Energy Subsidy Reform
Lessons and Implications

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EDITORS
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INTERNATIONAL MONETARY FUND
Motivation

- An important issue because of their impact on budgets, economic growth, climate change, and income distribution

- Subsidies are an issue in practically every country in the world

- Energy subsidies have proven difficult to reform
Plan of presentation

I. Consequences of energy subsidies

II. Magnitude of subsidies by region and product
   - covers 176 countries
   - covers subsidies for petroleum products, electricity, natural gas, and coal

III. “How to do” subsidy reform
   - case studies undertaken for 19 countries
I. Consequences of energy subsidies
Consequences of energy subsidies go well beyond fiscal costs

- Aggravate budget deficits, not only through direct spending but also through forgone revenues if energy taxes are set below ‘efficient’ levels
- Depress growth
  - make investments in the energy sector unattractive
  - crowd-out critical growth-enhancing public spending
  - over-allocate resources to energy-intensive sectors
- By increasing energy consumption, exert pressure on the balance of payments of net energy importing countries
- Intensify climate change by pushing energy consumption
- Widen the gap between the rich and poor
How energy subsidies increase inequality

- Energy subsidies benefit the wealthiest, who consume much more energy than the poor
- The richest 20% get more than 40% of the benefits from energy subsidies (6 times the share of the bottom 20%)

Distribution of Petroleum Product Subsidies by Income Group
(In percent of total petroleum product subsidies)

Source: Arze del Granado, Coady, and Gillinham (2010)
II. Magnitude of subsidies by region and product
Measuring consumer subsidies

- **Pre-tax subsidies** exist when energy consumers pay a price below the supply cost of energy, including transportation and distribution costs.

- **Tax subsidies** arise if energy taxes are too low.

  Efficient taxation requires that:
  - energy should be taxed the same way as any other consumer product [consumption taxes],
  - plus additional taxes to account for the adverse effects of energy consumption (so-called “externalities”) [corrective or Pigouvian taxes]

- **Post-tax subsidies** equal pre-tax + tax subsidies
Petroleum and electricity dominate pre-tax subsidies, while coal subsidies are negligible.

Pre-tax

$492 billion (0.7% GDP, 2.1% revenues)

Sources: IEA World Energy Outlook 2012; OECD; World Bank; and IMF staff estimates.
Nearly half of pre-tax subsidies are from MENA region

Pre-tax
$492 billion (0.7% GDP, 2.1% revenues)

- MENA, 237
- CEE-CIS, 72
- E.D. Asia, 102
- LAC, 36
- S.S. Africa, 19
- Advanced, 25

Sources: IEA World Energy Outlook 2012; OECD; World Bank; and IMF staff estimates.
Post-tax subsidies are four times larger than pre-tax subsidies, with more than a quarter from coal

- **Pre-tax**
  - $492 billion (0.7% GDP, 2.1% revenues)

- **Post-tax**
  - $2 trillion (2.9% GDP, 8.7% revenues)

Sources: IEA *World Energy Outlook 2012*; OECD; World Bank; and IMF staff estimates.
Advanced economies account for 40 percent of tax subsidies

- **Pre-tax**
  - $492 billion (0.7% GDP, 2.1% revenues)

- **Post-tax**
  - $2.0 trillion (2.9% GDP, 8.7% revenues)

Sources: IEA World Energy Outlook 2012; OECD; World Bank; and IMF staff estimates.
Post-tax subsidies as a share of GDP and government revenues are much higher in MENA

Sources: IEA World Energy Outlook 2012; OECD; World Bank; and IMF staff estimates.
III. “How to do” subsidy reform
“How to do” subsidy reform

- Identify ingredients for successful subsidy reform from 22 country case studies
  - 14 on fuel, 7 on electricity, and 1 on coal
  - Broad regional coverage (7 from SSA, 2 from E.D. Asia, 3 from MENA, 4 from LAC, and 3 from CEE-CIS)
  - 28 reform episodes (12 successful, 11 partially successful, and 5 unsuccessful)
  - Supplemented by lessons from FAD technical assistance (19 reports in the past 5 years) on energy subsidies and work by other institutions
Six key reform ingredients

(i) A comprehensive reform plan

- clear long-term objectives
- assessment of the impact of reforms
- consultation with stakeholders

(ii) A far-reaching communications strategy

- inform the public of the size of subsidies and benefits of reform
- strengthen transparency in reporting subsidies
(iii) Appropriately phased and sequenced price increases

- permit households and enterprises time to adjust and governments to build social safety nets
- sequence increases differently across products

(iv) Improvements in the efficiency of state-owned enterprises (SOEs) to reduce their fiscal burden

- improve information on their costs, set performance targets and incentives, and introduce competition where appropriate
- improve collection of energy bills
Six key reform ingredients

(v) Targeted mitigating measures to protect the poor
- targeted cash transfers are preferred
- when cash transfers are not feasible, other programs can be expanded as administrative capacity is developed
- SOE restructuring may also require targeted measures (e.g., job training)

(vi) Depoliticize price setting
- implement automatic price mechanism (with price smoothing)
- establish an autonomous body to oversee price setting
Subsidy Reform in MENA: Recent Progress and Challenges
Subsidy Reform in MENA
Recent Progress and Challenges Ahead

- Subsidy reform in MENA has gained new momentum under rising fiscal pressures and demands for better economic conditions, particularly in the Arab countries in transition (ACTs).

- Several governments have taken steps to reduce the fiscal cost of subsidies, but citizens remain concerned about the rise in inflation and are uncertain about the benefits of reform.

