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Medium Term Frameworks In Public Finance

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EDITOR'S NOTE

The Pacific Financial Assistance Center (PFTAC), in its role as a disseminator of information of financial management in the pacific, and an agency committed to developing capacity in the region, had recently organized a workshop on medium term fiscal frameworks (MTFF). The workshop, as decided earlier in the year during the last Pacific Financial Managers Association (PIFMA), was held at Nadi, Fiji Islands from 28-30th November, 2006 and was attended by representatives from all PFTAC member countries, except for Tonga which had recently suffered a tragedy, and several donor partners.

The main focus of the workshop was to deliberate on the theory and practice of implementing medium term fiscal frameworks. PFTAC however, focuses not merely on the theory but is very conscious of the fact that sharing of experiences is a valuable learning tool. In pursuance of this aim, while the workshop focused on relevant models being implemented, the workshop participants also heard the actual experiences from three countries- Fiji, Vanuatu and Samoa on the implementation of such systems.

The key note address was delivered by Mr. Christian Schiller from the Fiscal Affairs Department (FAD) of the IMF. He emphasized that multi-year budgeting, in the sense of appropriations extending beyond a single budget year, is not the focus of medium term fiscal frameworks, although the first year estimate of a medium term framework typically becomes the starting point for preparing the budget of the following year. This is because nearly all decisions taken by a government today have an impact that transcends the present year and the single budget period. In general, therefore, it is useful to make full explicit of the future implications of current budget decisions by means of medium term frameworks. Indeed, most countries have justified adopting a medium term approach not merely as a natural extension of annual budgeting, but also in the belief that proper annual budgeting, to be effective and needs such an analysis.

Different approaches have been adopted to suit differing country situations. Some are very detailed and complex, others are less sophisticated and easier to operate. Basically, they can be divided into medium-term fiscal framework which provides a top-down statement of fiscal policy objectives and sector strategies, those where an MTFF, in addition, incorporates realistic projections of spending by individual agencies that allocate resources in line with strategic priorities and consistent with overall objectives of the MTFF. Finally, those where a medium-term expenditure framework extends the analysis further with more detailed costing within the sectors and with performance measures. The applicability of each approach depends on the level of human and other resources available in a country and which, in turn, determine the quality of information available for decision making.

The workshop arrived at several conclusions in regard to implementing a medium term fiscal framework. These conclusions were:

- MTFFs are important but there is a need for comprehensive availability of information to make them realistic;

- Donor information is important but often the details are available within the various constituents of a national government and need to be collated internally;
- It is important to set up systems to collate donor information correctly, and on time, and factor them in the budget.; and
- The various pre-conditions to make a medium term framework operational, especially considering the capacity constraints in the Pacific, are indicative of the need for a sustained effort to make them work.

It is therefore important to start on the development of medium term frameworks carefully and only after ensuring that all the basic conditions are in place and to avoid haste.

Some of these important, but basic, conditions are:

- A deep political commitment and endorsement at the highest level to make the MTF process a serious and meaningful exercise;
- Strong management of donors to ensure they operate within the framework of the MTF;
- Willingness to subject policy decisions with financial implications, made outside the budget process, to the discipline of the MTF;
- Improvements in expenditure control so that the MTF is not undermined by over expenditures and reallocations during budget implementation;
- Improved macroeconomic management and revenue collection so that revenue shortfalls do not necessitate adjustments to the budget estimates; and
- Briefings of politicians and senior managers during implementation.

This would indicate that to implement a successful MTFF the implementers must ensure, at the very least, that:

- They start with a simple medium-term framework first- the less complicated and more gradual the framework and implementation processes, respectively, are the greater are their chances of success;
- MTEFs should not be launched in selected sectors until there are medium-term ceilings in place;
- Integration of capital and recurrent budgets need to be done before a MTFF is implemented;
- There is recognition that one MTF approach does not fit all, and enable country specific modifications, which should ensure success;
- Government wide involvement needs to be ensured if success is to be achieved; and
- The importance of producing reliable multi-year budget estimates is appreciated widely.

It was in appreciation of this that the topic of the next PIFMA meeting, to be held at Cook Islands from 28-30th March 2007, was selected to be “Improved cash management practices and control of commitments”.

The workshop provided a good opportunity to promote a degree of interaction between the Pacific island country participants and some of the donor partners who not only contributed to the workshop, but who are active participants in the development process around the region. The workshop therefore included a presentation by AUSAID on the aims and modalities of the Public Expenditure and Financial Accountability Framework (PEFA), and the assessments it makes. The Forum Secretariat also made a presentation on the Forum principles of accountability. The UNDP made a set of interesting presentations on pro-poor policies and the millennium development goals and on aid coordination and management. A case study on revenue estimation was also presented during the workshop, and will be separately presented as a paper on revenue estimation that PFTAC is currently working on.

The idea of compiling a book of this nature was to present to the participants, and other users around the region, the papers presented in the workshop. We hope that these papers, both the theory and the practice in the Pacific, would provide guidance in the implementation of medium term fiscal frameworks.

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I. CHAPTER 1

Medium-Term Frameworks in Public Finances --- An Introduction

Christian Schiller, International Monetary Fund, Washington D.C.

Many countries employ multi-year policy and planning frameworks

While budgets are generally on an annual basis, many countries now also employ multi-year frameworks (MTFs). They typically cover a three-year time horizon.

- Over sixty percent of OECD countries have a published medium-term framework with targets and ceilings for expenditure, deficits and revenues covering, in most cases, a three-year horizon;
- All EU countries produce annual reports on their medium- and long-term budgetary strategy that include a medium-term objective for the budget position and the expected path of the debt to GDP ratio; and
- MTFs are increasingly being implemented in developing countries. There was a big push toward this goal in Anglophone African countries in the mid 1990s, with the World Bank's taking the lead role.

At the same time, long-term fiscal frameworks that exceed a five-year time horizon are increasingly being used to assess the forward impact of current policies or to examine new policy options. They have been used in Europe and the U.S., for instance, to analyze the impact of changing demographic conditions. In low-income countries (LICs), such long-term fiscal frameworks have been used to assess debt sustainability or, more recently, long-run objectives such as the Millennium Development Goals and poverty reduction strategies.

Analyses of public debt sustainability commonly rely on medium- to long-term projections of the debt-to-GDP ratio given macroeconomic forecasts and fiscal policy assumptions.[1] While such projections per se do not allow one to determine the sustainability of a particular public debt position, the expected debt path provides some indication as to whether the underlying policies can be sustained under plausible macroeconomic conditions without endangering government solvency. A projected decline in the debt ratio is typically interpreted as a signal that government policies do not jeopardize sustainability, whereas a positive trend or even stabilization at a level that exceeds an indicative threshold level (such as 60 percent of GDP) typically raises concerns about sustainability. [2]

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[1] For work done in this area by the International Monetary Fund see IMF, ***Assessing Sustainability*** (2002).

[2] It should also be clarified that multi-year budgeting, in the sense of appropriations extending beyond a single budget year, is not the focus of medium term fiscal frameworks, although the first year estimate of an MTF typically becomes the starting point for preparing the budget of the following year. Countries, however, almost

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universally require an annual appropriation law. Multi-year appropriations are used by some countries for certain expenditure items—notably capital spending—and some countries have the flexibility to carry forward unspent annual appropriations from one year to the next.

The case for MTFs

Proponents of the MTF approach argue that these frameworks help governments do better in terms of the key objectives of public financial management (PFM) systems.[3] The three main objectives of PFM systems are:

- Stability: to help ensure macro-fiscal discipline and stability, thus to avoid public finance crises and to support economic growth and employment;
- Strategic resource allocation: to enable government to match government expenditures with government policy, so that the structure of government spending is consistent with the policies of government.
- Technical efficiency: to get the most from each dollar spent, to get, for example, the best health care from each Dollar in the budget of the Ministry of Health.

Let us look at each of these three PFM objectives:

- Macro-fiscal discipline and stability---fiscal adjustment, i.e. cutting back expenditures and lowering the deficit is best dealt with over multiple years. If, for instance, the fiscal deficit is high and needs to be reduced, this can be best dealt with within a medium term framework. An MTF allows one to design a path that cuts the fiscal deficit over a period of time;
- Structure of government spending---again, a change in the structure of government spending cannot be done overnight but is best dealt with in a framework covering several years, where one sector may expand over time while another may shrink, reflecting the policies of government; and
- Technical efficiency---this leads to the issue of more performance-oriented budgeting approaches. An MTF has often been viewed as a cornerstone for such an approach. A critical issue is how to create incentives for managers to spend more efficiently, to improve technical efficiency of the budget. Again, this needs to be done in a multi-year framework to give budget managers the opportunity to adjust over time.

From a different perspective, nearly all decisions taken by a government today have an impact that transcends the present year and the single budget period. Accordingly, it has been argued that, in general, it is useful to make fully explicit the future implications of current budget decisions by means of medium-term frameworks. Indeed, most countries have justified adopting a medium-term approach not merely as a natural extension of annual budgeting, but also in the belief that proper annual budgeting, to be effective, needs such an analysis.

[3] See World Bank, ***Public Expenditure Management Handbook*** (1998).

I want to conclude this discussion with a caveat: Developing a comprehensive MTF can be effective when circumstances permit. Otherwise it might take time and resources and might distract attention from the immediate needs for improving the annual budget and budget execution process. The track record of developing countries, and also many middle-income and transition countries, in this field is actually not very encouraging. We will discuss the issue of challenges and preconditions of setting up an MTF in more detail later in the Conference.

MTFs--Fiscal, Budgetary, and Expenditure

The MTFs that exist in different countries differ in terms of what they do and what they do not to. Some are very detailed and complex. Others are less sophisticated and easier to operate. They generally have in common that they are rolling frameworks and thus need to be updated every year.

The MTFs that exist in countries can be grouped in three different categories. When countries implement an MTF, these three groups can also be seen as three stages where each country moves from a basic MTF to a more sophisticated one. Clearly, there is a huge difference in institutional capacity needed between the early and advanced stages of an MTF.

- Medium-term fiscal framework (MTFF)

A medium-term fiscal framework provides a top-down statement of fiscal policy objectives and sector strategies. The sector strategies are typically not disaggregated to spending agencies. On the expenditure side, an MTFF typically includes only an aggregate total. It also comprises a set of medium-term macroeconomic and fiscal targets and projections.

The MTFF is designed to augment the compliance requirements of the traditional annual budget to meet the government's stabilization objectives. This typically includes the identification of fiscal risks, such as the vulnerability to shocks in the export sector, and the need to control fiscal aggregates and coordinate with monetary policy.

In terms of the three main goals of PFM, the focus of the MTFF is clearly on the first one, i.e., maintaining aggregate fiscal discipline. The MTFF is the appropriate vehicle to explore the boundaries to the set of fiscal and macroeconomic policies that are consistent with continued financial stability and debt sustainability.[4]

[4] Medium-term fiscal frameworks need to be distinguished from medium-term fiscal outlooks. The former imply that political decision-making over the fiscal outlook has taken place. Medium-term fiscal outlooks are also very useful instruments as they provide a medium–term view of public finances before policy decisions.

Medium-term fiscal frameworks have been developed further into two directions, first to link it up more closely to the objectives of improving resource allocation; and second, to improve coordination with monetary policies.

- Medium-term budget framework (MTBF)

A medium-term budget framework is an MTFF that in addition incorporates realistic projections of spending by individual agencies (e.g. line ministries) that allocate resources in line with strategic priorities and is consistent with overall objectives of the MTFF. Moving from an MTFF to an MTBF means adding a mechanism for allocating resources between competing spending agencies, again over a multi-year horizon.

This is about the composition of expenditure, reflecting political choice and/or microeconomic issues. Information on the distribution of resources within the overall budget constraint seeks to both bolster the stabilization objective of the budget with harder medium-term spending constraints for line ministries and the productivity of public expenditure.

- Medium-term expenditure framework (MTEF)

A medium-term expenditure framework extends the analysis further with more detailed costing within the sectors and with performance measures.

This kind of MTF typically also seeks to identify and promote incentives for better public sector performance, often through the increased delegation of authority to line ministries or agencies and increased flexibility in the mode of service delivery. In developing countries that have gone that far, a move to an Integrated Financial Management Information System (IFMIS) was often added to this already demanding mix. [5]

Many proponents of MTFs sees the major objective of the MTF here: MTEFs should help to shift government bureaucracies from an administrative to a managerial culture. In his view MTFs should help to foster managerial flexibility and innovation and result in greater effectiveness of programs and policies.

- Medium-term fiscal and monetary framework (MTFMF)

A medium-term fiscal and monetary framework (MTFMF) extends the analysis of an MTFF further, but in a different direction than the MTBF and the MTEF, with the focus on monetary and fiscal policy coordination.

In the European Union, all countries now have medium term frameworks that, inter alia, serve also for coordination of fiscal and monetary policy following the introduction of the Euro as common currency.[6]

Under the Maastricht Treaty of 1992, member countries are required to abide by two fiscal rules. First, the general government fiscal deficit must not exceed 3 percent of GDP, except for exceptional and temporary reasons. Second, gross general government debt must not be higher than 60 percent of GDP. Later on, within the Stability and Growth Pact of 1997, the deficit rule was further refined by requiring that the governments should aim for a medium-term fiscal balance that is close to balance or surplus. At the same time, the European Central Bank aims at an inflation rate that is close to or below 2 percent.

Stages of an MTF process

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[5] It should be noted that often MTBFs and MTEFs were been developed jointly with a programmatic classification of the budget. While progression towards program budgeting may be desirable, it is not strictly necessary to advance the medium-term planning of expenditure.

[6] The stability programs that Euro zone members must update annually, are MTFs. Any underlying expenditure changes are not identified in any detail.

In this section, we try to go through the whole process of a medium term framework and discuss what is implied or what the issues are at different stages of the process. References to countries are used to illustrate the issues.[7]

Stage 1: Macroeconomic framework, revenues, aid, expenditures, financing, fiscal policy paper

- Macroeconomic framework

The process begins with the development of a sound forecast for the macroeconomic framework. The key activities here are macro-analysis and modelling. Models can assist in identifying problems by checking the internal consistency of proposals and by generating accurate forecasts. Constructing a model can expose differences in assumptions about what drives decisions. Personal computers and new software have increased the scope for using models for analysis and explanation.

It is important to distinguish between political macroeconomic estimates and sound macroeconomic estimates for the use of developing a fiscal policy framework. The former are optimistic estimates prepared for public consumption, to convey the government goals, and to build optimism in the general public over the economic direction of the government. This is serving primarily a political purpose. For a variety of reasons, these are not good estimates to use in developing a medium-term budget.

A useful framework for developing a sound macroeconomic forecast is the IMF's financial programming exercise. It basically uses accounting identities that bring together the fiscal, external, monetary and real sectors.

Countries use a variety of techniques to assure sound economic estimates. Current practice in Poland, Canada and the US, for example, is to compare the government forecasts with forecasts prepared by the private sector; vetting of forecasts through academic or non-government fora; using the median forecasts of several reputable non-government organizations as the government forecast.

Countries process the economic estimates themselves in different ways: Ministry of Finance staff share the estimates only with the Minister of Finance for information purposes or for general approval to move to the next stage of the formulation of the MTF; economic estimates are shared with the cabinet for general information and approval; economic forecasts are sent by government to Parliament (or the general public) early in the cycle for information and transparency.

- Revenue envelope

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[7] The discussion follows World Bank, ***Public Expenditure Management Handbook*** (1998).

Once the macroeconomic estimates for the balance of payments, the monetary sector and the real sector (i.e. growth and inflation) are prepared, sound estimates of government revenue need to be developed. Equally critical as sound macroeconomic estimates are conservative revenue estimates based on collection experience. Overly optimistic revenue estimates can also lead to excessive spending.

It is useful to separate the base estimate for revenues without policy or administrative changes and those revenues expected because of policy changes or expected improvements in compliance and collection rates.

Of course, all revenues must be considered to provide a complete picture of government revenue. The coverage of revenues should be as comprehensive as possible.

China and Korea are reportedly two countries that tend to be particularly conservative in their revenue forecasts, with the result that there is generally extra revenue at the end of the year available for other priorities such as debt reduction. Korea, as a country with a culture of fiscal conservatism, has one of the lowest ratios of general government expenditure to GDP in the OECD (23 percent); its gross public debt is around 22 percent of GDP as compared with 74 percent on average in OECD countries.

- External aid

External aid needs to be estimated for the three years under review. This is typically a very challenging task for several reasons: (i) aid agencies often have a good appreciation of aid on a commitment basis, but expected cash disbursements, which are needed for the MTF, are often a very different story; (ii) domestic counterpart funds must be identified and available from domestic resources; (iii) for foreign loans, debt service costs and repayments must be factored into the multi-year plan; (iv) budget aid can be treated like tax revenue, as an inflow into the budget, but project aid is different, because it has a corresponding counterpart on the expenditure side and, if there is no domestic counterpart, cancels out in terms of its impact on the fiscal deficit. However, leads and lags can result in accounting problems; (v) debt relief reduces interest payments and credit repayments (i.e. is a negative expenditure item and financing item). The former shows up above the line, the latter below the line; and (vi) for capital projects, often in kind, the future recurrent spending for operations and maintenance need to be factored in to the MTF.

- Expenditure

With conservative economic estimates in hand, the Ministry of Finance can prepare broad expenditure estimates based on current policies. It is important to explicitly note that this covers all expenditures. Otherwise, the picture is only partial.

These initial estimates are often termed “baseline” estimates. While different countries use different bases for calculating them, the general concept is to forecast future spending assuming continuation of the current spending levels or laws (i.e., no changes in policy).

The U.S. develops baseline estimates on "current law". For mandatory spending (spending that occurs through statute, rather than annual budget bills), the forecast assumes no changes to laws and uses economic estimates and demographic trends to extrapolate spending. For discretionary spending (that occurs only though the annual budget), the most recently enacted budget is extrapolated using typically the consumer price index for wage and non-wage expenditures. Australia uses the concept of current policies, focusing more on the policy commitments of the current government.

- Deficit and financing

The simple fiscal deficit calculated from revenues minus expenditure, if in deficit, needs to be financed from either domestic or foreign sources. Financing from the banking sector is one part of domestic financing; the other one is non-bank financing, for example by issuing domestic bonds to nonbanks.

The path of the fiscal deficit over the period under review is clearly one of the key variables of an MTF. It is the bridge to monetary and exchange rate policies.

- Fiscal policy paper

The fiscal policy paper lies at the heart of an MTF. This document draws together the results of the macro-fiscal forecasting exercise into an understandable report of trends and policy implications for senior government officials. Essentially, the document should explain the national goals of economic policy—growth targets, and inflation and balance of payments objectives—and link these to the fiscal and monetary instruments available to the government. The paper explores trends in fiscal policy, deficits and debt under current trends and broad options for policy change.

Typically, the fiscal policy paper would be presented to Cabinet for discussion, with the objective of obtaining some Cabinet decision on overall revenue, expenditure and deficit in a medium term context. The discussion should be on policies to attain government objectives. The discussion should generally not turn on the economic forecasts themselves, especially as these represent best estimates. Given the national implications of the policy strategy statements, it is important that all relevant economic ministries and agencies have an input.

Countries follow different practices in releasing the fiscal policy and expenditure estimates to the Parliament and the public. Finland releases this information to the public and parliament for informational purposes only. Sweden actually submits for passage by parliament the fiscal policy, expenditure envelope and allocations to sectors. In other countries, such as the United States, the fiscal policy, expenditure targets, and sector funding levels are not released until the formal budget is approved.

Stage 2: Development of sectoral programs (bottom-up sector programs)

This stage can proceed in parallel with stage one and involves a sector review process through which sector/ministry objectives and activities are agreed and then costed.

The sophistication of this stage depends on the kind of MTF employed. In an MTFF, not much, if any, attention would be paid to it, because sector allocations are not a central part of it. The development of sectoral programs plays, however, a major role in an MTBF and even more in an MTEF.

The sector review process consists of: (i) agreeing on objectives, outputs and activities for the sector; (ii) reviewing agreed and developing new programs; and (iii) costing these programs.

Costing these programs over a medium-term period needs information. One of the key difficulties in preparing sectoral programs is to develop detailed parameters than can be effectively used by spending units in costing their programs. Parameters are variables over which spending units have no control but which will influence the costs of carrying out public services.

Generally, there are two forms of parameters: economic and program-specific. Economic parameters refer to economy-wide, such as wages or inflation, whereas program-specific parameters refer to items which influence that program only, such as the number of elementary school students, the number of unemployed and the number of social security beneficiaries.

As the credibility of the parameters is so important, the parameters used should be calculated from outside the line ministry concerned, though with the assistance of the line ministry. In some cases, the government may decide to fund a program with a fixed amount for a certain number of years. In such cases, the specific amount should become part of the sectoral estimates. At this stage, ministries also need to go through the process of ranking activities and assessing which activities could be scaled back or expanded if wanted.

Ministries can also develop performance indicators for programs so that over time, there can be greater emphasis on what ministries are achieving with the resources they are given. We are now talking of course about an MTEF.

To conclude, an important issue is the extent to which the spending ministries have the policy and program analysis skills to undertake the reviews of activities and laws to develop sound cost estimates. These skills that have so far not been in great demand may require training to further develop.

Stage 3: Development of sectoral expenditure framework

With the macroeconomic framework and the sector reviews in hand, the Ministry of Finance now typically develops an expenditure framework that includes allocations by sectors or ministries. Thus, after the global expenditure envelope is developed, decisions need to be made on the allocation of this envelope across sectors (e.g. health and education) and ministry (which may be the same as sectoral or not, depending on the budget classification system).

This stage involves first a series of hearings between the Ministry of Finance and the sector ministries to go over their projections.

The next step is the development of a sectoral expenditure framework. This framework enable the analysis of the trade-offs between and within sectors and is the basis for the establishment of sector expenditure ceilings for the upcoming budget as well as for the two outer years.

This framework should be used to guide the deliberations of the decision making body—usually the Cabinet—that makes strategic resource allocation decisions. The consensus that emerges at this stage should ideally include technicians, politicians at the highest level and, where aid is significant, major donors as well. In any case, leadership has to come from within government.

Stage 4: Definition of sector resource allocation

This is a crucial stage of the MTF process and requires the main decision-making body in government such as the Cabinet to make medium-term sectoral resource allocations on the basis of available resources and intersectoral priorities. This is done by defining budget ceilings for the next three years.

Ideally, policies and resources should be in complete balance. The ceilings will allow the line ministries to deliver on their policies. The poorer the balance, the more difficult it will be to deliver on these ceilings. An unallocated contingency can be withheld to cope with uncertainties and to allow for adjustments for unexpected expenditures.

Stage 5: Preparation of sectoral budgets

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

In this context, it is interesting to mention that different countries provide different degrees of flexibility to ministries to allocate spending among alternatives. In the Australia and New Zealand New Public Management model, ministries are assumed to allocate resources optimally among programs and are given great discretion in their choices. In other systems, such as Finland, fewer degrees of freedom are offered. Spending ministries that want to reallocate across programs face difficulties doing so because of detailed and tight targets by the Ministry of Finance.

Stage 6: Final political approval

The final stage is the final political approval. The final stage will take different forms depending on the structure of the budget process. In the U.S., after decisions have been taken, ministries have the opportunity to appeal and contest the decision, eventually to the President. This approach is intended to assure some due process to ministries in funding decisions, but makes for a contentious MTF process. In Australia, Ministry of Finance discussions with line ministries are less contentious, and more in the nature of a management consultant, the Ministry of Finance, advising a client, the line ministry.

A final role of the Ministry of Finance in many countries is the preparation of a communications strategy and material to explain decisions, elaborate the rationale for choices made, and explaining the directions for budget policy.

International experience

MTFs differ across countries. In this section we briefly describe MTFs that can be found in industrialized and developing/transitional countries.

MTFs in OECD countries

Over the last decade or so, a large number of OECD countries have introduced significant reforms in PFM. Three general trends can be discerned.

- First, in many countries, budget responsibilities have been devolved from the central budget authority to individual spending departments, thus giving these departments the freedom to allocate funds within centrally determined spending limits;
- Second, a large number of countries have moved towards result-oriented budget techniques into the budget processes that are based on measures of departmental performance; and
- Third, countries have moved their annual budget process to a multi-year framework.

The following section summarizes salient features of some of these reform efforts in a number of countries: [8]

- Austria

The Austrian approach to MTFs reflects one end of the spectrum of choices. The main purpose of the MTF in Austria is to show the medium-term fiscal consequences of

[8] See L.F.Jameson Boex, Jorge Martinez-Vazquez and Robert McNab, "Multi-year budgeting: A Review of International Practice and Lessons for Developing and Transitional Economies," ***Public Budgeting and Financing*** (2000).

government policies which have already been enacted. As such, these multi-year budget estimates reflect future fiscal flows under current tax and spending policies and are basically strictly informative in nature. Unlike in many other countries, the MTF in Austria is not produced concurrently with the annual budget, but later in the year. It is not submitted to Parliament in October, but just published by the government in June of the following year.

- Germany

In stark contrast to the simple nature of the Austrian multi-year budget process, the approach to an MTF taken in Germany integrates multi-year budget estimates into a broad-based medium-term financial plan. Its focus is on the first of three PFM goals mentioned above, i.e. macroeconomic stability. It is one of the most comprehensive approaches to MTF in terms of coverage, including the budget of the central government as well as all the regional governments and local authorities. Proponents of the German approach argue that (i) the financial plan ensures that the government's fiscal policies, including the central, regional and local governments, are consistent with the central government's medium term fiscal strategy; and (ii) that if executed properly and updated frequently, a German type MTF provides a high degree of certainty about future fiscal policies and continuity to the budgeting process. However, critics of the German approach argue that the formulation of a comprehensive MTF is quite complex and administratively very demanding. In addition, given the rapid economic and institutional changes that often take place in developing countries, such an MTF is too rigid for many of these countries.

- Great Britain

Great Britain should be considered the pioneer of multi-year budgeting, as it began the practice of conducting multi-year public expenditure surveys as early as 1961. Observers always mention the focus of fiscal discipline and efficiency in the British approach. As a result of historical ties and continued interaction between Great Britain and members of the Commonwealth, this feature is also found in other countries of the British Commonwealth, such as Australia, Canada and New Zealand.

The formulation of the annual budget proposal and the multi-year strategy starts in late spring, when the Chancellor of the Exchequer sets forth the fiscal strategy for the coming three years. Upon determination of the fiscal strategy in early summer, the Cabinet Committee on Public Expenditures, led by the Chancellor of the Exchequer and comprising several senior ministers, establishes aggregate and departmental expenditure limits for the coming three years, referred to as "Control Totals". The government conducts a review of existing spending commitments for the next two fiscal years and develops a projection for the third year. This review is known as the Public Expenditure Survey (PES).

In Great Britain, the individual line ministries are responsible for determining program priorities within the limits set by the Treasury, a practice followed in other Commonwealth nations. The line ministries are given extensive authority in the budget formulation process.

As in other Commonwealth countries, the MTF is not presented in a separate document. Instead, the MTF is fully integrated into the annual budget and presented to Parliament as a component of the government's annual budget proposal.

- Australia

Australia's MTF approach is another example of the "Commonwealth" approach, with focus on efficient use of public resources and fiscal discipline. The MTF was introduced in the early 1980s. Until recently, and unlike other Commonwealth nations, the forward estimates were not made by line departments themselves, but rather by the Department of Finance.

Four documents are circulated as part of Australia's Budget Papers. The "Budget Strategy and Outlook" contains the fiscal strategy, the economic outlook and general budget projections; the "Budget Measures" contains the proposed budget measures for the coming year along with detailed multi-year budget estimates; the "Federal Fiscal Relations" describes the state of intergovernmental relations; and the "Commonwealth Public Account" contains the appropriation bills for the coming fiscal year. All Four budget papers incorporate an MTF.

- New Zealand

The budget process in New Zealand has undergone a series of important reforms in the past decade.

The budget process in New Zealand is highly devolved and places a large share of the responsibility for financial management at the ministerial level. Consistent with this philosophy, the multi-year estimates in New Zealand are produced by the line departments.

Three key documents are produced throughout the year as part of the budget cycle. First, concurrent with the second reading of the budget in Parliament, the Government must submit its "Budget Policy Statement" to Parliament. This document outlines the government's short-term fiscal plan, as well as medium-term strategic fiscal policy objectives. Second, the "Fiscal Strategy Report" must be published at the time of the final submission of the budget to Parliament. This document contains updated fiscal estimates and discusses differences between the budget and the "Budget Policy Statement". Third, multi-year fiscal and economic projections must be published twice each year, which are compared to independent estimates produced outside the government.

- United States of America

The federal budget process in the United States contains several multi-year elements. Most importantly, actual multi-year appropriations are included in the budget for certain capital projects. In addition, the annual budget includes expenditure and revenue estimates for the coming year and for four additional years. The multi-year expenditure estimates provide an informal starting point for the formulation of the annual budget for the following year.

Unlike many other countries, the budget department in the U.S. is part of the President's Office and not part of the Ministry of Finance. The President's Office of Management and Budget has a powerful counterpart in the Parliament with the Congressional Budget Office.

MTFs in developing and transition countries

In 2001, the World Bank estimated that 25 developing countries in Africa, Asia, Latin America, and Eastern Europe were at various stages in implementing a MTF. This number has probably increased significantly in the meantime. The majority of these MTFs have been adopted in Africa in the context of implementing poverty reduction strategies.

In Ghana, the MTF built on reforms started in budget preparation, in the civil service and in development planning. The MTF in Ghana is multi-year (this is a departure from previous annual budgeting to a three year budgeting), integrated (the process integrates both development and recurrent expenditures), broad based (it involves domestic as well as foreign resources) and performance based (the process is based on achieving agreed levels of performance or deliverables).

In Tanzania, the MTF built previous reforms into the planning and budgeting system, as well as the reforms introduced under the civil service reform program. In Kenya, the MTF started by setting up sector working groups that were responsible for defining sector priorities. In Malawi, the MTF built on the introduction of program budgeting. A World Bank study of 2001 on MTFs in Africa is the only comprehensive review of MTFs so far.[9] The study draws lessons of general reliance, which we will discuss tomorrow.

Among transitional countries, the new budget codes for the Russian Federation and Kazakhstan (adopted in 1998 and 1999, respectively) require the inclusion of a multi-year perspective in the annual budget process. The IMF has just sent a mission to Cyprus to help the authorities in designing and implementing an MTF.

Issues in the design and implementation of MTFs

In this section, we will discuss a number of issues that are critical for the design and implementation of MTFs. In the discussion, we follow Diamond.[10]

Clarity in the policy statement

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[9] Philippe Le Houerou and Robert Taliercio, Medium Term Expenditure Frameworks: From Concept to Practice. ***Preliminary Lessons from Africa: African Region,*** Working Paper Series, Number 28 (2002).

