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## Is Latin America on the Right Track? An Analysis of Medium-Term Frameworks and the Budget Process

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## **An Analysis of Medium-Term Frameworks and the Budget Process**

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Carlos Scartascini

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**Inter-American Development Bank**  
Department of Research and Chief Economist

# Is Latin America on the Right Track?

## An Analysis of Medium-Term Frameworks and the Budget Process

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## **Abstract\***

Medium Term Fiscal Frameworks (MTFs) have become one of the most popular reforms to the budgetary process in Latin America during the last decade, and introducing MTFs seemed to be the magic solution for most fiscal ailments. Nonetheless, there has been no comprehensive evaluation of their impact. This document discusses the normative merits of using MTFs, provides a characterization of the different types of MTF, and describes their development in the Latin American region based on extensive field work. As a first approximation for understanding how they are working, this document explores in detail the cases of Argentina, Colombia and Peru. While an unambiguous diagnosis is not possible, this document lays the groundwork for progress toward comprehensive impact evaluations and, eventually, to the consolidation of MTFs in the region.

**Keywords:** Latin America, Medium-Term Fiscal Frameworks, Medium-Term Expenditure Frameworks, Budget Process, Fiscal Outcomes, Fiscal Reforms

**JEL Codes:** H61, H68, H00.

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## 1. Introduction

*“When the plan ambitiously portrays a bountiful future with enhanced public services, but the budget fails to make a down-payment on that future—it does not allocate spending increases to social programs—then the government probably is using the plan to escape from its dire predicament.” Schick (1998, p. 38)*

The budgetary process of a country is where decisions about how much to spend and on what are made. In a democratic context, the decisions are not made by a social planner, but they are the result of negotiations among a set of actors, each with its own preferences and incentives. Thus, the president and his/her ministers, legislators, civil servants, and civil society actors interact in the different stages of the process to set their priorities, attempt to influence the amounts and the form in which the resources are allocated, and try to ensure that the promises are fulfilled. The role of each of these actors varies from country to country, according to both what type of institutions oversee the operation of the process in its different stages and the capacity of each actor to make use of its prerogatives in the process.

The budget process is not an isolated discussion. On the contrary, it is one of the most important bills—if not the single most important bill—to be discussed each year in a country. Because almost each policy has a budgetary component (affecting spending, income, and financing decisions, among others), each one has to be discussed during the budgetary process.

Despite the fact that the budget process has usually been considered as a technocratic process, this is rarely the case. Budget decisions are significant not only in terms of their implications for the efficiency and effectiveness for reaching a policy goal, but also in terms of their political implications. Through the budget process not only are public policies financed, but they can also be used to compensate those affected by certain reforms, and the foundations can be laid for forming coalitions that may help to implement the government’s agenda (Filc, Scartascini, and Stein, 2005; Hallerberg, Scartascini and Stein, 2009b). In some countries, it may become the mechanism to hold agreements together and sustain coalitions. Consequently, the budget process is at the core of the more general policymaking process.

Budgets, therefore, are a key tool for the implementation of public policies and in some cases for ensuring the durability of the government. However, the annual horizon of traditional budgets entails certain limitations that reduce their potential for ensuring a correct execution of governmental policy. In terms of the efficiency of expenditures and their accounting, public

policies and public works have implications that transcend the budget year. First, administrative processes, such as bids, can extend beyond the calendar year. Second, infrastructure projects can take many years to be completed. Third, capital investments may entail future operating expenses. When these aspects are not taken into account, public finances and the success of policies can be negatively affected (programs are started but their long-term financing needs may not be secured.) All these factors imply that the annual budget process is not adequately integrated with the planning of public policies.

From a political perspective, yearly budgets may not be the best mechanism for cementing long-term agreements. With a yearly budget, some policies have to be negotiated every year, making them less likely to survive. In response, many countries have introduced earmarks, which make annual budgets more rigid. In the long run, earmarks are making it harder for governments to adapt the budget to the needs of the moment.<sup>1</sup> Alternatively, policies are subject to high volatility according to changes in political winds and the weakening of political coalitions.

In the Latin American context, the weaknesses of annual budget processes—reflected in problems related to the sustainability and efficiency of public policies—have been persistent. In contrast to this, medium-term frameworks (MTF) can provide a better foundation for the discussion of public policies and reduce some of the deficiencies of annual budgets.

Unfortunately, MTFs do not provide a magic solution. As Schiavo-Campo (2009: 1) states, “By neglecting institutional and capacity considerations, medium-term expenditure frameworks (MTEF) introduction has produced in most developing countries elaborate facades of fiscal reform at high transaction costs without improving budgetary outcomes.” Therefore, MTFs are not for every country. If they are adopted, they have to be sufficiently tailored, and steps should be taken to ensure that they are implemented under conditions conducive to success.

This document complements Schiavo-Campo (2009) by discussing the normative merits of using MTFs, providing a characterization of the different types of MTF, and describing their development in the Latin American region based on extensive field work. As a first approximation for understanding how they have been working, this document explores in detail the cases of Argentina, Colombia and Peru. The initial evidence indicates that there is still a long

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<sup>1</sup> For an overview for several LAC countries see Echeverry, Bonilla and Moya (2006). The eight country chapters in Hallerberg, Scartascini, and Stein (2009a) describe the situation in terms of rigidities in detail.

way to go before MTFs can help to solve the problems of the budgetary process in the region. Relatively low capacity and participation of key actors in the bureaucracy, lack of coordination among certain areas and across levels of governments, and intermittent and relatively weak flows of information and statistics seem to conspire against the objectives of the frameworks.

Although the diagnosis is still preliminary to be considered a comprehensive evaluation, the evidence and the information in this document lays the groundwork that should help to advance towards comprehensive impact evaluations and eventually to the consolidation of the MTFs in the region.

## **2. The Medium-Term Frameworks**

### ***2.1 Definition and Objectives***

Medium-term frameworks are institutional tools aimed at extending the planning horizon of public policies beyond the annual budget schedule but without the characteristic deficiencies of medium-term development plans (Shack, 2008).<sup>2</sup> The emergence of different MTF experiences in developing countries took place mostly starting in the second half of the 1990s. According to a World Bank report (2001), at the beginning of the century there were some 25 countries in Africa, Asia, Latin America, and Eastern Europe in different stages of implementing or adopting MTFs, while 10 more were considering them. The introduction of the frameworks occurred in a short period of time; of the existing cases in 2001, 90 percent had been implemented in the four previous years. In Latin America, as will be shown later, MTFs reached the region abruptly, with most countries implementing them in the mid part of the decade of the 2000s.

The cornerstone of the MTFs are the macroeconomic projections (basically the forecasts regarding economic growth and tax revenues), which increase the transparency of fiscal policy and the predictability of financial flows. This information helps to establish expenditure levels compatible with the level of indebtedness and the resources in the economy over the medium term.

The level of depth with which the MTF is promoted and the types of projections included determine the type of framework that is used (Oxford Policy Management, 2000). A framework

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<sup>2</sup> An intermediate instrument between the two are the revolving public investment plans known as PIPs (Public Investment Programs) that were implemented in countries with high dependence on international assistance. The World Bank, one of the principal advocates of such an instrument, was the actor that supported the implementation of the MTF in Africa to resolve poor budgetary outcomes that resulted from the inadequate connection between policies, planning, and budgeting (World Bank, 1998).



with a smaller number of projections is called a medium-term fiscal framework (MTFF). It is usually limited to establishing fiscal policy objectives and presenting a set of projections and comprehensive goals in respect to macroeconomic and fiscal outcomes. Usually, the central variable of the analysis is the evolution of the public debt with respect to gross domestic product (GDP). In turn, other variables are considered in relation to the construction of this variable, such as the evolution of expenditures and government receipts, inflation, debt, and GDP.

Second in terms of the number of projections is the medium-term budget framework (MTBF or basic MTEF). This framework includes the projections in the MTF and adds medium-term expenditure estimates for individual administrative units. The objective is to provide some predictability to expenditures across units that is consistent with overall fiscal discipline. The projections that typify this approach are those that classify expenditures by purpose-function, sector, or ministry.

Finally, the medium-term expenditure framework (or expanded MTEF) is a broader instrument which adds elements of program and results-based budgeting. This instrument is supposed to increase the efficiency of public spending. The MTEF can adopt different degrees of detail in its expenditure projections, up to the point that all of the classifications of the annual budget are replicated. Table 1 shows what information is included in each of these modalities.

**Table 1. Fiscal, Budgetary and Expenditure MTF**

Level			Projections	
MTEF	MTBF	MTFF	GDP Projections	
			Inflation Projections	
			Aggregated Expenditure Projections	
			Aggregated Income Projections	
			Expend. Projections by Administrative Unit	
				Expend. Projections by Function
				Disaggregated Income Projections
				Expend. Projections by Program
				Results Projections

Source: Authors' compilation.

The three major objectives sought by medium-term frameworks are macro-fiscal discipline and stability, strategic allocation of resources (allocation efficiency), and technical efficiency (reduce the waste of resources). Macro-fiscal stability can be classified as a macro level objective, while the other two can be classified as micro level objectives (UNDP, 2007).

