

Tamil Nadu - Recommendations on the Operationalization of a Medium Term Expenditure Framework (MTEF)

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This note is based on the assumption that the first MTEF exercise to prepare a three-year expenditure plan will be completed in time so as to provide the basis for the preparation of the 2001-2002 budget. If the exercise is started in June 2000 it may possible to complete it by December 2000.

Background

Recent fiscal trends in the state, including the rate of growth in current expenditures and the growing debt burden indicate the need for fiscal reforms with a view to place the state budgets on a more sustainable path. Such reforms are also indicated for increasing the allocation of resources to high priority programmes and for reducing the rate of growth in other expenditures. More effective use of available resources also requires the fixing of targets on certain broad indicators of fiscal performance such as the primary deficit, resource mobilization and total expenditures. These reforms require the elaboration of medium term fiscal plan to guide the annual budget exercises and to estimate the full financial implications of current programmes over a three-year period.

What is Medium Term Expenditure Planning?

It is against this background that the preparations of a medium term (three-year) expenditure plan, as a "pre-budget" activity and ahead of the annual budget is under consideration. When finally prepared and approved within the context of broad fiscal targets and macro-economic forecasts, the first year of the three-year expenditure plan becomes the annual budget. The three-year expenditure plan is a rolling plan prepared every year and updated taking into account the policy developments and changes in the fiscal situation.

Preparing a three-year expenditure plan within the context of a medium term macro-economic forecast of the state's economy and within the

parameters of pre-determined fiscal targets is also referred to as a Medium Term Expenditure Framework (MTEF). The overall objectives of MTEF are :-

- (i) to place the annual budget within the context of a medium term expenditure plan;
- (ii) to improve the sustainability of state government's fiscal stance through encouraging policy reforms on the allocation and use of resources;
- (iii) to establish a process for improving the allocation of resources to priority programmes; and
- (iv) to improve service delivery through greater autonomy to spending departments within well defined expenditure limits.

MTEF seeks to establish a macro-fiscal framework for a three-year period within which the annual budget exercises are carried out. A macro-fiscal framework provides a tool for analyzing and adjusting fiscal (tax and expenditure) policies in a manner consistent with trends in the state economy and the overall fiscal objectives of the state government. It can guide budget preparation and fiscal forecasts. The framework recognizes the inter-relationships between the state's economy and the budget in two directions. First, macro-economic trends in the state like the projected rate of growth on nominal GSDP and rate of inflation influence the tax base and some expenditure levels. Second, the budget itself may include measures for influencing the rate of growth of the state economy through taxation and expenditures measures. The framework attempts to capture the main linkages between the state's macro-economic environment and macro-level tax and expenditure planning and management. It is emphasized that the model described in this brief is not the financial programming model that is generally used for driving overall macro policy settings. It is a preliminary attempt and needs to be improved both in terms of availability and quality of data and a more careful specification of the inter-relationships.

Many governments usually prepare a three-year MTEF as a mechanism to link their planning and budgeting processes more effectively. Once the first year (or the next budget year) of the framework is developed firmly, the framework can be used to explore the fiscal implications of the projected macro-economic developments and the existing fiscal policy parameters for two more years beyond the next budget year. Such projections are useful to quantify the impact of future debt service payments and other committed liabilities over the three-year period and assess whether any advance corrective action will be required. The medium term fiscal projections will of course reflect the implications of other policy measures implemented in the budget year, such as for example, wage or pension increases and major categories of expenditures such as PDS costs, major construction programmes, and grants-in-aid because of their continuing effects and schedule of implementation.

The Process in Brief

A three-year expenditure plan is normally prepared within the context of the projected macro-economic situation in the state and within certain broadly defined fiscal targets for the medium term. Such targets normally cover the primary deficit, the revenue deficit and the ratios of revenues and expenditures to GSDP. Following the determination of GSDP forecasts and fiscal targets, revenue and borrowing projections are made for the three-years period to identify the possible resource envelope available for financing expenditures.

