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**PUBLIC GOVERNANCE DIRECTORATE
COMMITTEE OF SENIOR BUDGET OFFICIALS****Medium-term and top-down budgeting in OECD countries**

This paper, based on preliminary results of the 2023 OECD SBO Survey on Budget Frameworks, takes stock of OECD countries' practices in top-down and medium-term budgeting. It shows that OECD countries' fiscal frameworks can be characterised by strong reliance on multiple fiscal rules or objectives for enforcing fiscal discipline, with medium-term and top-down budgeting not used yet to their full potential in many countries. Drawing on the OECD Spending Better Framework, this paper advises that countries that wish to strengthen their fiscal frameworks reinforce the processes and institutions that underpin effective medium-term and top-down budgeting systems. Central to this is producing and publishing more regularly baseline projections of government expenditures on a more regular basis and setting credible multi-year expenditure ceilings that serve as stringent guidelines for budget planning, while also allowing for some degree of flexibility under clearly defined conditions.

Delegates to the Committee of Senior Budget Officials are invited to approve this report for publication. Please provide any comments by 27 November 2023. If no objections have been received by that date, the report will be considered approved.

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The statistical data for Israel are supplied by and under the responsibility of the relevant Israeli authorities. The use of such data by the OECD is without prejudice to the status of the Golan Heights, East Jerusalem and Israeli settlements in the West Bank under the terms of international law.

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¹ Responses are from Australia, Austria, Belgium, Canada, Chile, Colombia, Costa Rica, Czechia, Denmark, Estonia, Finland, France, Germany, Greece, Hungary, Iceland, Ireland, Israel, Italy, Japan, Korea, Latvia, Luxembourg, the Netherlands, New Zealand, Norway, Poland, Portugal, the Slovak Republic, Slovenia, Spain, Sweden, Switzerland, Türkiye, the United Kingdom and the United States. Data for Lithuania and Mexico are not available.

1 Introduction

1.1. What are Top-Down and Medium-Term Budgeting

In the wake of the COVID-19 pandemic, Russia's war of aggression against Ukraine and the related energy crisis, most OECD countries are grappling with elevated debt levels and high deficits. This is coupled with short to long-term spending pressures from factors such as ageing and the climate transition (OECD, 2023^[1]). The requirement of both putting public finances back on a sustainable path while spending more in new and vital areas calls for budget frameworks that not only support fiscal consolidation but also “ensure that resources are allocated where they are most valued and away from areas where they are less valued” as encapsulated in the OECD Spending Better Framework (OECD, forthcoming^[2]).

The OECD Spending Better Framework is organized around ten principles defining core entities, functions, processes, and procedures for quality budget institutions. The first four principles of the OECD Spending Better Framework refer to the setting of fiscal objectives, production of medium-term fiscal forecasts based on objective economic assumptions, preparation of multi-year expenditure baselines (referred to as “baselines” hereinafter) and adoption of top-down expenditure ceilings (referred to as “expenditure ceilings” hereinafter) (Figure 1).

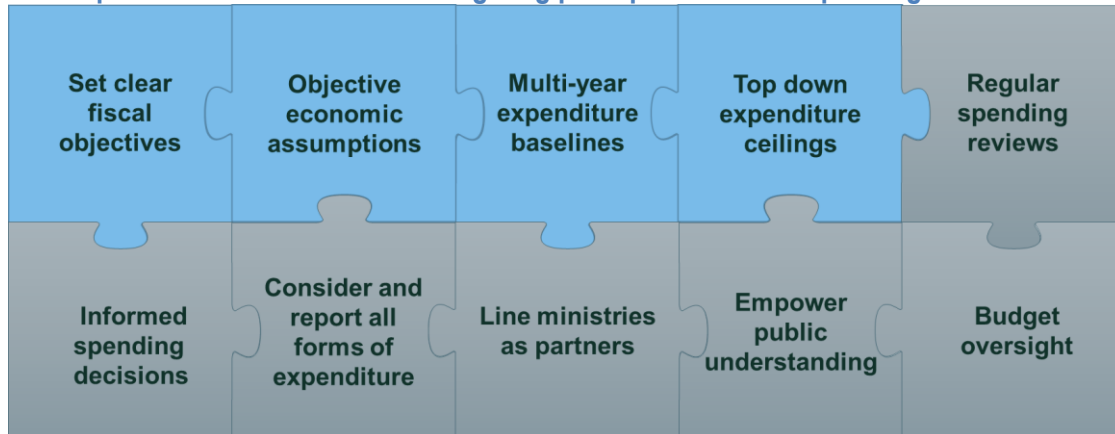
These four principles relate to the concept of medium-term and top-down and budgeting, defined as the actions of:

- Budgeting for multiple years (usually 3-5 years), as opposed to focusing solely on the upcoming fiscal year.
- Defining spending limits based on the economic forecast, estimates of future spending on current policies (the baselines) and the government's fiscal objectives.

The benefits of medium-term and top-down budgeting are well known. Medium-term budgeting is designed to bring a longer-term perspective to the budget process, both helping policymakers to consider the future fiscal implications of immediate policy decisions and providing greater predictability on future availability and allocation of resources. The top-down approach is aimed at maintaining fiscal discipline and ensuring that budgeting is aligned with the government's fiscal strategy and policy priorities. Both of these budgeting approaches are therefore advocated in the OECD *Recommendation of the Council on Budgetary Governance* (OECD, 2015^[3]).

Medium-term and top-down budgeting are different concepts, but they should be implemented concurrently. This is because the setting of expenditure ceilings is a budget decision that can be done only when fiscal constraints from fiscal objectives and economic forecasts, as well as bottom-up pressures evidenced by multi-year baselines at the most granular level, are identified and analysed. In other words, the role of expenditure ceilings is not to put arbitrary and unmanageable constraints on budget preparation, but rather to ensure that no overspending takes place once all constraints have been identified and acted upon, including through tax policy.

Figure 1. Top-down and medium-term budgeting principles in OECD Spending Better Framework



Note: Principles relating to top-down and medium-term budgeting are highlighted in blue.

