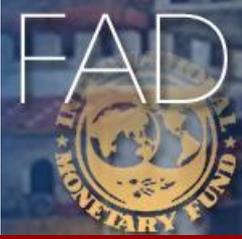


# Budget Institutions in Low-Income Countries: Lessons from G-20

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# Budget Institutions in Low-Income Countries

## Outline of Presentation

### I. Budget Institutions for Credible Fiscal Strategy

- A link between institutions and fiscal outcomes?
- What institutions can support building credible fiscal strategy
- What are their key design features

### II. Evaluating Budget Institutions in Low-Income Countries (and G-20 Advanced and Emerging Market)\*

- Are these institutions in place

### III. Strengthening Budget Institutions: Priorities for Institutional Reform

- What institutional reforms are required
- What is the proper sequencing of these reforms

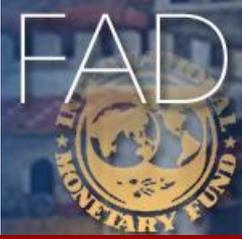
\***Low Income:** Bolivia, Kenya, Mozambique, Myanmar, Uganda, Vietnam, Zambia;

**Advanced:** Australia, Canada, France, Germany, Italy, Japan, Korea, UK, US;

**Emerging Market:** Argentina, Brazil, China, India, Indonesia, Mexico, Russia, South Africa, Saudi Arabia, Turkey

# I. Budget Institutions for Credible Fiscal Strategy

## Background



- **Evaluation framework developed in FAD**
- **First applied to G20 countries...**
- **... but been subsequently applied to wider set of countries...**
- **... with different fiscal policy needs**
  - Consolidation
  - Overall fiscal discipline

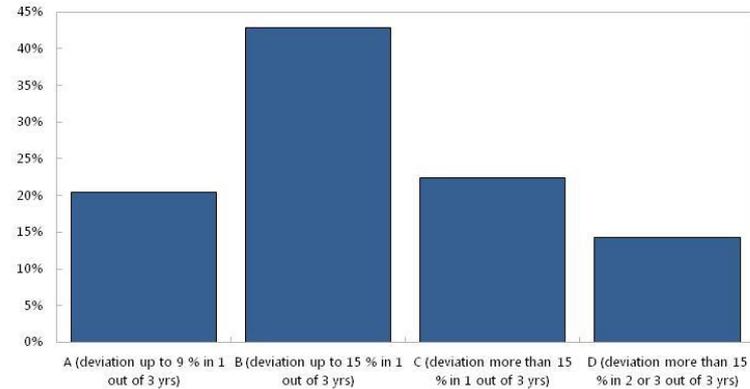
# I. Budget Institutions for Credible Fiscal Strategy

