Relations between strategic planning method and performance budgeting system in the OECD countries

Elena Flores, Director ECFIN.G,
European Commission

Presentation prepared with A. Rutkowski

Conference on:
Performance Based Budgeting – prospects for Poland
Kraków
2-3 October 2008

Outline

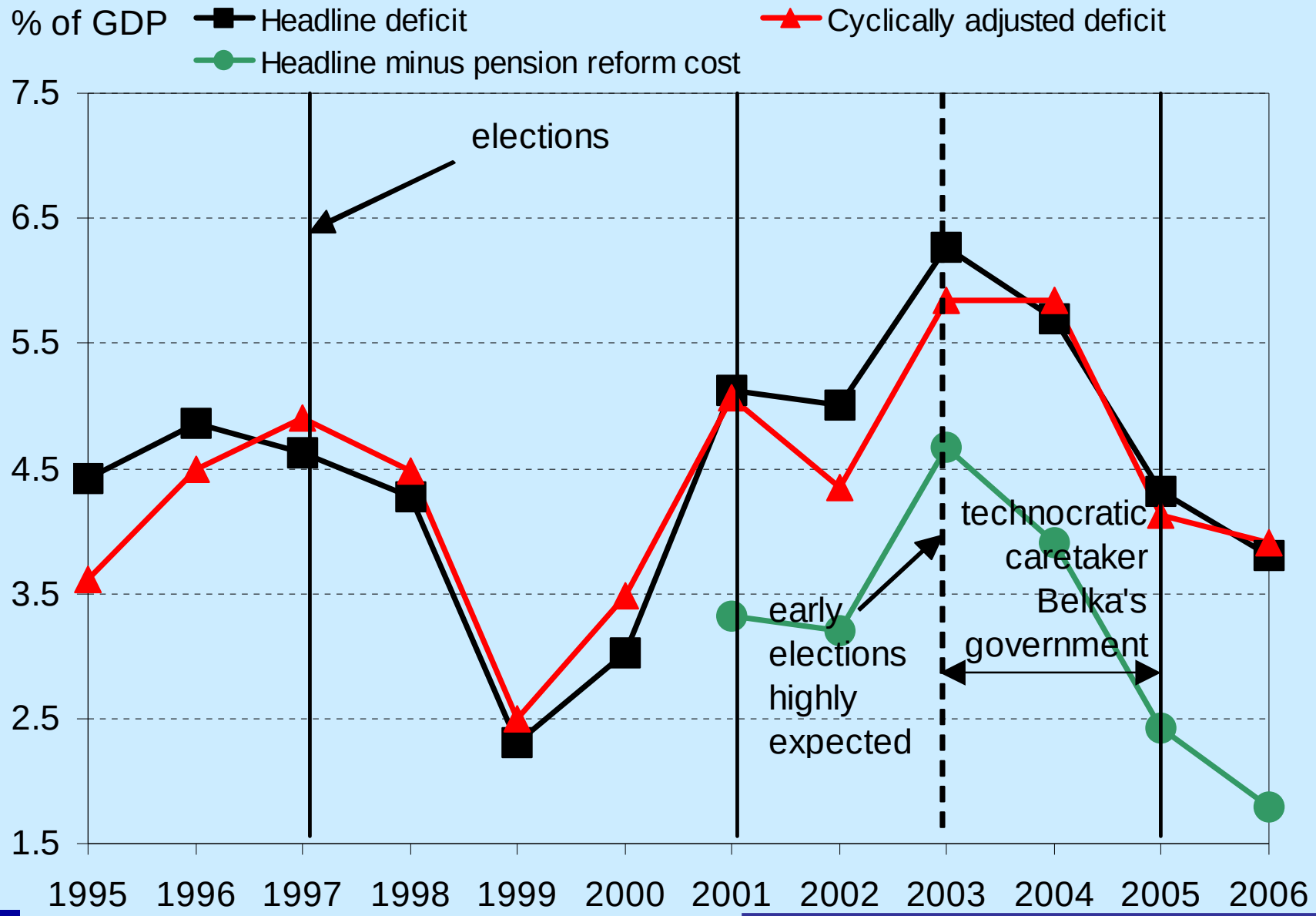
- Why the medium-term budgetary frameworks are needed
- Is there a need for a medium-term budgetary framework in Poland?
  - Political budget cycles
  - Many unsuccessful multiannual reform attempts
- Benefits from medium-term budgetary frameworks
- Key conditions for the effectiveness of medium-term budgetary frameworks
  - Cautious macroeconomic scenario
  - Credibility of medium-term projections – role of fiscal rules
- Main types of medium-term budgetary frameworks
- What types of medium-term budgetary frameworks in the EU?
- Medium-term budgetary frameworks and performance budgeting
  - The quality of performance budgeting in the EU
  - Is there need for performance budgeting in Poland?

