

**UNIVERSITY OF TAMPERE**  
**Master Programme in Public Finance Management**

**MEDIUM - TERM EXPENDITURE FRAMEWORKS**  
**The Application of Medium-Term Expenditure Framework**  
**for Budgeting in Sonla Province of Vietnam**

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## ABSTRACT

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In recent years, many developed and developing countries have moved to develop their annual budget process in a strategic medium-term expenditure framework (MTEF). While a common feature of medium-term expenditure approach is the inclusion of revenue forecasts and expenditure estimates for two or three years beyond the current year, medium-term expenditure practices vary substantially between countries in size, degree, forms, and success. In Vietnam, a pilot project of adopting MTEF has been done in the period of 2003 - 2011 in order to find out whether MTEF can be tailored to Vietnam's circumstances and to determine which core elements of MTEF will work best over there. Interestingly, Sonla province is in the process of evaluating how MTEF can be applied for budgeting at provincial level.

This thesis aims to provide a systematic study identifying the necessity, rationality, model and essential factors for applying MTEF in the budget process of Sonla province. The research conducted involved both the collection of secondary data through a literature review and international experiences of MTEF application, and primary data obtained through self-administered questionnaires. The main findings reveal that the application of MTEF for budgeting in Sonla province is necessary and rational. The design and application of MTEF in Sonla province will be carried out consistently and in collaboration with the national MTEF process. Reform of budgeting institutions, ensuring commitment of the provincial leadership, improving capacity of human resources, and developing information systems are main critical factors for successful implementation of MTEF in Sonla province.

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## ABBREVIATIONS

<b>Abbreviations</b>	<b>Equivalence</b>
<b>DOF</b>	The Department of Finance
<b>DPI</b>	The Department of Planning and Investment
<b>ed.</b>	edition
<b>et al.</b>	and others
<b>IMF</b>	International Monetary Fond
<b>MTBF</b>	The Medium-term budget framework
<b>MTEF</b>	The Medium-term expenditure framework
<b>MTFF</b>	The Medium-term fiscal framework
<b>MOF</b>	The Ministry of Finance
<b>MPB</b>	The Ministry of Planning and Budget
<b>MPI</b>	The Ministry of Planning and Investment
<b>ODA</b>	Official Development Assistance
<b>OECD</b>	The Organization for Economic Cooperation and Development
<b>PBB</b>	Performance-Based Budgeting
<b>PEM</b>	Public Expenditure Management
<b>VND</b>	Viet Nam Dong

## **1. INTRODUCTION**

*This section includes a background, literature review of medium-term expenditure framework and a problem statement which leads to the purpose and main research question of the paper. In order to guide the reader to go along with the study, a general methodology and expected outcomes are provided.*

### **1.1 Background**

In recent years, a large number of governments in both developed and developing countries have introduced significant reforms in the budget process to make fiscal policies more consistent and effective over the medium-term and emphasize the impact of policies and expenditures. Two reforms - performance-based budgeting (PBB) and medium-term expenditure framework (MTEF) - have been key elements in improving public financial management. PBB has been especially important in many countries in bringing an increased focus on results sought and achieved from government expenditures (i.e. getting better value for money). The reform is aimed at enhancing the efficiency with which public resources are allocated. At the same time, many countries have moved to frame their annual budget process in a strategic, multi-year framework that determines government revenues and appropriate expenditures for a multi-year period. MTEF provides a link between the expenditure allocation according to policy priorities and the fiscal disciplines required by budget realities. Some of the concepts which underpin MTEF also overlap with the PBB approach and help to improve programme performance through better predictability in resource flows to programmes, planning beyond one year horizons and by managers searching for higher value of public money (Boex, Martinez & McNab, 2000: 92; Kaşek and Webber, 2009: 9).

The idea of MTEF was devised originally in countries suffering from heavy government debt such as Sweden and the United Kingdom (Seok-Kyun, 2004: 43). However, the current paradigm of MTEF can be traced formally and most transparently in Australia - a leader among developed countries in reforms to control expenditure growth - in the 1980s (Schiavo-Campo, 2009: 04). The increase in adopting MTEF throughout the developing world can be seen as the central elements of public expenditure management reforms from the middle to late 1990s. At once, the Africa region is considered as "MTEF laboratory" of the World Bank with universal applications (Houerou & Taliencio, 2002: 01).

The rationale for introducing MTEF approach is based on several potential benefits. MTEF can improve macroeconomic stability through fiscal discipline, better intra- and inter-sectoral allocation of budget resources, effective prioritization of expenditures on the basis of clearly articulated socio-economic programmes, greater budgetary predictability, more efficient use of public finances, greater accountability for the expenditure outcomes and greater credibility in budgetary decision-making (the World Bank, 1998: 46). Yet, does MTEF work in practice?

In particular, by 2008, more than 100 countries had adopted elements of MTEF, and an additional dozen were in the process of MTEF implementation (Joshi, 2011). Countries are referred to as typical for the application of MTEF including as Sweden, Australia, New Zealand, Italy, Canada, Czech Republic, France, Holland, Mexico, the United State, Kenya and South Korea, etc. However, specific framework of MTEF significantly differs among countries and it reflects different purposes of MTEF and country's unique environment. More importantly, the big challenge is how to apply MTEF at the right time, based on objective conditions and a clear understanding of its benefits and limitations. Failure to do this may devalue the concept of MTEF which then becomes another empty term associated with unfulfilled expectations of public sector reform (Kąsek and Webber, 2009: 40).

In Vietnam, the decision to focus on applying MTEF was taken on the basis of actual reform strategies adopted across MTEF pilot in recent years, combined with the potential opportunities and synergies the reform has provided more generally improving public expenditure management (PEM). The establishment of MTEF can be seen as a natural complement to a performance budgeting framework because it provides realistic time frame within which most programmes can be properly implemented and have some of their impacts measured.

## **1.2 Literature review**

There are numerous books, articles, reports and researches which have introduced the medium-term expenditure framework over time. The relevant literature discusses four main aspects: characteristics, objectives and means of MTEF approach relating to the public expenditure management reform; specific implementing processes for a more effective budget; anticipated fundamental benefits, requisites and problems from adopting this budget reform; and practical lessons from MTEF implementing experiences.

MTEF concept has been the cornerstone of the approach to medium-term budgeting advocated by international organizations including the World Bank and the International Monetary Fund. The extremely broad reasons for adopting MTEF were promoted in the World Bank's 1998 *Public Expenditure Handbook*, as a key to increasing predictability and strengthening the links between policy, planning and budgeting and associated institutional mechanisms that facilitated the making and enforcement of strategic resource allocation decisions. In addition, MTEF was captured as mechanisms to promote consultation and debate, transparency and accountability, and to restrain decision making by resource availability. The World Bank also introduced sector and whole of government approaches to linking policy making, planning and budgeting in a medium-term expenditure framework (the World Bank, 1998).

In 2000, a review of multi-year budgeting practices<sup>1</sup> in six developed countries<sup>2</sup> was done which attempted to draw lessons from these experiences for a potential application of multi-year budget techniques by developing and transitional countries. Accordingly, five lessons that were relevant for developing and transitional economies were drawn: "(1) a multi-year dimension could be a valuable fiscal policy and management tool for developing and transitional countries; (2) the approach chosen in each developing or transitional economy should reflect the country's policy objectives, unique budget institutions and traditions, and administrative capabilities; (3) the introduction of a multi-year budget dimension is a gradual process; (4) the multi-year budget should be used to encourage the constructive involvement of line ministries in the budget process; and (5) the usefulness of the multi-year budget approach will crucially depend on the reliability and accuracy of the medium-term budget estimates" (Boex, Martinez & McNab, 2000).

In 2002, Philippe Le Houerou and Robert Taliencio drew preliminary lessons from experiences of nine African countries by a comparative assessment of the design and impact of MTEF on their public finance and economic management. They concluded that MTEF alone could not deliver improved public expenditure management in countries in which other key aspects of budget management, notably budget execution and reporting, remained weak. More importantly, their study recommended that comprehensive, detailed diagnoses of budget management systems and processes preceded MTEF in order to ensure appropriate design of budget reforms. For countries with weak capacity, a full-fledged MTEF could not be introduced all at once. They proposed

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<sup>1</sup> The term "MTEF" is not one which is used much by developed countries, where the terms "multi-annual" or "medium-term" budgeting are much more common (Robinson: 133).

<sup>2</sup> Australia, Austria, Germany, New Zealand, Great Britain, and the United States

guidelines for sequencing the overall public expenditure management reform programme and phasing in its MTEF - specific components. Furthermore, to have an impact, MTEF should be integrated with the budget process from the start, with MTEF outer year projections published as part of the budget document. In the view of differences in situations of each country, they suggested that these reforms were best managed by a set of overlapping, mutually reinforcing organizational structures, some of which should be specifically established to handle MTEF, though the Ministry of Finance should have ultimate responsibility. And lastly, they stressed that political motivations and incentives for launching MTEF explained in part why MTEF has been more successful in some African countries than others.

Brian Levy (2007) reported that “developing comprehensive MTEFs can be effective when circumstances and capacities permit. Otherwise, it can be a great consumer of time and resources and might distract attention from the immediate needs for improving the annual budget and budget execution processes”. He also introduced the preconditions that ought to be in place before MTEF implementation, including: reliable macroeconomic projections, linked to fiscal targets in a stable economic environment; a satisfactory budget classification and accurate and timely accounting; technical capacity and disciplined policy decision-making, consisting of budgetary discipline; and political discipline for fiscal management.

Salvatore Schiavo-Campo (2009) did research on the application and applicability MTEF to developing and lower middle-income countries. He reported that a medium-term fiscal and expenditure forecast to frame the annual budget preparation was essential in every country, to inject into the budgeting system awareness of the future and frame annual budget preparation. Thus the formation of a macro-fiscal analysis and projections unit was a priority. However, attempts to introduce a detailed and comprehensive programmatic MTEF in developing countries were invariably costly failures, causing waste, frustration and illusion, for trivial or imaginary benefits. Selective introduction of programmatic elements in the budget system was possible and may be desirable, but as any other institutional reforms it required years of persistent efforts consistent with capacity, resources, awareness, incentives, and institutional realities. In his point of view, the two ingredients of a potential successful MTEF approach were gradualism and selectivity, and the two main conditions of success were simplicity and communication.

In the study in six selected Emerging Europe countries<sup>3</sup>, written by a World Bank team and edited by Leszek Kąsek and David Webber (2009), implemented MTEF and PBB together have the potential to importantly raise the quality and consistency of forward estimates of public expenditure through their common use of policy-based expenditure programmes and programme- and activity-based costing methodologies. It could achieve results in more credible future budget commitments, more efficient expenditure prioritization and increased consensus around what fiscal policies are seeking to attain. The study recognized that, in all cases, many of the full benefits of these reforms were yet to be realized in terms of improved budget management, more evidence-based decision-making, quality and professionalism of administrative performance, expenditure effectiveness and fiscal stability. Overall, however, these emerging Europe countries are, to varying degrees, now taking significant steps toward a similar and worthwhile path. This study identified a number of critical factors which determined the speed and success of MTEF and PBB reforms in particular including both the character and quality and of public institutions and laws within the country, plus the degree of technical knowledge, degree of effort and experience applied to design and implementation of these methods. Additionally, different factors may be more or less important in each country's circumstances.

In Vietnam, the study on the application and applicability of MTEF in state budget process has been done by the Government (piloting MTEF in four ministries and four provinces from 2003 - 2011) and many researchers (Duong, 2005; Su et al., 2005; and Le, 2010, etc.). In these studies, MTEF were assessed as a potential solution for improving the efficiency of public expenditure management and budgeting uses by allocating limited resources more affordably and rationally to important priorities of the government. A set of documents, forms and process for applying and implementing MTEF at national and provincial level was done and a proposal for amending the 2002 State Budget Law and applying extensively MTEF in the whole country was submitted to the National Assembly.

In summary, the literature defines numerous theoretical aspects of medium-term expenditure framework including different characteristics, specific implementing process, critical successful factors, lessons from practical applications, and the challenges ahead. The literature also identifies anticipated problems and benefits of MTEF in the theoretical perspective and practical experiences.

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<sup>3</sup> Bulgaria, Croatia, Latvia, Poland, Slovakia, and Turkey

However, almost international and Vietnamese researchers did on the national scale. There are a few studies on the application of MTEF at provincial level.

### **1.3 Purpose and methodology of the study**

Sonla is a poor mountainous province located in the northwest of Vietnam, with 80% of total revenue transferred from the central government. Like other provinces, Sonla shares the same important causes of poor budgeting outcomes and the serious need of public expenditure reforms to increase efficiency and transparency of the way public resource is allocated and spent. For this reason, "The application of medium-term expenditure framework for budgeting in Sonla province of Viet Nam" may be accepted as an appropriate response to the problem based on potential benefits of MTEF and valuable experiences and lessons of eight-year pilot implementation of MTEF in Vietnam.

The main purpose of this paper is to provide a systematic study identifying the necessity, rationality, model, specific work and essential factors for applying MTEF in the budget process of Sonla province. In this paper, I go a step further to find out how MTEF work in order to do not breach between the promise of MTEF and its actual impact and how MTEF becomes a potential solution not only for the inadequacies of the current budget system but also for the broader issues in providing public services effectively and efficiently in Sonla province. This will be achieved by considering the main research question: "How can the medium-term expenditure framework be applied for budgeting in Son La province?" and the following sub-questions:

1. Should MTEF be applied for budgeting in Son La province?
2. How can MTEF be designed and applied in the budget process of Son La province?
3. What factors are essential for implementation of MTEF in Son La province?

The above-mentioned questions will be explored through both qualitative and quantitative methods. Secondary research in the form of a literature review will be conducted to better appreciate relevant concepts within a Vietnamese-specific context. The study will start with collecting and reviewing general features, objectives and process of MTEF, strengths and threats to MTEF, and requisites for the implementation of MTEF on a long journey to improve the public expenditure management. International experiences of MTEF performance will also be presented and considered as useful

lessons. The following is a description of practical contexts of state budgeting and the application of MTEF in Vietnam, and practical contexts of budgeting and posing a question for budget reform in Sonla province. These will inform the primary research process, through which empirical data will be accumulated during questionnaires. In other words, theoretical review and official documents of Vietnamese government are analyzed, which serves prior development of theoretical propositions to design the survey content, to guide data collection, and to develop framework for qualitative data coding and analysis.

This study benefits from the existing literature on MTEF implementation in the budget reform. It attempts to contribute to this research tradition by providing a guideline for the application of MTEF for budgeting in Sonla province in accordance with the national progress in the budget reform. This study will capture the attention of Sonla province's leadership and financial managers because no studies had been conducted or any attempts made to document a need and chance to apply MTEF in case of Son La province until this research. In addition, doing research on the application of MTEF for local budget is my dream of applying my new knowledge gaining from the master programme of public finance management at the University of Tampere to my position as an officer at the Office of People's Council of Sonla province.

#### **1.4 Expected outcomes**

The research will culminate in a combination of applied research papers and practical policy tools for MTEF practitioners:

- A literature review on MTEF in both developed and developing countries, and Vietnam.
- A process to guide applying MTEF for budgeting in Son La province.
- Policy briefs setting out the institutional and political environments in which MTEF instrument might be useful, and how the central government can support the provincial MTEF implementation.

The research outputs will be disseminated to Sonla government and other practitioners to discuss the findings of the research and policy implications.

This paper is structured in six sections. Section 2 provides a brief overview of the government budget and budgeting institutions, and public expenditure management and then spends a large space to present the budgeting elaboration according to MTEF and experiences of application MTEF in some countries. Section 3 reviews the current situation of budget in Vietnam and Sonla

province, including summarizing the pilot implementation of MTEF in Vietnam and posing a research question. Section 4 describes research methodology while section 5 answers the main research question dividing into three sub-questions. Section 6 concludes my study.

## **2. THE THEORETICAL FRAMEWORK**

*In this section, the theory of government budget and budget institutions, and the theory of public expenditure management will be reviewed in order to show the relationship related to how MTEF improves the public expenditure management. The objectives, general features, the implementing process, strengths and threats to MTEF, and requisites for the implementation of MTEF will also be presented in order to display the impact and benefits of MTEF in the budget process. In addition, a comparison of the traditional budget and MTEF, experiences of application MTEF in some countries will be introduced.*

### **2.1 The theory of government budget and budgeting institutions**

Every country needs serious financial resources for its existence. The word "budget", according to the Oxford Advanced Learner's Dictionary, is defined as "an official statement by the government of a country's income from taxes, etc. and how it will be spent". Academically, Jadranka Djurović-Todorović, Marina Djordjević (2009) referred the budget as "the main instrument through which governments collect resources from the economy, in a sufficient and appropriate manner; and allocate and use those resources responsively, efficiently and effectively". Another generally accepted definition of the government budget is "a record of the revenues and expenditures of a government during a given period of time. Ex ante, it shows what the government intends to do during that period and how it intends to finance these activities. Ex post, it shows what the government actually did and who had to pay for it and in what form" (Von Hagen, 2007: 28-29).

According to Jurgen Von Hagen (2007: 29), the budget is the result of the budgeting process, the way in which decisions on the use and funding of public resources are made. The budgeting process within the executive and the legislature is governed by budgeting institutions defining as the collection of the formal and informal rules, principles and procedures governing budget planning, approval and implementation. Under budgeting institutions, the budgeting process is divided into different steps, determining who does what and when in each step, and regulate the flow of information among the various actors. In doing so, budgeting process play a constitutional role in providing a framework in which all competing claims on public funds are manifested and reconciled with each other.

There are two main functions for the government budget in an overall sense: economic and financial. Economic functions concern how the government, through the budget, influences the entire economy. Through the budget, government tries to determine the level of public activity in the economy, a reasonable distribution of income and wealth, and to provide some control over the overall level of economic activity. These are usually described as policies for allocation, distribution and stabilization. Allocation policy is mentioned the relative size of the public and private sectors. In other words, the budget establishes both the overall level of government activities and specifies which activities are to be carried out publicly rather than privately. Distribution policy represents the government's attempt to redress to some degree the inequalities in wealth and income between citizens. Stabilization policy is where the government aims to improve the overall economy through budgetary policy. On the other hand, the financial functions of the budget are: first, an evaluation of total government and public authority expenditures within the budget sector; and, secondly, to act as the legislature's instrument of accountability and control over the government in its handling of financial matters (Hughes, 2003: 166-169).

Budget institutions shape and regulate the policy and process of generating and allocating public resources for carrying out government functions. Consequently, sound budgeting institutions are important for the ability of a country in order to design and implement effective fiscal policies. "Such institutions help ensure government accountability and prevent the leakage of public funds; increase efficiency of scarce public resources; and improve the prospects of maintaining fiscal stability and meeting social development needs". In particular, low-income countries have been put more effort to strengthen budgeting institutions because stability is more fragile, resource constraints are more binding, and social needs remain more pressing. Especially, the current global financial crisis and its impact on low-income countries have reinforced the importance of budget institutions in enhancing the effectiveness of fiscal policy as a stabilization tool (Dabla-Norris et al., 2010: 3-4).

Jurgen Von Hagen, in his study of Budgeting Institutions for Better Fiscal Performance (2007: 48-49), concluded that "good institutional design of the budgeting process is an important prerequisite of good fiscal performance". The adverse effects of the principal-agent relationship between voters and politicians can be reduced based on the design of budgetary institutions. "The environment in which the budgeting process evolves strongly affects accountability and competitiveness, which are strengthened by ensuring that the budget is comprehensive, that the budgeting process is transparent, and that budgeting is understood as a management exercise and not just a legal one".

Thus, institutional reform of the budgeting process is an important part of a policy aiming at achieving better fiscal outcomes. However, it does not mean that a change in legal and procedural rules mechanically produces better results. Practical experiences show that the outcomes of political decision-making processes are systematically shaped by the institutional environments within which these processes evolve and that reforms of the budgeting process have contributed significantly to achieving better fiscal outcomes. "In practice, institutional reforms are often the result of acute fiscal crises, of times when there is widespread awareness of the principal-agent and the common pool problems of public finances and a general recognition of the need for change. Better institutions help to make this awareness a durable one and thus serve as a commitment device for good fiscal performance".

In short, public budgeting systems are intended to fulfill several important functions of the government. These functions consist of establishing budget priorities that are consistent with the mandate of the government, planning expenditures to pursue a long-term vision for development, exercising financial control over inputs to ensure fiscal discipline, managing operations to ensure efficiency of government operations, and providing tools for making government performance accountable to citizens (Shan & Chunli, 2007: 138). The increasing significance of budgets in economy, through revenue and expenditures units, has obliged utilizing new techniques in managing it. On the other hand, public sectors have continued to face with big problems in the achieving of sources, effective and productive usage, source allocation, deficits and gradually increasing public loans. As a result, the significance of controlling public expenditure - the most fundamental function of a budget - has been stressed by both theorists and practitioners through their studies in order to present new approaches for these former problems mentioned (Djurović-Todorović & Djordjević, 2009: 282).

## **2.2 The theory of public expenditure management**

Public expenditure management (PEM) is a basic means of government policy distributing and utilizing sources productively, effectively and sensitively (Allen & Tommasi, 2001:19). While expenditure policy is trying to carry out an answer for the question "what" is to be done, the expenditure management tries to come up with an answer for the question "how" it is to be done. Additionally, the public expenditure management always considers the integral relationship between revenue and expenditure, such as between the money collected directly or indirectly from

the people, and the use of that money in a manner that reflects most closely the people's preferences (Djurović-Todorović & Djordjević, 2009: 282-283).

Public expenditure management is a necessary but difficult task in all countries. Governments in both developed and developing countries are pressured to spend more than the economic or tax foundation that can sustain, to continue funding old programmes even when new priorities are assessed to be more urgent, and to pay the rising expenses of inefficiently-operated departments. Significantly, many developing countries have to face with special problems in public finance management because "their resources are extremely constrained, the stockpile of needed skills and information is inadequate, pressure to spend more than they can afford on unmet needs is very intense, and they have meager reserves to ride out shocks or unexpected difficulties" (Schick, 1998: 29).

In fact, public expenditure management system varies from one country to another, but it requires accomplishing some complicated and determined duties. These elements and their salient characteristics are summarized as following (Schick, 1998: 2; Djurović-Todorović & Djordjević, 2009: 287-288):

- *Aggregate fiscal discipline* requires overall expenditure control, with expenditure estimates based on realistic revenue forecasts, and the capacity to set up fiscal targets and enforce them. It is also crucial to prepare a macroeconomic and fiscal framework done by the Ministry of Finance.
- *Allocative efficiency* operates at different levels within the government. The resource allocation among "strategic areas" and/or line ministries, provinces entails appropriate arrangements at ministerial and provincial level, and between ministries and provinces to formulate policies and decide on sectoral financial envelopes. The resource allocation among programmes, projects, and activities within these strategic areas requires both appropriate arrangements within line ministries and provinces for sector policy formulation and adequate technical capacities within spending agencies to select the most cost-effective programmes, projects and activities.
- *Operational efficiency* mainly concerns the operational level, and is dependent on arrangements to implement programmes within spending units on the basis of efficient and effective management systems.

All three objectives are in very strong interaction (The World Bank, 1998: 3), complementary and interdependent both theoretically and practically. "Without fiscal discipline, it is impossible to achieve

effective prioritization and implementation of policy priorities and programmes. Improving the internal management systems to achieve efficiency without a hard constraint is not credible. But mere fiscal discipline in the presence of arbitrary resource allocation and inefficient operations is inherently unsustainable" (Djurović-Todorović & Djordjević, 2009: 283). Beyond the three basic objective, public expenditure management also needs to take into account the wider values and requirements of society. "Accountability<sup>4</sup>, transparency<sup>5</sup>, predictability<sup>6</sup> and participation<sup>7</sup> are important instruments for sound budget management, but also have an intrinsic value, and are generally seen as the four pillars of good governance" (Djurović-Todorović & Djordjević, 2009: 290).

Public expenditure management reform, as a general concept, is a driving force behind public sector modernization in developed and developing nations alike. In its most basic form, PEM reform can help countries emerging from a major crisis (such as a hyper-inflation) set up basic rules and systems for budgeting and expenditure control, focusing on macroeconomic stability and monitoring key fiscal aggregates. In this context, the result may entail strengthening the operational capacity of the central fiscal authority and its links to revenue agencies. In addition, measures can be put in place to foster greater efficiency in the expenditure allocations - that is, to align the budget with public policy priorities, coupled with some degree of monitoring of the outputs produced. It is often at this stage that countries consider migrating from a line-item budgeting to a performance-based budgeting, as well as establishing basic monitoring and evaluation capacities; in some cases, medium-term expenditure frameworks are also introduced (Kąsek & Webber, 2009: 26). In particular, improving public expenditure management requires changes in budgetary institutions - the roles of spenders and controllers, the rules under which they claim, allocate and use resources, and the information available to them for making and enforcing expenditure decisions (Schick, 1998: 11, 20). The changes are applied to the three basic objectives of modern public expenditure management: to strengthen aggregate fiscal discipline, to allocate public resources in accordance with strategic priorities, and to promote the efficient provision of services, summarized in Table 2.1, 2.2 and 2.3 (Appendices)

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<sup>4</sup> Accountability means the capacity to call public officials to task for their actions.

<sup>5</sup> Transparency entails low-cost access to relevant information.

<sup>6</sup> Predictability results primarily from laws and regulations that are clear, known in advance, and uniformly and effectively enforced.

<sup>7</sup> Participation is needed to generate consensus, supply reliable information, and provide a reality check for government action.

(According to Salvatore Schiavo-Campo in *The Budget and its Coverage*, edited by Anwar Shah in *Budgeting and Budgetary Institutions*)

According to Rajaram & Krishnamurthy (2001: 2), public expenditure management approach was put into practice in the early 1980s by the World Bank and has been improved to a large extent so far. Especially, an increasing ratio of expenditure allocations, provisions, financial management and evaluations which form the significant units of public expenditure management approach have been followed after the year 2001. Public expenditure management approach has attracted the interest and has been supported not only by the World Bank and International Monetary Fond (IMF) but also the Organization for Economic Cooperation and Development (OECD) and European Union, so as to provide a better management in public (Djurović-Todorović & Djordjević, 2009: 284). Examining its studies, the World Bank has confirmed that it is possible to see "medium-term expenditure system" which forms the most important step of public expenditure management and budget rules (Djurović-Todorović & Djordjević, 2009: 284). The World Bank has supported many countries both technically and financially in terms of their application of medium-term approaches in public expenditures (The World Bank, 2000: 110). Nowadays, many countries have been able to develop their instutitonal capacities for conducting budget allocations and budget plans better through public expenditure management (Rajaram & Krishnamurthy, 2001: 5).

## **2.3 The medium-term expenditure framework**

### **2.3.1 The definition of MTEF**

According to the World Bank - the principal researcher in MTEF development (1998: 48), MTEF is "a whole-of-government strategic policy and expenditure framework within which ministers and line ministries are provided with greater responsibility for resource allocation decisions and resource use". MTEF consists of a "top-down resource envelope, a bottom-up estimation of the current and medium-term costs of existing policy and, ultimately, the matching of these costs with available resources... in the context of the annual budget process". The "top-down resource envelope" is fundamentally a macroeconomic model that demonstrates fiscal targets and estimates revenues and expenditures. To supplement the macroeconomic model, the sectors engage in "bottom-up" reviews that begin by scrutinizing sector policies and activities with an eye toward optimizing intra-sectoral allocations (Houerou & Taliercio 2002: 02).

MTEF is also defined as "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" (Pearson, 2002: 01).

Another definition of MTEF is "a rolling budget that covers the current budget year and the next two budget years. It contains a macroeconomic framework with a forecast of revenues and expenditures in the medium term, a multi-year sectoral programme with cost estimates, a strategic expenditure framework, a plan for allocating resources among sectors and detailed sectoral budgets" (Economic Commission for Africa).

In addition, MTEF in the developing world defined by Andrew Graham "is a fiscal planning framework that stresses certain key elements of the planning process to assure its stability, a strong linkage of inputs to anticipate outcomes, full budgetary transparency, and a unity in the cycle such that the legislative authority has both the information and capacity to direct the outcomes". In developed countries, "MTEF is really just one way to articulate a formalized and integrated financial planning process designed to instill fiscal discipline, predictability, and greater certainty with respect to predicted outcomes".

There is no doubt that MTEF implementation in practice varies from a country to another due to the heterogeneity of the situation which each country is faced with. In essence, MTEF links policy, planning and budgeting, thereby permitting expenditures to be driven by policy priorities and disciplined by budget realities, injecting a medium-term perspective and allowing for policy choices that enhance long-term development (Economic Commission for Africa).

In short, MTEF is an integral part of the annual budget cycle and typically includes: (1) a top-down resource envelope consistent with macroeconomic stability and broad policy priorities; (2) a bottom-up estimate of the current and medium term cost of existing programmes and activities; and (3) an iterative process of decision-making, matching costs and new policy ideas with available resources over a rolling 3-5 year period.

### **2.3.2 General features of MTEF**

To gain deeper understanding about concepts of MTEF, it is useful to distinguish three levels of development in defining a medium term framework as an operational concept.

*A medium-term fiscal framework* (MTFF) typically includes a statement of fiscal policy objectives and a set of integrated medium-term macroeconomic and fiscal targets and projections. It can be said that MTFF is the first, necessary step towards an MTEF (Oxford Policy Management, 2000).

In particular, MTEF establishes financial bounds such as budget expenditure rate/GDP, budget revenue rate/GDP, budget deficit rate/GDP, debt rate/GDP, aid rate/GDP, and the increase in total expenditure annually, etc. The limits are determined from 3 to 5 years and budget decision must be done within this framework. Briefly, the objective of MTEF is to set up overall financial tie with distribution of resources (Duong, 2005: 170).

*A medium-term budget framework (MTBF)* is a next step of MTEF based on developing medium-term budget estimates for individual spending agencies. The purpose of MTBF is to allocate resources to the nation's strategic priorities and ensure that these allocations are consistently with overall fiscal goals. This gives some degree of budget predictability to spending agencies, while ensuring overall fiscal discipline. Actually, MTBF is the most basic type of MTEF (Oxford Policy Management, 2000).

*A medium-term expenditure framework (MTEF)* develops the approach further by adding elements of activity and output based budgeting to the MTBF. Put simply, the objective of MTEF is to achieve efficient use of public resources for government activities in order to provide better public goods and services for citizens. It means the efficiency of distribution. These methods seek to improve the value for money of public expenditure, in addition to reinforcing fiscal discipline and strategic prioritization (Oxford Policy Management, 2000).

### **2.3.2.1 Objectives and means of MTEF**

The World Bank (1998: 31-32) reported four main factors contributing to poor budgeting outcomes in traditional budgeting, including (1) the failure to link policy, planning and budgeting; (2) unpredictability of funding; (3) the failure to direct resources to policy priorities; (4) the lack of authority and responsibility given to line managers to manage resources at their disposal. In the absence of effective decision-making processes, policy making and planning are disconnected from each other and from budgeting, and they are not constrained by resource availability or by strategic priorities. Overall, this leads to a massive mismatch between what is promised through government policies and what is affordable. The annual budgeting process therefore becomes more about scrambling to keep things afloat, rather than allocating. Those weaknesses lead to developing and implementing the medium-term framework for linking policy, planning and budgeting which can be accomplished progressively at a pace that fits a country's capacities.

Another interesting finding was that MTEF is intended to facilitate a number of important outcomes: (1) improving macroeconomic balance by developing a consistent and realistic resource framework; (2) improving the allocation of resources to strategic priorities between and within sectors; (3) increasing commitment to predictability of both policy and funding so that line ministries can plan ahead and programmes can be sustained; and (4) providing line agencies with a hard budget constraint and increased autonomy, thereby increasing incentives for efficient and effective use of funds (The World Bank, 1998: 48) .