[10] Jack Diamond, ***Budgetary System Reform in Emerging Economies: The Challenges and the Reform Agenda***, Occasional Paper 245, IMF (2006).

As mentioned earlier, the fiscal policy paper lies at the heart of the MTF. There should be an explicit statement of fiscal policy with a target for the fiscal deficit for the budget year and a planned path for the fiscal deficit in the two following years.

This document draws together the results of the macro-fiscal forecasting exercise. Essentially, the document should explain the national goals of economic policy—growth targets, and inflation and balance of payments objectives—and link these to the fiscal and monetary instruments available to the government. The paper explores trends in fiscal policy, deficits and debt under current trends and broad options for policy change.

Such a policy statement should be: (i) stable over time—and not substantially change every year or so; (ii) realistic---and thus be based on conservative estimates for revenue and external assistance; and (iii) transparent--- and thus be easily understandable for senior government officials and parliamentarians.

An issue to consider is to what extent the policy statement will be endorsed by the Minister of Finance, by the Cabinet of Ministers, or by the Parliament.

*Distinction between new and old poli*cy

An MTF generally requires that a clear distinction be drawn between expenditures associated with new and with existing policies.

What countries sometimes do, is to prepare a baseline scenario built on current tax policies and conservative assumptions for foreign aid and borrowing. Such a baseline scenario may include new expenditure programs, if the estimates for revenues, aid and borrowing allow that. Alternative scenarios could then be explored on the basis of alternative assumptions.

I have seen countries with three scenarios: baseline scenario, optimistic scenario and pessimistic scenario. The optimistic scenario would include new expenditures, while the pessimistic scenario would typically include expenditure cuts, or higher fiscal deficits.

Sound macroeconomic framework.

The government must have a macroeconomic forecasting capacity and be able to set realistic envelopes for total government expenditure within the medium term. This in turn requires the capability quantitatively to assess likely balance of payments developments, inflation and monetary trends. Clearly, the more stable the main parameters are, such as inflation and the exchange rate, the easier the task. This may require capacity building in the MoF in macroeconomic forecasting techniques, particularly with regard to revenues.

Allowance for cyclical factors

A number of countries make allowance for cyclical factors by accommodating the variation in certain well defined expenditure programs. Such an approach imposes fiscal discipline during upswings when, say, unemployment expenditure programs are low and policymakers are tempted to use those resources for other expenditure programs. When first developing macroeconomic forecasts it is recommended that, at least initially, no specific allowance be made for cyclical factors.

Inflation

The question arises whether expenditures should be forecast in terms of cash or in terms of volume, i.e. at constant prices. Several countries that started with a real expenditure-based norm have switched back to a cash planning system. In the cases we are looking at, it is clear that cash-based MTFs are the preferred approach.

Constant-price projections are technically more difficult to undertake. It is also argued that it provides line ministries with complete protection at a time when it may be desirable to cut spending. This was one of the reasons why the United Kingdom switched back to the cash concept. It is also argued that by setting a clear cash limit and giving greater flexibility to managers, governments have provided stronger incentives to line managers to use their budget resources more efficiently.

Coverage

The question of the scope of the MTF is crucially dependent on the ultimate objective of the MTF.

In its widest interpretation, if the focus is more on macroeconomic stability and fiscal control, the coverage should be as broad as possible. From this perspective, the key concern is the extent of total public sector borrowing and of total public sector spending, central and local. Such a view forms the basis of public expenditure planning in Germany, for example.
A narrower approach is to view the MTF as an adjunct to the central government's annual budget and focus on central government revenue and expenditure only.

Clearly, there is a tension between planning for those expenditures that are wholly under the government control and a wider expenditure aggregate (which may be less subject to central government control but more meaningful for macroeconomic analysis and thus more relevant to establishing the acceptable size of the deficit and tax burden).

While practice varies, most OECD countries now employ an aggregate that includes the activities of the secondary and tertiary levels of government—although generally excluding public sector enterprises, except for transfers and net lending to them.

Time horizon

While practice has varied, there is a growing consensus for MTFs of three to four years, with the majority of OECD countries now using three years. While there seems to be a growing consensus that estimates beyond three years become increasingly unreliable and should not be given official status, there are questions where the government should look much further forward, for example questions about the consequences of existing health and pension policies as the population ages. Another question is that of debt sustainability.

The inclusion of a planning and contingency reserve

A planning reserve can be defined as a reserve in the forward years available to be allocated for provision to priority expenditures in forthcoming annual budget negotiations. Reserves accommodate uncertainties of several types. They accommodate changes in the macroeconomic environment. So, countries with higher or more unpredictable inflation paths should have a higher planning reserve. They accommodate exogenous shocks such as natural disasters. They accommodate changes in the costs of programs, when the projection of demand for government services underestimates demanded volumes.

How high should such a reserve be? Generally speaking, it should be high enough to cover all the uncertainties but should not be so high that it negates efficient budgeting. Diamond argues that a figure higher than 5 percent of total government spending would be hard to justify, except for a high debt/inflation economy. In Australia, the MTF includes an allowance of less than 2 percent of total outlays for policy changes and external factors.

Lessons from Africa

The World Bank has made the development of MTFs a center of its reform efforts in PFM in many of the countries in Africa where the Bank is active. In 2002, the Bank undertook a critical survey of its work and reached a number of conclusions, which also might be useful for other regions, including the Pacific island countries. Let us now review the recommendations of Le Houerou and Taliercio (2002).

Importance of initial PEM conditions

In order to work, the MTF must rest upon a good macro-fiscal model. Good, realistic macro-fiscal projections are key to the success of an MTF. The MTF should also rest upon a solid budget foundation, which would encompass many elements, though chief among them is budget execution that complies with the adopted budget. Consistency between the budget and its execution is a precondition for a success in the implementation of an MTF. In country, where budget execution bears little resemblance to the voted budget, an MTF is not likely to be taken seriously by the sector ministers, by parliamentarians, nor by civil society. Hence, a key issue is the credibility of the annual budget: execution must be consistent with the voted budget.

Other key elements of basic budgetary management also impinge greatly on the potential success of the MTF. Budget comprehensiveness, that is, the extent to which the budget takes account of all public expenditures, including donor funds, off-budget accounts, user fees and expenditures left out of the budget, the MTF can only be of limited value. For an MTF to have an impact, the problem of budget comprehensiveness must be addressed.

- World Bank recommendation 1: Lay the foundations---The MTF should be seen as a complement to, not a substitute for, basic budgetary reform. Before launching an MTF reform, a comprehensive and detailed diagnosis of the most important PEM problems should be undertaken. Based on this diagnosis, reforms of budget classification, formulation, comprehensiveness, execution, controls and audit should be undertaken. The MTF should then be tailored to the initial PFM conditions. For example, in a country with a weak PFM system, a full-fledged MTEF or MTBF should not be introduced. Rather, it would be preferable for the government to engage in a comprehensive and in-depth reform of the PFM system, focusing on budget preparation, execution and reporting, while at the same time introducing some of the basic components of an MTFF, starting with a realistic three year macroeconomic and fiscal projection.

Sequencing MTF reforms

In the countries reviewed by the World Bank, MTFs have been implemented both in a phased and in a piloted manner. Tanzania and Rwanda, for example used a pilot approach by beginning with a subset of priority sectors. Similarly, many MTFs were phased in over time. In Mozambique, the first phase of the MTF saw the estimation of aggregate expenditure, while the second phase focused on sectoral expenditures.

Uganda introduced the MTF over a 10 years time period (1992-94: macroeconomic framework plus selective treatment of medium term allocations—wage bill; defense and roads; 1995-97: macroeconomic framework plus comprehensive and detailed sector allocations, linked to sector policy objectives; 1998-2001: Annual consultations on MTEF with donors, parliament, and civil society; the MTEF became the focal point for the dialogue of the government with the parliament and civil society)

- World Bank recommendation 2: Adopt the piloting and phasing to existing capacity. The World Bank is in my view a bit vague in terms of what they recommend.

Integrating the MTF with the existing budget process

Many countries have experienced problems integrating the MTF with the existing budget process. Numerous problems have resulted from launching the MTF as parallel to the existing budget process.

- World Bank recommendation 3: As the building blocks of the MTF are developed, they should be built into the budget process from the start. There should not be parallel budget and MTF processes. Thus, the approved annual budget should constitute the first year of the MTF.

How the MTF is issued, approved and disseminated

If the MTF is part of the budget presentation and adoption, the issue is moot; if not, the manner in which the MTF is issued and approved matters. In South Africa, the MTF is issued by the Minister of Finance as a public document, with a foreword by the Minister, which gives it a high profile. In Kenya, the MoF issues the MTF, which is then approved by cabinet and sent to parliament. Requiring approval by cabinet and parliament should provide incentives to take it more seriously. In Tanzania, the MTF is part of a joint government and donor expenditure review process; what may be lacking in the Tanzanian model is the high-level political endorsement of the document. In Mozambique, the MTF is issued by the Ministry of Finance and treated more as an internal technical report and not publicly available.

- World Bank recommendation 4: The MTF needs to make the transition from an internal, technical document to a public, politically backed plan. The MTF should be published as part of the budget document.

The design of the MTEF management structures

The design of the MTF management structures, which has not received much attention, various across African countries, though most countries use a combination of existing and ad hoc management structures. The World Bank found that the budget office alone cannot handle the formulation of the MTF. Rather, it seems that an overlapping set of organizational actors is better positioned to promote the MTF adoption.

South Africa is an example of a very thick organizational environment. The budget office in the MoF manages the whole MTF process--it takes the lead. All ministries are heavily involved in the process, but overarching MTF specific committees pull the process together and provide checks on the ministries. The management design seems able to move the process forward from the technical to the political level.

Tanzania is an example of a very broad participation of government, donors and academia in the MTF process. The MTF is managed through a public expenditure working group, which is under the leadership of the MoF's deputy Permanent Secretary. The working group has two subgroups—macro and sectors.

- World Bank recommendation 5: Though each country's budget management process is distinct, and thus each MTF management structure will have to be designed accordingly, the African cases suggest that MTF reforms should be managed by a combination of existing departments and new MTF-specific units in order to provide the support necessary for implementation.

Standardization of the MTF

Standardization of the MTF components, in particular, the sectoral components, also matters. The process of MTF formulation needs to be standardized in terms of sectoral output. In Mozambique, the lack of standards complicated the process, as some ministries presented costs at very general program levels, while others presented them according to the ministry's organizational structure.

- World Bank recommendation 6: The sectoral plans should be developed according to centrally agreed upon guidelines, which should be published, and a realistic timetable, based on capacity constraints.

The relevance of the political and institutional dimensions

Most MTF efforts in Africa have focused on the technical to the detriment of the political and the institutional. The political and the institutional dimensions seem to be a persistent blind spot in the Bank's MTF work, the authors write, which is perhaps not surprising given that this dimension has been a blind spot in the Bank's PFM work in general. I have to add that this applies as well to the Fund.

In South Africa, the MTF was motivated by the political transition and the need for the government to take greater control of the budget process. High expectations had motivated politicians to care about resource allocation, efficiency and effectiveness. In Uganda, it is widely recognized that presidential support plays and important role in the relative success of the MTF in Uganda. In Mozambique, the motivation was more technical and included the need to estimate the cost of civil service reform and the need to take into account sectoral allocations.

In many of the cases, the bank played a major role in the introduction of the MTF. Political support for the MTFs varied across cases and helps to explain why some MTFs were more successful than others. Some of the reforms were "owned by the countries; others were not.

In the case of sectoral ministries, in some countries, they were heavily involved; in others not. If the MTF process itself was not credible, sectors would judge the benefits of investing scarce staff time and resources to be limited and informally opt out. Here, the president and the cabinet could play an important role in making a credible commitment to line ministries that the MTF would be adopted and executed as planned.

- World Bank recommendation 7: The political and institutional dimensions of the MTF reform must be explicitly addressed. Though specific measures to increase the overall credibility of the reform will vary, reformers would do well to build in positive incentives for implementation.

Lessons from the Pacific

Some lessons that can be drawn from this workshop are:[11]

- MTFFs are important but there is a need for comprehensive availability of information to make them realistic.
- Donor information is important but often the details are available within the various constituents of a national government and need to be collated internally.

[11] This section has been drafted by the Editor after the workshop.

- It is important to set up systems to collate donor information correctly and in a timely manner, and factor this information into the budget.
- The various pre-conditions to make a medium term framework operational, especially considering the capacity constraints in the Pacific, are indicative of the need for a sustained effort to make them work.

It is therefore important to start on the development of medium term frameworks carefully and only after ensuring that all the basic conditions are in place. Some of these important, but basic, conditions are:

- A deep political commitment and endorsement at the highest level to make the MTFF process a serious and meaningful exercise;
- Strong management of donors to ensure they operate within the framework of the MTFF;
- Willingness to subject policy decisions with financial implications, made outside the budget process, to the discipline of the MTFF;
- Improvements in expenditure control so that the MTFF is not undermined by excessive expenditures and reallocations during budget implementation;
- Improved macroeconomic management and revenue collection so that revenue shortfalls do not necessitate adjustments to the budget estimates; and
- Briefings of politicians and senior managers during implementation.

To implement a successful MTFF, then, the implementers must ensure that:

- They start with a simple medium-term framework first; the less complicated and more gradual the framework and implementation processes are, respectively, the greater their chances of success;
- MTEFs should not be launched in selected sectors until there are medium-term ceilings in place;
- Integration of capital and recurrent budgets need to be done before an MTFF is implemented;
- There is recognition that one MTFF approach does not fit all. Allowing for country specific modifications should ensure success;
- Government-wide involvement needs to be ensured if success is to be achieved; and
- The importance of producing reliable multi-year budget estimates is appreciated widely.

CHAPTER 2

The Public Expenditure and Financial Accountability (PEFA) Framework[1]

The Public Expenditure and Financial Accountability (PEFA) framework is a diagnostic tool used to identify strengths and weaknesses in planning, budgeting and financial management systems. The PEFA framework was released in February 2004 and assessments have since been completed in 31 countries, with a further 50 assessments currently underway or in the planning stage.

The PEFA framework has been developed as a collective effort by donors, to include the World Bank, IMF, EU, DFID and others, to assess and develop essential public financial management systems. It is intended to provide a common pool of information for measurement and monitoring of public financial management performance progress, and to promote a common dialogue on reform priorities.

Donors recognise the importance of public financial management, and that partner countries need to be able to identify existing weaknesses, and also to monitor progress over time. The PEFA framework is a simple, structured and universally applicable framework. All indicators in the framework can be applied to any country, with very few exceptions such as indicators relating to sub-national government. Also, it supports the Paris Declaration principle of using and strengthening partner country systems wherever possible, which is also encouraged by the Australian Aid White Paper.

PEFA provides a comprehensive, consistent and objective assessment of public financial management systems that allows a shared understanding of reform priorities between donors and the partner country. As PEFA missions can and should be a coordinated activity between donors, it reduces the burden of multiple assessment missions by various donors.

In addition to being an assessment or diagnostic tool, PEFA is a management tool that allows countries to identify, design and monitor programs for improved public financial management, as the assessment can be repeated over time to monitor progress.

It is important to recognise that good public financial management systems and practices are essential for effective policy implementation. PEFA does **not** attempt to evaluate the quality of government policies in promoting economic growth and poverty reduction. Instead, it measures whether or not the existing public financial management systems and processes enable the government to meet their policy objectives, and identifies areas for improvement.

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[1] This chapter is based on the lecture delivered during the workshop, and the power point presentation that follows, and has been written by Kylie Coulson and Nick Cumpston, AusAID, after the workshop.

We are aware of the limitations of PEFA in informing a decision on whether or not to use partner government systems. It can inform this decision, but it cannot be used as the sole criteria.

There are 31 indicators in a standard PEFA assessment. Of these, 28 apply to the partner country and three apply to donor practices. Each indicator is rated from A to D, where A is best practice, and D highlights areas of weakness. The output of assessment, the Public Financial Management (PFM) performance report, provides a narrative on the indicators, details evidence used in the assessment, and draws a summary from the analysis.

- Budget credibility – Is the budget realistic, and implemented in the way it was intended?;
- Comprehensiveness and transparency - Are the budget and assessment of the financial risks comprehensive, and is financial and budget information accessible to the public?;
- Policy based budgeting - Is the budget prepared with due regard to government policy?;
- Predictability and control in budget execution - Is the budget implemented in a predictable manner, and are there enough controls in the collection and use of public funds?;
- Accounting, recording and reporting - Are adequate records and information produced, maintained and disseminated to meet decision-making, control, management and reporting purposes?;
- External scrutiny and audit - Are there effective arrangements for scrutiny of public finances and follow up by the executive?; and
- Donor practices – Is direct budget support predictable, and what proportion of aid is managed by national procedures?

PEFA assessments have been conducted in Fiji, PNG, Vanuatu and Samoa. Donors involved with PEFA in the Pacific include the World Bank, ADB, EU, NZAID and AusAID.

Donors have agreed that the PEFA framework will be used as a common means for assessment of public financial management. Assessments will be used to inform and support partner country-led reform efforts, and will be conducted in individual countries as opportunities arise.

The PEFA framework will be used to support harmonisation and the use of country systems, and donors will coordinate in the planning and implementation of PEFA missions.

From the PEFA assessments undertaken in the Pacific, we have learned of the considerable potential of the assessments to inform a common dialogue on reform. We also recognise the need to have an explicit link with donor programs, and the need for discipline and communication to promote genuine donor harmonisation.

CHAPTER 3

Forum eight principles of accountability, and related implementation progress in Forum Island Countries[1]

The Pacific Islands Forum Secretariat (PIFS) was invited to make a presentation on the *Forum Eight Principles of Accountability* at the Medium Term Fiscal Framework (MTFF) Workshop. This paper summarizes the key issues, messages and conclusions from the presentation.

The FEMM good governance decisions encompass the Ministerial adoption of the **Forum Eight Principles of Accountability** in 1997, including supplementary notes in 1998. The adoption of these supplementary notes follows consideration by the Ministers of the *IMF Code of Principles and Good Practices on Fiscal Transparency*, which was used to draw out practical steps towards the implementation of the Eight Principles. The principles and supplementary notes are annexed to this paper.

The accompanying reform measures contribute not only to the achievement of accountability and good governance, but also to an effective and efficient fiscal management and policy. This is done through establishing a transparent framework for public financial management that can be monitored and understood by oversight bodies such as the Parliament, and also by the general public.

Provided below is a brief description of the principles:

(i) **Principle 1:** *Budget processes, including multi-year frameworks, to ensure Parliament/Congress is sufficiently informed to understand the longer term implications of appropriation decisions;*

(ii) **Principle 2:** *The accounts of governments, state-owned enterprises and statutory corporations to be promptly and fully audited;*

(iii) **Principle 3:** *Loan agreements or guarantees entered into by governments to be presented to Parliament/Congress;*

(iv) **Principle 4:** *All government and public sector contracts to be competitively awarded, and publicly reported;*

(v) **Principle 5:** *Contravention of financial regulations to be promptly disciplined;*

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[1] This chapter was written by Mr. Sanjesh Naidu, Economic Advisor, Pacific Islands Forum Secretariat, after the workshop.

(vi) **Principle 6:** *Public Accounts Committees of the legislature to be empowered to require disclosure;*

(vii) **Principle 7:** *Auditor General and Ombudsman to be provided with adequate fiscal resources and independent reporting rights to Parliament/Congress; and*

(viii) **Principle 8:** *Central bank with statutory responsibility for non-partisan monitoring and advice, and regular and independent publication of informative reports.*

The first and third principles focus on transparency in fiscal management of the economy. They also suggest that budgets be presented over a multi-year framework in order that the implications of current and new fiscal policies can be well understood. A key element is the need to provide Parliament or Congress with all the information used to compile the budget in order that the longer term implications of appropriate decisions can be better understood and debated.

Furthermore, principle one inherently implies that the budget needs to present all the details of fiscal performance including the results of audits and other evaluations, and the assessed impact including on the key objectives previously specified for major programs. In addition, the budget presentation papers also need to include forecasts of the key budget figures for at least two years in advance together with the details of the assumptions on which they are based and the policy objectives they are meant to serve.

Principles 4 and 5 are also of particular interest since they involve specific public fiscal and financial management functions. Principle 4 relates to the need for all government and public sector contracts to be openly advertised, competitively awarded, administered and publicly reported. This principle is expected to be enshrined in the law.

Principle 5 relates to the need for the principal and subordinate laws and instructions governing fiscal and financial management to be comprehensive, up-to-date and workable. The administration of the legal framework governing fiscal and financial management should be active and vigorous.

The bulk of the remaining principles deal with accountability of government for its financial resources and the way in which these have been used. These deal with the processes of reporting expenditures or the use of capital assets, the sanctions on those misusing these resources and the powers to investigate these matters. In addition, the independence of monetary policy formulation and functions is also an explicitly stated requirement.

At the 2003 FEMM, Ministers noted the importance of ensuring the implementation of key FEMM decisions and the role of biennial stocktakes, as requested in 2002, in measuring this progress at both the national and regional level. Ministers agreed to: *endorse* *the framework for biennial FEMM stocktakes, noting in particular the requirements this places on input from member countries*.

Thus, the Stocktake provides a status report on each FIC's implementation of key areas of FEMM Action Plans. In addition, the Stocktake report also highlights barriers to implementation of FEMM decisions and efforts to overcome these barriers. The key areas for examination are:

(i) *good governance (which encompasses the Forum Eight Principles of Accountability);*
(ii) *economic reforms;*
(iii) *financial reforms; and*
(iv) *public enterprise reforms.*

The **2006 FEMM Stocktake** highlighted the most recent performance of FICs in implementing FEMM decisions in these four areas. The efforts of all fourteen FICs in responding to the stocktake survey helped form a very strong basis of a review of implementation of FEMM decisions in the key reform areas.

Generally FICs' responses indicated that there is a strong commitment to implement the Forum Eight Principles of Accountability but some divergence in the extent of actual compliance. Nonetheless, ongoing improvements in implementation over the past two years indicate that the region is making a concerted effort to move in the direction of improved transparency and accountability. Of the four areas examined in the stocktake, on average these principles were the best implemented.

FICs highlighted that difficulties in implementing the Eight Principles were related to a lack of technical capacity and human resources – issues which are of course to some degree linked. A base situation of restricted human resources was considered to be exacerbated by high levels of staff turnover (including as a result of migration) and absences on study leave. This generally stretched human resource situation is then in turn often exacerbated by the need to learn new skills, and in cases poor management of human resources, thus impacting on the stock of technical skills available to government to implement reforms.

Whilst in general the principles are quite well implemented, there is still a significant degree of divergence amongst the eight principles. Whilst progress in some areas are still slow, others are close to full implementation, or are already fully implemented.

For example, problems persist with the implementation of **principle 1**, which advocates multi-year budget frameworks, capable of providing good quality information regarding the long term impact of appropriation decisions. The vast majority of FICs have still to implement this principle, and yet budgeting is a core responsibility of finance ministries and treasuries. There is an obvious need to focus attention on meeting the technical skill gaps here in order to move towards achievement of this very important principle.

Other principles are, however, more successfully implemented. For example, **Principle 3**, which refers to the need for loan agreements to be presented to Parliament with enough information to allow Parliament, or Congress, to make an informed decision regarding the loan, has a high and rising level of compliance. Moreover, **principle 8** on the independent and timely provision of monitoring and advice by the Central Bank is now fully implemented.

In noting the overall progress of the implementation of the principles, the 2006 FEMM, amongst a number of other recommendations:

(i) *Renewed the commitment for the implementation of an effective accounting system, in cognizance of capacity constraints, which is capable of providing relevant and accurate information for decision makers throughout the multi-year budget process in a timely fashion; and*

(ii) *Placed continued emphasis on capacity building — both in terms of transferable technical skills and management processes — to support the implementation of reform endeavours as endorsed by FEMM.*

The 2006 FEMM also agreed that members use their stocktake responses as a basis to approach development partners for technical and financial assistance with implementation, with the Secretariat to assist with this process.

Engagement with the Pacific Islands Financial Management Association (PIFMA), in particular, is a practical means of progressing these implementation efforts through relevant information sharing and strategising at a technical level, amongst other key financial management issues.

Tools such as PEFA, are gaining interest and acceptance amongst fiscal management experts, and could be considered, on a case by case basis, in helping to strengthen priority reform areas, including fiscal management frameworks, such as MTFF.

FEMM has an abiding interest in ensuring the implementation of its key decisions and commitments. Therefore, the continued collaboration with member countries, and development and donor partners to assist with implementation remains an on-going effort. Another FEMM Stocktake is expected in 2008, with an added focus on monitoring the effectiveness of the principles endorsed by past FEMM’s.

CHAPTER 4

Revenue Estimates in Multi Year Budgets: the Pacific Experience[1]

While budgets are developed in all countries, in several developing countries this exercise is undertaken in an annual isolation. An attempt is now being made to set the context for the annual budget so that it provides a direction to the budgeting exercise and puts short term changes in perspective. This is done by enabling a medium term perspective which allows gradual integration of large changes and displays the multi year implications of decisions made by governments. This perspective, in turn, encourages good reforms because it allows a balancing of short terms costs with long term gains and enables benefits to be perceived on the basis of a long term vision provided by a multi year analysis.

It is important, while making forecasts to ensure that:

- They are defensible and are supported by good technical reasons;
- They are plausible, and explained satisfactorily either to superiors, peers or to the public;
- Errors are small, but recognizing that no estimate can be totally error free;
- Revenues are to underestimate rather than overestimated.

  Construction of forecasts requires the factoring in of three elements, both for tax and for non-tax revenues:
- Good economic forecasts- include forecasts of the real economy, that is the GDP and the employment and consumption figures; the inflation figures including wages, CPI and production prices; and the values in the economy like profits and interest payments;
- Good information from tax administration and;
- The effect of tax reforms.

For medium terms forecasts economic fundamentals like the governments' policy reforms, developments in the world markets, population growth, productivity improvements, the current business investments and, of course, the past trend of growth must all be taken into account to ensure that medium term forecasts are as reliable as possible.

In addition, administrative information like current collections, the administrative costs associated with them, and any special cases, need to be assessed correctly so that the changes to the system brought about by introduction of new taxes, the abolishing of old taxes and any changes in the top structure are correctly factored into the revenue estimates. This enables the medium term consequences of the exercise to be clearly perceived.

[1] This chapter is based on the lecture delivered by Bruce Taplin during the workshop, and the power point presentation that follows, and has been written by S. Joshi, Editor, after the workshop.

The forecasting process involves gathering of information from several sources including the treasury, the Ministry of Finance, the Central Bank, the tax administration, non –tax revenue agencies, statistics and the budget department. However, the forecasting time table needs to be clearly enunciated so that the initial revenue estimates are available at the start of the budget process. This enables the development of expenditure envelopes based on reasonable revenue estimates so that they can be communicated to line ministries in time for them to develop their own budget requests. The final revenue estimates are needed at the end of the budget process to finalize the budget balance, include tax reform decisions, and new data on economy, revenue collections and policies.

The inclusion of these data must all be documented in the budget papers, with explanations of the numbers and details, including the reasoning behind various measures proposed and the assumptions made. A clear analysis of the revenues risks and the possible alternate scenarios must also be assessed along with their impact on the budget and economic development to make the forecasts meaningful.

CHAPTER 5

Medium Term Fiscal Framework - Presentation by Fiji[1]

A medium term fiscal framework (MTFF) is an institutional device that formally and transparently tries to link policies, planning and budgeting. An MTFF has several variants starting from the simplest where aggregate projections for the next 2 or 3 years are made to more sophisticated ones where the costs of policy are projected over the medium term.

In Fiji, the Strategic Development Plan (SDP) provides indicative fiscal targets and indicators for the medium term and this feeds into the annual budget strategy, linking finally through the annual budget and the strategic policy statement.

The SDP includes indicative fiscal policies and targets over the medium term which are annualized through the Annual Budget Strategy and the Strategic Policy Statements. These are required under the Financial Management Act, 2004, to be tabled in Parliament on or before 30th June, each year.

The Annual Budget Strategy of Fiji sets out the indicative Medium Term Fiscal Framework following a consultative process which involves various stakeholders and takes into account revenue, expenditure, deficit, debt and GDP projections. It details the policy measures to achieve proposed targets.

The Fijian budget process determines the mid term targets, drawn from the SDP, and setting them on the basis of results of the last two years and the prevailing economic climate. These factors determine the fiscal policy stance of the government, taking into account political considerations, if any.

The annual budget then sets out allocations for agencies for the budget year plus two forward years. This projection is done using a simple methodology of projecting the forward year estimates which excludes new expenditures or ongoing projects that need to be reviewed and does not factor in either expected salary increases or inflation.

Given these constraints, there are several ways in which Fiji's forward estimates can be improved. These include a combination of top down and bottom up approach, by setting of strategy and the fiscal envelop by the Ministry of Finance, with the line ministry requests to Finance based on costs of implementing plans and policies. These could then be examined in some detail by Finance, and following consultations, the final funding could then be determined.

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[1] This chapter is based on the lecture delivered during the workshop, and the power point presentation that follows, and has been written by S. Joshi, Editor, after the workshop.

Another important area is the integration of overseas development assistance into the budget. In the 2006 budget, cash grants and aid-in-kind was integrated into the budget very substantially. However, ad-hoc assistance provided directly by some donors was not reflected in the budget and to address this issue, the government closed all trust accounts with agencies and moved them into a centrally managed trust fund, managed by the Ministry of Finance. However, the problem still exists and the government has now decided to close off the centrally managed trust fund by March 2007 and to reflect the amounts in the Budget 2008 so that such assistance is fully reflected in the budget and the impact of such assistance which does not materialize is understood.

The government is able to link the SDP to the Portfolio Performance Statement (PPS) to some extent to address the problem of linking policies to the budget. The PPS ensures that outputs are produced from budgetary allocations and performance indication measures and targets for the budget year are used to report on past years performance. It also ensures better allocation of financial resources and optimizes staff distribution to outputs.

However, few implementation issues remain. These include a lack of structured system to regularly record agency performance, excessively detailed indicators which are not easily amenable to measurement and the difficulty in collecting information. Nevertheless, refinements continue to be made and the efforts made to overcome the challenges of reorienting the mind set of the staff, the time taken to absorb the new concepts, commitment from the top, proper dissemination of information and overcoming capacity constraints.

Chapter 6

A medium term approach - Presentation by Vanuatu[1]

Vanuatu is presently implementing a medium term strategic framework (MTSF) for planning and budgeting, designed to implement the government's strategic blueprint for development, called the Priorities and Action Agenda -2006-2015 (PAA). The Medium Term Fiscal Framework, which rolls forward annually, is a critical component of the MTSF.

In Vanuatu, for the initial design of the MTEF, inputs were obtained from the most recent budget documents. In addition, the final and provisional budget numbers, both revenue and expenditure for the two years under review, updated GDP estimates and the figures for revenues, domestically financed operating and capital expenditures and budget financing are also used.