- Sustained progress will require more countries to start comprehensive reform, while the countries that have already taken measures will need to consolidate their gains.

- Subsidies play an important role in MENA countries: Magnitude

- Energy subsidies create economic distortions: Macro, social and environmental implications
Several MENA countries have recently taken steps to lower energy subsidies

- In the past few years, Egypt, Jordan, Mauritania, Morocco, Sudan, Tunisia, and Yemen initiated subsidy reform by increasing energy prices while mitigating the impact on the poor—albeit with varying levels of effort and results.
- In most cases, reforms have been part of a broad-based fiscal strategy to reduce fiscal deficits and free resources to be put toward social spending and infrastructure—which could help boost growth and reduce poverty and inequality.

Reform efforts need to go further as subsidies remain large ... furthermore, many countries have not yet acted on subsidy reform
Subsidy Reform in MENA
Recent Progress and Challenges Ahead

• To ensure the reductions are durable:
  – Countries need to introduce, or implement more rigorously, automatic price-setting mechanisms for energy products—possibly coupled with smoothing mechanisms to avoid domestic fuel price volatility—which will also help depoliticize pricing.
  – Countries should also deepen reform by combining tariff increases with restructuring of the energy sector

• Managing the political economy of subsidy reform is crucial in the current difficult political situation,
  – Aim for reform mix that balances fiscal returns against social opposition to price increases.
  – Mitigate the impact of price increases
  – Strengthen confidence that the resulting savings will be put to good use
  – Scale up of well-targeted social safety nets to compensate those who will be hardest hit by higher prices.
  – Targeted cash transfers or vouchers, especially if based on need, are particularly effective.
Six Barriers to Reform
Six barriers to reform

1. Lack of information. Public unaware of:
   – Size of fiscal costs
   – difference between world and domestic fuel prices
   – adverse impact of subsidies on priority public spending and poverty reduction (e.g. Ghana, Nigeria, Mexico)

2. Lack of government credibility and administrative capacity (e.g. Indonesia and Nigeria)
   – little confidence in how reform savings will be spent
   – history of corruption, lack of transparency

3. Concerns about social impact in particular on the poor
   – Fuel price increases can still hurt the poor even though subsidies are regressive
Six barriers to reform

4. Concerns about inflation, price volatility, and competitiveness (e.g. Iran and Nigeria)
   - Higher oil prices can fuel inflation in the short run
   - International fuel prices are volatile
   - Energy-intensive sectors may suffer from a loss of competitiveness

5. Opposition from losers of the subsidy reform
   - Politically vocal groups, labor unions (e.g. Mexico), or losers from the reforms (e.g. SOEs in the energy sector)

6. Unfavorable initial macroeconomic conditions at the start of the reform (e.g. Brazil)
   - Public resistance to reforms are higher in periods of low economic growth and unstable prices
   - Rising household income can help people to afford higher fuel prices (e.g. Peru and Turkey)
Resistance from stakeholders

1. Vested interests, government/administration insiders – why should they accept reform?

2. How to protect the most vulnerable groups?

3. Middle/Upper class – are subsidies part of the social contract? How can they feel they are not losing out?

4. Business/exporters – will they be able to manage the increase in input costs?
Thanks!
Data sources

- **Pre-tax subsidies**
  - IEA *World Energy Outlook 2012* for 39 countries for electricity, natural gas, and coal
  - OECD: producer subsidies for coal for 16 countries
  - World Bank and IMF staff estimates for 36 countries in electricity
  - IMF staff estimates for petroleum products (gasoline, diesel, kerosene) for 176 countries

- **Post-tax subsidies**
  - IMF staff estimates based on pre-tax subsidies and adjustments for revenue considerations and externalities
Under-pricing for externalities accounts for a large share of post-tax subsidies across all regions.

Sources: IEA World Energy Outlook 2012; OECD; World Bank; and IMF staff estimates.
THROUGH THE LOOKING GLASS: TRANSPARENCY AND FOSSIL-FUEL SUBSIDIES

6th Annual Meeting of Middle-East and North-Africa Senior Budget Officials (MENA-SBO)

Doha, 25 November 2013

Jehan SAUVAGE
Trade Policy Analyst
OECD, Trade and Agriculture Directorate
Why look at FFS? (1) The climate challenge as background

• Addressing climate change requires not only introducing new policies but also adapting old ones.

• Attention has for long centred on the introduction of new policies aiming to tax “bads” and subsidise “goods”, with mixed results to date.
  – FITs, carbon taxes, emissions trading schemes...

• But there is a growing recognition that older policies also need to be reviewed and adapted.
Why look at FFS? (2) The economic context

- Concerns about fiscal sustainability in several countries.
- Growth-oriented tax reform may involve a shift of taxation from income taxes toward environmental taxes.
- Subsidised energy prices distort the allocation of resources.
- Fossil-fuel subsidies are poorly-targeted instruments to help low-income households.
Why look at FFS? (3) The political context
Why look at FFS? (4) The political context

• President Obama: “On top of these record profits, oil companies are also getting billions a year in taxpayer subsidies. Think about that. It's like hitting the American people twice. You're already paying a premium at the pump right now. And on top of that, Congress thinks it's a good idea to send billions more of your tax dollars to the oil industry?”

• Connie Hedegaard: “Fossil fuels subsidies have no place in today's world. They must be phased out as the G20 pledged.”

• Jim Yong Kim: “They are regressive, negatively impact the environment and act as a barrier to progress on clean technology.”
Reform requires a **solid information base**

- Key to reforming fossil-fuel subsidies is **making information on support available** to decision makers and the broader public.
  - Informed discussion and debate among stakeholders are crucial.
  - Data feed into the **analysis of the costs and benefits** of reform.
  - Transparent data can facilitate **peer reviews and compliance** with reform processes.