Jand Kiringai and Geoffrey West (2002: 20) also shared a common ideal in goals of MTEF implementation in the context of a developing country like Kenya, including: (1) fiscal discipline - expenditure by line agencies must abide by hard budget ceilings to remain within aggregate resource constraints; (2) allocative efficiency - expenditure allocation should tackle national development priorities; and (3) operational efficiency - public spending should accomplish explicit outputs at minimum cost by applying performance targets of outputs relative to inputs.

The starting point in ensuring fiscal discipline through MTEF is to determine the revenue and spending aggregates. Accordingly, the government is required to make realistic forecasts of the resource envelope by estimating domestic revenue, external grants and concessional loans. The aggregate expenditure ceiling is determined by applying a politically-endorsed deficit and financing strategy. Fiscal targets for the aggregates and the main components of revenue, expenditure, deficit and financing over MTEF period are then specified, expressed as real or nominal values or as ratios relative to GDP. Then, the aggregate amount of public expenditure must be distributed to the main categories of expenditure. It is also essential to establish an indicative allocation of discretionary resources between recurrent and development expenditure. In addition, the aggregate expenditure ceiling must be split into hard budget ceilings for each sector and expenditure agency over the medium-term in order to enhance the credibility of the budget and avoids a hand-to-mouth approach to budgeting (Kiringai & West, 2002: 21).

According to Jand Kiringai and Geoffrey West (2002: 21-22): "It is important to acknowledge that setting expenditure ceilings is a difficult task but ensuring adherence throughout the year poses an even greater challenge. It is difficult to maintain fiscal discipline if political or administrative decisions cause expenditure to increase without an equal commitment to introduce policy and/or administrative measures that will enhance revenue collection". As a result, it requires that the Ministry of Finance has the capacity to estimate and project the standard cost of programmes to

minimize cost overruns and re-evaluation of contracts in view of the information asymmetry problem and the tendency of spending agents to underestimate the cost of proposed programmes. It should also have the capacity to develop a base line scenario that can measure the financial impact of proposed policy changes.

To maintain aggregate fiscal discipline, it requires changes in budgetary institutions to establish and enforce expenditure constraints. Allen Schick (1998: 85-88) summarizes the tasks of ensuring aggregate fiscal discipline as follows:

- Targets should reflect political commitments made by political leaders;
- Targets must be realistic and achievable;
- Budget aggregate targets should be set and enforced within a medium-term framework;
- Aggregate expenditure norms should be supported by sub-targets for major expenditure categories;
- The aggregate expenditure ceilings should be based on several indicators including sustainable revenue, the deficit, and total public debt;
- Expenditure targets should include mandatory expenditure;
- The budget system must include enforcement mechanisms, such as timely monitoring of outcomes;
- Hard budget constraints should allow some flexibility.

Jand Kiringai and Geoffrey West (2002: 22) also noted that, although fiscal discipline is essential for macroeconomic management, it is important to remember that aggregate expenditure limits do not guarantee quality expenditure. Quality can be achieved by concentrating resources on priority programmes (allocative efficiency) and by ensuring that the implementing agency utilizes resources productively (operational efficiency). MTEF usually recommends the adoption of a sectoral approach to planning and budgeting in situations of overlapping responsibility and duplication among ministries. The functional classification provides a starting point, however, each country should determine sectors according to its own economic and development priorities. This approach provides continuity and allows consistent budget analysis, which becomes a starting point for monitoring and evaluation.

For allocative efficiency, it can be improved if a government reallocates expenditure from low priority to high priority programmes and from less effective to more effective programmes. This

approach differs dramatically from incremental budgeting that locks in old programmes and locks out new ones even for emerging priorities. However, it faces severe opposition because of creating winners and losers. Resource reallocations require the government to: "define national development priorities, usually by formulating a strategic plan that defines what the government intends to accomplish; evaluate the cost-effectiveness of existing policies and ongoing programmes to determine whether they achieve their objectives efficiently; and reallocate resources from low priority and ineffective activities on the basis of comprehensive information on programme costs and effectiveness" (Kiringai & West, 2002: 23).

To enhance inter-sectoral allocative efficiency it is important to determine the cost of existing policies in the medium term after making proper allowance for expanding demand. It is also vital to determine the benefits to be derived from these policies in terms of actual and projected outputs and outcomes, and also the recurrent and capital costs of implementing these policy proposals. In addition, allocative efficiency can be enriched by intra-sectoral reallocations that involve choices which are best made by line ministries or by sectoral working groups. It is not surprising; therefore, that MTEF approach advocates greater managerial autonomy. One problem here is the tendency of line agencies to protect special programmes especially in cases where an impartial evaluation might recommend budget cuts. This is why it is essential that the Ministry of Finance need to develop capacity to evaluate programmes. It is also need to require line agencies to demonstrate that their expenditure programmes are achieving agreed development objectives in a cost-effective manner by providing monitoring and evaluation information as part of the budget preparation process (Kiringai & West, 2002: 25).

Regarding to operational efficiency, Jand Kiringai and Geoffrey West (2002: 25) said that "achieving sustained improvements in operational efficiency is likely to be the hardest step in reforming the budget process". It would be wasteful to allocate resources to a high-priority activity if they are not being utilized efficiently. Thus, the Ministry of Finance needs to have the capacity to assess the comparative worth of programmes in order to implement inter-sectoral reallocations. It also requires that right incentives and institutional arrangements are in place to ensure operational efficiency in the planning and budget system. Managers must be provided greater discretion in running their operations, determining what services to provide in-house and which ones to contract-out. In return, they must be held accountable for the results. Jand Kiringai and Geoffrey West also introduced a summary of institutional arrangements that would contribute to improved operational efficiency:

- Clarity of purpose (outcomes to be achieved);
- Clarity of task (outputs to be produced);
- Resources and systems commensurate with responsibilities (inputs to be utilized);
- Authority/flexibility to pursue the purpose and undertake the task;
- Accountability for use of authority; and
- Monitoring and evaluation.

In addition, Seok-Kyun Hur (2004: 43), discussing in Successful installation of MTEF to the Korean fiscal system, indicated clearly these multi-purposed and means which encouraged the pursuit of MTEF. The first aim of MTEF is to maintain fiscal sustainability by reigning in excessive expansion of public expenditure. There are two different types of ceilings - a global ceiling and sectoral ceilings in MTEF. These ceilings are determined interdependently by considering medium-term economic forecasts and sectoral demand estimates for public spending over the matching period. By requiring that the global ceilings be stricter than the sectoral ceilings, such a two-tier ceiling system can accommodate fiscal sustainability as well as flexibility of moving public resources across sectors. It help to remedy the current bottom-up budgeting system, conflicting interests among line ministries are often resolved by aggregate budget expansion beyond what is optimal.

Second, MTEF enhances the public expenditure efficiency by setting national priorities. Determining a production portfolio of diverse public goods and services needed to be prioritized within the limited resources is a critical and difficult task of the public sectors. Accompanied with a top-down allocation system, MTEF allows each line ministry to make a self-motivated sectoral budget plan based on a longer time horizon. This in turn ensures the time consistency and effectiveness of government expenditure programmes and enhances the possibility of these programs contributing to long-run economic growth. However, the importance and complementary role of bottom-up resource allocation needs to be emphasized enough. It is clear that a successful MTEF relies on both approaches of allocation. It means that physical resources and information on macroeconomic forecasting should be delivered from top to bottom. On the other hand, vital information for allocation of fiscal resources, such as production efficiency and demand quantity of specific public goods (or projects), should be transferred from bottom to top. Hence, a key to successful introduction of MTEF lies in finding harmony between top-down and bottom-up allocations (Seok-Kyun Hur, 2004: 43).

Third, MTEF bolsters the function of the fiscal management system as an automatic stabilizer. According to traditional public finance theory, one of the public sector's roles is the stabilization of an economy. The role of automatic stabilizers is vital in that it smoothes out the production stream of public goods and reduces swings in business cycles by absorbing shocks, which otherwise would be directly born by private entities (Seok-Kyun Hur, 2004: 43).

Seok-Kyun Hur (2004: 45) also introduced a picture of matching MTEF objectives with relevant policy components in MTEF (Table 2.4):

**Table 2.4: The objectives and their matching policy tools of MTEF**

Objectives	Policy tools in MTEF and their analogies
Fiscal Consolidation (Cross-time substitution)	<ul style="list-style-type: none"> <li>- Setting a global ceiling and sectoral ceilings on the budget plan based on medium-term economic forecasts</li> <li>- Analogous to consumption-savings decision by a private entity</li> </ul>
Enhancing Efficiency in Public Spending (Cross-sectional substitution)	<ul style="list-style-type: none"> <li>- Assigning sectoral ceilings based on national priorities and encouraging line ministries to allocate resources within their sectoral ceilings</li> <li>- Analogous to consumption bundle decision by a private entity</li> </ul>
Automatic Stabilization Mechanism (Cross-state substitution)	<ul style="list-style-type: none"> <li>- Smoothing public expenditures across time (in a business cycle) by assigning public expenditures within a medium- (or long-) term framework</li> <li>- Analogous to precautionary savings by a private entity</li> </ul>

To sum up, the strengths of MTEF, reported in Economic Commission for Africa, consist of improved macroeconomic stability through fiscal discipline, better intra- and inter-sectoral resource allocation, effective prioritization of spending on the basis of clearly articulated socio-economic programmes, greater budgetary predictability, more efficient use of public finances, greater accountability for the outcomes of expenditures and greater credibility in budgetary decision-making. Interestingly, implicit in the above are two further objectives including improving the linkage between annual budgeting and medium-term considerations, such as investment plans, borrowing capacity, changing spending policies, and priorities; and providing information relevant to political decision-makers on the cost implications of expenditure policies (VIE/96/028, 2003: 4).

### 2.3.2.2 The comparison of the traditional budget and MTEF

In order to get better understanding a new budget approach, the comparison of the traditional budget and MTEF have been made according to four main features, following (Table 2.5):

**Table 2.5: The comparison of the traditional budget and MTEF**

<b>Features</b>	<b>Traditional Budget (at Ministry level)</b>	<b>MTEF (3-year-rolling program at Sector level)</b>
<p><b>Aggregate Fiscal Discipline</b> (to keep expenditure within the means)</p>	<p>Focused on short-term macro-economic concerns (with international agencies providing the discipline in many countries).</p>	<p>Situates short-term macro-economic concerns within a medium-term macro-economic and sector perspective (3 years: n+1, n+2, n+3). Involves building domestic macro-economic modeling capacity.</p>
<p><b>Link between Policy, Planning, and Budgeting</b> (Reflecting the government's capacity and willingness to prioritize expenditure programs)</p>	<p>Very weak because policy choices are made independent of resource realities. Thus policy is not sustainable and spending patterns may not reflect the priorities articulated by government.</p>	<p>Policy-making tightly disciplined by resource realities. Thus a much stronger link exists between policy-making, planning, and budgeting. Spending reflects the stated priorities of Government.</p>
<p><b>Performance and Service Delivery</b> (Relating to operational performance of all resources human as well as financial)</p>	<p>Incentives for results in terms of outputs and outcomes are generally low because emphasis is on input control. Little attention to the predictability of budget funding.</p>	<p>Emphasis is on the delivery of agreed outputs and outcomes with available resources. Incentives are structured to increase the demand for evidence of good performance (accountability for sector managers for results). Consequently, service delivery should improve.</p>
<p><b>Autonomy of Credit Managers</b></p>	<p>Generally low, because lack of discipline within the traditional budget framework is translated into detailed input controls</p>	<p>Generally high because of greater discipline in setting and enforcing hard budget constraints plus accountability mechanisms that makes it possible for managers to be given more authority to determine how agreed outputs and outcomes should be achieved.</p>

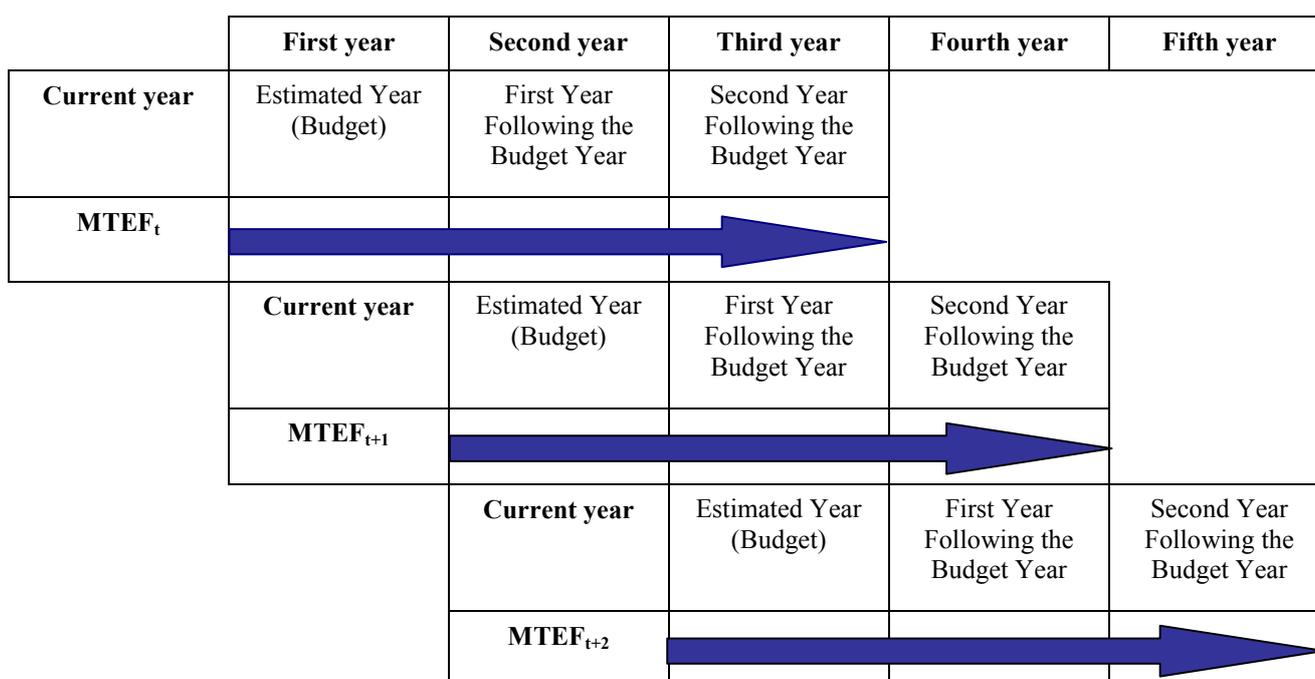
*Source:* Successful Installation of MTEF to the Korean Fiscal System (Seok-Kyun Hur, 2004: 45)

### 2.3.2.3 MTEF process

In general, MTEF tries to link policy with resource allocation decisions in a multi-year context to better reflect the effects of decisions on public finances, and mostly lead to improved policy decisions. In addition, it involves structuring the decision-making process to encourage economy and efficiency, and focus expenditure and policy on attaining the government's objectives. It could be said that MTEF is about strategic allocation of resources in line with government priorities and the opportunity costs of decisions (Dorotinsky, 2004: 01). However, MTEF cannot be achieved without the operation of key government processes on which it depends.

In fact, MTEF has not yet developed a formal set of procedures describing the process. Particularly, each government must consider a number of essential issues affecting the operation of MTEF approach in the light of local circumstances. It also decides concerning whether MTEF will: (1) be an annual exercise or will remain valid for several years; (2) set rigid or indicative ceilings for the initial year and the outer years; (3) set gross or net expenditure ceilings; (4) adopt a comprehensive approach including public enterprises and all levels of government, or will simply cover central government operations (Kiringai & West, 2002: 27).

A successive MTEF process can be seen in the following chart where each MTEF prepared covers next three years.



Source: Hakkı Hakan Yılmaz, (accessed January 13, 2008), [available at <http://ekutup.dpt.gov.tr/kamumali/yilmazh/dunyaba1.doc>]

Although MTEF process will depend on the institutional arrangements in each country, the Public Expenditure Management handbook (1998, 47-52) identifies seven main stages of a comprehensive MTEF, each of which feeds into the next, through an integrated bottom-up and top-down strategic planning process.

\* **Stage 1:** This stage involves developing the macroeconomic framework, which will be used to make projections of revenues and expenditures for three years. It is a necessary step in achieving aggregate fiscal discipline based on macro-analysis and modeling. Information on what is fiscally affordable and sound is required for restrained decision making. Thereby, it is vital to keep in mind the role of linking economic projections to fiscal targets and the requirements for constructing and using models. In fact, the transition from planning to budget frequently suffers from inconsistencies such as over-commitment. In this case decisions do not take into consideration the aggregate resource constraint or their ongoing costs. Many evidences show that linking economic projections to fiscal targets can assist in identifying problems by checking the internal consistency of proposals and by generating accurate forecasts. It can also demonstrate trade-offs between alternative uses of resources and can make clear the underlying assumptions about relationships and priorities (the World Bank, 1998: 49).

\* **Stage 2:** This stage involves a sector review process through which sector/ministry objectives and activities are agreed and then costed. It includes three steps: (1) agreeing on objectives, outputs and activities of sectors/ministries; (2) reviewing/developing agreed sectorial/ministry programmes and sub-programmes; and (3) costing agreed programmes for 3 years (consisting of recurrent and capital costs). After reviewing and costing programmes and sub-programmes, ministries need to go through a process of prioritization to make programme costs fit within available resources. In other words, it involves determining on which activities need to be scaled-down, postponed until the following year or dropped altogether. This information is provided to the Ministry of Finance in order to develop the expenditure framework and ceilings. During this stage, performance indicators for agreed programmes and sub-programmes can also be developed. Consequently, ministries can assess outputs which are achieved with the resources they are given. This stage can proceed in parallel with stage one (the World Bank, 1998: 52).

\* **Stage 3:** It involves a series of hearings between the Finance Ministry and sector ministries to go over the outputs of the sector review (the World Bank, 1998: 52).

\* **Stage 4:** A detailed strategic expenditure framework will be established based on the macroeconomic framework and the sector review output. This framework enables the analysis of the trade-offs between and within sectors of certain funding decisions. It is also the foundation for the establishment of sector expenditure ceilings for the next budget year as well as the two coming years. This framework needs to cover a medium-term time frame (usually 3 to 5 years) and includes clear statements on the following: (1) the broad objectives of policy and the role of government in the economy; (2) the need for discipline in macroeconomic management; (3) targets for broad aggregates of public revenue and expenditure; (4) procedures for setting and revising the expenditure framework; and (5) responsibilities of key agencies (the World Bank, 1998: 52).

\* **Stage 5:** This is a crucial stage of MTEF process because it presents an approval of budget ceilings for the next three years done by the Cabinet, making medium-term sectoral resources allocations on the basis of affordability and intersectoral priorities. Top-down sector resource envelopes reflecting existing policy and the dynamic of the changing priorities of government - political, economic and social in a medium-term horizon are a foundation for predictability so that appropriate strategic and efficient operational decisions can be made and implemented. Predictability of resource flows can be increased relying on restraint and discipline in defining the sector resource envelope, thereby increasing operational efficiency, and permitting greater flexibility in the resource management that are defined by the sector envelope. A set of criteria applied in deriving broad expenditure allocations needs to identify. The agreement on criteria will provide guidance on how to adjust to new or altered circumstances and can increase discipline and predictability (the World Bank, 1998: 52-53).

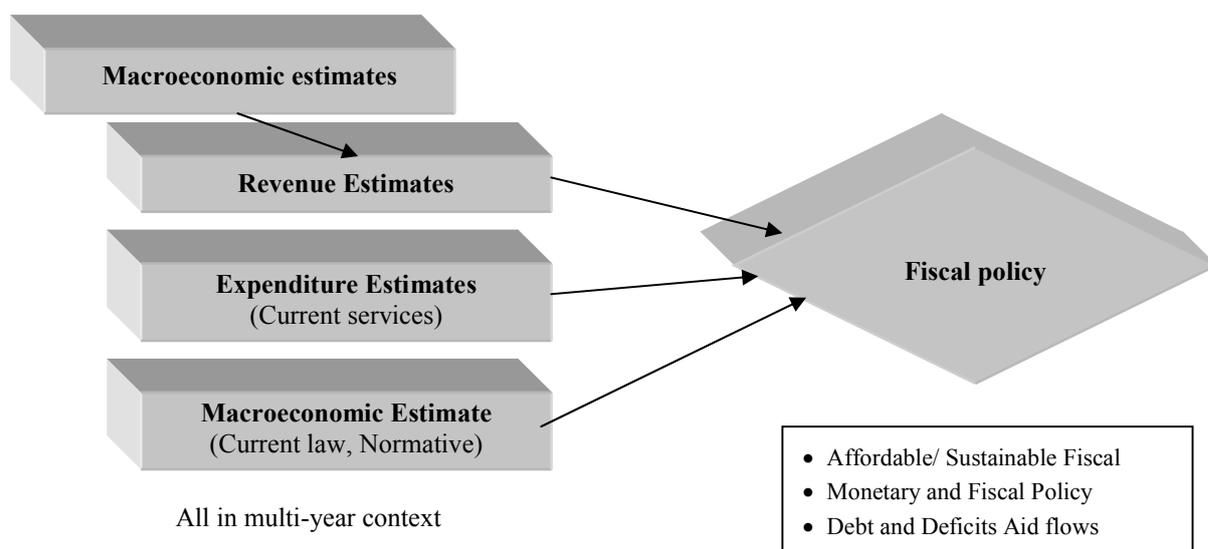
\* **Stage 6:** At this stage, revisions to the budget estimates in order to make them fit within the approved ceilings will be done (the World Bank, 1998: 53).

\* **Stage 7:** The revised budget estimates are reviewed again by the Ministry of Finance and presented to the Cabinet and the Parliament for final approval (the World Bank, 1998: 53).

In the view of Bill Dorotinsky (2004: 01-15), actual decision-making processes and institutions will vary by country, but broadly speaking, MTEF process can be divided into five general operational stages.

**\* Stage 1: Macroeconomic and public sector envelopes.**

**Figure 2.1: Stage 1 - Macroeconomic and public sector envelopes**



*Source:* Developing a Medium-Term Expenditure Framework (Dorotinsky, 2004: 2).

This stage begins with the development of macroeconomic forecasts for budget development. Countries use a variety of institutional measures to support sound macroeconomic estimates consisting of during the budget development stage and after budget passage to assure alignment of the budget with best estimates or emerging trends (Dorotinsky, 2004: 2-3).

Once the macroeconomic estimates are prepared, revenue and expenditure estimates will be developed. All revenues must be considered, including user fees, administrative fees, ministry own revenues, etc. as well as external aid flows in order to provide a complete and comprehensive picture of government financing levels and needs. Another exercise is to prepare broad expenditure estimates based on current policy, and explore expenditure sensitivity to changes in economic estimates. Its objective is to explore, at a relatively aggregate level of spending, expenditure trends and gauge affordability over several years. Bill Dorotinsky said clearly that the multi-year aspect allows the Ministry of Finance an early warning indicator if some programmes are likely to increase beyond affordable limits, as well as to explore general policy options and their impact on

expenditure trends (as well as explore policy changes that might liberate resources in current and future years for new initiatives) (Dorotinsky, 2004: 4-5).

He called these initial estimates as ‘baseline’ estimates which is to forecast future expenditure assuming continuation of the recurrent expenditure levels or laws – that is, assuming no changes in policy or expenditure trends, what do the out-years look like? In his point of view, a useful exercise would be to prepare two broad baseline estimates: one assuming current funding levels of discretionary expenditure and current laws for mandatory expenditure as a current ‘policy’ baseline; and one assuming current normative and other laws with implicit commitments were fully funded (which may require expenditure ministry assistance, and which may in fact also represent the current annual requests from expenditure agencies). The exercise would be instructed to identify the ‘policy gap’ or difference between current levels of public expenditure and those required to fulfill policy commitments as contained in normative laws (and gauge the realism of normative sector policies) (Dorotinsky, 2004: 5-6).

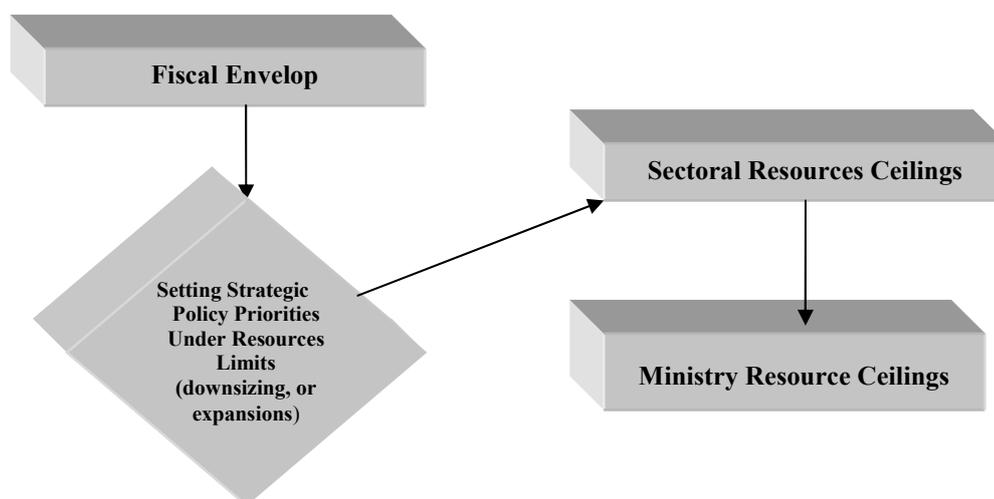
Accordingly, a fiscal policy paper will be presented to Cabinet for discussion, with the objective of obtaining some Cabinet decision on over-all government revenue, expenditure, and deficit policy or framework. For this reason, this document will be drawn jointly the results of the modeling and forecasting exercises into an understandable report of trends and policy implications for senior government officials and the public. The paper explores implications of monetary and fiscal policy for economic growth, as well as trends in fiscal policy, deficits and debt projections under current trends, and broad options for changing policies. If it serves clearly in presentation and readily assessable to non-economists, it will be a useful vehicle for educating senior policy officials related to basic economic issues, and linking between government policies and outcomes. He suggested that the paper should include recommendations of the Finance Ministry on a path for sustainable or improved economic growth, consisting of aggregate revenue and expenditure paths (including deficits and debt policy) (Dorotinsky, 2004: 6).

**\* Stage 2: High-level policy: aligning policies and objectives under resource constraints.**

After the fiscal policy envelope is developed setting the aggregate public revenues and the expenditure ceiling, decisions need to be made on the allocation of this ceiling across sectors (such as health, education, etc.) and ministry. Each ministry is then bound to meet the ceiling set by Cabinet and Parliament. Specifically, the allocations of some key sectoral expenditure, which its

trends may have been identified as threats to policy or fiscal stability, may have developed in the course of the fiscal policy discussions. The rest of funds need to be allocated, and the allocations would reflect at least general policy directions of Government, and specification or modification of Government objectives, in broad terms, for each sector (Dorotinsky, 2004: 7).

**Figure 2.2: Stage 2 - High-level policy**



*Source:* Developing a Medium-Term Expenditure Framework (Dorotinsky, 2004: 7).

According to Dorotinsky (2004: 7), a good starting point for setting the indicative ceilings for sectors and ministries is the second year of the prior budget's multi-year forecast, adjusted for known modifications in Government priorities and policies, improved expenditure estimates, main revisions in revenue and expenditure targets, etc. Moreover, some countries decrease sector ceiling allocations and create a central 'policy reserve' that is used to fund new initiatives after expenditure requests are received in Stage 4.

He also showed that it is important to distinguish between mandatory and discretionary expenditure in making allocations within sectors. Unless key policy changes are expected for extra-budgetary funds and mandatory programmes, the best estimate of expenditure for these programmes would receive its full allocation. Discretionary programs would receive residual amounts for the sector - perhaps lower than desired. This stage can generate much debate on growth of entitlement expenditure and its crowding-out of other government expenditure, and helps clarify the tension in these programmes (Dorotinsky, 2004: 8).

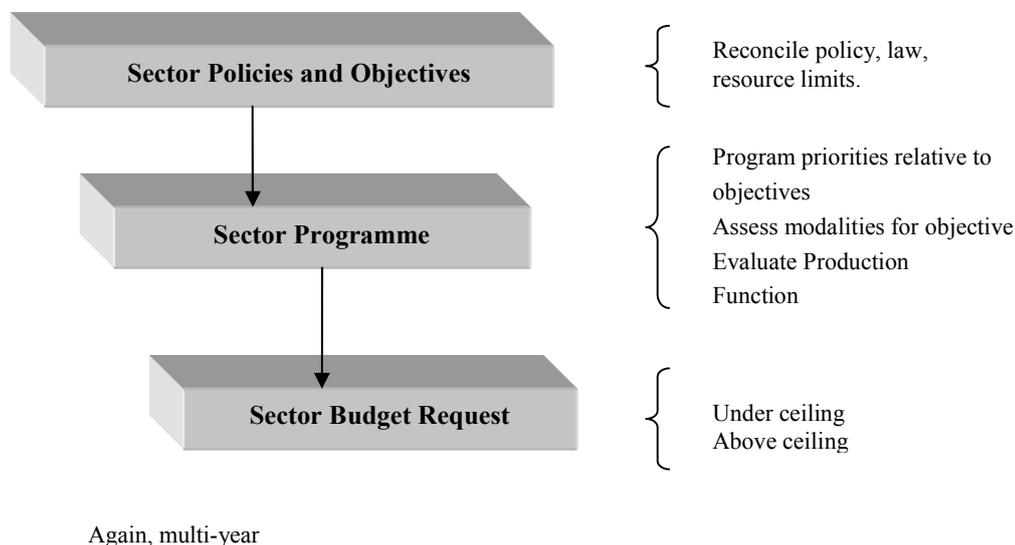
Furthermore, sectoral allocation needs to be reviewed for revenue earmarking and the constraints it imposes on reallocation of expenditure across sectors or programmes (Dorotinsky, 2004: 8).

Once approved by Cabinet, these indicative ceilings for each sector/ministry are transmitted to Ministries, usually as part of the annual budget call circular that initiates the budget process and provides instructions for ministry budget submissions (Dorotinsky, 2004: 8).

**\* Stage 3: Linking policy, resources, and means by sector.**

The first activity in this stage is to prepare budget proposal. After receiving sector or ministry indicative ceilings, each line Ministry must develop its budget proposal. The expectation of each Ministry is to take the resource ceiling as given, and allocate expenditure among its activities and programmes to succeed its objectives. This is particularly important to assure harmonization of normative laws and sectoral and ministry strategic plans and attendant objectives, organization and staffing, with the available resources. These decisions include both recurrent and capital expenditure, encouraging ministries to think strategically about their programmes, to evaluate what are the necessary labor and capital inputs to attain an objective or implement a programme (Dorotinsky, 2004: 10).

**Figure 2.3: Stage 3 - Linking sector policy**



*Source:* Developing a Medium-Term Expenditure Framework (Dorotinsky, 2004: 10).

