement in budget approval
  - Coverage and transparency of budget documents

- **Oversight of the budget by the legislature**
  - Quality of oversight provided by legislature
  - Existence of an independent fiscal council
New framework for MTBFs

Four Phases of the MTBFs

- **Phase I (Pre-MTBF)**
  - No meaningful multi-year perspective
  - Produces annual budget based on traditional line items
  - Budget preparation is driven from the center

- **Phase II (Maturing MTBF)**
  - Basic medium-term expenditure planning framework
  - Expenditure estimates or ceilings in outer years are indicative
  - Link between planning and resource allocation is weak
  - Strategic and development plans are not costed adequately
  - Planning and budgeting functions are poorly aligned
New framework for MTBFs
Four Phases of the MTBFs

• **Phase III (Maturing MTBF)**
  - An established MTBF with a credible link between planning and budgeting phase
  - Reliable macro-fiscal framework
  - Budget ceilings are effective (binding)
  - Some aspects of program-based budgeting

• **Phase IV (Advanced MTBF)**
  - A mature MTBF that has high level of credibility with stakeholders
  - Well-developed accountability mechanisms for executive branch
  - Strong performance orientation
  - Regular spending reviews
# Phases in development of MTBFs

## Credible budget process

<table>
<thead>
<tr>
<th>Characteristics</th>
<th>Pre-MTBF</th>
<th>Elementary MTBF</th>
<th>Maturing MTBF</th>
<th>Advanced MTBF</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Integration of capital/development spending</strong></td>
<td>Capital and recurrent budgets are prepared separately</td>
<td>Capital budget is partially integrated but the planning ministry sets priorities</td>
<td>Capital budget is fully integrated; the ministry of finance sets priorities on capital spending</td>
<td>Multiyear capital appropriations are fully integrated in budget</td>
</tr>
<tr>
<td><strong>Extent of in-year revisions to approved budget</strong></td>
<td>Many unauthorized revisions</td>
<td>Many revisions, authorized by central budget office</td>
<td>Some revisions, authorized by budget office and legislature</td>
<td>Revisions to budgets are rare</td>
</tr>
<tr>
<td><strong>Arrangements for managing contingency reserves</strong></td>
<td>Contingency reserves are not used</td>
<td>Contingency reserves exist, but without well-defined rules on their size/use</td>
<td>Contingency reserves exist, but rules are not strictly enforced</td>
<td>Strict rules for managing contingencies</td>
</tr>
</tbody>
</table>

## Appropriation and budget classification

<table>
<thead>
<tr>
<th>Appropriation structure</th>
<th>Economic classification; large number of line items</th>
<th>Economic classification; fewer line items</th>
<th>Program structure introduced but for information only</th>
<th>Appropriation by program</th>
</tr>
</thead>
<tbody>
<tr>
<td>Performance orientation of the budget</td>
<td>None</td>
<td>Limited</td>
<td>Performance targets set at program level</td>
<td>Legislative review of performance targets</td>
</tr>
<tr>
<td>Classification of the budget</td>
<td>Basic economic and administrative classification only</td>
<td>Classification largely based on national standards</td>
<td>Classification broadly compliant with international standards</td>
<td>Classification fully compliant with international standards</td>
</tr>
</tbody>
</table>
### Phases in development of MTBFs

#### Institutional characteristics

<table>
<thead>
<tr>
<th>Characteristics</th>
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<th>Maturing MTBF</th>
<th>Advanced MTBF</th>
</tr>
</thead>
<tbody>
<tr>
<td>Devolved authority of line ministries to execute their budgets</td>
<td>Little devolution of authority, with strong central control</td>
<td>Some devolution of authority, with central control</td>
<td>Substantial devolution of authority, with central oversight</td>
<td>Full devolution of authority, with central monitoring of overall spending</td>
</tr>
<tr>
<td>Cabinet involvement in budget approval</td>
<td>Ministry of finance has primary role in preparing and approving budget</td>
<td>Cabinet approves annual budget, but with limited policy engagement</td>
<td>Cabinet approves budget ceilings, and annual budget, with substantive policy engagement</td>
<td>Cabinet approves MTFF, budget ceilings and MTBF</td>
</tr>
<tr>
<td>Coverage and transparency of budget documents</td>
<td>Documents contain basic information only, not published</td>
<td>Documents provide limited information, restricted public access</td>
<td>Documents provide substantial information, wide public access</td>
<td>Documents provide comprehensive information, published on a website</td>
</tr>
<tr>
<td>Oversight of the budget by the legislature</td>
<td>No effective oversight of fiscal strategy or budget by legislature</td>
<td>Some debates on annual budget bill, but limited consultation with executive</td>
<td>Pre-budget consultations with the executive</td>
<td>Legislature is consulted on MTFF and budget, and has powers to amend the budget</td>
</tr>
<tr>
<td>Review of fiscal strategy by an independent agency</td>
<td>None</td>
<td>Limited review of fiscal strategy, except within the executive</td>
<td>Informal mechanisms for independent review</td>
<td>Independent fiscal council established</td>
</tr>
</tbody>
</table>

#### Institutional characteristics of the budget process (continued)
Conclusion
Where does that leave the MTEF?

• In *Public Budgeting and Finance (2009)*, S. Schiavo-Campo advises that:
  “the two ingredients of a potentially successful MTEF approach are gradualism and selectivity, and the two main conditions of success are simplicity and communication”.

• Choose an appropriate variant of MTEF, in line with local institutional capacity

• Within the various reform steps, prioritize the following:
  – Formation of a macro-fiscal analysis and projections unit
  – Focus on a well formulated, realistic annual budget
  – Produce a fiscal strategy paper that has a medium-term perspective/ targets
  – Run a budget process that allows Ministry of Finance to play a challenge function
  – Design the MTEF to facilitate and support good political decision-making
  – Introduce independent oversight of the budget (parliamentary committees)
  – Provide comprehensive budget information (budget appropriation and outturn)

• Approach advanced budgeting features with caution and realism, when fundamentals are well entrenched
Thank you