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# **Overall Design and Framework of MTEF**

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*Session 1-1 : Conceptual Framework*

## **PRESENTERS**



## Developing a Medium-Term Expenditure Framework (MTEF)

by  
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Moving towards a MTEF involves building upon the current budget and policy decision-making process, with an aim to overcome some of the current incentives in the process and improve public expenditure decisions and management. This paper will explore the stages of a MTEF process, the role of some of the key institutions in the MTEF process, and references international practices to illustrate points. The paper is not exhaustive, but tries to provide more insight into a good budget formulation process, and some considerations for countries to keep in mind as they seek to strengthen budget formulation. Some aspects of improved budget formulation have already been addressed in the main paper, and this Annex seeks to pull these together into a broader context.

Generally, a MTEF tries to integrate policy with resource allocation decisions in a multi-year context to better reflect the effects of decisions on public finances, and generally lead to improved policy decisions. It also involves structuring the decision-making process to encourage economy and efficiency, and focus spending and policy on attaining the government's objectives. So a MTEF could be said to be about strategic allocation of resources in line with government priorities and the opportunity costs of decisions.

A very simplified outline of a MTEF process can be represented in three steps<sup>1</sup>:

1. Estimating total available resources for the public sector over a multi-year period, usually within a multi-year macroeconomic and fiscal policy framework.
2. Estimating the actual cost of current government policy and programs by sector, again in a multi-year context.
3. Reconciling the information in steps 1 and 2 to align policies with available resources, and using this information as a basis for improved policy and funding choices, and ultimately improved outcomes.

This simplified framework provides the general thrust of the MTEF concept, but is necessary to break the process into greater detail to explore the dynamics of the process. Actual decision-making processes and institutions will vary by country, but for ease of exposition, an MTEF process can be divided into five general operational stages:

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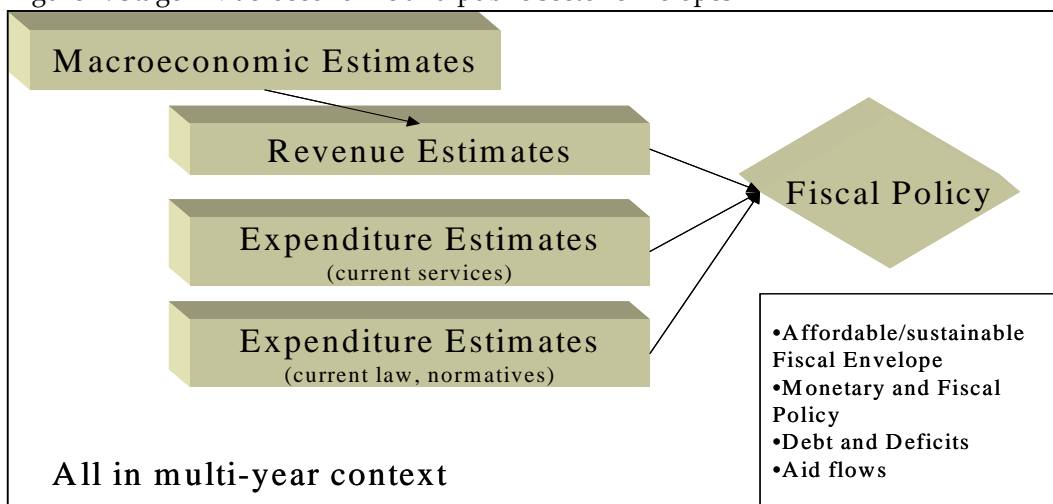
<sup>1</sup> Drawn from Mozambique: Assistance with the Development of a Medium Term Expenditure Framework. Draft Report. Elizabeth Muggeridge. June 1997.

- Stage 1. Macroeconomic and public sector envelopes
- Stage 2. High-level policy: aligning policies & objectives under resource constraints
- Stage 3. Linking policy, resources, and means by sector
- Stage 4. Reconciling resources with means
- Stage 5. Reconciling strategic policy and means

In general terms, Stages 1 and 2 are about developing macroeconomic estimates for the economy, and shaping public fiscal policy within the multi-year framework. Stage 3 is about sectoral (e.g. health, education, welfare, etc.) policy development. Stages 4 and 5 are about reconciling competing claims on public resources with available resources.

**Stage 1. Macroeconomic and public sector envelopes (see Figure 1)**

Figure 1. Stage 1 Macroeconomic and public sector envelopes



Stage 1 begins with develop of sound, conservative macroeconomic forecasts for budget development. It is important to distinguish between political macroeconomic estimates --- estimates of desired or hoped for growth --- and sound estimates for budget development. The former are optimistic estimates prepared for public consumption, to convey the governments goals, and to build optimism in the general public over the economic direction of the government. This is serving primarily a political purpose. For a variety of reasons, these are not good estimates to use in developing the budget. Being optimistic, they will lead to excess spending relative to likely revenues, and higher deficits and debt. More importantly, they are not estimates that will influence the public or private sector investors (foreign or domestic). Investors have many sources of information, and generally government’s own estimates will be the least credible and least relied upon for investor decision-making. Moreover, the simple fact that more economic researchers are using consumer confidence surveys as leading indicators of economic direction suggests that it is consumer sentiments that serve as early indications of trends rather than government economic estimates that heavily influence citizen perceptions.<sup>1</sup>