As far as expenditures are concerned the projections are made in two distinct stages and cover only programmes and projects already approved by the government and reflected in the current year's budget. This is especially the case for the first year of the three-year expenditure projections. At the **first stage**, all departments are required to submit an expenditure forecast for a three-year period covering only the existing programmes. The only adjustments to be made are technical in nature such as for example, the expected increase in the number of beneficiaries under on-going schemes, or say, number of students, etc., which will require additional resources to carry out the same service. No change in the design of the service or any new programme is involved while making the first set of projections.

Once the first set of projections are received from all the departments and compiled, the macro level expenditure totals are compared with the fiscal targets and the resource envelope determined earlier in the process. It is at this stage, adjustments are made to the projected expenditure levels to ensure that medium term fiscal targets can be achieved, given the macro-economic projections and the resource envelope. Once such adjustments are made, department-wise expenditure ceilings are developed, which will result in a consistent fiscal framework for the medium term. The departments are then communicated the expenditure ceilings and requested to adjust their expenditure forecasts within the limits of the expenditure ceilings made available to them. It is at this stage, the departments are encouraged to do programme review and prioritization and allocate the available ceilings in the best possible manner. When such exercises are completed and reviewed by the Finance department, the three-year expenditure plan gets a firm shape. The first year of the forecast automatically becomes the annual budget.

Steps in Preparing an MTEF

The preparation of a three-year MTEF is organized around the following four blocks: -

- (1) macro-economic data input;
- (2) projections of revenues based on the macro-economic data inputs, tax bases and elasticities implicit in current fiscal policy;
- (3) first level expenditure projections based on current programmes, and parameters currently controlled by fiscal policy, and financing projections that take into account both the state budget deficit and net borrowing; and
- (4) review of first level expenditure projections, identification of policy measures and determination of macro-level and departmental expenditure ceilings for incorporation in the MTEF.

(1) Macro-economic Data Inputs

A comprehensive macro-economic framework will incorporate both the response of the budget to the state's macro-economic situation and the expected impact of the budget on the state economy. However, given the limitations of time, availability of data, and the conceptual problems in establishing key macro-economic relationships, the framework recommended deals with determining fiscal profiles that follow from a projected macro-economic environment. It is also possible to develop projections of the macro-economic framework based on an explicitly laid down fiscal profile and then modifying the macro-economic framework, if the analysis indicates that a different fiscal profile is required.

As a starting point, the MTEF process will be consistent and timely macro-economic data for preparing a macro-fiscal framework. At the Minimum, projections of the following macro-economic data for a three-year period will be required; Nominal GSDP, Real GSDP, Sectoral Growth Rates, GSDP Deflator, and CPT Inflation.

(2) Revenue Projections

Detailed projections of state revenues, non-tax revenues, share in central revenues and grants will need to be prepared for a three-year period. Assumptions behind such projections need to be explicitly agreed upon and recorded. The projections recently completed in the Finance Department for the Finance Commission could be used as a starting point.

As far as state revenues are concerned, projections can be based on estimates of average effective tax rates of the main tax categories, with the annual nominal GSDP being used as the tax base. Preliminary projections can also be based on extrapolation of past revenue trends together with information about anticipated inflation developments.

In general, projected growth of state's revenue will depend on the growth rate of the tax base (GSDP or other approximate equivalent), the built-in-elasticity with respect to the tax base and changes in the tax structure. Tax bases used to project revenue will depend on the specific nature of the tax in question. For example, for some taxes it could be the

nominal GSDP while for others it could be industrial production. The built-in-elasticity of a revenue category measures the percentage change of that revenue category in response to a 1 per cent change in the tax base. Built-in-elasticity (e) of revenue from a tax (T) with respect to a tax base (B) is generally defined as $e = (DT/DB/B/T)$, where "D" denotes the change in a variable. This measure does not take into account that part of the change in tax revenue that reflect changes in tax rates. If the amount of tax collected is proportional to the tax base, the built-in-elasticity is equal to one. This happens when a constant average effective tax rate is applied. Assumptions will have to be made on the categories of state revenue for which a proportional tax rate is appropriate. The average tax rate (r) to be used for making revenue projections is simply the tax revenue (T) divided by the tax base (B) or $r=T/B$. For some taxes, such as a tax on property transactions (stamp duty), the elasticity with respect to growth in nominal GSDP could be only 0.550, as the tax base is likely to change less than proportionately with respect to growth in nominal GSDP.