- Identifying subsidies is, however, not easy:
  - Lots of confusion around measurement methods and definitions.
  - No agreement over what the concept of “subsidy” encompasses.
  - Lack of transparency and data availability.
Illustrating data gaps: the example of IEA data

Fossil-fuel consumption subsidy rates as a proportion of the full cost of supply, 2010

OECD Trade and Agriculture Directorate
The OECD Inventory (1) Overview

- The OECD’s *Inventory of Estimated Budgetary Support and Tax Expenditures for Fossil Fuels* aims to help fill the gaps. It identifies, documents and estimates more than 550 budgetary transfers and tax expenditures relating to fossil fuels for all 34 OECD countries.
  - Covers both production and consumption.
  - Also includes sub-national jurisdictions in the case of federations (e.g., Australia, Canada, United States).
The OECD Inventory (2) Overview

• The OECD Inventory is primarily an information tool.
  – Information is provided measure by measure.
  – Links fossil-fuel support to actual policies in place.

• No judgment on the purpose of the measures or their effects.
  – Information -> Evaluation -> Reform (or not)

• The information collected is peer-reviewed by countries.
  – Improves accuracy through participation of government officials.
  – Provides some sense of country ownership.
  – Finds a middle ground between self-reporting and third-party reporting.
The OECD Inventory (3) Specific policy examples on the supply side

• **Alberta (Canada): Energy Industry Drilling Stimulus**
  – Provided temporary reductions in royalties to oil and gas producers operating in the province (about CAD 1.7 billion in 2010).

• **Germany: Support to coal producers in North-Rhine Westphalia**
  – This aid package to hard-coal producers is co-financed by the federal government and the Land of NRW (about EUR 1.8 billion in 2011).

• **Turkey: Aid to the hard-coal industry**
  – Compensates the national TTK hard-coal company for its high costs (about USD 300 million in 2011).

• **United States: Excess of Percentage over Cost Depletion**
  – Allows for a more favourable treatment of asset depletion for tax purposes (about USD 1.2 billion in 2011).
The OECD Inventory (4) Specific policy examples on the demand side

- **Ontario (Canada):** Fuel-Tax Exemption for Coloured Fuel
  - Exempts from fuel-tax sales of coloured fuel to sectors like farming, forestry, fishing, etc. (about CAD 285 million in 2011).

- **Finland:** Energy-Tax Exemption for LPG
  - Self explanatory (about EUR 10 million in 2011).

- **Mexico:** Negative Excise Tax on Motor Fuels
  - Consists of a price-setting mechanism that considers the international price of oil (about MXN 169 billion in 2011).

- **France:** Excise-Tax Reduction for Taxi Drivers
  - Consists of an annual capped refund (about EUR 21 million in 2011).

- **Italy:** Tax Relief for Trucking Companies
  - Provides partial refunds of excise tax (about EUR 350 million in 2011).
Germany’s Ministry of Finance produces every two years an annual subsidy report documenting both direct budgetary transfers and tax expenditures. It only looks at federal support, however.
Reporting measures supporting fossil fuels (2) The example of Belgium

Based on a 1985 recommendation from Belgium’s High Council of Finance, an inventory of tax expenditures is updated every year and sent to the Belgian Parliament.

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The US Office of Management and Budget releases its Analytical Perspectives as part of the federal budget documents. They contain a lot of information on energy-related tax expenditures (among others). The DOE’s Energy Information Administration also produces regular reports on federal energy subsidies.
Support to fossil fuels in OECD countries by year and type of fuel

The OECD Inventory (6) Summary results

- Of the more than 550 measures identified and documented:
  - 1/3 are budgetary transfers and 2/3 are tax expenditures.
  - 59% relate to consumption (incl. power generation), 29% production and 12% general services.
  - 34% relate to extraction, 48% to final use and 18% to transport, refining and processing (initial recipients, not final incidence).

- Sub-national support matters.
  - 53% of all producer support in the US in 2011.

- No international comparisons, however.
Next steps and remaining data gaps

• Data collection should focus more on emerging and developing countries.
  – Lack of information on producer measures in particular.

• Need to develop ways of measuring support provided through more indirect ways.
  – Example of loan guarantees.

• More should be done on modelling and analysis.
  – Challenges for modellers.
For more information

• Visit our website: www.oecd.org/iea-oecd-ffss

• Contact us:
  – Jehan.SAUVAGE@oecd.org
  – Ronald.STEENBLIK@oecd.org
Obstacles to reform

• It is very hard to separate the issue of support from that of resource rent.

• Measures interact with each other.

• Distributional concerns.

• Competitiveness concerns.
Budget Reform in Austria
How to Bring Stakeholders on Board

Gerhard STEGER

Qatar, 25 November 2013
Why a Reform?
How to design a Reform 1

Learning from others.
How to design a Reform 2

Trust and train public staff.
How to design a Reform 3

Keep it digestible. Minimize complexity.
How to Design a Reform 4

Look for alliances.

Create win-win-situations.

Align interests.
Austrian Federal Budget Reform - Overview

Result-oriented management of administrative units

Performance Budgeting

Budgetary discipline and planning: binding medium term expenditure framework

Flexibility for line ministries through full carry-forward of unused funds

New budget structure: „lump-sum budgets“

Accrual budgeting and accounting

new budget principles: outcome-orientation; efficiency; transparency; true and fair view
MTEF - the Idea

Keep a lid on expenditure.
Highly aggregated, legally binding ceilings for expenditure and human resource capacity

4 years in advance

on a rolling basis (2014-2017; 2015-2018 …..)