The second activity is to allocate flexibly resource. The degrees of freedom to allocate expenditure for ministries are different among countries. Some countries provide great latitude for allocating resources to ministries. In this case, the Ministry must justify and defend its choices, and bear

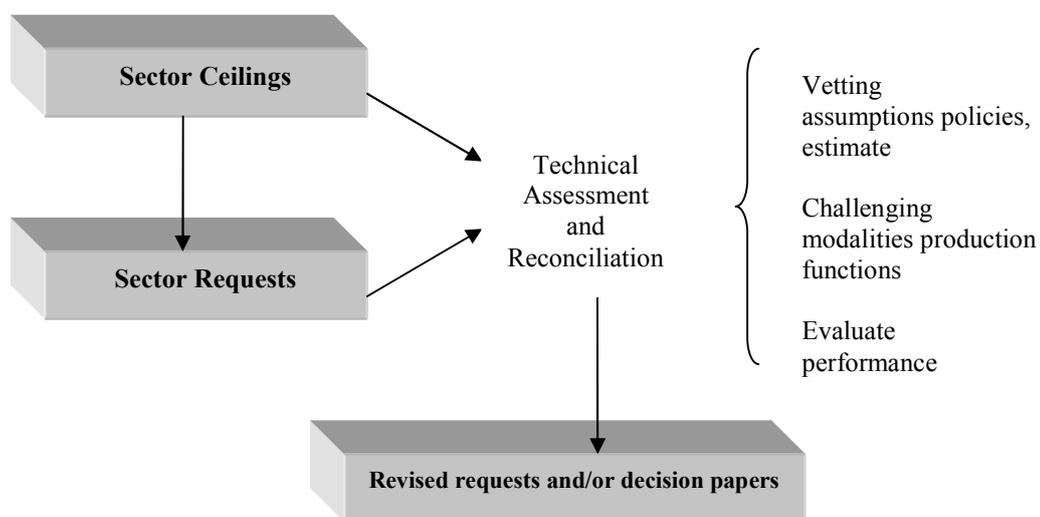
responsibility for the consequences of their choices. Significantly, the transparency and accountability play the vital role in providing some incentive for sound allocation choices. In other systems, the degrees of freedom are fewer because the Ministry of Finance not only has indicative ministry or sector ceilings, but also indicative expenditure targets for programmes within the sector ceiling. As a result, expenditure ministries have to face with difficulty in want of reallocation across programmes (Dorotinsky, 2004: 11).

At the end of the day, the ministries will submit their budget requests to the Ministry of Finance. Generally, the format of the requests should be included the text explaining the policies contained in the proposals, changes in policy from prior years, significant reallocation decisions, new objectives. Moreover, the budget requests should consist of the output or outcome targets associated with the resource levels and allocations contained in the request. Importantly, simple identification within the request of on-going activities and programs from new programs assists in evaluating the proposals (Dorotinsky, 2004: 12).

**\* Stage 4: Reconciling resources with means.**

In this stage, the received requests must be reconciled with the resource ceilings, competing demands and policies reconciled, and final policy and funding decisions reached. He mentioned that it may proceed with varying degrees of cooperation or conflict between Ministry of Finance and expenditure ministries (Dorotinsky, 2004: 12).

**Figure 2.4: Stage 4 - Reconciling**



Source: Developing a Medium-Term Expenditure Framework (Dorotinsky, 2004: 12).

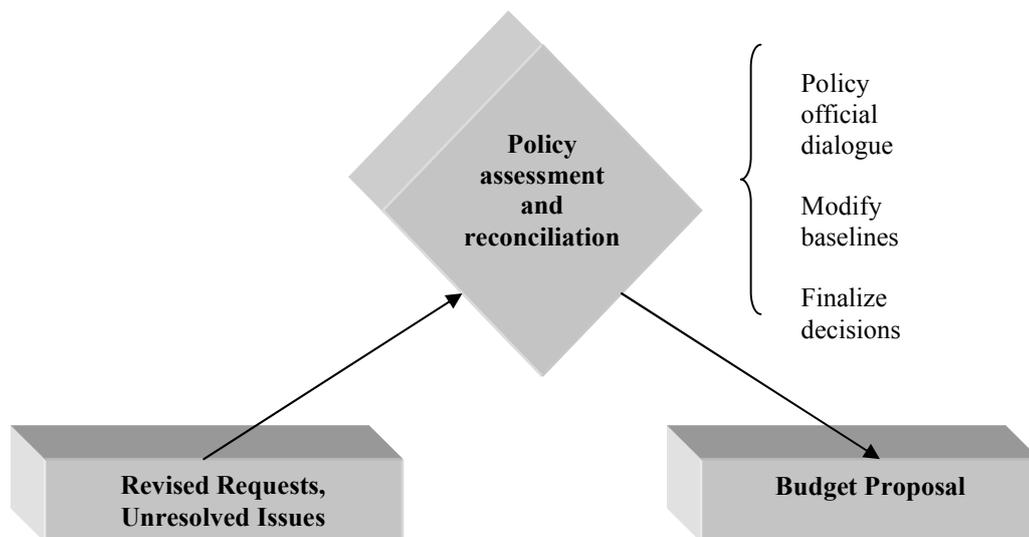
It is perfect if the sector ceilings and sector requests will match. However, the Ministry of Finance still needs to examine the expenditure requests, probing whether recurrent expenditure is needed and ministries have adequately reviewed existing programmes, and whether new programmes are well-developed. It also needs to assess the reviews of capital expenditure and progress in capital projects, as well as assessments of whether external and internal audit findings have been addressed by each ministry. And the results of assessments covering many aspects of performance should be fed into the Ministry of Finance's recommendations on funding (Dorotinsky, 2004: 12-13).

If the sector requests and ceilings are not the same, the Ministry of Finance needs to quickly assess if recurrent spending is over target, and respond appropriately to the source of the problem (Dorotinsky, 2004: 13).

In addition, this stage gives a chance for discussing the various new funding proposals to compete for resources. If the Government sets aside some resources during the sector ceiling stage for new funding proposals, these funds will be used to fund the best of the new spending initiatives. In contrast, if no reserve is established, and instead government allocates all available funding to the sectors, giving some priority to some sectors over others, then competition between proposals may occur within the sector (Dorotinsky, 2004: 13-14). At the end of the stage, the Ministry of Finance must make some recommendations, and forward these on to Cabinet for final approval (Dorotinsky, 2004: 14).

**\* Stage 5: Reconciling strategic policy and means.**

**Figure 2.5: Stage 5 - Pulling it all together**



Source: Developing a Medium-Term Expenditure Framework (Dorotinsky, 2004: 14).

In this stage, line ministries are busy revising their requests, preparing their own justification material to support the policies contained in the budget.

Turning to Ministry of Finance, it plays a primary role in resolving any loose-ends in the decision process, finalizing or refining numbers and policies to assure consistency. It also puts more efforts into production of documents and tables and graphs, getting everything ready for final review and approval by Government and transmission to Parliament.

Generally, actual decision-making processes and institutions will vary by country, according to Elizabeth Muggeridge (1997), David Hutton and Bill Dorotinsky (2004), the simplified outline of MTEF process can be represented in three steps, following:

**Step 1:** Estimating total available resources for the public sector over a multi-year period, generally within a multi-year macroeconomic and fiscal policy framework.

**Step 2:** Estimating the actual cost of current government policy and programmes by sector, again in a multi-year context.

**Step 3:** Reconciling the information in steps 1 and 2 to align policies with available resources, and using this information as a basis for improved policy and funding choices, and ultimately improved outcomes.

#### **2.3.2.4 Strengths of MTEF**

The experience of several developed countries such as Australia demonstrates that a country that successfully implements MTEF approach on a sustainable basis can achieve a significant improvement in its planning and budget system. Kiringai & West (2002: 30-31) reported some potential advantages of MTEF as following:

**Medium-term planning:** MTEF improves the link between planning and budgeting by placing greater stress on the medium-term. It addresses the main weakness in traditional budget systems such as the burden of past policy, budgetary and legislative decisions in the limited resources of the annual budget by providing a bridge between the need for a legally binding annual appropriation and by providing indicative ceilings for the outer-years (Kiringai & West, 2002: 30).

**Forecasting:** "MTEF is intended to improve the credibility of the budget process. This involves setting aggregate resource ceilings that are realistic and achievable over a range of macroeconomic outcomes and assuring spending agencies of the projected level of sectoral funding in order to plan ahead. The development of improved modeling and forecasting capacity is therefore an integral part of MTEF process. To the extent that capacity is improved, MTEF improves the ability to predict resource allocations to organisations and sectors. This increases the credibility of the budget process, encourages budget honesty, reduces haggling during the annual cycle and improves efficiency" (Kiringai & West, 2002: 30).

**Analytical budgeting:** Unlike line-item budgeting focusing on control of inputs, MTEF highlights the important of allocative efficiency. This encourages stronger focus on strategic issues and improves the targeting of resource allocations on key priority activities. Moreover, the value added of MTEF approach comes from integrating the top-down resource envelope with the bottom-up programmes for resolving conflicts between what is affordable and delivery needs (Kiringai & West, 2002: 30).

**Improved service delivery:** MTEF improves resource utilization by shifting attention from what the government buys to what the government delivers. This can be achieved by increasing decentralization and giving line managers more autonomy and incentives for efficient performance. They are also encouraged providing detailed analysis of policy options, accurate costing of viable alternative policies, and an assessment of their expected impact on national development objectives. Further, MTEF helps to set up an effective monitoring and evaluation system by establishing targets for performance (productivity) for direct service provision (Kiringai & West, 2002: 30).

**Political endorsement:** All expenditure allocation decisions involve political choices that create winners and losers. However, MTEF process builds commitment to the strategic and operational objectives of public expenditure by including several stages that require explicit political endorsement (Kiringai & West, 2002: 30).

#### **2.3.2.5 Threats to MTEF**

Many developing countries are now in the process of introducing MTEF approach to achieve the substantial benefits that it can bring if successfully implemented. To attain this, it is essential to

anticipate the key threats to the design and sequence of introducing MTEF in order to maximize its benefits and minimize its risks.

**Weak institutions:** Practical experience, in the view of Jand Kiringai and Geoffrey West (2002: 31) showed that it is really difficult to establish suitable institutions and sustain them in doing MTEF over time. The vital question in MTEF implementation is not what needs to be done but also how to create an operating environment that will sustain the reforms. The success of MTEF rests on introducing institutional arrangements that provide correct incentives and assist in balancing priorities with affordability.

**Capacity constraints:** Introducing MTEF approach imposes a considerable administrative burden on public service. Actually, the capacity constraints tend to be underestimated or ignored. Spending agencies lack the necessary skills and capacity to undertake accurate self-assessment of policy options according to costs and benefits. In addition, the difficulty in investigating complex policy issues on an extensive, annual basis makes unlikely success (Kiringai & West, 2002: 32). "MTEF budget prioritisation process as it stands, lacks the means to evaluate the cost of bids objectively, something that seriously undermines its ability to maximize the achievement of government objectives within the funds available" (Diamond et. al, 2000: 59). MTEF also seem be introduced too quickly and may not be sustainable. Moreover, line agencies seem to be reluctant to change existing polices and procedures (Kiringai & West, 2002: 32). "It is extremely difficult, however, to devise a budgeting system which provides sufficient incentive for better analysis to be made by the technical agencies of government." (Allan & Hinchliffe, 1982: 148).

**Sustainability of old and new systems:** Like other reform initiatives, a new MTEF approach to budgeting comes with a new set of rules, procedures and guidelines. However, with time, line managers devise new ways of taking care of their self-interest. Concurrently, new systems can become a routine over time and as the willingness to enforce the rules wanes, they are likely to be abandoned. "To avoid this outcome, care must be taken to ensure that the guardians of the system remain in control and can enforce adherence. Transparency and accountability must be enshrined and the punishment for violating rules must be clearly defined". Another danger is that introduction of a new budget system might lead to dropping prematurely existing systems and lacking a necessary fallback or complementary system (Kiringai & West, 2002: 32-33).

**Credibility and prudent fiscal management:** The credibility of MTEF introduction will be damaged if its expectations in the delivery of government services are not fulfilled. However, MTEF does not alter the underlying budget realities. The difficulty of developing countries is to generate accurate forecasts of resource availability, especially if they are dependent on mineral resources or primary export commodities. Economies with a shallow revenue base will depend on external funding and will not be able to respond to adverse shocks, such as a deterioration of the terms of trade. Consequently, it can disrupt the achievement of targets, reduce accountability and damage the credibility of MTEF process. Furthermore, unexpected expenditure requirements, shortfalls in revenue outcomes, or withdrawal of donor support may force the government to renege on its commitment to fiscal discipline or to cut back on programmed expenditure projects, therefore threatening both allocative and operational efficiency. The imposition on budget cuts during implementation means that resource allocations in outer years will not achieve indicative MTEF ceilings and will preclude many of the presumed benefits of MTEF approach (Kiringai & West, 2002: 33).

**Premature decentralization:** MTEF expectation is to improve efficiency by authorizing line managers to exercise greater managerial autonomy. However, implementing agencies should not be given autonomy before establishing reliable internal and external control systems. This is really useful for addressing some fears in the incentive structure that line managers have considerable potential to manipulate both their control over inputs and the payment of bonuses (Kiringai & West, 2002: 34).

**Securing political commitment:** Although MTEF process contains provision for political involvement, there is no guarantee that a political and technical consensus on optimal resource allocations will emerge. The technical solution may involve development of a budget negotiation framework that analyses trade-offs between marginal resource allocations and defines percentage shares going to each ministry/sector by economic/strategic categories. However, this approach may not be acceptable to politicians who wish to select policies and determine expenditure priorities for political reasons (Kiringai & West, 2002: 34).

**Setting criteria for resource allocation:** In practice, it is extremely difficult to determine the various trade-offs between sectors, within sectors and over time. Even if choices are clear, line agencies find it difficult and time-consuming to adjust their resource base as quickly as central agencies would like. Equally, it is hard to assure that operational efficiency is improved. Many

evidences in budget reforms have shown that it is very difficult to identify suitable output indicators and performance targets and to measure the annual achievement of targets. Central agencies in most developing countries do not have the huge amounts of information and adequate analytical capability required for successful introduction of MTEF (Kiringai & West, 2002: 34). To deal with these issues, Kiringai & West (2002: 35) determined relevant tasks, including:

- "Ensuring that MTEF applies to all categories of public expenditure, including central, provincial and local authorities, public enterprises and subvented organizations;
- Setting ceilings by sector rather than by administrative category which is likely to create problems for resource allocation decisions because sectors typically cut across ministerial and departmental boundaries;
- Defining expenditure targets clearly, for example by showing gross and net ceilings so that appropriations-in-aid are made explicit and their generation and application subjected to the same rigorous level of appraisal;
- Developing capacity to ensure that all spending agencies apply the same criteria in evaluating their activities, for example performance targets, cost benefit analysis and cost-effectiveness analysis; and
- Monitoring resource utilization by economic category to ensure that the budget achieves an appropriate balance between personnel and other recurrent costs and between recurrent and development expenditure".

**Complementary planning and budget initiatives:** It is vital to remember that MTEF is not a stand-alone reform system and that it does not by itself deal with all of the outstanding issues which affect the quality of public expenditure management. Implementing a number of complementary planning and budget initiatives can only attain the full benefits of reform. A long-term strategic planning framework, periodic medium-term operational documents, periodic sectoral reviews, and a range of budget structure and management reforms need to be prepared. For instance, attaining allocative efficiency requires a clear consensus on national development objectives, usually by preparing a long-term strategic vision that defines the main features of a pro-poor growth strategy. Improvements in public sector productivity rely on a large-scale range of reforms covering central and local government, the public service, and the legal system. In addition, gains in operational efficiency through introduction of performance targets will require main changes in the budget structure while many administrative constraints must be tackled through sustained improvements in

budget management. The development of an accurate and timely monitoring and evaluation system is also a critical measure (Kiringai & West, 2002: 35).

### **2.3.2.6 Requisites for the implementation of MTEF**

MTEF is widely proliferated as an important and effective mechanism for ensuring budgetary discipline as it links policymaking, planning and budgeting. Ideally, a well implemented MTEF should: (1) link national priorities with a budget within a sustainable expenditure envelope; (2) emphasize the tradeoffs between the competing objectives of the government; (3) link budgets with the policy choices made; and (4) improve outcomes by increasing transparency, accountability, and the predictability of funding (Seok-Kyun Hur, 2004: 47).

To meet its targets, seven major requirements must be considered for MTEF implementation, highlighted by Seok-Kyun Hur (2004: 47), following:

- \* **Good macroeconomic policies and reliable forecasting:** Solid and reliable macro-economic analysis and forecasts are needed as a basis for MTEF. Inaccurate macro-economic forecasting dilutes the credibility and feasibility of MTEF.
- \* **Adaptable fiscal policy and instruments:** In essence, MTEF approach is based on a strong link between macro-economic and fiscal policy. Plans for future expenditure must be based on reasonable estimates of prospective resources.
- \* **Reprioritization and reallocation:** A major function of an MTEF is to provide a better mechanism for aligning budgets with policies. MTEF is a promising mechanism for shifting resources from lower to higher priority use. In fact, the government should not and can not distribute budget to all its activities because of limited public financial resources. It should allocate to key sectors and areas in order to foster all the rest. Moreover, priority policies must be transparency and consistency to ministries, sectors and local governments.
- \* **Budgetary discipline:** Budget allocations must be based on a hard aggregate budget constraint derived from what is affordable, and line ministries must live with their budget allocations.

\* **Institutional conformity and absence of bias:** An MTEF requires a supportive institutional base; that is to say, one in which the various actors use MTEF as a framework within which expenditure decisions are made. Particularly, political decision makers must accept MTEF as the means by which resources are allocated.

\* **Appropriate parameters:** Designing an MTEF requires that its parameters be set. These parameters consists of the definition of aggregate expenditure to be used, the relationship between the sectoral breakdown and the organizational structure of the government, the content of expenditure envelopes, the appropriate price basis for estimating future expenditures, the mechanism for its coordination with the annual budget process, and the degree to which it is to be flexed for different scenarios.

\* **Transparency:** Transparency of fiscal and policy improve the accountability of actors engaged in MTEF process. Fiscal transparency means being open to the public about the structure and functions of government, fiscal policy intentions, public sector accounts, and fiscal projections. Meanwhile, policy transparency means being open to the public about what Government intentions are in a particular policy area, which outcomes are to be achieved, and the costs of achieving these outcomes. Also, transparency means reporting actual performance with quality of outputs and results achieved.

Interestingly, Seok-Kyun Hur (2004: 48) initiated key supporting processes have to function for MTEF to work as in Table 2.6.

**Table 2.6: Annual procedure of MTEF**

<b>Core Processes</b>	<b>Supporting Processes</b>	<b>Purpose</b>
<b>Define the aggregate resources</b>	Macro-economic analysis, revenue forecasting, and definition of sustainable fiscal policy	To provide a realistic estimate of the total resources available in the medium-term to allocate to spending programs
<b>Formulate and cost sectoral spending plans</b>	Spending ministries formulate sectoral expenditure programs (SEPs)	To show sectoral objectives, programs and activities, and their costs
<b>Reconcile available resources with sectoral spending plans</b>	Politicians and other decisionmakers reconcile top-down constraints with bottom-up spending demands	To reach agreement on medium-term expenditure programs
<b>Set medium-term sectoral allocations</b>	On the basis of relevant data, decision-makers allocate the aggregate resources to sectors	To communicate to ministries a sectoral expenditure policy constrained by aggregate resources
<b>Announce sectoral expenditure limits for year one of MTEF</b>	Formulation of annual budget	To ensure that the budgets prepared by ministries reflect agreed sectoral expenditure programs
<b>Ensure that budget execution is in line with budget intentions</b>	Accounting, reporting, and expenditure controls are used during the execution of the annual budget	To prevent excessive deviation from the annual budget and MTEF
<b>Ensure that desired results are achieved</b>	Incentives for civil workers to apply. Ex-post audit and evaluation	To align civil workers' and politicians' incentives with public goals

*Source:* Successful Installation of MTEF to the Korean Fiscal System (Seok-Kyun Hur, 2004: 48).

However, the most important thing in his suggestions is the critical role of political commitment in successful introduction MTEF once and for all. In his words, MTEF involves a radical change in the business of budgeting. The lack of political support is of concern because budgeting is still seen as a technical exercise mainly driven by the Ministry of Finance. Moreover, politicians seem to be unaware of benefits of the new process, and still rely upon the old and incremental methods to gain funding. Consequently, without political commitment, it has little chance of succeeding. He also claimed that a comprehensive approach is preferable to bring in MTEF incrementally, starting with

select sectors and then expanding coverage for the whole government. This is half a question of data collecting, analysis, and reporting; and half of people who can both supply and use the information, and the institutional mechanisms for coordinating the efforts of participants.

## **2.4 Experiences of application MTEF in some countries**

More recently, many governments have adopted a wide range of reforms to make fiscal policies more consistent and effective over the medium-term and emphasize the impact of policies and expenditure. Budget reforms involving especially MTEF and PBB approaches have been introduced first in Australia. MTEF is also introduced as a powerful tool in Kenya - a developing country in Africa. In East Asia, Philippines and Korea are leading countries to design and implement a broader programme of public finance reforms according to new approaches. These approaches have been on the agenda in order to address a key challenge faced by policy officials and public finance systems in developed and developing economies. In fact, most countries have succeeded in putting in place the basic foundations for improving public financial management and contributing to other positive changes in public management culture and fiscal performance.

The main purpose of this section is to identify the lessons from experiences of successful and familiar countries, including the constraints faced by these countries and some of their major challenges for the future, in order to better understand and compare these experiences and to identify some of the good practices and ideas they have developed in implementing MTEF reforms.

### **2.4.1 MTEF in Australia**

In more recent times, the United Kingdom is known as a pioneer in medium-term expenditure forecasting. "The current paradigm, however, can be traced mainly in Australia, a leader among developed countries in reforms to control expenditure growth" (Schiavo-Campo, 2009: 4). In particular, facing the lack of adequate links among policies, programmes and using allocated resources, the budget process in Australia has undergone profound reforms since the launch of a White Paper entitled Budget Reform in 1984 which set the process in motion. Early reforms focused on performance and results, reducing central input controls and granting more flexibility to expenditure ministries and agencies. In addition, MTEF (the forward estimates) and a more effective cabinet committee process for identifying priorities and promoting fiscal discipline were instituted. Australia's "forward estimates" approach is well known with the aims of "strengthening

the link between government policy and expenditure programmes and improving the affordability of policies by combining projections methods with institutional arrangements to enforce outcomes". The application of MTEF in Australia has been highlighted some special features, following (Blöndal et al., 2008: 7):

### **Financial target overall**

Starting point in 1985, Australian central government has adopted a strategy of the medium-term trio including unincreased rate of budget expenditure/GDP and reduced rate of budget deficit/GDP. The fascinating statistics between 1985 and 1990 showed a significant result in turning a fiscal deficit of 4% of GDP into a 2% surplus (Schiavo-Campo, 2009: 4). Simultaneously, the government has reoriented expenditure tasks in order to reflect its strategic priorities and has enhanced mechanisms in order to encourage greater efficient use of resources. Another reform was the introduction of the Charter of Budget Honesty Act 1998 which stipulated a high level of budget transparency and specific disclosures. Accordingly, the government is required to regularly publish forecasts of revenues and expenditure, especially during the period of three months before the election (Blöndal et al., 2008: 8).

### **The forward estimates (MTEF)**

In Australia, the forward estimates are rolling baseline projections for all revenues and expenditures for three years. After the budget is adopted, the first year of the forward estimates becomes the base for next year's budget, and another out-year is added to the forward estimates. The forward estimates are an integral part of the budget process - actually, the whole budget process is built around them - and they are generally viewed as the single most significant and successful budgeting reform (Blöndal et al., 2008: 17).

The forward estimates represent a provisional government decision on future expenditures. That is to say, the out-year expenditures become the budgets in the respective years in the absence of any new decision, and of other adjustments for new price or volume indexes where applicable. The cost of all ongoing programmes are recorded in the forward estimates, however, they do not consist of any allowance for the introduction of new programmes in future years or the expansion of existing programmes due to policy measures. In fact, such measures would involve new government decisions. Thus, the Australian budget system is designed to ensure that incremental budget

decisions are strategic, rather than to overcome incrementalism. As noted by the Finance Minister at the time of the 1987/88 budget: “By providing a consistent and continuing basis for budget deliberations, and minimising unproductive contention over baseline estimates, these new procedures improved outlays control and enhanced the government’s capacity to focus on substantive issues in the budget context.” (Blöndal et al., 2008: 17).

The process for the forward estimates is managed actively throughout the year, and extreme caution goes into assuring that any new decisions, or changes in assumptions underlying expenditure projections, are included in the forward estimates so that they are accurate and update at any given time. The Department of Finance is responsible for the forward estimates of expenditure and non-tax revenue and the Treasury for the forward estimates of tax revenue. In addition, The Department of Finance plays the main role in validation these costing to ensure their accuracy and reasonableness based on the initial costing of new initiatives which are done by individual agencies. Moreover, it will work with individual agencies to up-to-date the agreed methodology for ongoing costing as it is necessary (Blöndal et al., 2008: 18).

Schiavo-Campo (2009: 5-6) defined some requirements leading to well performance of the Australian MTEF. That is the political and governance requirements, including:

- High level of public integrity;
- High propensity to rule-compliance;
- Robust administrative accountability mechanisms;
- Political discipline of a well-organized executive apparatus;
- Prodding and vetting by an active and representative legislature; and
- Contestability arising from a vibrant civil society possessing both exit opportunities and voice channels.

Equally demanding, the economic and technical reasons consist of:

- Macroeconomic stability;
- Revenue predictability and low dependence on external financing;
- Executive commitment to a transparent budget process;
- Strong technical capacity of the finance ministry and core central agencies;
- Capacity to enforce a hard budget constraint on line ministries;
- Line ministries’ capacity in sector policy analysis and program formulation and costing;

- Availability of a large pool of highly competent government economists, accountants, econometricians, sector specialists, others;
- Availability of reliable data on a timely basis; and
- High degree of flexibility given to line ministries and budget managers regarding both personnel management and financial resource allocation.

To sum up, the forward estimates are viewed very positively in Australia, bringing stability and discipline to the budgeting process by providing appropriate benchmarks for necessary fiscal action. They have served to lengthen the time horizon in decision making, provided an agreed baseline that permits budget discussions to concentrate on substantive decisions and - very importantly - brought the special (permanent) appropriations systematically into the annual budget process. Furthermore, they form the necessary basis for any top-down budgetary decisions and naturally support any fiscal rule based on expenditures.

#### **2.4.2 MTEF in Kenya**

To improve the resource allocation process, in the three previous decades, Kenya introduced three main initiatives such as the Programme Review and Forward Budget in the early 1970s, the Budget Rationalization Programmes in the mid-1980s, and the Public Investment Programme in the early 1990s. Despite these reforms efforts, there are outstanding problems. The overall conclusion is that the resource allocation process and implementation is flawed with the four critical problem areas, including: (1) the failure to define strategic priorities, (2) the excessive size of government, (3) the failure to achieve aggregate fiscal discipline, and (4) the poor quality of public expenditure. In addition, a number of weaknesses in the planning and budget process have contributed to this poor performance. These consist of: (1) poor forecasting ability, (2) lack of medium-term perspective, (3) failure to cost future resource requirements, (4) excessive political interference in budgeting, (5) separation of the planning and budget process, (6) failure in integrating strategic planning concerns into the budget cycle, (7) failure of expenditure control by line item, (8) lack of adapting to changes for funding emerging priorities by using incremental recurrent budgeting, (9) delays in issuing resources, (10) lack of funding recurrent activities through the development budget, (11) weak accounting systems, (12) inadequate monitoring and evaluation systems especially for outputs and outcomes, and (13) failure to develop management information systems (Kiringai & West, 2002: 38-50).

The introduction of MTEF approach in Kenya was in 1997 and implemented for the first time in the budget presented in June 2000. The Public Expenditure Review in 1997 was the starting point in the action of Kenya. The following was to consider internal work with the aim of understanding the main components of MTEF approach and agreeing on the appropriate organizational and institutional structure and the possible timetable for introducing MTEF approach. Accordingly, MTEF in Kenya is designed as "a top-down and bottom-up resource allocation process intended to establish an explicit link between policy framework and planning and budget process by reviving the original concept of the Programme Review and Forward Budget". Defining the aggregate resource envelope, determining inter-sectoral resource allocations by basing them on core functions, and then proposing intra-sectoral allocations based on intended outcomes, activities, inputs, outputs and operational efficiency were determined as the main components of MTEF. The tasks of MTEF also attained three key objectives including fiscal discipline, allocative efficiency and operational efficiency (Kiringai & West, 2002: 50-54).

Many evidences in Kenya have shown that strengthening of MTEF process will ensure initial success, future sustainability of the process, and therefore realizing of the potential benefits of improved public expenditure management. The most important thing for successful introduction of MTEF is sustained political commitment to the reform process. "The government must develop the capacity and demonstrate the political will, to improve the planning and budget system, to introduce complementary reforms, to restructure public expenditure and to improve the management of public expenditure". It is also vital that the planning and budget system's reform is not pursued in isolation but as part of broader reforms being implemented through the Public Sector Reform Programme to ensure that MTEF process adopts common goals and an integrated implementation plan (Kiringai & West, 2002: 63).

**Fiscal Discipline and Economic Forecasting:** The first step in attaining fiscal discipline is to improve the quality of economic modeling and to use realistic forecasts in preparing the fiscal strategy. The main outstanding challenge is to assure long-term sustainability of the model and its continued application in preparing the rolling fiscal strategy as part of the annual MTEF process. Particularly, it is essential to enhance the availability, timeliness and reliability of data used in updating and calibrating the model runs. All agencies involved in this exercise should have a significant coordination and use the same definitions of all categories of revenue and expenditure that allows easy reconciliation between the different concepts used in the planning and budget process. It is also vital to ensure the aggregate forecasts generated by the model are consistent with

expected performance at the sectoral level and that public sector action plans address any constraints that would otherwise prevent attainment of the model outcomes. The next step involves observing the recommendations contained in the fiscal strategy. The fiscal strategy paper should be prepared and distributed early in the annual cycle and there should be explicit political endorsement of the aggregate ceilings (Kiringai & West, 2002: 64).

**Sector Level Planning and Budgeting:** Setting inter-sectoral ceilings is a difficult and politically sensitive task, especially because the constraints on aggregate expenditure ceilings mean that the recurrent and development allocations by sector will be less than optimal considering of spending agencies. To improve strategic inter-sectoral and intra-sectoral resource allocations, guidelines on optimal shares, according to Kenya's experience, must be developed based on an iterative process that combines information generated from the central agencies (top-down) and from the spending agencies (bottom-up) (Kiringai & West, 2002: 64-65).

Kenya introduced one tool used in this process is the Budget Negotiation Framework with the view of help to improve targeting of public expenditure. Resource allocations would be based on a comprehensive assessment of the full cost of sectoral action plans and of their progress in meeting agreed performance targets. It also requires the development of benchmarks of effectiveness and efficiency, that is assessing the contribution that sectors can make to the achievement of national development objectives and how those sectors actually utilize resources. By identifying those activities that deserve additional resources or those that should incur expenditure cuts, this tool would allow trade-offs between and within sectors to be made on a consistent, transparent and equitable basis (Kiringai & West, 2002: 65).

A specific proposal in setting sectoral ceilings should be based on: (1) a comprehensive review of the policy framework (long-term national development objectives); (2) an assessment of the efficiency with which the public service can address these objectives; (3) consideration of the expected fiscal constraints to strike an appropriate balance between aspirations and affordability, and (4) definition of the appropriate role for government in the sector following consultations with other stakeholders (Kiringai & West, 2002: 66).

**Linking Budgets to Effectiveness, Efficiency and Outputs:** In the case of national resource constraints, it is only possible to achieve expansion of public services through sustained improvement in the quality of public expenditure. It is necessary to design a strategy in order to

exploit the considerable scope to make savings by: (1) enhancing effectiveness through reallocation of resources to core activities and by better design of programmes; (2) improving efficiency both internally and through contracting out to more efficient private sector providers; and (3) changing the budget focus from allocation of inputs to delivery of agreed outputs (Kiringai & West, 2002: 67-68).

According to Kenya's experience, the introduction of an output-based budget process can be seen as an essential pre-condition for MTEF to be successful. This will be the starting point in the shift from line item, input-based budgeting to output and outcome-based budgeting. That is, performance should be measured in terms of the outputs delivered and not by the expenditure of allocated resources. Because spending agencies may be encouraged to retain existing programmes without evaluating their impact on economic growth and poverty reduction if resource envelopes remain input oriented. Initially, however, it may not be possible to include all activities in this format (Kiringai & West, 2002: 68).

