Medium Term Expenditure Frameworks (MTEFs)

An introduction

A paper produced by DFID's Health Systems Resource Centre
for the UK Department for International Development

DFID Health Systems Resource Centre

An MTEF is a multi-year public expenditure planning exercise that is used to set out the future budget requirements for existing services, and to assess the resource implications of future policy changes and any new programmes. This paper describes the role and value of an MTEF, and how it links with other initiatives such as sector wide approaches (SWAps), Poverty Reduction Strategy Papers (PRSP) and the Heavily Indebted Poor Countries Initiative (HIPC).

The budget in context

The budgeting process in low income countries tends to result in the allocation of resources on a historical incremental basis. This bears little relation to current health priorities and leads to a system which is unresponsive to changing health needs. It often involves programme managers submitting bids which are cut at the last minute, often in an arbitrary manner, by finance ministries to fit within existing resource ceilings. Overoptimistic assumptions about the amount of money to be mobilised through taxation or other sources, and weaknesses in financial management systems, also mean that budgeted allocations are rarely disbursed in full or in a timely and predictable fashion. Links between the development and recurrent budgets tend to be weak or non existent. Budget processes therefore lack credibility and provide little basis or incentive for sound planning even if the technical capacity exists to do so. Without this the scope for developing approaches based on sector or budgetary support is extremely limited.

The development of an MTEF is one way to begin breaking this vicious cycle. The process is intended to allow policy makers to stand back from the day to day fire fighting and reassess resource needs in the light of national priorities. The aim is to put in place a framework which offers some scope for significant resource shifts and offers a degree of continuity which is likely to survive changes in key personnel.

Key characteristics of an MTEF

An MTEF is a multi year public expenditure planning exercise which is used to:

- set out the future resource requirements for existing services, and
- assess the resource implications of future policy changes and any new programmes implied by this.

Practices vary considerably between countries, including OECD member states. However, key features of a 'model' MTEF are set out below.

- **The MTEF should be realistic.** Ideally it should be set within a macroeconomic framework and coordinated by a ministry of finance (or its equivalent). Countries, especially low income countries, do not spend what they need – they spend what they can afford. Public expenditure, therefore, should be set at a level which remains, when all revenue sources (including aid flows) are considered, consistent with macroeconomic stability[1]. Within this overall framework, allocations to the various sectors, including health, are made according to national strategic priorities. Best estimates of future resource levels are usually referred to as a 'resource envelope' – a term which can be applied at both sector and aggregate spending levels.
- **An MTEF takes a medium term perspective (usually 3 to 5 years)**. The figure for year 1 of an MTEF should always be the same as the annual budget.

[1] The implication being that macroeconomic instability hampers economic growth which reduces the capacity to support public expenditure programmes in the long term.

Indeed both MTEF and annual budgets should be developed through the same process and ultimately be approved by Cabinet. For future years practices usually vary by country but in all cases the recurrent implications of existing commitments need to be projected throughout the planning period and the financial implications of any policy changes and new programmes included. In some countries the practice is that in later years (say years 4 and 5) no new policy commitments are included leaving scope for more spending on existing programmes[2].

- **The MTEF is a rolling programme** and therefore needs to be updated on an annual basis. The annual budget is fixed and subject to a 'hard budget constraint'. The figures projected for later years are not seen as entitlements but as best estimates for planning purposes. However, any budgetary system needs to have some flexibility to respond to changing priorities throughout the budget year.
- **It should be comprehensive,** covering all public expenditure and revenues from all sources (including external development partners[3]).
- **There should be broad participation** in decisions related to sectoral allocations, intra-sectoral allocations and on sector policy discussions.
- **The MTEF should be based on realistic (conservative) cost and revenue estimates.** This could involve the provision of contingencies to cover changes in economic circumstances such as changes in the inflation rates and new policy commitments.
- **The MTEF should be presented in sufficient detail** to allow broad judgements to be made as to the appropriateness of the proposed allocation of resources and its consistency with stated national policies (see box on costing).
- **The MTEF should provide clarity in terms of accountability and responsibilities.** It should be approved by Cabinet and published (rather than just adopted as a working document) to enhance its credibility.

What can an MTEF achieve?

Some stakeholders question the value of MTEFs, seeing them as an additional obstacle recipients must overcome before accessing donor funds. However, although an MTEF requires significant effort the benefits can be considerable.

