

What is Medium Term Expenditure Framework (MTEF)?

MTEF is a transparent planning and budget formulation process within which the Cabinet and central agencies establish credible contracts for allocating public resources to their strategic priorities while ensuring overall fiscal discipline. The process entails two main objectives: the first aims at setting fiscal targets, the second aims at allocating resources to strategic priorities within these targets.

“Allocation to strategic priorities” requires determination of government wide priorities by the Cabinet collectively and portfolio-wide priorities by Ministries individually. Transparency requires that the priorities of the Cabinet are explained in a Budget Policy Statement whereas the priorities of individual ministries are explained in their Corporate Plans.

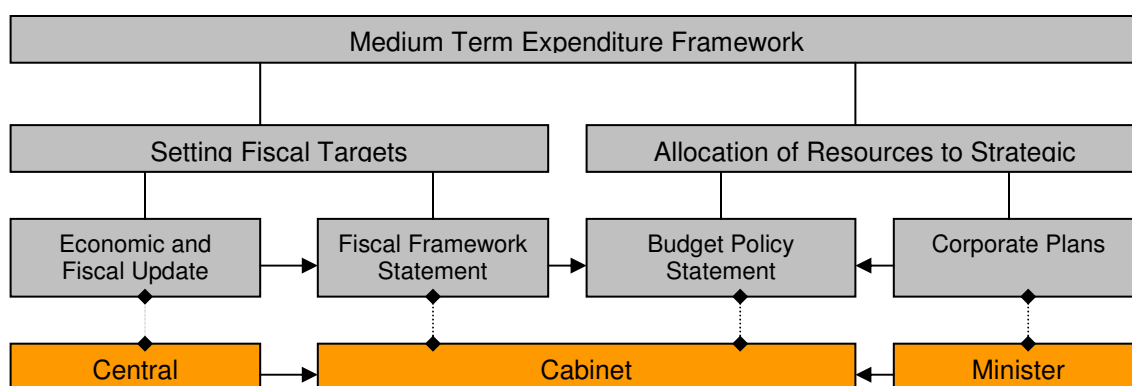


Exhibit 1. General look at MTEF

The process of setting fiscal targets consists of two separable sub-processes: the first is the preparation of an economic and fiscal update by central agencies, and the second is the setting of fiscal targets by the Cabinet. Transparency requires that the results of the first are published in an Economic and Fiscal Update (EFU) Report and results of the second are published in a Fiscal Strategy Report.

This study separates the complete MTEF process into four sub-processes. Three criteria were considered in deciding the sub-processes: Sequencing, organizational units responsible from processes, documents produced at the end of the sub-process.

Sub-processes, their organizational units and the documents they produce are:

Economic and Fiscal Environment Update	Central Agencies	Economic & Fiscal Update
Budget Policy Statement	Cabinet	Budget Policy Statement
Corporate Plans & Cabinet-Sector Negotiations	Ministries / Cabinet	Corporate Plans
Budget Documentation	Central Agencies	Budget

Updating economic and fiscal environment can be considered as the beginning of the budget preparation cycle. EFU guides the budget deliberations between Cabinet and Ministries. In general Central Government Agencies are responsible from this document, namely Planning Office, Budget Office and the Treasury. The main activities of this sub-process are the determination of economic outlook and fiscal outlook. (Exhibit 2). *Prepare Economic and Fiscal Update – Level 1*

The time horizon for the outlook is a key issue that needs to be determined. It is expected that as the country gets more experienced in MTEF, the time horizon stretches further into the future. Although the involved agencies need to focus on the reliability and the precision of the economic and fiscal outlook, the uncertainty that is involved in any forecast has to be recognized. The economic and fiscal outlook can be used as an excuse by the skeptics for discrediting MTEF and the experience may justify their concern especially during the early years its implementation. As in any forecasting or future focused planning, the organizations, the bureaucracy and the government will make both judgmental and predictive errors but will perform better at this task as experience accumulates. The recognition of the uncertainties and their impact on financial position and other fiscal risks should be considered and communicated to the related parties in advance. (South African labor negotiations was hampered due the union's disappointment over unsuccessful forecast of the inflation rate) (Exhibit 3) *Determine Impact of Government Policy Changes – Level 3* The Budget Office should be encouraged to provide detailed financial statements for the upcoming years under different scenarios. (Exhibit 4) *Update/Produce Financial Statement Tables – Level 3*

The document is expected to provide information on fiscal impacts of government policy changes. The detail of this impact can be as specific as quantifiable and unquantifiable contingent liabilities. (Exhibit 5) *Update/Determine Contingent Liabilities – Level 3*

Economic and Fiscal Update Report should also provide advise and request for further studies on areas that require more information. Future focused studies depend on many assumptions and sometimes simplifications. More studies can eliminate the need for simplifications and help to justify the assumptions. While the economic and fiscal outlook can be considered as a forecasting attempt in many aspects it also serves as a planning function which will benefit from these studies. This information can be provided both by local institutions or international organizations. One possible area that most EFU reports suffer from its lacking is the private sector data. The non existence of information should be recognized and considered for the future reports.