The MTEF in Vanuatu was also organized by program activity and by cost center. The Government Investment Program (GIP) includes the completed and ongoing programs and projects, where funding is available within the MTEF time frame, and those where no funding has yet been allocated, or is available. Simultaneously, all line ministries, agency strategies and business plans are also revised.

Currently, in Vanuatu, while all Ministries and Agencies have completed their expenditure templates and linkages have been established. However, certain issues remain. These relate to political commitment to the process, establishing the move from an annual budget cycle towards and three year cycle, the human resource constraints that face this development, data gaps and the coordination and sharing of information between planning, finance and the line ministries.

In a bid to overcome these constraints, the Government has taken several steps. These have been in the form of workshops conducted at various line ministries and departments, presentations made to the Development Committee of Officials to gather political support for the process. Consultations have also been conducted with individual line ministries to assist them with drawing up their future programs and costing. Efforts have also been made to organize regular meetings between planning and finance and with the development of strong linkages between these two important Ministries.

The process faces several challenges too. Some of these are political stability, fiscal absorptive capacity and the human resources needed to ensure implementation. Donors also need to display their support to the process, or else the line ministries would not put in the effort required. Lastly, of course, the MTEF process need to be used vigorously, or it would atrophy and die.

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[1] This chapter is based on the lecture delivered during the workshop, and the power point presentation that follows, and has been written by S. Joshi, Editor, after the workshop.

CHAPTER 7

Public Financial Management System - Presentation by Samoa[1]

Samoa's planning framework is based on Sector plans which cover a period of 5-10 years, followed by corporate plans covering a period of three years. These, in turn, are followed by annual management plans and the annual budget estimates. In Samoa, the budget allocations made to line ministries are based on outputs delivered by ministries and all outputs have performance measures. Line Ministry budgets are divided into three categories- outputs by line ministry, outputs by third parties and transactions on behalf of the state.

The annual budget is submitted with a draft annual management plan and reporting on it is done through monthly financial reports, mid year and annual reviews, annual line ministry reports, annual pubic accounts and the Controller and Chief Auditor's reports. This is supported by the Finance One system, implemented from 1 July for the fiscal year 2005-2006. With the implementation of this system, an opportunity was taken to shift more responsibility and accountability to line ministries, and purchase orders and check requisitions now originate there. The system also ensures that financial information is available daily within the line ministries so that they can analyze the information more promptly. This is done though the use of reports generated by the system which allow monthly budget monitoring and cash management. Timely reporting, and the on going development of the Financial Management Framework, should allow output managers being held responsible for the management of their resources.

The principle components of the medium term fiscal framework are the medium term economic forecasts, the medium term fiscal targets and the forward estimates, and it is important to ensure that all these components are linked and are consistent. Government of Samoa's expectations from a medium term fiscal framework are that it would improve economic stability, sustainability of the budget and allow better policy advice and prioritization of resources. It also expects, as a result, better coordination and planning by line ministries.

For major projects, the planning cycle is initiated by the Budget department informing line ministries of the size of the revenue envelope and policy priorities over the next three years. The line ministries, in turn, provide their capital submission, defined as expenditures in excess of $500,000. The budget planning/aid committee then prioritizes and makes recommendations for funding, and these are screened based on budget availability, planning and aid assessment. Recommendations are thereafter based on these factors. Once the aid coordination committee approves funding, the line ministries are informed about the accepted projects and the information included in the next years budget estimates.

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[1] This chapter is based on the lecture delivered during the workshop, and the power point presentation that follows, and has been written by S. Joshi, Editor, after the workshop.

In Samoa, the main concerns about medium term fiscal frameworks fall under two categories- internal and external. The internal concerns focus on capacity to develop and maintain the system, the use of appropriate systems and software and appropriate linkages to policy and planning, budget, accounts and aid administration. External concerns focus on political commitment, the absorptive capacity in line ministries, relationship with organizations involved in forecasting and, the comprehensiveness and integrity of data. Another area of concern is the misconceptions that sometimes surround the forward estimates system.

Accordingly, in Samoa the main challenges to a medium term fiscal framework revolve around the need for a sound policy framework, the effective use of the new financial system and the processes that link performance and medium term budgeting to the contracts of the CEOs in line ministries. Operational challenges of analyzing and implementing medium term revenue forecast, and filling the information gaps, are also areas of concern while the development of human resource capacities is an on-going challenge.

CHAPTER 8

The IMF- An Overview[1]

The IMF is the world's central organization for international monetary cooperation. It is an organization in which almost all countries in the world work together to promote the common good.

The IMF's primary purpose is to ensure the stability of the international monetary system—the system of exchange rates and international payments that enables countries (and their citizens) to buy goods and services from each other. This is essential for sustainable economic growth and rising living standards.

To maintain stability and prevent crises in the international monetary system, the IMF reviews national, regional, and global economic and financial developments. It provides advice to its 184 member countries, encouraging them to adopt policies that foster economic stability, reduce their vulnerability to economic and financial crises, and raise living standards, and serves as a forum where they can discuss the national, regional, and global consequences of their policies.

The IMF also makes financing temporarily available to member countries to help them address balance of payments problems—that is, when they find themselves short of foreign exchange because their payments to other countries exceed their foreign exchange earnings.

And it provides technical assistance and training to help countries build the expertise and institutions they need for economic stability and growth.

The IMF was conceived in July 1944, when representatives of 45 governments meeting in the town of Bretton Woods, New Hampshire, in the north-eastern United States, agreed on a framework for international economic cooperation. They believed that such a framework was necessary to avoid a repetition of the disastrous economic policies that had contributed to the Great Depression of the 1930s.

During that decade, attempts by countries to shore up their failing economies—by limiting imports, devaluing their currencies to compete against each other for export markets, and curtailing their citizens' freedom to buy goods abroad and to hold foreign exchange—proved to be self-defeating. World trade declined sharply, and employment and living standards plummeted in many countries.

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[1] This chapter is based on the article "What does the International Monetary Fund do?" and available at the IMF web site at http://www.imf.org/external/pubs/ft/exrp/what.htm

Seeking to restore order to international monetary relations, the IMF's founders charged the new institution with overseeing the international monetary system to ensure exchange rate stability and encouraging member countries to eliminate exchange restrictions that hindered trade. The IMF came into existence in December 1945, when its first 29 member countries signed its Articles of Agreement. Since then, the IMF has adapted itself as often as needed to keep up with the expansion of its membership—184 countries as of June 2006—and changes in the world economy.

Box 1

Exchange rate stability

Countries that joined the IMF between 1945 and 1971 agreed to keep their exchange rates (the value of their currencies in terms of the U.S. dollar and, in the case of the United States, the value of the U.S. dollar in terms of gold) pegged at rates that could be adjusted only to correct a "fundamental disequilibrium" in the balance of payments and only with the IMF's agreement. This so called par value system—also known as the Bretton Woods system—prevailed until 1971, when the U.S. government suspended the convertibility of the U.S. dollar (and dollar reserves held by other governments) into gold. Since then, IMF members have been free to choose any form of exchange arrangement they wish (except pegging their currency to gold): allowing the currency to float freely; pegging it to another currency or a basket of currencies; adopting the currency of another country; or participating in a currency bloc.

The IMF's membership jumped sharply in the 1960s, when a large number of former colonial territories joined after gaining their independence, and again in the 1990s, when the IMF welcomed as members the countries of the former Soviet bloc upon the latter's dissolution. The needs of the new developing and transition country members were different from those of the IMF's founding members, calling for the IMF to adapt its instruments. Other major challenges to which it has adapted include the end of the par value system and emergence of generalized floating exchange rates among the major currencies following the United States' abandonment in 1971 of the convertibility of U.S. dollars to gold; the oil price shocks of the 1970s; the Latin American debt crisis of the 1980s; the crises in emerging financial markets, in Mexico and Asia, in the 1990s; and the Argentine debt default of 2001.

Despite the crises and challenges of the post-war years, real incomes have grown at an unprecedented rate worldwide, thanks in part to better economic policies that have spurred the growth of international trade—which has increased from about 8 percent of world GDP in 1948 to about 25 percent today—and smoothed boom-and bust cycles. But the benefits have not flowed equally to all countries or to all individuals within countries. Poverty has declined dramatically in many countries but remains entrenched in others, especially in Africa. The IMF works both independently and in collaboration with the World Bank to help its poorest member countries build the institutions and develop the policies they need to achieve sustainable economic growth and raise living standards.

The IMF has continued to develop new initiatives and to reform its policies and operations to help member countries meet new challenges. It also enable them to benefit from globalization and to manage and mitigate the risks associated with it. Cross-border financial flows have increased sharply in recent decades, deepening the economic integration and interdependence of countries, which has been beneficial overall although it has increased the risk of financial crisis. The emerging market countries—countries whose financial markets are in an early stage of development and international integration—of Asia and Latin America are particularly vulnerable to volatile capital flows. And crises in emerging market countries can spill over to other countries, even the richest. Particularly since the mid-1990s, the IMF has made major efforts to help countries prevent crises and to manage and resolve those that occur.

In 2004, the year the IMF marked its 60th anniversary, its Managing Director initiated a broad strategic review of the organization's operations in light of the new macroeconomic challenges posed by 21st century globalization. The emergence of new economic powers, integrated financial markets, unprecedented capital flows, and new ideas to promote economic development required an updated interpretation of the mandate of the Fund as the steward of international financial cooperation and stability.

Globalization, poverty, the inevitability of occasional crises in a dynamic world economy—and, no doubt, future problems impossible to foresee—make it likely that the IMF will continue to play an important role in helping countries work together for their mutual benefit for many years to come.

Box 2

The IMF and the World Bank have different mandates

The World Bank was established at the Bretton Woods Conference at the same time as the IMF. Its purpose was to help war-ravaged countries rebuild. The earliest recipients of its loans were the European countries and Japan. By the early 1960s, these countries no longer needed World Bank assistance, and its lending was redirected to the newly independent and emerging nations of Africa, Asia, Latin America, and the Middle East, and, in the 1990s, to the transition countries of Central and Eastern Europe.

The IMF and the World Bank complement each other's work. While the IMF's focus is chiefly on macroeconomic and financial sector issues, the World Bank is concerned mainly with longer-term development and poverty reduction. Its loans finance infrastructure projects, the reform of particular sectors of the economy, and broader structural reforms.

Countries must join the IMF to be eligible for World Bank membership.

The IMF performs three main activities:

- monitoring national, global, and regional economic and financial developments and advising member countries on their economic policies ("surveillance");
- lending members hard currencies to support policy programs designed to correct balance of payments problems; and
- offering technical assistance in its areas of expertise, as well as training for government and central bank officials.

When a country joins the IMF, it agrees to subject its economic and financial policies to the scrutiny of the international community. And it makes a commitment to pursue policies that are conducive to orderly economic growth and reasonable price stability, to avoid manipulating exchange rates for unfair competitive advantage, and to provide the IMF with data about its economy. The IMF's regular monitoring of economies and associated provision of policy advice—known as surveillance—is intended to identify weaknesses that are causing or could lead to trouble.

Country surveillance takes the form of regular (usually annual) comprehensive consultations with individual member countries, with interim discussions as needed. The consultations are referred to as "Article IV consultations" because they are required by Article IV of the IMF's Articles of Agreement. During an Article IV consultation, an IMF team of economists visits a country to collect economic and financial data and to discuss the country's economic policies with government and central bank officials. IMF staff missions also often reach out beyond their official interlocutors for discussions with parliamentarians and representatives of business, labor unions, and civil society. The team reports its findings to IMF management and then presents them to the IMF's Executive Board, which represents all of the IMF's member countries, for discussion. A summary of the Board's views is transmitted to the country's government. In this way, the views of the global community and the lessons of international experience are brought to bear on national policies. Summaries of most discussions are released in Public Information Notices and are posted on the IMF's Web site, as most of the country reports are prepared by the staff.

Box 3

Crisis prevention

Since the Mexican crisis of 1994–95 and the Asian crisis of 1997–98, the IMF has intensified its efforts to help countries prevent financial crises. It has emphasized the importance of countries' incorporating "shock absorbers" into their policies—such as adequate foreign exchange reserves, efficient and diversified financial systems, social safety nets, and a fiscal policy that allows governments to run higher deficits during difficult times, if necessary. And it has introduced several initiatives designed to make countries less vulnerable to crisis.

- In collaboration with the World Bank, the IMF conducts in-depth assessment of countries' financial sectors under the Financial Sector Assessment Program.
- It has developed, sometimes in cooperation with other organizations like the World Bank and the Bank for International Settlements, standards and codes of good practice in economic policymaking, financial sector regulation and supervision, statistical collection and dissemination, and other areas. It issues reports on its members' observance of these standards and codes (known as ROSCs). The IMF's Data Standards Initiatives encourage members to make reliable, timely, and comprehensive statistics available to the public, thereby enabling investors to make well-informed decisions, improving the functioning of financial markets, and reducing the likelihood that shocks will precipitate crises. The IMF launched the Special Data Dissemination Standard (SDDS) in 1996 to provide guidance to member countries that have, or wish to gain, access to international capital markets on the dissemination of data. The General Data Dissemination System (GDDS) was established in 1997 to help countries that are not yet in a position to subscribe to the SDDS and need to improve their statistical systems. Participation in both systems is voluntary.
- It has developed vulnerability indicators and early warning system models to improve its ability to identify countries at risk.
- It has stepped up its efforts to promote good governance, particularly in the public and financial sectors.
- It participates in international efforts to combat money laundering and the financing of terrorism.

Box 4

Crisis resolution

By far the greater part of international financial flows are private flows. This points to the importance of the role that the private sector can play in helping to prevent and resolve financial crises.

Crises may be prevented, and the volatility of private flows reduced, by improved risk assessment and closer and more frequent dialogue between countries and private investors. Dialogue can also foster greater private sector involvement in the resolution of crises when they do occur, including through the restructuring of private debt, benefiting both creditors and debtors.

And the involvement of the private sector in crisis prevention and resolution should help limit "moral hazard"—that is, the possibility that the private sector may engage in risky lending if it believes that potential losses will be limited by official rescue operations.

The IMF has strengthened its dialogue with market participants, for example, through the establishment of the Capital Markets Consultative Group in 2000. The Group provides a forum for regular communication between international capital market participants and IMF management and senior staff on matters of common interest, including world economic and market developments and measures to strengthen the global financial system.

In some crises, coordinated debt restructuring by private creditors may be needed. To facilitate debt restructuring, the IMF has promoted the inclusion of Collective Action Clauses in international bond issues. The use of these clauses, which is the norm under U.K. law and has become the market standard for bonds issued under New York law, is designed to prevent a small minority of creditors from blocking a restructuring deal to which the majority of creditors agree. The IMF also supports the Principles for Stable Capital Flows and Fair Debt Restructuring drafted by the Institute for International Finance in 2004, and the Paris Club's Evian Approach to debt relief for countries that have unsustainable debt but that do not qualify for assistance under the HIPC Initiative.

Global surveillance entails reviews by the IMF's Executive Board of global economic trends and developments. The main reviews are based on World Economic Outlook reports and the Global Financial Stability Report, which covers developments, prospects, and policy issues in international financial markets; both reports are normally published twice a year. In addition, the Executive Board holds more frequent informal discussions on world economic and market developments.

In 2006, the IMF introduced a new tool, multilateral consultations, designed to bring small groups of countries together to discuss a specific international economic or financial problem that directly involves them and to settle on a course of action to address it.

Regional surveillance involves examination by the IMF of policies pursued under regional arrangements such as currency unions—for example, the euro area, the West African Economic and Monetary Union, the Central African Economic and Monetary Community, and the Eastern Caribbean Currency Union.

The growing interdependence of national economies, and the potential impact of national economic policies on the world economy and vice versa, have prompted the IMF increasingly to integrate the three levels of surveillance. Through its Article IV consultations, the IMF pays close attention to the impact of the larger economies' policies on smaller economies. It also studies the impact of global economic and financial conditions on the economic performance of individual countries and the repercussions of national policies at the regional level.

Box 5

The IMF's main business: macroeconomic and financial sector policies

In its oversight of member countries, the IMF focuses on the following:

- macroeconomic policies relating to the government's budget, the management of money and credit, and the exchange rate;
- macroeconomic performance—government and consumer spending, business investment, exports and imports, output (GDP), employment, and inflation;
- balance of payments—that is, the balance of a country's transactions with the rest of the world;
- financial sector policies, including the regulation and supervision of banks and other financial institutions; and
- structural policies that affect macroeconomic performance, such as those governing labor markets, the energy sector, and trade.

The IMF advises members on how they might improve their policies in these areas so as to achieve higher rates of employment, lower inflation, and sustainable economic growth.

Box 6

Terminology

Technically, countries do not receive loans from the IMF—they "purchase" foreign exchange from the IMF's reserve assets, paying with their own currency. The loan is considered repaid when the borrower "repurchases" its currency from the IMF in exchange for reserve assets.

Any member country—rich or poor—can turn to the IMF for financing if it has a balance of payments need—that is, if it cannot find sufficient financing on affordable terms in the capital markets to make its international payments and maintain an appropriate level of reserves. The IMF is not an aid agency or a development bank. Its loans are intended to help its members tackle balance of payments problems, stabilize their economies, and restore sustainable economic growth. Unlike the World Bank and other development agencies, the IMF does not finance projects.

In the first two decades of the IMF's existence, over half of its lending went to the industrial countries, but, since the late 1970s, these countries have been able to meet their financing needs in the capital markets. At present, all IMF borrowers are developing countries, countries in transition from central planning to market-based systems, or emerging market countries. Many of these countries have only limited access to international capital markets, partly because of their economic difficulties.

In most cases, IMF loans provide only a small portion of what a country needs to finance its balance of payments. But, because IMF lending signals that a country's economic policies are on the right track, it reassures investors and the official community and helps generate additional financing. Thus, IMF financing can act as a catalyst for attracting funds from other sources.

Box 7

IMF lending facilities

Most of the IMF's lending falls into three different categories:

- Stand-By Arrangements are designed to deal mainly with short-term balance of payments problems. The IMF's largest loans fall into this category. In 1997, the IMF introduced the Supplemental Reserve Facility, under which it can quickly provide large loans with very short maturities to countries going through a capital account crisis.
- The IMF introduced the Extended Fund Facility to help countries address balance of payments difficulties related partly to structural problems that may take longer to correct than macroeconomic imbalances. A program supported by an extended arrangement usually includes measures to improve the way markets and the supply side of the economy function, such as tax and financial sector reforms, privatization of public enterprises, and steps to make labor markets more flexible.
- Under its Poverty Reduction and Growth Facility, the IMF provides concessional loans—loans with an annual interest rate of 0.5 percent and a maturity of 10 years—to its poorest member countries. The majority of the IMF's loans now fall into this category. In 2005, it approved the establishment of the Exogenous Shocks Facility, under which it can give low income countries that are not receiving funds under the Poverty Reduction and Growth Facility, and that are suffering a balance of payments problem because of a shock beyond their control, quick access to funds on a concessional basis.

The IMF also provides Emergency Assistance to countries coping with balance of payments problems caused by natural disasters or military conflicts. The interest rates are subsidized for low-income countries.

The Trade Integration Mechanism allows the IMF to provide loans under one of its facilities to a developing country whose balance of payments suffers because of multilateral trade liberalization, either because its export earnings decline when it loses preferential access to certain markets or because prices for food imports go up when agricultural subsidies are eliminated.

When a country approaches the IMF for financing, it may be in or near a state of economic crisis, with its currency under attack in foreign exchange markets. Its international reserves maybe depleted, economic activity stagnant or falling, and a large number of firms and households going bankrupt.

The IMF provides the country with advice on the economic policies that may be expected to address its problems most effectively. The IMF and the government agree on a program of policies aimed at achieving specific, quantified goals. For example, the country may be expected to reduce its fiscal deficit or build up its international reserves. Loans are disbursed in a number of instalments over the life of the program, with each instalment conditional on targets' being met. A program may range from 6 months to 10 years, depending on the nature of the country's problems. Program details are spelled out in "letters of intent" from the governments to the Managing Director of the IMF, which can be revised if circumstances change.

The IMF provides loans under a variety of "facilities" that have evolved over the years to meet the needs of its membership. The duration, repayment terms, and lending conditions attached to these facilities vary, reflecting the type of balance of payments problem and circumstances they address.

Countries that borrow from the IMF's regular, non-concessional lending windows—all but the low-income developing countries—pay market-related interest rates and service charges, plus a refundable commitment fee. A surcharge can be levied above a certain threshold to discourage countries from borrowing large amounts ("exceptional access," as it is called in the IMF). Surcharges also apply to drawings under the Supplemental Reserve Facility. Low-income countries borrowing under the Poverty Reduction and Growth Facility pay a concessional fixed interest rate of 0.5 percent a year.

The foreign exchange provided by the IMF is subject to limits determined partly by a member's quota in the IMF and is deposited with the country's central bank to supplement its international reserves. To strengthen safeguards on members' use of IMF resources, in March 2000 the IMF began requiring assessments of central banks' compliance with desirable practices for internal control procedures, financial reporting, and audit mechanisms. At the same time, the Executive Board decided to broaden the application, and make more systematic use, of the tools available to deal with countries that borrow from the IMF on the basis of erroneous information.

The IMF is probably best known for its policy advice and its loans to countries in times of economic crisis. But the IMF also shares its expertise with member countries by providing technical assistance and training in a wide range of areas, such as central banking, monetary and exchange rate policy, tax policy and administration, and official statistics. The objective is to help improve the design and implementation of members' economic policies, including by strengthening skills in institutions such as finance ministries and central banks.

The IMF began providing technical assistance in the mid-1960s, when many newly independent countries sought help setting up their central banks and finance ministries. Another surge in technical assistance occurred in the early 1990s, when countries in Central and Eastern Europe and the former Soviet Union began shifting from centrally planned to market-based economic systems. More recently, the IMF has stepped up its provision of technical assistance as part of the effort to strengthen the architecture of the international financial system. Specifically, it has been helping countries bolster their financial systems, improve the collection and dissemination of economic and financial data, strengthen their tax and legal systems, and improve banking regulation and supervision. It has also given considerable advice to countries that have had to re-establish government institutions following severe civil unrest or war and has stepped up trade-related technical assistance since the launch of the Doha Round of trade negotiations in 2004.

More than 75 percent of the IMF's technical assistance goes to low-income and lower-middle-income countries, particularly in sub-Saharan Africa and Asia. Post-conflict countries are major beneficiaries, with Timor-Leste, the Democratic Republic of the Congo, Iraq, and Afghanistan among the top recipients in the early 2000s.

Box 8

The IMF provides technical assistance and training mainly in four areas:

- monetary and financial policies (monetary policy instruments; banking system supervision, and restructuring; foreign management and operations; clearing settlement systems for payments; and structure development of central banks);
- fiscal policy and management (tax and customs policies and administration, budget formulation, expenditure management, design of social safety nets, and management of domestic and foreign debt);
- compilation, management, dissemination, and improvement of statistical data; and
- economic and financial legislation.

Technical assistance is delivered in a variety of ways. IMF staff may visit member countries to advise government and central bank officials on specific issues, or the IMF may provide resident specialists on a short- or a long-term basis. Since 1993, the IMF has provided a small but increasing part of its technical assistance through regional centers—AFRITAC, serving eight countries in central Africa and based in Libreville, Gabon; West AFRITAC, serving western Africa and based in Bamako, Mali; East AFRITAC, serving eastern Africa and based in Dar es Salaam, Tanzania; CARTAC, serving 20 Caribbean islands and territories and based in Barbados; METAC, serving the Middle East and based in Beirut, Lebanon; and PFTAC, serving the Pacific region and based in Fiji.

The IMF offers training courses for government and central bank officials of member countries at its headquarters in Washington, D.C., and at regional training centers in Austria, Brazil, China, India, Singapore, Tunisia, and the United Arab Emirates.

Supplementary financing for IMF technical assistance and training is provided by several countries, of which Japan is the biggest donor, and international agencies such as the African Development Bank, the Arab Monetary Fund, the Asian Development Bank, the European Commission, the Inter-American Development Bank, the United Nations, the United Nations Development Program, and the World Bank.

Most of the IMF's loans to low-income countries are made on concessional terms, under the Poverty Reduction and Growth Facility. They are intended to ease the pain of the adjustments these countries need to make to bring their spending into line with their income and to promote reforms that foster stronger, sustainable growth and poverty reduction. An

IMF loan also encourages other lenders and donors to provide additional financing, by signalling that a country's policies are appropriate.

The IMF is not a development institution. It does not—and, under its Articles of Agreement, it cannot—provide loans to help poor countries build their physical infrastructure, diversify their export or other sectors, or develop better education and health care systems. This is the job of the World Bank and the regional development banks.

Some low-income countries neither want nor need financial assistance from the IMF, but they want to borrow on affordable terms in international capital markets or from other lenders. The IMF's endorsement of their policies can make this easier. Under a mechanism introduced by the IMF in 2005—the Policy Support Instrument—countries can request that the IMF regularly and frequently review their economic programs to ensure that they are on track. The success of a country's program is assessed against the goals set forth in the country's poverty reduction strategy, and the IMF's assessment can be made public if the country wishes.

Box 9

Collaborating with other institutions

The IMF collaborates with the World Bank, the regional development banks, the World Trade Organization, United Nations agencies, and other international bodies. Each of these institutions has its own area of responsibility and specialization and its particular contribution to make to the world economy.

The IMF's collaboration with the World Bank on poverty reduction is especially close because the Bank is the leading international institution promoting economic development. Areas in which the IMF and World Bank collaborate include social policies, assessments of member countries' financial sectors, development of standards and codes, and improvement of the quality, availability, and coverage of data on external debt.

The IMF is also a member of the Financial Stability Forum, which brings together government officials responsible for financial stability in the major international financial centers, international regulatory and supervisory bodies, committees of central bank experts, and international financial institutions. It also works with standard-setting bodies such as the Basel Committee on Banking Supervision and the International Association of Insurance Supervisors.

Collaboration with the World Trade Organization takes place formally as well as informally. The IMF has observer status at WTO meetings and IMF staff contribute to the work of the WTO Working Group on Trade, Debt, and Finance. The IMF is also involved in the WTO-led Integrated Framework for Trade-Related Technical Assistance to Least Developed Countries, whose other members are the International Trade Commission, UNCTAD, UNDP, and the World Bank.

The IMF also participates in debt relief efforts for poor countries that are unable to reduce their debt to a sustainable level even after benefiting from aid, concessional loans, and the pursuit of sound policies. (A country's debt is considered sustainable if the country can easily pay the interest due using export earnings, aid, and capital inflows, without sacrificing needed imports.)

In 1996, the IMF and the World Bank unveiled the Heavily Indebted Poor Countries (HIPC) Initiative. The initiative was enhanced in 1999 to provide broader, deeper, and faster debt relief, to free up resources for investment in infrastructure and spending on social programs that contribute to poverty reduction. Part of the IMF's job is to help ensure that the resources provided by debt reduction are not wasted: debt reduction alone, without the right policies, might bring no benefit in terms of poverty reduction.

In 2005, the finance ministers and heads of government of the G-8 countries (Canada, France, Germany, Italy, Japan, Russia, the United Kingdom, and the United States) launched the Multilateral Debt Relief Initiative (MDRI), which called for the cancellation of the debts owed to the IMF, the International Development Association of the World Bank Group, and the African Development Fund by all HIPC countries that qualify for debt reduction under the HIPC Initiative. The IMF implemented the MDRI in January 2006 by cancelling the debt owed to it by 19 countries. Most of the cost is being borne by the IMF itself, with additional funds coming from rich member countries to ensure that the IMF's lending capacity is not compromised.

Box 10

UN Millennium Development Goals

In 2000, the international community agreed on a set of development targets known as the UN Millennium Development Goals, which range from halving extreme poverty to halting the spread of HIV/AIDS and providing universal primary education, all by the target date of 2015. They have been agreed by all countries and the leading development institutions. The financial assistance and advice the IMF offers to its poorest members are geared partly to helping them achieve these goals.

1. Eradicate extreme poverty and hunger
2. Achieve universal primary education
3. Promote gender equality and empower women
4. Reduce child mortality
5. Improve maternal health
6. Combat HIV/AIDS, malaria, and other diseases
7. Ensure environmental sustainability
8. Develop a global partnership for development

To ensure that developing countries reap full benefit from the loans and debt relief they receive, in 1999 the IMF and the World Bank introduced a process known as the Poverty Reduction Strategy Paper (PRSP) process. To qualify for loans under the Poverty Reduction and Growth Facility and debt relief under the HIPC Initiative, countries must draw up their own strategies for reducing poverty, with input from civil society. The IMF and the World Bank provide an assessment of the strategies, but the latter are "owned" by the countries that formulate them.

Economic growth—rising average income—is necessary for the sustained reduction of poverty, and a considerable body of research has shown that international trade stimulates growth. Developing countries face many obstacles, however, to expanding their trade with other countries. Access to the industrial countries' markets is restricted by barriers such as tariffs and quotas, and developing countries themselves have barriers that prevent them from trading with each other. The IMF and the World Bank have been urging their members for years to eliminate barriers to trade.

Even if their access to other markets is increased, however, many developing countries may not be able to benefit from trade opportunities. Their export sectors may be weak because of policies that discourage investment or trade, and they may lack appropriate institutions (like customs administration) and infrastructure (for example, electricity to run plants, and roads and ports to get products to markets).

In 2005, the IMF and the World Bank introduced the concept of Aid for Trade for the least developed countries. Aid for Trade includes analysis, policy advice, and financial support. The IMF provides advice to countries on such issues as the modernization of customs administration, tariff reform, and the improvement of tax collection to compensate for the loss of tariff revenues that may follow trade liberalization. The IMF also participates in the Integrated Framework for Trade-Related Technical Assistance, a multi-agency, multi-donor program that helps the least developed countries by identifying impediments to their participation in the global economy and coordinating technical assistance from different sources.

The IMF is governed by, and is accountable to, its member countries through its Board of Governors. There is one Governor from each member country, typically the finance minister or central bank governor. The Governors usually meet once a year, in September or October, at the Annual Meetings of the IMF and the World Bank.

Key policy issues related to the international monetary system are considered twice a year by a committee of Governors called the International Monetary and Financial Committee, or the IMFC. A joint committee of the Boards of Governors of the IMF and the World Bank—the Development Committee—advises and reports to the Governors on development policy and other matters of concern to developing countries.

The day-to-day work of the IMF is carried out by the Executive Board, which receives its powers from the Board of Governors, and the IMF's internationally recruited staff. The Executive Board selects the IMF's Managing Director, who is appointed for a renewable five-year term. The Managing Director reports to the Board and serves as its chair and the chief of the IMF's staff and is assisted by a First Deputy Managing Director and two other Deputy Managing Directors.