Why the medium-term budgetary frameworks are needed

- Most fiscal policy decisions have economic and **budgetary implications which go well beyond the year** in which they are taken (some show up only in the medium or long run).

- A single-year budget is a poor tool for **strategic budgetary planning** and the **consistent multiannual implementation** of complex structural reforms

Is there a need for a medium-term budgetary framework in Poland? Political budget cycles



Source: Commission services

Is there a need for a medium-term budgetary framework in Poland? Many unsuccessful multiannual reforms

- 1999: **Balcerowicz strategy** aimed at reducing the general government deficit below 1% of GDP and public debt below 30% of GDP by 2003. **Part of tax reforms vetoed** by President Kwasniewski. **Expenditure reforms not adopted**.
- 2001: **Belka rule** aimed at limiting the real growth of central government expenditure to 1%. **It was not adopted.**
- 2003: **Kolodko package** focused on **one-off measures** to increase revenue (one-off payments from enterprises in exchange for cancellation of their tax arrears) and did not durably increase revenues. An attempt to reform expenditure indexation failed.
- 2003: **Hausner plan** most comprehensive and specific attempt at expenditure reform in social protection, public administration and state aids. Slightly more than a **half of the plan was adopted** (mainly social protection reforms lagged behind), with budgetary impact of about 2.8% of GDP over 2004-2007.
- 2005: **4-year deficit "anchor"** (nominal ceiling). Became outdated due to strong growth and revenue windfalls.
- 2006-2007: **Gilowska package**. **Deficit decreasing:** reorganisation of public finances (4 attempts) and fuel excise duty harmonisation **– none adopted**. **Deficit increasing:** Child benefits, social contribution cuts in 2007-2008 and personal income **tax cuts** in 2009 **– adopted**.

Benefits from medium-term budgetary frameworks

- Increased transparency of fiscal policy
- Better time consistency in the conduct of fiscal policy

→Smaller uncertainty for economic agents

- Alleviation of the common pool problem (particularly important in countries with ideologically dispersed coalitions)

→Less overspending and smaller accumulation of deficits and debt over time

- Better budgetary planning

→Major structural reforms more likely to be implemented

→Higher efficiency and effectiveness of fiscal policy

Key conditions for the effectiveness of medium-term budgetary frameworks

- A **cautious macroeconomic scenario**, which determines the availability of government resources

→"Prudence factors", contingent reserves, independent bodies

- **Credible medium-term projections** (targets) for the main aggregates of government finances (government balance and debt; government expenditure and revenue and their composition)

→Involvement of parliament, strong link with the annual budgets, clear indication of the implementation schedule for necessary reforms (forecasts under no policy change vs. targets)

Key conditions for the effectiveness of medium-term budgetary frameworks (continued)

Legally-binding fiscal rules contribute to the credibility of medium-term projections

- An **expenditure rule** (a ceiling for an annual nominal expenditure growth, as recommended in Lisbon assessments and Council opinions on the Conv. Prog.) can help achieving multiple goals in Poland:
  - → reduced political discretion in annual budgets → higher time-consistency and credibility of medium-term projections
  - → gradual deficit reduction
  - → macro stability (counter-cyclicality)
  - → stimulation of the reallocation of resources → performance budgeting