The MTFs can contribute to macro-fiscal discipline and stability through a number of channels. On the one hand, they lead to a better intertemporal management of fiscal policy. This occurs for two reasons. In the first place, the existence of a developed MTF makes it more difficult for the governments to conceal or underestimate the multi-year effect of new measures. Second, a well defined MTF forces the fiscal authorities to commit themselves to a predefined evolution of the principal aggregate public finance variables. This way, MTFs grant greater credibility to budget decisions and increase the transparency of the future outlook of public finances for all economic agents.<sup>3</sup>

On the other, MTFs can also have an effect on fiscal results because of their impact on budget institutions, which may help to reduce the impact of the “tragedy of the commons” problem (Ostrom, 1990). Budget institutions are the set of standards, practices, and procedures according to which the budgets are prepared, approved, and implemented. Budget institutions influence the rules of the game within which agents interact, either by imposing restrictions on the entire budget process, or by distributing power, responsibilities, and information among the different actors, therefore affecting the fiscal results (von Hagen, 1992).

The literature has demonstrated that among the budget institutions that affect fiscal outcomes are numerical rules, such as limits on the deficit, the degree of hierarchy of decision-making authority—which measures if any agency has more power in the negotiations or if the relationship among agencies is more collegiate—and the degree of transparency (including what information must be made public and the form in which this is done) (von Hagen, 1992; Alesina et al., 1998; von Hagen, 2006; Filc and Scartascini, 2006; Hallerberg, Strauch, and von Hagen 2009). The MTFs influence these dimensions in three principal ways. First, they can strengthen or weaken compliance with the numerical rules. Second, the mechanism used for defining goals may affect the degree of decision-making hierarchy (both within the national executive branch and among the different branches or levels of government). Finally, MTFs affect the degree of

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<sup>3</sup> In the absence of an MTF it is not possible to take into account the long-term results of current political and expenditure decisions.

transparency of the budget process. How much they affect each of these dimensions—and in what way—depends on the type of MTF.

The number of channels are also multiple for the impact of MTFs on efficiency. MTFFs may affect technical and allocation efficiency by granting greater predictability to the annual budget cycles. MTBFs and MTEFs are aimed at improving both technical efficiency and the strategic allocation of expenditures because they entail a broader range of projections. Through better linkage between policies and expenditures, these frameworks facilitate a better allocation of inter- and intra-sectoral resources, provide greater budget predictability to the spending ministries, and encourage strategic planning within the institutions.

The implementation of MTEFs especially improves technical efficiency because they facilitate oversight and control of programs and projects that take several years to be completed. In turn, these frameworks facilitate greater rationality in budget decisions since the changes that are proposed must be explained with respect to the known current budget estimates and the commitments made. The possibility of improving efficiency through this channel increases if the frameworks are integrated with a results-based budgeting system and there is in place a strong and able technical bureaucracy.<sup>4</sup>

### **Box 1. Typology of MTFs**

MTFs may be classified according to a set of characteristics: degree of coverage, flexibility, recurrence or periodicity, and detail (European Commission, 2007).

- *Degree of coverage.* These instruments may cover all or part of the general or central government. In principle, the broader their coverage, the better the results will be (IMF, 2001). Lower levels of coverage can work against both planning capacity and sustainability. Its effects on the degree of hierarchy of decisions are relatively direct in the vertical dimension: lower levels of coverage will imply less capacity of the national government to influence the decision-making of sub-national governments.

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<sup>4</sup> The impact on another potential feature of interest, representativeness, is not clearly evident. It depends both on whether it is a MTFF or a MTEF and on its particular design, especially the role given to the congress, the spending ministries, and the community stakeholders in the multiannual process. Since the objective of the MTFFs is to improve fiscal results, they usually tend to concentrate decision-making power in the finance ministry, which *a priori* diminishes representativeness. The presence in the case of the MTBF and MTEF of collegiate entities in which sectoral ceilings are discussed has the potential to increase budget representativeness. This possibility is strengthened if planning is participatory and open to civil society stakeholders.

- *Flexibility.* Flexible MTFs allow revisions of the objectives each year. By contrast, in fixed MTFs the most important budget objectives are set only once and are formulated around a projection of total expenditures that cannot be changed except in the case of significant shocks (for example, a serious recession or a change of government). By construction, the fixed MTFs link the annual budget with the multiannual budget. To the extent that this is the case, the degree of hierarchy of decision-making increases as the framework more closely approaches a pure fixed model.
- *Recurrence or periodicity.* Periodic frameworks cover a finite time period and are not reviewed, except in emergencies, until the period is completed. Usually, they are linked to the government period and emphasize planning over the search for sustainability (similarly to the old development plans). Conversely, recurrent frameworks are reviewed annually. In each review estimates for a new year are added.
- *Level of detail of medium-term expenditure and income projections.* The degree of detail of the estimates (by program, function, etc.) is what allows medium-term frameworks to be classified into three general types: fiscal, budgetary, and expenditure.

## ***2.2 Desirable Features in MTFs***

Although the objectives that can be pursued by the MTFs are common across countries, the set of desirable features that the frameworks should have may vary from country to country depending on their capacities and budgetary needs as well as the political context in which they are applied. Despite this, there is a common set of desirable features, which is described next.

First, the frameworks should cover the entire general government in order to take into account the medium-term impact of political decisions on the budget. In some cases, sub-national government and public enterprise expenditures represent a considerable share of total public spending. Thus, the possibility of forecasting the public sector's impact on the economy over the medium term diminishes if they are not included.

Second, ideally they should coordinate the actions of the national government and sub-national governments. MTFs' potential as a planning tool is reduced if the different government levels that are involved in a particular public policy sector are not included.

Third, medium-term fiscal goals should have a high level of political commitment to have credibility. Without the support of decision-makers in complying with their provisions, the frameworks will not be able to increase predictability or solve collective action problems. For example, while in the OECD countries the role of the legislative branch is essential given its responsibilities in the approval of the MTFs, in Latin America it does not play such an important role. In turn, a key factor for the credibility of the goals lies in the transparency of the projections (Oxford Policy Management, 2000).

Fourth, the projections should be conservative, since an overestimation of GDP and of available resources to finance the expenditures of the government may create ex ante pressure to increase multi-year expenditure plans. This risk may be strengthened by the fact that spending ministers may consider the projections as a vested right, thus making it very difficult to negotiate reductions in expenditures later on. A possible alternative for avoiding revenue overestimations is the implementation of “a safety margin,” either through an automatic downward adjustment of the macro assumptions, or through the incorporation of contingent reserves in the budget that can be activated only in the event of unexpected expenditures resulting from shocks (European Commission, 2007). The use of prudent factors is being applied in countries such as Canada and the Netherlands. In the case of Canada, the projections are based on an exercise with the private sector consisting of subtracting an amount allocated to a contingency fund and an amount stipulated by a factor of economic prudence to the average projections of the private sector. The annual budget process must be strongly related to the medium-term frameworks in such a way that the multi-year goals set in these frameworks become the basis from which the budget is prepared.

Moreover, although expenditure projections should not be regarded as vested rights by the different agencies (Holmes and Evans, 2003), the MTF must have a clear link with the annual process. That is, while the annual budget should not be automatically prepared based on the multiannual budget, the latter should really be taken into account when preparing the former. The objective of the projections in the frameworks is to establish a series of possibilities given the existing and potential policies and the estimated macroeconomic context. Under appropriate conditions, these can become the baseline for a new programming period (Allen and Tommasi, 2001). Unlike what is observed in the case of a multiyear budget such as the five-year budget of Uruguay, MTFs preserve the annual budget system. By not establishing legal obligations for the

future, the projections have enough flexibility to be adapted in response to a changing economic environment (Moreno, 2005).

Finally, there should be virtuous feedback between the MTFs and the political process of formulating the budget. On the one hand, the proper operation of MTFs depends on finance ministries' regarding them as a fundamental tool and promoting their use and management in the spending ministries, particularly by those ministries' political directors. This, in turn, requires that the spending ministers see some benefit in using the framework. Budget reforms are sustainable only if the key actors that participate in the process can observe their benefits fairly quickly. In this case, one of the most obvious benefits for the spending ministers is the increase in the predictability of the flow of funds (Oxford Policy Management, 2000).

After identifying the desirable characteristics of the frameworks, it is useful to compare them with other similar instruments, such as "development plans." These plans, used by many developing countries during the 1960s and 1970s, consisted of four to six-year plans aimed at defining and implementing medium-term economic and social objectives. However, the fact that they had fixed time horizons and were prepared in each government period often made them not very realistic and not sufficiently flexible to incorporate changes into the economic framework. Thus the assumed perspective was static, valid for just a specific period, and usually defined outside the budget process, without much commitment in terms of fiscal discipline (Schiavo-Campo and Tommasi, 1999). On the other hand, MTFs are supposed to involve a continuous, encompassing, and disciplined process that promotes the review of the prioritization of expenditures in the context of a dynamic of evaluation, adjustment, and constant updating of projections and information on expenditures and acting on that information.

## **Box 2. Stages in the Development of the MTFs**

In order for medium-term frameworks to gain the support and compliance of those who make policies, their development should include opportunities for interaction between the leading unit of the expenditure framework and the executing units to promote coordination between planning and budgeting. Thus, their design has to be based in stages that combine the determination of the ceilings “from the top down” and the establishment of priorities “from the bottom up.” According to Le Houerou and Talercio (2002), the stages can be characterized as follows:

- *Stage 1.* Development of a macroeconomic/fiscal framework: designed based on a model that makes medium-term income and expenditures projections.
- *Stage 2.* Development of sectoral programs: agreements are reached concerning sector objectives, products, and activities. Existing programs are reviewed and new ones are developed. The cost of the programs is estimated.
- *Stage 3.* Development of sectoral expenditure frameworks: inter and intra-sectoral trade-offs. Consensus development concerning strategic allocation of resources.
- *Stage 4.* Definition of sectoral allocation of resources: determination of medium-term sectoral budget ceilings (approved by the cabinet).
- *Stage 5.* Preparation of sectoral budgets: medium-term sectoral programs based on the budget ceilings.
- *Stage 6.* Final political approval: presentation of budget estimations to the cabinet and parliament for approval.