In addition, MTEF approach anticipates that improvements in operational efficiency can be attained through a great increase in the autonomy of line managers to make decisions regarding the level and mix of resources. For instance, line managers have freedom to re-allocate resources within broad expenditure categories and in utilizing part of any revenue generated subject to sectoral priorities and efficiency criteria. The corollary to greater budget autonomy is that: (1) "managers accept greater responsibility for the achievement of agreed goals"; and (2) "central agencies provide adequate incentives and impose more rigorous discipline on managers who fail to adhere to the relevant budget and planning procedures" (Kiringai & West, 2002: 69-70).

**Training:** "Successful implementation of MTEF process will require capacity building in all agencies". It means that the development of a specific training programme or the preparation of an MTEF module within a existing programme are needed to build capacity in operating the revised budget process. Detailed action plans should be done in order to identify training needs and programmes to be undertaken. The development of a manual for MTEF also provides an essential tool for all those involved in budget formulation. It is useful to close the knowledge gap for officials participating in the budget exercise for the first time and it is also used in the curriculum for training finance and planning officers (Kiringai & West, 2002: 71-72).

**Sequencing of MTEF process:** To be successful, MTEF needs to be properly sequenced. It is important to formulate an achievable work-plan and assign roles and responsibilities to the various

key players. That is to say, it would form a firm foundation for the institutionalization of MTEF if it covers the proposed evolution of MTEF process, provides an indicative outline of the next steps, and takes into account the constraints which would be face if the work-plan is too ambitious. It is also important to define the steps to managerial autonomy and the time frame for each step. Describing the product expected at each stage of the process and explaining how each activity should be applied need to be provided for all participants in MTEF process. It is vital to remember that MTEF is a process and not an event. It needs to be provided at each cycle an opportunity to ensure that those responsible manage the process better next time (Kiringai & West, 2002: 73-74).

**Budget Structure:** Budget structure certainly has a significant impact on aspects of budget preparation and implementation. The main change to the budget structure is the introduction of the two MTEF cycles including ceilings for two additional indicative years. In addition, MTEF must design a new and appropriate format for an output-budget that clearly shows what the government expects to deliver instead of focusing on what the government is buying. In other words, this involves establishing a consistent structure for setting performance targets for line agencies and reflecting the costing exercises described earlier by activity or cost centre (Kiringai & West, 2002: 75).

Kiringai & West (2002: 76-77) introduced necessary features of the proposed MTEF budget structure including:

- Assessed departmental work programmes with specified targets for outputs and outcomes.
- Detailed cost estimates for core activities using standard cost norms and detailed costing of the resource implications of all new policy proposals before consideration by Cabinet.
- Submission of realistic capital cost estimates and implementation schedules.
- Submission of realistic estimates of the recurrent budget requirements once projects are operational.
- Accurate assessment of implementation capacity constraints.
- Agreed procedures for the retention and utilization of revenue raised from departmental activities in accordance with sectoral development priorities and performance benchmarks.
- Implementation of management information systems that provide data on inputs, outputs and outcomes.

**Budget management and analysis:** To strengthen budget management and analysis, a number of complementary improvements are required, following (Kiringai & West, 2002: 77- 80):

- Stronger financial controls.
- Strengthening the management of external assistance.
- Stronger cash-flow management.
- Improved debt management
- Reducing the extent of appropriations-in-aid in the recurrent budget.
- Ensuring consistency in the annual budget and MTEF.
- Increasing budget analysis.
- Implementing pay and benefits reform.
- Adhering to budget norms.
- Improve accounting systems.

**Monitoring and Evaluation:** MTEF needs to be complemented by undertaking annual public expenditure reviews, that is, assess overall macroeconomic performance and conduct in-depth studies of specific issues. It is essential to utilize information from the monitoring and evaluation system to determine whether MTEF has attained its objectives and to assess its impact over time. The findings could then be used to fine-tune components of the fiscal strategy and improve the productivity of public expenditure (Kiringai & West, 2002: 80-81).

### 2.4.3 MTEF in Korea

In the last 1990s, after suffering the Asian financial crisis in 1997, the general economy and the particularly public financial potential of Korea had a profound impact, resulting in the significantly decreased economic growth rate. The Korean government also found that the mechanism of public financial management had numerous problems, threatening the public financial sustainability such as input and growth-oriented budgeting, restrictions of line ministries' discretion, and lack of transparency in the fiscal system. Consequently, public expenditure reforms focusing on MTEF have been initiated (Dong Yeon Kim, 2004: 24).

The introduction of MTEF had a great ambition to address the current problems of Korea. Firstly, the current budget process of Korea operates on a short-term perspective, yearly based, and is highly tilted toward bottom-up approach. Accordingly, revenues are calculated for only the upcoming year and expenditure prepared based on anticipated revenues for that year only. Thus, it is the lack of medium/long-term perspective and weak linkage between national policy priorities

and budget. The structure of public expenditure has barely changed over the past decades because bottom-up approach tends to lead to gradual yet consistent increases across almost all budget items. For instance, expenditure on ‘economic affairs’, the biggest item by function, has remained at relatively the same level between 1970 (27.4% of GDP) and 2000 (25.2 %) even though the purpose of this expenditure, spending for economic development, has become less relevant in today’s market-oriented economy. Another concern regards the strategic decision-making mechanism in resource allocation with the argument over the lack of achieved consensus during the early stage of the budgeting process and the lack of transparency in decision-making for resource allocation and setting policy priorities (Dong Yeon Kim, 2004: 24-25).

Secondly, future fiscal risks threaten fiscal soundness in the future. One of the most serious risks lies in social welfare demands with a fast aging phenomenon, that is, expenditure demand will rise rapidly and on a large scale and revenue source will decrease near in the future. It is also difficult to maintain fiscal balance for quite a long time because of debts of 69 trillion won, equivalent to 12% of GDP in 2002. Moreover, further aggravating the potential danger of threats is the outlook of Korea’s economy growth rate, which is expected to slow remarkably in the coming years. That implies declining rates of revenue, which will test Korea’s fiscal discipline (Dong Yeon Kim, 2004: 25-26).

Finally, there is a lack of managerial flexibility and limited autonomy in line ministries both in planning policies and implementing budget. One of the main causes of inefficiency and rigidity is the existing centralized, input-control based, bottom-up approach in budgetary decision-making. It also causes accountability problems. The tenuous link between responsibility and the discretion to apply flexibly and autonomously create a mismatch between policy and accountability (Dong Yeon Kim, 2004: 26).

Under the main direction of reform initiatives such as long-term perspective, top-down budgeting, strategic decision making mechanism and decentralization, Korea’s budgeting process will undergo fundamental changes. These changes, incorporating the necessarily detailed description of MTEF system and country specific factors counted, will lead to new processes and stages which are outlined below:

**\* Stage 1: Long-term financial management planning.**

This stage covers medium-term macroeconomic forecasting, and review of social and economic factors that may affect public finance. It would also review various national debt levels at this time. The long-term financial management plan is constructed by the Ministry of Planning and Budget (MPB), based on the findings and reviews conducted at this stage. Additionally, the long-term national agenda and sectoral expenditure demands are checked and a strategic, long-term resource allocation plan is suggested (Dong Yeon Kim, 2004: 27).

**\* Stage 2: Fiscal targeting and budget aggregate**

In this stage, the fiscal target and vital fiscal policy for three years will be set based on the macroeconomic forecasting and the long-term financial management plan. The fiscal balance policy is considered as the core fiscal target. Moreover, analyses of other important factors including revenue estimates and the budget aggregate for three years are suggested (Dong Yeon Kim, 2004: 27).

**\* Stage 3: Sectoral and ministerial ceilings**

For this start, the MPB suggests strategic resource allocation in line with sectoral and ministerial expenditure ceilings. Simultaneously, the national strategic policy objective and sectoral objectives are considered and key budget projects are classified according to strategic importance (Dong Yeon Kim, 2004: 28).

**\* Stage 4: Cabinet meetings**

In this stage, cabinet meetings are convened twice during a fiscal year in order to discuss and agree on macro-economic forecasting, long-term plans, fiscal targeting, and expenditure aggregates and sectoral ceilings. The first in March would discuss and agree on the fiscal target, total size of budget, and sectoral ceilings. The second, held in August, would update macroeconomic conditions and review the necessity of adjustments, and finalize the coming year's budget proposal. After reaching consensus at the special cabinet meeting, the proposal will be presented and explained to the National Assembly by the MPB (Dong Yeon Kim, 2004: 28).

**\* Stage 5: Line ministries' requests**

Line ministries will have more autonomy and discretion to prepare their budget proposal so that it clearly reflects policy priorities and respects sectoral ceilings. By contrast, the MPB

will provide guidelines, including criteria for common expenses in order to facilitate line ministries' preparation. In case of complicated projects which involve more than one ministry such as regional development projects, the MPB could consider establishing committees, including relevant stakeholders inside and outside government, to reach an objective and concerted decision (Dong Yeon Kim, 2004: 28).

**\* Stage 6: Review and budget documentation**

The MPB reviews line ministries' budget requests for sectoral ceiling compliance and policy priorities. In this stage, negotiation/bargaining between the MPB and line ministries will still occur. The MPB may also raise questions and suggest changes to line ministries if it believes policy objectives can be better achieved with different projects/programs within sectoral ceiling, based upon transparent and fact-based rules (Dong Yeon Kim, 2004: 28).

In the view of Dong Yeon Kim (2004: 28), it will be essential to analyze key issues Korea may face down the road of reform and suggest how Korea can prepare itself to address these challenges. In fact, not every country has been successful in introducing MTEF or fully realizing its benefits. "One of the commonly cited reasons for less successful MTEF in many countries, developing and developed alike, is that too much attention is given to the technical aspect of MTEF and little consideration on how to change the institutional framework, decision-making process, and organizational culture of public sector. International experience clearly suggests that basic principles of MTEF must be carefully adjusted to fit into country context". Accordingly, special attention should be paid to country's context in the areas of macroeconomic forecasting, strategic decision-making, setting the level of line ministries' discretion, designing incentive systems, and reforming budgetary basics such as budget structure, scope and improving information system. He also gives some suggestions for implementation strategy in case of Korea, following:

Firstly, to succeed in implementing MTEF, it is critical to acknowledge the unique public sector environment of a country because Korea's country context and its public sector have very distinctive features from western countries where MTEF was originally developed and practiced (Dong Yeon Kim, 2004: 35-36).

Secondly, there are several important pre-conditions for successful implementation of MTEF in Korea including: strong political support, the MPB's willingness and commitment to the new system, compliance of line ministries, capacity building for the MPB and line ministries, and

development of a legal framework for the new system. However, it is not required to wait everything becoming impeccable. MTEF should be used as an instrument to alter the status quo and improve along with strengthening policy linkage with budget while simultaneously striving to develop these pre-conditions (Dong Yeon Kim, 2004: 36).

Thirdly, strong leadership and capacity building are essential to initiate the reform. Skills in macroeconomic and policy analysis, policy prioritization, coordination and conflict resolution, and problem-solving abilities are critical capacities for the MPB staff. On the other hand, line ministries should develop capacity in planning and policy analysis, development of implementation strategy and tools, and problem-solving abilities. Besides the technical features, it is vital to convey clearly the benefits of MTEF to all staff levels. More importantly, it requires creating an incentive system that motivating self-development and capacity building in order to gain benefit from the learning curve as they internalize MTEF process (Dong Yeon Kim, 2004: 37).

Fourthly, it will increase the likelihood of successful reform by a combination of a big bang approach and gradual approach together. For example, top-down decision-making may be adopted via a big bang approach, that is, strategic decision-making for budget aggregate and sectoral ceiling introduced together with resource allocation policy making. However, a more gradual approach should be adopted in areas not covered in strategic decision-making. This consists of various budget stages, such as budget proposal preparation, review, monitoring, and evaluation. A comprehensive long-run plan should map out smaller steps designed to realize the gradual approach (Dong Yeon Kim, 2004: 37).

Fifthly, Korean experience shows that "MTEF and performance management represent two sides of the same coin". It means that although MTEF is successfully introduced, it may be vulnerable unless performance-oriented management is implemented correspondingly. Nurturing a performance-oriented environment is of central importance before new tools and techniques for performance management or PBB can be fully introduced (Dong Yeon Kim, 2004: 37-38). "MTEF itself is a fiscal program and is an object of performance". "The provision of performance measures for MTEF will complete the evolutionary cycle of MTEF" (Seok-Kyun, 2004: 55).

Sixthly, to address organizational complexity regarding macroeconomic forecasting and policy coordination between ministries, it is better to clarify roles of each ministry under the current system and set up a coordination mechanism than dramatic change of organizational structure.

Because this change is likely to not only be unfeasible but also create significant resistance to the change that MTEF will bring in. It is also strongly recommended to devise a macroeconomic forecasting formula for objective analysis and avoid pressure from outside political circles in order to contribute to fiscal soundness. Additionally, it is advisable to establish a unit/department within MPB responsible for macroeconomic forecasting and assessment of social/political factors that affect fiscal policy. It is useful for the MPB staff to appropriately address macro-issues, undergo training to enhance their capacity, and to coordinate greater links with outside experts (Dong Yeon Kim, 2004: 29-30).

Seventhly, all the resources under the discretion of the government need to be reviewed and prioritized for expenditure in order to improve resource allocation in line with the government's priority. In addition, it is recommended that MTEF should cover a three-year time horizon. Because the longer the horizon, the less responsive the annual budgeting is to change in the socio-economic environments. On the other hand, a shorter time horizon is not consistent with the basic motive of MTEF, the provision of insurance to line ministries (Seok-Kyun, 2004: 50).

Eighthly, an optimal of top-down and bottom-up approaches needs to be worked together in harmony within MTEF, including the following transfer processes of information and physical resources.

- Top-down: information flows on macroeconomic forecasts and national priorities, broadly itemized budget allocation and risks of performance;
- Bottom-up: information flows on performance measurement and demand or social need for specific public good and risk of budgeting and debt management;
- These duplex exchanges of information and resources are made at legally set (or publicly guaranteed) opportunities (Seok-Kyun, 2004: 50-51).

Ninthly, a complete form of MTEF should provide information on the cost of individual programs and its overall impact. That is to say, it will serve as a basis for decision-making when programs compete for funding and aggregating all selected program expenditure to make a sectoral budget proposal. It is advisable that classification and presentation of budget estimates under MTEF be presented in a way to link expenditures to objectives, outputs and activities clearly. However, this result-oriented budget structure is not an essential condition to implement MTEF. It can be opted to apply existing budget classification and charts of accounts for better sectoral allocation. When this

stage of MTEF is internalized, the government can move on to enhance budget classification and charts of accounts to produce sufficient information in determining policy and program costs, which will further the benefits of efficient resource allocation and financial operation. Under this situation, it is also recommended that the government should consider improving or modifying the budget structure and the chart of accounts to build a stronger link between resources and priorities (Seok-Kyun, 2004: 51).

In short, it is important to remember that MTEF is not a perfect solution guaranteeing the efficiency of the public sector. However, it has some advantages in comparison with the current system. First, "MTEF is less reliant on discretionary factors and is rather rule-based. Rule-based allocation of public resources ensures system predictability to participants. Accordingly, the participants can pursue fiscal programs in a more consistent way". Second, "MTEF system encourages efficiency-based competition among the conflicting agents leading to a pseudo-market allocation. In contrast, allocation under the current system does not provide a formal channel, through which the agents can compete against others" (Seok-Kyun, 2004: 55).

Dramatically, international experience shows that the implementation of MTEF should adapt the socio-economic environments of an economy it is applied to. "Accordingly, different schemes can be adopted from country to country depending on the country-specific factors. Though seemingly heterogeneous, diverse types of MTEF are designed to attain a common goal, the provision of information channels and mechanism for early resolution of uncertainty within a government, which is a necessary condition for Pareto efficiency in welfare economics" (Seok-Kyun, 2004: 55).

### **3. THE CURRENT SITUATION OF BUDGET IN VIETNAM AND SONLA PROVINCE**

*This section presents the current Vietnamese budget system and serious problems which MTEF may address. Interestingly, it elaborates on characteristics and results of the pilot MTEF initiative, and the budgeting process under the new MTEF system at the provincial level. In addition, this section provides more details on the practical contexts of state budgeting leading to a main research question for budget reform in Sonla province.*

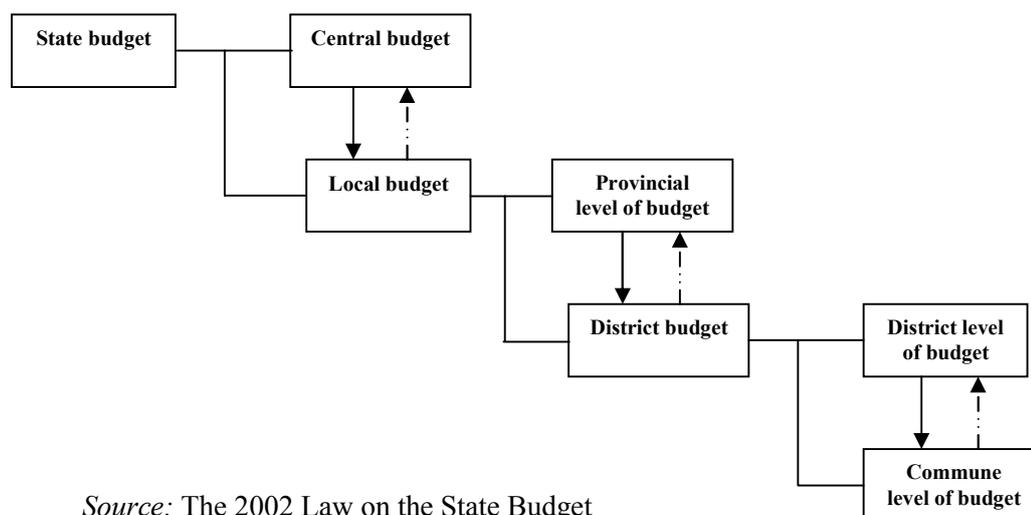
#### **3.1 Practical contexts of state budgeting and the application of MTEF in Vietnam**

##### **3.1.1 The current budget system in Vietnam**

In Vietnam, budget elaboration and execution have become more transparent over the last decade with the current organic law governing the budget process - the 2002 Law on the State Budget - and the increasing power of the National Assembly.

\* **The state budget system:** The Budget Law specifies that there is a single, unified state budget which must ultimately be ratified by the National Assembly. The budget process is the hierarchical nature of the structure, that is, just as candidates for elected offices at one level must be “approved” by the next higher level, budgets of lower levels are examined and may be changed by the next higher level of government (Fforde, 2003). This nested budgetary arrangement is comparable to the "Matruska-doll" model (Martinez-Vazquez & Gomez, 2005) that has characterized the arrangements in Russia (Nguyen & Schroeder, 2010: 701). The budgeting at the sub-national level is complicated because the outcomes of the entire process must be integrated into the single state budget although each local government has some autonomy in setting its budget (Nguyen & Schroeder, 2010: 701). It can be illustrated by figure 3.1.

**Figure 3.1: The hierarchical nature of Vietnamese state budget structure**



\* **The decentralization of state budget:** In the context of the state nested budget, the 2002 State Budget Law has tackled basically the budgetary relationship between the central government and local authorities towards strengthening the decentralization of budget management for sub-national governments, especially provinces. The Budget Law has regulated responsibilities and authorities of the National Assembly and the State President, the Government, the Ministries, the Provincial People's Councils, the Provincial People's Committees and other state agencies in managing the state budget. It has established the institutional framework for financial relations between the central government and local government levels, determining clearly powers and tasks of each level in the budget process. It has also stipulated revenue sources and expenditure tasks of the central budget and local budget. Accordingly, the Provincial People's Council has power and responsibility to decentralize revenue sources and expenditure tasks of local levels.

\* **The budget allocations:** Annually, the additional allocations from the superior budgets to the subordinate budgets will be effected in order to ensure fairness and balanced development among regions and localities. The additional allocations<sup>8</sup>, determined by the National Assembly, will be constituted revenues of the subordinate budgets, called a balancing transfer and be kept stable for 3 to 5 years, called the "budget stability period". The Provincial People's Council regulates the budget stability period between local levels in accordance with the budget stability period between the central and local budget. In the period of stability, the local budgets are kept stable revenue sources

<sup>8</sup> Including the balance addition and targeted addition.

and expenditure tasks, the revenue division percentages and the additional allocation norms from the central budget which are determined in the first year of the budget stability period.

The central government sets or assigns the competent State agencies to set the allocation norms and the regulations, the principle, criteria and norms on State budget expenditures for use as bases for unified elaboration, allocation and management of the State budget to ministries/sectors/central agencies and provinces/cities throughout the country. One of the important improvement is that the budget allocation norms and the budget expenditure regimes, criteria and norms are established publicly according to the criteria on population, natural conditions as well as socio-economic conditions of each region, paying attention to deep-lying and remote areas, former revolutionary bases, ethnic minority people areas and other difficulty-hit regions. On the basis of the budget allocation norms decided by the Prime Minister, financial capacities and the practical situation in their respective localities, the Provincial People's Committees submit to the Provincial People's Councils in order to promulgate budget allocation norms for setting and allocating budget in the province. The improvement has contributed to ensure the transparency and the equality of sectors and localities in budget allocations; moreover, it enhances public agencies' initiative on balancing and using budget. However, different provinces have different progress in developing and implementing the budget allocation norms.

\* **The budget process:** Annually, the guidelines for budget estimation are deployed from the central level. The starting point is the instruction of the Prime Minister about preparing socio-economic development plan and budget estimation (before May 31). After that, the Ministry of Finance and Ministry of Planning and Investment issue circulars in order to guide ministries/sectors/central agencies and provinces/cities. Then, the similar procedure continues to apply from provinces down to district and commune level. Setting and summarizing budget estimation are done in reserve. The subordinate sets and summarizes its budget estimation to submit to the superior: the commune level submits to the district level, the district level submits to the provincial level, and the provincial level submits to the central level.

The decision-making process and formally assigned budget estimates are done from the central government (the National Assembly decides the State budget estimates and resource allocations of the central budget before November 15) to the provincial level, then from the provincial level (the Provincial People's Council decides the provincial budget estimates and allocation plans of the provincial budget before December 12) to district level and from the district level (the district

People's Council decides its budget estimate and allocation plans before December 20) to the commune level (the Commune People's Council decides its budget estimate before December 30). The work contents and processes for elaboration socio-economic development plan and the State budget estimates in current budget system of Vietnam can be seen in Table 3.1 and Figure 3.2.

**Transparency in public financial management:** Although Vietnam has not yet fully met the standards of financial transparency mentioned in Code of Good Practices on Fiscal Transparency of the International Monetary Fund (IMF), the current reforms have created greater improvement in financial transparency and accountability (Hoang & Bui, 2010: 15). Since 2004, a large amount of efforts have gone into making a more favourable environment for financial transparency through the adoption of a series of regulations on disclosure of financial information in order to implement the State Budget Law, the Accounting Law and the Auditing Law. Posting financial information on the internet has created greater participation of citizens in the development process, thereby promoting transparency and contributing to improve governance efficiency. Since 2006, the National Assembly has organized for live broadcasting its meeting on discussing about the budget estimate and budget execution. By doing this, social organizations and citizens can take part in contributing their ideas and monitoring the budget process.

**Increasing autonomy and self-responsibility of budgetary-using units on finance:** The Government has signed some important documents<sup>9</sup> giving budgetary-using units greater autonomy and greater responsibility in their personnel and finance in order to improve efficient use of state budget in these agencies.

**Reforming public financial management:** Vietnam has made significant progress in its efforts to promote gradually the public financial management system according to international practices (Hoang & Bui, 2010: 17). The Government has committed to reforming the public financial management system as a component of the Master Programme on Public Administration Reform for the period 2001-2010 approved by the Prime Minister<sup>10</sup>. The project on reforming the public financial management aims to (1) modernize the management in budget plans, budget execution, and budget reports and strengthen budget accountability; (2) improve budget transparency; and (3)

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<sup>9</sup> Decision No. 192/2001QD-TTg on 17 December 2001 of the Prime Minister; Decree No. 10/2002/ND-CP on 16 January 2002, Decree No. 130/2005/ND-CP on 17 October 2005, and Decree No. 43/2006/ND-CP on 25 April 2006 of the Government.

<sup>10</sup> Decision No. 136/QD-TTg on 17 September 2001 of the Prime Minister.

ensure the financial security in the process of national development and integration. In addition, the project is determined to strengthen the link among requirements of the budget management, objectives of sectoral development and technical- economic indicators through the application of the MTEF & MTEF and enhance the capacity of governmental debt management. The project has developed with three components in the period of 2003- 2013, namely:

- *Component 1:* Establishing a Treasury and Budget Management Information System (TABMIS) aims to support the process of setting, examining, monitoring and applying method of budget accounting at all levels from the centre to provinces and districts in order to strengthen budget and treasury management.
- *Component 2:* Enhancing capacity of state budget planning and investment planning through elaborating the MTEF and MTEF working in close collaboration between the MOF and MPI as well as between the DOF and DPI at provinces.
- *Component 3:* Focusing on strengthening the public debt management and financial risks of State enterprises.

Until now, the project has been implemented comprehensively across all three components and achieved important results.

Basically, the method of the budgetary management is to manage the inputs using the traditional line-item budget system, particularly controlling input costs of the budget-using units according to the regulations, criteria and norms set by competent State bodies. These line items are often quite detailed, specifying how much money a particular agency or subunit will be permitted to spend on personnel, fringe benefits, travel, equipment, and the like. The most vital concern of the budget system is to specify the line-item ceilings in the budget allocation process and to ensure that agencies do not spend in excess of their allocations. The strengths of such a system rely on its relative simplicity, lack of ambiguity, and potential for control of expenditure through easy comparison with prior years and through the detailed specification of inputs. However, budgets which are organized according to line items give no information about why money is spent, or on the efficiency and effectiveness of programmes, leading to insufficient and inappropriate information for resource allocation decision-making and weak accountability mechanism for designating responsibility. In addition, these line-item systems are almost all associated with a short-time period, leading to failure to take longer-term costs into account (the World Bank, 1998: 11-12).

### **3.1.2 The pilot implementation of MTEF in Vietnam**

#### **3.1.2.1 The overall pilot implementation of MTEF**

In the reform process, the Vietnamese government decided to shift budget to a multi-year basis. That is, Vietnam has piloted the medium-term fiscal framework (MTFF) and the medium-term expenditure framework (MTEF) for some line ministries and provinces in order to gain experience and continue improvement the mechanisms, policies and procedures for public financial management towards reaching the modern, transparent, and effective management in the public expenditure, in accordance with specific conditions of deep and comprehensive integration in the global economy of Vietnam. Testing the methods over past three years - pilot projects - were done in four line ministries (including the Ministry of Transport, the Ministry of Agriculture and Rural Development, the Ministry of Education and Training, and the Ministry of Health) and four provinces (namely Hanoi<sup>11</sup>, Hatay, Binhduong and Vinhlong).

MTEF pilot is one of the important components of the "Reform of public financial management" project which are financed by the World Bank and the British Government Department for International Development. With the help of international consultants, in 2005, the first MTEF 2006-2008 was published at central level, which was done in collaboration among MOF, MPI and others.

Between 2006 and 2008, MTEF 2007-2009, 2008-2010, and 2009-2011 were published at central level and four pilot provinces. More importantly, MTEF plans in the period of 2008-2010 and 2009-2011 with higher quality were built parallel and alignment with the annual budget process in 2008 and 2009, respectively. These plans included alignment of MTEF timetable with main budget timetable, MTEF taken into account in budget negotiations, and publication of MTEF submissions alongside conventional budgets. Besides, process, templates and guidelines for the piloting of MTEF 2008-2010 and 2009-2011 were developed and tailored by the MOF<sup>12</sup>. There were also an increasing awareness of MTEF among leaders in sectors and provinces. MTEF plan in the period of 2009-2011 was the last for closing MTEF pilot project.

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<sup>11</sup> From 1/8/2008, MTEF pilot of Hanoi city consists of Hatay province because they are merged according to the Resolution of the National Assembly.

<sup>12</sup> Two Circular, namely No. 87/2007/Circular-MOF dated 19/07/2007 and No. 55/2007/Circular-MOF dated 20/06/2008

From 2009 to 2010, with the help of international consultants, the MOF focused on bringing the project to completion, taking account of lessons learned with set of documents, forms and process for applying and implementing MTEF at national and provincial level before a February deadline in 2011. A proposal for amending the 2002 State Budget Law and applying extensively MTEF in the whole country was submitted to The National Assembly.

### **3.1.2.2 The necessity for the implementation of MTEF in Vietnam**

There is no doubt that the efficiency of public expenditure management is one of the important strategic target of all countries because it demonstrates the government's responsibility in the management and use of public resources to create public goods and public services, to foster the economic growth, and to meet material and spirit needs of their citizens. Dramatically, it becomes more and more important responsibility in the situation of limited resources in comparison with unlimited expenditure demand.

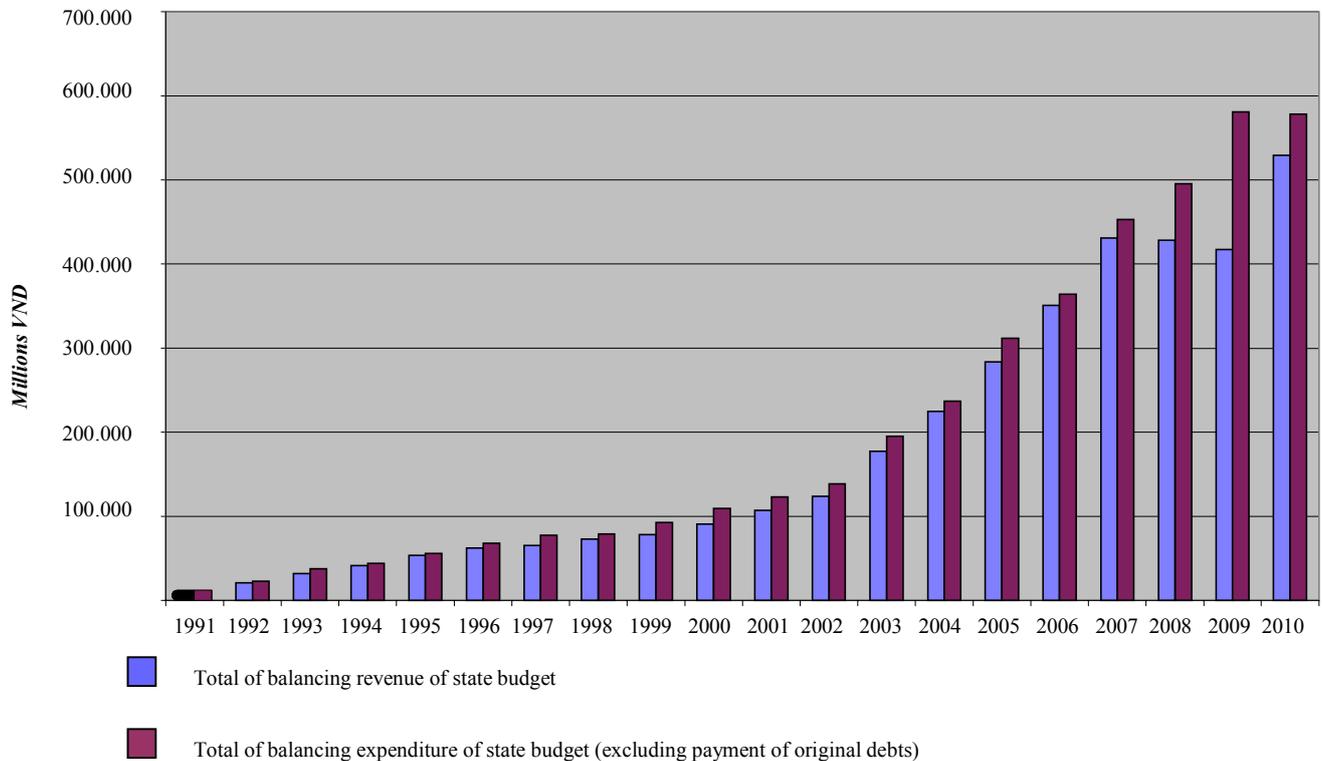
In Vietnam, PEM reform is one of the most important tasks and the overarching target of the public financial management reform towards the efficiency of budget use and management. Although introducing many fiscal reform measures and gaining some mixed positive results in recent years, the PEM and the present budget process still have numerous problems. These shortcomings limited the PEM is due to: (1) small-scale budget and unsustainable budget; (2) budget dispersion; (3) the budget process focusing on input controls; (4) poor link between policy, planning and budgeting; (5) poor resources allocations; and (6) poor transparency and accountability. These are the main reasons for requiring a new budget mechanism in order to overcome these limitations. As a result, the Vietnamese government has initiated public expenditure management focusing on MTEF, which have been applied by many countries, as a potential solution for many unresolved problems and a component in the process of transferring from line-item budgeting to performance-based budgeting (Le, 2010: 47; Su et al., 2005: 157; Strengthening Local Governance Programme, 2007: 36).