<sup>1</sup> For a longer discourse on the adverse effects of overly optimistic forecasts, see *It Flows Downhill*, Bill

Institutional measures to support sound macro-estimates. Countries use a variety of techniques to assure sound economic estimates, some during the budget development stage (ex ante to budget enactment) and some after budget passage (ex poste to budget passage) to assure alignment of the budget with best estimates or emerging trends. Among 'ex ante' good practices are: comparison with private or other forecasts during forecasts development<sup>2</sup>; vetting of forecasts through academic or non-government fora or blue-ribbon panels<sup>3</sup>; early release of forecasts to Parliament and the public; using the median forecasts of several reputable non-government organizations as the government forecasts<sup>4</sup>; technical rules (publicly announced) for making the forecasts more conservative<sup>5</sup>; economic updates prior to budget enactment that allow modifications to the budget proposals to fit emerging trends;<sup>6</sup> inclusion in the budget of a table comparing the key economic variables of the government forecast with several reputable private or public forecasts, with explanations for significant variation for median forecasts; and, having multiple government forecasts that could be the basis of budget development (e.g. Central Bank or legislative budget office, the latter being more applicable to presidential systems with separation of powers where the legislature can enact a budget entirely different from the executives).<sup>7,8</sup>

Good ex poste practices include: 'reserves' set-aside during budget formulation to account for some variation in forecasts after budget passage<sup>9</sup>; mid-fiscal year economic

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Dorotinsky, US Treasury, 1999.

<sup>2</sup> Current practice in Poland, Canada, U.S..

<sup>3</sup> Also current practice in Poland.

<sup>4</sup> For example, the United States Government does not have a macroeconomic forecasting office for budget development. Rather it purchases six leading blue-chip and academic forecasts which form the basis of forecasts. Economists from the Office of Management and Budget, Council of Economic Advisors, and Department of the Treasury gather to evaluate the forecasts with respect to the most recent Government data and expected trends, and collectively agree on the most likely evolution of key variables. The variables are then fed into a mini-model to produce all those variables needed for producing the budget.

<sup>5</sup> Canada, for example, had systematically over-estimated economic growth and public revenues during the 1980's, contributing to their annual deficits. To compensate, Canada averages several non-governmental forecasts, then adds 50-100 basis points to interest rates to assure a conservative forecasts, and runs these through a small model to produce the forecast variables for budget formulation.

<sup>6</sup> Finland prepares economic forecasts four times each year: in February for the Government decisions on aggregate spending limits; in May as a mid-year update; in August for the budget discussions; and a smaller exercise in November to confirm the estimates used in budget development.

<sup>7</sup> Many countries have independent Central Banks that produce their own forecasts for monetary policy, but these are rarely used in budget formulation. In the U.S., the Federal Reserve and Executive branch forecasts are informally shared at a technical level to try to assure some consistency in the basis of policy formulation by both institutions. Also, the Congressional Budget Office also produces its own independent set of economic estimates for Congress, which can serve as the basis of Congress' budget development.

<sup>8</sup> Coordination, at least informally, of Central Bank estimates and expected monetary policy with Government economic estimates and fiscal policy, is important to assure a sound basis for both monetary and fiscal policy. Doing so informally, at a technical level, can preserve the independence of the Central Bank and still assure Government fiscal policy is fully informed and sound. Developing a budget expecting moderate monetary policy can be easily undermined where the central bank adopts a tight monetary stance, driving up interest rates and lowering economic activity.

<sup>9</sup> Canada also builds a reserve into the budget that can only be used for variations from forecast and unexpected events. If unspent at year end, these funds automatically pay off outstanding debt. Sweden similarly uses unspent reserves for debt reduction, but rather than conservatively adjusting the macroeconomic estimates Sweden reduces its public expenditure target below its estimated affordable

updates after budget passage, combined with required proposals to bring the budget into line with emerging trends during the fiscal year; formal procedures for passing supplemental budgets during the fiscal year, and use of these procedures;<sup>10</sup> and, subsequent annual budgets include a comparison of prior year budget forecasts with actual economic variables to assess the quality of the estimates.

Countries process the economic estimates themselves in different ways: Ministry of Finance staff share the estimates only with the Minister of Finance for information purposes or for general approval to move to the next stage of budget formulation; economic estimates are shared with Cabinet for general information and 'blessing;' or, economic estimates are sent by the Government to Parliament (or general public) early in the budget cycle for information and transparency. While distribution of the economic forecasts varies, it is accepted practice that policy officials not modify the economic estimates or alter the technical details, and certainly not for political expediency. The estimates need to be the best, objective estimates possible by technical staff in order to form a sound basis for setting economic policy and for budget development.