## **3. The Experience of the Developed Countries**

Multiannual budgeting mechanisms in the developed countries are long-standing. The implementation of programming processes and medium-term expenditure projections started in OECD member countries between the 1960s and 1970s. Some illustrative cases are those of Germany, the United Kingdom, and Australia. In Germany, in 1969, the Budget Principles Law mandated that the federal government carry out a multiannual framework. In the United

Kingdom, since 1980 there has been a multiannual framework called the Medium-Term Financing Strategy. In Australia, after a failed attempt in the 1970s, one of the most successful MTFs was implemented in 1982.

Although at first these tools were aimed at identifying policy alternatives and their financing, this situation changed in the mid-1980s. In a scenario in which the medium-term projections reflected a list of needs based on different sectoral interests, changes in the economic context forced a rethinking of the use of the MTF. From this moment on, it began to be used to gain control of future expenditures (Allen and Tommasi, 2001).

The adoption of fiscal goals within the framework of the Maastricht Treaty gave a new impetus to this tool in the countries belonging to the European Union since it was believed that an adequate MTF could facilitate compliance with the budget goals required for compliance with the treaty. In this context, it is not surprising that, as shown in Table 2, there are few countries within the European Union that do not have a medium-term expenditure framework (MTEF).

The frameworks adopted by the countries belonging to the European Union have many points in common in their design. Most of them place an emphasis on transparency, their time horizon is similar, and they are reviewed every year (Table 3). The differences are more notable in the degree of coverage. In 14 countries, the framework totally covers the general government. In the Netherlands and Sweden, the MTEF covers the central government and social security. In Ireland, it covers the central government and local governments, while in the remaining three it covers only the central government (Table 2).



**Table 2. Characteristics of MTEFs in the European Union, Part 1**

	When are medium-term budgetary objectives established and reviewed?				Framework Coverage			
	Annually	With Gov't Change	Other	Don't have	All the general Gov't	Central Gov't	Local Gov'ts	Social Security
Germany	X					X		
Austria	X				X			
Belgium					X			
Bulgaria	X				X			
Cyprus				X				
Denmark	X				X			
Slovakia		X			X			
Slovenia	X				X			
Spain	X				X			
Estonia	X				X			
Finland		X				X		
France	X				X			
Greece				X				
Netherlands		X				X		X
Hungary				X				
Ireland	X					X	X	
Italy	X				X			
Latvia	X					X		
Lithuania	X				X			
Luxemburg				X				
Malta	X				X			
Poland	X				X			
Portugal				X				
United Kingdom			X		X			
Czech Republic			X		X			
Romania				X				
Sweden			X		X			
	14	3	3	6	16	5	1	1

Source: Authors' compilation based on data from the European Commission (2007).

**Table 3. Characteristics of MTEFs in the European Union, Part 2**

	Period Covered by the MTEF	How are multiannual goals incorporated into the budget formulation?		
		Fully complied with	Serves as basis	Other
Germany	4		X	
Austria	4		X	
Belgium	4			
Bulgaria	3		X	
Cyprus	No MTEF			
Denmark	4			X
Slovakia	3	X		
Slovenia	3		X	
Spain	3	X		
Estonia	4	X		
Finland	4		X	
France	3		X	
Greece	No MTEF			
Netherlands	4		X	
Hungary	No MTEF			
Ireland	5		X	
Italy	3	X		
Latvia	5		X	
Lithuania	2		X	
Luxemburg	No MTEF			
Malta	3	X		
Poland	3		X	
Portugal	No MTEF			
United Kingdom	Other		X	
Czech Republic	3	X		
Romania	No MTEF			
Sweden	3		X	
		6	13	1

Source: Authors' compilation based on data from the European Commission (2007).

#### **4. The Situation in Latin America**

The experience in Latin America is more recent. Various countries implemented MTFF at the beginning of this decade, in many cases accompanied by fiscal responsibility laws (Fisc and Scartascini, 2007). In this region, unlike what is observed in Africa, the panorama is not only heterogeneous with respect to the degree of depth of the medium-term fiscal frameworks, but also displays differences in the focus of the multiannual approach adopted. That is, there are not only cases in which MTFF or MTEF have been adopted, but differences are observed concerning their relationship to the annual budget, as in the Uruguayan case, or in regard to dynamic by which it is updated, as in the cases of Brazil, Venezuela, and Uruguay. It should be noted that the Uruguayan case is not only unique in this regard, but is also one of the first developing countries to have adopted the MTF.

The differences in the degree of depth (the first dimension of classification) can be observed in Table 4.

**Table 4. Degree of Depth of MTFs in Latin America<sup>5</sup>**

COUNTRIES	MTEF								
	MTFF			MTBF					
	GDP Projections <sup>4</sup>	Inflation Projections	Aggregated Expenditure Projections	Aggregated Income Projections	Expenditure Projections by Administrative Unit	Expenditure Projections by Function	Disaggregated Income Projections	Expenditure Projections by Program	Results Projections
Argentina <sup>1</sup>	✓	✓	✓	✓	✓	✓	✓	✓	✓
Bolivia	x	x	x	x	x	x	x	x	x
Brazil	✓	✓	✓	✓	✓	✓	✓	✓	✓
Colombia	✓	✓	✓	✓	✓	✓	x	x	x
Costa Rica	x	x	x	x	x	x	x	x	x
Chile <sup>2</sup>	✓	✓	✓	✓	x	x	✓	x	x
Dominican Rep.	x	x	x	x	x	x	x	x	x
Ecuador	x	x	x	x	x	x	x	x	✓
El Salvador	x	x	x	x	x	x	x	x	x
Guatemala	✓	✓	✓	✓	✓	x	✓	x	x
Nicaragua	✓	✓	✓	✓	✓	✓	✓	✓	✓
Mexico <sup>2</sup>	✓	✓	✓	✓	x	x	✓	x	x
Honduras	✓	✓	✓	✓	✓	✓	✓	✓	x
Panama	x	x	x	x	x	x	x	x	x
Paraguay	✓	✓	✓	✓	✓	✓	x	x	x
Peru <sup>3,5</sup>	✓	✓	✓	✓	x	x	x	x	x
Uruguay	✓	✓	✓	✓	✓	✓	✓	x	x
Venezuela	✓	✓	✓	✓	x	x	x	x	x

<sup>1</sup> The projections of expenditure by program and result are pilot experiences

<sup>2</sup> They have expenditure projections by economic classification

<sup>3</sup> With regard to programs, projection is based on a static perspective and only for those sectors related to production

<sup>4</sup> If they are outside a multiannual budgetary framework they are not taken into account

<sup>5</sup> Peru has multi-year sectoral frameworks, some of which carry out financial projections of the expenditure for four years but not as part of an encompassing medium-term expenditure framework

*Source:* Authors' compilation.

<sup>5</sup> The data are provided in Stata format and available for download at <http://www.iadb.org/research/statistics.cfm?lang=en>

Below, the characteristics of the frameworks are explored in greater detail, country by country. The order used is the degree of depth of implementation, depending on whether they have a MTFF, MTBF, or MTEF.<sup>6</sup>

A first group are those countries that have implemented the MTFF in its most basic form. That is, they have multiannual information in respect to macroeconomic variables.

In Chile, based on the reform of the Financial Management Law, the Ministry of Finance was mandated to develop a medium-term fiscal framework. Currently, a financial projection of the public sector for a period of four years is presented in the draft legislation of Public Sector Budgets prepared by the Finance Ministry, which has been made public since 2000. It includes macroeconomic<sup>7</sup> assumptions, income classified as budgetary and extra-budgetary, and lastly, expenditures, also classified as budgetary and extra-budgetary. Finally, it presents the projection of the budget balance of the consolidated central government, which incorporates the provision for the fulfillment of the goal of obtaining a structural fiscal surplus of 0.5 percent of GDP. The coverage of this framework encompasses the consolidated central government. Its objective is basically related with anticipating allowances or restrictions with current legislation and commitments in order to adopt preventive measures that allow expenditure levels compatible with fiscal policy rules to be maintained. It is prepared in a revolving annual time horizon.

In Peru, the multiannual macroeconomic framework is framed within the scheme established in the Fiscal Responsibility and Transparency Law approved in 2000. The goal is to increase transparency as well as to frame the budget within the economic policy of the government. Budgetary and non-budgetary expenditures and income projections are included. At the same time, it presents projections for macroeconomic variables as well as for fiscal results. Both the limited scheme and its relation to the Fiscal Responsibility Law establish a scenario in which the framework is oriented toward facilitating compliance with the fiscal rule.