## Institutional Gaps Linked to Weaknesses in Fiscal Outcomes?

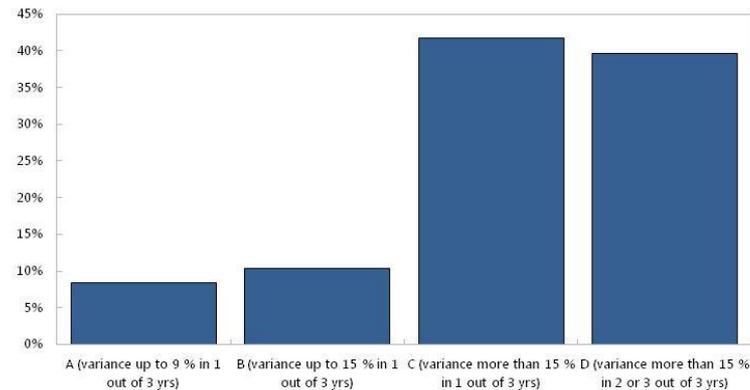


Figure 1. Budget Planning and Execution in Low-Income Countries

Aggregate expenditure out-turn compared to original approved budget



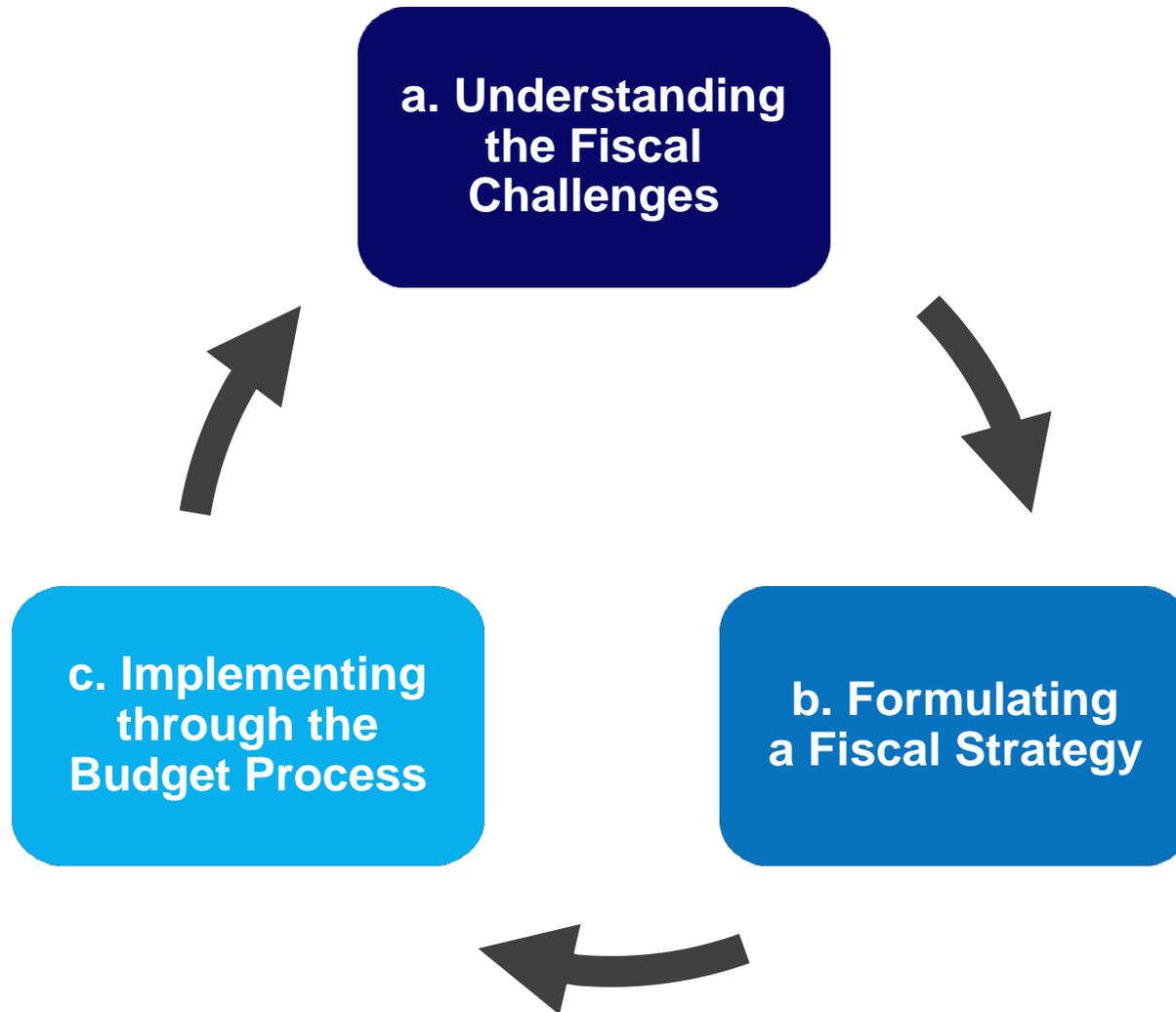
Composition of expenditure out-turn compared to original approved budget

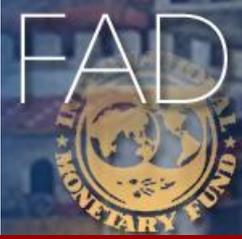


Source: PEFA Database (50 countries). Percentages show the share of countries who received the score in question.