2 kinds of expenditure ceilings: nominally fixed: ~ 75 %;
variable: ~ 25 % (for instance: expenditure tied to business cycle)

Strategy report as explanatory document
MTEF: Win - Win

- Ministry of Finance gets hard expenditure ceilings
- Line ministries may carry forward unused funds to future years, no earmarking of these reserves
- Ministry of Finance saves interest, as money is spent later
- Better predictability for parliament, citizens and markets
MTEF: Big Success

- Fiscal discipline supported effectively
- Spending behaviour of line ministries changed substantially
- Better value for money for citizens
- Countercyclical design helps to stabilize economy
New Budget Structure

- **Total Budget Headings**
- **Budget Chapters**
- **Global Budgets**
- **Detail Budgets**
- **Cost Accounting**

**MTEF:** 5 Headings (across ministries)
- ~30 (each assigned to a specific ministry)
- annual budget: 70
  - on average: 3-4 per ministry
  - shown in the budget documents: ~400

Flexible steering tool

Transparent budget structure as a prerequisite for other reform elements
New Budget Structure: Win-Win

- Public: Self explaining budget structure
- Line ministries: More flexibility and more responsibility
- Parliament: Less involved in spending and revenue details in exchange for new lever: Performance Budgeting
Accrual Accounting and Budgeting

Operating Statement
(direct linkage with federal cost accounting system)

Statement of Financial Position
(Balance Sheet)

Cash Flow Statement

Purpose: Providing relevant financial information

Regulatory oriented towards IPSAS

Putting tax money to effective use for citizens.
Accrual Accounting and Budgeting: Win-Win

- Administration: Sufficient information to steer public finances appropriately (cash important, but cash only not sufficient)

- Public: Realistic view on public finances: Is the country poorer or richer than a year ago?
Performance Budgeting?

- Typical budget decision: Who gets how much?
- Complementary decision: Who has to deliver which results for citizens?
- Budget should steer resources AND results to strengthen strategic policy impact and
- to provide transparency to citizens: value for tax-payers money
Performance Budgeting

Max. 5 outcome objectives, at least 1 gender objective

Global Budget 1 – 5 primary activities

Explanatory budget documents

Annual Budget Statement

Annual Budget Statement as of 2013 per Chapter 1/2

Mission Statement:

<table>
<thead>
<tr>
<th>Cash Flow Statement</th>
<th>Ceiling MTEF</th>
<th>Budget n+1</th>
<th>Budget n</th>
<th>Actual n-1</th>
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<td>Receipts</td>
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<td>Expenditures - fix ceiling</td>
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<td>Expenditures - variable ceiling</td>
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MTEF = medium term expenditure framework
Annual Budget Statement as of 2013 per Chapter 2/2

Outcome objective 1:

Why this objective:

What will be done to achieve this objective:

What would success look like:

- Max. 5 outcome objectives per chapter
- 1 outcome objective directly addressing gender equality
- Overall objective: Integrated view on budget and performance information
**Annual Budget Statement as of 2013 per Global Budget 1/2**

**Global Budget xx.01 Operating Statement**

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<th>Budget n+1</th>
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<td>Revenues from operating activities and transfers</td>
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<td>Revenues from financing activities</td>
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<td><strong>Revenues</strong></td>
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<td>Expenses on financial activities</td>
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**Global Budget xx.01 Cash Flow Statement**

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Comment: On global budget level, total expenses (operating statement) and total expenditures (cash flow statement) are legally binding.
### Activities/Outputs (max. five incl. gender-activity)

<table>
<thead>
<tr>
<th>Contribution to outcome objective/ s no.</th>
<th>What will be done to achieve the outcome objectives? Activities/Outputs:</th>
<th>What does success look like? Milestones/Indicators for n+1</th>
<th>What does success look like? Milestones/Indicators for n</th>
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**Comments on activities/outputs of the preceding budget statement, which are no longer listed in the present budget statement**

**Recent recommendation of the Court of Audit**

**Response of the ministry**
Outcome: Improving ability to work for elderly persons (50+)

➢ Why? Know how; contributes to growth and productivity; securing affordability of social system

➢ How? Fostering re-integration into the labour market; support programs

➢ Success? Employment rate for elderly persons; number of persons supported by allowances; number of health checks, of counseling interviews
Practical Example: E-Government (Summary)

Outcome: More comprehensive e-government services for citizens, enterprises and public administration

Why? Enhanced value for citizens, enterprises and public administration; paperless handling of applications greens processes

How? Several additional e-government projects; cost-benefit analysis

Success? Number of e-government users, of e-applications and e-official notifications; benefit of e-government projects according to cost-benefit analysis
Tools to Support Performance Budgeting

Impact assessment ex ante:

- Applies for draft legal acts and major spending programs
- 8 dimensions
- Supported by a standardized IT-tool

Evaluation ex post:

- Respective line ministry in charge for legal acts and major spending programs
- Chancellory coordinates and reports to Parliament
- Evaluation interval: 5 years
Performance Budgeting: Win-Win

- Administration: Focus on intended results crucial to steer appropriately; administration can flag achievements
- Citizens: Value for money
- Parliament: New important element of budget decisions.
How to Bring Stakeholders on Board

- Depends on political, cultural and economic circumstances.
- Differs from country to country.
- Basic requirements for a successful approach:
  - Get a clear picture: Why and how to aim for reform?
  - Identify potential allies.
  - Create a common understanding why reform is needed and which basic elements it should comprise.
  - Form powerful reform alliances.
Administration started to lobby for reform and got support from Minister of Finance.