Box 11

Evaluating the IMF's operations

In 2001, the IMF's Executive Board established the Independent Evaluation Office (IEO), which reviews selected IMF operations and presents its findings to the Board and to IMF management. The IEO operates independently of management and at arm's length from the Board, although the Board appoints the IEO's director. The IEO establishes its own work program, selecting operations for review based on suggestions from stakeholders inside and outside the IMF. Its recommendations strongly influence IMF policy and activity. In recent years, it has reviewed the IMF's role in Argentina in 1991–2001, the Poverty Reduction Strategy Paper process, IMF technical assistance, and IMF global surveillance, among other things.

The Executive Board usually meets three times a week, in full-day sessions, and more often if needed, at the IMF's headquarters in Washington, D.C. Of the 24 Executive Directors on the Board, 8 are appointed by single countries—the IMF's 5 largest quota-holders (the United States, Japan, Germany, France, and the United Kingdom) and China, Russia, and Saudi Arabia. The other 16 Executive Directors are elected for two-year terms by groups of countries known as "constituencies."

Unlike some international organizations (such as the United Nations General Assembly) that operate under a one-country-one-vote principle, the IMF has a weighted voting system. The larger a country's quota in the IMF—determined broadly by its economic size—the more votes the country has, in addition to its "basic votes," of which each member has an equal number. But the Board rarely makes decisions based on formal voting; most decisions are based on consensus. In the early 2000s, in response to changes in the weight and role of countries in the world economy, the IMF began to re-examine the distribution of quotas and voting power to ensure that all members are fairly represented.

IMF employees, who come from over 140 countries, are international civil servants. Their responsibility is to the IMF, not to the national authorities of the countries of which they are citizens. About one-half of the IMF's approximately 2,700 staff members are economists. Most staff work at the IMF's Washington, D.C., headquarters, but the IMF also has over 85 resident representatives posted in member countries around the world. In addition, it maintains offices in Brussels, Paris, and Tokyo, which are responsible for liaison with other international and regional institutions and civil society organizations, as well as in New York and Geneva, which focus on liaison with institutions in the UN system. The Geneva office is also responsible for liaison with the World Trade Organization.

Box 12

What is the SDR?

The SDR, or Special Drawing Right, is an international reserve asset that member countries can add to their foreign currency and gold reserves and use for payments requiring foreign exchange. Its value is set daily using a basket of four major currencies: the euro, Japanese yen, pound sterling, and U.S. dollar.

The IMF introduced the SDR in 1969 because of concern that the stock and prospective growth of international reserves might not be sufficient to support the expansion of world trade. (The main reserve assets at the time were gold and U.S. dollars.) The SDR was introduced as a supplementary reserve asset, which the IMF could "allocate" periodically to members when the need arose, and cancel, as necessary.

IMF member countries may use SDRs in transactions among themselves, with 16 "institutional" holders of SDRs, and with the IMF. The SDR is also the IMF's unit of account. A number of other international and regional organizations and international conventions use it as a unit of account, or as the basis for a unit of account.

The IMF's resources come mainly from the quotas that countries deposit when they join the IMF. Quotas broadly reflect the size of each member's economy: the larger a country's economy in terms of output, and the larger and more variable its trade, the larger its quota tends to be. For example, the United States, the world's largest economy, has the largest quota in the IMF. Quotas are reviewed periodically and can be increased when deemed necessary by the Board of Governors.

Countries deposit 25 percent of their quota subscriptions in Special Drawing Rights or major currencies, such as U.S. dollars or Japanese yen. The IMF can call on the remainder, payable in the member's own currency, to be made available for lending as needed.

Quotas, together with the equal number of basic votes each member has, determine countries' voting power. Quotas also help to determine the amount of financing countries can borrow from the IMF, and their share in SDR allocations.

Most IMF loans are financed out of members' quotas. The exceptions are loans under the Poverty Reduction and Growth Facility, which are paid out of trust funds administered by the IMF and financed by contributions from the IMF itself and a broad spectrum of its member countries.

If necessary, the IMF may borrow from a number of its financially strongest member countries to supplement the resources available from its quotas. It has done so on several occasions when borrowing countries needed large amounts of financing and a failure to help them might put the international monetary system at risk.

Like other financial institutions, the IMF also earns income from the interest charges and fees levied on its loans. It uses this income to meet funding costs, pay for administrative expenses, and maintain precautionary balances. In the early 2000s, there was a decline in the demand for the IMF's non-concessional loans, reflecting benign global economic and financial conditions as well as policies in many emerging market countries that had reduced their vulnerability to crises. To diversify its income sources, the IMF established an investment account in 2005. The funds in the account are invested in eligible marketable obligations denominated in SDRs or in the securities of members whose currencies are included in the SDR basket. The Fund also began to explore other options for reducing its dependence on lending for its income.

The IMF posts a vast amount of information on its own activities and policies, as well as on its member countries, on its Web site, *www.imf.org*. It also publishes *Finance & Development*, a quarterly magazine; a series of pamphlets called Economic Issues; a biweekly newsletter, the *IMF Survey*; the semi annual *World Economic Outlook* and *Global Financial Stability Report*; various statistical publications; and a wide array of working papers, occasional papers, and books. Some of these materials and the IMF's *Annual Reports* are available free of charge on the Web site; others can be ordered from IMF Publication Services (1-202-623-7430; publications@imf.org).

Articles of Agreement of the International Monetary Fund
Article I
Purposes
The purposes of the International Monetary Fund are:

i. To promote international monetary cooperation through a permanent institution which provides the machinery for consultation and collaboration on international monetary problems.
ii. To facilitate the expansion and balanced growth of international trade, and to contribute thereby to the promotion and maintenance of high levels of employment and real income and to the development of the productive resources of all members as primary objectives of economic policy.
iii. To promote exchange stability, to maintain orderly exchange arrangements among members, and to avoid competitive exchange depreciation.

iv. To assist in the establishment of a multilateral system of payments in respect of current transactions between members and in the elimination of foreign exchange restrictions which hamper the growth of world trade.

v. To give confidence to members by making the general resources of the Fund temporarily available to them under adequate safeguards, thus providing them with opportunity to correct maladjustments in their balance of payments without resorting to measures destructive of national or international prosperity.

vi. In accordance with the above, to shorten the duration and lessen the degree of disequilibrium in the international balances of payments of members.

The Fund shall be guided in all its policies and decisions by the purposes set forth in this Article.

Highlights in the Evolution of IMF Lending

1944	1945	1947
The Articles of Agreement of both the IMF and the World Bank are drawn up at the Bretton Woods Conference.	The IMF's first 29 members sign the Articles of Agreement.	France is the first country to draw funds from the IMF, followed in the same year by the Netherlands, Mexico, and the United Kingdom.
1952	1962	1969
Members agree on procedures for annual consultations on exchange restrictions and for Stand-By Arrangements, drawings, and charges. Belgium is the first country to enter into a Stand-By Arrangement with the IMF but makes no drawing until 1957.	To ensure that it has enough cash on hand should an industrial country need a loan to cover a balance of payments problem, the IMF introduces the General Arrangements to Borrow. These arrangements enable it to supplement its financial resources by borrowing from the governments of a group of member countries.	In response to the threat of a shortage of international liquidity, the Articles of Agreement are amended to create Special Drawing Rights.
1971	1973-74	1975
The United States suspends the convertibility of the dollar into gold, ending the par value system of fixed exchange rates, under which countries defined their currencies in terms of U.S. dollars or gold and were obligated to get IMF approval to change the "par value" by	On December 23, 1973, oil-exporting countries announce a steep increase in crude oil prices to take effect on January 1, 1974. To help oil importers deal with anticipated current account deficits and inflation in the face of higher oil prices, the IMF sets up the first of two oil	The *Extended Fund Facility* is established in 1974 to provide medium-term assistance to developing country members that need several years to address the economic weaknesses leading to their balance of payments problems. In 1975, Kenya is the first

more than 10 percent.	facilities.	country to benefit from an Extended Fund Facility arrangement.

1982	1986	1987
The oil shocks of the 1970s, which forced many oil-importing countries to borrow from commercial banks, and the interest rate increases in industrial countries trying to control inflation lead to an international debt crisis. Throughout the 1980s, the IMF plays a central role in helping resolve the crisis.	The *Structural Adjustment Facility*, one of the predecessors of the Poverty Reduction and Growth Facility, is established, enabling the IMF to lend at below market rates to poor countries.	To increase the resources available for concessional lending to developing member countries, the IMF introduces the *Enhanced Structural Adjustment Facility*.
1992	1995	1996
The Russian Federation and 13 of the 14 other states of the former Soviet Union join the IMF.	An $18 billion loan is negotiated for Mexico to help the country recover from a capital account crisis.	The IMF and the World Bank jointly launch the *Heavily Indebted Poor Countries (HIPC) Initiative* with the aim of reducing the external debt of the world's poorest and heavily indebted countries to sustainable levels in a reasonably short period.
1997-98	1999	2000
Financial crisis erupts in Thailand, followed by crises in other Southeast Asian countries. The IMF provides loans totaling more than $36 billion to Indonesia, Korea, and Thailand in support of stabilization policies and structural reforms. The crisis spills over to countries in other areas, such as Russia, whose currency is devalued. Russia defaults on its debt.	The IMF replaces the *Enhanced Structural Adjustment Facility with the Poverty Reduction and Growth Facility*, which gives explicit attention to poverty reduction, and the HIPC Initiative is enhanced to provide faster, broader, and deeper debt relief.	The *UN Millennium Development Goals* are agreed by world leaders at the UN Millennium Summit.
2001	2005	
Argentina suffers a financial crisis and a deep recession, defaults on its debt, and is forced to abandon its currency board pegging the peso to the U.S. dollar.	The G-8 launch the *Multilateral Debt Relief Initiative*, and the IMF agrees to forgive 100 percent of the $3.3 billion debt owed to it by 19 of the world's poorest countries.	

CHAPTER 9

Improving Aid Coordination and Aid Management [1]

"*We further welcome recent efforts and initiatives to enhance the quality of aid and to increase its impact, including the Paris Declaration on Aid Effectiveness, and resolve to take concrete, effective and timely action in implementing all agreed commitments on aid effectiveness, with clear monitoring and deadlines …*", 2005 World Summit Outcome (Para 23) (http://daccessdds.un.org)

Over the last 30 years, remarkable - but uneven - progress has been made by developing countries to improve the standard of human development across the world. Development cooperation has played a significant role in this achievement.

Aid management for better development effectiveness has become a renewed priority for donors and partner countries alike, with donor consultation meetings increasingly becoming a key annual feature. The High-Level Forum on Aid Effectiveness in Rome in February 2003 created a new aid agenda in which countries were encouraged to take greater ownership of and leadership over development interventions at national level. The momentum of this new aid architecture has since picked up, with the convergence of two milestone meetings in 2005. The first was the Paris High-Level Meeting in March 2005 (the follow-up to the Rome Declaration on Aid Effectiveness) from which the Paris Principles derive. These Principles are being adapted to reflect the realities of the Pacific Islands countries, known as Pacific Aid Effectiveness Principles (still in draft form). The second was the UN World Summit in New York in September 2005, 5 years after the Millennium Summit which led to the adoption of the Millennium Declaration and the endorsement of the Millennium Development Goals (MDGs) by all UN Member States. The 2005 World Summit reaffirmed the UN General Assembly's commitment towards achievement of the MDGs through two important outcomes:

(a) developing countries committed to adopt national plans by end of 2006 to reduce poverty and achieve the MDGs (MDG-based plans)

(b) developed countries committed to scale up aid to developing nations up to US$50billion a year by 2010, representing at least 0.7% of their Gross National Income (GNI). The commitment by the international community to mobilize additional resources is meant to support national efforts in developing countries to finance poverty initiatives and achieve the MDGs in the next ten years.

These two meetings in 2005 had commonality of purpose in that, ultimately, both were looking at how to improve people's lives through mobilizing additional financing

[1] This chapter is based on the lecture delivered during the workshop, and the power point presentation that follows, and has been written by Carol Flore-Smerecznaik, after the workshop.

and making more aid available to developing countries, but also getting countries to use those resources more effectively to produce greater impact. However, aid producing better development results is predicated upon existing capacities and systems at country level, as well as specific behaviors from donors.

The Paris Principles of ownership, alignment, harmonization, mutual accountability and managing for results place the onus on governments to define their national priorities, and formulate poverty reduction strategies that are aligned with the MDGs. Because MDG goals such as equitable access to education, health, water, sanitation, food, energy, etc are part of national development priorities, the MDGs need not be a separate development agenda. MDG-based plans therefore do not need to be a separate plan, but start with national development priorities and integrate the MDGs, which should be localized to reflect key national development concerns.

The Paris Principles also place governments in a lead position to determine how domestic and external resources are used, primarily by aligning these with national priorities through consultations with national and international partners. The success of the implementation of the Paris Principles (and the Pacific Principles) is premised upon the existence of national capacities, systems and institutions at country level - with donors aligning with recipient countries national priorities, policies and systems, and establishing common arrangements, and simplifying their procedures. The challenge comes when these capacities are non-existent. Country capacity requirements to improve aid management and coordination includes the ability to (i) set the development agenda through the formulation of an MDG-based national development strategy or plan; (ii) integrate aid flows within national budgets on an annual basis and through medium term expenditure frameworks; (iii) improve links between planning, budgeting, aid coordination, monitoring and evaluation; (iv) report to donors on aid use in terms of development outcomes rather than just inputs; and establish robust national systems, with Governments getting donors to agree to use those (www.devaid.org).

At the center of the discussions on aid effectiveness has been the concern on how to use aid as effectively as possible to obtain the optimum impact, as evidenced in the 12 indicators of aid effectiveness, which mostly address finance and procurement issues. In setting targets and baseline indicators, and in measuring impact, there has been no mention of normative issues such as gender equality, human rights, of freedom, or some of the broader issues which are relevant in discussions on access over resources. As progress is made on the financial aspects, it will be useful to look at the normative framework so that the inter-connectedness between aid effectiveness and the MDGs and the Millennium Declaration can be made more explicit.

Available data on aid flows to the Pacific indicate that the region is still a strong beneficiary of donor funding (OECD Database and World Bank Indicators). In aggregate terms, aid flows as a % of GNI are higher in the Pacific than in any other region, even when compared to developing countries as a whole. Even though aid flows to the Pacific have been declining by almost 50% in the last two decades in aggregate amount, ODA is still an important component of government budgets in many Pacific countries (Abbott &

Pollard, 2004). The challenge is to ensure that countries make the most of these resources so that they are the best dollars spent.

The starting point is for governments to initiate the planning cycle by adapting the 2015 MDG targets to align with national priorities, and translate these targets into interventions which are then costed, with implications for medium term plans and budget frameworks. The characteristics of MDG-based National Plans (or strategies) are that they incorporate macro-economic policy, sectoral policies, the cost of strengthening capacities or institutions, and governance issues in a consistent and cross-sectoral framework The need for assessment would identify priority areas where interventions are most needed and would guide the sequencing of public investment on a medium to long term basis. Since interventions and associated investments are policy choices, this approach is useful as it enables policy makers to formulate appropriate domestic and external financing strategy to mobilize additional resources, if necessary. Monitoring mechanisms would be an integral part of the process to verify that resource allocation and interventions are producing planned outcomes.

A key issue is that while aid has the potential to contribute to the achievement of the MDGs, both domestic and aid resources are required to fund MDG interventions (which should be home-grown), and should be reflected in budgetary frameworks. In terms of aid management, therefore, aid becomes part and parcel of the available resource envelope (not additional resources) to translate the cost of interventions to achieve MDG-based national goals and priorities by integrating both domestic revenue and aid resources (grants and loans) into annual budgets and the MTEF/MTBF. This entails aligning policies and priorities, including sectoral policies, with macro-economic fiscal constraints, integrating both top-down and bottom-up processes. Experience shows that governments are best able to exert ownership and influence aid allocation to the MDGs and their national priorities if the National Development Strategy or NSDS are matched by sector strategies, which are themselves reflected in the national budget framework. As a result, the different linkages from the NSDS to the MTEF/MTBF to the policies and sector levels are important.

Some of the issues (www.aideffectiveness.org) which need to be addressed to progress aid coordination and management at country level include:

- strengthening the budget formulation process;
- strengthening public financial management systems so that they lead to enhanced government accountability and responsibility; encourages parliamentary oversight of national budgets; and fosters an integrated and multi-disciplinary approach to identifying financing options for development, aligning both domestic and external resources and based on needs assessments and costing; and facilitates the integration of aid into the budget;
- strengthening national capacities to lead aid coordination and dialogue mechanisms for better communication on government-donor aid information, such as Consultative Groups, Round Tables, strengthening of national coordination mechanisms, Thematic or Working Groups;

- integrating aid planning and strategic decision-making into a coherent national information management system. This includes putting in place country specific aid policies, and aid information management systems that are web-enabled and easy to use; promote transparency and accountability, including beneficiaries; build on existing government systems; and support analysis and reporting for decision makers;
- ensuring that aid is more predictable to allow for more credible policy making, enabling the MTEF/MTBF to function as a flexible tool;
- establishing country specific independent systems and reinforcing government capacity to monitor the implementation of the Paris Declaration and other international commitments, focusing on both the use of resources and the results (impact) of interventions.

If aid is to increase significantly to US$50 billion a year by 2010 to make a significant dent in reducing poverty and achieve the MDGs, it would require partner countries and donors to do things somewhat differently. Aid management is not just about an information system which tracks the source, quantity, use, impact and reporting of aid. Though these are important, it is much more about developing robust national capacities for sound planning and budgeting, and ensuring that these align with national issues of concern. Aid coordination encompasses the softer skills which governments must have to negotiate with all partners, including donors, on modalities to better manage aid. Eventually, the Paris Declaration is about reforming the way that governments and donors work together, with the end result of reducing poverty and achieving the MDGs. Hopefully, by the time the OECD DAC Third High Level Forum is held in Ghana in September 2008, significant progress will have been made on the implementation of the Paris Declaration on Aid Effectiveness based on country reviews, and it will be timely to address emerging issues.

<u>Speech at the closing session of the workshop delivered (*in absentia*) by the Hon. Minister of Finance for Tonga</u>

Ladies and Gentlemen,

It is indeed a pleasure to be here today to speak at the workshop organized by the Pacific Financial Technical Assistance Center on medium term fiscal frameworks. I am glad to hear that very lively discussions took place here over the last few days not only on the theory but also the practice of MTFFs. I am particularly happy that the entire program was based not merely on theory but also on practical advice from the presenters in response to the country presentations made here. Indeed, it is just this kind of dialogue that is needed in the larger context in this region and I am extremely happy that PFTAC has fostered it with its usual practical approach to issues.

My contribution will focus on practicalities – the reality of fiscal policy-making.

As you are all aware, setting up of medium term fiscal frameworks is an enterprise that needs substantial preparation before it can be fruitfully implemented. For a developing country like Tonga, which is always juggling far more competing priorities that it can successfully implement, such a big commitment forces us to think clearly and carefully about the costs and benefits of MTFFs - including the issue of who pays the costs and who gets the benefits.

Given any PIC government's limited supply of good financial managers, macroeconomists and economic statisticians, the opportunity costs of implementing and operating a MTFF can be high. As for benefits: if a MTFF does little to improve the fiscal decisions of Cabinet, but does much to help Parliament criticize these decisions, how enthusiastic will PIC Finance Ministers and their Cabinet colleagues be about implementing a MTFF?

Internationally, there may appear to be an emphasis on informing Parliament. Several OECD countries require that the budget documents contain a statement of medium term fiscal policies. While this is true for about 80% of the OECD countries, it is interesting to observe that in only 50% of them is the medium term fiscal framework a legal requirement. In our own case, the first of the Forum's eight principles of accountability covers setting up "Budget processes, including multi-year frameworks, to ensure Parliament/Congress is sufficiently informed to understand the longer term implications of appropriation decisions." The principles go on to say that "*The budget presentation papers also need to include forecasts of the key budget figures for the next two years together with the details of the assumptions on which they are based and the policy objectives they are meant to serve.*" All that seems to indicate a lot of work for officials that is primarily intended to serve the needs of Parliaments/Congress.

If that had been the intention, then I would have to disagree. To me, the primary emphasis is – and should be – on improving the quality of fiscal decisions, and Parliamentary scrutiny of the quality of those decisions is important but secondary – it is the back-up or safeguard to make sure Cabinet has done this job well.

In fact, the Forum principles do emphasise the kind of budgetary processes that are needed for MTFFs to generate the intended benefits. After the passage I have just quoted, they go on to add that "*Budgetary processes, including the full involvement of ministers, need to be directed specifically at the generation of good estimates which are properly aligned with policy and program output intentions.*" I suggest that is likely to be the biggest challenge in many – perhaps most – of the Pacific Island countries: different behaviour by ministers, not merely extra work for officials and extra information for parliamentarians. Perhaps the countries represented here can share their own stories about the difference between:

- a participatory medium-term budget process where senior ministers are fully engaged in the clarification of outputs, prioritisation of spending on outputs, and management of fiscal risks, and for this purpose they demand and make active use of the information that can only be provided by a MTFF; and
- a centralised annual budget process run by the Minister and Ministry of Finance that tends to exclude most other ministers and officials except when their own spending is under discussion.

This gives us a different perspective on the OECD examples which I mentioned earlier. I suggest that the apparent emphasis on good governance in providing parliaments with explicit statements of medium-term fiscal policies, was not a denial of the importance of the budget process. Instead, it was simply their next priority. In other words, it probably reflects the fact that they had **already** reformed their budget processes and changed to the first model - participatory medium-term budget processes based on the information that can only be provided by a MTFF. In the case of these OECD countries, the next step of the reforms was that parliaments also had to change the information they received. This was because the quality of ministerial fiscal decision-making had already improved, and parliamentarians had to catch up and apply these new, higher standards in evaluating the fiscal performance of the executive.

That is very different from the situation in most Pacific Island countries.

So I see this as a triple reform challenge – in its simplest terms:

- firstly, better quality information provided by officials;
- secondly. better quality decision-making by ministers; and
- thirdly, better oversight and review by a parliament or Congress.

To me, this triple reform challenge emphasizes the fact that this task requires a great degree of preparation – including building stakeholder awareness, support and capability among officials, ministers and parliamentarians – in order to be implemented properly. I think it is important, at this stage of your deliberations, when you are about to go back and reflect on what you have learnt here over the last three days, to think about the steps needed to take forward what you have learnt and the sequencing of the reform activities across these three inter-related areas for reform.

Looking now at the big picture, there are two key steps.

- Firstly, you will need to list, analyse, understand and communicate to your key stakeholders the specific limitations and constraints in each of your own countries in each of those areas – for example: How far advanced are you in each of those three areas? What are the "supply and demand" factors at work – in other words, the capabilities and the pressures to reform?
- Secondly, based on that understanding, you will need to play your part in the reforms required.
    a. Perhaps you will convince your key stakeholders to unite around a comprehensive action plan, with shared goals, a shared understanding of your starting position and how to overcome these limitations and constraints in the specific context of your own countries; and so on. That's the reformer's dream – and you will need to aim that high if your analysis suggest it is feasible.
    b. But perhaps the circumstances are not favourable. Perhaps you are not going to get quickly or smoothly to an ideal result in which each area is working well and supporting the other two areas. In reform terms: "Situation is normal – get used to it!" The selection, sequencing and allocation of responsibilities for reform actions are going to be very important, but let's face it: it will be almost impossible to design the "perfect implementation plan".

What are you likely to find when you analyse your own situations? The primary problem most Pacific Island countries face is a lack of policy perspective when developing a medium term fiscal framework. And my more fortunate counterparts – the Finance Ministers in more developed countries – assure me that this is NOT a battle that is ever decisively won once and for all time. You have to keep renewing the understanding and commitment of all key stakeholders, and keep up the repairs and maintenance on the MTFF system itself. One key element is a shared understanding that it is not just a political imperative for the Executive arm of government – Cabinet – to make its decisions collectively and be collectively responsible for all its decisions. The practical necessity for Cabinet to collectively adopt and be bound by various constraints – an integrated set of development priorities; fiscal guidelines, monetary discipline, etc – is that our societies and our economies are systems. They are inter-connected. They affect each other and are affected by a shared "big picture" – what we economists loosely call "macro factors". The MTFF process – the selection of outputs within resource constraints and financial constraints, within a timeframe that allows for powerful but slow-acting processes – is a practical response to these realities.

This is **not** a widely shared perspective. Most of the population want instant results, and they don't want to listen to reasons why they can't get what they want. Sometimes politicians, including Cabinet Ministers, reflect these demands all too well. But I want to emphasise that this is not a so-called "developing country problem" and it is definitely not a new phenomenon. One hundred years ago, the first top American trade unionist was Samuel Gompers – founder president of the American Federation of Labor for almost forty years, between 1886 and 1924. He often was asked what were the main objectives of the trade union movement. His most famous reply was: "More! More! More! More! Now!" [Now just in case you think this was pure greed , Sam expanded as follows: "More schoolhouses and less jails, more books and less arsenals, more learning and less vice, more constant work and less crime, more leisure and less greed, more justice and less revenge."!] Now I am encouraged by things like that – firstly the evidence that we can and should consider adopting public sector practices used by many developed countries, because some of our problems are no different to theirs – and secondly the historical perspective that these are not "quick fixes" – they are institutions that great countries have struggled to build and refine over the centuries.

This strategic-level policy problem is made much worse when capacity in both the finance and the line ministries is limited. The results include a sub-optimal setting of targets initially; implementation problems later when avoidable conflicts and errors emerge; incomplete and unreliable measurement of achievements against such targets. A tendency to centralize decision-making also contributes to this problem. This tendency arises mainly from the inadequate feedback on policy achievements, a problem which has its roots in lack of adequate capacity at several levels. We therefore need to see what we can do to address these problems.

Clearly one of the most important tasks, especially in the Pacific context, is capacity development. I am glad that this workshop, and the efforts made by PFTAC, and many of our donor partners, have gone a long way in mitigating this problem. However, it is important to realize that training is an on-going effort and given the economic imperatives of many of the countries in the Pacific, shall never really be completed. We must continue the training effort on an almost continuous basis and I am glad that this workshop, and others to follow, shall ensure this.

No matter in what sequence each country addresses the three levels I have identified, the foundation must be more comprehensive and more reliable information for decision-making, and it is you – the people at this workshop – who must provide that foundation for each country. Without your contribution to rely on, neither Cabinet Ministers nor Parliamentarians can do much to improve fiscal decision-making.

Our efforts to make medium term fiscal forecasts realistic must also recognize that there are several other steps a country must take to achieve this aim.

During the Forum Economic Minister's Meeting in Majuro in 2003, we recognized this when we said that "It is important to note that the volatility in reform progress is influenced by substantial social and political factors – as would be expected in any country undertaking economic, public sector and governance reform. One of the main reasons driving the reform efforts in the region is the need to address macroeconomic instability." Indeed, proper medium term fiscal frameworks are an attempt to address this problem or mitigate its effects.

Last year Tonga provided an example of both sides of this problem. The downside was that our fiscal crisis forced us to drop our plans to introduce multi-year budgets and macro-forecasts. Instead, our scarce expert resources had to concentrate on restoring macroeconomic stability – centred around fiscal correction through a re-centralisation of the budget process. The upside was that, thanks to ADB allowing us to use their scheduled Pacific Islands Economic Report (PIER) team to construct a medium term fiscal perspective on our problems, we were able to brief Cabinet and other stakeholders on the big picture using MTFF techniques, and to illustrate the main options which had been modelled. Thanks also to PFTAC, AusAID and NZAID supplying experts to help us design and implement these solutions within a multi-year framework, this kind of "supercharged trial implementation" of MTFF has passed every test so far. Now we face the challenge of building the permanent local capability – and ensuring that Cabinet sees the need for a MTFF, supporting a disciplined planning and budgeting process, even when we are not so obviously in a crisis.

So at Cabinet level, there needs to be an acceptance that our laudable aims for macroeconomic stability and prudent planning and budgeting, cannot be achieved without a medium term fiscal framework in place. Once such a framework is indeed in place, what next do we need to do? Success depends on mutual cooperation and trust. For too long have the Ministries of Finance and the line ministries had a relationship of mutual distrust. We need to build a culture of honest and full dialogue between them so that realistic budgets can be developed and later implemented. This should be an iterative process and should be conducted at the level of outcomes and program outputs and not on a line-by-line analysis of output costs, as most Finance Ministries are accustomed to do.

It is difficult. But it is not new, and this is another challenge that is not confined to developing countries. To stay with the USA as our illustration I would paraphrase another famous American: ***if we think that people lack the wisdom and judgement to make good decisions, the solution is to build that capacity: to give them the education and information they need, not to take away their power to make these decisions.***[2] Thomas Jefferson – President of the whole republic, not just USA trade unions, was talking about the whole population, but I suggest that

[2] "I know no safe depositary of the ultimate powers of the society but the people themselves; and if we think them not enlightened enough to exercise their control with a wholesome discretion, the remedy is not to take it from them, but to inform their discretion by education. This is the true corrective of abuses of constitutional power." US President Thomas Jefferson in a letter – 1820.

his sentiments apply equally – perhaps even **more** strongly – to decisions made by the representatives of the people, and by the public servants – like you – who give effect to those decisions: who turn those decisions into action and results.

And I suggest that Ministers and Ministries of Finance need to listen more carefully than most to the wisdom in those words. We can't plan everything; we can't control everything; we certainly can't manage everything – and we shouldn't. We are **not** the sole source of wisdom and knowledge. Our countries need the combined efforts of many talented and dedicated people. But we had better not relax unless and until there is in place a capacity to plan within constraints; reliable and comprehensive systems of control; and the full range of management capabilities – financial as well as operational and the rest. (And even then we better not relax too much!)

Getting to this stage, however, means considerable effort to strengthen internal financial management. Ministries of Finance need to recognise that line ministries with responsibility for achieving certain outputs must be given the authority they need for effectively managing the delivery of their programs; while line ministries need to build trust by honing their skills at making reasonably accurate forecasts. Once this is done, and ministries have built up the ability to make accurate forecasts, the Ministry of Finance can allow greater flexibility to them to manage their outcomes within the overall fiscal framework and the government's budget priorities. Indeed, perhaps the greatest longer-term challenge for better financial management is to develop middle-level operations managers who are skilled in adjusting their activities to fit their budgets with the minimum reduction in target outputs/results.

I am sure that the deliberations here, and the contacts you are developing now amongst yourselves, over the last three days would go far in helping you to achieve these ends.

I am told that the next Public Financial Managers Association meeting shall be held in the second half of March 2007 in the Cooks Islands where topics of interest in the financial management area, and to all of you in particular, shall be discussed. I am glad that PFTAC is taking the lead in organizing there seminars and I am sure our other donor partners shall support them, and all of us, in these efforts. Mr. Joshi has also told me that the IMF is planning a wider, more comprehensive, assessment of public financial management in Tonga and this would go far in helping us improve our own systems.