#### **a. The small-scale and unsustainable budget**

The total of state budget revenues in the period of 1991 - 2010 was 3,244,930 billion Vietnam Dong (VND); the annual average revenue was 162,246 billion VND. Meanwhile, the annual average expenditure (including original debts) increased from 38 trillion VND in the period of 1991 - 1995

to 87 trillion VND in the period of 1996-2000. That figure continued to increase to about 207 trillion VND during 2001 - 2005 and about 493 trillion VND during 2006 - 2010<sup>13</sup> (Le, 2010: 48).

**Chart 3.1: The size of state budget in the period of 1991 - 2010**



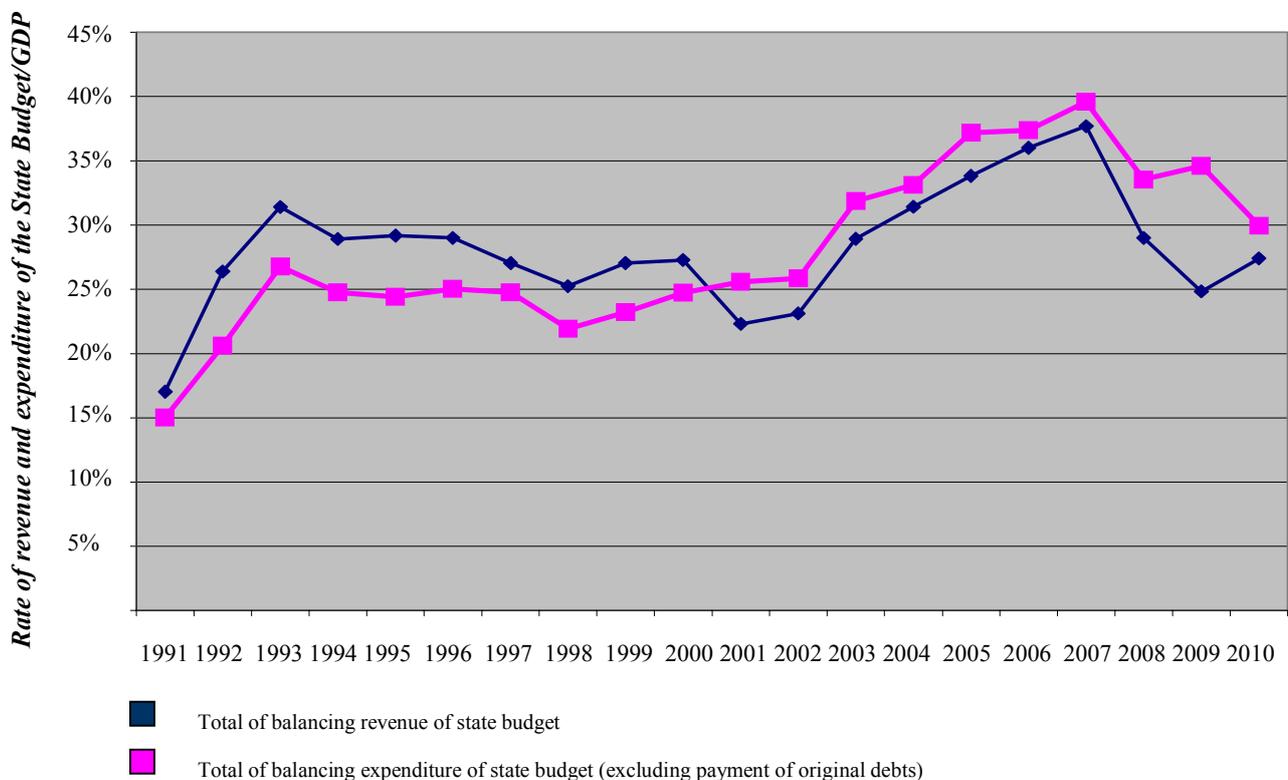
*Source:* The Ministry of Finance

Compared in GDP, the total of state budget revenues rose from 13.5% (1991) to 23.3% (1995), and the annual average revenue in this period was approximately 21.6%; the total of state budget expenditures rose from 15% (1991) to 26.8% (1995), and the annual average expenditure in this period was about 23.4%. Suffering the Asian financial crisis, however, the total of state budget revenues decreased from 22.9% (1996) to 19.6% (1998) and then increased to 20.5% (2000), the annual average revenue in the period of 1996 - 2000 was about 20.6%; the total of state budget expenditures reduced from 25% (1996) to 21.9% (1998) then increased to 24.7% (2000), and the annual average expenditure in comparison with GDP increased by 23.4%. Between 2001 and 2005, the total of state budget revenues grew from 21.6% (2001) to 27.2% (2005), the annual average revenue in this period reached 25%; there was a significant increase in the total of state budget

<sup>13</sup> In terms of absolute number, not to mention to inflation factor.

expenditures from 25.6% (2001) to 37.2% (2005), and the annual average expenditure in comparison with GDP increased by 31.6%. During 2006 and 2010, in the context of the financial crisis and economic recession globally, the total of state budget revenues fell from 28.7% (2006) to 23.3% (2009) and then rose to 27.3% (2010), the annual average revenue was about 27% of GDP. Noticeably, the government had to increase capital investment from the state budget because of sharp dropping in foreign investment funds. During this period, the averaging total of state budget expenditures in comparison with GDP increased by 34.7% (Le, 2010: 49-50).

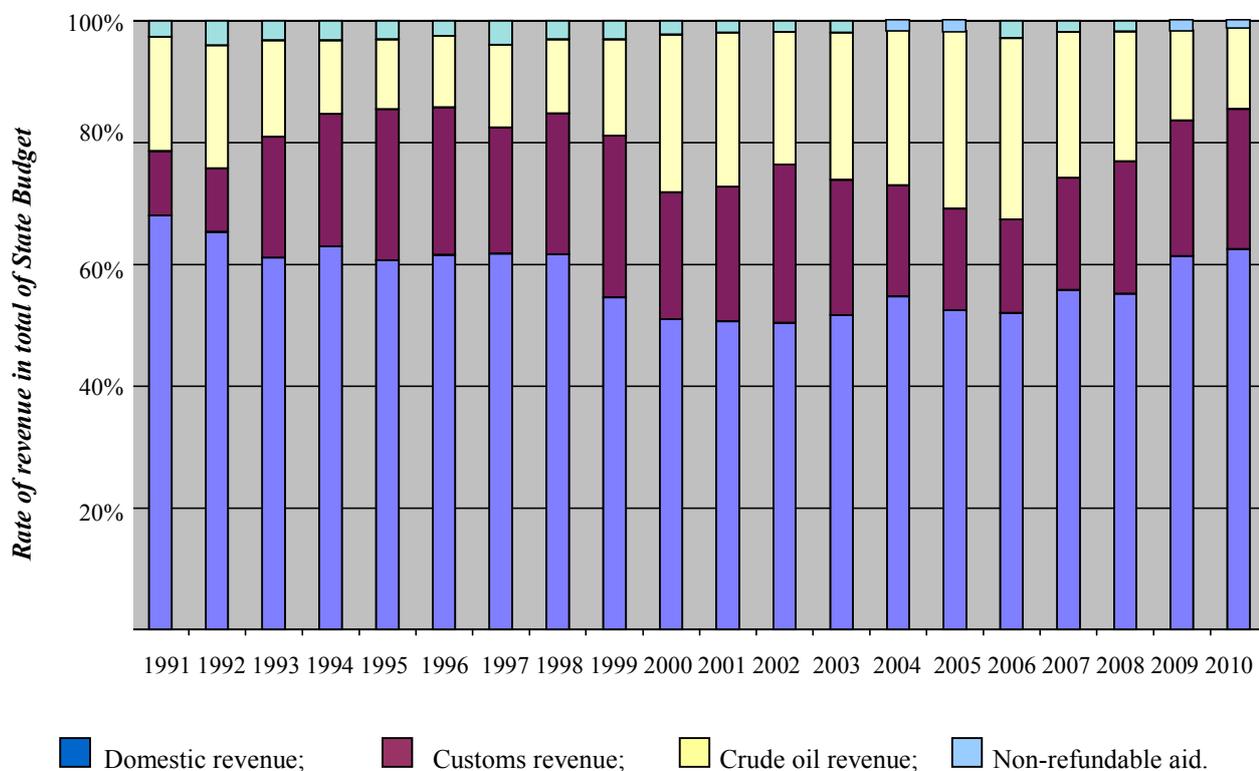
**Chart 3.2: The size of the state budget/ GDP in the period of 1991 - 2010**



*Source: The Ministry of Finance*

Moreover, the state budget was not really sustainable. The first reason is that the economic growth was slowed. Another reason is the domestic revenues did not become the solid foundation for the state budget. Specifically, from 1991 to now, although the proportion of domestic revenues (excluding crude oil revenues) was higher than that of revenues from crude oil, customs, and non-refundable aid, however, in the structure of state budget, the state budget revenues from crude oil, natural resources and land, etc. still accounted for high proportion (Le, 2010: 51).

**Chart 3.3: The state budget revenues divided into domestic revenue, customs revenue, crude oil revenue and non-refundable aid in the period of 1991 - 2010**



Source: The Ministry of Finance

Briefly, the small-scale and unsustainable budget led to the difficulties in the public expenditure management in Vietnam. Thus, a fiscal discipline is needed to control excessive expenditure of line ministries and local governments (Duong, 2005: 179).

### b. Budget dispersion

According to the 2002 Law on the State Budget of Vietnam (article 1), "the State budget comprises all revenues and expenditures of the State, which have been decided by the competent State agencies and implemented within one year in order to ensure the performance of the functions and tasks of the State". In addition, it recognizes a fundamental principle of unified budget applied widely in many countries, that is to say, all revenues and expenditures of the State should be taken account into a single document and fully integrated. However, the current mechanism of budget management in Vietnam gives rise to special tool for formation of off-budget funds at the central level (such as social insurance fund, health insurance fund, and export subsidy fund, etc.) and at the

local level (such as national defense and security fund, fund for prevention of floods and storms, and fund for study promotion, etc.) (Duong, 2005: 180). As a result, the state budget is dispersed and the expenditure planning is often misleading. It is clear that there are an expenditure transferring from the state budget to off-budget funds but they are not reflected in the reports of state budget balance-sheet leading to not only the difficulties in accurate analysis and forecast of the national and provincial revenues and expenditures but also lack of transparency (Le, 2010: 53). Therefore, it is important to establish a budget estimate in order to control public finance more easily, combat corruption, and protect people from having to pay more money besides taxes and fees (Duong, 2005: 180).

### **c. The budget process focusing on input controls**

Currently, Vietnamese public sectors are still using the traditional method in budgetary management, namely input controls. According to Irene Rubin (2007: 142), "A budgetary focus on inputs is oriented to fiscal control, ensuring that budgets are justified in terms of how much labor, equipment, fuel or electricity, insurance, and so on will be needed to accomplish a task". They are managed through line items in which the allocation to each department or programme is broken down into the cost for each main purchase according to the regulations, criteria and norms set by competent State bodies. There is no doubt that the input controls does have some points in its favour such as (1) easy implementing, easy understanding and making estimates; (2) a good control mechanism because line item details allow readers to assess the reasonableness of the cost estimates and whether resources appear to be wasted (Rubin, 2007: 142-143); and (3) reducing arguments to the major changes based on taking advantages to incremental budgeting, etc. But the disadvantages of input controls with line-item budget far overweigh its benefits, following:

Firstly, input controls focus on the quantity and ways money spent by putting caps on each category of expenditure, or even each item of expenditure rather than what money is spent on. Public managers calculate how much of each type of resource they will need to accomplish their tasks for the budget year rather than how they can accomplish objectives such as improving public health. In a line-item budget, it is not clear from budget figures what departments or agencies actually do, or whether they do it well because it stresses inputs rather than outputs. In other words, they focus on decision making small items rather than on whether the programme is efficient and effective. It also does not encourage budget-using units in saving because there is no necessary relationship between input costs and the achievement of any goals. Additionally, it leads to the lack of necessary and

sufficient information to balance resources and priorities ((Rubin, 2007: 142-143; Hughes, 2003: 169-171).

Secondly, the input model often deteriorates. It usually tends to be added small amounts to each line item each year rather than recreating a plan or changing the targets or goals. Thus, it requires less work, and any waste tends to stay in the budget from year to year (Rubin, 2007: 143). With such a short-term view of the budget there is often no idea of the future costs of new programmes or recurrent expenditure arising from the current investments to a second, third or even tenth year (Hughes, 2003: 169-171).

Thirdly, and most importantly, with the line item budget, public managers have little discretion when the budget year has begun. The specific items of expenditure within a budget are normally inflexible in moving resource form one kind of spending to another. "If a manager has overestimated the number of pencils needed, and underestimated the costs of phone calls or postage, he or she will find it difficult to transfer funds for one item to another item without giving the impression of mismanagement or overspending. Even savings from careful use are hard to transfer into other budget lines, because all the estimates were (presumably) based on a plan for accomplishing a certain amount of work and with a certain amount of each resource" (Rubin, 2007: 144). Moreover, if amounts are allocated to particular inputs they are invariably spent; otherwise the budget for the next year may be reduced. Thus, departments might employ extra staff, or spend money on items that are unnecessary, just to use up the allocation (Hughes, 2003:169-171).

Finally, the paucity of information in the traditional budget means that politicians have only limited ability to make major changes, and only limited data linking costs to achievements. Politicians or the public have no satisfactory way of judging whether taxpayers' money is serving desired ends, or is doing so efficiently or effectively (Hughes, 169-171).

In short, "although input controls aim to prevent overspending, their inflexibility can stymie good management and actually waste resources available in one budget line but needed in another line. They do not focus on the relationship between inputs and outputs and, hence, say nothing about how efficiently resources are used" (Rubin, 2007: 146). In other words, operational effectiveness is limited. Vietnam lacks even a basic mechanism for monitoring the actual outcomes of public spending and for feeding this information back into future resource allocation decisions.

### The weaknesses of input controls with line-item budgeting

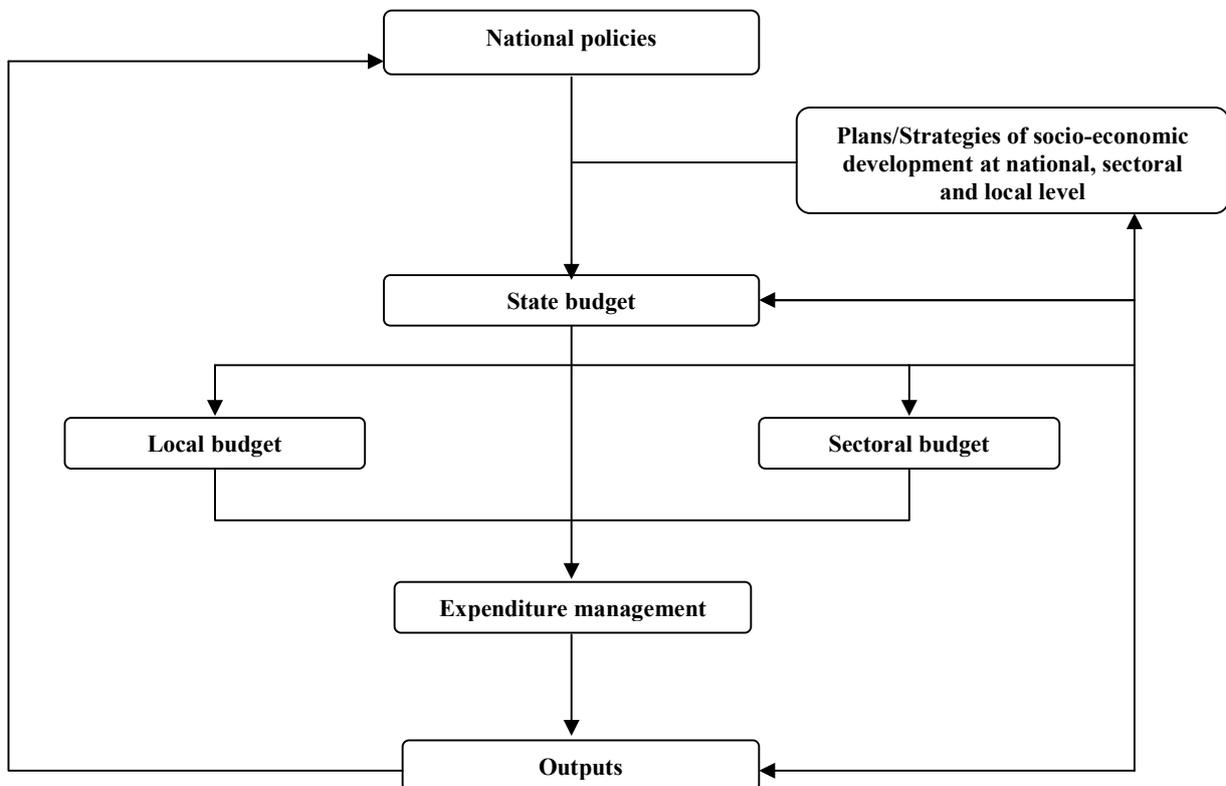
- Only showing line-item input expenditures.
- Focusing on controlling input factors purchased within expenditure ceilings rather than improving performance.
- One-year budget framework.
- Emphasizing short-term macroeconomic issues, short-term budgetary estimate, and estimating separately between recurrent expenditure and capital expenditures.
- No information about outputs and outcomes.

*Source:* Application of Performance-Based Budgeting in the public expenditure of Viet Nam, Su Dinh Thanh et al., 2005, p 139.

#### d. Poor link between policy, planning and budgeting

In Vietnam, the link between policy, planning and budgeting can be described following:

**Figure 3.3: The link between policy, planning and budgeting**



*Source:* Improving capacity for public financial management at local level. Report of Strengthening Local Governance Programme in Vietnam. 2007, p 37.

Actually, this link is weak and need to be strengthened. The first reason is that instead of allocations according to aggregate target programmes linking to policies, the state budget is designed yearly and distributed to budgetary-using units (ministries, provinces, departments, etc.) leading to the difficulties in making direct links between policy goals and costs needed to achieve these goals. The dispersed budget process also results in lacking a strong linkage between agencies and a close integration with the socio-economic development plans. Every sector develops its strategies, but in different depth and for different time periods, usually 5-10 years, but with different starting points for different strategies. In addition, identifying targets in the socio-economic development plan at all level often has some problems (The Report of Strengthening Local Governance Programme in Vietnam, 2007: 37-39):

- Lack of cohesion needed for the mobilization and allocation of resources to implement those plans and strategies.
- Not solving the root of priority problems, anti-spread in resource allocations. An incremental approach to updating budgets has undermined prioritization and not tackled inefficient or unnecessary expenditures.
- Lack of cohesion needed in financial management for approved plans and strategies; ineffective mechanism for financial management of investment projects financed by public resources (ODA, state budget, loans, etc.).
- Lack of methods and tools needed for effective linkages between the strategic goals and financial resources to gain those goals.
- Limited capacity and authority in planning and finance of local government.

In short, there has been no process for looking across these separate exercises to update them on a basis that enforces consistency between them. It cannot be said that annual budgets are in conflict with the plans and strategies. But nor can it be said that they are consistent with achieving those plans and strategies within the timescales envisaged. Short-term pressure has hit annual budget and has driven a gap between them and plans and strategies which has widened with time. To foster strong link between policy, planning and budgeting, it is necessary to change the method and process of planning, the method and process of budgeting, reforming thinking about expenditure management, and the method and process of defining and reviewing policies.

#### **e. Poor resource allocation**

Processes for prioritizing expenditures remain ineffective. The absence of a credible multi-year fiscal framework means that expenditure planning is conducted without reference to medium-term resource constraints. Prioritization is carried out separately for capital expenditure (by the Ministry of Planning and Investment) and for recurrent expenditure (by the Ministry of Finance), with significant imbalances between the two. There is a lack of clarity about the respective roles of sector ministries and provinces in prioritizing expenditures, with unrealistic centrally-specified norms laid down by sector ministries and then largely ignored by provinces.

In terms of limited financial resources, expenditure norms are a consistent basis for the financial resource allocation. However, the input model with line-item budget, as mentioned above, puts the resources allocations based on the norms in the place of weaknesses. First, there is disconnection between budget expenditures and outputs leading to the absence of agencies' responsibility in budget expenditure. Second, the expenditure norm system is sometimes not realistic, inflexible and does not encourage the creative and initiative abilities of budget-using units. Third, although the stability period (from 3 to 5 years) creates additional certainty in planning resource availability at the sub-national level, each province and line ministry still has to work with the centre on the entire budgeting process, even in the middle years of the stability period. It means that the budget allocation admits methods, norms and "negotiation" which can be inefficient and inequitable in the expenditure distribution (Nguyen & Schroeder, 2010: 701; Su et al., 2005: 141-142).

Moreover, there is a lack of strong linking between medium-term socio-economic development plans and resource allocations which are projected in the medium-term macroeconomic framework leading to the poor results of budget. Due to a one-year budget preparation, it could not be considered and assessed resource allocations associated with programmes of medium-term or long-term socio-economic development plans. The annual budget also are not built on the medium-term macroeconomic forecasts with rapid changes, consequently, it faces increasing impact of socio-economic changes. In addition, resource allocations are spreading and lack appropriate criteria to determine expenditure priorities (Le, 2010: 54-55; Su et al., 2005: 139-140).

In the current budget process, there is a lack of integration reflected in the adoption of a given split between current expenditures and capital expenditures, resulting in inefficiencies of public resources and insufficient maintenance of public assets. For example, it is often lack or difficulty in

increasing recurrent expenditures for road maintenance in considerable expansion of infrastructure assets. Actually, there are not only two different ministries (MOF and MPI) in charge of preparing long-term investment plans and annual budgets, but also limited coordination between them. The former is in responsible for the budget preparation including the allocation of recurrent expenditures whereas the latter is in charge of long-term plans and strategies and bears considerable responsibility for the compilation of the Public Investment Programmes including the allocation of capital expenditures. Each ministry plays a supporting role to the other in the areas where it does not take the lead. Province and line ministries have to send their financing requests to both MOF and MPI. As a result, a much better coordination between the decisions of MOF and MPI would be needed in order to translate a medium-term vision into short-term. MTEF could play a vital role in supporting a synchronized and integrated process for planning and budgeting (Su et al., 2005: 139-140; Joint Donor Report to the Vietnam Consultative Group Meeting, 2004: 9-10).

#### **The weakness of an annual budget**

- Budget system is not comprehensive and unified.
- The off-budget funds are not included in the state budget.
- There is a lack of linking between recurrent expenditures and capital expenditures.
- Recurrent expenditures are formulated incrementally.
- The concept of medium-term is merely applied for capital expenditures.
- There is a lack of aggregate financial discipline and the budget is made primarily based on short-term macroeconomic forecasts.
- There is a lack of linking between policy, planning and budgeting and between the decision-making and available resources, leading to unsustainable policies and not expression the government's priority policies.
- Poor public services are as a result of focusing on input controls.
- Choosing priorities are affected by donors.

*Source:* Application of Performance-Based Budgeting in the public expenditure of Viet Nam, Su Dinh Thanh et al., 2005, p 140.

## **f. Poor transparency and accountability**

Characteristically, the state budget belongs to the people, be contributed by the people, and serve the people. The transparency in the budget is a manifestation of the State's democracy and accountability to the people on the use and management of state budget and properties derived from the state budget. International experiences have showed that public sectors will not provide public goods and services in terms of cost-effectiveness if they do not have mechanisms to ensure transparency and accountability in public expenditure management. Transparency requires providing the accounting process and reports of budget and financial clearly and precisely. Accountability requires the effective monitoring, not only by state agencies but also by elected agencies and the public. Both the transparency and accountability demand that the estimation, the settlement, and the result of auditing of the State budget settlement must be publicized and timely. It also needs to have a mechanism in order to collect the citizens' interest and respond to them by adjusting the public financial allocations if it is necessary (Le, 2010: 55).

Vietnam has made significant progress and transparency in the public financial management in comparison with its starting point (The Vietnamese Government and the World Bank, 2005). However, Vietnam needs to further strengthen the financial publicity and transparency consistent with international standards, especially "Government Financial Statistics" standards set by the International Monetary Fund, which has recognized by many countries. According to recommendations given for Vietnam, the financial statements should be made timely, accurate and consistent with international standards. It is also important to enhance the role of the National Assembly and the State Audit. In addition, all auditing reports should be publicized (Le, 2010: 55).

### **3.1.2.3 The key features and process of MTEF at national level**

In order to tackle the sorts of issues described, Vietnam has moved to introduce reforms in the budget process including MTEF pilot and a gradual change towards performance-based budgeting. Although starting point with some common elements, the specific nature of developing MTEF in Vietnam varies according to its history and socio-political background.

For Vietnamese public sectors, the application of MTEF aims to achieve five main desired outcomes. The first expectation is to improve macroeconomic balance by developing a consistent and realistic resource framework. The second is to improve allocation of resources to strategic

priorities between and within sectors. It is also expected that the commitment to predictability of both policy and funding will be increased so that ministries and provinces can plan ahead and expenditure programmes can be sustained. Furthermore, it expects to increase incentives for efficient and effective use of funds by providing budgetary-using units with a hard budget constraints and increased autonomy. Finally, the long-term outcome is improved transparency and accountability for the use of public resources. To achieve its targets, MTEF requires significant changes in the methods of budget preparation and adoption.

According to the guidelines of the MOF (2008), the proposed enhancements to the budget process will:

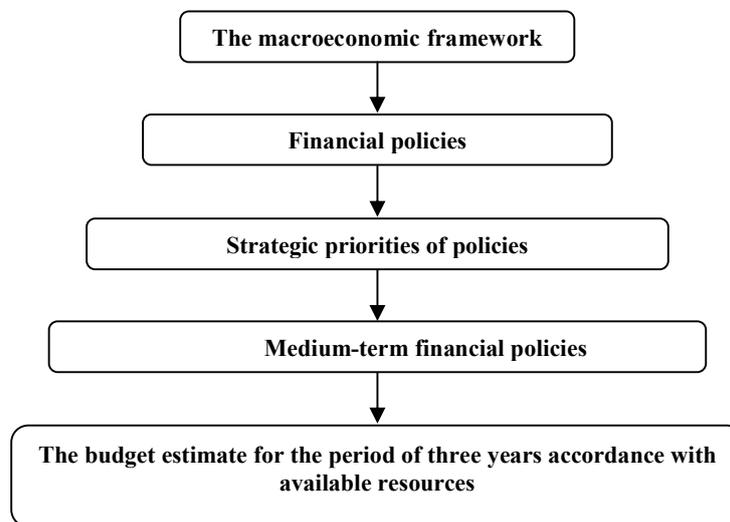
- Prepare a comprehensive fiscal analysis of the statewide major trends and forecasts in revenues, expenditures, debts and fiscal risks at an early stage of the annual budget process in order to support the preparation and decision making for the budget.
- Require the annual budget proposals from budgetary-using units to be presented using a three-year rolling process with reliable information about available resources and expenditure (recurrent and capital expenditures, budget and off-budget) and a comprehensive framework for linking expenditures to available revenues and linking expenditures to policies and results, instead of a budget preparation and adoption for one coming year. In general, countries can use a medium-term period that is usually from 3 to 5 years. For a developing country like Vietnam, however, going for shorter periods - a rolling three-year expenditure plan - is suitable and more realistic due to rapidly changing circumstances. Rolling budget process, including year 1 consistent with the annual budget, year 2 and year 3 starting point and be adjusted for next MTEF rather than start again, is critical to achieve stability between one cycle and the next.
- Set ceilings of total expenditure within which budget proposals must be made.
- Distinguish between the forecast costs of continuing to provide the levels of services under existing government policies from the costs of adding new policy initiatives for which funds are requested in the budget process.
- Make clearer responsibilities for service delivery and funding between central and local government.
- Improved transparency for sources of revenue that is not now included in the budget.

- Provide for regulations to ensure that the quality and consistency of performance information used in preparing and reporting on the implementation of the budget is improved.
- Tightening the rules about when the ‘books’ are closed off at the end of the fiscal year.
- Better linkages of: (1) budget funds with organizations delivering the services; (2) the budget and accounting information systems: and (3) 5-year planning and annual budgets.

Following this, MTEF process in Vietnam comprises three main parts in order to achieve transparency in the budget process and combine policy, planning and budgeting:

- Drawing up strategic plans and financial policies based on a multi-year macroeconomic framework.
- Establishing policies, determining objectives, activities, outputs and input costs in each sector in order to balance and allocate resources consistent with strategic priorities.
- Planning public expenditures, linking recurrent expenditure and capital expenditure based on the increased cooperation in resource allocations among line ministries, provinces and the MOF.

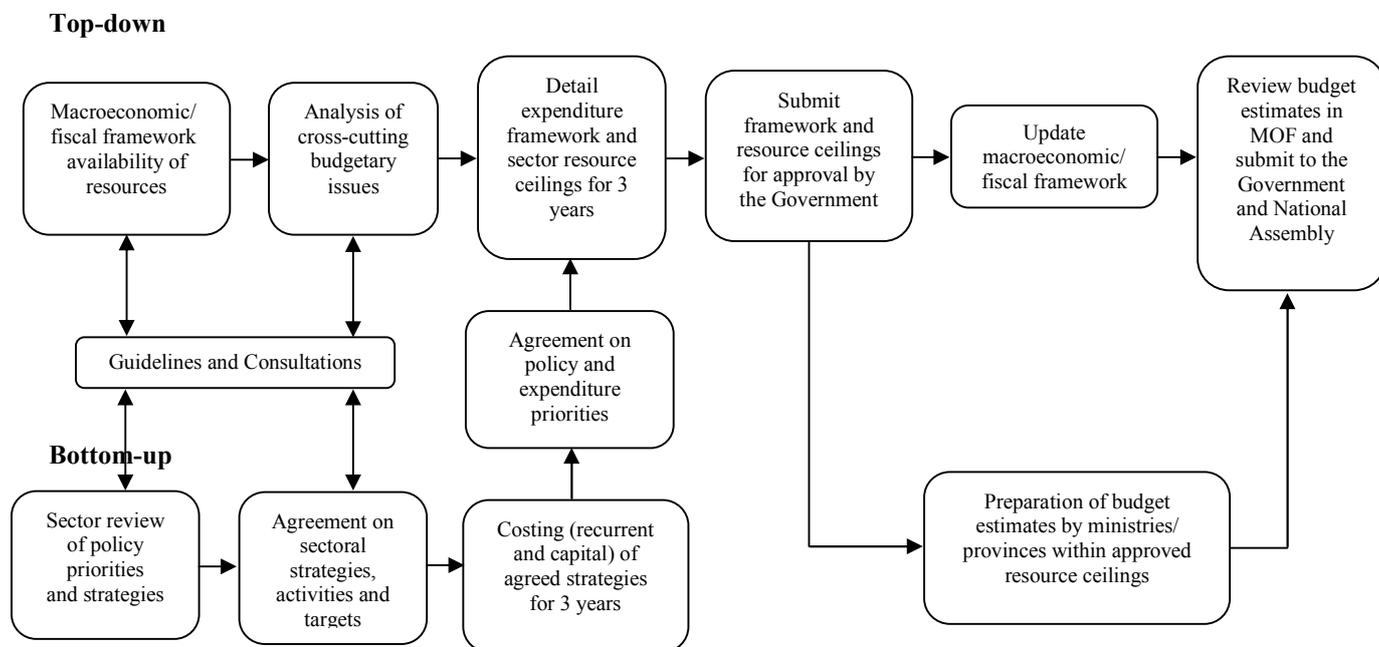
**Figure 3.4: The connection between policy, planning and budgeting in MTEF process**



*Source:* Application of Performance-Based Budgeting in the public expenditure of Viet Nam. Su Dinh Thanh et al., 2005, p.177.