Pilot projects to test the new budget world went very well.

Ministry of Finance started to build a reform alliance consisting of:
- Court of Audit
- Chancellory
- All political parties represented in Parliament

Informal reform committee worked 2004-2007
2007: Unanimous decision in Parliament on
- Change of constitution (made reform irreversible for first and second reform stage)
- Detailed provisions of first reform stage (applied as of 1.1.2009)


2010-2012: Detailed technical preparation, training of staff
Budget reform: Who got what?

- Ministry of Finance: Hard medium-term expenditure ceilings; enhanced financial transparency to foster fiscal discipline and prevent fiscal illusions

- Parliament: A new key element of decision (performance objectives and measures), a parliamentary budget office and additional reports from government
How to bring Stakeholders on Board - Austrian Procedure IV

- Cancellory: New important task (performance controlling)
- Court of Audit: New important task: Scrutinize performance
- Line ministries: More budget flexibility; can present performance achievements in public
- Public: Enhanced transparency concerning fiscal issues and performance of government
Thank you for your attention!

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Expenditure Prioritization & Performance Budgeting

Marc Robinson
PFM Results Consulting
pfmresults.com
Prioritization

- Resources go to best possible use
- Avoid wasting money on:
  - Ineffective or low-priority spending
  - Inefficient service delivery
- New spending decisions made carefully
  - Scrutiny of all new spending proposals
  - Objectives and expected results clearly specified
  - Fit with major government priorities
  - Clear processes for new spending approval
- Not enough to make good new spending decisions
- Focus also on ongoing spending – *baseline* spending
Why Baseline Spending Focus Needed

- Incrementalism = baseline spending not examined
  - Last year’s funding renewed automatically
  - With any new spending added
  - Recourse to indiscriminate across-the-board cuts

- Consequences of incrementalism:
  - Ineffective and inefficient spending untouched
  - Fiscal space for new spending severely limited
  - Pressure to let aggregate spending rise too fast

- Good prioritization impossible if baseline not examined

- Top-down budgeting makes incrementalism more costly
  - Aggregate spending ceiling
  - Can’t increase fiscal space by increasing aggregate expenditure
Fiscal Space vs. Baseline Spending

AGGREGATE EXPENDITURE CEILING

FISCAL SPACE

BASELINE EXPENDITURE
Spending Review (SR)

- Systematic review of baseline spending
  - Efficiency savings and/or strategic savings
  - Increases fiscal space
  - Tool for reallocation of resources

- Many OECD countries using SR after global crisis

- Principles for good spending review
  - Ongoing routine process, not just one-off
  - Selective, not comprehensive (no “zero base” review)
  - Ministry of Finance leadership
  - Partnership with spending ministries
  - Supported by good performance information
Performance Budgeting (PB)

- PB = making performance impact on budget decisions
- SR needs PB
  - Programs indicate what objectives money is being spent on
  - PB provides performance information which SR can use
- PB needs SR
  - Program classification & indicators not sufficient
  - Need for budgeting processes which ensure use of information
  - Spending review as a key process to support PB
- Other processes needed as well
  - *Performance justifications* for agency budget requests
  - *Performance dialogues* after budget execution
Good Performance Information

- Basis of PB, and greatly strengthens SR
- Right type of performance indicators
  - Outcome and output indicators
  - Avoid input and activity indicators
  - PB indicators different from managerial indicators
- Evaluation as information source for budgeting
  - Efficiency reviews – scope for savings by reducing waste
  - Outcome evaluations – is spending delivering intended results?
  - Commissioning evaluations to inform budgeting
  - Avoid building huge evaluation industry
Performance Budgeting

PRIORITIZATION

Spending Review

Evaluation

Medium-term Expenditure Frameworks: experiences from OECD countries

Ronnie Downes
Deputy Head - Budgeting and Public Expenditures, OECD

MENA-SBO Network
Doha, 25-26 November 2013
What problems does a MTEF address?

Aligning *resources* with *plans*:

- **Different TIMESCALES**
  - Annual budget process v. multi-annual planning process
- **Different PEOPLE**
  - Ministry of Finance v. Ministry of Planning, Prime Minister
- **Different LANGUAGE**
  - *Budget*: line items, departmental allocations
  - *Plans*: programmes, strategic objectives
How does MTEF address these problems?

• MULTI-YEAR
  – common frame of reference for budgets and plans
  – Ambitions, objectives must match with resources available

• CLEAR OBJECTIVES
  – Single, strategic approach to designing budgets and plans
  – Link to Performance-based Budgeting
  – Encourages medium-term planning – structural reforms

• LEADERSHIP
  – All parts of the bureaucracy understand the common, strategic approach
  – Link to Accountability
Which OECD Countries are using MTEF?