Revenue envelope. Once the macroeconomic estimates are prepared, sound estimates of government revenue are developed. Equally critical as sound macroeconomic estimates are conservative revenue estimates based on collection experience. Overly optimistic revenue estimates can also lead to excessive spending. Even if the budget will contain proposals for tax increases or improvements in collection rates, it is valuable to separately identify the base estimate for revenues without policy or administrative changes and those revenues expected because of policy changes or planned improvements in compliance and collection rates. The latter could be further divided into revenues expected with a high degree of certainty (e.g. new revenue from a 1 % increase in the sales or income tax, or foreign aid under already signed agreements) and revenues with low certainty of materializing (e.g. promised foreign aid, revenues from entirely new taxes or fees, and improved collection rates from improved enforcement). By differentiating the different sources of revenue and their likelihood of materializing, better judgment can be used in setting fiscal policy as well as in ex post assessment of the quality of estimates used in budget formulation. . Of course, all revenues must be considered, including user fees, administrative fees, ministry own revenues, etc., to provide a complete picture of government financing levels and needs.

External aid flows must also be included to provide the comprehensive revenue picture. These deserve some special treatment in the estimates for several reasons: counterpart funds must be identified and available from domestic resources; the aid flows themselves may be highly unpredictable, and it is important to assure that spending does not occur in advance of receipt of aid funds that may not materialize; in selected cases, domestic expenditure must occur before the aid flows are released as reimbursements, and these must be identified as well; the future cost for operating and maintenance of infrastructure financed by foreign aid must be factored into the budget, and this is more difficult if the budget does not even contain all aid revenues; ideally, aid inflows would match government sectoral priorities rather than driving them; for foreign loans, debt service costs must be factored into the multi-year plan.

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expenditure estimates to build a margin of safety. These reforms provide a systematic bias towards conservative expenditures, and prudent use of unspent funds for debt reduction.

<sup>10</sup> Sweden has two formal supplemental budgets, one in the spring accompanying the spring fiscal policy update and one in the fall accompanying the budget proposals for the following year. In the U.S., supplemental requests can be transmitted at any time, but are discouraged unless large and of high importance.

Also important is identification of tax expenditures – special exemptions from general taxation for special interests, industries, regions, etc. These are revenues foregone, and future estimates should assume current laws or policies remain in place, and model the multi-year trends in tax expenditures for appropriate factors such as economic growth. Tax expenditures should be explicitly identified for each type of tax revenue, allowing policy officials to assess the benefit of this tool.

Expenditure Estimates. With conservative economic estimates in hand, the Ministry of Finance can prepare broad expenditure estimates based on current policy, and explore expenditure sensitivity to changes in economic estimates. The objective of this exercise is to explore, at a relatively aggregate level of spending, the trends in spending and gauge affordability over several years. The multi-year aspect allows the Ministry of Finance an early warning indicator if some programs are likely to grow beyond affordable limits, as well as to explore general policy options (e.g. pay policy) and their impact on spending trends (as well as explore policy changes that might liberate resources in current and future years for new initiatives). It is important to explicitly note that this covers ALL public spending trends --- consolidated central government in GFS terminology. If only budgetary central government is included, the picture is only partial, and does not allow exploration of all sources of spending, identification of over-all trends that may require Government attention, and will lead to suboptimal policy decisions. <sup>11</sup>

These initial estimates are often termed ‘baseline’ estimates, and while different countries use different bases for calculating them, the general concept is to forecast future spending assuming continuation of the current spending levels or laws – that is, assuming no changes in policy or spending trends, what do the out-years look like?<sup>12,13</sup>

A useful exercise would be to prepare two broad baseline estimates: one assuming current funding levels of discretionary spending and current laws for mandatory spending as a current ‘policy’ baseline; and one assuming current normatives and other laws with implicit commitments were fully funded (which may require spending ministry assistance, and which may in fact also represent the current annual requests from spending agencies). The exercise would be instructed to identify the ‘policy gap’ or difference between current levels of public spending and those required to fulfill policy commitments as contained in normative laws (and gauge the realism of normative sector policies).

With conservative revenue estimates in hand, the Ministry of Finance can prepare a fiscal policy paper for presentation to Cabinet. This document draws together the results of the modeling and forecasting exercises into an understandable report of trends and policy implications for senior government officials and the public. The paper explores

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<sup>11</sup> While more attention in projections and sensitivity analysis will be paid to consolidated central government, especially extrabudgetary and social funds, trends in subnational government revenues, spending, and deficits also need to be reviewed. Excess subnational spending can directly threaten the central budget, and monitoring trends early for possible Government intervention is important for long-term fiscal health.

<sup>12</sup> The U.S. develops baseline estimates on ‘current law:’ for mandatory spending (spending that occurs through statute, rather than annual budget bills), the forecast assumes no change to laws, and uses economic estimates and demographic trends to extrapolate spending to the budget year plus nine additional years. For discretionary spending (spending that occurs only through the annual budget), the most recent enacted budget is extrapolated out nine years using basic economic assumptions supplied by the budget office, typically the consumer price index for wage and non-wage expenditures.

<sup>13</sup> Australia uses the concept of current policy, focusing more on the policy commitments of the current government over several years. Termed ‘forward estimates,’ Australia’s multi-year forecast separately identifies revenue policies, including tax expenditures, as well as general spending. For a good example of a comprehensive multi-year document, see Australia’s 2002-2003 Budget Paper No. 1 at <http://www.budget.gov.au/2002-03/bp1/html/>.