The more important outcome for the region as a whole, would be that the lessons learnt from the mission to Tonga would be used by the IMF and PFTAC, on a wider basis, to help improve public financial management systems in the pacific region. I am glad that this approach is being taken and wish to extend my support for this approach in general, and to the mission in particular.

Thank you.

MEDIUM TERM FISCAL FRAMEWORK WORKSHOP
28-30 NOVEMBER 2006
Tanoa International Hotel, Nadi, Fiji

MINUTES DAY 1 – 28 November 2006 (9am – 5pm)

Present:

Participants
Cook Islands – Helen Henry
Fiji – Kelera Vakaloloma, Sereima Bulouniwasa
Federated States of Micronesia – Resty Shotaro
Kiribati - Nuntaake Tokamauea
Marshall Islands – Bruce Bilimon
Nauru - Onassis Dame, Javan Tamakin
Niue – Douglas Dunstan
Palau – Ghandi Ngirmidoi
Papua Niu Guinea – Manu Momo
Samoa – Samuel Ieremia, Benjamin Pereira (Govt. Funded)
Solomon Islands – Merrylyn Kodoleke
Tokelau – Lalotoa Chadwick
Tuvalu – Esita Morikao
Vanuatu – Collin Tavi, Betty Zinner-Toa (Govt. Funded)

Donor/International Organisations & PFTAC
Asian Development Bank (ADB) – Anqian Huang
AUSAID – Kylie Coulson, Nick Compston
The International Monetary Fund (IMF) – Christian Schiller
NZAID – Vicki Plater
Forum Secretariat (FS) – Sanjesh Naidu, Laisiasa Tora, Sila Kotobalavu
European Union (EU) – Myfanwy van de Velde, Carl-Henrik Hall
UNDP – Carol Flore Smereczniak, David Abbot
World Bank – David Chandler
Resource/Australian Treasury – Bruce Taplin
Pacific Financial Technical Assistance Centre (PFTAC) – Susan J Adams, Suhas Joshi, Nina Samuela
Fiji – Aisake Taito (representing Minister and CEO of Finance)

Apologies:

Tongan representation
Minister & CEO of Finance

9:00am	Registration of participants.
9:40am	Susan J Adams - Opening Prayer & Address. Appreciation noted to all participants and the following international organisations: PIFS, UNDP, IMF, AUSAID, NZAID, Governments of Japan and Korea.
9:45am	Aisake Taito – Apologies and declared the workshop open on behalf of the Minister & CEO of Finance for Fiji.
9:54am	Suhas Joshi – Vote of thanks. Announced the next PIFMA Conference to be hosted by the Cook Islands 28-30 November 2006.
9:58am	Photo Session & tea break.

10:40am **Christian Schiller – Presentation on Public Finances: Medium Term Frameworks - Benefits, Taxonomy, Stages & International Experiences.** (See PowerPoint doc for detail).

In his presentation Mr. Schiller stated that while budgets are generally formulated on an annual basis, many countries now also employ a multi-year policy and planning frameworks (MTF) typically over a three year time horizon. He emphasized that multi-year budgeting, in the sense of appropriations extending beyond a single budget year, is not the focus of medium term fiscal frameworks, although the first year estimate of an MTF typically becomes the starting point for preparing the budget of the following year. The three main objectives of any PFM systems are:

1. Macro fiscal discipline and stability to avoid public finance crises and to support economic growth and employment;
2. Strategic allocation of resources so that the structure of government spending is consistent with the policies of government.;
3. Technical efficiency to get the most from each Dollar spent

MTFs in different countries differ in terms of which of these objectives are designed to achieve. Some are very detailed and complex, others are less sophisticated and easier to operate and, in turn, can be grouped into three different categories:

1. A medium-term fiscal framework which provides a top-down statement of fiscal policy objectives and sector strategies. Here the sector strategies are typically not disaggregated to

spending agencies. On the expenditure side, an MTEF typically includes only an aggregate total. It also comprises a set of medium-term macroeconomic and fiscal targets and projections.
2. A medium-term budget framework where an MTFF, in addition, incorporates realistic projections of spending by individual agencies that allocate resources in line with strategic priorities and consistent with overall objectives of the MTFF. Moving from an MTFF to a MTBF means adding a mechanism for allocating resources between competing spending agencies, again over a multi-year horizon.
3. Lastly, a medium-term expenditure framework extends the analysis further with more detailed costing within the sectors and with performance measures. Such an MTF typically also seeks to identify and promote incentives for better public sector performance, often through the increased delegation of authority to line ministries or agencies and increased flexibility in the mode of service delivery.

Mr. Schiller elucidated the different stages of the MTFF process and guided the workshop through the different stages of macroeconomic framework, revenues, aid, expenditures, financing, fiscal policy paper, the development of Sectoral Programs, the development of Sectoral expenditure frameworks, definitions of Sectoral resource allocations, preparation of Sectoral budgets and finally the political approval. He also discussed the international experience in MTFF and the lessons from developing and transition counties.

Responding to a question on the standard recommended percentages of 60% of Debt and 3% of deficits, Mr. Schiller clarified that these figures were evolved by European countries so that in good times surpluses were available and when revenues were down, these surpluses could cover the deficits. He also clarified that MTF's differ across countries and should be designed to suit country specific needs.

In response to the question whether MTF should be linked with annual budgets Mr. Schiller clarified that it is very important that that such linkages be established. Evidently problems will arise if other departments compile the MTF and the Ministry of Finance formulates the budget, especially if the two are not in line with each other.

He also clarified that it is always difficult to work with political instability but care must be taken, when formulating estimates, to ensure that the 'up' and 'down' periods are considered with care. Conservatism with projects and constant reviews are the only way to minimize problems regarding unforeseen predictions. Many officials know when changes are expected but may be too reticent to elucidate their views or concerns and it is always important to document the assessments for future use.

Several participants expressed concern at the difficulty in obtaining information from donors especially where funding is channelled directly to departments instead of through the aid units set up by governments. Mr. Schiller clarified that it is important to be clear with donors from the start about country requirements, and perseverance in requesting information from donors is important. Donors, on the other hand, are rarely certain of the details of the financial information required by the Ministry of Finance because their main contacts are with the Ministry of Foreign Affairs.

Summing up the discussions, Mr. Joshi stated that MTFFs are important but there is a need for comprehensive availability of information to make them realistic. Donor information is important but often the details are available within the various constituents of a national government. It is therefore important to set up systems to collate this information correctly, and on time, and factor them in the budget. This data can then be supplemented by donors if a format for collecting such information is provided by governments to donors, as has been done in several countries.

AUSAID: Kylie Coulson, Nick Cumpston – Public Expenditure and Financial Accountability (PEFA) Framework. (See PowerPoint doc for detail)

The presenters explained the basis and working of PEFA assessments, emphasizing the fact that PEFA assessments should be country driven. PEFA is a diagnostic tool for identifying strengths and weaknesses in planning, budgeting and financial management systems and the framework has been developed as a collaborative effort by donors including the World Bank, IMF, EU, DFID and others. PEFA provides a comprehensive, consistent and objective assessment of public financial management systems, facilitates a common understanding of reform priorities between donors and partner countries and reduces the burden from hosting multiple assessment missions. So far, PEFA assessments have been conducted in Fiji, PNG, Vanuatu, Tuvalu and Samoa. The draft principles of donor engagement indicate that PEFA will be used by donors as a common means for assessment of public financial management, will be used to inform and support partner country-led reform efforts, and will be used to support harmonization and the use of country systems.

In response to queries, they clarified that such assessments cover donor and government funds so that the entire expenditure is covered. It was emphasized that PEFA assessments should not be viewed as documents prepared for the benefit of the donors but instead as a tool for the partner country to assess and improve its own systems. It helps identify problems and areas of concern so that measures can be taken to act on these to improve country practices and ensure future progress.

12:30pm Lunch

2:10pm **Sanjesh Naidu – Brief Note on FEMM issues** (See PowerPoint doc for detail)

Mr. Naidu discussed the promotion of good governance & public financial management and the interface of forum eight principles to promote this aim. He explained the forum eight principles, which cover areas of budget process, audits, loans & guarantees through the parliamentary system, awarding and reporting of contracts, formulation and implementation of regulations & discipline, disclosure, the role of the Auditor General and the Ombudsman’s Office and the independence of Reserve Banks. The Forum encourages performance budgeting, having credible estimates and ensuring that laws are comprehensive and up to date.

2:35pm **Bruce Taplin – Revenue Estimates in Multi Year Budgets**

Mr. Taplin explained that revenues need to be forecasted in the medium term because it sets the context of the medium term budgets, helps give direction to short term budgets, and puts short term changes in perspective. He emphasized the defensibility and plausibility of medium term forecasts and the need to underestimate, rather than overestimate revenues, so that frequent changes are not necessary in times of uncertainty. Partial indicators should be avoided and economic fundamentals should be used. These include government policy reforms, developments in world markets, population growth, productivity improvements, current business investments

and past trend growth. However, in most countries the issues are similar, it is the solutions that varies. The focus must, however, be on revenue generation rather than on expenditures. On comments from the participants that it was difficult to integrate policy changes into forecasts due to political interference, Mr. Taplin mentioned that if a strong bureaucracy advises the politicians dispassionately, they could influence the ministers to act wisely.

3:50pm Afternoon Tea break.

4:10pm **Country Presentations**
Kelera Vakaloloma – Fiji
Colin Tavi – Vanuatu
(See PowerPoint documents for details)

Presentations were made both by Fiji and Vanuatu to explain the way in which medium terms frameworks are deployed in these two countries.

The session ended with Mr. Joshi concluding that it takes time to implement and monitor any kind of system effectively. The various pre-conditions to make a medium term framework operational, especially considering the capacity constraints in the Pacific, are indicative of the need for a sustained effort to make them work. It is therefore important to start on the development of medium term frameworks carefully and only after ensuring that all the basic conditions are in place and to avoid haste.

4:45pm Close of Day 1.

6:30-9pm Dinner hosted by PFTAC.

I. MINUTES DAY 2 – 29 NOVEMBER 2006 (9 AM – 5 PM)

9:00am **Country Presentations**
Ben Pereira - Samoa.
(See PowerPoint document for details)

Continuing presentations were made by the Samoan participant to explain the way in which medium terms frameworks are employed in Samoa. Discussions were held on the nature of the computerized financial system put in place by Samoa in July 2006. The system allows personnel to be paid without restrictions, however more controls are in place for operational funding and to ensure a degree of commitment control, an operation the system currently does not ensure. While the exact costs were not indicated, it was mentioned that recently the system malfunctioned. It has since been repaired and Samoa anticipates further teething troubles before the new system is fully implemented, and its existing capacity restrictions removed.

It was also clarified by the Samoan presenter that output budgeting has actually promoted strategic thinking within the service. The participant from Solomon Islands spoke about their experience and explained that while they also changed software, they ran trials for 2 full years prior to full use. However, problems do persist and it is important to ensure that there are back up plans – recently the system developed a virus and it took 2 weeks to fix – to avoid time lost to the Ministry.

Participants also made the points that there should be more support available to implement systems and while it does not matter which system is chosen, it is extremely important to ensure that on-going training is provided widely to prevent large scale capacity attrition, merely because a few personnel leave.

Mr. Joshi summed up by saying that computerized systems need to be introduced with care. This is because while they provide solutions, several issues need to be addressed before a system yields optimal results. It is important to ensure that change management is effective, adequate amount of staff training is provided and a thorough use made of the system before it is accepted and operationalised. The introduction of any computerized system means major changes in the way work would be conducted in the future, and these concerns must be addressed properly before a system can work effectively and efficiently.

10:00am **Christian Schiller – What is IMF?**
Brief on 'The International Monetary Fund' - it's purpose , structure and benefits. (See PowerPoint document for details).

Mr. Schiller made a brief presentation on the nature and role of the International Monetary Fund. He clarified that the IMF is not a development bank, but is more in the nature of an international cooperative financial institution. The IMF also conducts surveillance of member countries' economies and provides technical assistance in a number of areas. While it does not fund specific projects, it does make foreign exchange available to member countries' central banks to finance imports.

Answering a question on the cost of joining the IMF, Mr. Schiller explained that the cost of membership dependent on size and circumstances of the country, and that a deposit is made upon membership. IMF offers a variety of services to its members, and this includes offering technical assistance either directly through missions or through PFTAC. Training opportunities are available in Washington DC, and since PFTAC can recommend recipients to attend from certain countries either in these or other courses, Mr. Schiller recommended that participants could contact Mr. Joshi for further assistance.

10:32am **Bruce Taplin** – briefed on Case study exercise for Medium Term Fiscal Frameworks to be reconvened after the break.

11:07am Tea break.

11:40am **Bruce Taplin –** continue with Case Study Exercises introducing a basic scenario of MTF based on assumptions available.

12:35pm **David Abbott – Pro-Poor Policies** (See PowerPoint document for details)

Mr. Abbot explained that Pro-poor policy aims to target those who are most disadvantaged, in income, opportunity or hardship and that such policies lead to an increase in the income levels of the poor faster than the average rate of growth in income as a whole, a reduction in recorded poverty levels: MDG 1 and national poverty lines, an improvement in other MDG indicators, and lastly, an improvement in the HDI and HPI indicators. Regrettably, MDG Reports suggest that growth has not been pro-poor - or at least not sufficiently pro-poor to be making a real impact on poverty and MDGs and much more needs to be done in this area. A focus area should be to address weak fiscal situations and poorly defined budget parameters and priorities so that budget allocations are priority or policy driven and linked to national strategies. It is also important to have transparent budgets, realistic exchange rates, efficient financial intermediation and economic openness. To achieve results it is important to have a sound macroeconomic and fiscal policy framework and developing pro-poor, performance oriented budgets, to enable delivery of cost-effective, efficient and quality services for all.

1:15pm Lunch

2:10pm **Christian Schiller – Issues, Challenges & Lessons**
IMF and World Bank issues from experiences with countries in Medium Term Frameworks (MTF). (See PowerPoint document for details)

Mr. Schiller explained how the fiscal policy paper lies at the heart of any MTF. An explicit statement of fiscal policy with a target for the fiscal deficit for the budget year, and a planned path for the fiscal deficit in the two following years are necessary for the implementation of a good MTF.

Essentially, such a document should explain the national goals of economic policy — growth targets, and inflation and balance of payments objectives—and link these to the fiscal and monetary instruments available to the government. Such a policy statement should be stable over time, realistic and transparent and be easily understandable for senior government officials and parliamentarians.

There are certain basic essentials for setting up MTFs. In general, countries prepare a baseline scenario built on current tax policies and conservative assumptions for foreign aid and borrowing. Such a baseline scenario may include new expenditure programs, if the estimates for revenues, aid and borrowing allow it. Alternative scenarios could then be explored on the basis of different assumptions.

Secondly, the government must have a macroeconomic forecasting capacity and be able to set realistic envelopes for total government expenditure within the medium term. This in turn requires the capability to quantitatively assess likely balance of payments developments, inflation and monetary trends.

Thirdly, allowance must be made for cyclical factors by accommodating the variation in certain well defined expenditure programs. Such an approach imposes fiscal discipline during upswings when policymakers are tempted to use those resources for other expenditure programs. Factoring in of inflation correctly is another important area where care needs to be exercised.

Fourthly, the question of the scope of the MTF is crucially dependent on the ultimate objective of the MTF. In its widest interpretation, if the focus is more on macroeconomic stability and fiscal control, the coverage should be as broad as possible and the key concern is the extent of total public sector borrowing and of total public sector spending, central and local. A narrower approach is to view the MTF as an adjunct to the central government's annual budget and focus on central government revenue and expenditures only.

Fifth, the time horizon of the MTF and the inclusion of a proper planning and contingency reserves is also important.

Studies across the world have identified several areas where care must be taken so as to ensure that a proper and effective MTF is established. These are:

- Political commitment and endorsement at the highest level to make the MTF process a serious and meaningful exercise;
- Strong management of donors to ensure they operate within the framework of the MTF;
- Willingness to subject policy decisions with financial implications, made outside the budget process, to the discipline of the MTF;
- Understanding of, and commitment to, the difficult decisions at the line ministry level, that need to be made;
- Commitment at all levels to abide by the MTF decision so that new expenditure decisions are not introduced in a way that overturns the MTF agreement;
- Improvements in expenditure control so that the MTF is not undermined by over expenditures and reallocations during budget implementation;
- Improved macroeconomic management and revenue collection so that revenue shortfalls do not necessitate adjustments to the budget estimates;
- Briefings of politicians and senior managers during implementation;
- Improvements to expenditure reporting on results; and
- Development of a computerized accounting system.

These imperatives suggest a need to:

- Start with a simple medium-term framework;
- MTEFs should not be launched in selected sectors until there are medium-term ceilings in place;
- Integration of capital and recurrent budgets need to be done immediately;
- Performance information (outcomes, outputs) need not be incorporated immediately;
- Flexibility for spending ministries to allocate resources across programs and activities can be introduced gradually;
- It will be easier for line ministries to find savings within their sectoral allocations when accounting systems are in place that provide good information on program and activity costs;
- Recognize the value of a multi-year budget perspective;
- Also recognize that one MTF approach does not fit all;
- Recognize that the development of an MTF is a gradual process;
- Recognize the importance of government wide involvement; and
- Recognize the importance of producing reliable multi-year budget estimates.

In short, a number of concerns need to be addressed before a proper and effective MTF can be established.

3:45pm Afternoon Tea break

4:05pm **Country Discussions - MTF**
Round the table comments on country situations and proposed preconditions elucidated in Mr. Schiller's second key note address.

The various issues raised in the previous key note address were commented upon by each participant. It was the consensus that in general that MTFs will be useful and should be implemented, if not already done, within all participating countries. The immediate challenge will, however, be to convince Ministers to buy into the concept. There were general disappointments regarding obtaining information from donors and some participants felt that many donors tend to dictate procedures to recipient countries to suit their own requirements. Participating donors advised that their reporting and financial recording systems are very good and that availability of information was not a constraint. Countries should be aware that the information is being sent but perhaps not being filtered to the appropriate departments and they only need to ask for the information. However, presenting donors with a format in which to provide information helps donors identify the needs more precisely and allows quicker availability of information to the recipient. It was the consensus that greater dialogue with donors will help resolve such issues and that several steps need to be taken before an effective MTF system can be established.

5:10pm Close of Day 2

6:30-9pm Dinner hosted by The Australian AID Office.

MINUTES DAY 3 – 30 November 2006 (9am – 1:00pm)

9:00 am **Country Discussions - MTF**

Round the table comments on country situations and proposed preconditions elucidated in Mr. Schiller's second key note address continued.

It was concluded that standard practices will work better if filtered from the top and a strong bureaucracy, able to maintain sound systems from the bottom up can also help this process considerably. Positive changes will become visible providing officials constantly prepare forward estimates and maintain the process. The need to bring about fundamental improvements in processes, as a precursor to good MTFs, was recognized.

10:30am Tea break.

10.45 am **Ms. Carol Flore-Smereczniak, UNDP. Improving aid coordination and management** (See PowerPoint document for details)

Ms. Flore-Smereczniak mentioned that aid effectiveness means governments taking the lead in determining their national priorities, and leading the process of an MDG-based poverty reduction strategy. Traditionally, this has often been donor-driven, and so requires an important shift in perception now to put countries in the lead. The process should be participatory and consultative, both among government ministries, at the different levels of government (central, local, provincial) and between government and other stakeholders.

She emphasized that once national priorities are determined and strategies formulated, governments need to estimate how much it will cost to implement national plans or national strategies, looking at the short, medium and long term time frames. The cost of strengthening capacities or institutions to do these needs assessment or cost estimates should be included in the budgets and MTBFs to make them comprehensive. Once the cost is known, Governments then look at how it will finance implementation on a medium-term basis, and annually, considering both domestic resources and aid resources. She highlighted the issue that aid is part of the available resource envelope to finance development, and not additional resources and should be included comprehensively.

The point was also made that the principle of mutual accountability ensures that both governments and donors are accountable. This means that countries need to have stronger accountability frameworks (stronger institutions, stronger parliamentary oversight, etc), and that governments should be more accountable to their parliaments and their people on what they do with resources, but also that donors should be more supportive to countries. In addition, there are 12 indicators of aid effectiveness, and these are a very good starting points for thinking about how to improve aid effectiveness in countries. Experience also shows that governments are best able to exert ownership and influence aid allocation if the national development strategies are matched by sector strategies, which are themselves reflected in the national budget framework. Therefore the different linkages from the development strategies to the MTEF to the policies and sector levels are important. The session concluded with the lesson that to use aid effectively it is important to strengthen aid policies and architecture and the dialogue mechanisms, and integrating aid into the budget.

11:30 am- **Mr. S. Joshi - Feedback from participants, lessons learnt, needs identification and the way forward**

Mr. Joshi thanked Cook Islands for offering to host the next PIFMA meeting at Rorotonga from 28-30 Nov. 2006. He requested all participants to complete the feed back forms provided and opened the discussion on the main theme for the next PIFMA meeting. Three topics were suggested :

- Improved cash management practices and control of commitments;
- Transparent Fiscal Policy- Introduction of Fiscal Responsibly Acts and their implementation in the Pacific Region; and
- Performance Budgeting-challenges and opportunities.

In the context for the discussions over the last two days on the several preconditions to an effective MTFF systems, it was agreed by all participants that there was a great need to strengthen basic information and management systems. The workshop agreed that the main theme for the next PIFMA meeting at the Cook Islands should be "Improved cash management practices and control of commitments".

12 noon- **Closing Statement –MTBF- Challenges and Solutions- Minister of Finance, Tonga.** (please see detailed speech)
In the absence of the Hon. Minister, his speech was read out by Ms. Susan Adams.

12.25 pm- S. Joshi- Closing and Vote of Thanks

The workshop was closed by Mr. Joshi who thanked all the participants and the donors for making it so successful. He also thanked the Government of Palau for their offer to host the next PIFMA meeting.

Public Finances: Medium-term Frameworks---Benefits, Taxonomy, Stages and International Experience

November 28-30, 2006

Presenter:

Christian Schiller

Presented November 28, 2006

Many countries employ multi-year policy and planning frameworks

- Over sixty percent of OECD countries have a published medium-term framework with targets and ceilings for expenditure, deficits and revenues covering in most cases a three year horizon.
- All EU countries produce annual reports on their medium- and long term budgetary strategy that include a medium-term objective for the budget position and the expected path of the debt to GDP ratio.
- MTFs are increasingly being implemented in developing countries. There has been a big push in Anglophone African countries in the mid 1990s with the World Bank taking the lead role.

Many countries employ multi-year policy and planning frameworks

- At the same time, long-term fiscal frameworks, that exceed a five year time horizon, are increasingly being used to asses the forward impact of current policies or to examine new policy options.
- Analyses of public debt sustainability commonly rely on medium-term to long-term projections of the debt-to-GDP ratio given macroeconomic forecasts and fiscal policy assumptions.
- It should also be clarified that multi-year budgeting in the sense of appropriations extending beyond a single budget year, is not the focus of medium term fiscal frameworks.

The Case for Medium-term frameworks: Why introduce a medium term framework?

- Proponents of the MTF approach argue that medium-term frameworks help governments to do better in terms of the key objectives of PFM systems.
- Macrofiscal discipline and stability—the first objective of a good PFM system is to help ensure macro fiscal discipline and stability.
- Strategic allocation of resources—the second objective of a good PFM system is to enable government to match government expenditures with government policy.
- Technical efficiency—the third objective of a good PFM system is to get the most from each Dollar spent.

The Case for Medium-term frameworks: Why introduce a medium term framework?

- Let us look at each of these three objectives in terms of MTFs.
- From a different perspective, nearly all decisions taken by a government today have an impact that transcends the present year and the single budget period.
- I want to conclude this discussion with a caveat: Developing a comprehensive MTF can be effective when circumstances permit. Otherwise it might be a great consumer of time and resources and might distract attention from the immediate needs for improving the annual budget and budget execution process.

Taxonomy: MTFs--Fiscal, Budgetary, and Expenditure

- The MTFs that exist in different countries differ in terms of what they do and what they do not to. Some are very detailed and complex. Others are less sophisticated and easier to operate.
- Medium-term fiscal framework (MTFF). A medium-term fiscal framework provides a top-down statement of fiscal policy objectives . The sector strategies are typically not disaggregated to spending agencies. In terms of the three main goals of PFM, the focus of the MTF is clearly on the first one, i.e. maintaining aggregate fiscal discipline.

Taxonomy: MTFs--Fiscal, Budgetary, and Expenditure

- Medium-term budget framework (MTBF). A medium-term budget framework is an MTFF that in addition incorporates realistic projections of spending by individual agencies (e.g. line ministries) that allocate resources in line with strategic priorities and consistent with overall objectives of the MTFF.
- Medium-term expenditure framework (MTEF). A medium-term expenditure framework extends the analysis further with more detailed costing within the sectors and with performance measures.
- Medium-term fiscal and monetary framework (MTFMF). To conclude, a medium term fiscal and monetary framework (MTFMF) extends the analysis of an MTFF further, with the focus on monetary and fiscal policy coordination.

Stages of an MTF process

- We go through the whole process of a medium term framework and discuss what is implied or what the issues are at different stages of the process.
- Stage 1: Macroeconomic framework, revenues, aid, expenditures, financing, fiscal policy paper.
- Macroeconomic framework: The process begins with the development of a sound forecast for the macroeconomic framework.

Stages of an MTF process

- A useful framework for developing a sound macroeconomic forecast is the IMF's financial programming exercise. It basically uses accounting identities that brings together the fiscal, the external, the monetary and the real sectors.
- Countries use a variety of techniques to assure sound economic estimates.
- Revenue envelope: Once the macroeconomic estimates for the balance of payments, the monetary sector and the real sector are prepared, sound estimates of government revenue need to be developed.

Stages of an MTF process

- External aid: External aid needs to be estimated for the three years under review. This is typically a very challenging task for several reasons.
- Expenditure: With conservative economic estimates in hand, the Ministry of Finance can prepare broad expenditure estimates based on current policies. It is important to explicitly note that this covers all expenditures. Otherwise, the picture is only partial.
- These initial estimates are often termed "baseline" estimates.

Stages of an MTF process

- Deficit and financing: Revenues minus expenditure equals the fiscal balance that, if in deficit, needs to be financed from either domestic or foreign sources. Financing from the banking sector is one part of domestic financing; the other one is non-bank financing.
- Fiscal Policy Paper: The Fiscal Policy paper lies at the heart of a MTF. This document draws together the results of the macro-fiscal forecasting exercise into an understandable report of trends and policy implications for senior government officials.

Stages of an MTF process

- Typically, the fiscal policy paper would be presented to Cabinet for discussion, with the objective of obtaining some Cabinet decision on overall revenue, expenditure and deficit in a medium term context.
- Countries follow different practices in releasing the fiscal policy and expenditure estimates to the Parliament and the public.
- Stage 2: Development of Sectoral Programs (bottom up sector programs). This stage can proceed in parallel with stage one and involves a sector review process though which sector/ministry objectives and activities are agreed and then costed.

Stages of an MTF process

- The sector review process consists of (i) agreeing on objectives, outputs and activities for the sector; (ii) reviewing agreed and developing new programs; and costing these programs.
- Costing these programs over a medium-term period needs information.
- Generally, there are two forms of parameters: economic and program specific.
- At this stage, ministries also need to go through the process of ranking activities and assessing, which activities could be scaled back or expanded if wanted.

Stages of an MTF process

- Ministries can also develop performance indicators for programs so that over time, there can be greater emphasis on what ministries are achieving with the resources they are given.
- Stage 3: Development of Sectoral Expenditure Framework. With the macroeconomic framework and the sector reviews in hand, the Ministry of Finance now typically develops an expenditure framework that includes allocations by sectors or ministries.

Stages of an MTF process

- This stage involves first a series of hearings between the Ministry of Finance and the sector ministries to go over their projections. The next step is the development of a sectoral expenditure framework.
- Stage 4: Definition of Sector Resource allocation. This is a crucial stage of the MTF process and requires the main decision-making body in government such as the Cabinet to make medium-term sectoral resource allocations on the basis of available resources and intersectoral priorities.

Stages of an MTF process

- An unallocated contingency can be withheld to cope with uncertainties and to allow for adjustments for unexpected expenditures.
- Stage 5: Preparation of sectoral budgets. Having received sector or ministry indicative ceilings, each Ministry must develop its budget proposal.
- Stage 6: Final political approval. The final stage is the final political approval. The final stage will take different forms depending on the structure of the budget process.

International experience

- MTFs differ across countries.
- MTFs in OECD countries. Over the last decade or so, a large number of OECD countries have introduced significant reforms in PFM. Three general trends can be discerned.

International experience

- The following summarizes salient features of some of these reform efforts in a number of countries.
- Austria
- Germany
- Great Britain
- Australia
- New Zealand
- United States of America

International experience

- Medium term frameworks in developing and transition countries
- In 2001, the World Bank estimated that 25 developing countries in Africa, Asia, Latin America, and Eastern Europe were at various stages in implementing a MTF.
- Among transitional countries, the new budget codes for the Russian Federation and Kazakhstan (adopted in 1998 and 1999, respectively) require the inclusion of a multi-year perspective in the annual budget process.

END OF SLIDES ------

Annex - Chapter 1 part 2

Public Finances: Medium-term Frameworks --- Issues, Challenges and Lessons

November 28-30, 2006

Presenter:

Christian Schiller

Presented 29 November 2006

Issues in the design and implementation of MTFs

- In this section, we will discuss a number of issues that are critical for the design and implementation of MTFs. In the discussion, we follow Diamond.
- Clarity in the policy statement. The fiscal policy paper lies at the heart of the MTF.
- This document draws together the results of the macro-fiscal forecasting exercise.

Issues in the design and implementation of MTFs

- An issue is, to what extent the policy statement will be endorsed, (i) by the Minister of Finance; (ii) by the Cabinet of Ministers; or (iii) by the Parliament.
- Distinction between new and old policy. An MTF generally requires that a clear distinction be drawn between expenditures associated with new and with existing policies.

Issues in the design and implementation of MTFs

- Allowance for cyclical factors. A number of countries make allowance for cyclical factors by accommodating the variation in certain well defined expenditure programs.
- Inflation. The question arises whether expenditures should be forecast in terms of cash or in terms of volume, i.e. at constant prices.
- Constant-prices projections are technically more difficult to undertake.

Issues in the design and implementation of MTFs

- Coverage. The question of the scope of the MTF is crucially dependent on the ultimate objective of the MTF.
- In its widest interpretation, if the focus is more on macroeconomic stability and fiscal control, the coverage should be as broad as possible.
- A narrower approach is to view the MTF as an adjunct to the central government's annual budget and focus on central government revenue and expenditure only.