Source: OECD Spending Better Framework, 2022

1.2. The paradox with top-down and medium-term budgeting

Top-down and medium-term budgeting are well-established concepts. They are, in fact, among the most popular feature of budget systems in OECD countries. Medium-term expenditure frameworks (MTEFs) are the typical outcome of top-down and medium-term budgeting processes. They were used by just a half of OECD countries in 2007, but by almost all of them before the pandemic. This is the result of a decade of budget reforms in the wake of the global financial crisis (Figure 2). Accordingly, OECD countries are considered as both pioneers and leaders in in this area. A 2012 World Bank study identified for instance OECD countries as the group for which MTEFs have had most perceptible effects on improving fiscal outcomes, in particular for those countries that use the most advanced form of MTEFs (World Bank, 2012^[4]).²

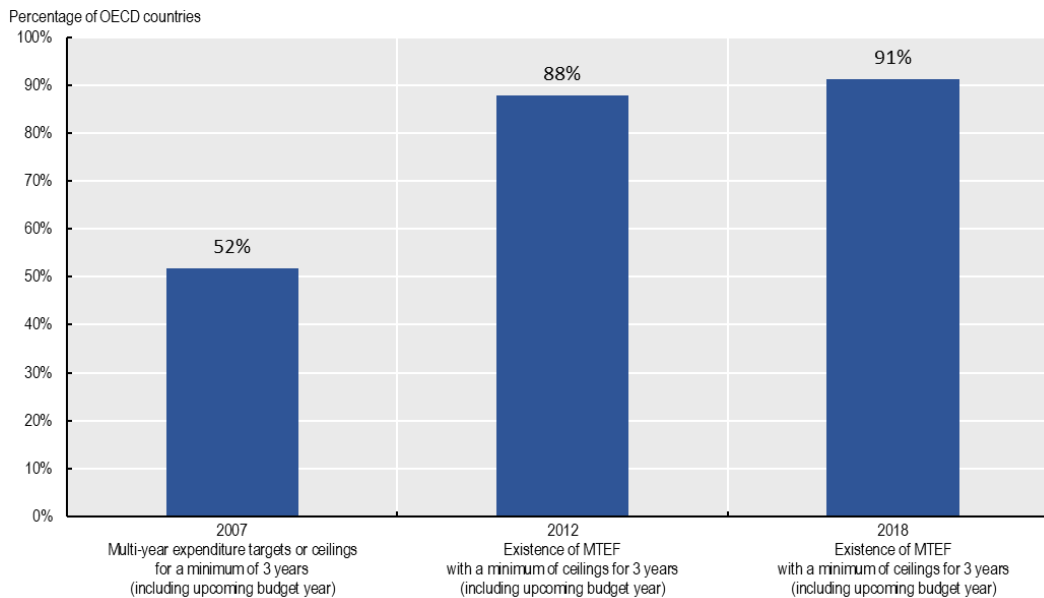
This raises the question: is there anything left to say on top-down and medium-term budgeting concerning OECD countries? The fundamental paradox with these approaches to budgeting, which is that their popularity also comes with substantial criticism of their effectiveness, suggests so. Indeed, recent OECD budget reviews, reports by OECD countries' budget oversight bodies and academic studies mention persisting challenges in designing and implementing effective top-down and medium-term budgeting processes, evidenced by recurring and sometimes significant divergences between stated fiscal objectives, expenditure ceilings and actual spending. For instance, a recent audit offices' report mentioned difficulties in determining whether medium-term budgets in seven European Union countries were "directing the level of expenditure or reacting to it" (Contact Committee Fiscal Policy Audit Network, 2022^[5]).

Preliminary results of the 2023 OECD SBO Survey on Budget Frameworks (referred to as "the 2023 SBO survey" hereinafter) reinforce this perception. To the question "is the most recent approved budget consistent with the multi-annual top-down expenditure ceilings set in the previous year?" only 8 countries, or less than a quarter of respondents, answered positively (Figure 5). Therefore, as summed up by Allen Schick already more than a decade ago, top-down and medium-term budgeting seem to remain "at once

² The World Bank identifies three types of medium-term expenditures frameworks, or MTEFs, by stage of development. These stages, from the least to most advanced stage, are as follows: (1) the medium-term fiscal frameworks or MTEFs, which reconcile fiscal policy objectives with aggregate expenditure and revenue estimates; (2) medium-term budget frameworks, or MTBFs, that further detail expenditure estimates, usually at same granularity than the annual budget; and (3) medium-term programme frameworks, or MTEFs, which present expenditures forecasts by programmes linked to medium-term outputs and outcome targets.

among the most popular contemporary [budgetary] innovations and among the most misapplied" (Schick, 2009^[6]).

Figure 2. Use of medium-term expenditure frameworks (MTEF) in OECD countries, 2007-2018



Source: OECD (2007), OECD Budget Practices and Procedures Survey, results for 29 countries; OECD (2012), OECD Budget Practices and Procedures Survey, results for 33 countries; OECD (2018), OECD Budget Practices and Procedures Survey, results for 34 countries.

Further, the debate over what constitutes “good” medium-term and top-down budgeting is somehow unsettled. On the one hand, considerable academic literature has analysed possible features for MTEFs - their legal basis, their duration, their binding or indicative nature, the granularity of expenditure ceilings, etc. - without identifying any clear link between a given approach and improved outcomes on enforcing fiscal discipline and improving allocative efficiency. On the other hand, the context in which MTEFs are implemented has been recognized as deeply affecting their effectiveness. For instance, a recent study identified political and administrative cultures as primary factors in using successfully or unsuccessfully MTEFs (Raudla, Douglas and MacCarthaigh, 2022^[7]).

While underscoring the significance of political and administrative cultures is essential for the success of MTEFs, doing so can also inadvertently instil a sense of powerlessness in budget offices. Over time, this may erode the credibility of top-down and medium-term budgeting approaches. To mitigate this risk, it is advisable that research also focus on how to proceed for establishing the requisite functions, processes, and procedures to support top-down and medium-term budgeting. Although these measures may not directly confront the political and administrative behaviours that have hindered past implementations, they serve as safeguards that can gradually foster behavioural change.