In a modified form to suit the situation of Vietnam, the process of MTEF at the national level can be described following based on comprehensive model provided by the World Bank:

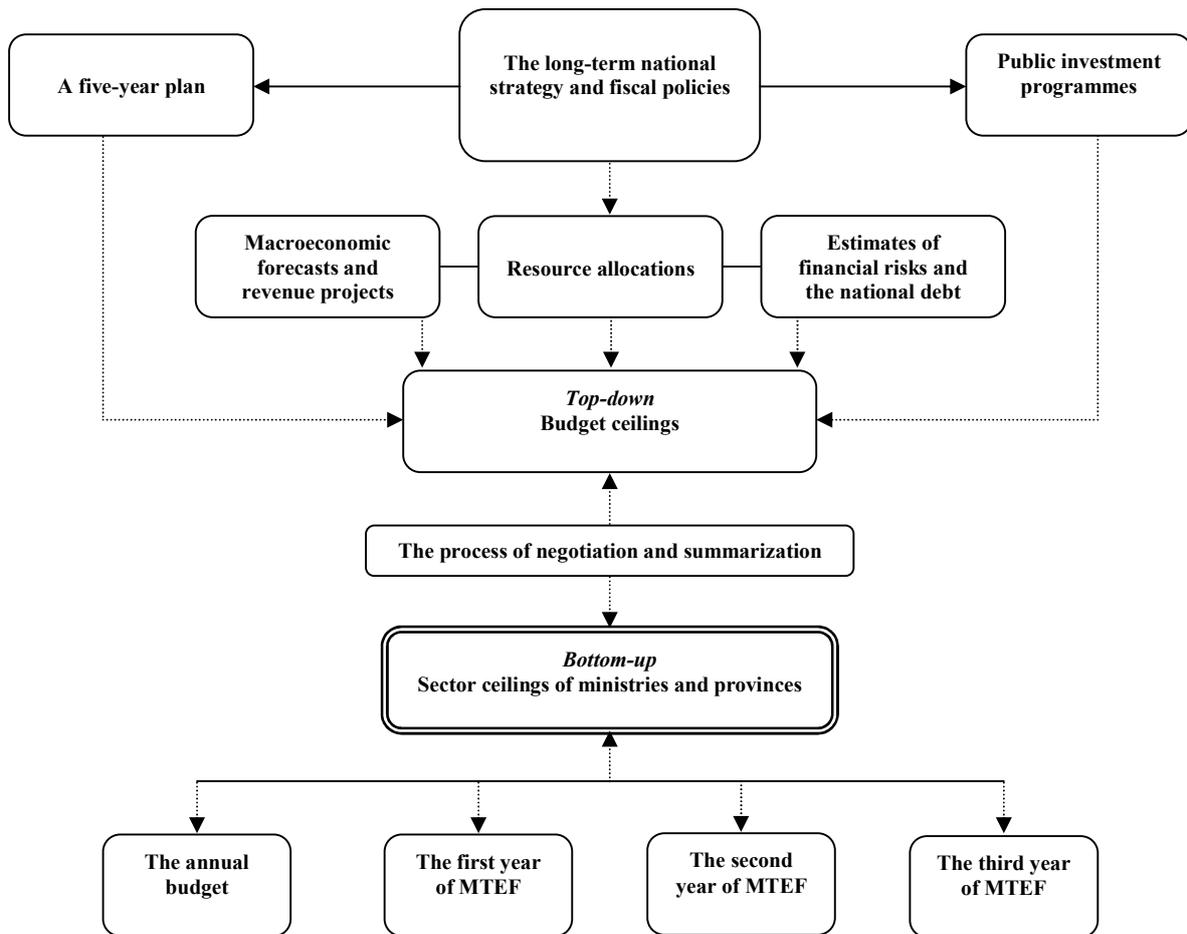
**Figure 3.5: Stages of MTEF in Vietnam**



Budget concept/ Medium-term expenditure framework	Annual budget
<ul style="list-style-type: none"> <li>- Outcome orientation (linked to services/outputs from budget institutions).</li> <li>- Strategic-multi-year, sectoral (mapped to budget institutions).</li> <li>- Integrated recurrent/capital expenditure, central/local government, budget/off-budget</li> </ul>	<ul style="list-style-type: none"> <li>- Institution-based</li> <li>- Single year</li> <li>- Detailed - item focused within ceilings</li> </ul>

Source: Guidelines for implementation of MTEF in Vietnam. The Ministry of Finance, 2008.

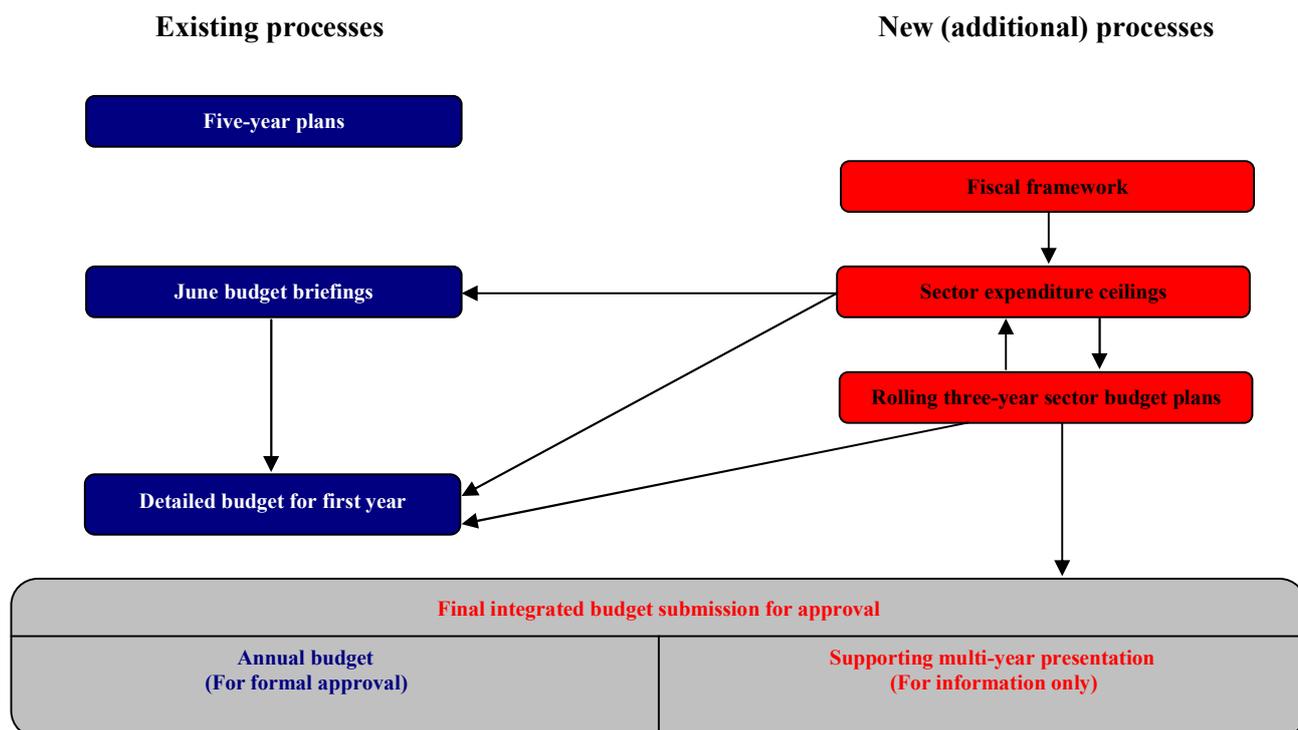
**Figure 3.6: The process of MTEF in Vietnam**



*Source: Application of Performance-Based Budgeting in the public expenditure of Viet Nam. Su Dinh Thanh et al., 2005, p.182.*

Significantly, the new additional process for integrating MTEF plan into the annual budget process in 2008 and 2009 was applied with the specific contents, the process of integration, progress requirements and execution time, etc. The proposed integration is important improvement leading to the coordination between the pilot and actual work in the budget process. It also created favourable conditions through practical experiences in order to improve the quality of the annual budget estimates and complete MTEF model in Vietnam.

**Figure 3.7: Integrating the proposed reform in Vietnam**



*Source:* Guidelines for implementation of MTEF in Vietnam. The Ministry of Finance, 2008.

In general, the public managers in pilot ministries and provinces have been aware of the benefits, the necessity and rationality reasonable of MTEF implementation. MTEF is an integral part of the state budget process. Compared to the current budget process, the implementation of MTEF helps to improve the transparency, the feasibility and effectiveness of budget estimates in annual, medium and long- term period. It is also the right way to reform the quality of the annual budget preparation in accordance with international practice during the integrative process, especially to promote a sense of responsibility and initiative of budgetary-using units.

### 3.1.2.4 The features and process of MTEF at provincial level

So far, four pilot provinces have held three pilot MTEF plans and gone according to outlined planning. The results showed that the methodology of MTEF has been formed based on the application of theoretical framework and country's experiences in doing MTEF to the context of public expenditure management of Vietnam. Accordingly, the model, form systems, the process of integration between the pilot MTEF and the currently annual budget, the process of providing and

tackling information; the process of coordination among MOF, MPI, line ministries and provinces, etc. have been done.

Because of the nested budgetary arrangements and the hierarchical nature of Vietnamese state budget structure as noted above, the provincial MTEF plan involves as a part of the national MTEF plan, providing necessary information for central level summarizing and setting the national budget estimate. It can also be seen clearly in the stages and process of MTEF presented above. In four pilot provinces, the process for developing MTEF includes seven stages, focusing on four main sectors namely education and training, health, agriculture and rural development, and transport which account for high percentages of public expenditures. The process of the provincial MTEF is integrated into the process of national MTEF, following:

- In June and the early July, the DOF in coordination with DPI prepare the three-year fiscal framework and set up expenditure ceilings to sector departments that are consistent with the fiscal framework. On the other hand, four pilot departments<sup>14</sup> formulate MTEF in the each sector focusing on analyzing issues affecting sector departments and their strategies; gathering data to assess baseline expenditure needs and assessing new spending initiative and priorities in the light of funds available within ceilings after baseline expenditure has been deducted. They also have to determine their objectives and expected outputs, necessary activities in order to achieve their objectives, the cost for each programme/project, and develop criteria for evaluating the outputs and the effectiveness of their performance. Then, it is important to identify clearly their expenditure tasks in order of priorities: activities needed to be maintenance and priority; activities needed to be narrowing; and activities needed to be elimination. This MTEF plan will be done simultaneously with the annual budget estimate and submit to the DOF, the DPI and pilot line ministries correspondingly.
- In July and August, the DOF and DPI discuss MTEF plan and the annual budget estimate at the same time with four pilot sectoral departments based on objectives needed to be achieved and analysis of cost-benefit. After reaching agreement in dealing with problems and priorities, the DOF has responsibility for submitting the aggregate MTEF and annual budget estimate of province to the MOF and the MPI. Then, the Provincial People's Committee, the DOF and the DPI will join in discussion forums on the annual budget estimate held by the MOF and MPI.

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<sup>14</sup> Department of Education and Training, Department of Health, Department of Agriculture and Rural Development, and Department of Transport

- In September, the provincial MTEF will be revised and completed based on the results of discussions with the MOF and MPI in order to submit to these ministries for aggregation before submission to the Government.
- In December, the pilot provinces improve and complete their final MTEF plans based on the budget estimate approved by the National Assembly.

According to the guidelines of the MOF (2008), at provincial level, part A and part B are the two main documents that make up the physical output of MTEF procedure. The contents of part A, namely overview, consist of:

1. *Executive summary*: Reviewing the results of implementation socio-economic development tasks during previous three-year period.
2. *Economic forecasts*: The purpose of this section is to put the fiscal strategy in the broader context of the province economy and to provide a basis for revenue forecasts. The key macroeconomic variables should be covered in three-year forecasts such as gross investment (private/public), nominal GDP, GDP growth (nominal & real), inflation (GDP deflator and consumer price index), population and job creation. This section highlights key assumptions and risks, and national forecasts annexed for comparison.
3. *Revenue policies and forecasts*: This section aims to establish the likely availability of resources for public expenditure in the province over the medium-term and to demonstrate the realism and reliability of the forecasts. The approach in this section consists of summarizing important revenue policies and administration changes relevant to the province and setting out revenue forecasts by taxes. In addition, it needs to summarize the rationale for the forecasts, including quantitative relationships with economic forecasts and special features for the province tax structure and trends. It is also vital to comment on important trends and changes, and highlight key assumptions and risks.
4. *Deficit financing and debt policy*: This section is intended to set out the province's medium-term borrowing plans and to demonstrate their realism and sustainability. According to the 2002 State Budget Law, provinces are not allowed to run deficits, but borrowing is included as balanced budget revenue in Vietnam - normal international practice is to define borrowing as deficit financing. In other words, provinces must balance their budgets but borrowing is counted towards budget balance. The way to approach this section is to review past trends in borrowing and outstanding debt, set out borrowing plans and sources of finance. More importantly, it is needed to set out impact of borrowing on outstanding debt and assess short-term sustainability of borrowing plans and long-run sustainability of debt.

5. *Aggregate fiscal framework*: The purpose of this section is to set out the aggregate fiscal framework for province's expenditure over the medium-term in the light of the preceding analysis of revenues and sustainable borrowing plans. Moreover, it is to demonstrate the sustainability of the proposed framework in relation to applicable fiscal principles. Therefore, this section will present aggregate fiscal forecasts in terms of revenues, expenditure, and deficit and financing; summarize high-level resource availability and expenditure picture; highlight the most important trends and changes; and set out fiscal principles applicable to the province and demonstrate conformity of the fiscal framework with these principles.
6. *Expenditure policies and forecasts*: The goals of this section are to demonstrate the link between the province's high-level expenditure policies and priorities and its strategic objectives. It is also to set out medium-term expenditure forecasts by function (sector) and economic classification consistent with these policies and priorities. Thus, this section deals with resources allocation by setting out province's main social and economic goals and demonstrating how resources will be allocated and reallocated to achieve these goals and explain links with national objective. It also describes main features of expenditure policy in relation to objectives and show forecasts of recurrent and capital expenditure by economic classification and function.
7. *Fiscal risks*: This section is needed to identify the areas of uncertainty attaching to forecasts and plans and to make an assessment of the risks and potential fiscal impacts attaching to these uncertainties. It should be identify type of risks (macroeconomic risks that will affect province revenues, e.g., economic growth or exports; external support; and unanticipated fiscal impact of provincial reforms), consequences for revenues, expenditures and the deficits; and probability of the event occurring.

Part B is MTEF for sectors including education and training, health, agriculture and rural development, and transport. This comprises six major sections, following (The MOF, 2008):

1. *Scope of the submission*: This section aims to clarify what is included in the submission and what is not, and to identify all the budgetary-using units that the sector encompasses. It will present a list of all budgetary-using institutions in the sector, consisting of those directly controlled by the province department and sector budget institutions that are under the budgets of the districts and communes. These institutions could be summarized in aggregate categories (e.g., 30 hospitals, 50 schools, etc.) if there are too many institutions.

2. *Trends and issues*: The purposes of this section are to map the environment for the sector and to clarify those factors which are causing or influencing expenditure requirements. To achieve those targets, it is necessary to identify the most significant trends<sup>15</sup> and issues<sup>16</sup> in the sector and then classify them in terms of economy, social environment, work of ministries and parts of the government, activities of donors, effects of environment and policies and decisions of the government. Finally, it is needed to make qualitative assessment of the scale and direction of their fiscal impacts.
3. *Sector priorities<sup>17</sup>, strategies<sup>18</sup> and policies*: The aim of this section is to clarify how sector policy is responding to the trends and issues identified and how these relate to priorities for the sector. The approaches needed are to identify priorities and links to sector policies and plans and rank priorities in order of importance. It also requires summarizing strategies for gaining priorities and specifying targets for verifying achievement of strategies. More importantly, noting how priorities, strategies and targets relate to previous MTEF and explaining any significant changes play a key role in this section.
4. *Funding*: This section will provide an overview of revenues from all sources of funding available to the sector over the medium-term period. In this section, revenues from budget funding are given by sector indicative expenditure levels issued by the DOF/DPI. The sector will make forecasts of revenues from non-state budget sources, including fees and other revenues. It also needs to estimate funding from approved bond issues and lottery receipts, and estimates repartition of different sources between provinces and districts & communes. Finally, consolidated estimates of total available funding for medium-term period and prior years are prepared.
5. *Medium-term expenditure plans of the sector*: The objectives of this section are to set out the constrained and prioritized expenditure plans for the sector, demonstrate the relationship between expenditure and sector priorities and signal the scale and consequences of any funding shortfalls. For doing these, the sector needs to estimate baseline expenditure<sup>19</sup> for

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<sup>15</sup> Factors that generate problems or challenges, or make it more difficult to address them.

<sup>16</sup> Problems or challenges have necessitated public expenditures.

<sup>17</sup> Resolution of an important issue to be addressed in the sector.

<sup>18</sup> Approach that is going to be taken to address an issue or problem, for example, how the priority will be achieved.

<sup>19</sup> Recurrent baseline - activities or projects that have been approved, and have had their finance approved. Capital baseline - projects that are approved, have their funding already approved, and are either ongoing in the current budget year or are likely to start in the current budget year. For example, cyclical replacement of school rooms damaged by climatic events or increased use of existing health services due to population growth or change in age structure.

recurrent and capital and costs for new initiatives<sup>20</sup>, and calculate funding gap (if any). It also makes clearly explanations how expenditure contributes to the achievement of priorities. Additionally, it is important to draw attention to identify unfunded services and projects (new initiatives or baseline expenditure) and consequences.

6. *Liabilities*: This section is needed to provide information on the level of debt within the sector and identify any problems arising from it. The sector will assemble consolidated information on outstanding debt, disaggregated by: debt related to capital expenditure/debt relating to recurrent expenditure; province/communes & districts. It also requires to make projections of debt for medium-term including plans for eliminating arrears.

### **3.1.2.5 The challenges of the pilot MTEF implementation at provincial level**

To review the piloting of MTEF, the Conference for the Review of medium-term expenditure framework piloting was convened by the Ministry of Finance on 19 March 2008. Besides evaluating the results and benefits of MTEF application, the main challenges of the pilot MTEF implementation at provincial level were highlighted (the Report No. 45/BC-BTC on 19 June 2008 of the MOF). It can be summed up following:

**\* The first challenge is the limited capacity for macroeconomic analysis and forecasts at the national and provincial level.** As mentioned above, solid and reliable macroeconomic analysis and forecasts are needed as a basis for MTEF. To achieve this requirement, having strong capacity for macroeconomic analysis and forecasts is a prerequisite for successful implementation of MTEF. Practical implementation of MTEF in many countries shows that the higher quality of macroeconomic forecasts is the higher effectiveness of public expenditure management can be gained. Because medium-term macroeconomic analysis and forecasts are a vital premise for formulating medium-term fiscal indicators. It is also important to remember that the work of analysis and forecasts can not be achieved unless statistical data, especially financial statistics, are reliable and consistent.

However, macroeconomic analysis and forecasts remain limited currently. In fact, almost ministries and provinces have an organ to be in charge of macroeconomic analysis and forecasts, but there is

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<sup>20</sup> New initiatives represent spending on new policies (including changes in standards or access criteria) or on new projects. For example, project to improve irrigation systems (project still under development and funding sources to be identified) or proposal to increase norm for child health services (proposal not yet adopted as policy).

lack of the coherence and coordination leading to macroeconomic and financial forecasts does not meet the requirements.

In particular, the basis of economic and financial statistics is still dispersive and unreliable. Until now, the information systems in financial management are delegated to separate units without paying attention to the flow of extremely important information between key components in the system itself and the external system. Therefore, the currently financial information is fragmented, delegated and inconsistent. As a result, the financial data is not only inconsistency and inaccuracy but also lack of transparency and control ability. To look at institution perspective, the lack of a common accounting system has led to inconsistency between financial statements, making the difficulty in comparison.

In addition, the lack of a unified budget system has caused the monitoring of revenues and expenditure more difficult, resulting in incorrect assessment of the financial situation and then threatening the fiscal stability. The lack of unified and integrative budget system has also led to the difficulty in resource allocation as well as comparison between the budget plan and the results of budget execution.

With the assistance of the World Bank and international donors, Vietnam is presently practicing reform and improving public financial management through the Treasury and Budget Management Information System (TABMIS) based on reforming institutions, upgrading information technology and previous systems. Accordingly, TABMIS will take the place of existing systems in order to support the process of budgeting, controlling, monitoring and accounting at the central and local government. In the future, if the reform is successful, it will create favourable conditions for improving the quality of macroeconomic and financial analysis and forecasts.

**\* The second challenge is that mechanisms and policies on the public financial management are not suitable for management approach according to MTEF.** Actually, one of the most important determinants for successful application of MTEF is that mechanisms and policies on the public financial management are appropriate, including performance-based budgeting<sup>21</sup> and accrual

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<sup>21</sup> According to Rivanbark (2004: 28), "Performance budgeting is a process for budget preparation and adoption that emphasizes performance management, allowing decisions about allocation of resources to be made in part on the efficiency and the effectiveness of service delivery". Another definition is that "performance budgeting is a system of budgeting that presents the purpose and objectives for which funds are required, the costs of programs and associated

basis of accounting<sup>22</sup>. Performance effectiveness of budgetary-using units, represented by the evaluation criteria, is the foundation for determining the sectors and activities needed to be priority to allocate resources. Accrual accounting allows accounting fully and clearly for the revenues and expenditures in the time series of years and being consistent with MTEF plan. However, Vietnam does not currently apply to performance-based budgeting and accrual accounting.

**\* The third challenge is that the local nature and spread investment are common.** Theoretical basis and practical application of MTEF show that the budget management according to MTEF is associated with the need to place high priorities on utility as the basis for resource allocations and efficiently budgetary use. The government and provinces have to concentrate their resources in key areas of activities, economic fields, territories, programmes and projects that have pervasive influence on other sectors and regions. In Vietnam, however, the state of pull on resources among sectors, localities, especially the local nature and spread investment, etc. is very common. This is the big challenge for the resource allocation and financial discipline.

**\* The fourth challenge is the lack of active measures to handle a budget shortfall in balancing between expenditure demands and expenditure ceilings.** The practical pilot in four provinces shows that it is difficult to balance the budget shortfall especially in the medium-term plan because expenditure demands significantly exceed expenditure ceilings. Actually, pilot provinces have offered some solutions but they are mainly based on the support of the central level such as budgetary supplement or government bond mobilization. However, relying on budgetary supplement from higher level is a passive solution because state resources are becoming more and more difficult and scarce, whatever mobilization plans are.

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activities proposed for achieving those objectives, and the outputs to be produced or services to be rendered under each program". A comprehensive performance budgeting system quantifies the entire results-based chain as follows (Shah & Chunli, 2007: 143-144):

- Inputs and intermediate inputs: resources to produce outputs
- Outputs: quantity and quality of goods and services produced
- Outcome: progress in achieving programme objectives
- Impact: programme goals
- Reach: people who benefit or are hurt by a programme.

<sup>22</sup> A basis of accounting under which transactions and other events are recognised when they occur (and not only when cash or its equivalent is received or paid). Therefore, the transactions and events are recorded in the accounting records and recognised in the financial statements of the periods to which they relate (IPSAS Board Definition, page 76).

**\* However, the biggest challenge in the pilot MTEF is lack of integration of MTEF work into decision-making.** The improved budget process in order to get better decision-making has been established (Figure 3.8). In fact, the application of MTEF has still faced with the big question in how to move MTEF process from a largely technical, information producing process to an information using process for improved decision-making.

### **3.1.2.6 Main recommendations for improving the quality of MTEF process**

In Vietnam, MTEF is not just an administrative or technical exercise. It is about providing decision makers with useful information on resource possibilities and expenditure trade-offs when they need it, so they can see how best to direct available resources at their policy priorities in a sustainable fashion. Planning for MTEF implementation, therefore, requires careful attention to the interface between technical analytical work and decision-making at the political level. In addition, MTEF work has to be timely, comprehensible and robust.

Based on the results of MTEF pilot, in 2009, the Ministry of Finance proposed some amendments articles of the 2002 Law on the State Budget concerning responsibilities and powers of the Government, ministries, sectors and provinces in MTEF implementation in order to gradually integrate MTEF plan into the decision-making of the annual budget estimates in the expectation of improving the budgetary-using efficiency in accordance with the conditions and the ability to apply in case of Vietnam.

In addition, the MOF summarized main recommendations for improving the quality of MTEF process, including:

**\* Recommendation 1: Promoting awareness and innovating the direction and governance of leaders of ministries, sectors and provinces.**

Many evidences show that without the direct involvement of political leaders, MTEF plan is like as a technical exercise, bringing out a forecast not policy decisions. Therefore, the direct interest of the leadership is crucial to the success of the budget process according to MTEF. For doing this, it is necessary to organize seminars and training courses in order to propagandize and disseminate basis knowledge, increase awareness of the needs, benefits and rationality of the budget elaboration according to MTEF. Furthermore, the State budget amendment should clearly define

responsibilities and powers of the ministries and provinces in linking MTEF into fiscal and budgetary preparation. This is a vital legal basis for promoting awareness and innovating the direction and governance of leaders of ministries, sectors and provinces. The changes in the perception will lead to the changes in habit working, that is, changing in budget preparation, improving accountability and transparency, and strengthening feasibility and effectiveness of budget estimation within a year, medium and long period.

**\* Recommendation 2: Changing mechanisms of public financial management.**

Most of difficulty in applying MTEF is related to the existing legal institutions and mechanisms. To create favourable conditions for implementing MTEF, therefore, the key changes in mechanisms of public financial management is necessary according to following aspects: (1) amending the 2002 Law on the State Budget focusing on responsibilities and powers of public agencies in doing MTEF plans; (2) changing process of budget estimate; (3) replacing the input control with line-items budgeting by performance-based budgeting; and (4) changing the cash basis of accounting into accrual accounting.

**\* Recommendation 3: Improving information systems.**

Information plays an important role in the decision-making of public managers; especially decisions are related to expenditure priorities in the scope of limited resources. Consequently, it is necessary to make available information systems consisting of forecasting systems, financial information systems, data flow systems and performance monitoring systems for MTEF process. In addition, the available information systems should be widely shared among public agencies at all levels.

**\* Recommendation 4: Improving human capacity.**

Human capacity is one of the most important factors for successful implementation of MTEF. The leaders and professional staffs should be trained on knowledge about the methodology, contents and process of MTEF. More importantly, improving human resources should be enhanced focusing on strategic thinking capacity, analytical capacity and performance orientation in order to meet academic skill requirements of MTEF implementation. It also needs changes in attitudes of working including: focus on results (what does expenditure achieve), base on analysis and evidence (the case for spending must be fully justified and reviewed), constructive challenge (accepting nothing as

fixed forever), cooperation (all participants respect each others role and seek to help each other), and reviewing and learning (checking what actually happened and why).

### **3.2 Practical contexts of state budgeting and posing a question for budget reform in Sonla province**

Sonla is the fifth largest province located in the northwest of Vietnam with about 75% of province's natural area covered by mountains and plateaus. It has a city and ten districts with the population of over 1 million people. The percentage of employed workers at 15 years of age and above among population is 59% in different sector in 2010, in which 85% labor work in agriculture and forestry.

Sonla is a developing province with the provincial gross domestic product (GDP) was 4.410 billion in 2010 (constant 1994 prices), increasing 94.05% compared to 2005, average growth rate during five years (2006 - 2010) was 14.2%. GDP per capita attained 12,4 million in 2010 (current prices), being equivalent to 650 USD, exceeding the target 550 - 560 USD/person in the socio - economic development plan. The economic structure shifted towards positive growth rate of industry - construction, reducing the proportion of agriculture, forestry and fisheries. In five years (2006-2010), the proportion of agriculture, forestry and fisheries declined from 50.81% to 39.6%, industry and construction rose from 15.78% to 22.12%, services increased from 33.41% to 38.28%. However, the economic structure had not met the provincial goal, that was the proportion of industry and construction accounted for 34% -35% and agriculture, forestry and fisheries accounted for 28% - 29% in 2010.

Budget revenues of Sonla province increased continuously over the years and far exceeding the target of the annual financial plan. During the period of 2006 - 2020, budget revenue in the province reached 2,213 billion with an average increase of 28.9%/year and the total expenditures of the state budget was 9,260 billion with an average increase of 26.5%/year. However, total revenues in the locality just afford about 24% on the average total expenditures of the province. Annually, Sonla province has to receive approximately 76% balancing transfer from central budget to provincial budget (Table 3.3). The limit of provincial financial capacity results in heavily depends on the central government. It also places upward pressure on expenditure because the annual budget process allocates extremely limited domestic resources to keep current investment projects and activities for implementing socio-economic development plan alive, especially corresponding costs for a series of donor-funded projects, target programmes or bailing provincial projects and

programmes out of financial difficulty. In addition, the lack of comprehensiveness in the coverage of fiscal operations also leads to weak public expenditure management systems.

**Table 3.3: The balancing transfer from central budget to Sonla provincial budget in the period of 2006 - 2010**

*Million dong*

Year	Total revenues in the locality	Ratio of shared revenues between central and provincial budget (%)	Total local budget balancing expenditures	Balancing transfer from central budget to provincial budget	Ratio of balancing transfer (%)
2010	733,200	100	2,521,839	1,788,639	71
2009	470,200	100	2,125,863	1,655,663	78
2008	407,100	100	1,895,049	1,487,949	78
2007	337,500	100	1,682,279	1,344,779	80
2006	273,300	100	1,035,474	762,174	74

*Source:* The Ministry of Finance

Like other provinces, Sonla province shares the same situation of the budget execution, as mentioned above in the contexts of Vietnam, with the weaknesses of the line-item budgeting and the budgeting process tending to result in the allocation of resources on a historical incremental basis and lack of predictability. It can also be found that there are many evidences of the weak links between policy making, planning and budgeting which lead to the poor performance. Budgeting has been challenged by the "needs" rather than "availability" psychology of the budget actors in all areas and sectors. While the Provincial People's Council and Provincial People's Committee stress "availability", that means the revenues is expected to be forthcoming from domestic and external sources, the districts and line departments persist in basing budget proposals on "needs". The result is a negative-sum budget process that undermines economic stability and project and programme effectiveness. In addition, the inadequacy of hard budget restraints on decision makers at the planning and budget formulation stage of the cycle leads to inadequate funding of operations, poor expenditure control and unpredictability in the flow of budgeted resources to agencies responsible for service delivery. Specifically, the socio-economic development plan, which is designed for the long period of five years, seems to be not feasible and often has to be adjusted because of ambitious targets and lack of resources for too many projects and activities planned. The big consequence is that Sonla province must cut down its annual expenditure from 2007 up to now in order to pay for

its outstanding debts (about 1,945 billion) for capital constructions which were completed or ongoing before May 2007.