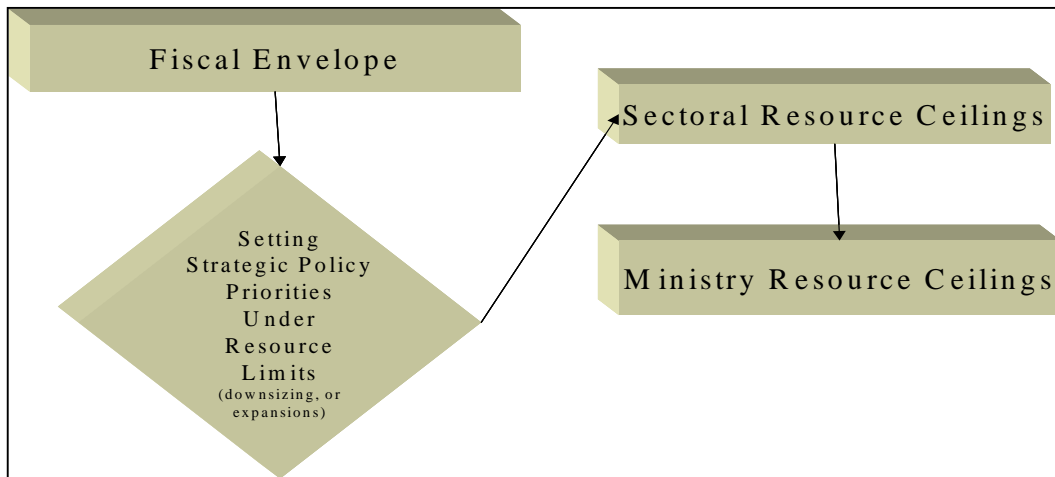
implications of monetary and fiscal policy for economic growth, as well as trends in fiscal policy, deficits and debt projections under current trends, and broad options for changing policies. It serves as a useful vehicle --- if clear in presentation and readily assessable to non-economists --- for educating senior policy officials of basic economic issues, and linkages between government policies and outcomes (economic, fiscal, etc.). The paper should include recommendations of MoF on a path for sustainable or improved economic growth, including aggregate revenue and expenditure paths (including deficits and debt policy).

The fiscal policy paper would be presented to Cabinet for discussion, with the objective of obtaining some Cabinet decision on over-all government revenue, expenditure, and deficit policy or framework.. The focus of the decisions should be on the policies for revenues and expenditures, the path over the budget and subsequent years, to attain government objectives. The discussion should generally not turn on the economic forecasts themselves, especially if these represent best estimates.

Countries follow different practices in releasing the fiscal policy and expenditure estimates to the Parliament and public. Finland releases this information to the public and parliament for informational purposes, while Sweden actually submits for passage by parliament the fiscal policy, expenditure envelope, and allocations to sectors. In Sweden, this was done to bind Parliament to the expenditure totals and sector ceilings, and prevent unproductive amendments that added to expenditure rather than encouraged efficient choices within sectors. In other countries, such as the U.S., the fiscal policy, expenditure targets, and sector funding levels are not released until the formal budget is proposed.

***Stage 2. High-level policy: aligning policies & objectives under resource constraints (see Figure 2)***

Figure 2. Stage 2: High-level policy



After the fiscal policy envelope is developed setting the aggregate public revenues and the expenditure ceiling, decisions need to be made on the allocation of this ceiling across sectors (e.g. health, education) and ministry (which may be the same as sectoral or not, depending on the budget classification system). These indicative ceilings may have been provided in the fiscal policy paper by the MoF, or may be addressed as a separate exercise. Sweden combines discussions on the fiscal policy, expenditure envelope, and sector ceilings into one 2-day Cabinet retreat, after which the approved levels are sent to Parliament for ratification. Each ministry is then bound to meet the ceiling set by Cabinet and Parliament.

Some sectoral allocations may have developed in the course of the fiscal policy discussions,<sup>14</sup> where key sectoral spending trends may have been identified as threats to policy or fiscal stability. The remainder of funds need to be allocated, and the allocations would reflect at least general policy directions of Governments (e.g. additional education spending), and specification or modification of Government objectives, in broad terms, for each sector.

A good starting point for setting the indicative ceilings for sectors and ministries is the second year of the prior budgets multi-year forecast, adjusted for known modifications in Government priorities and policies, improved spending estimates, major revisions in revenues and expenditure targets, etc. Some countries also reduce sector ceiling allocations and create a central 'policy reserve' that is used to fund new initiatives after spending requests are received in Stage 4.

Within sectors, it is important to distinguish between mandatory and discretionary spending in making allocations. Unless major policy changes are expected for extrabudgetary funds and mandatory programs, the best estimate of spending for these programs would receive its full allocation. Discretionary programs would receive residual amounts for the sector --- perhaps lower than desired. This stage can generate much debate on growth of entitlement spending, and its crowding-out of other government spending, and helps clarify the tension in these programs. Box 1 describes the Brazilian approach to making these decisions.

Also important for sectoral allocation is a review of *revenue earmarking* and the constraints it imposes on reallocation of spending across sectors or programs.

Once approved by Cabinet, these indicative ceilings for each sector/ministry are transmitted to Ministries, usually as part of the annual budget call circular that initiates the budget process and provides instructions for ministry budget submissions.