Issues in the design and implementation of MTFs

- Time horizon. While practice has varied there is a growing consensus for MTFs of three to four years, with the majority of OECD countries now using three years.
- While there seems to be a growing consensus that estimates beyond three years become increasingly unreliable and should not be given official status, there are questions where the government should look much further forward, for example questions about the consequences of existing health and pension policies as the population ages.

Issues in the design and implementation of MTFs

- The inclusion of a planning and contingency reserve. A planning reserve can be defined as a reserve in the forward years available to be allocated for provision to priority expenditures in forthcoming annual budget negotiations.
- Reserves accommodate uncertainties of several types.
- How high should such a reserve be? Generally speaking, it should be high enough to cover all the uncertainties but should not be so high that it negates efficient budgeting.

Lessons from Africa

- ***The World Bank has made the development of MTFs a center of its reform efforts in PFM in many of the countries in Africa where the Bank is active.***
- ***Importance of initial PEM conditions. In order to work, the MTF must rest upon a good macro-fiscal model. Good, realistic macro-fiscal projections are key to the success of an MTF.***

Lessons

- World Bank recommendation 1: Lay the foundations---The MTF should be seen as a complement to, not a substitute for, basic budgetary reform. Before launching an MTF reform, a comprehensive and detailed diagnosis of the most important PEM problems should be undertaken.
- Sequencing MTF Reforms. MTF have been implemented both in a phased and in a piloted manner.

Lessons

- World Bank recommendation 2: Adopt the piloting and phasing to existing capacity. The World Bank is in my view a bit vague in terms of what they recommend..
- Integrating the MTF with the Existing Budget Process. Many countries have experienced problems integrating the MTF with the existing budget process.

Lessons

- World Bank recommendation 3: As the building blocks of the MTF are developed, they should be built into the budget process from the start. There should not be parallel budget and MTF processes.
- How the MTF is issued, approved and disseminated. If the MTF is part of the budget presentation and adoption, the issue is moot. If not, the way in which the MTF is issued and approved matters.

Lessons

- World Bank recommendation 4: The MTF needs to make the transition from an internal, technical document to a public, politically backed plan. The MTF should be published as part of the budget document.
- The design of the MTEF Management Structures. The design of the MTF management structures, which has not received much attention, across various African countries, though most countries use a combination of existing and ad hoc management structures.

Lessons

- World Bank recommendation 5: Though each country's budget management process is distinct, and thus each MTF management structure will have to be designed accordingly, the African cases suggest that MTF reforms should be managed by a combination of existing departments and new MTF-specific units in order to provide the support necessary for implementation.
- Standardization of the MTF. Standardization of the MTF components, in particular, the sectoral components, also matters.

Lessons

- World Bank recommendation 6: The sectoral plans should be developed according to centrally agreed upon guidelines, which should be published, and a realistic timetable, based on capacity constraints.
- The relevance of the political and institutional dimensions. Most MTF efforts in Africa have focused on the technical to the detriment of the political and the institutional.

Lessons

- In many of the cases, the bank played a major role in the introduction of the MTF. Political support for the MTFs varied across cases and helps to explain why some MTFs were more successful than others. Some of the reforms were "owned" by the countries; others were not.
- In the case of sectoral ministries, in some countries, they were heavily involved; in others not.

Lessons

- World Bank recommendation 7: The political and institutional dimensions of the MTF reform must be explicitly addressed. Though specific measures to increase the overall credibility of the reform will vary, reformers would do well to build in positive incentives for implementation.

Lessons from the Pacific

– I would like to conclude the paper with some lessons that we have drawn from this workshop. I have included in this draft a list of lessons, taken from World Bank's public expenditure management handbook from 1998, a presentation of Bill Dorotinsky, World Bank expert, on medium term frameworks in Washington in 2006 and the Paper by Boex, Martinez and McNab of 2000.

– World Bank (1998)

Lessons from the Pacific

- Political commitment and endorsement at the highest level to make the MTF process a serious and meaningful exercise.
- Strong management of donors to ensure they operate with the framework of the MTF.
- Willingness to subject policy decisions with financial implications, made outside the budget process, to the discipline of the MTF.
- Understanding of, and commitment to, the difficult decisions at the line ministry level, that need to be made.

World Bank (1998)

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- Strong management of donors to ensure they operate with the framework of the MTF.
- Willingness to subject policy decisions with financial implications, made outside the budget process, to the discipline of the MTF.
- Understanding of, and commitment to, the difficult decisions at the line ministry level, that need to be made.
- Commitment at all levels to abide by the MTF decision so that new expenditure decisions are not introduced in a way that overturns the MTF agreement.

World Bank (1998)

- Improvements in expenditure control so that the MTF is not undermined by overexpenditures and reallocations during budget implementation.
- Improved macroeconomic management and revenue collection so that revenue shortfalls do not necessitate adjustments to the budget estimates.
- Briefings of politicians and senior managers during implementation.
- Improvements to expenditure reporting on results.
- Development of a computerized accounting system.

Bill Dorotinsky (2006)

- Start with a MTFF, a simple medium-term framework.
- MTEFs should not be launched in selected sectors until there are medium-term ceilings in place.
- Integration of capital and recurrent budgets need to be done immediately.
- Performance information (outcomes, outputs) need not be incorporated immediately.
- Flexibility for spending ministries to allocate resources across programs and activities can be introduced gradually.
- It will be easier for line ministries to find savings within their sectoral allocations when accounting systems are in place that provide good information on program and activity costs.

Boex, Martinez and McNab (2000)

- Recognize the value of a multi-year budget perspective
- One MTF approach does not fit all.
- The development of an MTF is a gradual process.
- The importance of government wide involvement.
- The importance of producing reliable multi-year budget estimates.

Chapter 3

Forum eight principles of accountability, and related implementation progress in Forum Island Countries[1]

The Pacific Islands Forum Secretariat (PIFS) was invited to make a presentation on the *Forum Eight Principles of Accountability* at the Medium Term Fiscal Framework (MTFF) Workshop. This paper summarizes the key issues, messages and conclusions from the presentation.

The FEMM good governance decisions encompass the Ministerial adoption of the **Forum Eight Principles of Accountability** in 1997, including supplementary notes in 1998. The adoption of these supplementary notes follows consideration by the Ministers of the *IMF Code of Principles and Good Practices on Fiscal Transparency*, which was used to draw out practical steps toward the implement of the Eight Principles. The principles and supplementary notes are annexed to this paper.

The accompanying reform measures contribute not only to the achievement of accountability and good governance, but also to effective and efficient fiscal management and policy. This is done through establishing a transparent framework for public financial management that can be monitored and understood by oversight bodies such as the Parliament, and also by the general public.

Provided below is a brief description of the principles:

(i) **Principle 1:** *Budget processes, including multi-year frameworks, to ensure Parliament/Congress is sufficiently informed to understand the longer term implications of appropriation decisions.*

(ii) **Principle 2:** *The accounts of governments, state-owned enterprises and statutory corporations to be promptly and fully audited.*

(iii) **Principle 3:** *Loan agreements or guarantees entered into by governments to be presented to Parliament/Congress.*

(iv) **Principle 4:** *All government and public sector contracts to be competitively awarded, and publicly reported.*

(v) **Principle 5:** *Contravention of financial regulations to be promptly disciplined.*

[1] This chapter was written by Mr. Sanjesh Naidu, Economic Advisor, Pacific Islands Forum Secretariat, after the workshop.

(vi) **Principle 6:** *Public Accounts Committees of the legislature to be empowered to require disclosure.*

(vii) **Principle 7:** *Auditor General and Ombudsman to be provided with adequate fiscal resources and independent reporting rights to Parliament/Congress.*

(viii) **Principle 8:** *Central bank with statutory responsibility for non-partisan monitoring and advice, and regular and independent publication of informative reports.*

The first and third principles focus on transparency in fiscal management of the economy. They also suggest that budgets be presented over a multi-year framework in order that the implications of current and new fiscal policies can be well understood. A key element is the need to provide Parliament or Congress with all the information used to compile the budget in order that the longer term implications of appropriation decisions can be better understood and debated.

Furthermore, principle one inherently implies that the budget needs to present all the details of fiscal performance including the results of audits and other evaluations, and the assessed impact including on the key objectives previously specified for major programs. In addition, the budget presentation papers also need to include forecasts of the key budget figures for at least two years in advance together with the details of the assumptions on which they are based and the policy objectives they are meant to serve.

Principles 4 and 5 are also of particular interest since they involve specific public fiscal and financial management functions. Principle 4 relates to the need for all government and public sector contracts to be openly advertised, competitively awarded, administered and publicly reported. This principle is expected to be enshrined in the law.

Principle 5 relates to the need for the principal and subordinate laws and instructions governing fiscal and financial management to be comprehensive, up-to-date and workable. The administration of the legal framework governing fiscal and financial management should be active and vigorous.

The bulk of the remaining principles deal with accountability of government for its financial resources and the way in which these have been used. These deal with the processes of reporting expenditures or the use of capital assets, the sanctions on those misusing these resources and the powers to investigate these matters. In addition, the independence of monetary policy formulation and functions is also an explicitly stated requirement.

At the 2003 FEMM, Ministers noted the importance of ensuring the implementation of key FEMM decisions and the role of biennial stocktakes, as requested in 2002, in measuring this progress at both the national and regional level. Ministers agreed to:

endorse the framework for biennial FEMM stocktakes, noting in particular the requirements this places on input from member countries.

Thus, the Stocktake provides a status report on each FIC's implementation of key areas of FEMM Action Plans. In addition, the Stocktake report also highlights barriers to implementation of FEMM decisions and efforts to overcome these barriers. The key areas for examination are:

(ix) *good governance (which encompasses the Forum Eight Principles of Accountability);*
(x) *economic reforms;*
(xi) *financial reforms; and*
(xii) *public enterprise reforms.*

The **2006 FEMM Stocktake** highlighted the most recent performance of FICs in implementing FEMM decisions in these four areas. The efforts of all fourteen FICs in responding to the stocktake survey helped form a very strong basis of a review of implementation of FEMM decisions in the key reform areas.

Generally FICs' responses indicated that there is strong commitment to implementation of the Forum Eight Principles of Accountability but some divergence in the extent of actual compliance. Nonetheless, ongoing improvements in implementation over the past two year indicate that the region is making a concerted effort to move in the direction of improved transparency and accountability. Of the four areas examined in the stocktake, on average these principles were the best implemented.

FICs highlighted that difficulties in implementing the Eight Principles were related in the main to a lack of technical capacity and human resources – issues which are of course to some degree linked. A base situation of restricted human resources was considered to be exacerbated by high levels of staff turnover (including as a result of migration) and absences on study leave. This generally stretched human resource situation is then in turn often exacerbated by the need to learn new skills, and in cases poor management of human resources, thus impacting on the stock of technical skills available to government to implement reforms.

Whilst in general the principles are quite well implemented, there is still a significant degree of divergence amongst the eight principles. Whilst progress in some areas is still slow, others are close to full implementation, or are already fully implemented.

For example, problems persist with the implementation of **principle 1**, which advocates multi-year budget frameworks, capable of providing good quality information regarding the long term impact of appropriation decisions. The vast majority of FICs have still to implement this principle, and yet budgeting is a core responsibility of finance ministries and treasuries. There is an obvious need to focus attention on meeting the technical skill gaps here in order to move towards achievement of this very important principle.

Other principles are, however, more successfully implemented. For example, **Principle 3**, which refers to the need for loan agreements to be presented to Parliament with enough information to allow Parliament, or Congress, to make an informed decision regarding the loan, has a high and rising level of compliance. Moreover, **principle 8** on the independent and timely provision of monitoring and advice by the Central Bank is now fully implemented.

In noting the overall progress of the implementation of the principles, the 2006 FEMM, amongst a number of other recommendations:

(i) *Renewed the commitment for the implementation of an effective accounting system, in cognizance of capacity constraints, which is capable of providing relevant and accurate information for decision makers throughout the multi-year budget process in a timely fashion; and*

(ii) *Placed continued emphasis on capacity building — both in terms of transferable technical skills and management processes — to support the implementation of reform endeavors as endorsed by FEMM.*

The 2006 FEMM also agreed that members use their stocktake responses as a basis to approach development partners for technical and financial assistance with implementation, with the Secretariat to assist with this process.

Engagement with the Pacific Islands Financial Management Association (PIFMA), in particular, is a practical means of progressing these implementation efforts through relevant information sharing and strategising at a technical level, amongst other key financial management issues.

Tools such as PEFA, are gaining interest and acceptance amongst fiscal management experts, and could be considered, on a case by case basis, in helping to strengthen priority reform areas, including fiscal management frameworks, such as MTFF.

FEMM has an abiding interest in ensuring the implementation of its key decisions and commitments. Therefore, the continued collaboration with member countries, and development and donor partners to assist with implementation remains an on-going effort. Another FEMM Stocktake is expected in 2008, with an added focus on monitoring the effectiveness of the principles endorsed by past FEMM's.

Annex to Chapter 3

FORUM EIGHT PRINCIPLES OF ACCOUNTABILITY

<u>Principle 1:</u> Budget processes, including multi-year frameworks, to ensure Parliament /Congress is sufficiently informed to understand the longer term implications of appropriation decisions.

To be fully understandable, the budget needs to present all the details of budget performance including the results of audits and other evaluations, and the assessed impact including on the key objectives previously specified for major programs (showing estimates where final figures are not available).

The budget presentation papers also need to include forecasts of the key budget figures for the next two years together with the details of the assumptions on which they are based and the policy objectives they are meant to serve.

Existing commitments should be distinguished from new policies.

Budget data, including revenue, grant and expenditure data, should be presented in a way that follows international practice and allows international comparisons.

Budgetary processes, including the full involvement of ministers, need to be directed specifically at the generation of good estimates which are properly aligned with policy and program output intentions.

In keeping the management of budget implementation under review during the course of the year, the government should give the legislature and the public timely reports as the year proceeds, as well as at year's end, which contain all of the details of actual budget performance which are needed for a full understanding of any impacts of deviations from the original budget policy intentions and estimates (using revised estimates where actual figures and results cannot be obtained).

Government operations should be subject to audit reports.

<u>Principle 2:</u> The accounts of governments, state-owned enterprises and statutory corporations to be promptly and fully audited, and the audit reports published where they can be read by the general public.

State-owned enterprises should be subject to the full force of the accounting, reporting, disclosure, and other relevant requirements of a modern regulatory framework for corporate governance adjusted to the circumstances of small island countries as appropriate.

<u>Principle 3:</u> Loan agreements or guarantees entered into by governments to be presented to Parliament/Congress, with sufficient information to enable Parliament/Congress to understand the longer term implications.

The principle should be enshrined in the law.

Presentations to the Parliament/ Congress should be timely.

<u>Principle 4:</u> All government and public sector contracts to be openly advertised, competitively awarded, administered and publicly reported.

The award of contracts should be reported publicly and immediately.

The principle should be enshrined in the law.

<u>Principle 5:</u> Contravention of financial regulations to be promptly disciplined.

The principal and subordinate laws and instructions governing fiscal and financial management should be comprehensive, up-to-date and workable.

Administration of the legal framework governing fiscal and financial management should be active and vigorous.

Ethical standards of behavior for public servants should be clear and well publicized.

There should be ready public access to the administrative laws governing access to government benefits, the application of taxes, duties, and charges, etc., which should be as specific as possible and which should limit the exercise of discretion by public servants and other holders of public office to the minimum compatible with good administration.

The exercise of discretion in public administration should be guided by clear, published criteria.

<u>Principle 6:</u> Public Accounts / Expenditure Committees of Parliament/Congress to be empowered to require disclosure.

<u>Principle 7:</u> Auditor General and Ombudsman to be provided with adequate fiscal resources and independent reporting rights to Parliament/Congress.

The principle of statutory independence should be applied to the public auditor and the ombudsman.

The law which provides for the appointment and tenure of the public auditor, and the ombudsman, and which deals with their functions, operations and resourcing, should accord with international best practice in specifying the independent functions they are to perform and fully protecting their performance from being compromised.

The law should specify the right of the two office holders to unimpeded access to the Parliament/ Congress where the office holder has grounds for believing that independence might be coming under threat.

<u>Principle 8:</u> Central bank with statutory responsibility for non-partisan monitoring and advice, and regular and independent publication of informative reports.

Revenue Estimates in Multi Year Budgets: The Pacific experience

Presentation to PFTAC Workshop on
Medium Term Budget Frameworks
28 to 30 November 2006
Bruce Taplin

Main Points

- Purpose of Medium Term Focus
- Forecasting Revenue
  - Economic Forecasts
  - Tax Administration
  - Tax Reform
  - Other Revenues, including Grants
- Procedures for Revenue Estimation
- Documentation in Budget Papers
- Link to Spending and Debt

Why Medium Term?

- Set context for Annual Budget
- Helps give direction to Annual Budget
- Puts short term changes in perspective

Why Medium Term?

- Allows large changes to be made gradually
- Shows multiyear implications of decisions
- Encourages good reforms
  - Short-term costs
  - Long-term gains
  - Multi-year analysis shows benefits

Objectives of Forecasts

- Forecasts should be Defensible
  - ie have good technical reasons
- Forecasts should be Plausible
  - ie be able to explain
- Aim for errors to be small
- Better to underestimate revenue than overestimate
  - For example, PEFA only penalises overestimates of revenue

Constructing Forecasts

- Three Elements of Tax Forecasts
  - Economic Forecasts
  - Information from Tax Administration
  - Effects of Tax Reform
- Non-Tax Revenues, including Grants
  - Similar issues

Economic Forecasts

- Real Economy
  - eg, real GDP, employment, consumption
- Inflation
  - eg, CPI, wages, production prices
- Values in Economy
  - eg, profits, interest payments

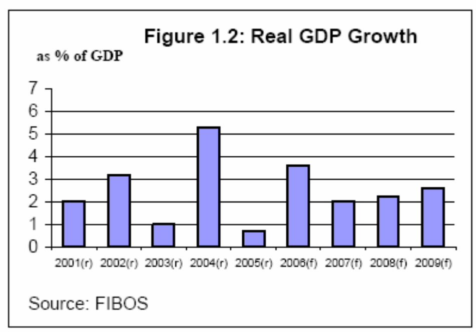
Budget Forecasts

- Forecasting past years
  - Many partial indicators
  - Use National Accounts methodology
- Forecasting the Budget Year
  - No partial indicators
  - Capture recent developments
    - eg, oil prices, CPI, weather, tourists
  - Any policy changes
    - eg, fiscal policy, industry policy

Medium Term Forecasts

- No partial indicators
- Use economic fundamentals, eg:
  - Government policy reforms
  - developments in world markets
  - population growth
  - productivity improvements
  - current business investments
  - past trend growth

Example: Fiji GDP



Administration Information

- Current Collections
- Extra administrative effort
  - eg, audit campaigns
  - eg, information on non-compliance
- Special Cases
  - eg, disputes going to court
  - eg, past disputes now resolved

Tax Reform

- Changes to Tax System affect Revenue
  - New taxes
  - Abolish old taxes
  - Changes to tax rates
  - Changes to tax bases
- Tax reform is often a package
- Medium-term consequences

Example: Samoa Measures

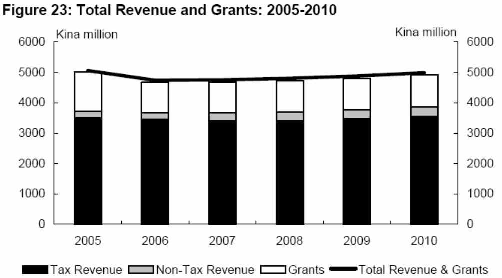
- Samoa 2006/07 Budget
- Package of Tax changes:
  - VAGST rate
  - VAGST threshold
  - Income and Company Tax Rates
  - Income Tax Threshold
  - Excise on Soft Drink, Alcohol and Tobacco
  - Administrative Fees

Other Revenues

- Non-Tax Revenues include:
  - User Charges
  - Royalties
  - Fishing Licences
  - Grants
- Similar techniques used
  - Changes in activity or exchange rates
  - Talk with administering agencies
  - Changes in revenue systems

Example: PNG Revenue

Figure 23: Total Revenue and Grants: 2005-2010



Sources: Department of Treasury, Department of National Planning and Rural Development.

Forecasting Processes

- Committees to gather information
  - Economic input
    - Treasury/Finance & central bank
  - Tax administration
  - Non-Tax Revenue agencies
  - Statistics
  - Budget
- One Individual to make decisions
  - Responsibility of Treasury/Finance

Forecasting Timetable

- Initial Revenue Estimates needed at start of budget process
  - to plan expenditure envelopes
- Final Revenue Estimates needed at end of budget process
  - to finalise budget balance
  - include tax reform decisions
  - includes new data on economy, revenue collections and policies

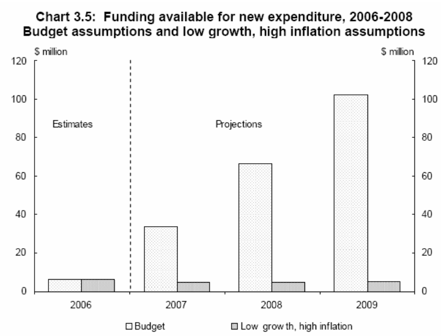
Documentation

- Write-up in Budget Papers
- Include
  - Budget Year
  - Medium Term Outlook
- Describe
  - Numbers in Tables
  - Charts and Graphs
  - Story
    - Stories explaining why are very powerful

Documentation

- Forecasts
  – What assumptions used?
  – Why does revenue change?
- Risks to Revenue
  – What risks to revenue forecasts?
  – What alternative scenarios?

Example: Solomon Island



Link to Budget

- Revenue is Linked to Expenditure
  – How much spending can revenue sustain?
  – How fast can it increase?
- Effect on Budget Deficit/Surplus
  – Budget Deficit, Surplus or Balance?
  – Debt rising or falling?
- Effect of Budget on Economic Development

Example: Tongan Budget

Table 2: Indicative Fiscal Aggregates as Shares of GDP

	2005/06	2006/07	2007/08	2008/09	2009/10
Total Revenue	35%	30%	29%	28%	28%
Ongoing Revenue	31%	30%	29%	28%	28%
Asset Sales	4%	0%	0%	0%	0%
Total Expenditure	35%	30%	29%	28%	28%
Expenditure on Wages	21%	16%	13%	10%	10%
Other Expenditure	15%	13%	16%	18%	18%
Funding Gap	**0%**	**0%**	**0%**	**0%**	**0%**

Main Points

- Purpose of Medium Term Focus
- Forecasting Revenue
  – Economic Forecasts
  – Tax Administration
  – Tax Reform
  – Other Revenues, including Grants
- Procedures for Revenue Estimation
- Documentation in Budget Papers
- Link to Spending and Debt

MEDIUM TERM FISCAL FRAMEWORK WORKSHOP

Country Presentation - FIJI

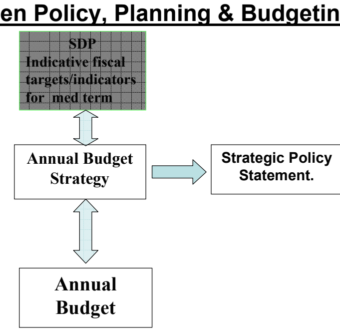
Outline

- ✓Definition
- ✓Linkages – Policy, Planning and Budget
- ✓Annual Budget Strategy
- ✓Indicative Medium Term Fiscal Framework
- ✓Annual Budget
- ✓Performance Budgeting

Definition

- MTFF – an institutional device that formally and transparently tries to link policy, planning and budgeting
- Several variants
  1. Simplest – aggregate projections for public spending for 2/3 succeeding years beyond budget year
  2. Illustrative figures for line ministries
  3. Projecting costs of policy over the medium term

Linkage between Policy, Planning & Budgeting



Linkage between Policy, Planning & Budgeting

- SDP includes indicative fiscal policies and targets/indicators over the medium term/plan period
- Annualized through Annual Budget Strategy and Strategic Policy Statements (SPS)
- SPS drawn from Budget Strategy and is a requirement under the Financial Management Act 2004 and must be tabled in Parliament on or before 30th June

Annual Budget Strategy

- Sets out indicative Medium Term Fiscal Framework
- Consultative process involving various stakeholders
- Contains revenue, expenditure, deficit, debt and GDP projections
- And policy measures to achieve the proposed targets
- Budget process and timelines

Indicative MTFF: 2007-2009

	2005 (Act)	2006 (Est.)	2007 Budget	2008 (Targets)	2009 (Targets)
Revenue	1,221.9	1,391.6	1,605.6	1,692.0	1,788.6
% GDP	*26.5%*	*28.5%*	*31.2%*	*31.1%*	*31.1%*
Expenditure	1,391.0	1,548.7	1,710.8	1,773.7	1,846.2
% GDP	*30.1%*	*31.8%*	*33.2%*	*32.6%*	*32.1%*
Deficit	168.6	157.1	105.3	81.6	57.6
% GDP Target	*3.6%*	*3.2%*	*2.0%*	*1.5%*	*1.0%*
Debt	2,422.5	2,579.6	2,684.9	2,766.5	2,824.1
% GDP	*52.5%*	*52.8%*	*52.1%*	*50.8%*	*49.1%*
*GDP at Market Prices ($m)	4,614.63 7	4,884.23 9	5,153.69 7	5,445.342	5755.12 7

Indicative MTFF – (cont')

- **Determining mid term targets**
  - ➢ Drawn from SDP
  - ➢ Past two years results sets the base for medium term fiscal targets
  - ➢ Also determined by prevailing economic climate
  - ➢ Which determines fiscal policy stance i.e. expansionary or consolidation
  - ➢ To some extent, political considerations play a role

Annual Budget

- **Sets out allocations for agencies for budget year and two forward years**
- **Simple method of projecting forward years**
  - excludes new expenditures, ongoing projects that need to be reviewed
  - Doesn't reflect salary increases or inflation factor
- **Therefore difference between MTFF forward projections and budget forward projections**

Annual Budget (cont')

Forward projections (MTFF vs Budget)

	2005 (Act)	2006 (Est.)	2007 Budget	2008 (Proj)	2009 (Proj.)
MTFF					
Expenditure	1,390.4	1,548.7	1,710.8	1,773.7	1,846.2
% GDP	*30.1%*	*31.8%*	*33.2%*	*32.6%*	*32.1%*
Budget					
Expenditure	1,390.4	1,548.7	1,710.8	1,541.2	1,487.0
% GDP	*30.1%*	*31.8%*	*33.2%*	*28.0%*	*26%*

How can we improve our forward estimates in the annual budgets???

Annual Budget - *Formulation*

- **Combination of Top down and Bottom up approach**
- **MoF sets strategy and fiscal envelope**
- **Ministry submit requests to MoF based on cost of implementing plans and policies**
- **MoF analyses submissions**
- **Consultations with agencies on proposed funding**
- **Determination of final funding for agencies**

Annual Budget

Integrating ODA into Budget

- As much as possible, cash grants and Aid-in-kind incorporated into budget e.g 2006 budget - $60m; 2007 Budget - $78.3m
- Issue - Ad hoc assistance that's not reflected in budget and direct assistance to agencies
- To address problem - closed off all trust accounts with agencies, moved into a Centrally Managed Trust Fund (CMTF), managed by MoF
- Problem still persists – about $7.5m sitting in CMTF and has been increasing
- Next step – by March 2007 close off CMTF and all to be reflected in budget 2008
- Those not reflected to be returned to donors

Annual Budget

Issues - Integrating ODA into Budget

- Trust fund is outside of govt. system - not recorded as part of govt. finances
- Donors bypassing govt. procedures by liaising directly with agencies - MoF unable to know total assistance given to agencies, could have therefore directed govt. funds to other areas
- Assistance doesn't materialise – as budget reflects indicative figures -where cash grants involved, it affects our revenue projections e.g. 2006 - $60m budgeted, revised projections $50.4m

Performance Budgeting – Progress

- Production of 2006 Portfolio Performance Statement (PPS)
  - Able to link SDP to PPS to Annual Corporate Plan – to some extent addresses problem of linkage of policies to budget
  - PPS has formed basis for formulation of ACP – mandatory requirement for 2007 ACP

Performance Budgeting – Portfolio Portfolio Statement

- Outlines
  - Outputs to be produced from budgetary allocation
  - Performance indicators/measures and targets for budget year and reports on past years performance
  - Allocation of financial resources
  - Staff distribution to outputs

Performance Budgeting – Implementation Issues

- Reporting on performance – lack of structured system in place to regularly record agency performance
- Indicators are too detailed/comprehensive or not easily measured (lack of response from agencies)
- Or information not easy to collect
- Continue to refine as we progress

Performance Budgeting - Challenges

- Re-orientating mind set
- New concepts take time to understand – focus on training
- Commitment from top hierarchy
- Lack of dissemination of information
- Capacity constraints

THANK YOU

Medium Term Fiscal Framework (MTEF) Workshop Facilitated by PFTAC

Nadi, Fiji Islands

Vanuatu Presentation

Date: 28-30th November 2006

1

Introduction: A medium-term approach

- Vanuatu is implementing a medium-term strategic framework (MTSF) for planning and budgeting
- MTSF designed to implement the Priorities and Action Agenda 2006-2015 (PAA): Government's strategic blueprint for development
- MTEF a critical component of the MTSF
- Medium-term approach will strengthen policy, planning, financial management and development outcomes

2

Definition of the MTEF for Vanuatu

– A 6-year budget review and planning strategy

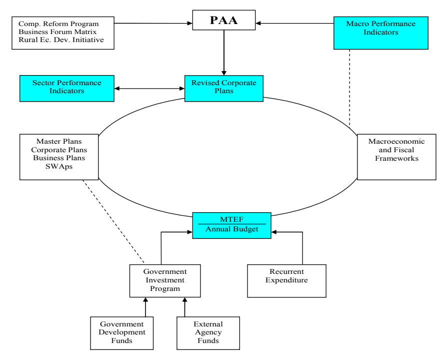
– Helps to provide fiscal and budget analysis information and helps to forecast expenditure trends

– A component of the Government's Medium Term Strategic Framework (MTSF)

MTEF is not a 5 year budget plan. It is a framework that rolls forward annually

3

Medium Term Strategic Framework (MTSF) Cycle of Activity



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Purpose of an MTEF

1) provide a medium term financial framework within revenue expectations that is tied to medium term economic and fiscal forecasts

2) tie expenditure to operational and development objectives and activities so better choices can be made

3) improve ongoing planning and monitoring to measure government performance

4) identify expenditure in terms of operational costs, development costs and debt obligation needs.