Dealing with these problems, the demand of reforms in order to improving public expenditure management in the limited resource is mainly placed on the budget. Budget reform concerns constantly changing approaches to budgeting, resource allocation and financial management to reflect three functions of budgeting in the ascendancy - control of public resources, planning for the future resource allocation and resources management. As a result, the public expenditure management of Sonla province needs effective fiscal discipline, a capacity to allocate resources to strategic priorities and to use resources effectively and efficiently.

Interestingly, the pilot of MTEF implementation at four provinces is showing some signs of improvements in the budget reform. From the purpose of enhancing efficiency and effectiveness of public expenditure management, the main research question of this study "*How can the medium-term expenditure framework be applied for budgeting in Son La province?*" was posed. The author divided the main research question into three sub-questions, following:

1. *Should MTEF be applied for budgeting in Son La province?*
2. *How can MTEF be designed and applied in the budget process of Son La province?*
3. *What factors are essential for implementation of MTEF in Son La province?*

## **4. EMPIRICAL STUDY OF APPLYING MTEF IN SONLA PROVINCE**

*This section details the chosen research approaches.*

### **4.1 Research design and methodology**

The inductive and the deductive methods are two scientific approaches representing an important variation within social research on how to get better understanding about reality as well as the relation between theory and empirical findings. Theory and empirical observations are the essential factors in both approaches, but the different starting point of the research are the main difference between two approaches. The inductive method implies that the researcher begins with collecting empirical observations about a specific situation, and afterward searches for appropriate theory. By contrast, in the deductive method, the researcher starts with studying theory, and afterwards searches and collect the empirical data needed. Doing this, the researcher creates some knowledge about the topic through reviewing the theory in advance, and then investigates the situation of interest with help of previously established knowledge (Babbie, 2010: 53-59). In other words, "a deductive approach is useful if the general aim was to test a previous theory in a different situation..." (Elo & Kynga's, 2007). Consequently, the chosen approach for this study is the deductive, that the literature is examined in advance of the data collection. In this case, starting with the existing theory is a necessity in order to know what information is needed from the practical application of MTEF.

In addition, both qualitative and quantitative methods were used for this study. As concluded by Creswell (1994: 177), "it is advantageous to a researcher to combine methods to understand a concept being tested and explored". Many evidences show that the use of a combination of both qualitative and quantitative research methods results in a stronger validity of outcomes, that is research being a truth-finding construction aimed at verifying and authenticating phenomena. Because of my personal interest in critical reflection, and logical conclusion, I believe that the use of both qualitative and quantitative research methodologies would provide a great experience. Mixed method approach that collects diverse types of data best provides on understanding of a research problem and more reliable and valid information for data analysis.

In short, the choice of research approach rests on matching the approach with the research questions of interest. In this case, given the research questions that this study intends to address, deductive and mix methods are useful.

## **4.2 Research instruments**

Combining documentary data analysis and questionnaires are two research instruments using in this study. In the practical social research, content analysis is known as a method of analyzing documents. Many authors proved that content analysis allowed the researcher to test theoretical issues to enhance understanding of the data. Through content analysis, it is possible to distil words into fewer content related categories (Elo & Kynga's, 2007). Content analysis is also a research method for making replicable and valid inferences from data to their context, with the purpose of providing knowledge, new insights, a representation of facts and a practical guide to action (Krippendorff, 1980). The aim is to attain a condensed and broad description of the phenomenon, and the outcome of the analysis is concepts or categories describing the phenomenon (Elo & Kynga, 2007). As a result, documentary data analysis is suitable for my purpose of study on the application of MTEF for budgeting in Sonla province.

In addition, to support and improve the reliability of documentary data review and analysis, a set of questionnaires was done in order to gain valid information from personal and professional views of leaders and officials in the state agencies. Actually, there are two basic ways in survey research data collection: questionnaires and interviews. However, this research survey employs questionnaire research instrument because of its following advantages. Firstly, since four provinces, where are collected empirical data, are geographical dispersed, mailed survey proves to be appropriate. Secondly, the respondents may find it easier just to circle the answer in the questionnaires and tend to provide more accurate and honest answers when they do not have to face-to-face with the researcher. Finally, data can be collected more inexpensively and much more quickly than interviews. Data collection in this survey research takes four weeks and can do at the same time.

To sum up, documentary content analysis would enable the researcher to build the conceptual framework and provide data triangulation for the questionnaire results. The data obtained from content analysis will be backed up by data gained from questionnaires.

## **4.3 Unit of analysis**

The unit of analysis was the three pilot provinces which had been implemented MTEF and Sonla province which was studied in order to apply MTEF for budgeting. The provincial officials were

given priority in terms of collecting the data for the questionnaires due to their better understanding and possession of information within their province.

The self-administered questionnaires were distributed to four provinces. In particular, in each province, the officials whose work was related to budget preparation and execution were appointed to respond to the questionnaires. Their responses were calculated as a composite index in order to represent their provinces.

#### **4.4 Data collection procedures**

The major sources of data used in the data analysis were mainly available documents and a self-administered survey.

As mentioned above, both qualitative and quantitative methods were chosen for this study. The first method consisted of documentary research or analysis of available documents, which is one of the best ways to conduct exploratory research. The second method consisted of self-administered questionnaires were conducted.

##### **4.3.1 Analysis of available documents**

The information provided in this analysis was collected using the following methods:

- Review of academic articles, books, and other research about budgeting, policy implementation, and financial management related to MTEF.
- Legislative writings, evaluating reports and case studies provided by Vietnamese state agencies, and other state governments.

Academic literature and research was collected by using books and articles from various authors relating to MTEF practice. The articles include those in the Public Administration Review, the Journal of Public Budgeting, the International Journal of Public Administration, the research of National Institute for Finance, Journal of Public Administration Research and Theory, Accounting and Financial Management, and so on from Vietnam and other countries. The books and articles provide information not only for Vietnam but also other states by comparing them. Most importantly, useful books and articles came from researches of the World Bank and The Organization for Economic Cooperation and Development (OECD).

Significantly, the Vietnamese Ministry of Finance reports provided useful information with regard to the pilot progress, various problems and efforts of implementing MTEF in the pilot ministries and provinces. Additionally this literature includes different perspectives and various solutions for improving the present situation. In particular, a large amount of data was gathered from reports of four pilot provinces.

#### **4.3.2 Self-administered survey**

The second method of the study consisted of self-administered questionnaires. They were prepared to ask officials in three pilot provinces (Hanoi city, Vinhlong and Binhduong provinces) and Sonla province about their perception of the following seven elements: (1) weaknesses in the current budget system at the provincial level of Viet Nam; (2) the necessity of applying MTEF in Vietnam; (3) advantages of MTEF; (4) obstacles affecting the application of MTEF to budgeting process in provinces; (5) favorable conditions for the implementation of MTEF; (6) the scope of the application MTEF; and (7) essential factors for applying MTEF successfully in provincial level (Figure 4.1 - Appendices).

These questions included nine open-ended and closed-ended questions, designed based on the literature, researches and reports of the World Bank (1998), Jand Kiringai and Geoffrey West (2002), Seok-Kyun Hur (2004), the Ministry of Finance (2008), Le Quang Thuan (2010), Su Dinh Thanh (2005), and Duong Thi Binh Minh (2005). These questions were written both in English and Vietnamese. The closed-ended questions were accomplished by asking the provincial officers to indicate the extent to which they agreed with the statements mentioned in questions number 2, 5, 6, 7 and 9. The scale of this set was based on a five-point Likert Scale (ranging from 1 - not important at all, 2 - moderately important, 3 - important, 4 - very important, and 5 - can not say).

The content validity was done by checking the content of questionnaires via expert opinion in order to test how long it takes to complete, check that the questions were not too ambiguous and the instructions were clear, and eliminate questions that did not yield usable data (the supervisor and budget executive officer were asked to comment on the questionnaires, and the questionnaires were revised based on their comments before being distributed to the provinces). The construction validity was judged by comparison with previous literature to see whether it was relevant to and supported by the former ones.

In particular, the respondents divided into two groups for two purposes. Firstly, the respondents whose work were directly responsible for provincial budget preparation and execution in three pilot provinces asked questions concerning their experience in doing MTEF. Secondly, provincial officials in Son La province who had chance to enjoy training and conferences about MTEF talked about their knowledge and willing to apply MTEF for provincial budgeting.

The questionnaires were sent to six agencies in four provinces. These departments included:

- Two departments that have main responsibility for preparing provincial budget: the Department of Finance and the Department of Planning and Investment.
- Four main departments accounting for high percentage of using public expenditure and participating in the pilot project: the Department of Education and Training; the Department of Health; the Department of Agriculture and Rural Development, and the Department of Transport.

The questionnaires were sent by mail and meeting face to face. Importantly, two techniques were used in order to increase the response rates: a covering letter and follow-ups. The covering letter, which was printed on the first page of the questionnaire, was an important means of inducing the reader to complete and return the questionnaire. The letter explained the importance of the study. It also added a letter of recommendation from the National Academy of Public Administration. In addition, follow-ups were distributed and telephone reminders were made to the respondents in order to remind them to respond and return the questionnaires. Consequently, the response rate of this study was 77.5% (31 respondents from a set of 40 distributed questionnaires).

#### **4.5 Data analysis and characteristics of the respondents**

There are two parts of data analysis. Firstly, qualitative data are analyzed by the researcher. Secondly, descriptive statistics, percentages and sum are used to illustrate the research statistical results. The number of non-response on sample is 22.5%, but the effect of non-response on does not influence on the reliability and validity of the sample.

Table 4.1 describes the respondents' profiles. Their current position levels are managers and finance officials in the proportion of 67.7% and 32.3%, respectively. The respondents from three pilot provinces and Sonla province accounted for 83.7% and 16.3% of respondents came from Sonla province. According to their office, the number of respondents working at the DOF and the DPI are

62.3% and the rest work for four pilot sectors which have high percentage of using public expenditure. Almost of them (83.9%) said that they knew MTEF reasonable well.

**Table 4.1: Detailed profiles of respondents**

<i>Characteristics</i>		<i>Number</i>	<i>Percent</i>
<b>Current position</b>	Managers	21	67.7%
	Finance officials	10	32.3%
	<b>Total</b>	<b>31</b>	<b>100%</b>
<b>Province</b>	Three pilot provinces	26	83.7%
	Sonla province	5	16.3%
	<b>Total</b>	<b>31</b>	<b>100%</b>
<b>Department</b>	The Department of Finance	11	35.4%
	The Department of Planning and Investment	8	25.8%
	The Department of Education and Training	3	9.7%
	The Department of Health	3	9.7%
	The Department of Agriculture and Rural Development	3	9.7%
	The Department of Transport	3	9.7%
	<b>Total</b>	<b>31</b>	<b>100%</b>

## 5. RESULTS

*This section reports findings from both documentary content analysis and questionnaires, analyzing based on descriptive and statistical techniques. It will start with the findings on the necessity and rationality of application MTEF, how to design and apply MTEF in the budget process of Son La province, and move on to the factors that are essential for implementation of MTEF in Son La province.*

### **5.1 Should MTEF be applied for budgeting in Son La province?**

As mentioned above, inefficient public expenditure management is a starting point for the strategy of budget reform in Sonla province. The weaknesses of the current budget system and the benefits of MTEF which meet the demands of budget reforms are two main evidences for the suggestion concerning the application of MTEF for budgeting in Sonla province.

Like other provinces in Vietnam, the political leadership and financial managers in Sonla province always try their best in order to find out the new methods for public expenditure management efficiently and effectively in the limited resources. However, the current public expenditure management in Sonla province fails to meet the province's performance targets because of poor resource allocation and inefficient operation. The major reason is that Sonla province is experiencing the same situation of weaknesses in the current budget system at provincial level which was demonstrated in the research on developing countries done by the World Bank and summarized in case of Vietnam (section 3.1.2.2) as mentioned above. These statements are strongly supported by survey questionnaires in four provinces encompassing Hanoi city, Vinhlong, Binhduong and Sonla provinces. First of all, failure to link policy, planning and budgeting and the lack of link between the decision-making and available resources, leading to unsustainable policies and not expression the province's priority targets are the main important factors contributing to poor budgeting outcomes at province level. According to survey questionnaires, almost respondents showed that poor link policy, planning and budgeting, and lack of link between the decision-making and available resources are important weaknesses in current budget system at their provinces, with 90% and 71% respectively. In addition, 87% respondents said that unrealistic forecasts of revenues and expenditures resulted in the poor budget outcomes. All of respondents also believe that one-year horizon is too short for effective budget planning and there is lack of link between capital and recurrent expenditure. More importantly, all of them affirmed that the budget process focusing on

the input controls with the traditional line-item budgeting directly leads to poor budget allocation and inefficient performance. According to table 5.1, the respondents confirmed that decision-makers are lack of reliable information about what proposed expenditure related to achieved results in practice (87%), by contrast, budget expenditures are changed by arbitrary increment rather than policy priority decisions (59%); there is weak accountability for achieving those results within the administration (81%), and no basis for monitoring actual achievement alongside expenditure made (67%). Finally, low scale of the success of budget preparation and execution related to rigid earmarking of funds for particular purposes reduces flexibility in setting budget priorities (58%); and no resources ceilings are set so budget planners are not working within realistic expectations of available funds (68%).

**Table 5.1: Weaknesses in the current budget system at the provincial level of Vietnam**

Statements	1	2	3	4	5	Total
- Failure to link policy, planning and budgeting		10% (3)	77% (24)	13% (4)		100% (31)
- Lack of link between decision-makings and available resources	7% (2)	22% (7)	71% (22)			100% (31)
- Unrealistic forecasts of revenues and expenditures	13% (4)		87% (27)			100% (31)
- Inadequate integration of capital and recurrent spending			100% (31)			100% (31)
- Time horizon too short for effective budget planning			77% (24)	23% (7)		100% (31)
- Lack of transparency about many revenue sources that are not included in the budget	23% (7)	23% (7)	54% (17)			100% (31)
- Poor budget allocation and inefficient performance because budget process focusing on the input controls with the traditional line-item budgeting			81% (25)	19% (6)		100% (31)
- Lack of reliable information about what proposed expenditure related to achieved results in practice		13% (4)	87% (27)			100% (31)
- Budget expenditures are changed by arbitrary increment rather than policy priority decisions		41% (13)	34% (10)	25% (8)		100% (31)
- Weak accountability for achieving those results within the administration		19% (6)	81% (25)			100% (31)
- No basis for monitoring actual achievement alongside expenditure made		33% (10)	67% (21)			100% (31)

- Rigid earmarking of funds for particular purposes reduces flexibility in setting budget priorities		42% (13)		58% (18)		100% (31)
- No resources ceilings set so budget planners are not working within realistic expectations of available funds	32% (10)		55% (17)	13% (4)		100% (31)

*(1 - Not at all a problem, 2 - moderately problem, 3 - important problem, 4- very important problem, 5- cannot say)*

Fortunately, international experiences provided by the World Bank and other researchers and the pilot project on implementation of MTEF in four provinces of Vietnam have proved the benefits of MTEF to satisfy the demands of budget reforms. As reported by the World Bank (1998: 32), "A medium-term approach provides such a linking framework and facilitates the management of the tension between policy and budget realities to reduce pressure throughout the whole budget cycle". Jand Kiringai and Geoffrey West (2002) and Seok-Kyun Hur (2004) also noted in their works, as mentioned above, the central features of MTEF have captured as an associated institutional mechanism that facilitate and enhance the three main objectives of public expenditure management namely aggregate fiscal discipline, allocation efficiency and operational efficiency. As the result in survey questionnaires, 84% of 31 respondents agreed that MTEF is the key to strengthening linking the policy, planning and budgeting in accordance with provincial financial capacity and improving the linkage between annual budgeting and medium-term considerations, such as investment plans, borrowing capacity, changing spending policies, and priorities. 83% of respondents confirmed that MTEF implementation facilitates having a long strategic vision of resources, covering the objectives of public policies and socio-economic development planning and making greater budgetary predictability which result in better control of public expenditure and better value for money within a hard constraint. The benefits of MTEF are also acknowledged as an institutional mechanism for providing information for public managers in using financial resources actively and flexibly, better intra- and inter-sectoral resource allocation, effective prioritization of spending on the basis of clearly articulated socio-economic programmes and greater accountability for the outcomes of expenditures and greater credibility in budgetary decision-making, ranging 83%, 77%, and 61% respectively. Although, with 58% of 31 respondents which is the lowest percentage, have recognized the role of MTEF in enhancing the public expenditure, the table 5.2 offered critical assessment in the advantages of MTEF for improving the traditional budget process.

**Table 5.2: Advantages of MTEF**

Statements	1	2	3	4	5	Total
- Having a long strategic vision of resources, covering the objectives of public policies and socio-economic development planning		17% (5)	25% (8)	58% (18)		100% (31)
- Strengthening linking the policy, planning and budgeting in accordance with provincial financial capacity		16% (5)		84% (26)		100% (31)
- Greater budgetary predictability		17% (5)		84% (26)		100% (31)
- Better intra- and inter-sectoral resource allocation, effective prioritization of spending on the basis of clearly articulated socio-economic programmes		33% (7)	77% (24)			100% (31)
- Greater accountability for the outcomes of expenditures and greater credibility in budgetary decision-making		39% (12)	61% (19)			100% (31)
- Improving the linkage between annual budgeting and medium-term considerations, such as investment plans, borrowing capacity, changing spending policies, and priorities		17% (5)	6% (2)	77% (24)		100% (31)
- Providing information for public managers in using financial resources actively and flexibly		17% (5)	48% (15)	35% (11)		100% (31)
- Enhancing the public expenditure efficiency		42% (13)	58% (18)			100% (31)

*(1 - Not at all an advantage, 2 - moderately advantage, 3 - important advantage, 4 - very important advantage, 5 - cannot say)*

In addition, all respondents who are working in the pilot provinces and Sonla province said that Vietnam government should apply MTEF for budgeting in the whole government in order to facilitate political decision making, get greater performance in budget process, leading to create a more predictable environment and cooperative governance within which public agencies could raise the quality of their services to citizens. They also paid great attention to five favorable conditions for the implementation of MTEF which can be seen from table 5.3.

**Table 5.3: Favorable conditions for the implementation of MTEF**

Statements	1	2	3	4	5	Total
- Good macroeconomic policies and reliable forecasting			77% (24)	23% (7)		100% (31)
- Adaptable fiscal policy and instruments			26% (8)	74% (23)		100% (31)
- Enhancing reprioritization and reallocation			39% (12)	61% (19)		100% (31)
- Respect for budgetary discipline			55% (17)	45% (14)		100% (31)
- Transparency of fiscal and policy			55% (17)	45% (14)		100% (31)

*(1 - Not at all a favorable condition, 2 - moderately favorable condition, 3 - important favorable condition, 4 - very important favorable condition, 5 - cannot say)*

In short, researching and applying MTEF for budgeting in Sonla province are necessary because of the demands for improving the province's public expenditure management itself and the national trend towards reform budgeting institutions for good governance.

## **5.2 How can MTEF be designed and applied in budget process of Son La province?**

There is no doubt that Son La province has a great opportunity to turn results of the pilot MTEF project into advantages in order to apply MTEF to province's budgeting process. A set of documents, forms, key features and processes as well as main challenges for applying and implementing MTEF at national and provincial level have been made and tested in the pilot MTEF project during the period of 2003 - 2011 under the management of the MOF. It means that Sonla province can take the advantages of a basically conceptual framework for applying MTEF in practice.

As considered above, the provincial MTEF plan involves as a part of the national MTEF plan, providing necessary information for central level summarizing and setting the national budget estimate. In order to build the provincial MTEF plan in particular and contribute to process of establishing the national MTEF plan in general, the first task of Sonla province is to prepare better

forecast and analysis of the socio-economic development, the real situation of budget revenue and expenditure, and the changes in the organization, functions and duties of the public authorities in the province. Thereby, the province can not only see its ability to mobilize financial resources of the provincial budget but also anticipate its expenditure tasks which are undertaken by the provincial budget. Accordingly, Sonla province should prepare two documents part A and part B as outlined in the section 3.1.2.4. For doing this, a great deal of work has to be done, including:

**\* Reviewing and summarizing functions and duties:** The agencies and departments should state the purpose of their existence, the main areas of activity, the objects of their service, and their core values in which decide the way agencies and departments do in order to provide better services meeting the objects' needs.

**\* Determining expenditure ceilings and funding strategies:** The building of MTEF based on the perception of financial resources of the province in the period is limited. To achieve better results with available resources, it is required to set tools to allocate resources in accordance with the objectives of priority strategies; concurrently determine in advance the limits of resources in order to actively allocate to priorities. In other words, MTEF requires: (1) determining the expenditure ceiling of province including expenditure ceilings for expenditure baseline and new initiatives, relying on the national expenditure ceiling; (2) evaluating available resources, given the assumption of total revenues which can be collected for a base year and for the planning period, including the state budget, fees and others, revenues from socialization, government bonds and loans, and estimating the actual cost of implementing the policy; (3) allocating resources according to strategic priorities: The factors needed to be considered consisting of: sectoral priorities consistent with targets of the government and Sonla province; demands of costs for each sector based on the intended objectives; other solutions for achieving province's objectives that could reduce the need for the provincial budget; methods for increasing saving. Provincial People's Committee will discuss these proposals and will announce the sector expenditure ceiling in order to guide budget estimate. After calculating the cost of activities and outputs, it is necessary to compare total resources with the needs of cost. This is the starting point in the process of selecting and arranging the order of priorities for the outputs and activities in order to ensure the activities and targets set are achievable and consistent with the limited resources. Generally, the cost for implementing objectives and activities are often asked higher than the ability of resources. Therefore, the next step is to create a list outputs and activities in order of priorities, ranging in the importance from low to

high in order to facilitate eliminating or reducing the scope of active and output which has lower priority.

\* **Developing strategic objectives:** Including overall goals and detail indicators which require the SMART criteria, that is, specific, measurable, attainable, realistic and timely.

\* **Evaluating policies, strategies and development plans:** The policies, plans and strategies must be reviewed annually to ensure that they are consistent with any changes in policies and priorities, and they also must be consistent with the level of available resources. Policy review should begin by assessing all the existing policies and documents related to a policy within the sector. And then it is essential to consider carefully the following issues: Are objectives, related policies and strategies of the sector consistent with other policies and strategies? Are they consistent with related national policies and strategies? What are positive and negative impacts of policies and strategies? Are these policies and strategies the most effective tool to achieve goals? Do they provide a direct impact or have other related policies to achieve objectives? How long do they take to achieve goals? Are there alternative policies and strategies which can also lead to attain objectives but they are cheaper and more effective? Can province's financial resources afford to fully implement policies and strategies? Can the province charge or increase fees for these services? Do the province and sector have abilities in human resources, skills and management to implement these policies and strategies?

For a proposed new policy, work contents mainly includes: (1) introducing policy changes; (2) agreeing objectives, outputs and activities to achieve planned objectives; (3) the time frame and costs required to achieve that objectives; (4) explaining how to get better use of existing resources through improving the efficiency of costs and/or a better combination of resources; (5) measures of socialization to attract the non-governmental organizations and/or communities to share responsibility with the province in order to provide better services; (6) identifying the problems encountered when narrowing the performance gap in the achievement of objectives; (7) evaluating solutions and the cost of each solution as they are applied, recommending solutions and activities which should be implemented and their feasibility to ensure successful achievement of objectives.

\* **Identifying outputs and activities and their costs:** Outputs and activities will be the basis for setting the unified budget in three years tied to the achievement of objectives. This phase includes some of the following works: (1) agreeing needed outputs to achieve the intended objectives and the number of planned output created in the three-year period; (2) determining activities which generate

these outputs with the highest efficient and effective performance and the number of planned activities implemented in the three-year period, (3) identifying the costs of these activities and comparing these costs with available resources; (4) listing these activities in order of priorities and reduce the activities in order to match the capabilities of available resources.

**\* Selecting and deciding priorities:** The first activity is to arrange the list of selected and decided priorities. This process will be started with list the outputs and activities in order of priorities. The order of priorities can be divided into four levels from high to low, consisting of legal purposes, the necessity, the importance and benefits. There are some guidelines to choose and decide priorities, including some following factors: (1) direct effects: it is more important to place a high priority on the outputs and activities which are directly contribute to solving problems and improving situations than others which only solve part of problems or depend on activities and/or other agencies; (2) time frame: outputs and activities which can solve the problem quickly and have long-term impact will be more preferred, (3) the efficiency of costs: outputs and activities which can achieve objectives with the lowest cost should be given more priority; (4) the ability to apply: agencies and units which have a higher capacity or outputs and activities needed lower costs should be put higher attention; and (5) the demand for funding: activities which are not required additional resources should place a higher priority.

Based on the identified priorities, the units should reduce budget estimates consistent with the expenditure ceiling notified. The budget estimate of activities having a higher level of the priority should be maintained; on the contrary, the budget estimate of activities with lower level of priority must be cut down or stopped allocation. Reducing budget estimate can be done in some ways such as: reducing the number of activities which will be executed; finding alternative ways which have lower costs to decrease the number of inputs; finding alternative activities to apply such as socialization; eliminating activities which have low priority; setting fees to offset the cost of providing services.

**\* Defining responsibilities and linking activities:** There are many activities which will be funded through one or more projects. Conversely, a project or a program may contain several objectives related to various sectors and units. Therefore, specifying agencies which will be responsible for providing outputs and applying intended objectives and linking them to the entire cycle of MTEF budgeting process is important work before planning and estimating costs for the outputs and activities.

\* **Assessing the feasibility of the proposals:** It is necessary to evaluate and examine in order to confirm their feasibility, efficiency and effectiveness of planned activities.

Besides, the preparation of MTEF at provincial level includes the dialogue and information between the province and line ministries, the MOF and MPI. These activities are divided into two phases: The dialogue and information phase is done in the early stages of preparing MTEF, in which the province will report on the key issues related to its plan and budget needs. The negotiation phase consists of reaching agreements about level and manner to deal with disputes, in which the province will provide the evidences in order to protect its plan and budget needs.

It can be said that the design and application of MTEF differ dramatically from the traditional budget process. To apply successfully MTEF in the budget reform, there are some essential factors for implementing MTEF which will be discussed in the next section.

### **5.3 What factors are essential for implementation of MTEF in Son La province?**

The international experiences in attempts to implement MTEF have shown that identifying critical factors for success plays the important role in the application of MTEF. Seok-Kyun Hur (2004: 47) highlighted seven major requirements must be considered for MTEF implementation as mentioned above. In Vietnam, the four main factors for improving the quality of MTEF process were also summarized by the MOF (2008) based on the practical application and challenges which pilot agencies had to face. The potential list of critical factors is long; however, the different factors may be more or less vital in institutional and political circumstances of each country or each governmental level. Interestingly, the clear experience from the pilot MTEF has evolved two kinds of factors which are essential for implementation of MTEF at provincial level including the legal environment supported by the central government and the commitment of the provincial leadership, improvement of human capacity and information systems of the province itself.

As reported by Mark Pearson (2002), the development of an MTEF was one way to begin breaking the vicious cycle of poor results in the traditional budgeting process. The process is intended to allow policy makers to reassess resource needs in the light of priorities and 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. He also emphasized the point that "what really drives the success of MTEF is policy change; resource reallocation plays a largely supporting role.

If there is no commitment for policy change simply shifting resources around, the system will not drive major change". The importance of adaptable fiscal policy and instruments and institutional conformity in the successful implementation of MTEF were also determined by Seok-Kyun Hur (2004) and Le Quang Thuan (2010) as considered above. Actually, one of the obstacles which affect the application of MTEF for budgeting process in provincial level is that current mechanisms and policies of public financial management in Vietnam are not suitable for MTEF implementation. These consist of the input controls with traditional line-item budgeting, one-year budget framework, cash basis of accounting and incremental budgeting system. Furthermore, the statement is supported by all of 31 respondents according to table 5.4. They also agreed that the Vietnamese government should change budgeting institutions and mechanisms of public financial management in order to create and improve legal environment and favourable conditions for implementing MTEF in national and provincial level. It means that amending the 2002 Law on the State Budget focusing on responsibilities and powers of public agencies in doing MTEF process, changing process of budget estimate; applying performance-based budgeting and accrual accounting should be done by the central government. In practice, good budgeting systems should evolve over many years and in parallel with other important improvements in public administration and management. In conclusion, adaptable fiscal policy and instruments are the first critical factor for implementation of MTEF in Sonla province.

**Table 5.4: Obstacles affected the application of MTEF for budgeting process in provinces**

Statements	1	2	3	4	5	Total
- The limited capacity of macroeconomic forecasting and analysis		20% (6)	61% (19)	19% (6)		100% (31)
- Human resources not enough available to understand and follow MTEF		29% (9)	52% (16)	19% (6)		100% (31)
- Current mechanisms and policies of public financial management are not suitable for MTEF implementation				100% (31)		100% (31)
- The lack of available and reliable information related to:						
+ forecasting and planning		29% (9)	55% (17)	16% (5)		100% (31)
+ determining and measuring outputs of public agencies		26% (8)	26% (8)	48% (15)		100% (31)

*(1 - Not at all an obstacle, 2 - moderately obstacle, 3 - important obstacle, 4 - very important obstacle, 5 - cannot say)*

Another essential factor for MTEF implementation is the willingness and commitment of provincial leaders. "One objective of MTEF is to secure stronger political commitment to both the process (the annual budget and planning cycle) and the product (the aggregate ceilings and sectoral allocations). This support must be sustained even if the political landscape changes" (Kiringai & West, 2002: 71). In addition, Leszek Kąsek and David Webber (2009: 17) pointed to "strong leadership, backed up by political commitment and consensus, are essential for sustaining budgetary reform. Without this, there are inevitably weaknesses in the link between the government's strategy and the budget, including the effects of historical inertia in spending allocations that can reduce the focus on new and more important strategic priorities". The importance of the willingness and commitment of provincial leaders was also supported by all respondents according to survey questionnaire (table 5.5). Actually, the institutional mechanisms adopted as part of MTEF approach can help to reinforce that commitment by ensuring involvement throughout the process (Kiringai & West, 2002: 71). However, it can be said that political enforcement and managerial commitment are critical pre-conditions for making budget reform towards MTEF approach. More importantly, the determination and political support must be specified in the province plans and strategies. Securing political commitment will facilitate a wide-ranging reform programme of the planning and budget system as well as the core elements of MTEF approach by intervening less in resources allocation decisions and by giving managers more autonomy to decide the most efficient way of attaining politically determined objectives.

**Table 5.5: Favorable factors for the implementation of MTEF**

Statements	1	2	3	4	5	Total
- Leaders' willingness and commitment to implementing MTEF			19% (6)	81% (25)		100% (31)
- Improvement in legal environment				100% (31)		100% (31)
- Improvement in human capacity including: strategic thinking capacity, analytical capacity, and performance orientation, etc.			32% (10)	68% (21)		100% (31)
- Development in information systems consisting of forecasting systems, financial information systems, data flow systems, and performance monitoring systems			32% (10)	68% (21)		
- Changes in attitudes of mind required:						
+ Focus on results - what does expenditure achieve			100%			100%

			(31)			(31)
+ Analytical and evidence based approach - the case for spending must be fully justified and reviewed			100% (31)			100% (31)
+ Constructive challenge - accepting nothing as fixed forever			100% (31)			100% (31)
+ Cooperation - all participants respect each others' role and seek to help each other			100% (31)			100% (31)
+ Reviewing and learning - checking what actually happened and why			100% (31)			100% (31)

*(1 - Not at all a favorable solution, 2 - moderately favorable solution, 3 - important favorable solution, 4 - very important favorable solution, 5 - cannot say)*

According to assessment of the MOF, limited capacity for macroeconomic analysis and forecasts at the national and provincial level is one of challenges in MTEF pilot. 80% of respondents also agreed that these were the difficulty in practice. They argued that the reality is the results from such limited human resources (71%) and the lack of available and reliable information related to forecasting and planning, and determining and measuring outputs of public agencies (71% and 74% respectively). For those reasons, improving in human capacity including strategic thinking capacity, analytical capacity, and performance orientation, etc. and developing information systems consisting of forecasting systems, financial information systems, data flow systems, and performance monitoring systems are placed a high priority on the list of essential factors for implementation of MTEF on the view of the MOF and respondents. All respondents believe that their provinces should improve human capacity and information systems, especially financial information systems.