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<sup>6</sup> For the preparation of this section the following sources were used, among others: Surveys of Open Budget Initiative (2006); Organic Law of Budgetary System of Venezuela; Organic Law of the Financial Management of the Public Sector; United Nations Development Program (UNDP), (2007); Resolution No. 616 of the Ministry of Finance of Paraguay; Organic Law of Fiscal Responsibility, Stabilization, and Transparency of Ecuador; Public Finance Report: Draft legislation of Public Sector Budgets 2008 of Chile; Shack (2008); Law of Fiscal Responsibility of Brazil; Pares (2007); Federal System of Fiscal Responsibility of Argentina; Law of Fiscal Solvency of Argentina; Multi-Year Macroeconomic Frameworks of Peru; Medium-term Expenditure Frameworks of Colombia; Medium-term Fiscal Frameworks of Colombia; Law of Fiscal Responsibility of Colombia; General Criteria for Economic Policy (2008) of Mexico; Multiannual Plan of Brazil; Medium-term Budgetary Framework of Nicaragua; Multiannual Budget of Honduras; Multiannual Budget of Guatemala.

<sup>7</sup> GDP (real variation rate and GDP growth trend); real variation rate of internal demand; inflation; exchange rate; copper price; molybdenum price.

The case of Ecuador is unique and difficult to classify. The institutions submit an Institutional Multiannual Plan (IMP) in which the multiannual budget for different activities must be included. However, as in the Peruvian case, they are not part of a comprehensive and consolidated medium-term budgeting system. These plans include the description of the vision and mission of the institution as well as its functions and principal operations. The multiannual plans for the different institutions must be framed within the multiannual plan of the national government.

This multiannual plan, which is considered static because it is not recalculated with the same time horizon each year, since this coincides with the beginning of the presidential term, establishes the objectives and the medium-term strategic goals. This document, which is submitted to the congress, does not specify a financing dimension establishing the needs for medium-term expenditure even though its purpose is to guide expenditure and public investment decisions (Organic Law of Fiscal Responsibility, Stabilization, and Transparency, approved in 2002). It should be noted that the monitoring of the multiannual plan of the government and of the budget is carried out by different entities.

In Mexico, since 2002, the multiannual framework has been presented in the rationale for the Draft Budget Law as the evolution of the economy and of public finances in the medium term or a time period of six years. It includes projections of macroeconomic variables,<sup>8</sup> of budget revenues classified as oil-related or other, of expenditures broken down into the categories salaries and wages, pensions, subsidies and transfers, and capital expenditure. Finally, the framework includes projections of the economic balance and the net debt. It should be pointed out that, unlike other cases, expenditures are not presented as current values but as a share of GDP.

Forecasts of economic and GDP growth, as well as the financial requirements of the public sector are developed in the General Criteria for Economic Policy (also as a percentage of GDP). Only for certain expenditure categories and investment expenditure were multi-year forecasts provided as established in the law following approval of the Finance Reform.

According to its regulatory framework, the MTF in Venezuela combines characteristics related to fiscal stability and to planning. Introduced in 2000, the Multiannual Budget

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<sup>8</sup> Real variation of GDP, inflation, interest rates, the current account, aggregate supply (GDP and imports), aggregate demand (consumption, gross capital formation and exports).

Framework (MBF) has a fixed horizon of three years that does not coincide with the presidential period.<sup>9</sup> This document is prepared through the joint effort of the Ministry of Finance, the Ministry of Planning and Development, and the Central Bank. The MBF includes economic policy objectives, medium-term macroeconomic assumptions, limits of expenditure and indebtedness for the annual budgets of the period, long-term fiscal policy objectives, and the general guidelines for the formulation of the budget. According to the regulatory framework (Constitution and Organic Law of the Budget Financial Management), the macro-fiscal rules are directly related to the medium-term fiscal framework, while they are defined with respect to the period of effectiveness of the multiannual budget framework.

A second group of countries promoted medium-term budgetary frameworks (MTBF). This limited version of the medium-term expenditure framework (MTEF), also presents projections for expenditure by function or economic classification.

In Guatemala, a multiannual budget has been included in the budgetary documents submitted to Congress since 2003. In 2006, a strategic vision was incorporated that takes into account the medium-term goals drafted by the ministries in their multi-year plans. The Multiannual Budget (MB) is included in compliance with the Organic Law of the Budget. The MB contains estimations of the revenue and expenditure fiscal aggregates for the following three years. The document, prepared by the Ministry of Finance of Guatemala, includes projections of the institutional and sectoral expenditures (a classification which differs from the classical functional classification), GDP, inflation, exports and imports, and revenues classified by type of tax.

According to the current regulatory framework, the preparation process is divided into two stages. During the first stage, the medium-term macroeconomic framework that serves as the basis for the revenue estimation and expenditure ceilings for the period is defined. In the second stage, the administrative entities formulate their respective provisional drafts of the multiannual budget based on their allocated expenditure limits.

Since 2006, Colombia also has had a MTBF with a revolving horizon of four years. Along with the medium-term expenditure framework presented with the Draft Budget

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<sup>9</sup> The national executive branch, through the Minister of Finance, will present to the National Assembly the draft legislation of the multiannual budget framework, before July 15 of the first and the fourth year of the constitutional period of the Presidency of the Republic, and this will be approved before August 15 of the same year of its presentation.

Legislation, projections of fiscal balances, expenditure ceilings by administrative unit, and an explanation of the differences relative to the previous medium-term expenditure framework are published.

The last group of countries opted for the broader MTEF scheme in which expenditure projections by program are also included.

In Nicaragua, starting in 2006, a medium-term budget framework has been prepared that covers various macroeconomic aggregates and the consolidated operations of the public sector and of the principal government agencies in a revolving horizon of three years. Pursuant to what is stipulated in the Law of Financial Management and Budget Regime, the formulation, approval, and execution of the budget must be linked to the National Development Plan (NDP), the medium-term budget framework, and the Public Investments Program, among other policy instruments. Included in the MTBF are macroeconomic aggregates and consolidated operations of the public sector and of the principal government agencies.

The medium-term expenditure framework of Brazil, formally introduced in 2000, is probably the most developed and stands out as well for the predominant role that planning plays. The budget of the federal government that is effective for one year is formally linked with the planning system which comprises four years, known as *Plano Brasil*. This plan is approved by law at the beginning of each presidential period. The instrument that bridges the plan and the annual budget is called Budget Directives, which is a law that is passed for each new fiscal year.

In the Brazilian budget context there are, thus, three planning horizons. The first is a long-term indicative stage (eight years). Next is a programming stage that entails the preparation of the four-year multiannual budget (MB) in which the allocation of budget resources is defined by programs and activities in accordance with the goals of the government. Revenue projections, macroeconomic variables, and fiscal results are also established in this framework (estimations for sub-national governments are also included), in addition to the annual budget.

Some characteristics of the MB differ from the traditional MTF, which reveals an attempt to link planning to budgeting. The classification of financing is clearly focused on the programs and their goals. The global amount is consistent with the revenue projections and the fiscal goals for the period (for example, in MB 2004-2007 the goal was to maintain a primary surplus of 4.25 percent of GDP each year). The aim to address planning is clear in that programs are classified



under macro-objectives and these, in turn, are categorized into mega-objectives within a hierarchical framework.

However, the ambitious approach to integrate plans and budgets under the orbit of the Ministry of Planning, has yet to yield all of the expected results. With respect to fiscal prudence in particular, the results of the Brazilian experience have not been as successful as expected (Gómez and Martínez-Vázquez, 2008).

In Paraguay, a presidential decree in 2006 granted the ministry of finance the task of formulating the Referential Multiannual Budget. This multiannual budget has a revolving horizon of three years and encompasses the general government. The document includes revenue and expenditure projections as a percentage of GDP within the scheme of savings-investment-financing, macroeconomic variables (GDP, inflation, and exchange rate), and expenditure by function, institution, and broad social goals.

In Honduras, as in Nicaragua, the influence of the Poverty Reduction Strategy and international assistance associated with it laid the foundation for the implementation of an MTEF. As a result, since 2003 the budget proposal sent by the executive branch to the congress includes an annex with a multi-year budget with information on the evolution of fiscal aggregates in the following three years. Although it includes not only macro projections but also expenditures by program projections, to date, this budget has consisted basically of a projection of the data of the base year for the fiscal year and three more years based on certain assumptions regarding the trends of specific expenditure categories (Acevedo, 2007).

Argentina has a three-year multiannual framework with a revolving time horizon that covers general administration, decentralized entities and trust funds but does not mandate actions; it is intended mainly as an information tool. It should be pointed out that most social spending is executed by the provinces, particularly education and health, and consequently is left out. The multi-year budget includes projections of macroeconomic variables, revenues, expenditures by objective and function, expenditures by administrative unit, and expenditures by program.

Although the regular budget in Uruguay is multiannual in nature, clarification is necessary. Its five-year budget coincides with the presidential term and does not have a specifically annual counterpart, thus differing from the large majority of MTEF experiences. In the first place, this particular scheme implies that it must be approved by the congress. Secondly,

unlike other cases observed in Latin America, compliance is compulsory. However, the budget can be modified. After one year, the record of budget execution is reported and a series of modifications are presented to the congress, which are subject to its approval. Since the MTEF is not considered to be a multiannual budgeting system that establishes legally binding expenditure allocations stretching out for several years, the multiannual budget in Uruguay would not be considered an MTEF.

The government of Costa Rica presented a MTEF for the first time for the 2008-2010 period containing projections for a three-year revolving horizon of the principal revenue and expenditure categories of the budget. The multiannual budget is proposed as a guide for the medium-term fiscal policy of the state and is a frame of reference for the annual budget and the public investment plan.

Among the remaining countries, the Dominican Republic and Panama have already developed the legal framework that will guide the implementation of medium-term fiscal frameworks.