- Implemented successfully, an MTEF can **improve the efficiency** of public expenditure by locking countries into a process which, over time, channels resources from low value to high value uses and helps ensure that key services are adequately funded. In particular, the MTEF allows the future implications of policy decisions to be fully assessed and their affordability considered – something which the annual budget approach cannot do[4].
- An MTEF can **improve predictability** of resource flows if estimates are based on more realistic assumptions about revenue. This can also improve efficiency, given that shortfalls are often borne disproportionately by non-salary items which can seriously reduce operational efficiency.
- An MTEF can **raise resource consciousness** and promote more **output or outcome focused** approaches by requiring line departments to be more explicit about what they propose to do, why they want to do it and what it will cost.
- An MTEF improves **accountability** by encouraging governments to consider the medium/long term financial implications of their policy choices. Whereas ministries of health may be familiar with focusing their attention on developing new programmes, the MTEF approach encourages government to consider whether funds are best spent on strengthening existing programme. As such the emphasis is shifted away from the identification of new programmes towards a more balanced one which also considers issues such as expenditure control and resource allocation.
- An MTEF can promote i**ntersectoral approaches**: the process emphasises the question: 'How can the health of the population be best improved?' rather than: 'Which health sector interventions are best at improving health?' In many ways the process of developing an MTEF and the questions it raises are as important as the actual output.

It is important to emphasise the point that what really drives the success of MTEF is policy change; resource reallocation plays a largely

[2] The US, for example, uses a 5 year planning horizon. Year 1 is the current annual budget, in years 2 and 3 new policies and their implications are included whilst in years 4 and 5 no new policy changes are included. The UK, on the other hand, does not use an MTEF approach. In 1998 it adopted a 3 year budget approach – with hard budgets set for 3 years rather than just one.

[3] Problems clearly emerge here with the classic chicken and egg situation in which donors are unwilling to be explicit about long term support without seeing a costed plan, and governments cannot complete a plan until they know what resources are likely to be available.

[4] Although the recurrent cost implications of project/programmes are often addressed at the appraisal stage they are rarely set within an overall resource context. Thus, whilst governments might be able to pick up the local costs of projects when looked at individually they may be unable to cover such costs when added together.

Costing approaches

Approaches to developing a sector MTEF vary. The process is usually coordinated by the finance/planning department but requires significant inputs from line departments. As with the usual annual budget cycle it generally involves a combination of ‘top down’ approaches – with the finance department setting agreed expenditure ceilings consistent with macroeconomic stability – and ‘bottom up’ ones in which line departments cost what they need and try to justify why they should get a greater share of the available cake. The final outcome is arrived at through a process of iteration.

For the purposes of an MTEF it is not necessary to cost every line item required for every sub component of every activity of every programme. This would be unwieldy and of little use to policy makers. If the MTEF relates to all sectors and forms the basis of broad structural adjustment-type support one might expect health just to be covered as one item (although primary health care might be separated out). If the MTEF is supporting the development of sector support one would expect much greater detail. The basis would have to be agreed at the country level. Options might include using broad budget heads e.g. medical education and training or other approaches such as primary, secondary and tertiary care. Detailed line budgeting need only be included in the annual budgets, which would need to be consistent with the MTEF. In short, the annual budget contains the detail for the coming year; the MTEF shows broad directions for a longer period with the degree of detail determined through discussions between key stakeholders (notably finance/planning, the line department and donors).

This places greater onus on line departments to cost the services or functions they are responsible for. In practice, the financing of health services is extremely fragmented and there is little data on the unit costs of providing services. At the outset resources may be allocated in a very skewed way, with a heavy emphasis on salary costs and on tertiary hospitals. It may be sufficient to include a scenario which starts shifting resources in the right direction, such as more non-salary costs, especially maintenance, and primary health care especially immunisation. At later stages it should be possible to introduce more sophisticated or fine tuned approaches for service standards (including staffing requirements by type of facility), costing these and aggregating them. In simple terms at the outset the aim might be to move in the right direction without necessarily knowing what the destination should be – the destination is determined during the process.

supporting role. If there is no commitment for policy change simply shifting resources around the system will not drive major change.

What problems do low income countries face?

A number of factors make it difficult for low income countries to implement MTEFs.