To apply MTEF, Sonla province should pay more attention on training staff because most of the work of developing and maintaining MTEF system is done by civil servants, especially the budget staffs in the executive and legislative branches. In the absence of adequate training, managers and staff members are unlikely to be able to understand the potential value of MTEF approach or be able to provide for effective implementation and use. It is not feasible to plan a reform and change budgeting institutions without sufficient resources and appropriately trained personnel. Personnel training can make a difference, not only by changing attitudes but also by preparing competent staff members. However, transforming an organizational culture by building performance consciousness

into daily functions is a difficult undertaking and actually training, guidance, and availability of technical assistance are required over a period of time.

In addition, quality of information, and its effective use in making better-informed budget management decisions, is much more vital than quantity of indicators. Thereby, good indicators must be carefully selected and information on them must be accurate, timely and regularly monitored. The introduction of MTEF practices requires a basic capability for data and information collection and reporting. There must be an underlying acceptance of the need for good information within sectors and robust technology for collecting and analyzing it. In the context of Sonla province, consequently, it is necessary to implement efficiently TABMIS so that the provincial agencies will collect data systems that can readily generate the performance information needed. Coupled with data quality needs, certain electronic systems must be in place for maintaining and tracking performance, responding to information needs in building credible forecasting and analysis systems for macroeconomic framework, revenues and expenditures, etc.

## 6. CONCLUSIONS

*This section being the last of the paper is meant to summarize the main ideas of the study as well as the findings and their implications. At the end of the section, the contributions and limitations of the research shall be outlined and possibilities for further research suggested.*

### 6.1 Conclusions

It is vital at this point to succinctly recapitulate the study and its findings. The essence of this study was to understand how MTEF approach can be implemented for budget reforms. This understanding would enable us to determine whether and how MTEF can be designed and applied for budget process, and what critical factors are needed for MTEF application in Sonla province. This fundamental purpose was achieved by addressing the following research questions:

- 1. Should MTEF be applied for budgeting in Son La province?*
- 2. How can MTEF be designed and applied in the budget process of Son La province?*
- 3. What factors are essential for implementation of MTEF in Son La province?*

A critical look at the literature review, the theoretical framework of MTEF and experiences of successful implementation of MTEF in some countries, and careful analysis the current situation of Vietnam and Sonla province as well as the pilot of MTEF in the period of 2003 - 2011 in four provinces, combining with survey questionnaires would answer these research questions.

Good public financial management is not only a concern of all governmental level in Vietnam but also the important issue of many countries around the world. In fact, many governments in both developed and developing countries have been implementing strongly public finance reforms focusing on performance-based budgeting and the medium-term expenditure framework in order to help the government managing, allocating and using efficiently and effectively public resources consistent with strategic priorities.

The application of MTEF has been around in various forms with special regard as an important and effective mechanism for ensuring budgetary discipline as it links policymaking, planning and budgeting. In principle, the link will allow expenditures to be driven by policy priorities and disciplined by budget realities, injecting a medium-term perspective and allow policy choices to

enhance long-term development. MTEF is a rolling budget covering the current budget year and the next two budget years. It contains a macroeconomic framework with a forecast of revenues and expenditures in the medium term, a multiyear sectoral programme with cost estimates, a strategic expenditure framework, a plan for allocating resources among sectors and detailed sectoral budgets.

According to documentary analysis and empirical findings, the idea of application MTEF has come from the current conditions and circumstances of Sonla provinces in which the provincial budget is not only small in scale but also scatter and not sustain because of depending on uncertain revenues and highly balancing transfer from central budget. In addition, it has to face with the difficulties and constraints of the budget management mechanism towards input control and lack of medium-term fiscal vision. As a result, the application of MTEF will be a promising and effective solution to help improving budgeting management and budgeting use through the more rational allocation of limited resources and policy priorities of the province in order to address the inefficiency of current budget allocation such as spread and fragmentation. Furthermore, advantages of adopting MTEF have been demonstrated in many countries around the world and through MTEF pilot in Vietnam that MTEF approach will overcome limitations and inadequacies of the current mechanism's fiscal and budget management. The main benefits of MTEF include improved macroeconomic stability through fiscal discipline, better intra- and inter-sectoral resource allocation, effective prioritization of expenditures on the basis of clearly articulated socio-economic programmes, greater budgetary predictability, more efficient use of public finances, greater accountability for the outcomes of expenditures and greater credibility in budgetary decision-making.

In general, the design and application of MTEF in Sonla province need to conform to the form, process and guidelines of the central government concerning the nature of Vietnamese government structure and budgeting institutions according to the single, unified and nested state budget. Hopefully, the implementation of MTEF in Sonla province will be worked under the most favourable conditions because it can take the advantages of a basically conceptual framework for applying MTEF in practice, that is, a set of documents, forms, key features and processes as well as main challenges for applying and implementing MTEF at national and provincial level which have been made and tested in the pilot MTEF project during the period of 2003 - 2011 under the management of the MOF. However, there is much of work need to be done based on the practical situation of Sonla province in order to build and apply the provincial MTEF plan in particular and contribute to process of establishing the national MTEF plan in general. Those are presented in the section 5.2.

Practical experience showed that factors which determine the speed and success of MTEF implementation include both the character and quality and of public institutions and laws within the country, plus the degree of technical knowledge, degree of effort and experience applied to design and implementation of the method. In most cases, budget reforms are initiated in public management environments in which institutional capabilities and technical understanding are less than ideal. Therefore, it is clear that a great deal of care and attention should be put into a major learning experience and allowances must be made for concepts and approaches that may not initially be well-suited to the situation, or well-received by the political leader or officials in the budgetary-using units. Consequently, patience, persistence and proper attention to change management would improve the likelihood of success.

Institutionally, MTEF reforms involve a range of complex steps starting from changes to budget classifications, some completely new managerial concepts, introduction of new budget process system and changed behaviors of public servants. All of this requires, firstly, a positive and determined attitude by political leaders and budget managers with a good communication between the province and ministries and the central government, and a well-working together among provincial agencies. The process of reform also needs to receive as much attention as the substance in order to design and implement successfully. Secondly, Sonla province needs the authorization and support from the central government, including changes in budgeting institutions and mechanisms of public financial management in order to create and improve legal environment and favourable conditions for implementing MTEF at provincial level. Last but not least, Sonla province itself has to improve the capacity of human resources and develop information systems in order to adapt itself to the new MTEF approach of budget management.

## **6.2 Recommendations**

Although MTEF approach is not a "miraculous remedy" for "any disease" arising in practice of budget management, the experience of many countries and Vietnam demonstrated that it is remarkably successful if MTEF receives trust and respect, and creates pressure on budget allocation in accordance with policy priorities. The initiative and respect of MTEF are not only political and technical decisions but also the need for a change of thinking at all levels of government, budget management agencies, and budgetary-using units. According to the results of the study, certain issues are recommended to the central government and Sonla province.

**For the central government:** Based on the results of MTEF pilot project, it is necessary to amend the 2002 Law on the State Budget and further research and institutionalize the formulation and implementation of MTEF in practice with wider scope. It is also important to clarify the role of the five-year socio-economic development plan at national and local levels related to MTEF. The five-year socio-economic development plan can be used as a guide and MTEF is seen as a tool to move targets of the plan into the annual fiscal plan. MTEF should be used annually in order to review the strategic priorities in terms of dramatically changing economy at present.

In parallel with the process of amending the 2002 Law on the State Budget, the Ministry of Finance should continue to complete the documentation as a basis for the understanding and implementation of MTEF throughout the country. In addition, it is essential to provide elected representatives, leaders, budget managers and budget executive with training courses related to the budget contents and forms of new MTEF approach. Integrating the content of MTEF into programmes of retraining for officials in financial sector, and training students of public finance management are also needed for rapidly expanding access to the new budget approach.

**For the Son La province:** The province's leadership and budget managers should take advantages of training and retraining courses provided by central government in order to improve capacity of province's human resources, especially staffs who involve in the budgeting process of the provinces in order to get better knowledge and skills in the new budget approach.

- Capacity of strategic thinking - ability to make choices in a general framework, linked to local priorities.
- Capacity of analysis - a method of thinking about how to achieve results, and making decisions on a systematically different ways to achieve goals.
- Thinking towards the efficiency of performance - accept the responsibility to achieve the desired results with available resources.

In addition, Sonla province needs to improve gradually the system to collect information and data, specifically:

- The system of forecast - making realistic predictions about the prospect of revenue and capacity to apply.
- The system of financial information and financial report - delivering information timely and reliably about expenditure and purposes of expenditure.

- The system providing specialized data - giving information on the actual plan and implementation of public service in both quality and quantity.
- The system of monitoring and evaluating results of activities - information on the expenditures and results achieved, as a basis for ensuring accountability.

### **6.3 Contributions**

In brief, the main contribution of the study has been to provide a better understanding about the rationality for application MTEF in Sonla province based on the literature review of MTEF implementation in both developed and developing countries, and Vietnam. It also summarized the process and work needed to design and apply MTEF for provincial budget as well as the critical factors for successful implementation of MTEF in Sonla province. More importantly, it suggested that some necessary issues related to how the central government can support the provincial MTEF implementation.

### **6.4 Limitations**

There are methodological limitations that must be considered when evaluating the results of this study. First, the respondents to questionnaires were single provincial officials representing the characteristics of their work in MTEF pilot; in this case, they may paint too positive a picture of his province than what is actually happening. Furthermore, my empirical findings need to be interpreted cautiously given the relatively small sample size due to time limitations and small number of provinces participating in MTEF pilot project. Last, the survey methodology employed in this study must also be considered as a limitation. Surveys of this type must be carefully constructed in order to allow the data to be complete and precise. Simple questions and the Likert-scale response format limit what a respondent is able to say.

### **6.5 Further research**

From the international experiences and research findings, it can be seen that MTEF has considerable synergies with PBB, that is, each reinforces the other in major ways. MTEF can improve transparency and facilitate greater prioritisation of government objectives. It can also improve predictability in funding and planning to achieve long-term objectives. Combining MTEF

with PBB can in theory provide information concerning the political objectives and strategies as well as the degree to which objectives are met, including the long-term financial consequences of decisions. PBB and MTEF reforms, implemented together, have the potential to significantly raise the quality and consistency of public expenditure forecasts through their common use of policy-based expenditure programs and program- and activity-based costing methodologies. The result is more credible future budget commitments, more efficient expenditure prioritization and increased consensus around what fiscal policies are seeking to achieve./.

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## APPENDICES

**Table 2.1: Institutional arrangements for enforcing aggregate fiscal discipline**

<b>Rules</b>	Limits on total spending (in some cases sectoral spending as well) are established before individual spending bids are considered. Total spending must be consistent with these limits. The limits may be expressed in money terms, relative to GDP, as rates of change, or in terms of the balance between receipts and expenditures. The limits are set for the medium-term (3-5 years) and budget decisions are made within a medium-term expenditure framework.
<b>Roles</b>	A strong finance ministry is empowered to enforce the budget aggregates in bilateral negotiations with spending departments and Cabinet discussions. The finance ministry is the official scorekeeper of the budgetary impact of spending proposals and other budget actions. During implementation of the budget, it may intervene to block (or notify the Government) of actions that would cause the fiscal aggregates to be breached.
<b>Information</b>	The medium-term expenditure framework provides a baseline for measuring the budgetary impacts of policy changes. Throughout formulation of the budget, information is provided on changes to the baseline. During implementation of the budget, spending is monitored to ensure compliance with the fiscal aggregates.

*Source:* A contemporary approach to public expenditure management. Allen Schick (1998: 13).

**Table 2.2: Institutional arrangements for improving allocative efficiency**

<b>Rules</b>	Spending limits are established for sectors or portfolios, and ministers are encouraged to reallocate within these limits. Bids to reallocate must be based either on evaluative findings of program effectiveness or on plans to evaluate policy initiatives.
<b>Roles</b>	Strong capacity at center of government to define national priorities and objectives, and make cross-sectional allocations consistent with its medium-term expenditure framework. Strong sectoral ministers with broad authority to reallocate within their areas of responsibility, subject to review by Cabinet and/or Parliament.
<b>Information</b>	Ministers and managers generate or receive information on the actual or expected effectiveness of programs, as well as on the social outcomes ensuing from ongoing programs, budget actions, and policy initiatives. They also receive information on the expenditure impacts (relative to the medium-term framework) of authorized and proposed budget actions.

*Source:* A contemporary approach to public expenditure management. Allen Schick (1998: 13).

**Table 2.3: Institutional arrangements for improving operational efficiency**

<b>Rules</b>	Running (or operating) costs are cash limited, but managers are given broad discretion in using these resources, including (in some countries) discretion to carry over unused funds or to prespend a small portion of the next year's running costs. Running costs are progressively reduced by a percentage equal to all or a portion of expected efficiency gains.
<b>Roles</b>	Strong line managers authorized to determine the mix of operating resources within fixed limits. Operating discretion devolved to subordinate managers, including those infield or regional offices.
<b>Information</b>	Budgeted outputs are specified in advance, and actual outputs are compared to the targets. Costs are allocated (ideally, on an accrual-basis) to the activities responsible for them. Information on financial and organizational performance is published in annual reports and other documents.

*Source:* A contemporary approach to public expenditure management. Allen Schick (1998: 13).

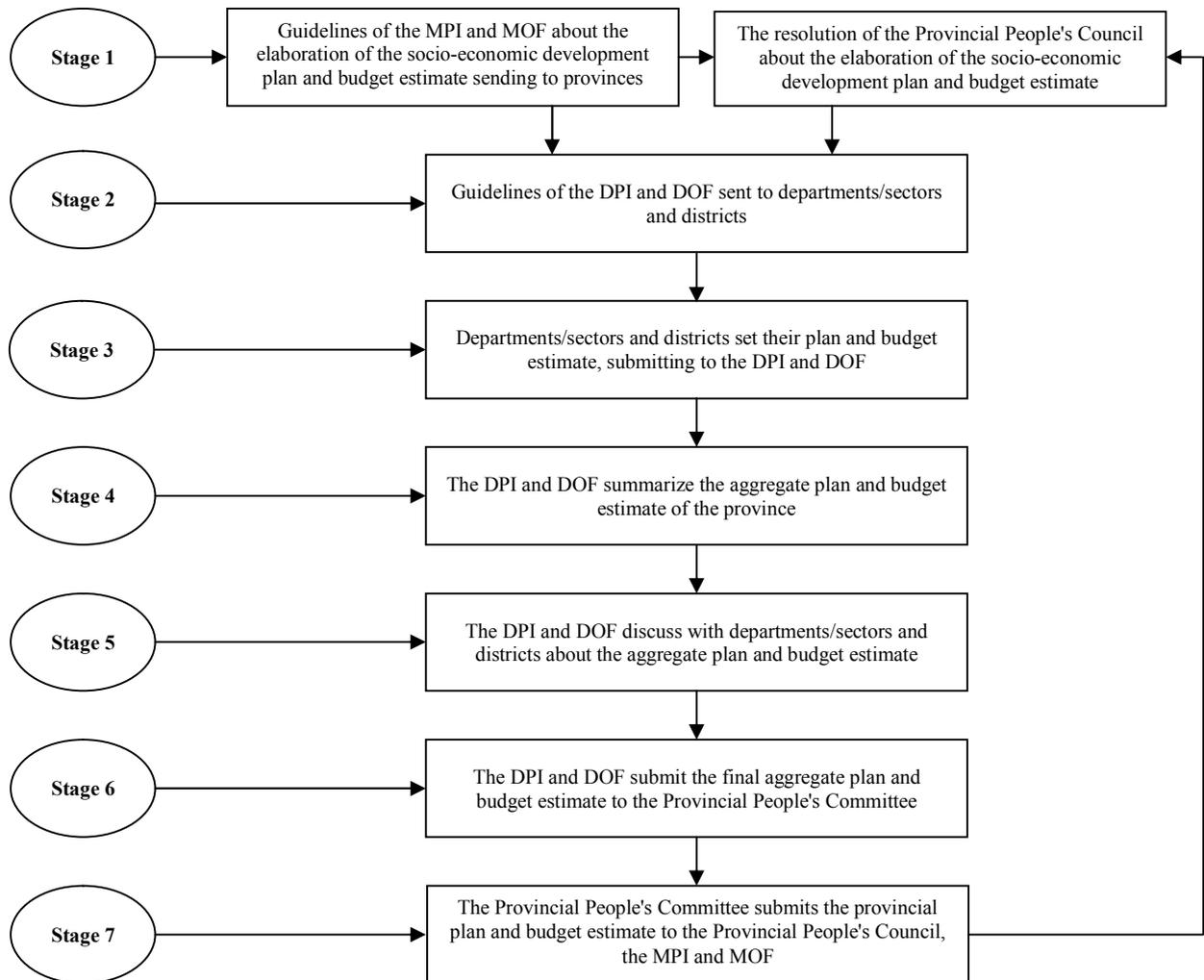
**Table 3.1: A summary of the budget process in Vietnam under the 2002 Law on the State Budget**

<b>Phases</b>	<b>Work contents</b>	<b>Time</b>
Preparation and budget estimates	Standing Committee of the National Assembly states the opinion on budget allocation norms and important expenditure regimes in order to set the State budget estimation.	Before May 1
	The Prime Minister instructs the elaboration of the State budget estimates for the following year.	Before May 31
	The Ministry of Finance guides the requirements, contents and time-limit for making the State budget estimates and notifying the inspection number of budget estimates regarding the total estimate, and estimate for each budget revenue and expenditure domain for the ministries and other central agencies.  The line ministries and the provincial People's Committees guide the estimation of budgets of various levels in their localities.	Before June 10
	The line ministries and the provinces submit their budget estimations to the MOF and MPI.  (Before submitting, the provincial budget estimate have to be considered by the People's Council)	Before July 20

	The MOF holds meetings for discussion with line ministries and provinces about the State budget estimate; summaries and submits to the Government.	Since late July
	The Government submits the State budget estimate to the National Assembly for examination.	Before October 1
Examination, approval and allocation of the budget	The National Assembly discusses and decides the State budget estimates and central budget allocations.	Before November 15
	The Government assigns tasks of revenues and expenditures for central agencies and provinces based on resolutions of the National Assembly on State budget estimates, the allocation of central budget, and the percentage of additional allocations from the central budget to provinces.	Before November 20
	The Provincial People's Committee revises its budget estimate based on the decisions of the National Assembly and then submits to the Provincial People's Council for discussing and deciding on local budgets. The Provincial People's Council decides the provincial budget estimate and local budget allocation plans	Before December 10
	The District People's Council decides its budget estimate and local budget allocation plans.	10 days after approved by the Provincial People's Council
	The District People's Committee assigns the budget estimate of communes and budgetary-using units.	Before December 31
Budget execution	The Government and the People's Committees at all levels implement the approved budget estimate.	In fiscal year
Budget settlement	The Government and the People's Committees at all levels establish budget settlement and submit to the People's Council at the same level and the National Assembly for approval.	18 months after the end of the budget year

*Source:* Gathered from the 2002 Law on the State Budget and current legislative documents

**Figure 3.2: The elaborative process of socio-economic development plan and budget estimate at provincial level**

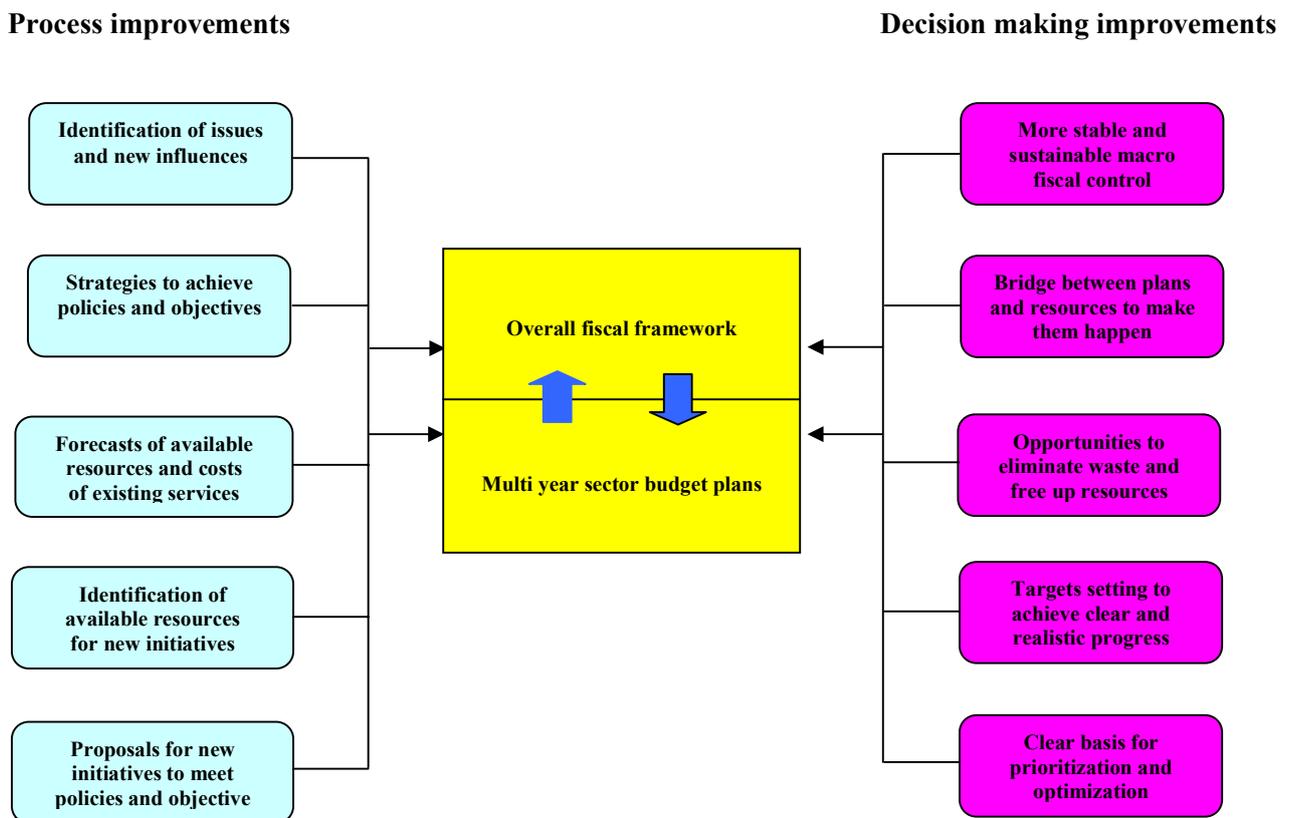


**Table 3.2: The timetable for budget estimates in MTEF process**

<b>Time</b>	<b>Agencies</b>	<b>Activities</b>
Before May 31	The Prime Minister The Ministry of Finance The Ministry of Planning and Investment	Formulating the detail MTEF and determining preliminary ceilings for three years based on the medium-term macroeconomic framework and fiscal policies
Before June 10	The Ministry of Finance The Ministry of Planning and Investment Line ministries and provinces	Guiding requirement, contents and time-limit for making the State budget estimates by the MOF. Discussing among these agencies to determine the priorities.
Before July 20	Line ministries and provinces	Reviewing the organization's aims, objectives, outputs and activities. Preparing estimates and submitting to the MOF.
Before August 31	The Ministry of Finance The Ministry of Planning and Investment Line ministries and provinces	Discussing to determine formal ceilings
Before September 30	Line ministries and provinces	Preparing budget estimates, allocating resources based on formal ceilings and submitting to the MOF, MPI
Before October 31	The Ministry of Finance The Ministry of Planning and Investment The Government	Completing state budget estimates and submitting to the Government. Submitting to the National Assembly done by the Government
Before November 15	The National Assembly	Deciding the first year of MTEF estimate
Before November 31	The Prime Minister	Assigning tasks of revenues and expenditures for central agencies and provinces based on resolutions of The National Assembly on State budget estimates.
	Ministries and provinces Budgetary-using units	Executing budget

*Source:* Application of Performance-Based Budgeting in the public expenditure of Viet Nam.  
Su Dinh Thanh et al., 2005, p.183.

**Figure 3.8: Improved budget process and better decision making**



*Source:* Guidelines for implementation of MTEF in Vietnam. The Ministry of Finance, 2008.

## Figure 4.1: QUESTIONNAIRES

### **Research on Application of the Medium-Term Expenditure Framework for Budgeting in Son La province of Viet Nam**

As a research student in the Master Course of Public Financial Management (confirmed by National Academy of Public Administration), I am interested in finding out about your knowledge and experiences since you have participated in the training and pilot implementation of medium-term fiscal and expenditure (hereafter MTEF) framework project in Viet Nam. This questionnaire includes questions about your knowledge, opinions, ideas and experiences concerning the current budget system and MTEF. All the information you provide is confidential and will be published only in summary form. You will not be identified in any way. In order to get accurate information about rationale for application of MTEF and factors which are essential for successful implementation of MTEF in the case of provinces, I need information from your practical experience. So please, answer the questions to the best of your ability. Your cooperation is essential as without answers the study cannot be undertaken.

Please fill out the entire questionnaire now. When you are finished with the questionnaire, put the questionnaire in my stamped addressed envelope and send it to me before **15/12/2011**. If you have any questions, please feel free to call me at **01234 869 869** or email me at **lannguyen267@gmail.com**.

Thank you for your cooperation!

Yours sincerely

Nguyen Thi Ngoc Lan

## QUESTIONNAIRES

**Question 1:** Can you tell me your current position? (*Circle your answer*)

1. Managers

2. Finance officials

**Question 2:** What are weaknesses in the current budget system at the provincial level of Vietnam according to your opinion?

(*Answer with a scale from 1 - not at all a problem, 2 - moderately problem, 3 - important problem, 4- very important problem, 5- cannot say; circle the alternative*)

- Failure to link policy, planning and budgeting	1	2	3	4	5
- Lack of link between decision-makings and available resources	1	2	3	4	5
- Unrealistic forecasts of revenues and expenditures	1	2	3	4	5
- Inadequate integration of capital and recurrent spending	1	2	3	4	5
- Time horizon too short for effective budget planning	1	2	3	4	5
- Lack of transparency about many revenue sources that are not included in the budget	1	2	3	4	5
- Poor budget allocation and inefficient performance because budget process focusing on the input controls with the traditional line-item budgeting	1	2	3	4	5
- Lack of reliable information about what proposed expenditure related to achieved results in practice	1	2	3	4	5
- Budget expenditures are changed by arbitrary increment rather than policy priority decisions	1	2	3	4	5
- Weak accountability for achieving those results within the administration	1	2	3	4	5
- No basis for monitoring actual achievement alongside expenditure made	1	2	3	4	5

- Rigid earmarking of funds for particular purposes reduces flexibility in setting budget priorities	1	2	3	4	5
- No resources ceilings set so budget planners are not working within realistic expectations of available funds	1	2	3	4	5
- Others ( <i>You can clearly state</i> ): .....	1	2	3	4	5
.....					
.....					

**Question 3:** How well do you know MTEF? (*Circle your answer*)

- a. Not at all      b. Very little      c. Reasonable well      d. Very well

**Question 4:** Do you think that Viet Nam government should apply MTEF for budgeting?

- a. Yes      b. No      c. I do not know

**Question 5:** The following arguments/claims are connected to the question should Vietnam government apply MTEF instead of the current traditional budget. What are advantages of MTEF according to your opinion?

(*Answer with a scale from 1 - not at all an advantage, 2 - moderately advantage, 3 - important advantage, 4 - very important advantage, 5 - cannot say; circle the alternative*).

- Having a long strategic vision of resources, covering the objectives of public policies and socio-economic development planning	1	2	3	4	5
- Linking the policy, planning and budgeting in accordance with provincial financial capacity	1	2	3	4	5

- Greater budgetary predictability	1	2	3	4	5
- Better intra- and inter-sectoral resource allocation, effective prioritization of spending on the basis of clearly articulated socio-economic programmes	1	2	3	4	5
- Greater accountability for the outcomes of expenditures and greater credibility in budgetary decision-making	1	2	3	4	5
- Improving the linkage between annual budgeting and medium-term considerations, such as investment plans, borrowing capacity, changing spending policies, and priorities	1	2	3	4	5
- Providing information for public managers in using financial resources actively and flexibly	1	2	3	4	5
- Enhancing the public expenditure efficiency	1	2	3	4	5
- Others ( <i>You can clearly state</i> ): .....	1	2	3	4	5
.....					
.....					

**Question 6:** What obstacles affect to what extent we can apply MTEF to budgeting process in provinces **according to your opinion?**

(Answer with a scale from 1 - not at all an obstacle, 2 - moderately obstacle, 3 - important obstacle, 4 - very important obstacle, 5 - cannot say; circle the alternative).

- The limited capacity of macroeconomic forecasting analysis	1	2	3	4	5
- Human resources not enough available to understand and follow MTEF	1	2	3	4	5
- Current mechanisms and policies of public financial management are not suitable for MTEF implementation	1	2	3	4	5
- The lack of available and reliable information related to:					
+ forecasting and planning	1	2	3	4	5

+ determining and measuring outputs of public agencies	1	2	3	4	5
- Others ( <i>You can clearly state</i> ): .....	1	2	3	4	5
.....					
.....					

**Question 7:** What are **according to your opinion** favorable conditions for the implementation of MTEF? (*Answer with a scale from 1 - not at all a favorable condition, 2 - moderately favorable condition, 3 - important favorable condition, 4 - very important favorable condition, 5 - cannot say; circle the alternative*).

- Good macroeconomic policies and reliable forecasting	1	2	3	4	5
- Adaptable fiscal policy and instruments	1	2	3	4	5
- Enhancing reprioritization and reallocation	1	2	3	4	5
- Respect for budgetary discipline	1	2	3	4	5
- Transparency of fiscal and policy	1	2	3	4	5
- Others ( <i>You can clearly state</i> ): .....	1	2	3	4	5
.....					
.....					

**Question 8:** Should we apply MTEF in the whole government sector or only make a partial reform and apply it in certain sectors such as education and training, health, agriculture and rural development, transportation, etc.? Why? (*Write down your answers here*)

.....

.....

.....

.....

**Question 9:** What are the solutions of applying MTEF successfully in provinces **according to your opinion?**

(Answer with a scale from 1 - not at all a favorable solution, 2 - moderately favorable solution, 3 - important favorable solution, 4 - very important favorable solution, 5 - cannot say; circle the alternative).

- Leaders' willingness and commitment to implementing MTEF	1	2	3	4	5
- Improvement in legal environment	1	2	3	4	5
- Improvement in human capacity including: strategic thinking capacity, analytical capacity, and performance orientation, etc.	1	2	3	4	5
- Development in information systems consisting of forecasting systems, financial information systems, data flow systems, and performance monitoring systems	1	2	3	4	5
- Changes in attitudes of mind required:					
+ Focus on results - what does expenditure achieve	1	2	3	4	5
+ Analytical and evidence based approach - the case for spending must be fully justified and reviewed	1	2	3	4	5
+ Constructive challenge - accepting nothing as fixed forever	1	2	3	4	5
+ Cooperation - all participants respect each others' role and seek to help each other	1	2	3	4	5
+ Reviewing and learning - checking what actually happened and why	1	2	3	4	5
- Others ( <i>You can clearly state</i> ): .....	1	2	3	4	5
.....					
.....					
.....					

**THANK YOU FOR YOUR COOPERATION!**