In the case of the Dominican Republic, in accordance with the Organic Law for the Public Sector Budget promulgated in 2006, during 2008 work was carried out to prepare a four-year multiannual budget for the non-financial public sector. The strategic guidelines of the Multiannual National Plan of the Public Sector must be consistent with the financial framework prepared by the Ministry of Finance for the same period. Although this medium-term framework will only be of an informative nature, the decree approved in 2007, which governs the Planning and Public Investment Law, calls upon the Governing Council to be knowledgeable about, debate, and make decisions in relation to this multiannual budget.

Panama is on the verge of approving an MTFF. In April 2008, the Finance, Planning, and Economic Policy Commission presented to the Plenary of the National Assembly the Draft Legislation of Fiscal Social Responsibility. This law has the characteristics of a fiscal responsibility law in which an MTFF is included. The draft legislation defines the compulsory nature of presenting a Government Strategic Plan at the beginning of each administration, which must include the Economic and Social Strategy, the five-year Financial Program, and the Public Investments Indicative Plan. The law covers all the entities of the public sector. Since this task is carried out at the beginning of each administration, the MTFF coincides with the government period and, as a result, has a fixed time horizon. The amendments to the Strategic Plan must be approved

by the Cabinet Council. The macroeconomic assumptions will include, at least, the following variables: the rate of growth of GDP and annual inflation, measured by the Consumer Price Index; revenue and expenditure projections of the non-financial public sector; amount of public investment, and expected changes in the public debt level. The special feature of the Panamanian draft legislation is that the medium-term fiscal framework must contain, at the very least, a comparison of the programmed fiscal goals against the results achieved and, in case of noncompliance with the expected goals, a detailed explanation of the reason or reasons for the noncompliance and the magnitude of the necessary fiscal adjustment to resume compliance with the fiscal goals.

## **5. Case Studies: Colombia, Peru, and Argentina**

Understanding how MTFs are working in LAC requires in-depth understanding of the conditions of implementation and their characteristics, as well as the fullest possible analysis of whether they are fulfilling their objectives. This section describes the MTFs in three countries and analyzes their effects on the budget process. The cases have been selected so that each of the different MTF types is covered.

### ***5.1 The MTF in Colombia***

#### ***5.1.1 Description***

The MTEF was introduced in Colombia at the time it passed its Fiscal Responsibility Law. After the fiscal crisis of the 1990s, Colombia reached an agreement with the International Monetary Fund (IMF) to implement various economic adjustments in expenditures, pensions, and fiscal rules. Among the last rules adopted within the framework of the fiscal responsibility law were the fiscal and medium-term expenditure frameworks.

The Medium-Term Fiscal Framework has a time horizon of ten years and a fundamental objective to reduce, and increase the sustainability of, the public debt. To this end, it sets primary surplus goals in line with the debt goals and establishes GDP and revenue collection projections that determine expenditure ceilings. The goal that guides the MTEF is to reach a net debt level of 25 percent of GDP by 2018. In order to achieve this, a surplus of 2.5 percent is considered necessary, with GDP growth of 4.5 percent.

During the drafting of this document the macro discussion takes place, estimating the adjustments needed that are consistent with meeting the goal, taking into account inflation, unemployment, growth (productivity), and investment projections. The framework is prepared jointly by the Ministry of Finance and the National Planning Directorate which represents the sectors.

Preparation of the MTEF began in 2006. It has a time horizon of three years, is recurrent and sets expenditure goals for the different sectors. In its preparation the primary surplus goals of the MTEF, as well as the data produced within each entity, are taken into account. This document provides the context for the budget discussion in respect to the spending under execution and compulsory transfers (for example, those stipulated in the Constitution) and debt service, which is a significant, rigid portion of the budget. It should be noted that the Fiscal Responsibility Law establishes firm restrictions on increasing current expenditures (with the exception of certain sectors, such as the Armed Forces, the Office of the Comptroller, and Audit). The rest of the discussion deals with the investment expenditure framework.

However, these are not the only medium-term planning instruments. There is a Government Plan that establishes sectoral goals for the presidential term. The sectors and the National Planning Directorate participate in establishing these goals, but the Ministry of Finance does not participate. The Government Plan has a financing section that encompasses all expenses that are not operational in nature (taking into account the MTEF) and a programming section. It includes sectoral plans prepared by each ministry. These sectoral plans must be adapted to the conditions imposed by three different processes: the Government Plan, the MTEF, and the long-term Sectoral Plans that have a 10-year horizon. The latter establish general goals without including a financing facet. A noteworthy characteristic is that its preparation is the result of a collective process in which different sectoral actors participate (for example, those in education, unions, universities, NGOs, and political parties). The existence of various parallel medium-term frameworks is not the only element of originality exhibited by the Colombian case. The budget is articulated on the basis of a classification that does not coincide with the notion of capital and current expenditure. On the one hand, the Ministry of Finance manages three quarters of the budget. This portion includes part of the current and operational expenditures such as acquisition of equipment, maintenance, and personnel, as well as debt service. On the other hand, the National Planning Directorate manages investment spending, including that related to education

programs, as well as health subsidies, military expenditure, fixed capital, and transfers to sub-national entities.

First, a medium-term budget programming circular is sent to the ministries with sectoral ceilings approved by the cabinet. Based on this circular, the sectors review their medium-term programs. Subsequently, the sectors submit a financing request that must be accompanied by an adjustment in the goals (although formally there is no direct linkage) if it surpasses the ceiling. At this time, the first filter for adapting the requests from the sectors to the MTEF is set in motion. Technical groups from the Ministry of Finance, the National Planning Directorate, and the different sectors meet to reconcile the financing requests.

The second filter consists of bilateral discussions between the Ministers of Finance and Planning, on the one hand, with the ministers of each sector, on the other. In this stage, an attempt is made to structure policy and program priorities. Finally, this is discussed again in the cabinet. At this point, the sectors typically gain strength. Usually the president supports the expenditure ministers particularly in certain strategic areas that he/she prioritizes, such as education. To this end, the ministers put in play the achievement of the goals of the development plan.

It should be pointed out that throughout this process the Congress does not have the power to interfere. In fact, the MTEF and the MTEFF are sent to the legislators for information purposes only, given that it does not have the power to modify or veto them.

What are the prevailing perceptions of the quality and timeliness of the statistical information? The feeling one is left with is that the accounting system at the sub-national level is quite inefficient as well as the statistics. Also, according to the sources interviewed, there are deficiencies in the information “below the line” (for example, in the calculation of the pension debt). Despite this, there is a general perception that the information systems have improved.

### *5.1.2 Projections*

As can be observed in Table 5, the macroeconomic projections of both GDP and inflation have been fairly accurate. The expenditure projections by sector were incorporated in 2007, which means that it is too early to evaluate them.

**Table 5. Projections of the MTEF**

Medium Term Macroeconomic Framework	Projected Year	Inflation		GDP Growth	
		Projected	Actual	Projected	Actual
<b>2004</b>	2004	0.055	0.055	0.04	0.046
	2005	0.044	0.0485	0.04	0.057
	2006	0.035	0.0448	0.04	0.069
<b>2005</b>	2005	0.05	0.0485	0.04	0.057
	2006	0.045	0.0448	0.04	0.069
	2007	0.04	0.0569	0.04	

*Source:* Authors' compilation based on the medium-term fiscal frameworks, Ministry of Finance and Public Credit and National Administrative Statistics Department, Colombia.

### 5.1.3 The Budget Process

The implementation of the medium-term fiscal and expenditure frameworks has generated changes in the budget process. It should be noted that the MTEF period of operation has been too limited to consider the effects observed as institutional changes that have become consolidated.

A first achievement was for the process of adjusting expenditure to budget constraints to be done with greater involvement of the sectors. This does not imply that the ceilings are necessarily agreed upon. Before the adoption of the framework, the pressure to comply with expenditure limits fell on the Ministry of Finance which led, in some cases, to arbitrary cuts. This change in the budget dynamic is also expressed in the fact that, previously, the sectors tended to develop “inflated” provisional budget proposals in order to prevent cuts from the Ministry of Finance. This trend was reduced with the multiannual perspective.

The improvement in the predictability of the allocation of funds also had positive effects. The resources that were previously assigned but not delivered have been reduced. This is due to the fact that previously the entities preferred to ensure funds even though they did not have plans on how to spend them. According to the interviewees, without the MTEF the budget became institutional plunder: since no entity had guaranteed financing in the future, each entity sought to obtain as much as possible every year. The MTEF made it possible to view a time horizon beyond one year and to begin to prioritize and program for the medium term. However, there are factors outside of this process that can alter both planning and budgeting. Among them are laws

passed by Congress that require investments to be made and judicial rulings. It should be pointed out that these two powers are excluded from the MTEF.

In turn, certain characteristics of the budget process and of the policymaking process prevent the MTEF from functioning with all of its potential, particularly the conflict between the national government and subnational governments. The principal reason is the decision of the central government to assume traditional functions of the subnational governments, such as water supply systems and roads. This competition between the different levels generates negative incentives that are aggravated because the periods of government and the plans do not coincide at the national and subnational levels.<sup>10</sup>

#### *5.1.4 Conclusions about the Colombian Case*

In addition to the previously mentioned effects on the budget decision-making process, the actors' perceptions are that the MTFs have demonstrated various positive effects. The MTFF has served as a reference for generating fiscal discipline, made the different actors aware of fiscal restrictions, and made budget discussions more transparent. This is observed in the fact that even though there is no formal relationship between the Government Plan and the MTFF, during preparation of the former the restrictions imposed by the latter are taken into account.