# I. Budget Institutions for Credible Fiscal Strategy

## Stylized Phases of Fiscal Strategy Process





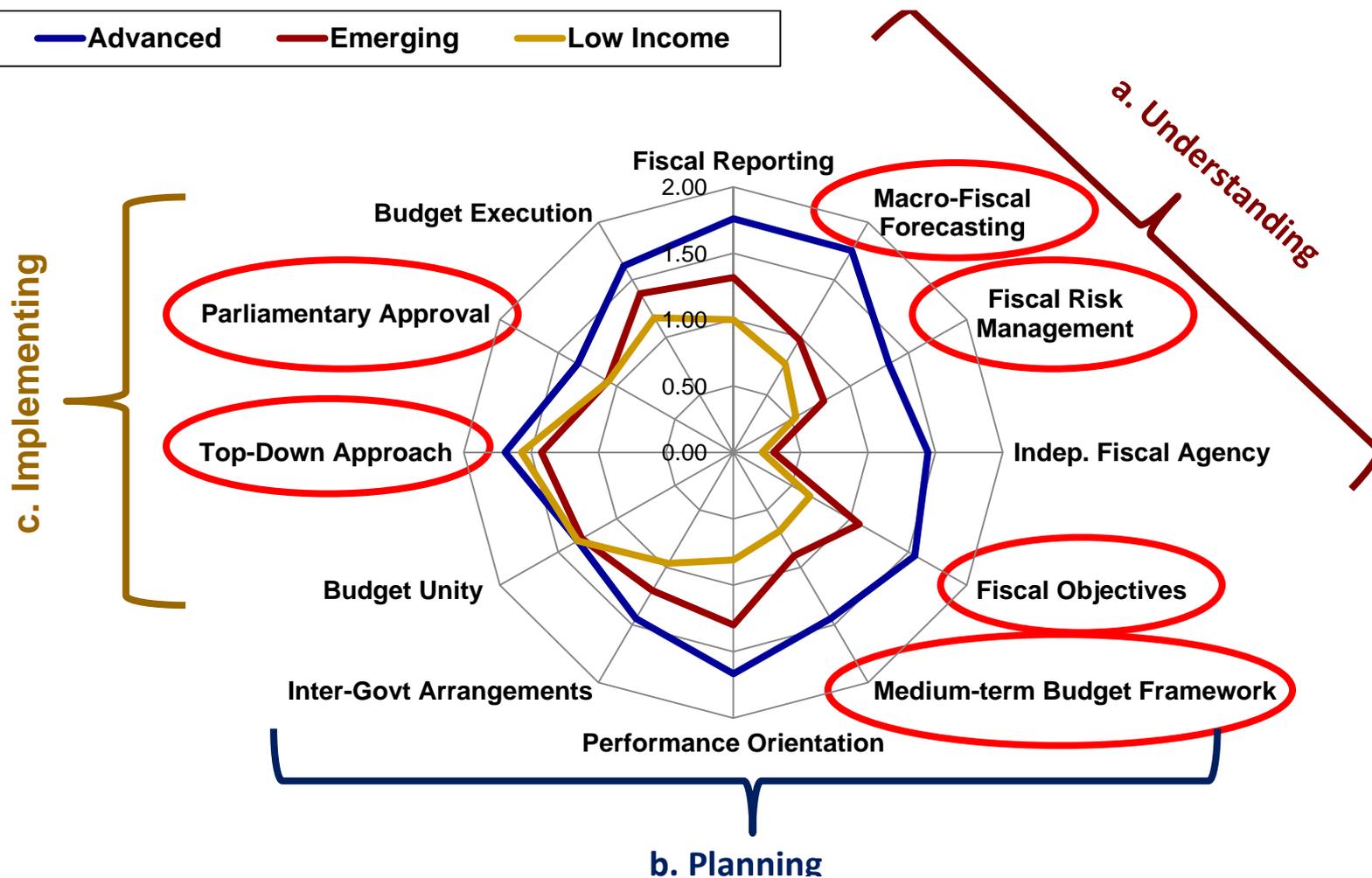
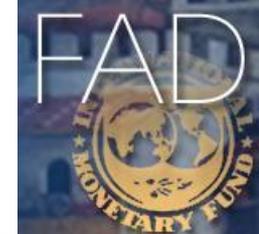
## II. Budget Institutions for Credible Fiscal Strategy