Whether the indicative ceilings are actually cabinet-approved can differ by country. In the U.S., indicative ceilings are not President approved, and thus do not carry much weight with the spending ministries. Moreover, in the U.S. system, even if the ceilings were presidentially-approved, it is not very likely there would be adverse consequences to a cabinet secretary that submitted spending requests in excess of the ceiling. It certainly is not a serious enough transgression to warrant dismissal from cabinet. The US Budget Office could try to impose some sanctions or negative incentives for such behavior, but it currently does not, and such efforts would be difficult to sustain in the US context. In Parliamentary systems, Cabinet sanction can be important for compliance, as it represents to collective Government decision, which each Cabinet Member is more bound to follow.<sup>15</sup> Regardless, adherence to indicative ceilings by ministries in developing budget proposals makes budget preparation far easier in following stages.

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<sup>14</sup> In Finland and The Netherlands, the allocation stage is 'easier' during budget preparation as many of the policy priorities have been set in government coalition agreements. Absent coalition governments, it is not clear these pre-specification of policy priorities would continue.

<sup>15</sup> For a more thorough treatment of cabinet dynamics, see [Strategic Decisionmaking in Cabinet Government: Institutional Underpinnings and Obstacles](#). Manning, Barma, Blondel, Pilichowski, and Wright. Sector Study Series. The World Bank. Washington, D.C.; October 1999.

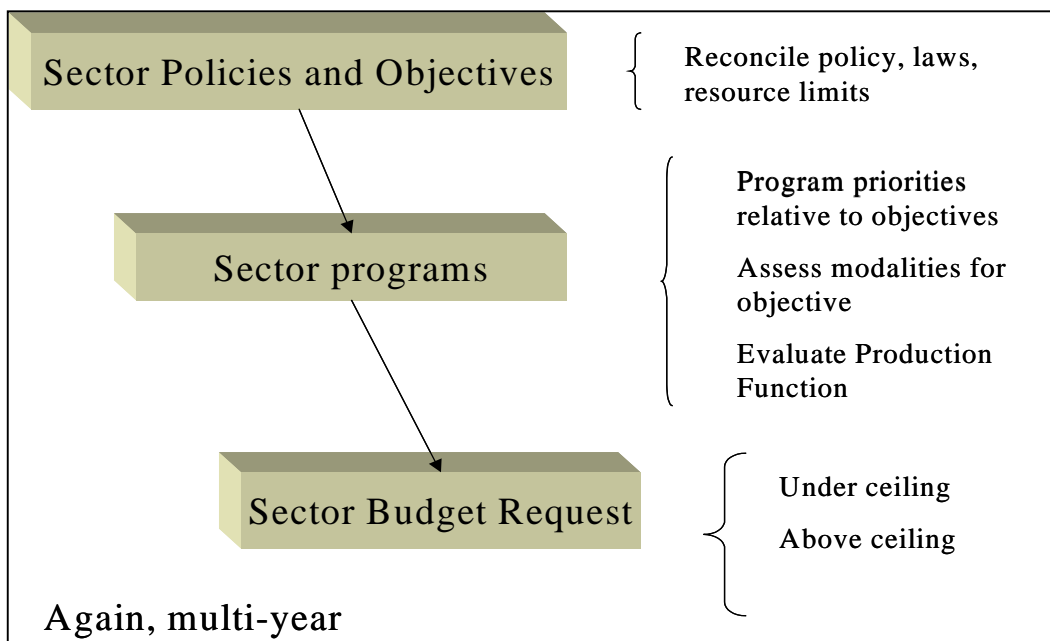
### Box 1. Brazilian Budget Process

The broad functional steps in the Brazilian budget formulation process are:

- Define the macro-economic projections, estimates of public revenues, and plan/set expenditure and debt levels.
- Develop indicative sectoral limits based on analysis of current operating costs, programs, and activities. The ceilings include several subsets of estimates:
  - a) Personnel costs. A detailed personnel registry provides information on wages, new hires, and early retirements. This is a known number.
  - b) Debt. Part of debt service for loans related to each Ministries programs are allocated to each Ministry and part to the Ministry of Finance. The budget office knows all contracts, and knows this number.
  - c) Activities, continuing. The cost of continuing the current programs is estimated by the budget office, and refined by the line Ministry. This includes administrative costs in support of personnel (utilities, etc.), plus mandatory activities (health, pensions, etc.)
  - d) Activities, new or expansions. Line Ministries develop these proposals and submit to the Ministry of Planning for review.
  - e) Projects, continuing. Line Ministries estimate the cost of maintaining the economic viability or continuing on-going projects.
  - f) Projects, new or expansions - Line Ministries estimate the cost of expansion of projects or of new projects.
- Within the available resource estimates, subset a, b, and c are treated as priorities in the annual budget process. Subsets d, e, and f are treated as residual: IF resources are available to allocate, they first go to new or expanded *activities*, then to *continuation of projects*, and finally to *new or expanded projects*.
- Note that items d through f are only the marginal cost of the activity or project. The personnel costs and associated overhead costs (running costs) are separately funded in a and c.
- This process assures the basic obligations of the state --- debt service, mandatory social benefits, personnel (which are fixed in Brazil) and fixed administrative costs, as well as transfer payments, receive funding first.