Main types of medium-term budgetary frameworks

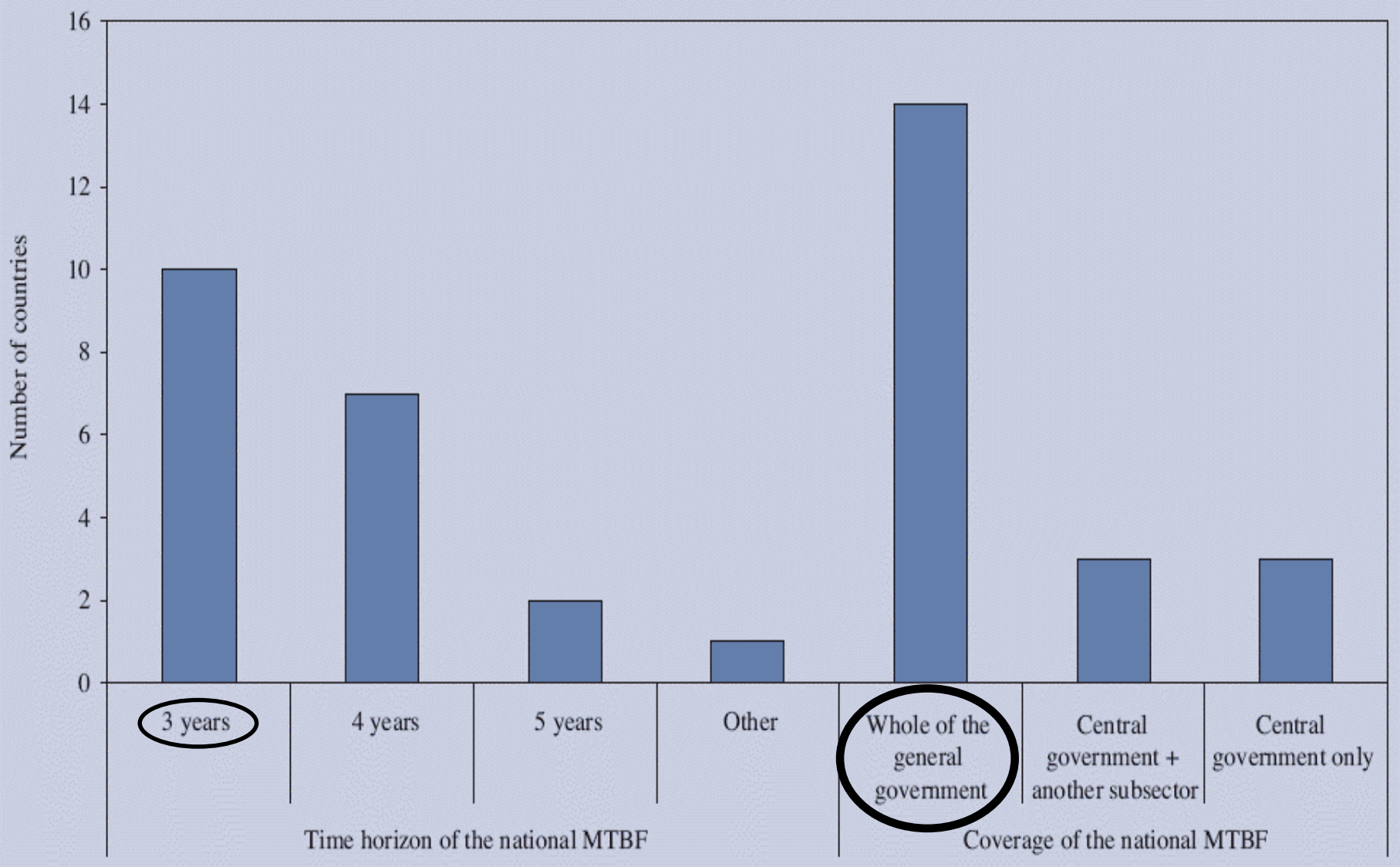
MTBFs vary across countries in different dimensions:

- cover part or the whole general government sector
- time span: usually 3-4 years, including the budget year
- level of detail of projections
- fixed vs. flexible frameworks
- rolling vs. periodical frameworks

	Fixed frameworks	Flexible frameworks
Rolling frameworks	**Rolling fixed frameworks** A new year is added every year, but the targets already set in the previous years for the intermediate years are not updated.	**Rolling flexible frameworks** A new year is added to the framework every year, and at the same time the targets for the intermediate years are revised.
Periodical frameworks	**Periodical fixed frameworks** The medium-term targets are set once and for all for a definite time period. There is no updating of the targets during the period.	**Periodical flexible frameworks** The medium-term targets are set for a definite time period (e.g. 2005–10), but the targets are revised during the period.