Against this background, this discussion paper uses the preliminary results of the 2023 SBO survey to present key findings on OECD countries’ practices in each of the four principles of the OECD Spending Better Framework most directly associated with top-down and medium-term budgeting and focuses on functions, processes, and procedures. It is structured as follows: section 2 discusses findings of the 2023 SBO survey on use of fiscal objectives and approaches to avoiding bias in economic assumptions, which are both serving as the foundation for top-down and medium-term budgeting. Section 3 and 4 discuss respectively the use of baselines and practices with expenditure ceilings. Section 5 concludes this paper with policy recommendations for strengthening top-down and medium-term budgeting approaches.

2 Fiscal objectives and economic assumptions

2.1. What are fiscal rules and fiscal objectives

Countries need to operate their public finances according to a clear strategy that the government is committed to, embodied in fiscal rules or fiscal objectives. In the 2023 SBO Survey, fiscal rules are defined as numerical parameters set in legislation to put a long-lasting constraint on budgetary aggregates. Fiscal objectives differ from fiscal rules only in that they are not legally binding but mandated through political decision (e.g., in a government statement to parliament). Academic studies emphasize that while a robust legal foundation enhances the durability and credibility of fiscal rules, the key determinant of a fiscal strategy's success lies in its effective implementation rather than its legal underpinning (Davoodi et al., 2022^[8]).

Fiscal rules and objectives can have different purposes and target different budget aggregates. The purpose of a fiscal rule or objective may be to provide either a long-term anchor for public finances or shorter-term budget targets, with the latter aimed at operationalizing the former. Budget aggregates that are targeted are traditionally the budget balance (or deficit/surplus), debt, expenditures or revenues. Although appropriate fiscal rules or objectives for a given country need to be appreciated on a case-by-case basis, recent research has highlighted that a prudent long-term debt anchor serving as a reference point for defining numerical budget balance or expenditure rules or objectives to be complied with in the annual budget process suit most countries well (Fall et al., 2015^[9]).

2.2. 2023 SBO Survey's findings

2.2.1. Types of fiscal rules

Consistent with trends observable prior to the pandemic (OECD, 2019^[10]), the 2023 SBO Survey shows that all 36 respondents set fiscal rules or fiscal objectives. Specifically, the majority of respondents (22 countries) operate with both fiscal rules and fiscal objectives; a large group of respondents (10 countries) use only fiscal rules set in Constitution or legislation; and a smaller group of respondents (4 countries) use only fiscal objectives set in a strategic policy document or political statement. Within the group of countries that use Constitutional and legislated fiscal rules, a significant group (9 countries) set additional fiscal goals in regulations or other such documents.

In countries that have politically mandated fiscal objectives, there may be a legal obligation for the government to establish its fiscal goals. For instance, in Korea, the government is required under the National Finance Act to set out their fiscal goal in the National Fiscal Management Plan submitted to the National Assembly. The extent to which these politically mandated targets align with the formal definition of a long-lasting constraint on budget aggregates requires retrospective evaluation, including an

assessment of whether these targets have been adjusted by the government in response to changes in the fiscal outlook.

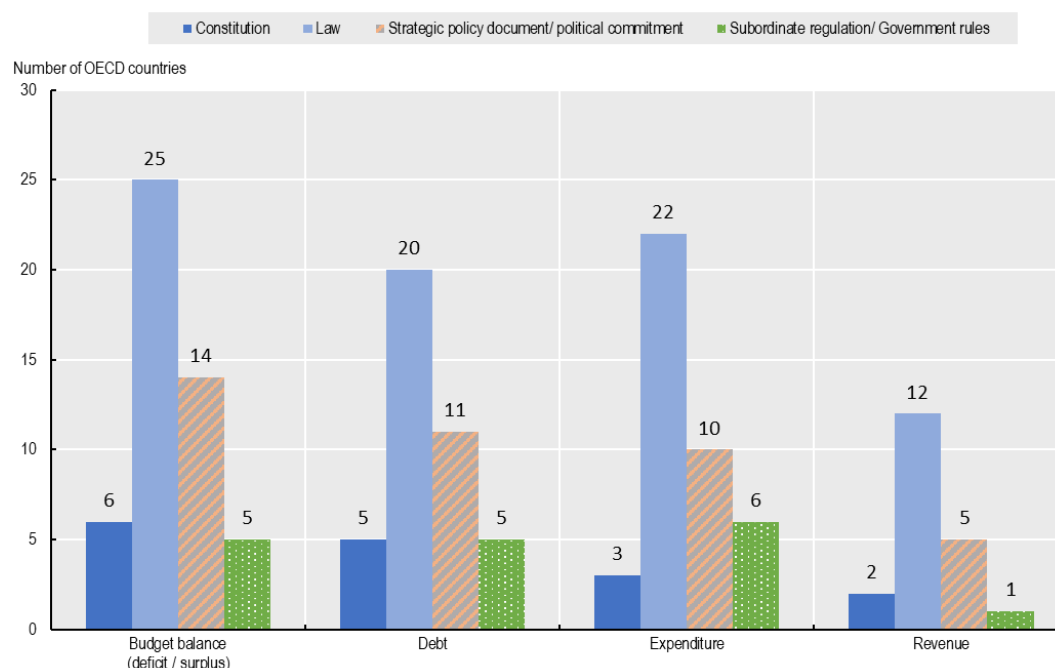
Additionally, it's worth noting that fiscal goals are not always expressed through precise numerical benchmarks. For instance, Australia's federal fiscal strategy outlines objectives such as stabilising and subsequently decreasing both gross and net debt relative to the size of the economy, as well as managing the rate of expenditure growth.

Also consistent with prior-pandemic trends, the 2023 SBO survey's preliminary results show that most OECD countries use multiple fiscal rules and objectives – that is, on average, more than 6 fiscal rules or objectives. For instance, countries with a budget balance objective may set both nominal and structural numerical targets (18 countries) and there might be separate expenditure rules constraining different spending areas (16 countries). Reasons for this include legacy effects (as economic and fiscal conditions change, new rules may be added to address emerging concerns without necessarily removing existing ones) and the choice by several countries to rely primarily on a rules-based approach to constrain spending decisions. For European Union member states, the complexity is further compounded by the coexistence of national fiscal rules and those mandated by EU Treaties.