The approval of the document by the Auditor General significantly adds to its credibility. It also brings a healthy questioning mechanism to the process and establishes a transparency and accountability culture. MTEF considers the transparency and accountability as key elements for the success of the process.

The document should be made public as it is submitted to the Cabinet and the Ministries.

Providing economic and fiscal outlook of a nation is a thankless task. It does not please many people or organizations. It requires constant judgment in balancing the trade-offs between specificity and accuracy, optimism and reality. It consists of many components that are specific to a country and the organization. There are many activities and many levels of sub-processes that need to be performed to complete the EFU. The reference model provided in this study is to be used as a general outline and to be modified according to the realities and capabilities of the specific governments. Exhibit 6 *Update Presentation* provides all the functions that were considered in this study. A more thorough study should integrate all the functions with organizational and informational views as well.

The second sub-process of MTEF is the production of Fiscal Strategy Report and Budget Policy Statement, both by the Cabinet. One appropriate generalization of MTEF is that it is a top down strategic allocation guide and a bottom up cost template. The Budget Policy Statement is the strategic allocation guide of the government. It takes its lead from the government program. The program itself becomes a part of MTEF. For some it may be considered too ambitious for the budget process to house the Government Program. Regardless of its home, budget preparation has to install procedures to encourage the Cabinet to determine and evaluate its priorities. The process that is designed in this study assumes that the government has already generated the Government Program. (Exhibit 7) *Budget Policy Statement V2*

After reviewing the EFU and the Government Program, Cabinet sets long term objectives for macroeconomic policy and fiscal policy. These objectives are detailed through short-term intentions. With the help of the Finance Ministry, Cabinet sets targets for macroeconomic determinants such as growth, inflation interest rate, exchange rate and public debt. This data is published in Fiscal Strategy Report. Publication of the report helps to establish the transparency and accountability culture.

In countries where MTEF is being implemented for some time, most of the adjustment are marginal and rather straight forward. However it is critical for a successful MTEF that review of new initiatives has to be integrated periodically and the changing scenarios has to be updated as new data become available. This allows the Cabinet to review and reconsider budget priorities with the latest information. (Australia's new database system allows continuous update).

The setting of the fiscal targets is followed by allocation of resources. Cabinet tries to integrate the new expenditure pressures to EFU. They set budget priorities. These are strategic negotiations among the sectors for resource allocation. The outcome of these negotiations defines the Budget Policy

Statement. Publication of the Budget Policy Statement formalizes sectoral activity. Now the ministries have their map to work on their portfolios. The publication and distribution of Budget Policy Statement initiates the budget call circular. The burden is on the sectors and the Cabinet assumes its monitoring role until the sectors present their Portfolio Budget Statements.

Now that the sectors have their mandates from the Cabinet, they can start finalizing and documenting their sectoral budget for final baseline negotiations. It should be noted that the efforts of the sectors of their review process (both the previous year review and fundamental review) and Cabinet deliberations for Budget Policy Statement occur simultaneously. The details of the fundamental review is given in Exhibit 8. *Part of developing Sector Level MTEF – Level 1* The communication between the two organizations (Cabinet and Ministries) is an important determinant for the success of the whole budget process. It is hard to offer a generic process design to encourage and formalize this communication. It depends on the organizational cultures and even personalities of the political appointees. Every specific organization should consider establishing this information flow with the objective of providing the Cabinet with the latest changes in their portfolios and the receiving updated information on potential funds from the Cabinet.

There is an important decision that needs to be made at this stage in terms of setting the baselines. The trade-off between Cabinet's hard ceiling versus negotiable baseline dictates the culture of planning within the ministries. If the Cabinet imposes hard ceilings early in the process, it may lead the sectors to money management rather than strategic resource allocation. Although both are necessary, establishing a strategic prioritization culture within ministries brings many desirable assets to the organization such as planning, performance measurement, accountability, and transparency. If part of MTEF's objective is to encourage the sectors to adopt a culture of strategic management and creating a competitive platform for resource allocation, the hard ceilings may be postponed in favor of soft baseline figures to guide and frame the portfolio budget statements.

