Medium Term Budget Framework

Why and How

High level workshop
Suva, April 4-7 2017

Presenter
Francesco Luna
Outline

I. Introduction
II. Motivation and key features of an MTBF
III. Institutions to support MTBF
Introduction

- Natura Noverca (Plinius the old)
  - Nature as Stepmother (Cinderella style)

- Life is a beach (Southern California rendition)

- .... Sheet happens (Forrest Gump)
And when it rains… it pours…

**Samoa**, 2009 tsunami: 21.4% of GDP
2012 cyclone Evan 26.6% of GDP

Projections are not encouraging…

**The Marshall Islands**: next 50 years 10% chance of incurring a loss of about 80% of GDP

http://pcrafi.sopac.org/documents/
Fundamental choice of approach:

Passive (fatalistic) or Pro-active?

- Passive
- Business as usual

- Proactive
- Medium term commitment
Proactive approach

ESSENTIAL FACTOR FOR SUCCESS

Unwavering political commitment

SUPPORTING POLICY TOOLS/INSTITUTIONS

❖ Medium Term Budget Framework
❖ Top-Down Budgeting
Definition of MTBF...

A set of systems, rules, and procedures to ensure that fiscal plans take into consideration:

- their impact over several years
- future events which may affect government accounts

It includes:

- requirements to present medium-term information at specific times
- procedures for making multi-year forecasts and plans for revenue and expenditure
- obligations to set numerical expenditure targets, whether binding or indicative, beyond the annual budget horizon
Why MTBF matters

1. Signaling future changes → managing expectations and pressure to spend, and allowing time to adapt
2. Capturing deferred effects → decisions today have consequences tomorrow
3. Making non-discretionary into discretionary → all policies can be changed with enough time
4. Committing to future expenditure limits → binding limits addresses time-inconsistency of spending preferences
5. Lags in public decision making → decision and implementation and impact lags
Goals of MTBF

1. To reinforce aggregate fiscal discipline ➔ presentation of deferred effects and restrictions on future budgets

2. To facilitate a more strategic allocation of expenditure ➔ early reaction to future adverse developments and provide an additional dimension in policy making

3. To encourage more efficient inter-temporal planning ➔ greater transparency and certainty to budget holders about their likely future resources
Key Features of MTBFs

**Credibility**
- Audit of Macro Assumptions
- Multi-year Costings
- Budget Sincerity Rules
- Reconciliation of Changes

**Discipline**
- SW/FIN/NL: Aggregate Ceilings
- UK/FR: Ministerial Ceilings
- AUS: Program Estimates

**Enforcement**
- Top-down Budgeting
- Commitment Controls
- Reserves & Margins
- Carry-over Rules

**Legitimacy**
- SW/FIN/NL: Coal. Agreements
- SW: Frame Budgeting
- UK: Spending Reviews
- FR: RGPP
- AUS: Exp Review Cttee

**PREREQUISITES**
- i. Credible annual budget
- ii. Prudent macro projections
- iii. Medium-term fiscal objectives
- iv. Unified & comprehensive budget process

**a. Multi-year spending limits**
- SW/FIN/NL: Aggregate Ceilings
- UK/FR: Ministerial Ceilings
- AUS: Program Estimates

**b. Expenditure Prioritization**
- FIN/NL: Coal. Agreements
- SW: Frame Budgeting
- UK: Spending Reviews
- FR: RGPP
- AUS: Exp Review Cttee

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Prerequisites

a. Credible annual budget
b. Prudent medium-term macroeconomic projections
c. Stable medium-term fiscal objectives
d. Comprehensive and unified budget process
MTBF to be accompanied by…

Top-Down Budgeting

1. Total Expenditure
   - Total expenditure is determined based on
     - Macroeconomic situation
     - Fiscal objectives or rules, e.g., fiscal balance or debt limit
     - Projected revenue

2. Sectoral Allocation
   - Subject to decision on total expenditure in stage 1, a sectoral allocation is decided and formalized through ceilings
     - no-policy-change/baseline assessment of existing policies
     - allocation of fiscal space/distribution of savings requirements

3. Budget Details
   - Subject to sectoral ceilings, the details of the budget are prepared
     - reallocations within ceilings can (normally) be allowed
     - proposals in addition to the ceilings are rejected
Key Features of a successful MTBF

a. Multi-year spending limits

b. Expenditure prioritization
   - Ex: Wage increase or investment in resilient infrastructure? (in the hands-on exercise)

c. Expenditure controls
   - Ex: cost drivers and how to protect reserves

d. Accountability arrangements
### i. Commitment Controls
MoF authorization needed before line ministries or ministers can enter into multi-year:
- **contractual** commitments
- **legal** commitments
- **policy** commitments

### ii. Key Cost Drivers & Risks
Residual MoF controls on:
- Workforce, pay, & pensions
- Guarantees and PPPs
- Acquisition/disposal of assets
- Tax expenditures

### iii. Reserves and Margins
Multiyear projections make provision for:
- **Reserve** for contingencies that arise during the budget year
- **Planning margin** to fund new policy measures in future budgets

### iv. Carryover Restrictions
Numerical restrictions on one or more of:
- Annual **accumulation** of underspends
- Total **stock** of accumulated carryover “entitlement”
- Annual **drawdown** of accumulated underspending over forthcoming year
Contingency Reserves
Size and Access Rules

Access Criteria: Expenditure must be:
- Unforeseeable
- Unavoidable
- Un-absorbable

Access Procedure: Ministry must state:
- How pressure matches criteria
- Mitigating actions taken
- Remaining pressure
- Action to address underlying cause