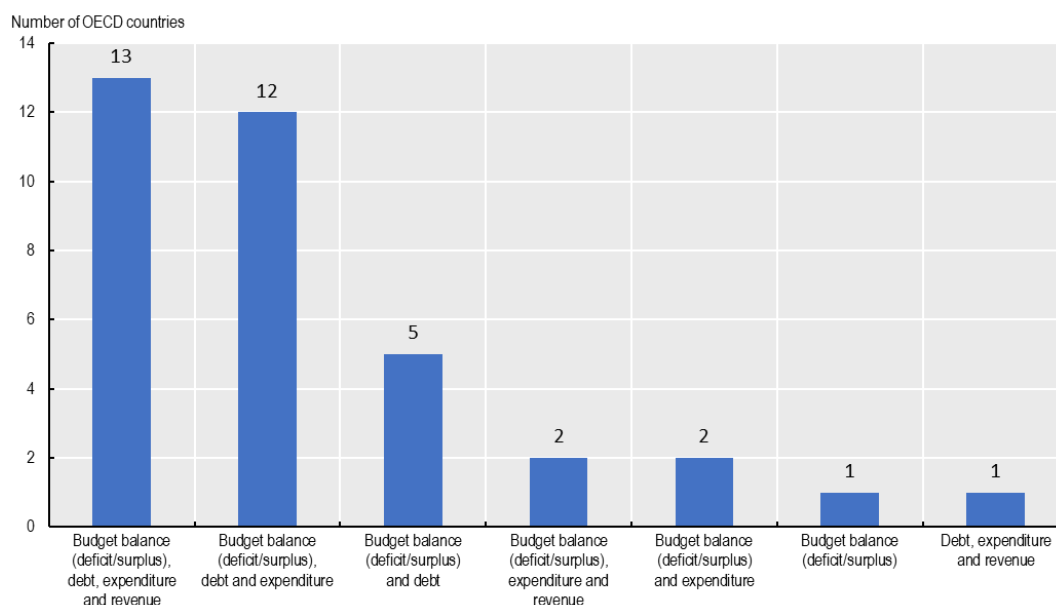
If fiscal rules and objectives are analysed individually, budget balance rules are the type of rule that is most used across OECD countries, followed by expenditure rules (panel a). However, a more insightful examination is to look at what type of combination are most used (panel b): more than a third of respondents use a debt rule operationalized by budget balance, expenditure and revenue rules and another third of respondents use a combination of debt, budget balance and expenditure rules. Other combinations are less prevalent, and it is noteworthy that New Zealand is the only country that uses a net worth-based fiscal objective, although the United Kingdom also made a commitment to monitor its public sector net worth, in addition to its three main fiscal objectives.

Figure 3. Fiscal rules and fiscal objectives used in OECD countries, 2023

a) Legal basis for fiscal rules and fiscal objectives



b) Combination of fiscal rules and fiscal objectives



Note: in the 2023 SBO Survey, fiscal rules are defined as numerical parameters set by the government to permanently or quasi-permanently constrain budgetary aggregates, usually based in legislation. Fiscal objectives differ from fiscal rules only in that they are not legally binding but mandated through political decision (e.g., a government statement to parliament, or a coalition or other political agreement). Other fiscal rules and objectives are not shown in the figures but include (i) the preservation of budget frameworks in case of negative changes in the original revenue and expenditure forecasts, if the budget is approved significant time before the beginning of the budget year (law), (ii) the specification of the public sector net worth (law) and (iii) specific rules for the Government Pension Fund (strategic policy document/political commitment). Data for Lithuania and Mexico are not available.

Source: 2023 OECD SBO Survey on Budget Frameworks, preliminary results for 36 countries, Q3.

2.2.2. Enforcement and flexibility mechanisms

Concerning enforcement of fiscal rules and objectives, a small group of 7 countries do not have any mechanism in place. However, within this group of countries, 4 countries indicated that governments have a proven record of strong political commitment and implementation of corrective measures. Other countries use systems of automatic correction (12 countries), require that the government provide reasons for deviations (12 countries) and/or propose corrective actions to the legislature (12 countries).³ Only 6 countries use a system of automatic sanction.

Concerning flexibility, most respondents to the 2023 SBO Survey that have quasi-permanent fiscal rules grounded in Constitutions or primary legislation have also embedded escape clauses in the legal framework (17 countries). Escape clauses also exist in some countries where fiscal objectives are politically mandated (e.g., Finland, United Kingdom and the United States). In addition, flexibility may be embedded in the fiscal rules themselves. For instance, around two-third of respondents use a cyclically adjusted budget balance objective that account for the economic cycle (24 countries).⁴

³ Within countries that use systems of automatic correction, it is especially notable that Poland and the Slovak Republic have a system of progressive “preventive triggers” for fiscal adjustment when debt level rises close to its ceiling.

⁴ A country can deviate from an anchor numerical objective in case of a crisis but is expected to return to the anchor level over the medium-term.

2.2.3. Fiscal rules and objectives after the COVID-19 pandemic

When public spending soared in OECD countries during the COVID-19 pandemic, most countries made use of the escape clauses embedded in their framework (23 countries). Where such escape clauses did not exist (or did not apply to all fiscal rules), governments resorted to ad hoc suspensions of their fiscal objectives (9 countries). For most OECD countries, in the wake of the pandemic, fiscal rules and objectives need to be credibly reinstated.

In restoring fiscal policy frameworks, nearly half of respondents (17 countries) have chosen to modify their pre-pandemic fiscal rules or objectives, while the other half (19 countries) have so far stayed the course with them. However, within the second group, reforms could be implemented within the short to medium term. A point in case is the European Commission's proposal, at the end of October 2022, to reform the European Union's Stability and Growth Pact, which would change supra-national fiscal rules for some OECD countries and could trigger changes to national rules too.⁵

The depth of and rationale for fiscal frameworks' revisions, actual or planned, vary across countries:

- In some countries, numerical targets set for certain fiscal rules or objectives have been recalibrated to account for a new macroeconomic and fiscal situation. For instance, in Denmark, a legislative change has allowed a structural deficit of maximum 1% of GDP, up from the previous ceiling of 0.5% of GDP.
- In other countries, more substantial revisions to fiscal policy frameworks are undertaken or considered. For instance, in Korea, the government renewed its proposal to embed fiscal rules in legislation along with flexibility measures.
- Finally, challenges with the use of multiple fiscal rules or objectives, which include a lack of clarity vis a vis citizens that feed into the wider issue of trust in governments (OECD, 2022^[11]), as well as difficulties in monitoring compliance and enforcing accountability (Davoodi et al., 2022^[8]), are also being considered in revising fiscal frameworks. This was the case for instance during discussions on potential reforms to the European Union's Stability and Growth Pact.