Going back to the fundamental review, it should be noted that whole sub-process is an important one in budget preparation cycle. It is a strategic planning exercise for the sectors from setting the mission to providing performance measures in forms of cost templates. Specification of outcomes and outputs, costing out outputs is a solid attempt to formalize corporate plans with accountability and incentives for efficiency. Since the sector still contemplates on negotiating on their baseline, there is an inherent incentive to make these plans credible, consistent, efficient and effective. As the sector uses these plans to negotiate for more resources, These plans also bind them as a set performance measures.

The sectors submit their budget initiatives to the Cabinet and start a negotiation cycle for resource envelopes. At the Cabinet level these negotiations are

extended to include all sectors and a competitive platform is created for limited resources based on the government priorities and the credibility of the corporate plans of sectors. Exhibit 9. *Second part of Developing sector level MTEF*. This study believes the impact of letting the sectors compete for funds on the merit of their corporate plans before the hard ceilings are established. Some may argue that without the hard ceilings which were set early in the budget preparation cycle will cause over commitment. It is arguable whether that outcome is unavoidable. Although it increases the chances of over commitment, with a structured process and a decisive Cabinet it can be avoided along with the benefits of strategic planning.

The last sub-process of MTEF is producing the Budget Documents. The consolidation of all corporate budgets by the sectors, preparation of the appropriation bill and fiscal strategy report completes the budget preparation cycle before the documents Budget Estimates) are submitted to the Parliament. Exhibit 10. *Produce Budget Documents- Level 1*