### 12 Key Institutions



# III. Evaluation of Budget Institutions

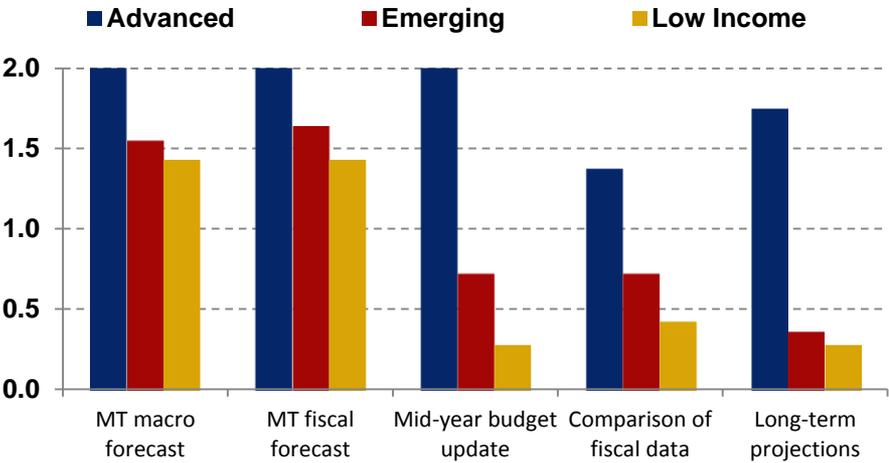
## a. Average Score by Institution



# III. Evaluation of Budget Institutions

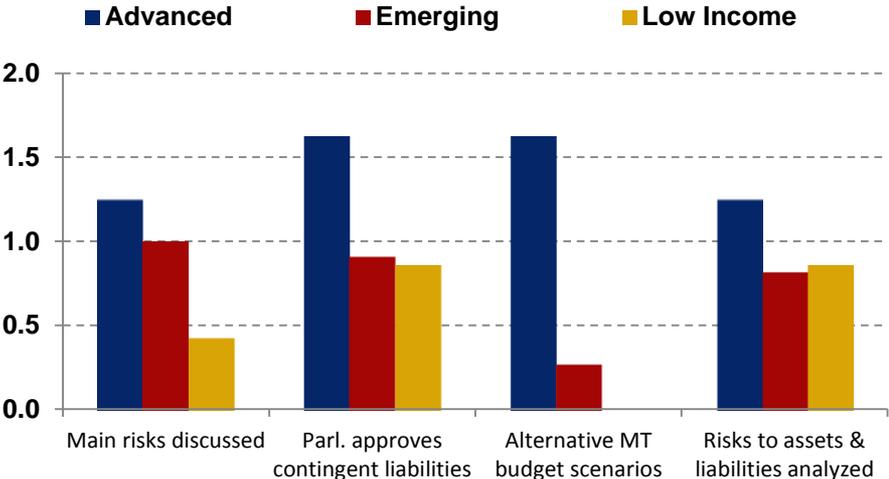
## a. Understanding the Fiscal Challenges

### Macro-Fiscal Forecasting



- About ½ of the LICs publish medium term forecasts in the budget documents with related assumptions but ...
- Generally speaking without any quality control through ex post comparison of previous forecasts with actual outturn
- Update half-way through the budget year, with updated projections of key fiscal variables is missing in almost all countries
- Long-term fiscal projections are also a rarity

### Fiscal Risk Management

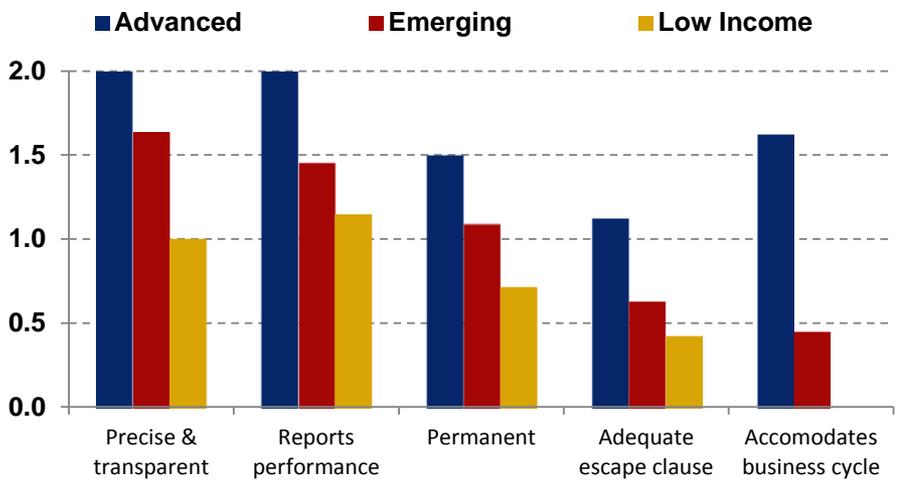


- Main fiscal risks are not discussed nor quantified in the budget documents...
- ... and alternative medium-term budget scenarios are not produced.
- In majority of the LICs, the government prepares a medium-term debt management strategy, including analysis of debt-related risks, but without including asset-related risks