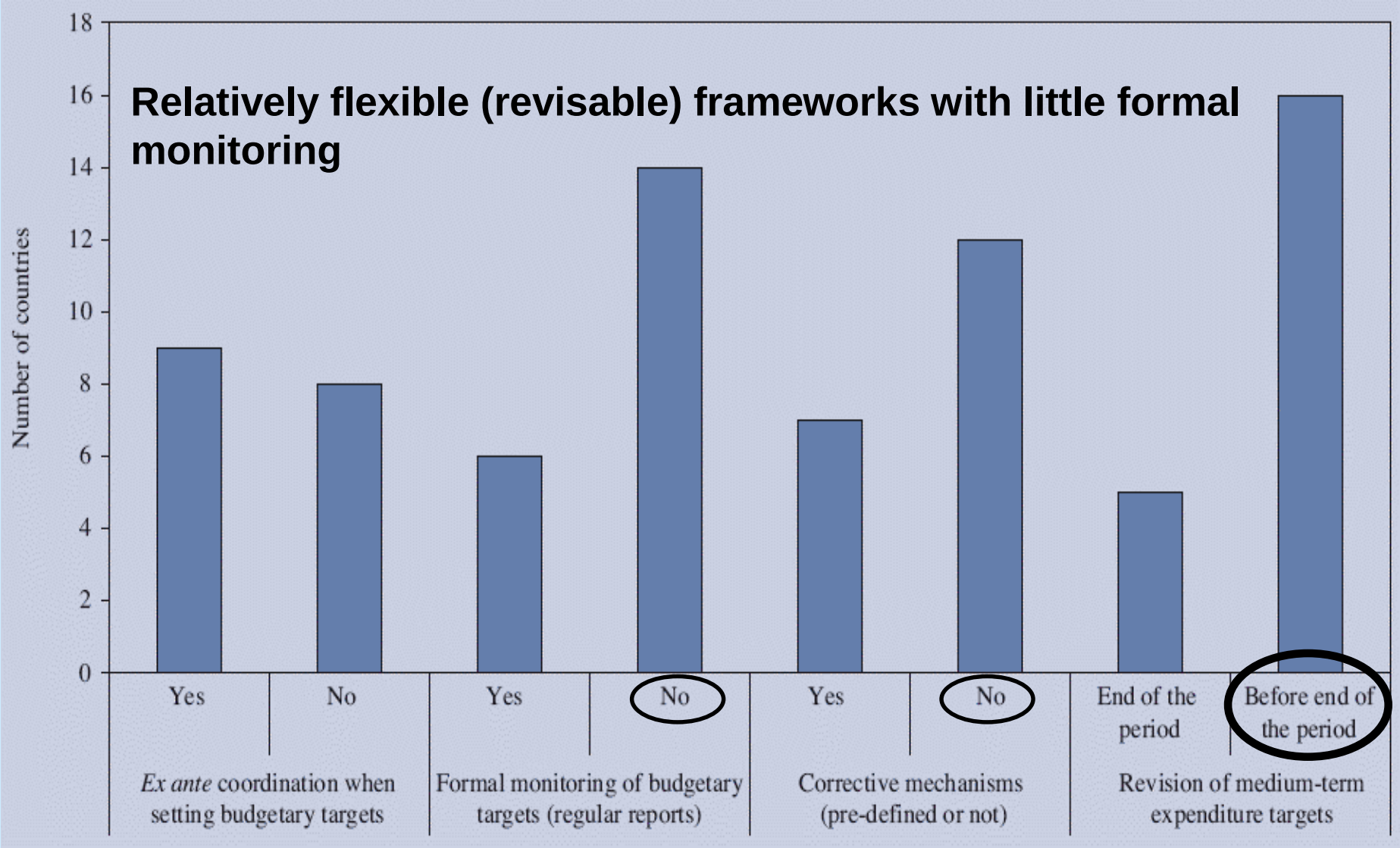
Source: “Public finances in EMU 2007”

What types of medium-term budgetary frameworks in the EU?