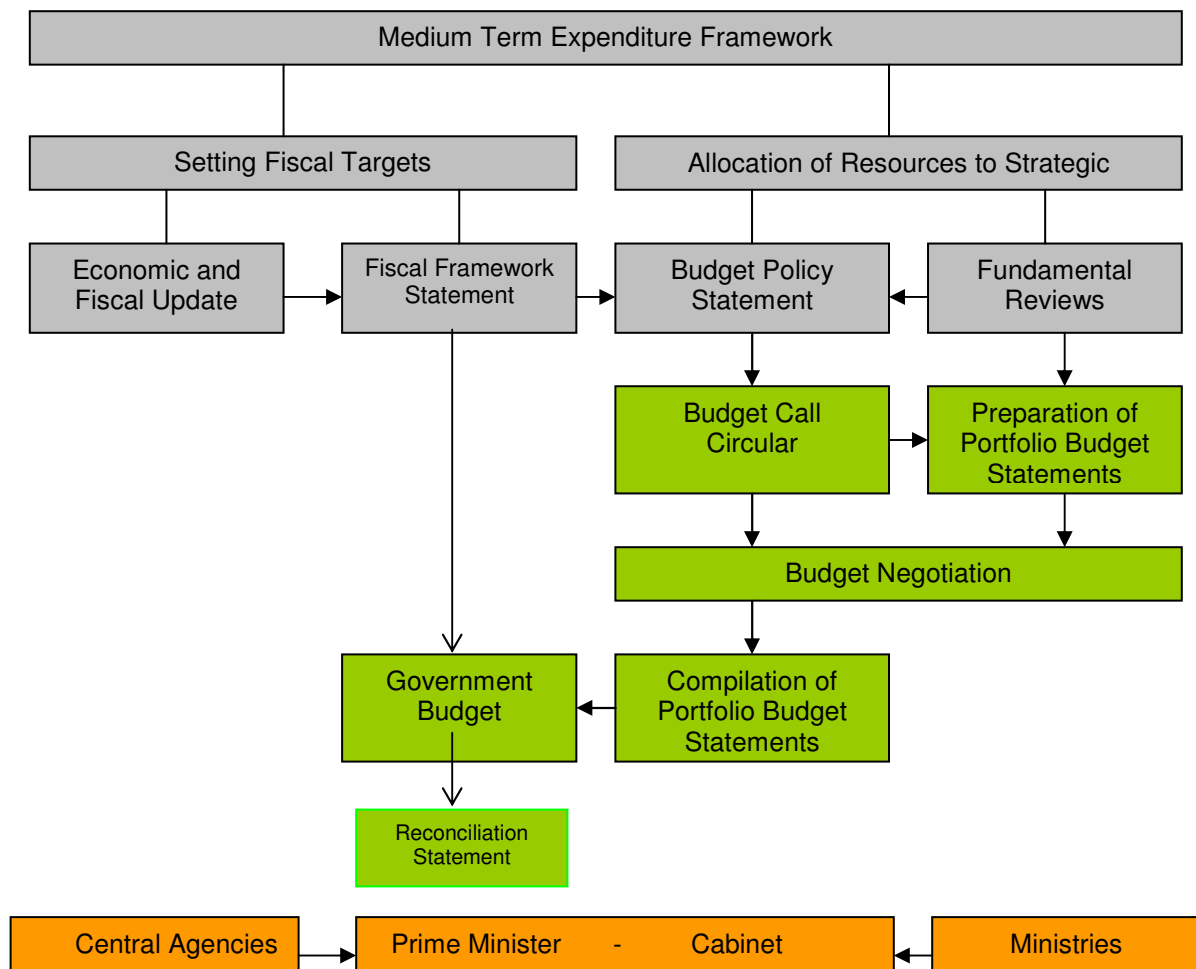


Exhibit 11. Summary flow of High Level Processes.

Exhibit 12 *Budget Formulation (MTEF) – High Level* provides the dynamic flow of the activities which were covered in the previous sections. It also includes the organizational units that are responsible for the activities. Information requirements and flows are integrated to the process flow as well.

The complete MTEF process, the way it is considered in this study is divided in to four major groups as mentioned earlier. Following EFU strategic guidance is provided by the Cabinet for the sectors. As the sectors provide information for structuring of this guidance, they also build their own corporate plans. This subprocess is the initial stages of group 3. In the later phases of group 3, the sectors negotiate the baselines with the Cabinet by supporting their claims with their Portfolio budget statements. The last group is the clerical sub-process of putting together the documents to be submitted to the Parliament.

Each of these sub-groups end up with an important document that feed the next sub-process. The first group is the production of the EFU. EFU initiates the budget policy statement process which generates that document. The third sub-process generates Portfolio Budget Statements for the sectors and the last sub-process is the produces the Budget.

Designing a MTEF

There is a natural sequence in designing budgeting reforms. Ensure the basics; traditional budget processes (green area) must be in place before designing a MTEF (gray area). Implementing a basic MTEF at the Center of Government is the prerequisite of designing reforms to regulate performance of the rest of the public sector entities (beige area).

Understanding the political economy of the Center of Government is key in designing a MTEF. First, the Cabinet matters. Tenure of the Cabinet matters; short tenured cabinets may not need to form medium term commitments. Form of the cabinet matters; strategic allocation process will be more complex in a coalition cabinet than in an uni-party one. Moreover, the form and the tenure of cabinet have an impact on the power of the Prime Minister and the Minister of Finance over the rest of the cabinet. When PM is weak, the capability of the cabinet making collective decisions lessens.

Next the central agencies matter. Their organization matter; they may be divided as a separate planning office, budget office and treasury, reporting to different ministers. Or they may be under one roof, reporting to the Minister of Finance. Their culture matter: having a senior executive service occupying the positions in central agencies may help in creating a culture of accountability. Deep political appointments may prevent them to have the capacity to provide political insulation with their regulations.

Once these issues are understood, the first step is getting the Center of Government want to make credible commitments among them. The Bank should be able to demonstrate “what happens” cases when there is such a commitment and when there is not. This presentation should aim at getting the Center of Government to understand the necessity of making credible commitments among them. Message is simple: if the center is not able to craft credible commitments within itself its ability to regulate the rest of the public sector will also be very low. Hence, it can not undertake reforms to improve the performance of other public entities. Public sector performance will continually decline. This is a pre-requirement.

When the Center of Government realizes the need and wants to establish credible commitments among them, the Bank should be able to demonstrate generally accepted practices, principles and standards governing the process of shaping credible commitments at the Center of Government. That is MTEF.

Measuring a Government’s Commitment to MTEF

The transparency conditions of MTEF allow easy measurement of government’s commitment to MTEF. Publishing the Economic and Fiscal Update, Fiscal Framework Statement, Budget Policy Statement and Corporate Plans of Ministries are measures for government’s commitment. This commitment could be formalized by a Public Information Act or by a Public Finance Act.

The IMF’s Manual for Fiscal Transparency lays out the generally accepted practices, principles and standards governing the form, content and timing of these reports.

Measuring a Government’s Progress towards MTEF

Once the measure is government’s reporting requirements, setting progress indicators becomes easy as well. It is the adoption of generally accepted practices, principles and standards governing the form, content and timing of these reports. The government should decide the order it will adopt these institutions and the preparation time necessary for their adoption.