2.3. What are economic assumptions

Economic assumptions (e.g., future GDP growth, inflation rates or demographic changes among other variables) are the foundational conditions for developing macroeconomic forecasts. In turn, these macroeconomic forecasts are the bedrock of fiscal forecasts, because the economy's cyclical position drives tax collection and expenditure developments. In the context of top-down and medium-term budgeting, getting economic assumptions right, including ensuring that they are unbiased, is therefore a prerequisite for producing realistic revenue forecast and expenditure baseline, and assessing accordingly future fiscal space or gap against fiscal objectives.

To cement the credibility of their medium-term macroeconomic and revenue forecasts, ministries of finance can use a range of approaches detailed in the OECD Spending Better Framework, which include transparency on key economic assumptions underpinning the forecasts, quantification of how fiscal outcomes might differ from baseline forecasts because of different macroeconomic assumptions and relying on independent fiscal institutions (IFIs), etc.

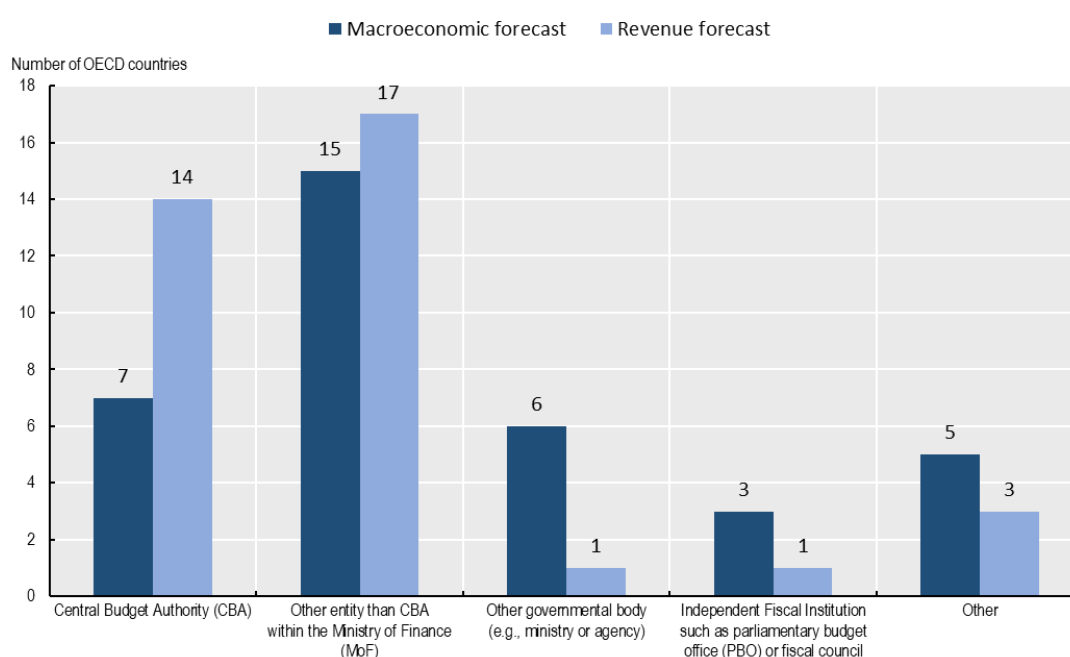
⁵ https://ec.europa.eu/commission/presscorner/detail/en/ip_22_6562

2.4. 2023 SBO Survey's findings

2.4.1. Ministries of finance's role

In a very large majority of OECD countries, macroeconomic forecasts are prepared by the ministry of finance (Figure 4). For cementing the credibility of the government forecasts, transparency is considered paramount in OECD countries: most respondents publish their forecast in the budget documentation, as well as disclose assumptions underpinning these forecasts and analyse related risks (Table 1). In addition, a large group of respondents rely also on ex post analysis of forecast accuracy and require that forecasters follow best professional standards. Other approaches, such as the requirement to take account of forecasts produced by other institutions, are however less used.

Figure 4. Entities responsible for developing forecasts, 2023



Note: Other includes independent research institutes, working parties with experts from different institutions and the central bank. Data for Lithuania and Mexico are not available.

Source: 2023 OECD SBO Survey on Budget Frameworks, preliminary results for 36 countries, Q6.

Table 1. Approaches to prevent forecasting bias, 2023

	Macroeconomic forecast	Revenue forecast
Forecasts are publicly disclosed in the budget documentation	33	34
Risks to the forecasts are discussed and/or quantified	32	22
Variables, components, and assumptions for the forecasts are disclosed in the budget documentation	27	23
Differences between successive versions of the forecasts are quantified and explained	25	25
Formal role for independent fiscal institution (IFI)	25	23
Requirement that forecasters commit formally to follow international/best professional standards	13	12
Institution producing the forecasts required to take account of forecasts produced by other institutions	10	8
Other	2	2

Note: Data for Lithuania and Mexico are not available.

Source: 2023 OECD SBO survey on Budget Frameworks, preliminary results for 36 countries, Q7.

2.4.2. The role of IFIs

Independent input into the forecasting process can help bolster its credibility. Independent fiscal institutions (IFIs) across OECD countries are often involved in the forecasting process in some way for this purpose⁶ For macroeconomic forecasts, the most frequent mandates are i) endorsing the government forecasts (11 countries out of 29 countries with IFIs) or assessing its reasonableness (16 countries); ii) publishing an ex-post evaluation of its accuracy (15 countries); or publish an alternative forecast (9 countries). In a small number of cases, the IFI is mandated to prepare the macroeconomic or revenue forecast itself (3 countries and 1 country respectively) (OECD, 2021^[12]). The small number of OECD countries that do not have IFIs may rely on country-specific approaches for solidifying the credibility of their forecasts. For example, in New Zealand, each economic and fiscal update is accompanied by statements of responsibility signed by the Minister of Finance and the Secretary to the Treasury.⁷

⁶ Other core function and mandates, which are not discussed in this paper, may include monitoring compliance with fiscal rules, policy costing, long-term fiscal sustainability analysis, and supporting the legislature in budget analysis.