**Stage 3. Linking policy, resources, and means by sector (see Figure 3)**

Figure 3. Stage 3: Linking Sector Policy



Having received sector or ministry indicative ceilings, each line Ministry must developed its budget proposal. The expectation is that each Ministry would take the resource ceiling as a given, and allocate spending among its activities and programs to attain its objectives.

This is particularly important to assure harmonization of normative laws, sectoral and ministry strategic plans and attendant objectives, organization and staffing, with the resources available. These decisions include both capital and current spending, encouraging ministries to think strategically about their programs, to evaluate what are the necessary labor and capital inputs to attain an objective or implement a program.

This is important for maximizing the effectiveness and efficiency of spending. An example may illustrate the point. Assume a health ministry wants to develop a health policy for the country, and it convenes expert groups as well as various groups involved in the sector, such as the Chamber of Doctors, hospital administrators, nurses organizations, etc. Collectively these groups will use their best professional judgment in devising an optimal health policy. This policy may include specific targets of number of beds per capita, physicians per hospital, etc. It may also specify vehicles for advancing the policy, such as the nature and type of health benefits included in the national health insurance plan, or assume certain modes of service delivery (e.g. expansion in government-owned clinics). Now, when it comes to financing the policy, it is commonly the case that the entire package is unaffordable. If the policy is retained as formulated, the best that can be hoped for is, for arguments sake, 60 percent of the total cost of the policy. The result is that the policy cannot be implemented, objectives cannot be achieved, and even the reduced funding level may be too low for individual elements of the policy to be

effective (e.g. funding for vaccines may be too low to assure adequate coverage of the population).

In contrast, if the over-all funding level were known in advance, framing the policy discussion, entirely different objectives, programs, or means of production may be explored. Instead of government-owned clinics, perhaps the government would contract with private clinics to provide services at lower cost. Or, vaccination programs would be considered essential and fully funded. The package of health benefits covered under the health insurance plan might be adjusted. The point is that both objectives and means of achieving the objectives will be different under different resource constraints.

A second example, more narrow, also illustrates the point. During the 1980's, the U.S. Consumer Product Safety Commission, an agency charged with regulating consumer products to assure their safety, trained staff in offices across the U.S. by sending specialists from Washington, D.C. to provide the training. As the budget became tighter, the agency changed its means of delivering training. Instead of sending trainers from Washington and incurring travel and lodging expenses, the agency made training videos in Washington, and mailed these to its offices. Evidence suggested this means of training was as effective as the live trainers. However, the agency used this as an example of the terrible effects of the budget restrictions. The Budget Office used this same case to illustrate the point that such evaluation of activities and improvements in efficiency are exactly what an agency should be doing. Different levels of funding influence choice of means of production.

Ministries may have begun to develop their budgets prior to receiving the call circular, and such early budget development can assure that ministry budgets are carefully developed. Ministries may have undertaken their own strategic planning exercise, or undertaken a special review of the effectiveness or continued usefulness of policies, programs and projects. These reviews and plans should be undertaken, either as part of the annual budget cycle, or prior to it and then fed into the resource allocation decisions in the budget process.

**Resource allocation flexibility.** Different countries provide different degrees of freedom to ministries to allocate spending among alternatives. In the Australia and New Zealand New Public Management model, ministries are assumed to allocate resources optimally among programs, and are given great discretion in their choices. Similarly, Sweden provides great latitude for allocating resources to ministries. In these systems, the Ministry must justify and defend its choices, and bears responsibility for the consequences of their choices. This transparency and accountability provides some incentive for sound allocation choices.

In other systems, such as Finland, fewer degrees of freedom are offered. The Ministry of Finance not only has indicative ministry or sector ceilings, but also indicative spending targets for programs within the sector ceiling. Spending ministries that want to reallocate across programs face difficulty doing so because of the Ministry of Finance targets.<sup>16</sup>

In the United States, the incentives work differently. Spending Ministries budget requests form the President's Budget, and the President is responsible for the policies contained therein. Allocations that would cause interest groups to strongly object would fall upon the President to advocate or defend, rather than the minister responsible. The dynamics promote gamesmanship, where spending ministries propose budget reductions in areas they know would never be approved by Congress, and reallocate those resources to ministry priorities, which may not be the President's priorities. As a result, the US Budget Office pays very close attention to the proposals of ministries.

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<sup>16</sup> Page 6, paragraph 18. Budgeting in Finland. OECD. Paris, 2002.