5

Initial MTEF Design Input

For the initial design of Vanuatu's MTEF and future implementation, the following inputs were required:

- Most recent Budget Documents (Volume 1: Fiscal Strategy Report; Vol. 2: Program Budget Estimates; Vol. 3: Program Budget Narrative) for all Ministries and Departments
- Final and provisional budget numbers (revenue and expenditure) for the 2 review years.
- Updated GDP estimates for the MTEF future timeframe
- Updated **Fiscal Framework** to medium term to include Revenue, Domestically Financed Operating/Capital Expenditure, and Budget Financing

6

Summary Medium Term Expenditure Framework by Ministry/Agency

	2004	2005	2006	2007	2008	2009
Ministry/Agency Expenditure by Economic Category 1. Subsidies 2. Personnel Emoluments 3. Other Goods and Services 4. Domestic Capital Expenditure						

7

Summary Medium Term Expenditure Framework by Ministry/Agency

- Also organized by Program Activity and Cost Centre (following budget breakdown)
- Government Investment Program(GIP). The GIP includes the following with the expenditure or planned expenditure allocated annually for the term of the MTEF:
  - Completed and ongoing programs/projects (with funding) during the MTEF timeframe
  - Proposed programs/projects (not implemented) with no agreed-to funding
- Ministry/agency Strategies and/or Corporate or Business Plans Revised

8

Government Investment Programs(GIP) summary Flows by Ministry/Agency FY 04-09

	2004	2005	2006	2007	2008	2009
Ministry/Agency						
Expended/Committed Funds						
Proposed Programs/Projects						
Total						

Proposed projects/programs now have funding broken down to identify recurrent costs and externally-funded development costs. This helps us identify funding gaps and look further into affordability.

9

Work currently being done

- Ministries/Agencies have to complete their future year expenditure templates so they have full expenditure frameworks
- Linkage of the MTEF to Performance Management. An Ministry/Agency Activity and Finance Performance Template was drafted. There must be a linkage between performance and finance or else the MTEF is solely numbers based.

10

Issues

1. Political Commitment

2. MTEF is a new budget approach - moving from annual Budget to a three year Budgeting cycle

4. Human resource Capacity

3. Coordination and sharing of information between Planning (economic/sector strategy unit), Department of Finance and line ministries/agencies

5. Data gaps

11

Solutions to the issues

1. Workshops conducted in various Ministries and Departments.
2. Presentations to the Development Committee of Officials (DCO) to gather political support
3. Consultation with individual Ministries and assist in drafting their future programs with costing.
4. Regular meetings organised by the planning with Department of Finance
5. DESP taking a leading role with strong linkages and cooperation with the Department of Finance

12

Challenges

- Political stability
- Financial absorptive capacity
- Human resource capacity needed for implementation
- Donors have to show their support or else Ministries will not put in more effort if there are funding gaps that cannot be met by external or domestic resources
- Use of the MTEF or else it will die

13

Thank you

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SAMOA'S PUBLIC FINANCIAL MANAGEMENT SYSTEM

Workshop on MTEF 28-30 November 2006, Nadi, Fiji

1

OUTLINE

- Current Financial Management Situation;
  - Output Budgeting
  - Financial System
- Medium Term Fiscal Framework Expectations;
  - Principal Components
- Concerns;
- Challenges;

2

Current Situation

Output Budgeting

3

Planning Framework

Strategy for the Development of Samoa
↓
Sector Plans (5-10 years)
↓
Corporate Plan (3 years)
↓
Annual Management Plan (1 year)
↓
Budget Estimates (annual)

4

Performance Output Budgeting

- Budget allocation to government ministries is based on outputs delivered by ministries;
- All outputs have sets of performance measures;
- Ministry budget is divided in 3 categories:
  - Outputs by ministry;
  - Outputs by third party;
  - Transactions on behalf of the State;

5

Performance Output Budgeting

- Ministry outputs (Corporate Plan goals, Sector Plan goals & SDS goals);
- Annual Budget Estimates provides the funds to achieve these goals;
- Annual Budget submission is submitted with a draft annual management plan;

6

BUDGET REPORTING FRAMEWORK

- ❑**Monthly financial reporting** *(focus on expenditure and revenue trends & compliance to budget policies)*
- ❑**Mid Year Review & Annual Review** *(focus on achievements of outputs based on performance measures)*
- ❑**Annual Reports (by Ministry)** *(include achievement matrix- performance assessment/review and reconciled annual accounts – endorsed by MOF CEO)*
- ❑**Annual Public Accounts** *(prepared centrally by MOF as our budget appropriations are still disbursed from MOF) – reports on actual spending and collections of the annual estimates)*
- ❑**Controller & Chief Auditor's report** *(on performance of individual ministries – based on annual accounts and individual performance of ministries)*

7

Current Situation

Financial System

8

Financial System

- ❑ **Finance One** implemented 1st July for financial year 05/06;
- ❑ Opportunity taken to shift more responsibility and accountability to ministries in line with PFMA 2001;
- ❑ Purchase Orders (TY11) originated on Finance One in line ministry;
- ❑ Cheque Requisition (TY1) originated on Finance One in line ministry;
- ❑ Financial information is available daily in Corporate Service division within line Ministry;

9

Financial System Cont'd

- ❑Monthly Reporting Formats developed for internal Budget monitoring and Cash flow management at ministry level;
- ❑Corporate Services encourage to provide monthly spending reports (revenue and expenditure) using Finance One;
- ❑With more timely information available, Output Managers could be held accountable for their actions to manage resources;
- ❑To assist Ministries, MOF is developing a Financial Management Framework;

10

Medium Term Fiscal Framework Expectations

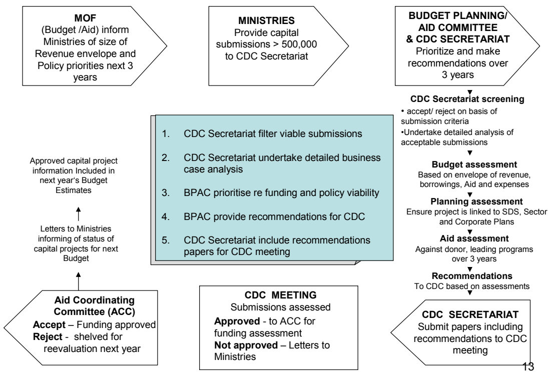
11

Expectations

1. **Improved Economic Stability;**
2. **Budget Sustainability;**
3. **Better policy advice and prioritization of resources;**
4. **Established MTFF;**
5. **Better coordination;**
6. **Better planning by ministries;**

12

MAJOR PROJECTS PLANNING CYCLE



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BUDGET PROCESS STAGE 1 Capital Submissions > $500,000

Medium Term Fiscal Framework

Principal Components

❑Medium Term Economic Forecasts;
❑Medium Term Fiscal Targets;
❑Forward estimates;

(need to ensure all components are linked and consistent;)

14

Medium Term Fiscal Framework Concerns

15

Main Concerns (Cont'd)

Internal

❑Developing and maintaining technical capacity;
❑Appropriate Systems and Software;
❑Appropriate Linkages:
- Policy and Planning;
- Budget;
- Accounts;
- Aid Administration;

16

Main Concerns

External

❑Political commitment and acceptance;
❑Absorptive capacity of Ministries and MOF;
❑Relationship with forecasting (CBS);
❑Comprehensive and integrity of data;
❑Misconception of Forward Estimates;

17

Medium Term Fiscal Framework Challenges

18

MTFF - Main Challenges

Policy
- Sound Policy Framework;
- Develop a shared view of the nature and purposes of Forward Estimates;
- Influence the way decisions are made;

Systems
- Improving effective use of the new financial system and ensuring enhancement for new challenges;

Processes
- Linking of performance and medium term budgeting and planning to CEOs contracts;

19

MTFF - Main Challenges (Cont'd)

Operational
- Implementing a medium term framework and macro-fiscal framework;
- Sound Medium Term Revenue Forecasts;
- Gaps in suitable information for Forecasting;
- Developing and analyzing forward estimates;

20

MTFF - Main Challenges (Cont'd)

- Human Resource Capacities
- Capacity in line ministries for budget monitoring & cash flow forecasting
- Maintaining experienced staff within the Ministry of Finance

21

The End

22

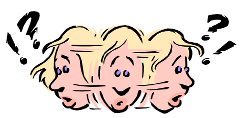
The IMF: An Overview

IMF Institute / Statistics Department
Course on Monetary and Financial Statistics in English
August 28, 2006

THE INTERNATIONAL MONETARY FUND

Outline

- **Why the Bretton Woods System was created**
- **IMF's Role in Relation to the World Bank and WTO**
- **Role of the IMF and how it changed**
- **Criticism and Achievements**
- **Questions**

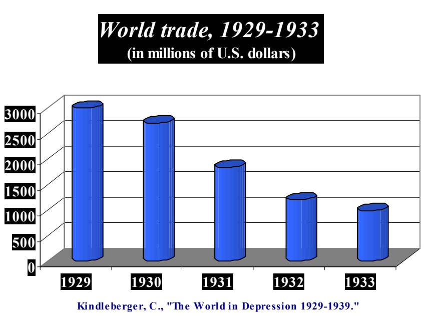


Why the Bretton Woods System Was Created

- **Avoid Past Mistakes**
- **Disastrous economic policies that contributed to Great Depression of the 1930s and WW II**
  - "Beggar-thy-Neighbor-Policies"
  - protectionism and tariff wars

- **Rebuild confidence in international cooperation and international financial system after failure of League of Nations and two World Wars**

The Breakdown of World Trade



The Roles of IMF, World Bank and WTO

The IMF

- Promote global financial stability
- Financial assistance to its members experiencing balance of payments difficulties
- Exchange Rate Stability

The World Bank

- Reconstruction and economic development after WWII
- Project financing
- Goal: "Our dream is a world free of poverty"

The WTO

- Trade liberalization
- Multilateral trade negotiations
- Global rules of trade
- Provide mechanism to resolve disputes

IMF 101....or how to become an informed protestor !

..this is how we are known...

This Is Who We Are:

Our Ultimate Bosses: Board of Governors and the IMFC

The IMF is accountable to the governments of its 184 member countries through the

***Board of Governors*, which consists of one governor from each member country (meets once a year)**

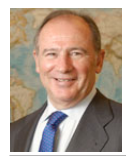
***International Monetary and Financial Committee* (IMFC), consists of 24 governors and advises the Board of Governors (meet twice a year)**

***Executive Board* (24 members) conducts day-to-day business of IMF (meets three times a week)**

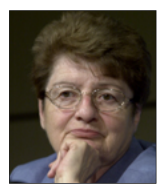
IMF Executive Board

Countries with their own Executive Director: France, Germany, Japan, U. K., U.S.A, China, Saudi Arabia, Russia
Other 176 members are represented by 16 Executive Directors

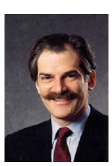
IMF Management: Rodrigo de Rato , Anne Krueger, Takatoshi Kato, Agustín Carstens

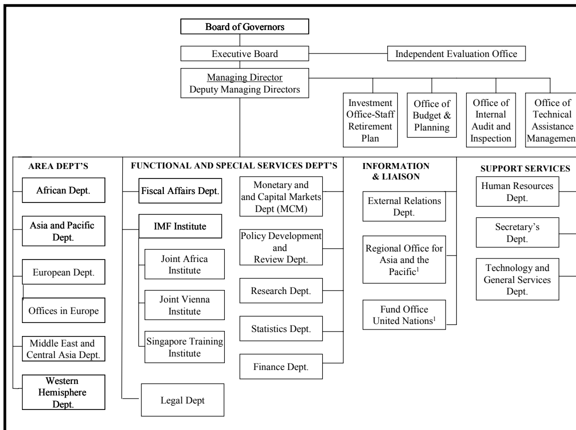


MD is head of IMF staff and Chairman of the Executive Board – assisted by three DMDs



- On Sep 1, 2006, Mr. John Lipsky will become FDMD, replacing Ms. Krueger.





Annex - Chapter 8

IMF Budget

Table 7.1 Administrative budgets, FY2003–06[1]

(In millions of U.S. dollars)

	Financial year ended April 30, 2003: Actual expenses	Financial year ended April 30, 2004: Actual expenses	Financial year ended April 30, 2005: Budget	Financial year ended April 30, 2005: Actual expenses	Financial year ending April 30, 2006: Budget
Administrative budget					
Personnel expenses					
Salaries	337.1	355.9	373.8	375.2	395.7[2]
Benefits and other expenses	191.3	200.3	259.9	259.5	263.8
Subtotal	**528.4**	**556.2**	**633.7**	**634.7**	**659.7**
Other expenses					
Travel	79.9	91.5	97.6	90.2	99.4
Other expenses	155.7	158.4	173.8	167.3	177.9
Subtotal	**235.6**	**249.9**	**271.4**[3]	**257.5**	**277.3**
Total administrative budget (gross)	**764.0**	**806.1**	**905.1**	**892.2**	**937.0**
Receipts	(44.1)	(58.5)	(55.5)	(66.1)	(60.9)
Total administrative budget (net)	**719.9**	**747.6**	**849.6**	**826.1**	**876.1**

Note: Figures may not add because of rounding.
[1] Administrative budgets as approved by the Board for the financial years ending April 30, 2005, and April 30, 2006, compared with actual expenses for the financial years ended April 30, 2003; April 30, 2004; and April 30, 2005.
[2] Includes $1 million in contingency reserves for salaries.
[3] Includes $2 million in contingency reserves—$1 million for travel and $1 million for other expenditures.

IMF Staff

- Headquartered in Washington, D.C.; also 90 +/- field offices around the world. As of 12/31/04:
- 2,714 Staff (1,301 economists, 695 other professionals and 718 support staff)
- 141 different nationalities represented on staff
- Strong commitment to DIVERSE, professional staff

Economists

- are assigned to work in:
  - AREA DEPARTMENTS covering broad geographic regions of the membership, or
  - FUNCTIONAL DEPARTMENTS covering specific policy areas or technical expertise across all member countries.

Travel is frequent and interesting!

Missions

- Article IV
- Use of Fund Resource (UFR)
- Technical Assistance
- Training missions

Review work

- Review&clearance process
  - Country papers
  - Policy papers
- Review
  - Intra-departmental
  - Inter-departmental
- Clearance
  - Dept (area and/or PDR)
  - Management

Work in Area Departments

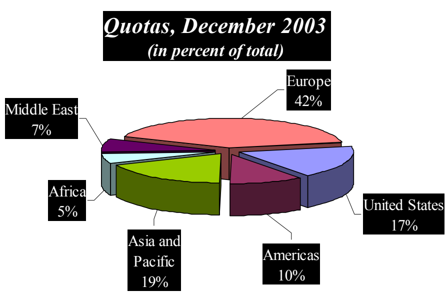
- Backbone of the IMF work
  - Processing information on member countries
  - Preparing for policy dialogue
    - At least once a year, often more frequent
    - Main output: Staff Report
  - Maintaining statistical database
    - World Economic Outlook
    - Increasing share of modeling work that feeds into the regular policy dialogue
  - Research

Work in Functional Departments

- Participate in Area Dept missions
  - External Sector, Fiscal, Financial Sector Data and Analysis
  - Selected Issues Papers
- Divisional Work
  - Research, Statistics,
  - Policy work, Review of country papers

IMF Resources

- **Provided by member Countries through payment of quotas**
- **Total amount of quotas determines the IMF's lending capacity (12/31/03 Quotas $316 billion)**
- **Gold holdings (about $43 billion); however, Articles of Agreement strictly limit its use**
- **Lending Capacity as of 12/31/03 $81 billion (one-year forward commitment capacity) – usable resources + expected loan repayments**



The Quota Determines....

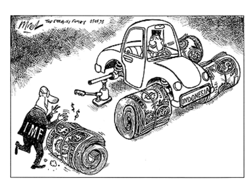
- **Subscriptions** (maximum amount of financial resources the member is obliged to provide to the IMF)
- **Voting Power**
- **Access to Financing**

What We Do - The IMF's Mandate

According to Articles of Agreement (Art I):

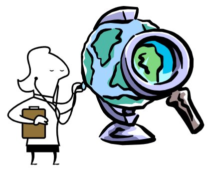
- Promoting **International Monetary Cooperation**
- Facilitating **Expansion of International Trade**
- Promoting **Exchange Stability**
- Helping to Establish **Mulilateral System of Payments**
- Making **Loans Under Adequate Safeguards** to Members in Balance of Payments Difficulties

Three Functions of the IMF: Surveillance, Technical Assistance, Lending



Multilateral Surveillance

- **Assessing the health of the world economy**
  - **World Economic Outlook (WEO) published twice a year (Spring and Fall AMs).**
- **Assessing the stability of international financial markets**
  - **Global Financial Stability Report (twice a year; first one published in March 2002).**



Bilateral Surveillance

- **Bilateral Surveillance (Article IV consultations)**
  - In FY 2003, surveillance consultations were concluded for 136 countries; annual health check up of economies
- **Fnancial Sector Surveillance**
  - FSAP—Financial Sector Assessment Program
  - Jointly with World Bank; introduced in May 1999
- **Regional Surveillance**
  - Examination of policies pursued under regional arrangements (e.g. Euro area, WAEMU)
- **Implementation of Standards and Codes**
  - How closely does a country adhere to widely accepted good principles, practices or guidelines in a given field.

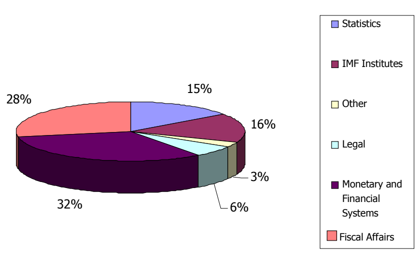
Technical Assistance

Types of Technical Assistance

- Designing and implementing fiscal and monetary policies
- Drafting and reviewing economic and financial legislation, regulations, and procedures
- Institution and capacity building
  - central banks
  - treasuries
  - tax and customs departments
  - statistical services
- Training for officials of member countries

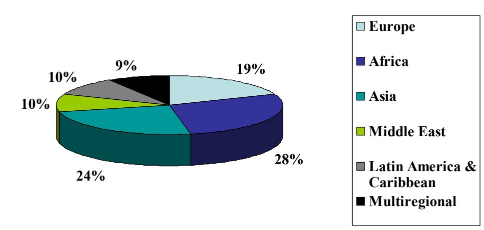
Technical Assistance by Function, FY 2003

(as a percentage of total Resources)

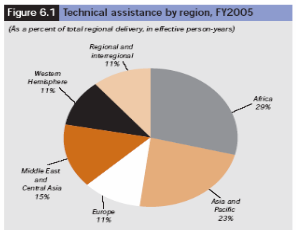


Technical Assistance by Region, FY 2003

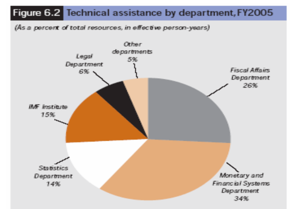
(as a percentage of total resources)



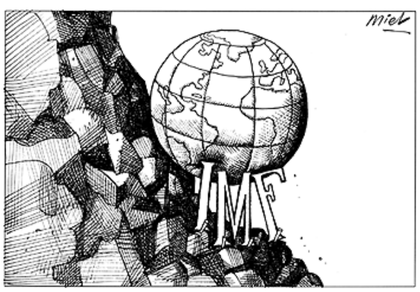
Technical Assistance by Region, FY 2005



Technical Assistance by IMF Department, FY 2005 (as a percentage of total resources)



Lending



IMF Resources (as of end-March 2006)

- Total quotas:$308 billion
- Total usable resources:$223 billion
- IMF one-year forward commitment capacity:$173 billion
- Non-concessional credit outstanding:$28 billion
- Concessional credit outstanding:$6 billion
- Gold holdings:103.4 million fine ounces ($60 billion)

Types of IMF Loans

Non-concessional Assistance

- Stand-by Arrangements (SBA)
- Extended Fund Facility (EFF)
- Supplemental Reserve Facility (SRF)

- Compensatory Financing Facility (CFF) – not used since 1999
- Emergency Assistance (post-conflict, natural desasters)

Concessional Assistance

- Poverty Reduction and Growth Facility (PRGF), formerly ESAF
- Heavily Indebted Poor Countries (HIPC) Initiative

Type of IMF Loans: Interest Rate and Duration

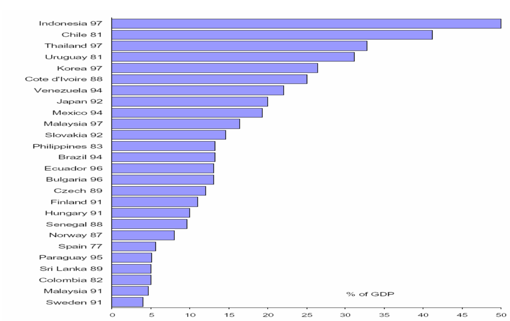
Type of Loan	Purpose	Interest Rate	Repayment (obligation)	Repayment (Expectation)
Stand-by Arrangement (SBA)	Medium-term assistance for temporary BOP difficulties	Basic rate Plus surcharge for heavy borrowing	3 ¼ to 5	2 ¼ to 4
Extended Facility (EFF)	Longer-term assistance for longer-term BOP problems	Basic rate Plus surcharge for heavy borrowing	4 ½ to 10	4 ½ to 7
Supplemental Reserve Facility (SRF)	Short-term assistance for BOP difficulties related to capital account crises	Basic rate plus surcharge (rising with duration)	2 to 2 ½	1 to 1 ½
Compensatory Financing Facility	Assistance for temporary export shortfalls or cereal import excesses	Basic rate	3 ¼ to 5	2 ¼ to 4
Emergency Assistance	Assistance in aftermath of natural disasters or in post-conflict cases	Basic rate	3 ¼ to 5	…
Poverty Reduction and Growth Facility	Longer-term assistance for BOP difficulties of a structural nature	0.5 % a year	5 ½ to 10	…

The World is Changing...

Incidence of financial crises ... An epidemic?

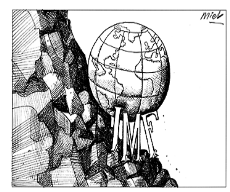
- Two-thirds of the IMF's members have experienced a financial crisis during the last two decades.
- Since the mid-1990s, there have been a number of high-profile financial crises in emerging markets.

Fiscal costs of financial crises can be high . . .



Who's responsible for fighting financial crises?

- **Domestic policymakers have the primary responsibility**
- **Among international financial agencies, IMF has the lead responsibility, consistent with its mandate**
  - to promote global financial stability
  - to help member countries in times of temporary financial difficulties



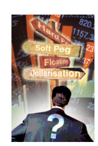
But it's a multilateral effort . . .

IMF works closely with:

- World Bank
- Other IFIs
- BIS, Basel Committee on Banking Supervision, Financial Stability Forum
- UN agencies
- WTO

Crisis Prevention

1. Strengthening of domestic financial sectors
2. Better surveillance of global capital markets
3. Macro policies that can 'crisis-proof'
4. Detecting vulnerability -- Better assessments of debt sustainability; early warning systems; and vulnerability assessments



Reducing the Damage – Crisis Resolution

- Improved design of IMF programs
- Involvement of private sector; sovereign debt resolution mechanisms

1. Improved Design of IMF programs

- **Choosing the right scale of IMF assistance**
  - Financial assistance that is too small relative to country's needs may not be effective
  - But programs that are too large may generate moral hazard in future

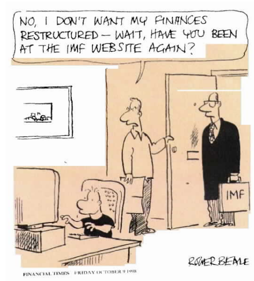
Improved Design of IMF programs

Streamlining conditionality

- Overloading a program with conditions leads to poor implementation
- IMF programs now focus on conditions essential to achieving the key goals of the program

2. Improving the process of sovereign debt restructuring

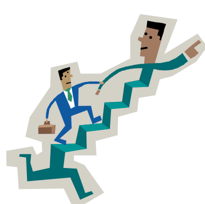
- **Increased use of collective action clauses in sovereign bonds**
- **Code of conduct**
- **IMF's Sovereign Debt Restructuring proposal (SDRM)**



The IMF's Role in Low-Income Countries

The IMF provides low-income countries with:

- **Policy Advice** (surveillance)
- **Technical Assistance** (nearly 50%)
- **Financial Support** (low interest rates, long time horizons, debt relief)



Why is the IMF Engaged in Poverty Reduction?

The reasons are two-fold:

- (i) in many of the IMF's member countries, the problem of poverty reduction is crucial to the entire policy discussion. It would make no sense for the IMF to operate in these countries without taking on board the central concern of policymakers there;
- (ii) there are also pragmatic reasons—policies recommended by the IMF will not be sustained if they are not perceived as broadly equitable. So the IMF needs to show great awareness of the distributional impact of the policies that it supports.

What Can Be Done to Reduce Poverty?

- **Monterrey Consensus:**
  - Two-Pillar Approach
  - Resources to meet the Millennium Development Goals
  - Conditions that will enable freer trade, more foreign investment, debt relief and efficient government.
- The **UN's Millennium Development Goals** include :
  - halving poverty by 2015,
  - universal primary education,
  - reducing child mortality,
  - improving maternal health,
  - combating HIV/AIDS and other diseases

PRGF

- 77 low-income members (42% of total membership)
- Three year loans
- Interest rate of 0.5 percent
- Repayment over ten years

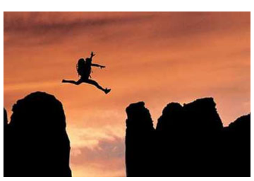
PRGF Programs – Key Features

- Explicitly linked to Poverty Reduction Strategy Papers (PRSPs)
- Broad Participation and Greater Ownership
- Embedded in the overall strategy for growth and poverty reduction
- Budgets that are more pro-poor and pro-growth
- Ensuring appropriate flexibility in fiscal targets
- More selective conditionality
- Improved public resource management
- Social impact analysis

Poverty Reduction Strategies (PRSP) – The Process

- Country driven
- Comprehensive
- Outcome oriented
- Provides a coordination mechanism among all development partners

What Has Been Achieved .....



- Increased transparency
- IMF as "Listening and Learning" Institution
- Openess to the public; publication rate, press, outreach
- Initiatives to increase member countries' data and policies

IMF Transparency

We publish

- Nearly all letters of intent and memoranda of economic and financial policies
- 80 percent of Public Information Notices (or PINs) of Article IV Board discussions are published.)
- In nearly 60 percent of cases, the entire staff reports, which generally contain more than most people want to know about a country, have been published.
- Most papers on general *policy issues* (as opposed to country documents) discussed by the Executive Board are published.

The Independent Evaluation Office (IEO)
(Established by the Executive Board in 2001)

IEO first projects:

- Prolonged use of Fund resources (UFR)
- Fiscal Adjustment in IMF-supported programs
- Capital account crisis cases (Brazil, Indonesia and Korea)
- Evaluation of the PRSPs and PRGF

Soon in a theater near you:

- IMF's Role in Argentina (1992-2002)
- Technical Assistance Provided by the IMF

The Road Ahead: The IMF's Medium-Term Strategy

- Launched in 2004
- Aims to
  - Strengthen IMF surveillance
  - Redefine the role of the Fund in emerging markets
  - Make more effective its work in poor countries
  - Improve the Fund's governance
  - Help members build their capacity
  - Streamline work of IMF
  - Reform its medium-term budget

Thank you!

Questions ????

PRO-POOR POLICIES

What Are They?
And
How Do They Fit Into a MTFF?