Reporting on Utilization:
- Qtrly to Cabinet on claims & “threats”
- Qtrly to Parliament on claims & balance
- NAO audit of claims against criteria
- Claims deducted from carryover stock
Lessons from international experience

- MTBF preparation process follows a similar pattern in successful examples
  - Assessing the medium term impact of present decisions
  - Integration with budget process
  - Reconciliation of top-down/bottom-up approaches
  - Separation of baseline estimates from discussion of savings and new policies
- But diversity in role of forward years in future budget preparation
  - From rolling and indicative to fixed and binding...
  - ... but tailoring is common (UK, France, Sweden)
  - Reflects different objectives for the reform and pre-existing institutions
- Need to align MTBF preparation with fiscal objectives
  - Mutual reinforcement of MTEF and fiscal rules
  - Importance of scope consistency
- The MTBF development must be thought within the PFM reform agenda
  - In the end “medium term approach” should be a natural component of decision making
Thank you for your attention
Extra slides covering different aspects touched in the presentation
Prudent medium-term macroeconomic projections

Average Error in Forecasting Real GDP Growth, 2000-2007
(In percent of real growth, Actual-Forecast)
<table>
<thead>
<tr>
<th>Country</th>
<th>National objective</th>
<th>Supranational objective</th>
<th>Statutory base</th>
<th>Coverage</th>
<th>Time-frame</th>
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<tbody>
<tr>
<td></td>
<td></td>
<td></td>
<td>Political</td>
<td>Central</td>
<td>General</td>
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<td>Australia</td>
<td>Balance, Debt</td>
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<td>Brazil</td>
<td>Expenditure, Debt</td>
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<tr>
<td>Chile</td>
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<td>Canada</td>
<td>Expenditure, Balance, Debt</td>
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<td>X</td>
<td></td>
</tr>
<tr>
<td>France</td>
<td>Expenditure, Balance, Debt</td>
<td>X</td>
<td>X</td>
<td>X</td>
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<tr>
<td>Indonesia</td>
<td>Balance, Debt</td>
<td>---</td>
<td>X</td>
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<tr>
<td>Japan</td>
<td>Expenditure</td>
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<tr>
<td>Mexico</td>
<td>Balance</td>
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<td>Netherlands</td>
<td>Expenditure, Balance, Debt</td>
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<td>Switzerland</td>
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</table>
### A unified budget process

<table>
<thead>
<tr>
<th>Issue</th>
<th>Explanation</th>
<th>Typical Challenges</th>
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</thead>
<tbody>
<tr>
<td>Budget Coverage</td>
<td>No large extra-budgetary funds</td>
<td>Large Social Security and Health Funds</td>
</tr>
<tr>
<td>Budget Fragmentation</td>
<td>All expenditure authorized together</td>
<td>Budget split between current and capital</td>
</tr>
<tr>
<td>Earmarked Revenues</td>
<td>Limited earmarking of revenue to expenditure</td>
<td>Fuel surcharges for road maintenance</td>
</tr>
<tr>
<td>Standing Commitments</td>
<td>No input commitments that can conflict with overall ceiling</td>
<td>Laws requiring fixed budget transfer to specific purposes</td>
</tr>
<tr>
<td>Parliamentary Approval</td>
<td>Limited scope for Parliament to amend budget</td>
<td>Parliament can increase without finding reductions</td>
</tr>
<tr>
<td>Supplementary Budgets</td>
<td>Supplementary budgets are rare or expenditure neutral</td>
<td>Supplementaries are significant and impact policy</td>
</tr>
</tbody>
</table>

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Expenditure prioritization

<table>
<thead>
<tr>
<th>COUNTRY</th>
<th>NO. OF 1st LEVEL PRIORITIZATION UNITS</th>
<th>FIXITY</th>
<th>MEDIUM-TERM PRIORITIZATION DECISION IN GOV’T</th>
<th>PARLIAMENTARY STATUS</th>
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<tr>
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<td>LEGISLATED</td>
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<td>FOR INFO</td>
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<td>MINISTERIAL ALLOCATIONS</td>
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<td>FUNCTIONAL/PROGRAM ALLOCATIONS</td>
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<td>ECONOMIC CATEGORIES</td>
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<td>Belgium</td>
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<td>Japan</td>
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</table>
Accountability Arrangements

Budget Sincerity Provisions

What are they?
Legal obligation on the MoF to certify that budget projections presented to Parliament reflect:
- all policy decisions announced by the government; and
- any other circumstances that may have an impact on the economic or fiscal outlook.

Examples
- NZ Fiscal Responsibility Act (1994)
- Australia Charter of Budget Honesty (1998)

Reconciliation of Changes to Ceilings

<table>
<thead>
<tr>
<th>Factor</th>
<th>Explanation</th>
<th>Examples</th>
</tr>
</thead>
<tbody>
<tr>
<td>Macro-economic</td>
<td>Revisions to macroeconomic parameters</td>
<td>GDP, inflation, exchange rate</td>
</tr>
<tr>
<td>Other Parameters</td>
<td>Revisions to operational parameters</td>
<td>Prices of goods, volumes of claimants</td>
</tr>
<tr>
<td>Accounting Adjustments</td>
<td>Revisions in accounting treatment</td>
<td>Reclassifying expenditure between ministries</td>
</tr>
<tr>
<td>Policy Measures</td>
<td>Discretionary additions or cuts to ceilings</td>
<td>New investment, efficiency savings</td>
</tr>
<tr>
<td>Carryovers</td>
<td>Net drawdown or accumulation of carryovers</td>
<td>As authorized by MoF at start of year</td>
</tr>
<tr>
<td>Over/Under Spending</td>
<td>Operational overruns or underspends</td>
<td>Claims on reserve, unauthorized overspending</td>
</tr>
</tbody>
</table>