- **Macroeconomic instability** – rapid inflation can render forward planning impossible.
- **Lack of quality (and timely) financial information** – data on donor flows is generally poor which is a major problem in aid dependent countries. In countries with multiple funding channels accurate data is difficult to obtain. National Health Accounts (or simpler rapid resource mapping approaches) can help address this.
- **Weak financial systems** – systems may not be in place to inform budget holders on whether budget ceilings are being adhered to.
- **Capacity and institutional weaknesses** – there may be weaknesses within line ministries to develop and present priority programmes effectively. Ministry of finance staff may also lack the capacity, or objectivity, to approve the most cost effective programmes.
- **Lack of budgetary discipline** – budgets are not treated seriously with a large number of supplementary allocations made during the year.
- **Overambition** – ministries of health, like many other ministries, often attempt to achieve too much with too little, spreading their resources too thinly resulting in poor performance across the board. Realistic costings may mean that it is not possible to provide adequate financing even for existing services. Yet there are major incentives to develop new programmes – in part because many donors are willing to fund capital and not recurrent costs.
- **Lack of realism** – projections are often made on the basis of overestimates of revenue sources.

Given this wide range of challenges, in some situations more limited approaches might be more appropriate. The constraints may need to be addressed before a full scale MTEF can be implemented.

MTEFs and other financial planning approaches

Other planning approaches are often used. Many countries use Public Investment Programmes (PIPs) as a key planning tool. This is often the case in many aid dependant countries where donor funding may finance a large proportion of the budget and support significant elements of recurrent funding. Although better than nothing, this approach does not take a comprehensive view of all public spending as it does not fully capture the link between capital (development) and recurrent spending.

Sector Investment Plans (SIPs) or Sector Expenditure Plans (SEPs) may cover both recurrent and development expenditure for a particular sector. They are not necessarily tied into an overall agreed macroeconomic fiscal framework and are, as a result, less credible and may just represent wishful thinking on the part of the concerned ministry[5].

How does an MTEF relate to other national initiatives?

SWAps – the MTEF is particularly important in a SWAp context. It can provide a SWAp with the medium term resource envelope for the sector. It can provide a broad financial framework though the detail might be contained in a financing plan for the SWAp. Though it may be possible to agree a resource envelope with the health ministry some countries have found to their cost that the finance ministry will simply transfer domestic resources out of the health sector if donors are putting large amounts of money in (the fungibility argument). A SWAp based on an MTEF significantly increases its credibility. At the same time there is a danger that donors can undermine the MTEF process by seeking to provide additional support outside an agreed MTEF. Ideally, all donor commitments should be included within the MTEF; the MTEF should not be a starting point for discussions on donor funding – it should be the outcome of such discussions.

Sector strategy reviews and annual performance reviews associated with SWAps can support both SWAps and MTEFs through the identification of new policy directions and their findings on effectiveness and how these might feed into the resource allocation process.

HIPC – this initiative releases additional resources to ministries of finance which can be used to fund more public expenditure or reduce debt. As such this affects the revenue projections to be included in the MTEF and, as HIPC is conditional on PRSPs or interim PRSPs, this may imply significant increases in expenditure on the social sectors.

PRSPs – the PRSP process affects the MTEF in a number of ways, by:

- increasing revenue flows (by releasing HIPC resources – see above);
- influencing sectoral allocations (towards the social sectors); and
- identifying the policy issues and new programmes required to achieve social objectives – the financial consequences and affordability of which the MTEF process will need to quantify.

National Health Accounts (NHA) – provide a comprehensive picture of past funding for health interventions. As a result they set a baseline on which an MTEF can be built. Whilst an MTEF is restricted to the government budget, NHA considers all financing source including private expenditure and provides essential inputs to discussions on sector financing priorities.

A Public Expenditure Review[6] assesses the effectiveness of public expenditure and makes recommendations as to how public funds can be better spent. The consequences for resource allocation need to be built into the MTEF.

Further reading

World Bank Public Expenditure Management Handbook: World Bank, 1998

Managing Government Expenditure, Salvatore Schiavo-Campo, Daniel Tommasi, Asian Development Bank, 1999

[5] Hence the need to involve Ministries of Finance in SWAP discussions. If donors agree to support a sector programme which is not fully supported by the Finance Ministry there is nothing to stop resources being withdrawn from the health sector (the fungibility argument).

[6] Some countries e.g. South Africa have carried out Health Expenditure Reviews which consider all health spending and not just public expenditure

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This publication was produced by the Health Systems Resource Centre on behalf of the UK Department for International Development, and does not necessarily represent the views or the policy of DFID.

The Health Systems Resource Centre is managed for the UK Department for International Development by the Institute for Health Sector Development.

Design/production: em associates, London