⁷ This statement attests that all policy decisions or circumstances with material economic and fiscal implications known to the government have been communicated to the Treasury and included in the forecasts, and that the Treasury has used its best professional judgment in their preparation.

3 Baselines

3.1. What are baselines

The concept of baselines refer to an estimate of future expenditures over a multi-annual period, assuming that the government's policies and programmes will remain unchanged. Baselines show therefore the multi-year financial implications of current policy decisions and act as a warning of potential future financial pressures. They are the building block of multi-year budgeting, in that any attempt to allocate resources beyond one year requires reliable estimates of how much existing policies and programmes will cost in the future to assess fiscal space or gaps against fiscal objectives and take appropriate actions.

The formulation of baselines requires that several prerequisites be met – e.g., a sound budget nomenclature, reliable accounting for establishing an accurate starting point, good capacities for policy costing, a clear definition of “no policy change”, etc. The latter, in particular, is of enormous operational importance.⁸

From that starting point, baselines can be prepared and updated in diverse ways, from a very aggregated one (and therefore relatively crude) to fairly detailed one, when baselines are an integral part of the budget and are prepared at budget article level. At a minimum, when they update their baselines, countries should ensure that they identify and lump together “items that may have common or similar expenditure drivers” (Rahim, Wendling and Pedastsaar, 2022^[13]).

In any case, as underlined in the OECD Spending Better Framework, baselines require both top-down and bottom-up inputs – that is a combination of methodological guidance and monitoring from the ministry of finance and costing by budget entities, as a preparatory step for their budget submission.

Finally, as noted also in the OECD Spending Better Framework, baselines are a powerful accountability tool in the budget process. Without a baseline, scrutiny of the budget often relies on comparing planned spending with previous budget figures or the budget outturn: this is often a misleading comparison, since circumstances necessarily change between two fiscal years. Baselines, on the contrary, quantify year-to-year variations of spending on a given policy or programme to maintain it at its current level and require explaining underlying factors for these changes. It therefore provides a neutral benchmark against which policy changes, reprioritisations, etc. can be more clearly identified and explained. Transparency over baselines provides therefore a powerful accountability mechanism.

⁸ “No policy change” can have different interpretations, including “current services” or “current legislation”. Current services means continuation of current service levels (including impacts of demographic changes and cost changes but excluding policy changes that may be decided in future years). “Current legislation” means continuation of services that are required by law, but not all other services (mostly investments). How “no policy change” is defined may be different between countries and has an impact on how baselines should be interpreted.

3.2. 2023 SBO Survey's findings

Preliminary answers to the 2023 SBO survey indicate that baseline budgeting is a common practice across all OECD countries. However, objectives, methodologies and transparency practices employed vary significantly. On one end of the spectrum, some countries have fully integrated baselines into their ongoing budgetary processes, updating them continuously. On the opposite end, there are countries where baselines are formulated independently of the budget process, serving as standalone forecasting exercises.

With regards to definition, answers to the 2023 SBO Survey highlight that only some OECD countries have a formal and public definition of baselines. For instance, in Australia, forward estimates, which are baselines in nature, are defined on the Department of Finance's website as "a system of rolling three-year financial estimates of (...) costs of ongoing government policy decisions, after allowing for estimated movements in economic parameters." The United States define baselines as "a projection of the budgetary resources, outlays, and receipts for mandatory programs and governmental receipts based generally on current law, and a projection of the CY levels of budgetary resources, outlays, and receipts into the outyears for discretionary programs."

Public disclosure of the methodology underpinning the preparation of baselines serves as a safeguard for quality by introducing transparency and accountability into the process, and also allowing for peer review and external validation. However, publication is not standard practice. The United States are an exception in publishing a public and detailed methodology for the development of baselines.⁹ Other countries do not publish any such guidance, or do it, often very briefly, as part of the budget circular. This is the case for instance for France.

With regard to updating baselines, the prevailing approach among OECD countries is an annual update, a practice followed by 25 countries. In other cases, updates may occur at least two times a year, timed to precede major budgetary events. For instance, in Australia, updates are done ahead of the main budget event and mid-year economic and fiscal update. Within this group of countries, a number of respondents note that additional updates may be done that are intended solely for internal use (e.g., Australia and Sweden). In the United States, it is notable that the baseline is updated for the effects of any legislation enacted or administrative actions taken since the President's Budget request was released and any new legislation is scored using the assumptions that underlie the baseline submitted with this request.

Typically, these updates are collaboratively carried out by the Ministry of Finance and line ministries (25 countries). In approximately half of these countries, the Ministry of Finance assumes the leading role, while in the remaining countries, the initiative lies with the line ministries. This shared responsibility may be exercised in different ways. For instance, in Australia, baselines are prepared by line ministries, with economic parameters provided by the ministry of finance. In France, baselines are calculated separately by the Ministry of Finance and by line ministries, then agreed as part of the budget negotiations that take place before the determination of expenditure ceilings. In Sweden, baselines updates are managed by line ministries. However, baselines are divided into those that are affected by macroeconomic developments and those that are not. categorization of appropriations into these two groups is predetermined through an agreement between the Ministry of Finance and the respective line ministries. However, for a small group of respondents, responsibility for the baseline update lies only with the budget office (5 countries), without any bottom-up inputs. For instance, in Costa Rica, the baseline update is a responsibility of specific team that also prepares the government's multi-annual fiscal framework.

Practices with disclosure of baselines are very variable. In some cases, baselines are prepared at the same level of detail as the budget, allowing each year's budget to contain a reconciliation between its own figures and the first outer year in the previous year's forward estimates. This has been the case for instance

⁹ <https://www.whitehouse.gov/wp-content/uploads/2018/06/s80.pdf>

for decades in Australia and has been adopted more recently in France, as part of a package of reforms aimed strengthening budget processes and transparency.