The problems of expenditure efficiency related to results-based budgeting are an issue that the MTEF has not addressed. This is due mainly to the fact that a scheme has been chosen that is limited to the operating environment. However, this process has influenced the efficiency of expenditures. First, based on what is perceived by the sectors, the MTEF increased predictability and facilitated the flow of certain processes that implied a time horizon that is longer than the annual one. This perception is shared by high-ranking officials in the ministries. In this regard, the MTEF also improved the availability of statistical information. The task of establishing goals purified the baselines, although monitoring indicates problems related to delays in the production of the information.

Furthermore, there are certain pending issues. For example, the effect of the MTEF on the reduction of the inertial nature of the budget is relative. This is explained to a great extent by the rigidity resulting from earmarking and the expenditures by function and the debt. In regard to

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<sup>10</sup> One issue that remains to be evaluated is what will happen when an administration has to work with the MTEF approved by a previous government.

investment spending, according to the sources consulted, the MTEF has helped make expenditures flexible and, as a result, reduces their inertial nature.

In the Colombian case, although the main objective of introducing the frameworks was to gradually reduce the public debt, elements that were incorporated aimed at favoring planning based on the participation of the spending ministers in the process. Nonetheless, there remain weaknesses related to planning capacity. One of the main flaws is that in practice it is difficult to reach the municipal level, although the latter plays a relevant role in the execution of public policies.

## ***5.2 The MTF in Peru***

### ***5.2.1 Description***

As in Colombia, the MTFF was instituted in Peru as part of a series of reforms of the budget process contained in the Fiscal Responsibility Law. This framework, known as the Medium-Term Macroeconomic Framework (MTMF) was adopted in 2000; it has a revolving time horizon of three years and is prepared for the general government. Its main objective is to adapt the expenditures and the evolution of the debt to the fiscal rules.

The document is prepared by the General Directorate of Economic and Social Affairs (DGAEyS, in Spanish) under the Ministry of Economy and Finance. This unit is responsible for guiding and coordinating the formulation, execution, monitoring, and evaluation of short, medium, and long-term economic and social policies, as well as the Economic Program. It should be pointed out that this entity is not in charge of the annual budget. The Public Budget National Directorate is responsible for the National Budget System and prepares the provisional draft of the Annual Budget Law.

To develop the MTMF, the DGAEyS uses historical budgeting of total expenditures plus a given additional percentage. This procedure holds two major implications: first, that the methodology has incremental characteristics, and second, that the planning done by the line ministries is not taken into account in the calculation of the ceiling established in the MTMF. Thus, the MTMF ends up being almost exclusively a restriction on expenditures and not a programming tool.

Indeed, different administrative units do not participate as sectors in the preparation of the macro framework. What does take place is that the historical expenditures are used as an



input to calculate the ceiling for total expenditures. However, the sectors provide information to the Ministry of Economy and Finance. The administrative units provide information concerning indebtedness and debt service payments to adapt to the fiscal rules.

Furthermore, there is an information flow in the opposite direction. The MTMF gives the sectors reference ceilings both for planning the subsequent years and for the annual period. It allows them to relate the variable projections such as GDP, total income and total expenditures to the historical allocation of the sector to predict certain tentative expenditure levels.

The resulting document is reviewed by the Central Bank. After responding to the comments that may have been made, it is submitted to the Cabinet (Council of Ministers) for its approval. The final document is sent to Congress one month before the annual budget goes to committee since the macroeconomic framework serves as the basis for the budget debate. Given that the Medium-Term Macroeconomic Framework is only submitted for information purposes, Congress usually does not discuss it. However, there have been occasions on which certain specific aspects of the projections, such as those related to the exchange rate, have been subject to debate.

Although there is no medium-term expenditure framework, the different sectors carry out a planning exercise, which is incorporated into the Medium-Term Sectoral Plans. These documents are basically, a medium-term management tool. Although they have a financing section, they do not necessarily bear a direct relation to the macroeconomic framework but use it as an input. These four-year sectoral plans coincide with the government term of office and are annually evaluated.

In turn, for some sectors such as education and health, these sectoral plans are framed as a part of national plans that establish long-term goals for the year 2020. Unlike the sectoral plans, the latter do not have a financial component. This is not the only difference between long-term and medium-term plans. Long-term plans are prepared through a more inclusive process, with sectoral stakeholders invited to participate during their development.

In addition to these initiatives within the sectors, the ministry of Economy and Finance has undertaken some steps to strengthen the MTFF. The first of its initiatives—to establish multiannual budgets for investment projects—was carried out through the reform of the National Public Investment System Law No. 27,293. Since multi-year investment budgets are extended at

the administrative unit level, the know-how and the necessary information for taking this step are available.

Another initiative is the preparation of a social macroeconomic framework. This recently launched instrument is aimed at defining sectoral goals. Although it has a financial component, not all of those responsible for sectoral budget management participate in its preparation. The objective of this initiative, which is led by the cabinet, is to reorient social programs toward reducing poverty levels. It should be pointed out that Congress is not involved in this initiative.

The social macroeconomic framework is, in turn, accompanied by the introduction of other budgeting techniques. In 2006, a pilot was begun of results-based programs in five sectors (among the programs included in this initiative are those focused on nutrition, maternal-neonatal health care, and student achievement). These programs, which are considered strategic, are evaluated on a quarterly basis in terms of their achievement of physical goals and results. Five strategic programs in results-based programming were initiated this year.

In order for undertakings such as multiannual frameworks or programs with results-based budgeting to work, adequate statistical information needs be available. The different sectors have a negative perception of the statistical data available. Serious problems are evident with respect to the quality of the data and there are numerous gaps. Due to the lack of coordination with the National Statistics and Informatics Institute (INEI) a solution in the short term is not expected.

### *5.2.2 Projections*

As can be observed in Table 6, the projections for GDP growth are moderate. This difference is associated with greater expenditures and surpluses than projected.

**Table 6. Projections of the MTF**

Medium Term Framework	Projected Year	Non-Financial Expenditure (millions of new soles)		Primary Result (millions of new soles)		GDP (millions of new soles)		Consumer Price Index	
		Projected	Actual	Projected	Actual	Projected	Actual	Projected	Actual
<b>2004</b>	2004	43,162	39,730	1,218	2,080	225.7	234.3	2.50	3.50
	2005	45,170	44,488	2,759	3,662	242.4	258.4	2.50	1.50
	2006	47,693	49,318	4,357	11,098	261.7	305.8	2.50	1.14
<b>2005</b>	2005	41,750	44,488	2,960	3,662	248.3	258.4	2.50	1.50
	2006	43,844	49,318	3,615	11,098	266.0	305.8	2.50	1.14
	2007	45,985	58,715	4,509	6,099	285.1	330.4	2.50	2.00
<b>2006</b>	2006	46,704	49,318	3,000	11,098	270.5	305.8	2.50	1.14
	2007	48,878	58,715	3,659	6,099	288.4	330.4	2.50	2.00
	2008	51,722	.	5,093	.	311.2	.	2.50	.
<b>2007</b>	2007	51,293	58,715	3,427	6,099	307.6	330.4	2.50	2.00
	2008	53,606	.	5,220	.	329.3	.	2.50	.
	2009	56,333	.	8,212	.	354.0	.	2.50	.

*Source:* Authors' compilation based on medium-term macroeconomic frameworks (2004-2008), Ministry of Economy and Finance, Peru.

### 5.2.3 The Budget Process

The Medium-Term Macroeconomic Framework is not an area of public policy discussion. In practice, the sequence that determines the ceilings is as follows: projection of GDP into the future, calculation of income and, finally, the projection of expenditure levels consistent with the compliance with fiscal rules. As mentioned earlier, within an analysis based on the sustainability-planning dichotomy, the MTF in Peru is oriented toward sustainability.

Within this scheme, it is consistent for the DGAEyS to attempt to prepare a moderate macro framework. Since one of the functions pursued is to restrict expenditure requests from the sectors, it tries to be conservative in its projections. Such practices have not generated complaints among the ministers. Thus, the ceilings established by the DGAEyS are usually approved without modification by the Cabinet.

This does not imply that the sectors lack a space in which to discuss the financing of public policies. The annual budget process is where this discussion takes place. According to the opinions of those interviewed, the allocation of budget limits stipulated by the Ministry of Economy and Finance, usually does not meet the budget needs of the sectors. As a result, additional demands are added to the ceiling amounts. The probability of getting those additional

funds depends to a great extent on the political weight of the head of the administrative unit during the discussion of the budget in the Council of Ministers.

During the annual budget process the lack of coordination between the sectoral plans and the budget comes to light. At times, this situation leads to conflicts between the spending ministries and the Ministry of Economy and Finance, which is perceived as an obstacle to its own ability to implement policies. Since the goals are established in the sectoral medium and long-term plans while the allocation of resources is determined, ultimately by the ministry of Economy and Finance, such inconsistency results in noncompliance with the established goals. All these conflicts could be resolved through the strengthening of the fiscal framework in an MTEF.

However, as previously seen, it is not necessarily sufficient to establish an MTEF to obtain coordination between planning and budgeting. In the case of Peru, there are other features of the political dynamic that should be controlled. For example, sectoral plans tend to be reviewed with each management change. Since rotation of ministers is important, planning loses most of its *raison d'être*.