Fig. 3.1 Percentage of OECD countries with MTEF in place (Q25)
Length of MTEF Ceilings

- 0%
- 5%
- 10%
- 15%
- 20%
- 25%
- 30%
- 35%
- 40%
- 45%
- 50%

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<thead>
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<th>Length (Years)</th>
<th>2012</th>
<th>2007</th>
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<tr>
<td>3 years</td>
<td>35%</td>
<td>40%</td>
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<tr>
<td>4 years</td>
<td>45%</td>
<td>35%</td>
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<tr>
<td>5+ years</td>
<td>15%</td>
<td>20%</td>
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Carry-over of expenditure from year to year

- **Discretionary**
- **Operational**
- **Investment**

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<th>Year</th>
<th>Discretionary</th>
<th>Operational</th>
<th>Investment</th>
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<tr>
<td>2012</td>
<td></td>
<td>Yes but requiring approval</td>
<td>70%</td>
</tr>
<tr>
<td>2012</td>
<td>Yes without requiring any approval</td>
<td>Yes but requiring approval</td>
<td>60%</td>
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<tr>
<td>2007</td>
<td>Yes without requiring any approval</td>
<td>Yes but requiring approval</td>
<td>50%</td>
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<tr>
<td>2007</td>
<td>Yes without requiring any approval</td>
<td>Yes but requiring approval</td>
<td>40%</td>
</tr>
<tr>
<td>2012</td>
<td>No, carry over not permitted</td>
<td>Yes but requiring approval</td>
<td>30%</td>
</tr>
<tr>
<td>2012</td>
<td>No, carry over not permitted</td>
<td>Yes but requiring approval</td>
<td>20%</td>
</tr>
<tr>
<td>2007</td>
<td>No, carry over not permitted</td>
<td>Yes but requiring approval</td>
<td>10%</td>
</tr>
</tbody>
</table>

OECD | BETTER POLICIES FOR BETTER LIVES
Challenges for MTEF?

• Multi-year forecasting of revenue and expenditure
  – Potential role for independent institutions
• Political commitment to medium-term discipline
  – Link to fiscal rules
  – Link to top-down budgeting
• Complete coverage of expenditure envelopes
  – Minimise the exceptions
• Deviation from plan?
  – Correction, enforcement, credibility?
  – CULTURE of medium-term planning is what matters
• Country experiences?
MTEF: Korean Experience

2013. 11

Seung Hyun(Luke) Hong
Korea Institute of Public Finance

MENA SBO Meeting
Contents

I. Brief Historical Background
II. Main Features of Korea MTEF
III. Lessons and Challenges

MENA SBO: L. Hong
I. Brief History
60 Years Since Korean War

[Graph showing GNI per Capita (USD) and Growth Rate (%)]

MENA SBO: L. Hong
5 Year Economic Development Plan

- From 1962, every 5 years
- Development plans with (mainly) industrial policies
- Financing these policies was a big challenge
- Medium-term fiscal planning/outlook was important
- ‘5 Year Economic Social Development Plan’ from 1982
Internal Medium-Term Fiscal Plans

- From 1982 till 2003
- 5 year window
- Annually updated
- CBA’s own internal use, not part of 5 year plans
- Checking medium-term fiscal implications of (development) plans
- Close to MTFO (medium-term fiscal outlook) in the beginning
National Fiscal Management Plan

<Korean MTEF>

- From 2004, strong support from the new administration
- Part of 4 Major Fiscal Reform Package
- Statutory support by National Public Finance Act of 2006

MENA SBO: L. Hong
Four Major Fiscal Reforms 1

<Need for a New Fiscal Management Framework>

• Slower growth
• Aging population (+Social Security Expansion)
• Concern for Medium-term Fiscal Soundness
Four Major Fiscal Reforms 2

◆ New Administration with New Priorities (‘03)
  ▪ Balance between growth & welfare
  ▪ Continue expanding social welfare system

◆ Not Satisfactory Existing PFM system
  ▪ Cannot address medium-/long-term (fiscal) issues systematically
  ▪ Not effective in aligning annual resource allocation with (new) policy priorities (Strategic Resource Allocation)

Reform Package

- National Fiscal Management Plan
- Top-down Budgeting
- Performance-based Budgeting
- Electronic Fiscal Information System

National Public Finance Act

MENA SBO: L. Hong
II. Main Features
Key Features 1

◆ Scope
  ▪ 5 year rolling plan, updated every year
    • t (current year),
    • t+1 (budget year)
    • t+2 ~ t+4
  ▪ All resources under the discretion of central government
    • General account, Special accounts, and Public funds
    • Sub-national governments have their own MTEFs.

◆ Expenditure Classification
  ▪ 12 sectors (functional categories)
  ▪ Mandatory spending vs. Discretionary spending

◆ Public Opinion
  ▪ Working Groups
    • Legacy of 5 Year Economic Development Plans
    • Experts from academia and research institutions
  ▪ Public Hearings
Key Features 2

◆ Statutory Support
  ▪ Article 5 of the National Public Finance Act (NPFA) of 2006, and
  ▪ Article 2 of Regulations for the NPFA
  ▪ Main contents and key procedures are stipulated in the NPFA and its Regulations

◆ Contents & Structure
  ▪ Key elements required by the law
    • Policy directions and targets on fiscal aggregates in medium-term
    • Major assumptions
    • Sectoral allocation plans & policy priorities
    • Mandatory/discretionary spending forecasts and their management plans
    • Tax burden forecasts
    • Explanations for changes in the plan
  ▪ Usually in 3 parts

MENA SBO: L. Hong
NFMP Preparation

- Macroeconomic Forecasting
- Fiscal Targets
- Total Expenditure Ceilings
- Sectoral Ceilings
- Annual Budget Preparation

- Updated Cost Estimates of Existing Programs
- New Sectoral Demands (Priorities/Cost Estimates)
- Sectoral Budget Preparation