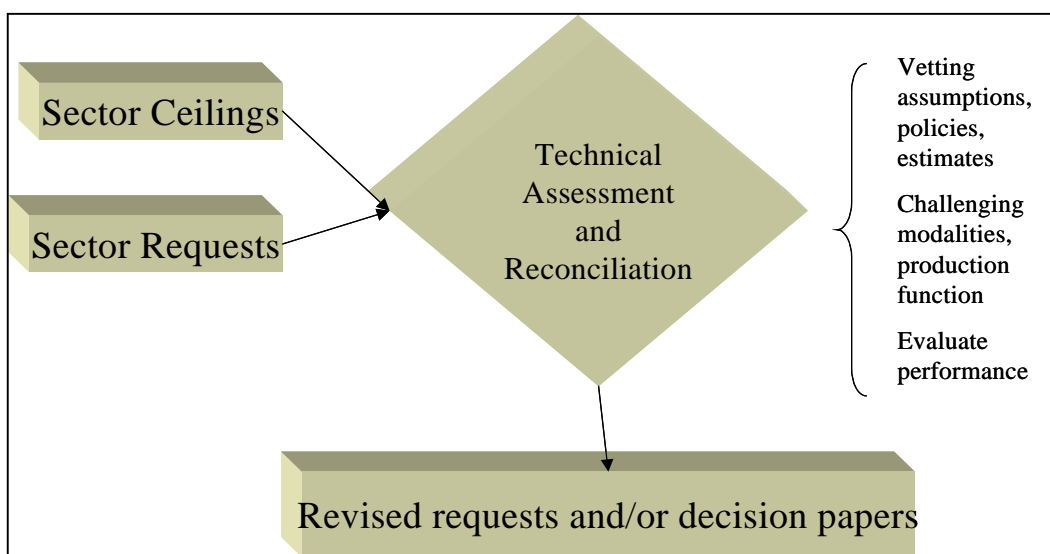
While in principle the ministry can propose any change, in practice, the proposals are carefully scrutinized for practical effect, incidence, and likelihood of being enacted, as well as technical justification.

An important issue is the extent to which the spending ministries have the policy and program analysis skills to undertake the reviews of activities and laws, assess their effectiveness and cost, and develop options for the responsible Minister. These are skills that have heretofore not been in great demand, and may require training to further develop.

At the end of the stage, the ministries will submit their budget requests to the Ministry of Finance. The format of the requests will vary by country, but something more than tables of numbers with a cover memorandum is appropriate. Text explaining the policies contained in the proposals, changes in policy from prior years, significant reallocation decisions, new objectives, all should be included. As countries move towards performance budgeting, the budget requests should include the output or outcome targets associated with the resource levels and allocations contained in the request. Moreover, simple identification within the request of on-going activities and programs from new programs assists in evaluating the proposals.

***Stage 4. Reconciling resources with means (see Figure 4)***

Figure 4. Stage 4: reconciling



After receiving the requests, the requests must be reconciled with the resource ceilings, competing demands and policies reconciled, and final policy and funding decisions reached. This stage can be contentious or productive depending on how the process is structured (extent to which ceilings were respected), whether budget retrenchment or expansion is the trend, and Ministry of Finance relations with spending ministries.

Assuming the sector ceilings and Sector requests match, the Ministry of Finance role becomes one of providing critical analysis of the agency requests, and conducting a process that leads the Ministries feel they had a fair hearing for their requests.

Ministries should be questioned in detail about their requests, especially the assumptions and data underlying their requests. It is also useful to conduct budget hearings, where the Ministries have an opportunity to meet with government officials to make the best possible case for their budget request. These hearings can be time consuming, but are important to give the Ministries a further stake in the budget process. The less Ministries feel they have had a fair chance to make their case, the less likely they are to accept the results of the process or to support the approved budget during budget execution.<sup>17</sup>

Generally, the Ministry of Finance needs to vet the spending requests, probing whether recurrent spending is needed and ministries have adequately reviewed existing programs, and for new programs to assure they are well-developed. *How* the MoF interacts with spending ministries can influence outcomes. The MoF should seek to engage in a dialogue with ministries to assess whether they have in fact considered the questions of mix of inputs, whether there are benchmarks for assessing staffing patterns, whether there are alternate means or modes of achieving the objectives, and should use these issues to develop a budget. It is the dialogue that is important -- the questions and answers. These issues must regularly be raised, or they will go unaddressed: thus, current staffing and production patterns will remain fixed, and only the increment for new programs or activities will be considered. For example, the MoF may provide additional funds to spending ministries for official pay raises but may provide no funds for "promotions." Assuming there is a salary cap per ministry, this puts a slight but palpable pressure on spending ministries to economize on salaries and the wage bill, examining where savings can be achieved within the wage bill, to provide some level of promotions. It also forces economical decisions on the number of promotions, which may differ from the "normal" practice of automatic promotions based on seniority and tenure (perhaps substituting performance evaluations and merit as the basis of promotions).

Ministry of Finance performance assessment should include reviews of capital spending and progress in capital projects, as well as assessments of whether external and internal audit findings have been addressed by each ministry. The assessment can cover many aspects of performance, and the results should be fed into the MoF recommendations on funding. In the U.S., policy papers with funding options are prepared for each program by the budget office, and these papers are used by senior policy officials in the administration to make budget decisions. These papers integrate findings on agency performance along many aspects in arriving at a funding decision.

If the sector requests and ceilings are not the same, differentiation between recurrent and new spending as suggested above allows the Ministry of Finance to quickly assess if recurrent spending is over target, and respond appropriately to the source of the problem.

In some countries, review of budget requests, especially recurrent spending, is given higher priority and more formal attention. The U.K.'s former Public Expenditure Surveys served as an annual 'functional review' of ministry programs. In the early 1990's to facilitate its fiscal retrenchment, Canada instituted program reviews under the auspices of a cabinet committee to review spending proposals in detail.