The critical inputs here are carefully identified tax bases, estimated building elasticities, and average tax rates for each type of state taxes. The accuracy of revenue projections made using the macro-economic framework will depend on the quality of data and assumptions.

(3) Expenditure Projections

Expenditure projections will have to be made separately for non-discretionary and discretionary expenditures. More accurate and precise projections are required for a three-year period for the following non-discretionary expenditures;

1. Interest payments
2. Debt service payments, including payments, if any under guarantee.
3. Pensions
4. Salaries, including DA and HRA
5. Payments under on-going social security schemes, if

applicable.

The inputs for 1 and 2 of the above projections have to come from the Finance Department. Interest payments will have to be projected on the basis of the projected debt and average interest rates. Redemption payments will be projected on the basis of information available on the schedule of redemption. The amount of projected net borrowing is indeed dependent on the projected fiscal deficit; therefore, there could be a potential instability or a problem in the projections-an increase in the financing gap will increase domestic borrowing, which will increase interest payments, which will in turn feed into an increase in financing gap. The first stage expenditure projections made by the departments can be reviewed and used as the basis for making projections of the other three categories of non-discretionary expenditures.

There are several methods of categorizing the three-years forecast of discretionary expenditures made by the departments in the first stage. For purposes of comparing the macro-level expenditure projections with fiscal targets, the following classification could be considered;

1. Non-plan revenue account expenditures
2. Non-plan capital account expenditures.
3. Plan revenue expenditures.
4. Plan capital expenditures.

For achieving consistency with budget documentation, it may also be necessary to have the projection for revenue and capital account based on the standard budget classification into (i) General services, (ii) Social services, (iii) Economic services and (iv) Grants-in-aid and contributions.

Finally, in order that the totalities of state government's expenditures are taken into account it is important to incorporate the total borrowing requirements in the MTEF. This is an integral and important component of the macro-fiscal framework, as the projected budget deficits during the medium term are expected to be covered fully by borrowing.

4. Review of First Level Expenditure Projections and Identification of overall Departmental Expenditure Levels for the Medium Term

If the data inputs are of good quality and consistent and if the current fiscal policy parameters are clearly stated, the first level revenue and expenditure projections can be used to project the likely fiscal developments over a three-year period. Such projections also provide a basis for highlighting the need for policy reform in specific cases.

A comparison of the first level revenue and expenditure projections and the pre-determined fiscal targets using a standard summary budget out turn will indicate the need for adjustments to be made in the projections to ensure consistency with medium term fiscal targets. The nature of the review to be undertaken will depend on the extent of deviation observed in the expenditure projections from the pre-determined fiscal targets.

After the departmental projections have been compiled and finalized taking into account any specialized information that may be available with the Finance Department, the framework can be used to assess the projected fiscal profile against fiscal targets. It is possible that the projected financial balance is higher than the financial balance targets planned for the medium term. The difference gives an idea of the concept of "financial balance gap". Taxation or expenditure measures can be identified to close the financing gap, taking care to recognize that a reduction of the financial balance will also reduce debt accumulation and interest payments. If the expenditure projections are higher than the levels indicated by medium term fiscal targets, the Finance Department will need to make the adjustments at the macro as well as departmental level (or at the level of heads of departments) and arrive at revised projections for the medium term. Expenditure ceilings for all departments will have to be prepared and communicated based on the planned macro level expenditure levels.

Once the departmental expenditure ceilings are thus determined by the Finance Department, the **Integrated Programme-cum-Budget Units** in the Finance Department will have a major role to play in

carrying out a detailed review of the programmes included in the projections and in making adjustments in expenditure levels and identifying policy reforms for which government approval may be required. The departments concerned will have to be fully involved at this review stage as they are free to reallocate the resources allocated to them according to their priorities.