MENA SBO: L. Hong
# NFMP & Budget Cycle

<table>
<thead>
<tr>
<th>Time</th>
<th>Main Player</th>
<th>Primary Tasks</th>
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| Dec.    | MoSF        | **Guidelines** for the next NFMP preparation sent to line ministries (By Dec. 31)  
- Prospect on future fiscal environments, medium-term policy priorities, program selection criteria, etc. |
| Jan.    | Line Ministries | **Medium-term Plans** submitted to MoSF (by Jan. 31)  
- 5 year plans on new programs and major continuing programs  
- Focus on changes from the last year’s plan  
- Restructuring of existing programs to accommodate new programs under the ceilings from last year |
| Feb.~Apr. | MoSF        | **NFMP Preparation**  
- Working groups on forecasting, budget aggregates, and sectors  
- Macroeconomic Forecasting and setting basic assumptions  
- Targets on fiscal aggregates and budget envelops  
- Sectoral policy priorities  
- Public Hearings |
| Apr.~May | Cabinet Meeting | Agree on national policy priorities, basic assumptions.  
Decide targets on budget aggregates, sectoral/ministerial ceilings |
| Apr.~May | MoSF        | **Guidelines** for budget preparations and **ceilings** |
| May~Jun. | Line Ministries | **Budget requests and performance plans** submitted to MoSF (by June.30) |
| July~Sept. | MoSF       | **Draft Budget Preparation**  
- Budget request deliberation  
- Consider fiscal rules/discipline, national policy priorities  
- Program level reviews → Deliberation committee(within MoSF)  
- Check ceilings/similar programs  
- Fiscal policy consultation committee: reflecting public opinion |
| Oct.    | MoSF        | **Draft Budget** submitted to the **National Assembly** (by Oct.2) |

MENA SBO: L. Hong
III. Lessons & Challenges
1. One of the biggest stimulus package
   - 6.5% of GDP (‘08~’10)
   - 3.7%p↑ in Debt/GDP(‘09)
   - Growth recovered quickly

2. From 2009, growing demand for fiscal consolidation as an exit strategy
   - Most stimulus measures are on expenditure side

3. NFMP as a guideline
   - After crisis spending level set from the pre-crisis NFMP

4. Withdrawal from stimulus measures
   - Fiscal soundness vs. economic recovery
Lessons from Past Experience

◆ Strong Political Commitment Matters
  ▪ New government with
    • different policy priorities,
    • a strong belief in the benefit of medium-term perspective

◆ Improving Efficiency and Fiscal Soundness
  ▪ Less incrementalism
  ▪ Right incentives for line ministries
  ▪ Managing long-term fiscal risks

◆ More Stable Public Policies
  ▪ Reduce market uncertainty
  ▪ Credible and clear enough information

◆ Build a Good Reputation
  ▪ to create a momentum

◆ Importance of Institutional Arrangements
  ▪ Appropriate organizational structures, rules etc.
  ▪ MPB was responsible for both annual budget and NFMP
    ▪ Behavioral changes in CBA and line ministries

◆ Importance of Basics
  ▪ Many variants of MTEF
    ▪ Need basic infrastructure for adopting advanced system
  ▪ Relatively strong fundamentals in Korea
    ▪ Reforms in a package

MENA SBO: L. Hong
Remaining Issues

◆ Planning vs. Management Device

◆ NFMP and Politics
  ▪ Re-define the nature of the NFMP?
    • 5 year presidential term vs. 5 year ‘rolling’ plan
    • Policy priorities across different administrations?
  ▪ Appropriate role for the National Assembly?
    • NFMP is only supplementary, not reviewed nor approved
    • Still heavily centered on annual review of individual projects

◆ Transparency and Reliability
  ▪ Macroeconomic Forecasting
    • Optimistic vs. Conservative?
  ▪ Transparent procedures & justification of forecasts

◆ Balancing between Flexibility & Predictability
  ▪ Find right mix of these two is a real challenge
    • Stable plans can improve confidence in government policies
    • Rigid plans can hinder counter-cyclical fiscal policy
감사합니다
Thank You
The Abu Dhabi MTEF Experience
OECD MENA-SBO
Doha, 26th November, 2013
Background

- Political Structure:
  - Abu Dhabi is a part of United Arab Emirates Federation:
  - Federation consists of seven Emirates: Abu Dhabi (where the capital is located), Dubai, Sharjah, Ajman, Umm al-Qaiwain, Ras al-Khaimah, Fujairah
  - Federal Government with broader function:
    - Foreign affairs, Defense and Monetary Policy
  - Each Emirate has full autonomy over its internal affairs
Key Principles of Fiscal Policy

Balance the Goals

- Macroeconomic Stability
- Economic Growth
- Fiscal Sustainability
- Stable Expenditures
- Growing Expenditures
- Conservative Expenditures
Government Flow of Funds

Non-Oil Revenues

ADNOC

ADIA

ADIC

Royalties & Taxes

Budget Deficit

Budget Surplus

Abu Dhabi government entities

Federal government

State-Owned Enterprises

DEPARTMENT OF FINANCE
Revenue and Expenditure Components

- Revenue:
  - Oil
  - Non-Oil

- Expenditure
  - Recurrent
  - Aid
  - Development
  - Loans and Equity
  - Federal Spending
Fiscal Rule

– First anchor: Estimate of actual spending for last year, 2013
– Second Anchor: Forecasted revenue in end year, 2018
– Straight line between the two to arrive at expenditure ceilings
Milestones

– Establishment of Fiscal Policy Unit in 2010
– Abu Dhabi macroeconomic model (ADEM) completed in 2010
– First MTFF produced in 2011, period 2012-2017
– Produced annually since then, ahead of budget cycle
– Ceilings recommendations have become staple of annual budget cycle
Sections of the MTFF

– Global economic outlook: global economic outlook (IMF WEO), assessment of oil market (OPEC & IMF) and sub-section on oil prices