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What is Pro-Poor Policy

- Pro-poor policy aims to target those who are most disadvantaged, in income, opportunity or hardship
- Pro-poor policies will lead to:
  - An increase in the income levels of the poor faster than the average rate of growth in income as a whole
  - A reduction in recorded poverty levels: MDG 1 and national poverty lines
  - An improvement in other MDG indicators, and
  - An improvement in the HDI and HPI indicators
- MDG Reports suggest that growth has NOT been pro-poor - or at least not sufficiently pro-poor to be making a real impact on poverty and MDGs

Pro-poor Policy: The Millennium Development Goals

- 1.Eradicate extreme poverty and hunger
- 2.Achieve universal primary education
- 3.Promote gender equality and empower women
- 4.Reduce child mortality
- 5.Improve maternal health
- 6.Combat HIV/AIDS, malaria & other diseases
- 7.Ensure environmental sustainability
- 8.Develop a global partnership for development

"Good" Pro-poor Policy

- Policy may be pro-poor when:
  - It is labour rather than capital intensive
  - Targets assets the poor possess – land/sea or labour
  - Targets sectors in which the poor are employed or engaged
  - It creates income and employment for the poor and disadvantaged:
    - Youth and other unemployed (low-skilled)
    - Women
    - Other disadvantaged groups (elderly, disabled, displaced people, rural/urban migrants)
  - Targeted at areas where poor live (urban or rural)
  - Targeted at individual disadvantaged and poor groups
  - Serves to reduce inequality
- Growth is a necessary but not sufficient condition for poverty reduction

Economic and Social Policy Issues 1

- Low rates of economic growth
- High rates of population growth
  - Declining per capita incomes
- Weak fiscal situations and poorly defined budget parameters and priorities
  - Budget allocations are not priority or policy driven
  - Not always (often) linked to national strategies
- Inequity in access to, and quality of, basic services between rural and urban areas

Economic and Social Policy Issues 2

- Declining governance standards
- Declining standards of basic service delivery
- Weakening of social environment
  - Changing attitudes to traditional roles, customs and responsibilities:
    - Exposure to outside influences including: money, "western values" in social relations, alcohol/drugs, DVD/videos, access to information and knowledge etc
    - Weakening of traditional family discipline and ties
    - Increasing social and domestic tension
- Lack of clearly defined pro-poor and sustainable development strategies to address these key issues

Economic and Social Policy Issues 3

- Impact of economic reforms
  - Increases in user charges for government services
  - Changes in taxes and tariffs may lead to increases in basic food prices and other "essentials"
  - Increasing monetisation of subsistence economies
    - Can the poor afford to pay?
  - Lack of economic opportunity in the rural areas leads to urban drift/migration
    - Increasing dependency ratios in rural areas
    - Decreasing rural agricultural production
  - Urbanisation, deterioration in environmental health and rising social tensions
  - Increasing youth unemployment

Linking National Strategies, Pro-poor Policy and the Budget

- National Sustainable Development Strategies
  - Vision: 10 – 15 years
  - Pro-poor / sector priorities, policies and strategies
  - Strategic outcomes: 3 - 5 year time frame, may be longer
  - Sector interventions and investment
    - Need to prioritise and set timetable
- Annual budgets should reflect national priorities
- MTFF: needs to integrate national priorities, strategies and budgets through clearly costed pro-poor policies

Costing Pro-poor and Other Policy 1

- Policy interventions must be properly costed
  - Policy costing methodology should be identified
  - Should give clear realistic costs and benefits
  - Casual forecasts are not sufficient
- MTFF must be a deliberate planned and costed future programme
  - Links planning, policy, budgeting into an overall framework

Costing Pro-poor and Other Policy 2

- Design and Implement Targeted Policies and Other Interventions
- Targeted Interventions
  - How should they be targeted
    - direct transfers
    - subsidies
    - other policy influence/interventions
- Assess the Impact of Policies on the Poor
  - Economic growth
  - Pro-poor budgeting; taxes and tariffs, user charges
  - Equitable social expenditure
  - Other targeted interventions including MDGs

Costing Pro-poor and Other Policy 3

- Pro-Poor Budgeting and Social Spending
  - Who uses public services (health and education)
    - Do the poor and disadvantaged have equal access
    - How does the quality of service provided vary by location and social group (poor/non-poor, urban/rural)
  - Cost and allocation of resources by user group
    - Do the poor get a proportionate allocation of resources
  - Unit cost of delivery/subsidy
    - Are the poor disadvantaged by user charges
    - Or the cost of accessing services
  - Impact of proposed policy interventions
    - Are policy interventions costed/assessed for pro-poor impact

Budget and Economic Implications MDG 2 to 6

- Poor educational attainment and gender inequality:
  - Cost of additional teachers/classrooms/books and teaching materials
  - Loss of productive potential from poor educational attainment
  - Additional budget burden from consequences of poverty
- Poor health:
  - Additional costs for clinics, hospitals, medications and treatment
    - Current burden on the budget
    - Better priority would be prevention rather than cure
  - Loss of production from sick workers
  - Loss of tax revenues
  - Poor health in childhood leads to poor health as adult
    - Future burden on the budget

Budget and Economic Implications: MDG 7 & 8

- Social tensions:
  - Additional cost of law and order
  - Additional cost of other social welfare services
- Pressure on infrastructure and public services:
  - New investment needed in roads, water, sanitation, power, health and education services to meet increased urban population
  - Additional maintenance costs
- Urban/Rural migration:
  - Rural transport services and public utilities become (even) less financially viable
    - additional subsidies required
    - or higher charges place additional burdens on the rural poor – or their working relations in the urban centres
  - Unit cost of rural social service delivery (education, health) increases as rural populations decline

Budget and Economic Implications 3

- Sustainable Development MDG 7
  - Increasing reliance on imported food
    - Poor diets and poor health
    - Declines in domestic agriculture
    - Weakening in food security
    - Impact on balance of payments
  - Increasing vulnerability at both rural and national levels
    - Natural disasters
    - Social impacts

Pro-poor Policy Process

Pro-Poor Policies
- **Fiscal**
- **Monetary & financial sector**
- **Trade and foreign exchange**
- **Investment**

Macroeconomic Impacts
- **Aggregate economic growth**
- **Sectoral growth**
- **Employment creation**
- **Inflation**

Poverty Impact
- **Reduction in poverty levels**
- **Achievement of MDGs**

Pro-Poor Policies 1

Fiscal Policies
- Non-distorting tax and tariff regimes
  - Progressive direct taxes
  - Indirect taxes with minimum impact on low income groups
- Transparent budgets
  - Subsidies, hidden and budgeted, clearly identified
  - Tax exemptions and other concessions for non-poor removed
  - Resource allocations for services used by poor
    - Basic education and health
    - Water and sanitation
    - Rural transport and communications
    - Agricultural extension and markets

Pro-Poor Policies 2

- Monetary & financial sector
  - Realistic exchange rate to:
    - maintain competitiveness
    - Encourage competitive import sourcing
  - Efficient financial intermediation
    - Reduce cost of capital
    - Improve access to finance for poor
    - Provide financial literacy and financial management skills
- Economic Openness
  - Trade policies to:
    - enhance exports
    - encourage productive investment and adoption of new technology, and
    - minimise protection of uneconomic domestic industries

Pro-Poor Policies 3

- Private Sector Development
  - Enabling environment for investment
    - Sound macroeconomic framework
    - High governance standards
    - Transparency and consistency of policy and regulatory frameworks
  - Ensure labour markets are deregulated, subject to minimum rights, to encourage employment creation

Pro-Poor Policies 5

- Growth alone is not enough
- Patterns of growth are important
  - Growth in sectors in which poor are more likely to be involved, agriculture, fisheries, informal activities
  - Rural sector must be made more attractive
- Enabling environment for economic opportunities to be created for the poor in their sectors
  - Access to resources and assets
  - Access to basic services
  - Access to rural financial services, credit facilities and financial literacy programmes
  - Decentralization, local empowerment and participation
  - Good governance
  - Land reform
  - Access to transport and markets
  - Access and other support to extension services

Poverty: A Vicious Circle

- Poverty Can Be Self-perpetuating
  - tendency for the poor to persist across generations
    - low income leads to a
    - poor diet
    - poor health and impaired ability to concentrate
      - this results in
    - poor educational attainment and lack of skills
      - these conditions together
    - limit ability to take advantage of opportunities, and lead to
    - unemployment
    - low income
    - social exclusion, and thus
    - perpetuate the cycle
- Pro-poor policies required to break this cycle

Pro-poor Policies: A Virtuous Circle

- The Growth Strategy
  - Creating sound macroeconomic and fiscal policy framework
  - Developing pro-poor, performance oriented budgets
  - Delivering cost-effective, efficient and quality services to all
  - Creating enabling environment for private sector
    - leads to
  - Creation of Employment
  - Generation of new economic opportunities
  - Increasing incomes
    - Resulting in
  - Economic growth and reduction of poverty
  - Raising welfare and progress towards MDG

Thank You

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Improving Aid Coordination and Management

Workshop on

Medium Term Fiscal Framework

28-30 November 2006

Carol Flore-Smereczniak
Regional MDG Specialist
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Outline of Presentation

- New Aid Coordination architecture
  - Aid flows
- Improving aid effectiveness
  - Paris Principles, Pacific Principles
- Aid coordination and aid management at country level
- Conclusion - some challenges

New Aid Agenda

- 2 milestone meetings in 2005:
  - **Paris High Level Meeting in March 2005** –
    - reforming the way donors and recipient countries work together so as to achieve better development results

  September 2005 UN World Summit –
    - developing countries to adopt national plans by 2006 to reduce poverty & achieve the MDGs
    - developed countries to scale up aid to developing nations up to US$50billion a year by 2010

Most of you are aware that the Rome Forum on Aid Effectiveness in Feb 2003 has created a new aid agenda. The momentum on this new aid architecture has since picked up, with what I would call 2 milestone meetings last year:

The Paris high level meeting in March 2005, which was the follow up to the Rome Declaration on aid Effectiveness, and

Later that year, the UN World Summit, reaffirmed commitment towards the MDGs, with two important outcomes:

One was a commitment by developing countries …

And the other was a commitment by developed nations to ….

Aid from developed countries to be equal to at least 0.7% of their GNI

Concurrence of purpose

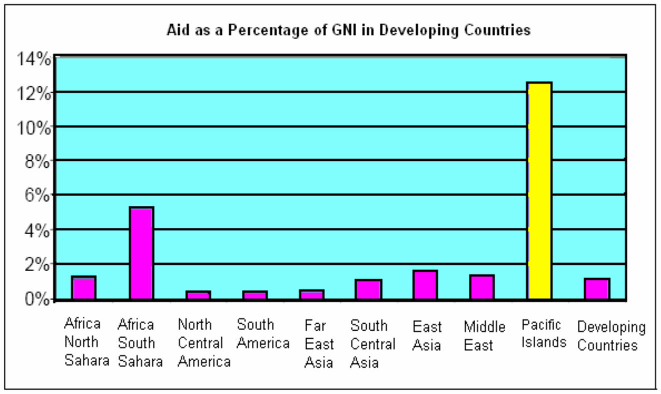
- The outcome of both meetings was about:
  - making more aid available to developing countries, and
  - using those resources more effectively to make significant improvements in the lives of people (reduce poverty, achieve MDGs)
- Challenge: country capacities and donor behaviour

Those two meeting had commonality of purpose in that ultimately, both were looking at how to improve people's lives through making more aid available to developing countries, but also using those resources more effectively to produce greater impact.

However, for aid to produce better development results, the premise is that there needs to be existing capacities at country level, and specific behaviors from donors

The questions one can ask are: What do countries need to have in place at national level? And what do donors need to do differently?

Aid Received Regionally as % of Gross National Income

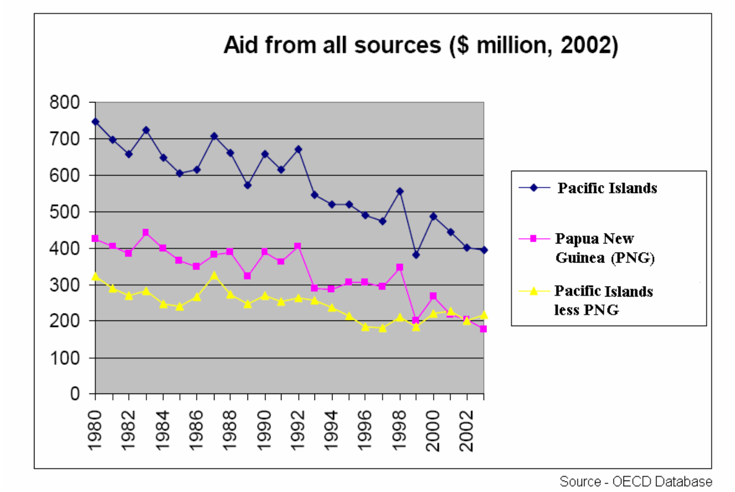


Source - OECD Database & World Bank Indicators

Aid flows as a % of GNI are higher in the Pacific than in any other region, and even when compared to developing countries as a whole.

No year listed

Aid flows to Pacific Islands



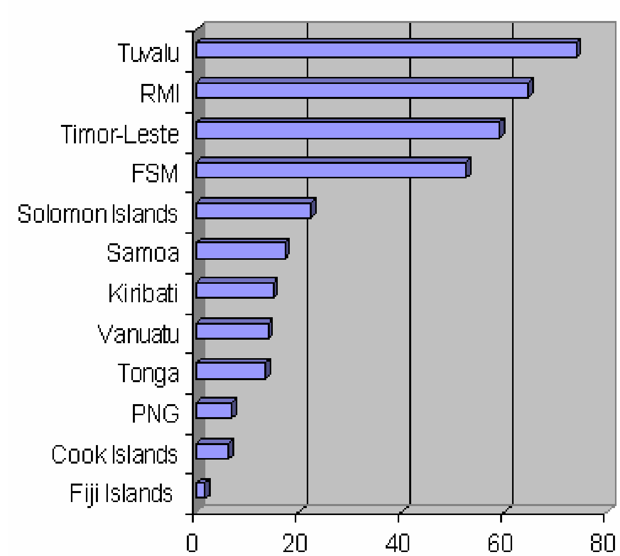
Even though aid flows to the Pacific have been declining by almost 50% in the last two decades, aid to the region is still very high.

The chart does not include aid flows to the Marshall Islands, Micronesia and Palau as data prior to the mid 1990's is not available.

ODA as a percentage of GNI.

Source: D Abbott & S Pollard 2004

- For most countries in the region, aid is a significant share of **Gross National Income (GNI)**
- and still a large share of **Government budgets**



ODA is therefore still an important component of Govt budgets in most Pacific countries.

You will note that the relevant figures are missing for Palau, Nauru, Tokelau, Nuie

So how do we make the most of these resources, and ensure that they are the best dollars spent, as Christian said in his first presentation?

Improving aid effectiveness

- Paris Principles: 5 key principles
  - Ownership
  - Alignment
  - Harmonization
  - Mutual accountability
  - Managing for results

The Paris High Level Meeting came out with a Declaration that was hinged on 5 key principles, meant to improve the effectiveness of aid:

In the next series of slides, I will take you through what these principles mean, and the implications at country level

Ownership

- Government to take leadership role in identifying national priorities and formulating home-grown poverty reduction strategies that are MDG-based
- Policies, priorities and strategies to be identified and formulated in a consultative process with all stakeholders, under government leadership

This is about government taking the lead in determining their national priorities, and government leading the process of an MDG-based poverty reduction strategy or MDG-based NSDS or MDG-NDP. As most of you will know, traditionally this has often been donor-driven, and so requires an important shift.

The process should be participatory and consultative, both among government ministries, at the different levels of government (central, local, provincial) and between government and other stakeholders.

You will appreciate that it requires capacity to lead and manage such processes.

Alignment

- Government to align the use of available funding (domestic and external) behind implementation of MDG-based PRS and other national priorities
- Donors to align with recipient countries national priorities, policies and systems

Once national priorities are determined and strategies formulated, governments need to estimate **how much it will cost** to implement national plans or national strategies, looking at the short-, medium- and -long term.

The cost of strengthening capacities or institutions to do these needs assessment or cost estimates should be included in the budgets and MTBFs.

Once the cost is known, Governments then look at **how it will finance** implementation on a medium-term basis, and annually, considering both domestic resources and aid resources.

The point to highlight is that <u>aid is part of the available resource envelope to finance development, and not additional resources</u>.

Donors should align the support they provide with national priorities as defined by governments and use national systems where possible.

Harmonization

- Call for donors to establish common arrangements, simplify their procedures, and share information

The harmonization principle is about donor behaviour – donors using common arrangements, sharing info, etc – donor coordination, if you wish.

This is very much in line with what was mentioned in the presentation on PEFA..

Mutual Accountability

- Stronger accountability
  - Recipient governments to:
    - have more effective ownership (strong systems, institutions, etc)
    - strengthen Parliamentary oversight
- More balanced accountability
  - Accountability to parliaments and citizens
  - Donors to support accountability and scale down excessive demands

The principle of mutual accountability shifts the focus for primary accountability from government and ensures that both governments and donors are accountable. What this means is that countries need to have stronger accountability frameworks (stronger institutions, stronger parliamentary oversight, etc), governments should be more accountable to their parliaments and their people on what they do with resources, but also that donors should be more supportive to countries and instead of asking for too much (too many reports, too many missions, etc) they should scale down their demands.

Managing for Results

- 12 indicators of aid effectiveness
- Targets for 11 indicators designed to encourage progress at all levels, and to be reached by 2010
- To be complemented by target setting at country level
- 3 rounds of monitoring: 2006 Baseline Survey, 2008 Interim Survey, and Final Survey in 2010

The Paris Declaration has set 12 indicators to monitor aid effectiveness, with 11 associated targets.

Countries are encouraged to set additional targets, if necessary, and many countries have localised these indicators (Vietnam, Uganda, etc).

There will be 3 rounds of monitoring at international level: countries that are signatory to the Declaration will conduct a baseline survey by the end of this year; there will be an interim survey in 2008, in time for the Ghana high Level Forum, and the final survey to look at what improvements have been made in aid effectiveness will be in 2010.

Indicators of aid effectiveness

1	Ownership – Operational PRS
2	Quality of PFM/ Procurement systems
3	Aid reported on budget
4	Coordinated capacity dev.
5	Use of country systems
6	Parallel PIUs
7	In-year predictability
8	Untied aid
9	Use of programme-based approaches
10	Joint missions & country analytic work
11	Sound performance assessment framework
12	Reviews of mutual accountability

These are the 12 indicators of aid effectiveness, and they are a very good starting point for thinking about how to improve aid effectiveness in respective countries.

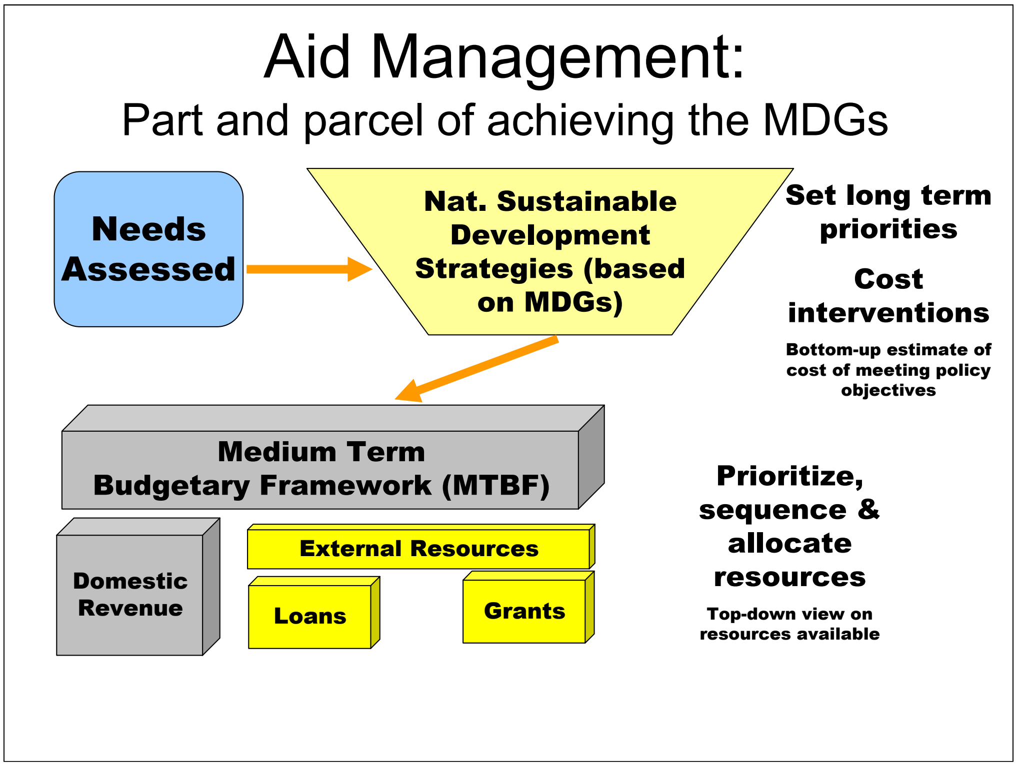
Countries that are serious about the Paris Declaration and aid effectiveness are actually using these indicators to get donors to to align with national development priorities identified by government and use national systems, without conditionalities.

Pacific Aid Effectiveness Principles

- 4 Pacific countries have signed on to the Paris Declaration (Fiji, PNG, Vanuatu, Sol Islands)
- Following a study on Aid Effectiveness in the Pacific in 2004, the Pacific Island Forum Secretariat has developed the Pacific Aid Effectiveness Principles
- These have been endorsed in principle

How do Paris Principles/Pacific Principles translate at national level to achieve the MDGs?

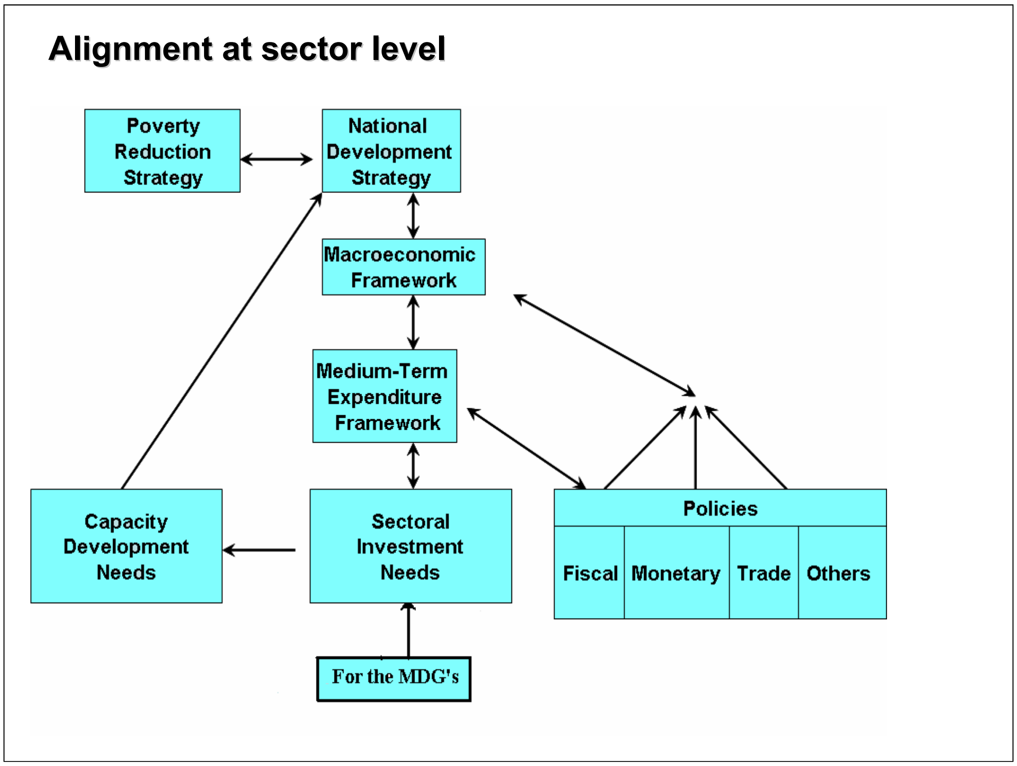
How do they fit in with MTEF?



Basically, aid becomes part and parcel of the resource envelope to translate the cost interventions to achieve MDG-based national goals and priorities by integrating both domestic revenue and external resources in the MTBF.

We are looking at both top-down and bottom-up processes, that is, aligning policies and priorities, inc sectoral policies, with fiscal constraints.

This has already been covered this week.



This slide is not so different from the previous one.

The point I want to make is that: Experience shows that governments are best able to exert ownership and influence aid allocation behind the MDGs and its national priorities if **the national Development Strategy or NSDS are matched by sector strategies**, which are themselves **reflected in the national budget** framework.

So the different linkages from the NSDS to the MTEF to the policies and sector levels are important.

Tying it all together at country level

- Aid policies
- Aid architecture
- Dialogue mechanisms
- Integrating aid into the budget

To use aid more effectively, there are four areas which countries can strengthen. These are ….

Please note that these are not prescriptive, but are meant more as a guide, based on country experiences.

Reinforcing aid policies

- Aid policies can include the following:
  - Statement of **objectives and guiding principles** (drawn from Paris/PPs) on how external assistance could best contribute to achievement of the MDGs – as laid out in Pacific Plan and NSDS.
  - Identification of areas in which **Government capacities need to be strengthened** in order for greater donor alignment to be facilitated, and proposals for dealing with Government weaknesses.

Countries should have clear aid policies that spell out how external assistance will be used

Aid policies should also identify where government capacities need to be strengthened to foster greater donor alignment with govt priorities so that donor support go to these areas.

Aid policies *cont*…

- Statements of Government preferences and priorities with respect to:
  - aid modalities (projects-SWAps-general budget support-technical assistance)
  - financial terms (grants vs loans, terms of loans)
  - donor specialisation and comparative advantages
- Should seek to reduce the cost of transactions:
  - Request donors to focus on few (3?) areas

Aid policies should reflect government preferences on aid modalities, financial terms, where they see donors fitting best.

And should also aim at reducing the cost of doing business by requesting donors to focus in few areas only, perhaps 3. This means fewer missions and fewer meetings, and therefore government counterparts can focus on improving the quality of interventions.

Aid policies *cont*…

- **Screening criteria** for the acceptance of aid proposals
- Take measures to enhance **local ownership of technical assistance** and ensure it is well aligned with the country's human and capacity development needs.
- Aid reporting requirements and modalities.
- Institutionalization of improved channels of collective Government-donor **dialogue**, including principles for the resolution of disagreements which occur from time to time
- Examples of aid policies on www.AidEffectiveness.org

There should be clear criteria for aid proposals,

Align technical assistance with the countries' human and capacity development needs

Address reporting requirements and modalities: how frequently do you report? Through what?

Institutionalise mechanims for dialogue between government and donor.

For those interested, you can look at examples of aid policies at …

The correct aid architecture

- What are the roles & responsibilities of different government agencies: for aid coord & management, planning, budgeting?
  - **Maldives 2006** – MoF (loans), MoFA (grants), MoP (prioritisation & monitoring): no body overseeing all development financing & alignment with plan. Project appraisal & approval slow (3 steps, 2 committees, many ministers). Poor use of scarce skills.
  - **Samoa 2003** – MoF takes lead role, tackling grant and loan together, linking ODA to plans & budget
  - **Afghanistan 2002** – new Aid Coordination Authority – enmity of OoPresident, MoF, MoP, MoFA, ….

The second area is to ensure there is a proper environment at country level to manage aid.

It means that the roles and responsibilities of the different government agencies are defined: for example, who is responsible for aid coordination & management, for planning, for budgeting, and how is the coordination done among them?

If we take the example of Maldives, we see that MoF handles loans …but there is no overall body coordinating and ensuring the alignment of financing with planning.

In the case of Samoa, more improvement has been achieved with the MoF ….

Dialogue Mechanisms that Deliver

Some lessons:

- Standing structure for information sharing and policy dialogue at macro & sectoral level?
- Avoiding parallel bilateral dialogues
- WG to focus on results; avoid endless conversation on process. Time-bound action plans with milestones.
- Link dialogue to budget process
- WG representatives to have sufficient seniority to represent agencies / ministries

Some good practice to improve aid coordination and aid management include setting up appropriate dialogue mechanisms. Some good practice suggest that …

- Avoid parallel or separate bilateral dialogue with each donor

-To set up WG that focus on results instead of process, and for this, they should have action plans with milestones and timelines; they should also be senior persons who can take decisions

-The dialogue has to link to the budget process so that there is integration of planning, policy and budgeting practices.

-These have been mentioned already in the last 2 days.

Dialogue Mechanisms … *cont*.

- Appropriate technical expertise to be present around the table
- Good information sharing on aid flows and donor activities is crucial to meaningful dialogue
- Strong Chair, competent Secretariat
- Donors & Government meet in advance to prepare
- Sub-groups to increase efficiency

Put people who have expertise in the various areas in the WG so that dialogue is meaningful

Get donors to share what they are doing and what they are financing

If necessary, set up sub-groups that work on specific issues and prepare info for WG ahead of time.

Govt and donors set agendas in consultation and decide on reports that need to be circulated, info that need to be shared

Integrating Aid into the Budget

- If a country has good national strategy:
  - donors commit to align their support (strategies, dialogue, funding) with National Sustainable Development Strategies (NSDS)
- BUT: experience shows that alignment with NSDS may not change much
  - "most national development strategies are very broad documents, and alignment at this level has **not required any substantial change** in donor programmes"

    – DFID-commissioned report, 2006

The fourth area is integrating aid into the budget.

The starting point is to have a good national strategy in place. The assumption is that if a good strategy is available, donors will align their support with the NSDS. However, a study commissioned by DFid earlier this year indicated that:

Integrating Aid into the Budget … sector level

- Governments can best exert ownership and influence aid allocation behind MDGs if its national strategies
  - are matched by **sector strategies**
  - which are themselves **reflected in the national budget** framework
- **Samoa**
  - Sector strategies can be reflected into the budget through Public Investment Programmes (PIPs) that are linked to MDG-based NSDS
  - PIPs provide a multi-year estimate of costs – a forward estimate of resources required.
    - Paris Declaration Indicator 7: “Provide reliable indicative commitments of aid over a multi-year framework and disburse aid in a timely and predictable fashion according to agreed schedules”
  - Aid funding and aid projects must be integrated into the PIPs.

As mentioned, national strategies do not always influence aid allocation unless they are matched by sector strategies which are reflected in the national budgets.

We need to recognise that while the MDGs are adopted at global and national level, implementation and success actually takes place at local and decentralised levels. Unless sectoral plans go to the local/provincial level and are matched by appropriate funding, no improvement will be seen. So the link is national strategies, matched by sectoral plans, with budget allocations.

Samoa is a good case in point, with for example, their sector strategies reflected into the budget through PIPs that are linked to MDG-based NSDS.

PIPs provide a multiyear estimate of cost, in line with Paris Declaration Indicator 7, which talks about ..

A good practice is to have both aid funding and aid projects integrated into the PIPs.

Aid coordination

- Coordination among local, national and international stakeholders
- Dialogue mechanisms are important

(among line ministries, government/ donors, government/ CSOs, at all levels)

- Capacities for coordination and negotiation

If aid is to increase significantly to US$50 billion a year by 2010 to reduce poverty and achieve the MDGs, clearly countries and donors have to do things a little differently.

We have already looked at some lessons learnt on aid coordination, which requires coordination among all partners, dialogue mechanism, and capacities for coordination and negotiation.

So let me conclude by looking at aid management.

Aid Management

- % of aid flows coming in /Where is it going?
- Aid modalities
- Tracking aid flows (grants & loans) through aid information management systems (AIMS)
- Reporting against results / reporting to donors
- Reporting on the budget
  - *Success hinges on capacities for effective planning & budgeting rather than technology*

Under Aid management, we look at:

- How much is coming in, the sources, where it is going,

- What Aid modalities are being used – budget support, pooled financing, project approach, etc

- How are both grants and loans being tracked? As you know in terms of AIMS, there is no single system that works : the best system is the one that meets your needs and fits your context.

- Aid management is also about reporting against results instead of just looking at expenditures, and reporting to donors on how the funds have been used, and reporting aid flows on the budget

Experience shows that success in aid tracking requires national capacities in planning and budgeting rather than IT.

Aid information management systems

Aid information management systems should :

– Be web-based and easy to use;

- Partners **enter data on-line** on their grants – MoF (or equivalent) not need large data gathering team
- **Partners get something back** – immediate access to their data and that of other partners
- **All ministries benefit** – not only MoF (or MoP, etc)
- **All levels of Government benefit** – not just the central level
- **Full transparency & accountability** – including **downwards accountability** to beneficiaries

On aid management, the lessons learnt show that there are many systems available and there is no one-size-fits-all.

Experience shows that the most useful AIMS should :….

-Partners **enter data on-line** on their grants – MoF (or equivalent) not need large data gathering team

Partners get something back – immediate access to their data and that of other partners. So that can be an incentive

All levels of Government benefit – not just the central government

Aid information management systems *cont* …

- provide overview of loans and grants;
- track outputs/results as well as use of financial resources
- Powerful reporting: support analysis and provide options for decision makers
- build on existing government systems, where applicable

– *How much will the system cost??*

It really depends on what you need, and can go from 0 to US$200,000 depending on whether you want to use an excel spreadsheet or a highly sophisticated system. Cambodia has a simple yet effective system which does not cost much. Other countries have more powerful systems. It’s really up to countries.

Some challenges

1. Alignment (with what? What systems are in place?)
2. Institutional capacity (absorptive capacity, procurement, PFM, PIUs…)
3. Donor field behaviour – HQ/field coordination
4. Normative framework e.g. gender, HR
5. Competing interests at country level (among donors, among sectoral ministries, within the UN)
6. Capacity of all actors, incl. donors

The final word is that there are some challenges to improving aid effectiveness.

-For e.g, When we talk about alignment, are the systems in place? If these are absent, what do donors align with?

-Is there adequate institutional capacity at different levels to absorb additional aid, for procurement , capacity for implementation, etc

-What about the way donors behave in the field? Is there enough coordination between what happens in the field and what HQ instruct donors to do?

-Some normative issues such as

Credit to:

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- *Thank you*

Before I will conclude, let me acknowledge the tremendous work done by my colleague at the UNDP Regional Center in Bangkok, who is leading some of the work on aid effectiveness. My presentation draws heavily on his work.

Thank you.