# III. Evaluation of Budget Institutions

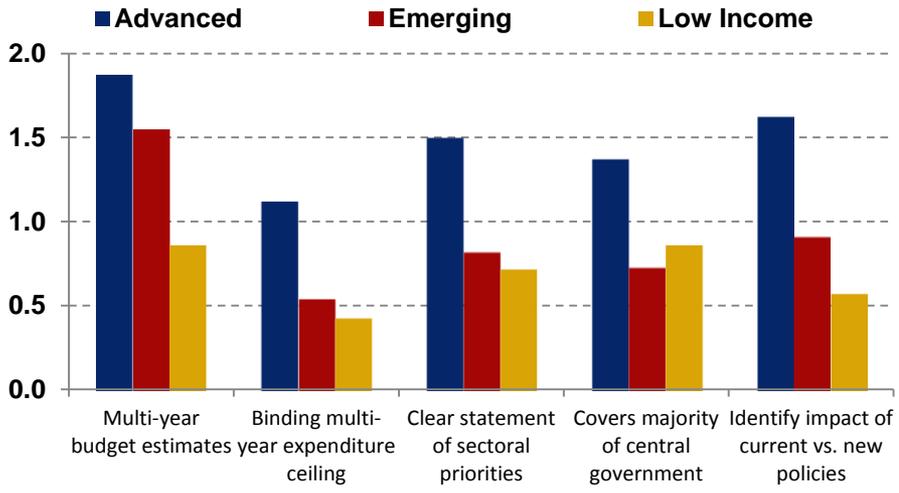
## b. Formulating a Fiscal Strategy

### Fiscal Objectives



- About half of the countries have specified some type of medium-term fiscal objective which also regularly report performance against the stated objective, but...
- ... in very few countries, the objective has been enshrined in the law, and...
- ... in almost all countries, exceptions from the rule take frequently place.
- Fiscal objectives do not accommodate the impact of the business cycle.

### Medium-term Budget Frameworks

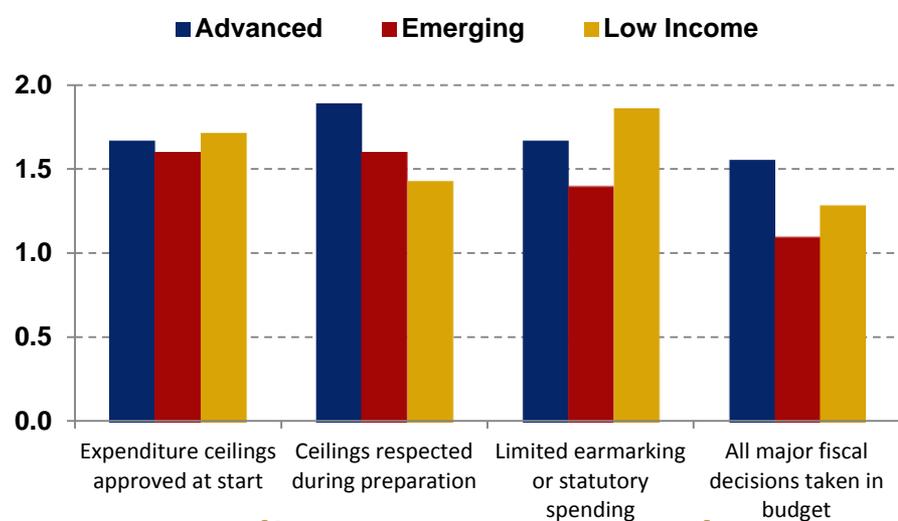


- About half of the countries have some type of multi-year estimates for major categories of revenue and expenditure, but...
- in all countries these amount only a non-binding restrictions to future budgets, and...
- no reconciliation of changes in sectoral allocations from year to year is produced
- Budget documents do not present consolidated summary of the fiscal impact of proposed new revenue and expenditure measures.