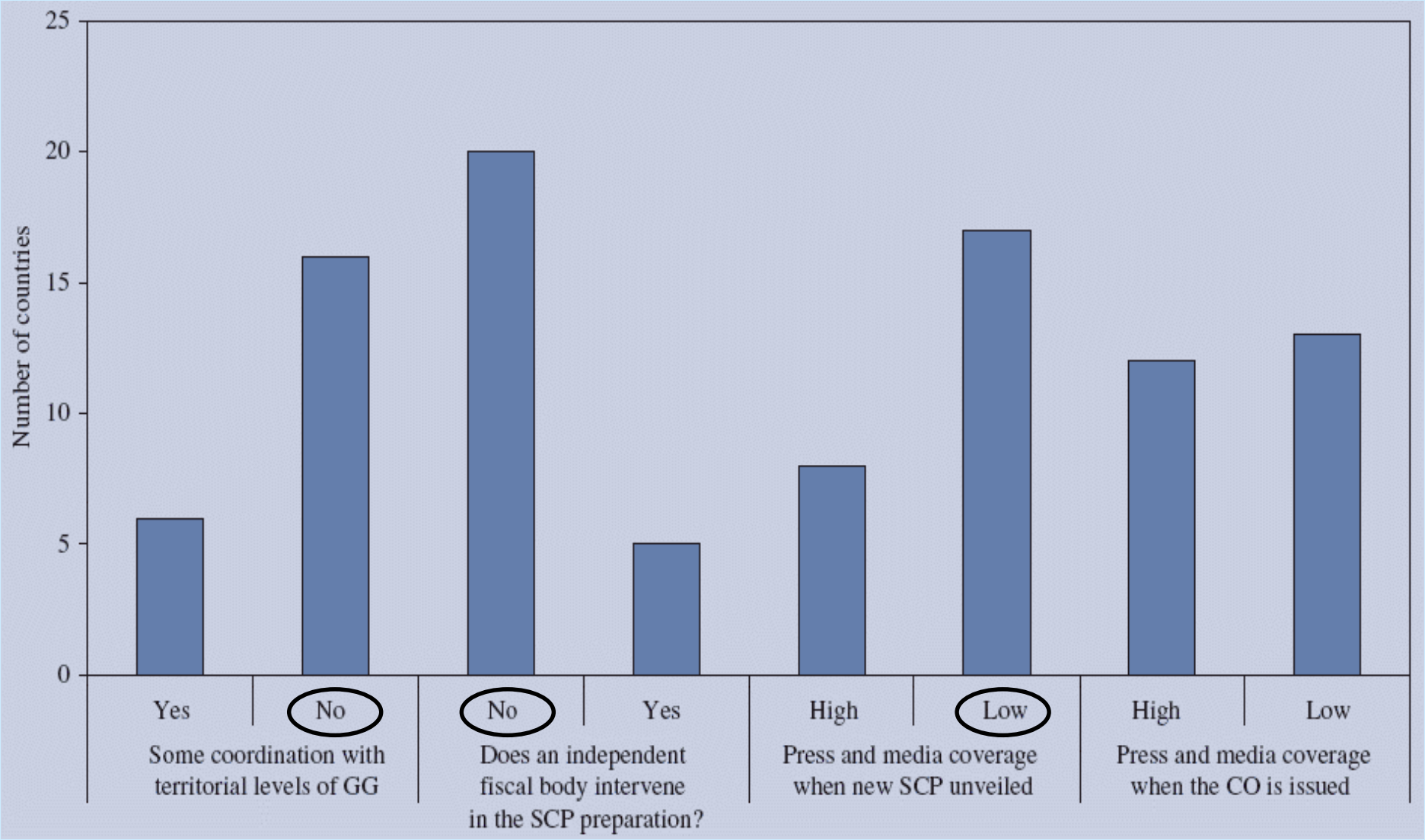
Source: “Public finances in EMU 2007”

What types of medium-term budgetary frameworks in the EU? (continued)