Further, some countries provide detailed explanations on changes to baselines. For instance, in the case of Canada, the budget documentation includes information on variations since the previous baseline forecast, differentiating between impacts of economic and fiscal developments, actions with existing policies and inclusion of new measures.

However, the 2023 SBO Survey's results also show room for improvement. In particular, baselines do not seem to be always disclosed in the national budget documentation. For instance, in the case of European Union member states, some countries indicated that baselines information was provided in their stability programme transmitted annually to the European Commission, which includes a "no policy change" fiscal forecast. Also, baselines are sometimes disclosed only as an aggregate forecast for all government spending (i.e., a single figure), hence limiting their usefulness for both medium-term budgeting and accountability mechanisms.

4 Expenditure ceilings

4.1. What are expenditure ceilings

Expenditures ceilings are a restriction on spending level(s) established in advance of the preparation of the budget. The setting of expenditure ceilings is a top-down process, in that it is an early announcement by the government to budgetary entities on the authorized level of expenditure to ensure consistency with the country's fiscal targets. In the context of medium-term budgeting, expenditure ceilings can be set on a multi-annual basis and therefore apply to successive budgets, which supports fiscal responsibility and predictability for budgetary entities.

To operate a system of multi-year expenditure ceilings, one of the most important decisions to make is in what manner, and how far in advance, the ceilings will be set. There are three inter-linked decisions to be made in that respect, which are:

- whether expenditure ceilings should be binding (i.e., they cannot be modified) or indicative.
- whether the ceilings should be revised on a rolling basis (i.e., ceilings are annually updated by adding an outer year) or fixed.
- which period the expenditure ceilings should cover (usually between 3 to 5 years).

In using multi-annual expenditure ceilings, in particular in the case when these ceilings are binding, governments aim in essence to separate decisions on expenditure levels from variations in macroeconomic and fiscal forecast. In other words, once an expenditure ceiling has been set based on realistic macroeconomic and revenue forecasts, actual macroeconomic developments and realisation of fiscal risks should not affect, or affect only in a limited way, the next year's ceiling. To achieve this, governments traditionally include precautionary "margins" or reserves within their expenditure ceilings.

Whether expenditure ceilings should be set at aggregate level or at ministry or programme level is another key decision to make for countries. While the aggregate ceiling operationalizes the government's high-level fiscal objective(s) and is a collective responsibility of the government, sectoral-level ceilings provide individual ministers with a precise indication of how they are expected to contribute to the collective effort—i.e., in the latter scenario, the right level for the ceilings is that someone can be made responsible for enforcing it. Although some budget specialists consider that the two types of ceilings complement each other, others underline that "it is impossible to maximise line ministry budget certainty while at the same time maximising the control of aggregate expenditure" (Robinson, 2022^[14]).

4.2. 2023 SBO Survey's findings

A first notable finding from the 2023 SBO survey shows is that a significant group of 12 OECD countries does not use multi-annual expenditure ceilings as part of their budget systems:

- 1 country (Italy) indicates that although legislation authorises the use of expenditure ceilings, these have not been used yet in practice.

- 2 countries (Australia and Belgium) indicate that they publish multi-annual expenditure forecasts that are not ceilings in nature.
- 1 country (New Zealand) uses multi-annual indicative allowances rather than expenditure ceilings *per se*. These allowances are in nature a management tool to ensure fiscal targets are achieved. Therefore, external publication focusses on fiscal targets rather than multi-annual allowances.
- 8 countries (Chile, Costa Rica, Japan, Korea, Luxembourg, Norway, Spain and United States) use expenditure ceilings for a single budget, which means that their system of budgeting is top-down in nature but the top-down upper limit on the level of government expenditure is determined for only one-year.¹⁰

The 2023 SBO survey's answers highlights that what constitutes a multi-annual expenditure ceiling may be subject to interpretation. Through either a multi-annual ceiling, indicative allowance or forecast, a government makes an early announcement on the future levels of expenditure. What best differentiates these three approaches is maybe the nature of the commitment made by the government. In the case of a simple forecast, it can be argued that there is no commitment at all. With allowances, a government may aim mainly at providing a level of transparency and predictability on future resources allocations. In the case of a ceiling, the government makes an explicit commitment not to exceed a certain level of expenditure. The greater credibility and certainty provided in theory by an expenditure ceiling however depends on how there are implemented. It could be argued indeed that the difference between a ceiling, in particular if it is indicative, and an allowance may be blurred. New Zealand is a point in case: it does not use expenditure ceilings but sets allowances for a four-year period on a rolling basis and these allowances, which are divided into "operating" and "capital," are generally adhered to.

4.2.1. Types of expenditure ceilings

Within the group of 24 OECD countries that use expenditure ceilings on a multi-annual basis (Table 2), a variety of practices can be observed:

- A majority of respondents (13 countries) set expenditure ceilings over a 4-year period; while 8 countries use a three-year period, and 3 countries use a five-year period.
- A large majority of respondents (19 countries) use rolling ceilings, meaning that a ceiling for the next outer year is added annually, and 5 countries use fixed ceilings, which are revised only after the full time-period covered by the medium-term framework is completed.
- Respondents are evenly split between the use of binding and indicative ceilings. A quarter of respondents (9 countries) use binding ceilings over the full time period of their medium-term framework and a smaller group (3 countries) use binding ceilings only for a 2-years period. Other respondents (12 countries) rely on indicative ceilings.

4.2.2. Granularity of expenditure ceilings

Concerning the granularity of multi-annual expenditure ceilings (Table 3), about half of all countries (12 countries out of 23 countries) use organisational ceilings for the full time-period of their medium-term framework. In addition, sub-ceilings for selected expenditure areas are sometimes used, in a majority of cases for wages (15 countries) and operating expenditures (10 countries). Their role is to either put a limit on certain types of expenditures or alternatively to ringfence them. In the latter case, the emphasis is on achieving allocative efficiency by setting a spending target. For instance, New Zealand had used such budget envelopes recently for COVID recovery and climate response policies. The United Kingdom also uses ceilings called "ringfences" for certain programmes and policies. Only 2 countries set ceilings only at aggregate level over the whole time-period covered by the expenditure ceilings. Another country (sets its

¹⁰ A top-down expenditure ceiling can be defined for one year along with the production of a medium-term forecast.

ceilings at quasi-aggregate level – that is for main sectors of general government (central, regional and municipalities) and by broad types of expenditures (operating and transfers).