The other factor of the political process that generates problems in planning and that should be taken into account at the time of designing an MTEF is the relationship between different levels of government. Currently there are coordination problems between the sectors at the national level and the regions. Although sectoral goals are established by the national ministries, the regional authorities in charge of executing the expenditures enjoy a high level of discretion in reassigning the expenditure among functions. As a result, an MTEF should include the participation of sub-national actors that allow management agreements to be reached that imply a commitment to carry out the actions aimed at reaching the goals.

#### *5.2.4 Conclusions for Peru*

As currently developed, the MTF in Peru prioritizes those instruments related to the pursuit of macroeconomic stability over those that would strengthen the planning aspect of the MTF. This results from the fact that the MTF does not include programming or functional categories.<sup>11</sup> This functional design for compliance with the fiscal rules also has effects on the distribution of the power of the actors. By not establishing consensus-based mechanisms in the preparation of the ceilings, this framework tends to concentrate budget decision-making power in the MEF.

In addition to affecting the powers of the actors, the MTF affects the results of budget policy. Although the effects on sustainability are positive, they are probably negligible or strengthen the preexisting dynamics in respect to efficiency and representativeness. With respect to efficiency, the greatest input the frameworks can provide is to increase predictability and reduce incrementalist practices. According to the opinions of those interviewed, this has occurred in Peru to a limited extent. The perception in the spending ministries is that a MTEF that provides certainty with respect to the flow of funds for a period greater than one year could be useful in avoiding under-disbursement as a result of rigid administrative procedures.

### ***5.3 The MTF in Argentina***

#### *5.3.1 Description*

The MTF was introduced in Argentina in 1999. Previously, there were some budget tools with a multiannual horizon such as the Public Investment Law that stipulated a three-year plan for investment spending.

Although it does not replicate the annual budget, the MTF entails a level of detail that makes it the closest to doing so among the cases reviewed. This framework not only includes the functional classification and administrative unit, but also incorporates information by program (even if it does not take into account the lower levels of this classification, such as subprogram,

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<sup>11</sup> This situation is not intrinsic to the Peruvian case, but is associated with the function given to the framework. Evaluation of the MTF in Mozambique reveals the same situation. From this case it is apparent that without an effective connection between budgeting and strategic planning, the framework becomes simply a tool to achieve fiscal discipline (Batley, Bjørnstad and Cumbi, 2006).

activity, project, and works) with the expected trends for the physical goals and their sources of financing. As a result, it meets the characteristics of a MTEF.<sup>12</sup>

As observed in Colombia and Peru, the Argentine experience originated in a broader fiscal reform promoted by an agreement with the IMF. The adoption of a Fiscal Responsibility Law by the national government (Law 25,152) implied, among other obligations, the commitment of the national executive branch to prepare a multiannual budget of at least three years. Given the prevailing economic situation and the latent fiscal crisis, the objective was mainly to achieve a time period of predictability in the reduction of the deficit.

Thus, since 1999, all the agencies that compose the national administration annually prepare a document known as a Multiannual Budget in a process which is integrated with the process for formulating the National Budget Law Proposal. This integration implies not only sharing the financial information system, but also a single timetable to be followed by the administrative units.

The first step in the preparation of the framework consists in the preparation of ceilings for each year of the three-year period for each national agency by the National Budget Office (NBO). For this budget, the NBO relies on different offices that perform the projections from the information used. The spending ministries can provide preliminary budgets that serve as an input in defining the ceilings. Combining the inputs produced by the sectoral officers of the NBO with the restrictions on consolidated expenditures imposed by the fiscal goals, the ceilings for each administrative unit are established. Through this exercise, the annual ceilings are also established. Based on those ceilings, the agencies prepare their provisional drafts of annual and multiannual budgets. Since budget ceilings are usually lower than initially required (either in the preliminary budgets or from the needs stated to the NBO), administrative units tend to submit “over-the-ceiling” budgets. They do not have to necessarily maintain the same programming for the second and third years, since possible termination of existing programs and the implementation of new policies are taken into account.

After a period of political decisions in which the demands from the different units are rejected or approved by the Chief of the Cabinet,<sup>13</sup> the proposed annual budget is submitted to

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<sup>12</sup> It includes projections of resources by categories; expenditure projections by purpose, function, and of an economic nature; investments program for the period; programming of credit operations from multilateral agencies; description of the budgetary policies that support the projections and the expected economic and financial results.

the legislative branch. It should be noted that the multiannual budget presented to congress is for information purposes and does not need the approval of this body.

### 5.3.2 Projections

Table 7 shows that during the first years following the devaluation, the projections diverged significantly from the actual values. That situation improved over time, particularly with regard to inflation projections. However, with regard to the GDP, the continuous and apparent differences suggest the strategic use of the projections. This is probably the result of the use of this practice in the preparation of the annual budget. Since the differences between projected and observed primary results are low, it can be inferred that a portion of the resources are allocated in a discretionary manner by the executive.

**Table 7. Macroeconomic Projections of the Multiannual Budget and Real Values**

Multiyear Budget	Projected Year	Inflation		GDP (Current Millions of Pesos)		Primary Result (% GDP)	
		Projected	Actual	Projected	Actual	Projected	Actual
2003	2003			533,726	375,909	2.18%	2.4%
	2004			621,087	447,643	2.72%	3.9%
	2005			700,095	531,938	3.24%	3.5%
2004	2004	10.5%	4.4%	416,865	447,643		3.9%
	2005	8%	9.6%	460,965	531,938		3.5%
	2006	6.5%	10.9%	501,451	654,438		3.54%
2005	2005	7.9%	9.6%	476,360	531,938	3.2%	3.5%
	2006	6%	10.9%	526,043	654,438	3.23%	3.54%
	2007	5.7%	8.4%	565,624	812,072	3.28%	3.3%
2006	2006	8.6%	10.9%	593,975	654,438	3.26%	3.54%
	2007	8.00%	8.4%	658,426	812,072	3.35%	3.3%
	2008	7.2%	.	729,180	.	3.4%	.
2007	2007	9.6%	8.4%	694,195	812,072	3.14%	3.3%
	2008	7%	.	754,401	.	3.17%	.
	2009	5.5%	.	809,069	.	3.33	.

Source: Authors' compilation based on multiannual budgets, Ministry of Finance, Secretariat of Economic Policy and the National Statistics and Census Institute (INDEC).

<sup>13</sup> Although there are technical recommendations made by the NBO to accept them or not, the final decision is made by the Chief of Cabinet. The role played by the Ministry of the Treasury varies in accordance with the idiosyncrasy of the person who heads the institution.

### *5.3.3 The Budget Process*

Although the MTF functions correctly, according to evaluations made by former staff members of the NBO (Vega, 2004), in practice the MTF exhibits various deficiencies that minimize its positive effect on the budget process. One of the reasons for this is that, despite the advice of the International Monetary Fund (IMF, 1999), the framework was not promoted in an environment in which the fiscal balance was ensured, but during the development of one of the most profound fiscal crises in Argentina. In fact, in the period 2002-2004, the MTF was not prepared due to the volatile characteristics of the existing crisis.

This situation has threatened the accuracy of the macro-fiscal projections developed. This problem, in addition to the strategic use of projections (Abuelafia et al., 2009), has eroded the credibility of multiannual budgeting. Low credibility in turn was furthered by the limited dissemination of this instrument among relevant political, technical and academic actors. One indicator of this is that concerns or comments have not been made on the multiannual budgets prepared (Vega, 2004), something that also has not occurred in Colombia nor Peru, where Congress does not discuss the MTF in depth. However, another symptom revealing little interest on the part of policymakers in the multiannual process is the fact that demands for more funds above the ceilings established by the NBO are made in respect to the annual budget, which is the one with legal force. The ceilings for the subsequent years are not discussed until they coincide with the current year.

Probably, one of the most decisive factors that explain the limited involvement of politicians and the technical sectors is the absence of a planning entity to support the allocation of funds from the multiannual budgets. The lack of a plan to serve as a foundation for the budgeting process is compounded by the fact of having to adhere to a very tight timetable for the preparation of the budget, making it difficult to embark on planning tasks. The result has been that, in practice, the multiannual budget consists of a formal exercise in which the budget of the first year of the multiannual budget is extended into the future (Vega, 2004).

Paradoxically, despite having a very complex tool, since it is not based on comprehensive planning, the logic that ends up prevailing is similar to that in Peru: strengthening fiscal restrictions without achieving very much in terms of strategic allocation of resources and technical efficiency.



Another deficiency of the multiannual budget is that, despite the new norm of the Federal System of Fiscal Responsibility, most social spending is the responsibility of the provinces and is not part of a multiannual budget. In the future this situation should change based on the approval of Law 25,917 in 2004. This law created the Federal System of Fiscal Responsibility, which, among other things, establishes the preparation of multiannual budgets by the national government, the provincial governments, and the government of the Autonomous City of Buenos Aires. Despite the law being in effect, provincial multiannual budgets are not operational in the whole country.<sup>14</sup>

#### *5.3.4 Conclusions for Argentina*

Despite the various deficiencies mentioned, the perception that prevails in the National Budget Office is that the MTF has been beneficial for the budget process. It is emphasized in particular that the exercise of forecasting itself results in a probable scenario and provides inputs to improve the budgets of subsequent fiscal years.