# III. Evaluation of Budget Institutions

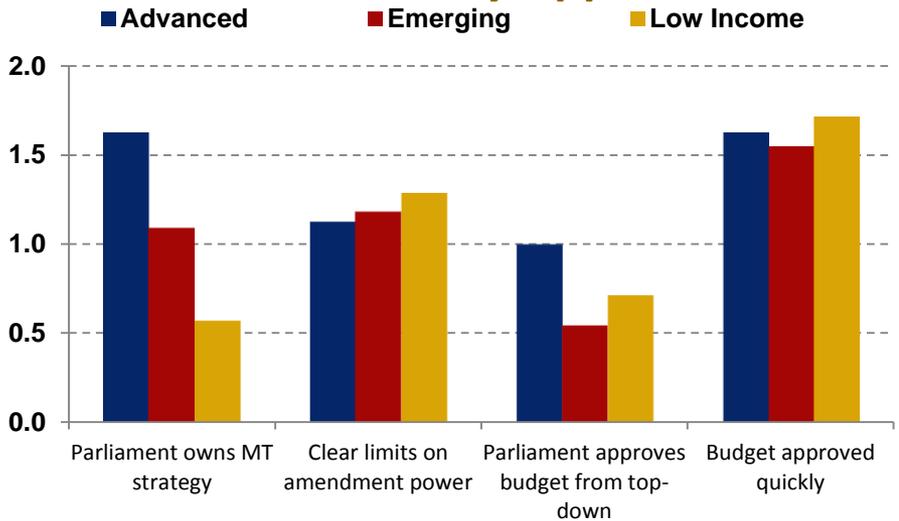
## c. Implementation through the Budget

### Top-Down Budgeting

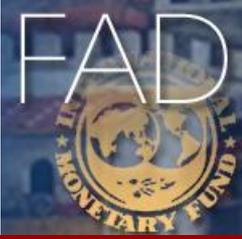


- In almost all countries, there are ex ante limits on both aggregate and sectoral or ministerial spending provided in budget submissions, but...
- in about half of the countries there ceilings are rarely respected, and...
- in about half of the countries, major revenue and expenditure decisions are often or sometimes taken outside the budget process.

### Parliamentary Approval



- The parliament typically does not endorse a medium-term fiscal target or objective, and...
- in about a half of the countries, the annual budget is not approved in a top-down sequence (i.e. parliament does not first approve an overall annual budget framework for total revenues and total expenditures)



## **V. Strengthening Budget Institutions:**

### **a. How to Prioritize reforms?**

- **Designing a reform agenda for low-income countries: a balancing act between ambition and realism**
  - Low capacity of many low-income countries to implement reforms, political economy constraints, weak governance systems
- **Reforms should address country-specific problems**
  - No operational rules that are applicable in all countries, in all contexts, and at all times.
  - Some guidance can be sought from the advanced country experiences

## **V. Strengthening Budget Institutions:**

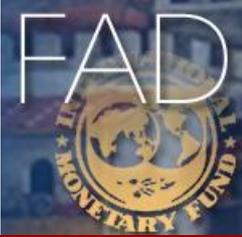
### **a. How to Prioritize Reforms: Experiences from Advanced Countries**



- **Countries should not attempt too many reforms at one time**
- **Important basic elements of a budgeting system need to be put in place first before more advanced elements are incorporated**
- **Reforms take time to implement and need to be adapted to country circumstances**
- **They should take into account the views of stakeholders external to the finance ministry**
- **Finally, they require reorganization of MoF**

# V. Strengthening Budget Institutions:

## b. Reform Priorities: I. Understanding the Fiscal Challenges



- **Fiscal Reporting**

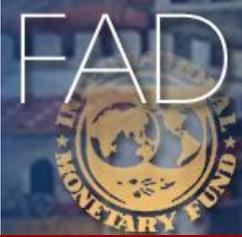
- Expand the coverage of their annual financial statements to central government (and further to general government), and ensure that there is a published external audit;
- Produce financial statistics by an independent office, in line with international standards;

- **Forecasting and Fiscal Risks**

- Include comprehensive information about fiscal risks in their budget documentation, particularly in countries where PPPs, for example, are being used;
- Produce and publish macroeconomic forecasts alongside related assumptions; and updating the forecasts in line with the budget process, and;
- Once the forecasting capacity improves, introduce medium-term forecasts with alternative medium-term budget scenarios

## V. Strengthening Budget Institutions:

### b. Reform Priorities: II. Formulating Credible Fiscal Strategy



- **Fiscal Objectives**

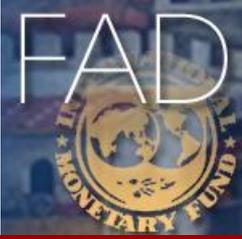
- Adopt a medium-term objective and regularly report on the fiscal performance against the stated objective

- **MTBF**

- Develop first a simple framework and develop it gradually further

- **Intergovernmental Relations**

- Ensure proper interaction between central or federal government and subnational government