There are several alternatives to organize such a review of expenditure projections with a view to make them consistent with fiscal targets. The review could concentrate on non-plan schemes in detail where appropriate or it could be confined to selected departments with programmes that have been continued for a long time with considerable financing problems. It is also important that the results of all available programme reviews and evaluation studies are taken into account at this review stage, with a view to implement appropriate changes in programmes.

Once the Integrated Programme-*cum*-Budget units have carried out their review and made the required adjustments in the first level expenditure projections, the projections can again be compiled by the Budget Unit to prepare the Medium term expenditure Framework. (An example of the macro-level medium term expenditure plan is given in Annex A, Annex B provides the assumptions used in preparing the medium term forecast shown in Annex A).

When the government approves the MTEF and the policy reforms identified in the process of preparing the MTEF, it can be published and circulated to all departments to give them an indication of the resources likely to be available for their programmes over a three-year period. The first year expenditure levels reflected in the MTEF will also be the annual budget for the next year. However before the next year's budget is developed, it is important to review the projections very carefully in order to modify them in the light of specialized information that has not been incorporated in the expenditure forecast and other input data and/ or assumptions and analysis.

The detailed fiscal projections derived from the framework are also of considerable utility in monitoring fiscal outcomes at quarterly or periodic intervals. For this purpose it is necessary to

"disaggregate" the annual budget projections into periodic intervals taking into account all known seasonal patterns in the realization of revenues and disbursement of expenditures. The actual fiscal outcomes can then be assessed with reference to the projected levels for the period in question and corrective measures taken in time. This is an important use of the framework as deviations from the budget can be a source of disruptions and inefficiencies.

Annexure A

Tamil Nadu Medium Term Expenditure Framework (Rs. Crores) (Illustrative Presentation)

		<i>2000/ 2001 Budget</i>	<i>2001/ 2002 Plan</i>	<i>2002/ 2003 Plan</i>	<i>2003/ 2004 Plan</i>
1.	Revenue Receipts (a+b)	18,406	21,659	25,403	29,762
	a. Tax Revenue	16,955	19,493	22,863	26,786
	b. Non-tax Revenue	1,451	2,166	2,540	2,976
2.	Revenue Expenditure (a+b)	21,564	23,873	26,536	29,507
	a. Non-Plan Revenue Exp.	16,603	18,263	20,090	22,099
	b. Interest payments	2,749	3,177	3,69	4,464
	c. Plan Revenue Exp.	2,212	2,433	2,677	2,944
3.	Revenue Deficit (1-2)	(3,158)	(2,214)	(1,133)	255
4.	Capital Receipts (a+b)	4,890	5,427	5,959	6,543
	a. Recoverable loans	275	350	375	400

	b. Borrowing (net)	4615	5077	5584	6143
5.	Capital Expenditure (a+b)	2,399	3,181	4,069	5,513
	a. Plan Expenditure	2,129	2,384	2,742	3,153
	b. Non-plan Expenditure	270	297	327	359
	c. Reserves		500	1,000	2,000
6.	Total Receipts (1+4)	23,296	27,086	31,362	36,305
7.	Total Expenditure (2+5)	23,963	27,055	30,604	35,020
8.	Budget Deficit (6-7)	(667)	31	758	1,285
9.	Fiscal Deficit [7-(1+4 (a))]	(5,282)	(5,046)	(4,826)	(4,858)
10	Primary Deficit [9-2(b)]	(2,533)	(1,869)	(1,057)	(394)
Memorandum items					
State Gross Domestic Product (Rs. Crores at current prices)		127,220	144,395	163,888	186,013
Ratios to SGDP					
Revenue Deficit		(2.48)	(1.53)	(0.69)	0.14
Budget Deficit		(0.52)	0.02	0.46	0.69
Fiscal Deficit		(4.15)	(3.49)	(2.94)	(2.61)
Primary Deficit		(1.99)	(1.29)	(0.64)	(0.21)
Revenues		14.68	15.24	15.73	16.21
Expenditures		18.84	18.74	18.67	18.83
Interest Payments		2.16	2.20	2.30	2.40