Beyond that, the need for a greater role of those responsible for managing the preparation of the budgets of the agencies is recognized. This point brings to light the underlying issue that lies beneath the limitations of the MTF in Argentina: medium-term budgeting appears detached from the planning of medium-term sectoral policies.

The lack of a space in which to integrate the different planning initiatives limits multiannual budgeting. The result is the impossibility of implementing a comprehensive process. As a result, the MTF ends up being nothing more than a reinforcement of the fiscal restriction.

#### *5.4 Conclusions of the Case Studies*

The three cases analyzed differ in respect to the depth of the coverage and objectives of the medium-term framework that was implemented. Peru has an MTFF, Colombia an MTBF, and Argentina an MTEF. Despite this difference, all the frameworks were part of fiscal reform processes promoted by the IMF. As a result, all the experiences initially reflected a bias toward the prioritization of objectives linked to the achievement of fiscal sustainability.

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<sup>14</sup> The jurisdictions that have promoted it are: Buenos Aires, Chubut, Córdoba, Entre Ríos, Formosa, Mendoza, Río Negro, San Juan, Santa Cruz, Santa Fe, Tucumán, and the Autonomous City of Buenos Aires (CABA). All include projections of the resources by category and economic classification. With regard to expenditures, most of them classify by economic function while only CABA, Córdoba, Entre Ríos, Mendoza, Río Negro, and Santa Fe do so by objective and function (Federal Council on Fiscal Responsibility, 2007).

This situation probably hinders ownership of the MTF on the part of local policymakers as a tool to facilitate budgetary management. In Peru, the choice was a scheme that is totally divorced from the planning processes. As a consequence, the MTF preparation process is not very participatory.

The Colombian experience reveals an interesting case where implementation occurred gradually. In the first place, the adopted MTFF limited planning or the participation of the spending ministers in the establishment of the budget ceilings. When the medium-term scheme was strengthened, according to the perception of the actors, the medium-term budget constraints had already been internalized. Although its implementation is too recent to permit an adequate evaluation, based on an agreement between the central actors in the process (Ministry of Finance and NPD) and the spending ministries, an area was established in which it is possible to discuss the financing of medium-term sectoral policies.

Although a scheme that theoretically favors the integration of budgeting and planning was chosen in the Argentine case, in practice this objective has not been achieved. Still, in a country with a long experience in working with a modern financial management system, the lack of institutionalized planning entities has led to a multiannual budget that, in practice, is only a formal exercise. In turn, the fact that the implementation of this tool coincided with one of the most profound economic crises in Argentine history and, subsequently, with a change in the role assumed by the state in the delivery of economic services, has hindered its proper performance.

The lesson learned from these three experiences is the need for greater institutional learning. In Colombia this process has been perhaps more fluid because of the gradual implementation of the MTFF and the MTEF in a scenario in which medium-term sectoral planning was already consolidated in a government plan. This approach has been recommended by several experts (Boex et al., 1998, and Schiavo-Campo 2009). Initiatives such as the social framework in Peru and the Strategic Territorial Development Plan in Argentina may signal the beginning of an evolution toward the integration of the political, planning, and budgeting processes.

There are some difficulties common to the three countries that conspire against the odds of integrating these processes. First, the representativeness of the budgets is limited. The two countries that allow the participation of civil society in the preparation of sectoral goals do so in an institutional setting that is not directly linked to the MTF. The participation of civil society

actors with a stake in sectoral policies could provide greater legitimacy to these frameworks that may, on occasion, encompass periods from different governments.

It is not only civil society that seems to be excluded from the formulation of the frameworks. The role of legislative branches in Latin America in the medium-term frameworks is minimal. Although at times it can be attractive for the executive branch not to subject the frameworks to debate, if they are not discussed in the legislatures, their political sustainability cannot be guaranteed.

Finally, the lack of coordination between government levels is also a weakness common to the cases discussed. This problem is particularly limiting in federal countries such as Argentina where the degree of decentralization of public policies is substantial. In order to resolve this, it is not only necessary to establish consistent MTFs for the different levels of government, but also to establish mechanisms that facilitate information flow and allow joint planning and coordination of policy execution at the different levels of government.

## **6. Final Thoughts**

The experience of implementing MTFs in Latin America (except for the particular case of Uruguay) is relatively recent if compared with that of developed countries or even Africa, since the first attempts took place at the end of the 1990s. However, their use is quite extensive. In the coming years, when some countries that are already developing the use of this tool are added, most of the region will have medium-term frameworks.

The time in which the frameworks were adopted and the actors who promoted them have influenced the logic of their implementation. Those countries that adopted this tool as a part of agreements with the IMF—leading to Fiscal Responsibility Laws—were aimed more at seeking fiscal sustainability (even Colombia, which today has a MTEF, began with a MTEFF). In turn, those countries where poverty reduction plans favored a greater role of other international organizations in the budget problems (such as Honduras and Nicaragua) opted for the MTEF. This is similar to what is observed in Africa, where the World Bank played a key role in the implementation of MTFs.

Although MTFs' recent application makes it premature to identify what problems are related to a lack of experience in the use of the instrument and which are due to more serious causes, among the weaknesses of the frameworks are problems related to the participation of key

actors, coordination between different levels of government, the estimation of projections, and the quality of financial statistics.

Low participation in the preparation of the MTF by actors who play an important role in the execution of the annual budget (spending ministries, Congress, civil society) make it difficult to strike a balance between the objectives of facilitating and improving planning and ensuring fiscal sustainability. In order to achieve a better balance between the medium-term sectoral goals and the fiscal or medium-term expenditure frameworks, the participation of stakeholders in the preparation processes of these frameworks should be sought. This should also take place within the ministries, where at times coordination between the management and budgeting units is not as fluid as it should be.

The lack of coordination with subnational governments affects both the objective of improving fiscal sustainability and increasing efficiency. In some cases, like that of Argentina, sub-national governments are not included in the MTF. In others, the delay in the arrival of financial information on sub-national governments and the form in which it is presented prevents an evaluation of their effect on sustainability. With respect to the efficiency of expenditures, coordination deficiencies between the different levels of government and problems in information flows result in an overlapping of programs and the impossibility of establishing a results-based budget. All these problems work against attempts at using this tool to establish medium-term guidelines.

The quality of statistics and the estimation of projections is another issue that threatens the positive development of the frameworks. Only with quality information can the frameworks serve the purpose of guiding the investment moving forward. With respect to the estimations, many of the MTFs seem to reproduce the deficiencies observed in the annual budgets. For example, they strategically use the macroeconomic projections (over or underestimation of economic growth) to boost the discretion of the executive branch in managing the budget.

Beyond these specific problems, the use of this tool warrants its detailed analysis and expansion in many countries. These processes are gradual and generate feedback dynamics with budget processes and political-institutional frameworks, thus their impact is not immediate. Given their relatively recent implementation vis-à-vis other experiences, the lack of development of the systems is understandable. Still, it is peremptory to incorporate some of the lessons provided by experience before moving forward with the extension of the frameworks.

First, the experience of developing countries shows that, at least at first, the use of limited MTEF (MTBF) is advisable. Implementing the broader MTEF requires the management of technical and human resources that often are outside the scope of developing countries. This effort can be counterproductive, because it diverts these resources from more productive uses. For those countries with greater capacities, the MTEF has potential advantages because it provides a perspective of results-based budgeting. In those cases where technical capabilities allow it, MTEFs should be integrated in greater depth with the planning processes and with other fiscal management tools such as stabilization funds and results-based budgeting.

Second, the study of the experiences highlights that it is important that the fiscal framework, in any of its three versions, be as broad as possible. That is, it should not leave out expenditures of other levels of government, or extra-budgetary funds or quasi-fiscal activities. Also, it is advisable for only one administrative unit to coordinate all aspects of the budget. It is also suggested that this unit publish a document centered on the MTEF in which both the fiscal goals and the priorities and sectoral policies are discussed. To do this, the work of the spending sectors in the development of strategic approaches that also include community stakeholders is important (Holmes and Evans, 2003).

Third, expectations should be in line with feasibility; otherwise, expected goals are not always met. For example, improvement of the government's fiscal balance is almost impossible to achieve if growth estimations are out of sync with reality. Usually, there is a statistically significant relationship between the degree of ambition of the MTF in terms of the extent of reduction it aims for, and its degree of compliance (European Commission, 2007).

Fourth, success is linked to the fiscal situation at the moment of implementation; therefore, countries that want to advance in the development of MTEFs should be in a financially sound situation before seeking to obtain large benefits from the MTF (IMF, 1999). Otherwise, fiscal imbalances can affect the predictability of financing flows. However, it may also happen that in those countries with sustainability problems, the MTEF can help improve the budget process if the projections are made with honesty and realism (Holmes and Evans, 2003).

Finally, the strategic use of the projections, a mechanism usually used to increase the discretion of the executive branch over the budget, is a clear example of practices that undermine the positive effects of the MTEFs because it takes credibility away from the projections (Jonung and Larch, 2006; Hallerberg, Scartascini and Stein, 2009a). Furthermore, if discretionary use of

projections is made to reduce the space of other actors, efforts to link planning with budgeting will always face difficulties in succeeding.

Summarizing, MTFs should neither be sold nor bought as a magical solution. Otherwise, unsatisfactory results over the short and medium term may lead to disenchantment and trigger the discontinuation of the use of the frameworks. MTFs are one tool among many that may help to overcome some of the ills of the budgetary process and help countries in their quest for development and greater government accountability—but only if they are implemented correctly.

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