In addition to Ministry of Finance vetting of requests, this stage serves as a forum for the various new funding proposals to compete for resources. If the Government set-aside some resources during the sector ceiling stage for new funding proposals, these funds would be used to fund the best of the new spending initiatives. (If no reserve was

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<sup>17</sup> The Swedish Ministry of Finance does 'second-guess' spending ministry budget submissions, especially on social transfer programs, mainly through seeking additional technical details on the estimates. The MoF does not directly challenge the requests. The Ministry budget requests are used to develop the Ministry of Finance recommendation to cabinet, but does not directly respond to each Ministry on their request. The MoF is prepared to detail its views at the 2-day cabinet retreat where MoF allocations are below Ministry requests.

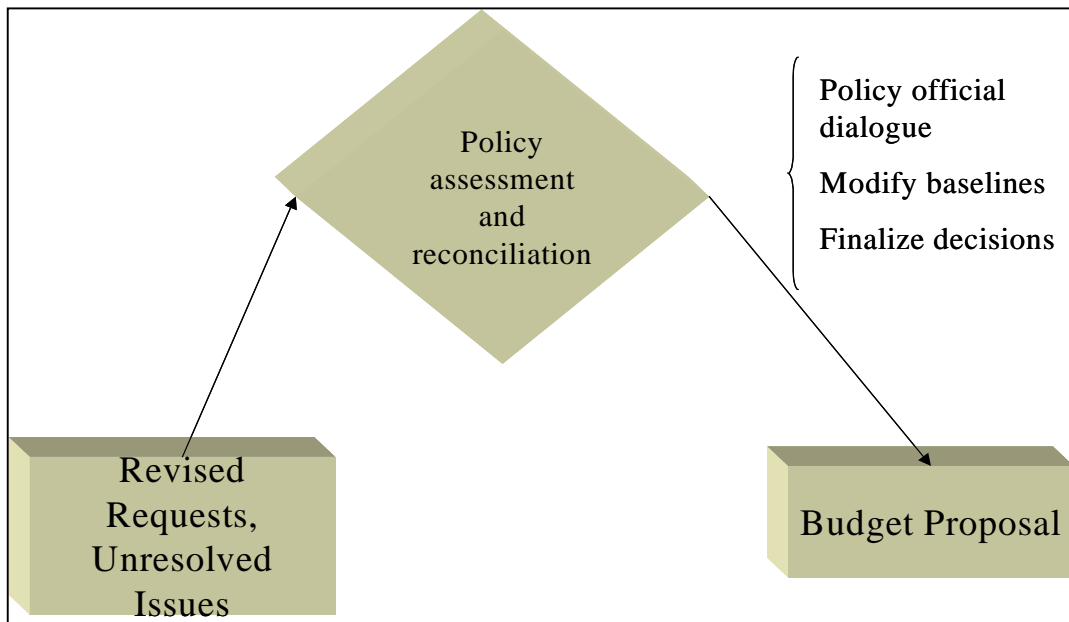
established, and instead government allocated all available funding to the sectors, giving some priority to some sectors over others, then competition between proposals may have occurred within the sector.)

As noted earlier, this stage may proceed with varying degrees of cooperation or conflict between MoF and spending ministries. In Australia, the process is a professional dialogue where both parties to the discussion bring their unique skills and perspective to the table to improve the projects and proposals. Ministries themselves revise the requests based on discussions with MoF, and may reconsider the means being proposed to attain an objective.

At the end of the day, the MoF must make some recommendations, and forward these on to Cabinet for final approval.

***Stage 5. Reconciling strategic policy and means (see Figure 5)***

Figure 5. Pulling it All together



This final stage will take markedly different forms depending on the structure of the budget process. In the U.S., after decisions have been taken, results are passed back to each Ministry, which has an opportunity to appeal the results to the budget office. If issues are not resolved at that level, they may appeal upward, eventually to the President. Not many issues reach this stage. After appeals are resolved, then ministries must revise their budget request to be in alignment with the President's policy. This process of appeals is intended to assure some due process to Ministries in funding decisions, but makes for a contentious process.

In Australia, MoF discussions with line ministries are less contentious, and more in the nature of a management consultant (MoF) advising a client (line ministry). Line Ministries take on board the MoF suggestions they agree with, and revise their budget requests to come into alignment with MoF.

Line ministries of course are busy revising their requests, preparing their own justification material, and even drafting legislation that may be required to support the policies contained in the budget.

A primary role for the MoF in this stage is resolving any loose-ends in the decision process, finalizing or refining numbers and policies to assure consistency. MoF efforts move into production of documents and tables and graphs, getting everything ready for final review and approval by Government and transmission to Parliament.

A further MoF role in many countries is preparation of communications strategy and material to clearly explain decisions, elaborate the rationale for choices taken, and explaining the directions for budget policy. An effective communication strategy, well executed, is a critical factor in the success of the budget proposals and sustainability of reforms. Careful attention to preparing policy officials to answer questions and defend the proposals, as well as to the positive messages that need to be communicated to the public, would increase the likely success and acceptance of any budget proposal.