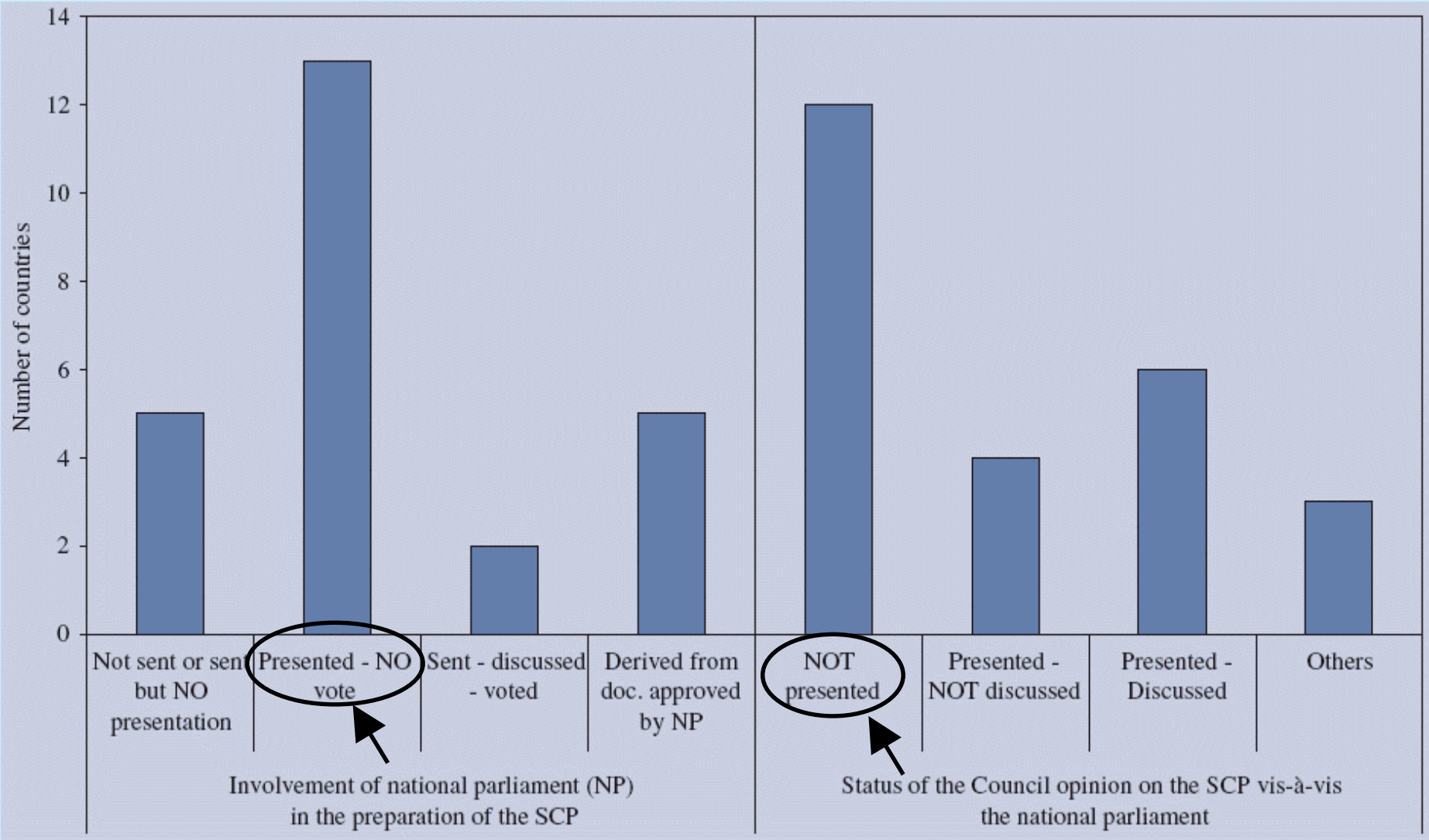
Source: “Public finances in EMU 2007”

Stability and convergence programmes as medium-term budgetary frameworks in the EU?



Source: “Public finances in EMU 2007”

Stability and convergence programmes as medium-term budgetary frameworks in the EU? (continued)



Source: “Public finances in EMU 2007”

Which factors explain the success in respecting expenditure plans?

(i) Realistic multiannual expenditure targets

(ii) Limited discretionary actions (time consistency) in reaction to lower or higher GDP growth