Annexure B

ASSUMPTIONS BEHIND THE ILLUSTRATIVE THREE-YEAR FISCAL PROJECTIONS

1. Nominal SGDP projected to grow at an average annual rate of 13.50%
2. Revenues (including central transfers projected to grow to 15.24% of SGDP in 2001/02, 15.73% in 2002/03 and 16.21% in 2003/04
3. 10% of total revenues to be realized from non-tax revenues.
4. Interest payments projected to grow to 2.2% of SGDP in 2001/02, 2.30% in 2002/03 and to 2.4% of SGDP in 2003/04.
5. Plan and non-plan revenue expenditures projected to grow at an average annual rate of 10% during the three-year period.
6. Non-plan capital expenditure assumed to grow at an average annual rate of 10% during the three-year period.
7. Plan capital expenditure projected to grow by 12% in first year, and 15% in the second and third years.
8. Borrowing to grow at an average annual rate of 10% during the three-year period.

Briefing Notes on Medium Term Expenditure Framework: Tamil Nadu (S. Ramarkishnan)

The purpose of this note is to provide a general background to the system of multi-year expenditure planning. An appreciation of the system's features and its potential benefits is useful as it could lead to a better **operationalization** of the system taking into account the strengths of the existing planning, budgeting and evaluation systems in Tamil Nadu.

Several countries have developed systems of multi-year expenditure planning which aim at developing more comprehensive and formal instruments to **place the annual budget into a multi-year perspective**. Expenditure planning is somewhat different from development planning. Annual budgets in Tamil Nadu do have the five-year development plan and the annual plan as important inputs for estimating resources and for allocation of expenditures for projects and programmes. In addition to the annual plan, there are several other important policy inputs that also influence the fiscal stance that the state government takes during the annual budget.

However, while the five-year development plan represents an organized look into the future taken at a particular time, multi-year expenditure planning is more comprehensive and represents a continuous process of making a forecast and assessing its validity as future progress is made in its implementation. Multi-year expenditure planning is a generic term. There are several variants of this in actual practice. Multi-year expenditure plans are prepared to provide a medium term framework for annual budget exercises in the majority of industrial countries although these are named differently. Some examples are "multi-year budgets", "forward budgets", "expenditure review", "multi-year estimates" and "rolling expenditure plan".

The system is also generally referred to as the Medium Term Expenditure Framework (MTEF), a term made popular by the World Bank in their attempts to strengthen planning and budgetary mechanisms in a number of countries.

A key purpose of the MTEF is an **extension of the budgeting horizon** through a systematic approach that includes a strong policy-budget link under a hard constraint derived from a sound macro-fiscal framework. It is a government wide strategic policy and expenditure framework which attempts to balance what is affordable at the aggregate with policy priorities of the state government and within which all spending departments are encouraged to improve the allocation and management of resources. MTEF consists of a "top-down resources envelope, a bottom-up estimation of the current and medium-term cost of existing policies and, ultimately, the matching of these costs with available resources" (*World Bank, Public expenditure Management Handbook, 1998, p. 46*)

Multi-year expenditure programmes, usually covering a period of three-years, are rolled over every year, and policy changes are identified. If costs exceed aggregate resources, allocations to the lowest priority programmes are reduced; if on the other hand, if aggregate resources are greater than the costs of carrying out current policies, the excess resources are distributed according to priorities throughout the period covered by the multi-year expenditure plan.

The first year of the rolling multi-year expenditure programme is fully consistent with the annual budget, while the outer years are generally **indicative**. In general, a multi-year expenditure plan shows the following :-

- (i) the present level of expenditure;
- (ii) additional expenditure, if any, to provide the same service in the future (for example to maintain a teacher/student ratio in primary education); and
- (iii) additional expenditure, if the level or quality of service is to be changed.

Elements (i) and (ii) can be considered as the financial implications of existing/continuing policy while (iii) can be defined as the implications

of "new policy", representing either an increase or decreased provision of services.