– Fiscal policy section: revenues (oil & non-oil), expenditure ceilings (baselines & fiscal space), financing (ADNOC dividends) and oil price sensitivity analysis

– Macroeconomic section: macroeconomic indicators, AD & UAE levels, real sector, monetary & BoP impacts

– Scenarios section: oil price dips, effect of changes in spending patterns, effect of no changes in spending patterns
Characteristics of the MTFF

- 5 year time-horizon
- Budget ceilings derived fiscal from rule of balancing budget in 5 years
- Model for forecasting oil and non-oil revenues
- Model for forecasting baseline spending for recurrent, aid and federal expenditures
- Take proposed figures for development and loans & equity spending
- Difference between baseline spending and ceiling is fiscal space for new projects
Points Worth Noting

– Support for fiscal policy
– Greater awareness on need for sound fiscal policy
– Concept of fiscal space
– Working with Budget Department on introducing spending review and investment analysis capabilities
– Identified the transition from MTFF to MTBF to MTEF
Definitions

– MTFF, Medium-Term Fiscal Framework: top-down allocations across spending categories, focus on aggregate spending

– MTBF, Medium-Term Budget Framework: top-down allocations reconciled with bottom-up spending requests, different to annual budget process

– MTEF, Medium-Term Expenditure Framework: programme-based allocation of resources
Biggest Challenges

– New mindset, new terminology, new approach
– Getting enough “air time”
– Difficulty of control
– Too many reforms happening at the same time
– Resistance to change
– Lack of concrete understanding of PFM
Biggest Concerns

– Diversification and competitiveness
– Role of SOEs
– Encouraging the private sector
– Transition to knowledge economy
– Job creation
– Are we saving enough? Inter-generational equity
– Are we saving the right way? SWFs vs SOEs
Future Plans

– Currently seeking approval to upgrade to MTBF and then to MTEF
– Assisting in introduction of spending review capacity
– Pushing for greater development of investment analysis capabilities
– Support the migration to PBB
– Seeking greater co-ordination of fiscal policy across the country
– Developing LTFF, until 2070
– Establish and clarify fiscal rules for the Emirate
Lessons Learnt

– Importance of having a strong team
– Importance of constant improvements to your model
– Importance of data quality
– Importance of being aware of developments on the ground
– Importance of communication and debates
– Important to listen to decision makers and their concerns
– Important to be flexible
Thank you
Good Budgetary Governance:
from Best Practices towards OECD Principles

Ronnie Downes
Deputy Head - Budgeting and Public Expenditures, OECD

MENA-SBO Network
Doha, 25-26 November 2013
OECD’s starting point

- Budget reports (7 in total)
  - Pre-election
  - Long-term sustainability
- Specific disclosures
  - Non-financial assets
  - Contingent liabilities
- Integrity & accountability
  - Audit
  - Parliamentary scrutiny
  - Public availability on internet
  - Promote public understanding
Since 2002 ...

• OECD Senior Budget Officials
  – Regional networks: MENA, LAC, CESEE, Asia; also CABRI
  – Thematic networks: Performance & Results; PPPs; Budget Accounting (Accruals); Independent Fiscal Institutions; Health Budgeting

• Budget Reviews / Public Governance Reviews

• Restoring Public Finances, 2011, 2012

Developments & Priorities in budgeting

- from annual to medium-term budgeting
- heightened focus on management of fiscal risks
- from inputs to outputs, performance and impacts
- from MoF to independent institutions
- greater engagement of parliament and citizens
- budgeting as an instrument of public governance
Setting norms across OECD

Country experiences
- OECD Networks
- Surveys
- Country reviews
- Studies and analysis
- Gathering and exchanging knowledge

Good practices
- Pooling knowledge
- Guidance tool
- Flexible

Recommendations & Principles
- “Locking in” what has been learned
- OECD norms
- Governments adopt
- Commitment to respect
OECD Budget Practices & Procedures Survey

• Covers all aspects of public budgeting
• Standard questions / topics for all OECD countries
  – Fiscal sustainability / fiscal rules
  – MTEF
  – Capital budgeting
  – Budget flexibility
  – Performance budgeting
  – Budget transparency
  – Independent institutions
• Some key findings:-
Fiscal rules

Fig. 2.9 Percentage of OECD countries using fiscal rules (Q18)

- 2012
- 2007
Fiscal rules

Expenditure rules
Revenue rules
Budget balance rules
Debt rules
All rules

Legislation International treaty Internal rules/ policies Other

OECD
BETTER POLICIES FOR BETTER LIVES
Fig. 3.3 Who approves the MTEF? (Q28)

- MoF: 2
- Cabinet: 15
- Legislature: 10
- Other: 2

Medium-term Expenditure Framework
Is CBA required to approve capital projects in line ministries?

- Yes for all projects
- Yes for projects above a certain threshold
- Yes on ad hoc basis or other
- No

[Bar chart showing the distribution of responses for PPP and TIP]
Budgetary settlement

Resolution of disputes between ministries in the budget formulation process

- Resolved by the cabinet
- Resolved by the finance minister
- Resolved by the President or the Prime Minister
- Other
- The issue is sent to a ministerial committee

Comparison between 2007 and 2012.
Performance Budgeting Index
draft Principles of Good Budgetary Governance

- Fiscal objectives
- Top-down budgeting
- Medium-term clarity
- Strategic plans & priorities
- Transparency, openness & accessibility
- Participation, Inclusiveness & Realism
- Performance, evaluation & VFM
- Fiscal Risks & Sustainability
- Quality, Integrity & Independence
- True, full & fair budget accounting