## **V. Strengthening Budget Institutions:**

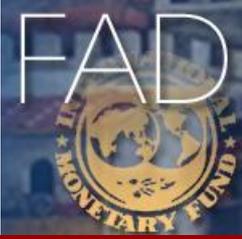
### **b. Reform Priorities: III. Implementing the Strategy**

- **Top-Down Budgeting:**

- Issue ex ante limits on both aggregate and sectoral or ministerial spending at an early stage in the budget preparation process, making sure that the size of the limits is realistic;
- Change parliamentary procedures to follow a top-down sequence

- **Budget Execution:**

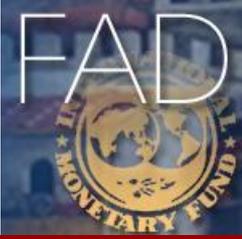
- Putting in place restrictions for overspending and gradually introduce limits on multi-annual expenditure commitments



**Thank you!**

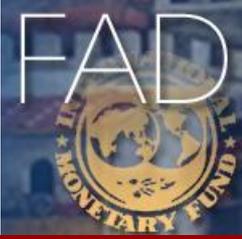
# **Annex**

- **Methodology**
- **Institutions**



# Budget Institutions for Credible Fiscal Strategy Methodology

- 1. For each institution, three to six factual questions**
  - a. Score 0 if criterion not met**
  - b. Score 1 if partially met**
  - c. Score 2 if fully met**
  - d. Simple average across 52 questions**
  
- 2. Weighting and sequencing**
  - a. Each institution has the same “1” weighting**
  - b. There is no implication of sequencing of reforms**



# Budget Institutions for Credible Fiscal Strategy

## a. Understanding the Fiscal Challenges

### 1. Fiscal Reporting

- a. Coverage
- b. Detail
- c. Quality
- d. Timeliness

### 2. Macro-Fiscal Forecasting

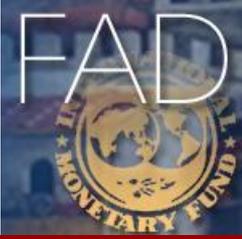
- a. Time horizon
- b. Frequency
- c. Comprehensiveness
- d. Quality Control

### 3. Fiscal Risk Management

- a. Coverage and quality of fiscal risk statements
- b. Approval and provisioning for contingent liabilities
- c. Alternative scenarios

### 4. Independent Fiscal Agencies

- a. Producing or evaluating macro-fiscal forecasts and assumptions
- b. Evaluating ex ante fiscal policy
- c. Evaluating ex post fiscal performance



# Budget Institutions for Credible Fiscal Strategy

## b. Formulating a Fiscal Strategy

### 5. Medium-term Fiscal Objectives and Rules

- a. Transparency about target and time frame
- b. Stability over time
- c. Escape clauses
- d. Monitoring and reporting
- e. Accommodation of the business cycle

### 6. Medium-term Budget Framework

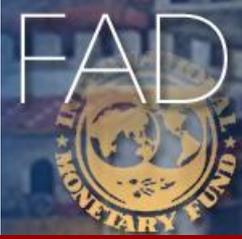
- a. Coverage
- b. Degree of commitment
- c. Level of detail
- d. Separation of current and new policy

### 7. Performance-Oriented Budgeting

- a. Program-based classification / appropriation
- b. Performance targets with regular monitoring
- c. Regular program reviews

### 8. Intergovernmental Financial Arrangements

- a. Clarity and comprehensiveness
- b. Clarity of rules and enforcement
- c. Fiscal policy coordination



# Budget Institutions for Credible Fiscal Strategy

## c. Implementing the Strategy

### 9. Budget Unity

- a. Coverage of the budget
- b. Annual expenditure authorization
- c. Disclosure and controls on tax expenditures

### 10. Top-Down Approach to Budget Preparation

- a. Ceilings fixed at start of budget process
- b. Ceilings respected during budget preparation
- c. Level of revenue earmarking or standing commitments
- d. Unity and finality of budget process

### 11. Constraints on Parliamentary Budget Approval

- a. Separate budget orientation debate and vote
- b. Parliamentary amendment powers
- c. Sequence of budget votes
- d. Timeliness of budget approval

### 12. Constrained Flexibility in Budget Execution

- a. Restrictions on supplementary budgets
- b. Restrictions on carryover of appropriation
- c. Size of and rules for contingency reserve
- d. Controls on multi-year commitments
- e. Residual powers of MoF