(iii) Sufficient control over autonomous units or their insufficient commitment

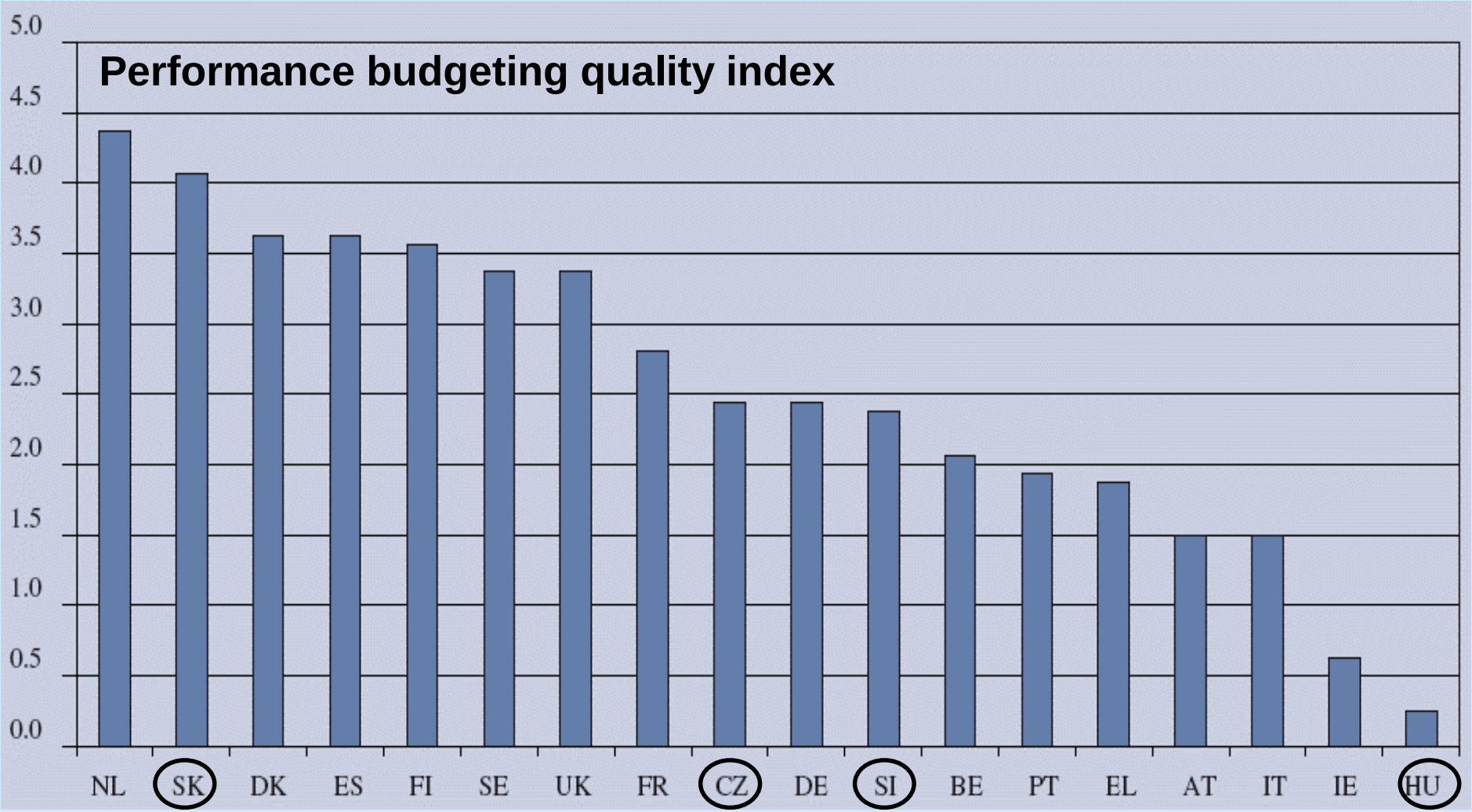
(iv) Quality of medium-term budgetary frameworks

- Existence of a national MTBF
- Connectedness between the multiannual budgetary framework and the annual budget
- Involvement of the national parliament when setting the medium-term budgetary objectives
- Coordination between levels of government
- Monitoring and enforcement procedures