A General Approach

How does one go about achieving the desired level of integration of policy priorities and a macro-fiscal framework, when a multi-year expenditure plan is to be prepared? An annual budget is not often the appropriate vehicle for introducing major policy reforms that can influence public expenditures for many years or for improving the allocation of resources. Such changes require a medium term approach.

A typical medium-term expenditure planning system has the following features:-

- Preparation of forward estimates
- Focus on policy change
- Conservative approach
- Coordinated processes
- Measures to increase operational efficiency

Two stages are involved in the preparation of forward estimates: the first stage is a **technical** one consisting of estimating the medium-term implications of on-going policies and programmes and the second a **programming** stage consisting of assessing the cost implications of changes in policies (whether upward or downward expenditure adjustment). The second stage is usually added to the first one. The process is generally organized as follows: -

- Cost estimates of **on-going** programmes are prepared before the start of the annual budget preparation stage ("projections stage"), thus indicating the available margin for new programmes in the next annual budget.

- A top-down approach is needed at the start of the process-macro level expenditures and their tentative allocation across sectors and across major items of expenditure are derived from a well-prepared macro-fiscal framework.
- Based on a macro level fiscal framework, the required level of savings on existing programmes and the financial envelope to be allocated to finance new programmes over the multi-year period are then determined at the start of the multi-year expenditure planning process.

The focus on policy change means that the previous year's projections are updated by the Finance Department, but only to take into account changes in technical parameters and in economic parameters. Since the previous year's projections are "approved" by the government, budget preparation is free to focus on policy changes and their cost (the programming stage).

The multi-year programme does not plan the implementation of new policies beyond the first year. The programme may include a "reserve" for the costs of new policies in the outer years, but such costs should be conservatively estimated. The "reserve" should not create rights to commit expenditures and / or to carry out new policies or must not exceed a very small percentage of the total estimates. This is referred to as a **conservative approach**.

To ensure coordination with the annual budget process, the first year of the programme should be fully consistent with the annual budget. Ideally, the preparation of the medium term expenditure plan and the annual budget must be merged into a single process.

To assure predictability, multi-year expenditure programme should at least be broken down by programme and by spending department. The level of disaggregation depends on the time available to complete the exercises and institutional capacity. Providing indicative funding levels at department level, may have the advantage of encouraging departments to keep their programmes

within the expenditure ceilings. However, to increase **operational efficiency**, departments are generally given more powers to reallocate their resources, but under a hard budget constraint.

In short, a medium term expenditure planning system represents a planning process and enables the determination of government wide total expenditure levels for the medium term and the **open enunciation of priorities for allocation of expenditure** amongst competing demands.

The distinguishing characteristics of this approach are the following:

- Much greater emphasis on **resource constraints** and linkages with a well-defined macro-fiscal framework.
- Emphasis on **policy reform** to realign expenditures and to improve the allocation of resources to high priority activities.
- A **greater role for the spending departments** to initiate policy reforms within the existing resource constraints.
- An emphasis on **improved delivery of services** with possible physical targets and schedule of activities.

However, the key focus of medium-term expenditure planning depends on the relative emphasis that the State Government may wish to place amongst the three basic objectives of any budget reform;

- Aggregate fiscal discipline and expenditure control.
- Improved allocation of available resources.

- Improved operational efficiency in service delivery.

Building Blocks of a Medium Term Expenditure Framework (MTEF)

- Two important inputs for the preparation of an MTEF are: (a) macro level fiscal planning and (b) a review of activities, programs and projects in spending departments for determination of sector level priorities for allocation of public expenditures.
- The final product of this planning process is a **policy document** which clearly enumerates specific Government policies that will guide the overall expenditure levels in the medium-term (usually three-year period) and their allocation amongst competing classes of expenditure (salaries vs O & M or recurrent vs capital) and amongst different departments.
- The set of **policy directions** in the document is accompanied by a medium-term economic forecast, projections of revenues and non-discretionary expenditures, global expenditure levels and fiscal targets. It will also include a three-year projection of planned expenditures and their allocation amongst different classes of expenditures as well as amongst the departments. These need to be consistent with the overall directions in the plan documents.
- The preparation of MTEF is a long and consultative Government-wide **planning** process for determining the broad directions of fiscal policy, the identification and review of major policies affecting expenditures, and the

determination of overall expenditure levels and their allocation.

- When an MTEF is prepared, widely discussed with all the departments and approved by the Government is becomes a **binding policy document** prepared in advance of the annual budget to guide the overall expenditure levels, the allocation of expenditures and the management of annual budgets.
- By providing a Government wide mandate through the clear enumeration of policies for allocation of expenditures, the **MTEF has the potential to strengthen budgeting and expenditure control and to improve the allocation of resources.**
- MTEF seeks to bring about a **better integration of planning, policy reform, annual budgeting and expenditure management;** the approach also recognizes a simple but fundamental aspect of budget management, namely without policy reform there can be no expenditure reform.

Key Role of Spending Departments

- The first requirement for introducing MTEF is widespread discussion with all the departments of the need to improve the allocation and utilization of resources. Such discussions could also create greater understanding of resource constraints, the problems in the present system of annual budgeting and the need for policy reform. Wide publicity and consensus building exercises must therefore precede any policy decision taken on the introduction of MTEF.

- MTEF also requires **major attitudinal changes in the public service.** This is perhaps the most important medium term challenge. **MTEF represents resource based and comprehensive budgeting for the entire Government.**
- The process of preparing an MTEF requires that all spending departments, irrespective of their mode of financing must take the initiative in **identifying options for prioritization, policy reform and change** within the sector. The administrative environment in which there is very little questioning or review of on-going programs and policies has to be replaced by a "managerial" environment of initiating policy reform.
- MTEF requires the development of **program evaluation and policy analysis skills** within each spending unit (or at least in the Finance Department to begin with) to assist in policy reform, Program evaluation is an essential requirement to assess the contribution of a program or service to the achievement of departmental objectives or plan targets. Policy analysis focuses on the design of changes in programs or delivery of services as a result of program evaluation.
- Policy analysis involves (I) a clear definition of the **outcomes** sought from various services, programs and activities, (ii) a clear definition of the **inputs and outputs** for various services, programs and activities, (iii) the **relative financial costs** of inputs and outputs in achieving the desired outcomes and (iv) the **adjustments or improvements** required to reduce financial costs or enhance effectiveness.

- Thus, key changes may be required in the planning and budgeting processes so that emphasis is placed on the distinction between inputs, outputs and outcomes and the focus of officials is broadened to an assessment of the cost effectiveness of the activities.
- This emphasis on the **input-output-outcome framework** is essential to achieve the best value from public expenditures. It is the sine-qua-non of an efficient and effective budgeting system. It requires two conditions to be met:
 - (i) existing activities, programs and services should be managed **efficiently and effectively** and
 - (ii) options for policy change should be **continually monitored** to ensure that the existing activities are in fact the best possible combination of activities for the Government to be understanding.
- The first condition relates to **technical efficiency** - in particular it requires the absence of "rent seeking" behavior by department, with the associated misdirection of budgetary resources. Budget allocations for each activity to be carried out in a manner consistent with policy objectives and expected outcomes.
- The second condition relates to the need to continually monitor options for changing the settings of existing policies and programmes to ensure that the existing way in which funds are spent is the best way - this refers to **allocational efficiency** of public expenditures.

Possible Advantages of MTEF

- By encouraging departments to identify policy reforms and expenditure norms through a thorough review of their activities, programmes and projects, MTEF can, over a period of time improve the allocation of resources and avoid under-funding of priority services and programmes.
- Through an annual review of their activities and plan performance, departments can develop detailed policy proposals for expenditure priorities and savings, refined and precisely targeted to achieve departmental objectives and priorities.
- MTEF must promote policy changes. When such changes are widely discussed and approved at the highest political level there is greater commitment for implementation of policy reform. The effective implementation of policy changes visualized in the MTEF will establish a more effective linkage between macro level expenditure constraints and cost effective use of such resources at the sectoral level.

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