Medium-term budgetary frameworks and performance budgeting

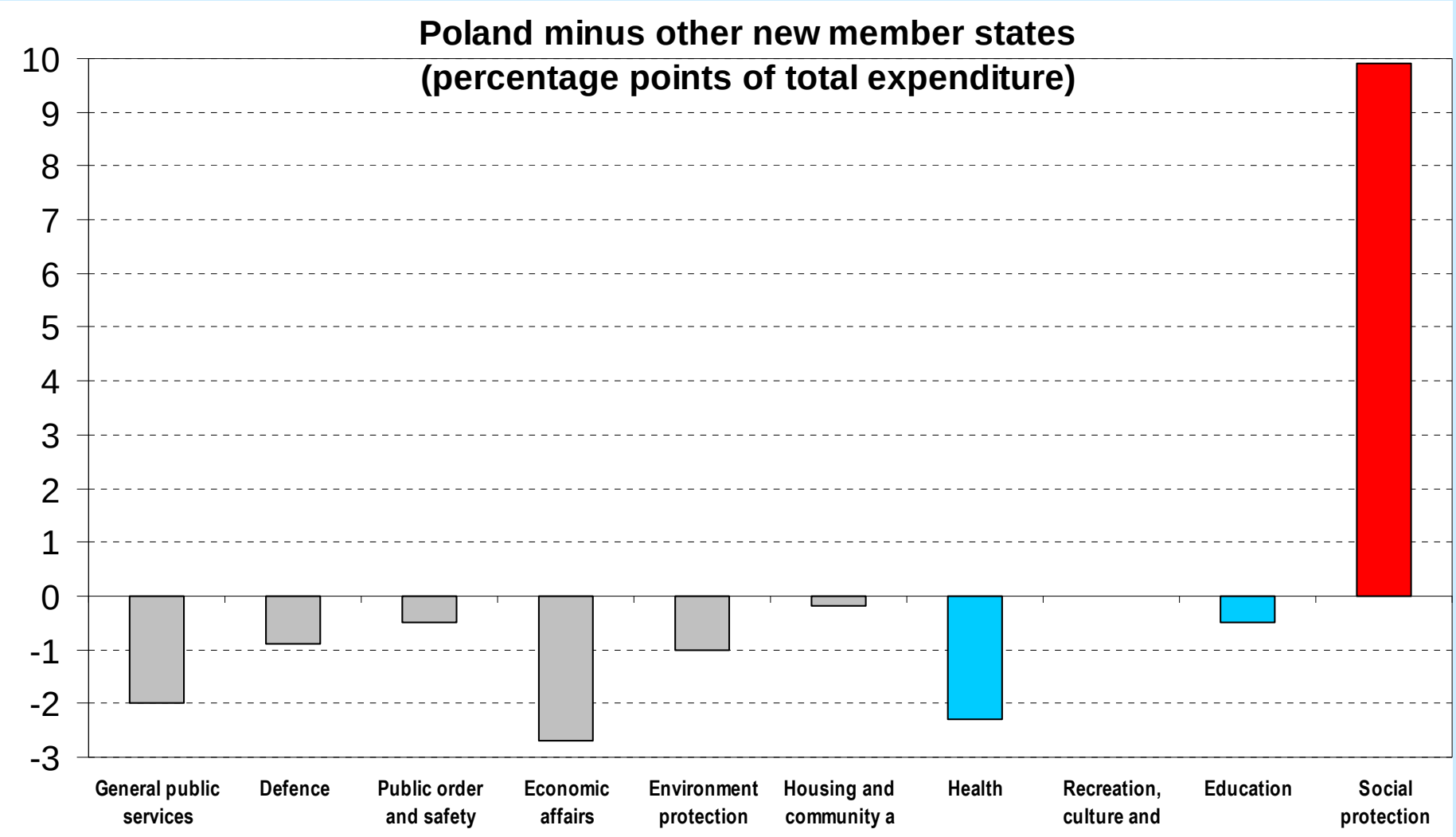
- Performance budgeting and medium-term budgetary frameworks reinforce each other
  - → Performance budgeting requires **MTBFs** because economic **structural goals** are usually achievable only in a **medium** or a **long term**
  - → Performance budgeting can strengthen the link between the **MTBFs** and the annual **budgets**
  - → Performance budgeting requires coordination between levels of government and monitoring (richer and more frequent information flow)
  - → Performance budgeting requires stronger enforcement procedures

The quality of performance budgeting in the EU



Source: “Public finances in EMU 2007”

Is there need for performance budgeting in Poland?



Source: Commission services

The recent public finance reform in Poland

An element of the proposed public finance reform: “Multiannual Financial Plan of the State” shall

(+) be adopted by the Parliament

(+) cover 4 years

(−) cover only the central state budget (non ESA95) thus not directly comparable with the Conv.Prog.

(~) be revised by the end of April each year to include new fiscal forecasts for the next 3 years

(+) the execution will be reported according to tasks and related outcome indicators (“task budgeting”)

(−) an amended fiscal rule which stops long-term public investment, rather than reduces public consumption or social transfers, if certain debt ratio threshold is exceeded

Conclusions

- Medium-term budgetary frameworks (MTBFs) help raising efficiency and effectiveness of public expenditure
- MTBFs and performance budgeting appear to need and reinforce each other
- Political budget cycles, unsuccessful budgetary reform attempts and suboptimal composition of expenditure suggest that Poland needs MTBFs and performance budgeting
- Key conditions for the effectiveness of MTBFs: cautious macroeconomic scenario, credibility of medium-term projections – importance of fiscal rules
- Dominating medium-term budgetary frameworks in the EU may be still suboptimal, so look at the overall evolution and frontrunners
- Being a new member state should not make it difficult to implement performance budgeting. Starting from scratch may be actually easier (no burden of bad habits)…