Table 2. Types of multi-annual expenditure ceilings, 2023

Country	Time period	Rolling	Fixed	Binding	Indicative
Austria	4-years	X		T1+3	
Canada	5-years	X			T1+4
Colombia	4-years	X			T1+3
Czechia	3-years	X		T1+2	
Denmark	4-years	X		T1+3	
Estonia	4-years	X		T1	T1+3
Finland	4-years		X	T1+3	
France	3-years	X		T1	T1+2
Germany	4-years	X		T1+3	
Greece	4-years	X		T1+1	T1+3
Hungary	3-years	X			T1+2
Iceland	5-years	X		T1+4	
Ireland	3-years	X		T1	T1+2
Israel	4-years	X		T1	T1+3
Latvia	3-years	X		T1+2	
Netherlands	4-years		X	T1+3	
Poland	3-years	X		T1	T1+2
Portugal	4-years	X		T1	T1+3
Slovak Republic	4-years		X	T1	T1+3
Slovenia	4-years		X	T1+1	T1+3
Sweden	3-years	X		T1+2	
Switzerland	4-years	X		T1	T1+3
Türkiye	3-years	X		T1	T1+2
United Kingdom	5-years		X	T1+1	T1+4

Note: T1 is the upcoming budget year. Only countries that use expenditure ceilings beyond T1 + 1 are shown in this table. Table shows up to which year either binding or indicative ceilings are used. (a) France did not have a multi-year programmatic law at the time of this survey. The most recent law used fixed ceilings over a five-year time period. Data for Lithuania and Mexico are not available.

Source: 2023 OECD SBO Survey on Budget Frameworks, preliminary results for 36 countries, Q16 and 19.

Table 3. Granularity of multi-annual expenditure ceilings, 2023

Country	Time period	Total expenditure level	Organizational level	Program level	Other
Austria	4-years	T1	T1 + 3		
Canada	5-years			T1+4	
Colombia	4-years				T1+3 (a)
Czechia	3-years	T1 + 2	T1 + 2	T1 + 2	
Denmark	4-years				T1 + 3 (b)
Estonia	4-years		T1 + 3		T1 + 3 (c)
Finland	4-years	T1 + 3			
France	3-years	T1 + 2	T1 + 2	T1 + 2	
Germany	4-years	T1 + 3	T1 + 3		T1 + 3 (d)
Greece	4-years		T1 + 3		
Hungary	3-years		T1 + 2		
Iceland	5-years	T1	T1	T1+4 (e)	
Ireland	3-years	T1+2	T1+2	T1	
Israel	4-years	T1 + 3	T1 + 3	T1	
Latvia	3-years	T1 + 2		T1	
Netherlands	4-years	T1 + 3	T1 + 3		
Poland	3-years	T1 + 2	T1 + 2	T1 + 2	
Slovak Republic	4-years	T1 + 3	T1 + 2		
Slovenia	4-years	T1+2	T1+1	T1+3	T1+1 (f)
Sweden	3-years	T1 + 2			(g)
Switzerland	4-years	T1+3			
Türkiye	3-years	T1 + 2	T1 + 2		
United Kingdom	5-years	T1 + 4	T1 + 1	(h)	

Note: T1 is the upcoming budget year. Only countries that use expenditure ceilings beyond T1 + 1 are shown in this table. Table shows up to which year a level of granularity is used. (a) Other for Colombia: Ceilings by sector (e.g., education, health, defence), (b) Other for Denmark: Ceilings by sector (state, municipality, regions) and type (expenditure, transfers), (c) Other for Estonia: Top-down expenditure ceilings are set on ministerial level (on current expenditure and investments) and on performance area level (on current expenditure). Ministerial level expenditure ceilings include one or several performance areas, (d) Other for Germany: Additional restrictions for line ministries in top down-decision are possible, (e) Programme level for Iceland: The ceilings are set out for 35 expenditure areas. The ceilings are divided into appropriations by expenditure and economic functions and shown for each line ministry. Those appropriations are then divided further by each minister into agencies and projects, (f) Other for Slovenia: Ceilings by group of budget items, (g) Other for Sweden: The framework includes an aggregate expenditure ceiling, combined with frames for the 27 expenditure areas that make up the budget., (h) Programme level for the United Kingdom: Not set except in limited circumstances, for example the 2020 Spending Review provided multi-year funding to build 40 new hospitals. For Portugal, information on the granularity level of the multi-annual expenditure ceilings is not available. Data for Lithuania and Mexico are not available.

Source: 2023 OECD SBO Survey on Budget Frameworks, preliminary results for 36 countries, Q17.

4.2.3. Flexibility and credibility of expenditure ceilings

Only a small group of countries (4 countries) set their expenditure ceilings in real terms, under which deviations from the underlying fiscal forecasts due to inflation will not affect the spending envelope. All other countries (28 countries) use nominal expenditure ceilings, which, in “normal times,” allow for simpler implementation and monitoring. However, they become more difficult to set and comply with in a high inflation environment although they can play a counter-cyclical role. Accordingly, revisions of nominal ceilings for out-years are in most cases authorised – only 3 countries that use nominal ceilings do not authorise such revisions. These revisions are done once per year in 11 countries and as needed in response to changes to forecasts in 3 countries.

The benefits of expenditure ceilings may however be undermined by too frequent and/or ill-timed revisions. Therefore, in order to manage the competing demands of flexibility and credibility, OECD countries follow mainly two approaches:

- Firstly, expenditure ceilings may exclude cyclically sensitive spending. For instance, in Denmark, unemployment-related spending is excluded from the ceilings. In both cases, credibility and usefulness of the ceilings is unaffected as they still cover a significant share of public spending.
- Secondly, risks of large downward revisions to macroeconomic forecasts may be mitigated with the inclusion of a budget margin or reserve in the aggregate expenditure ceiling and/or the lower-level expenditure ceilings. The main challenge with using a budget margin or reserve is that it should be large enough to absorb potential additional spending needs or realization of some fiscal risks, but small enough to avoid constraining unduly much needed spending in key policy areas.

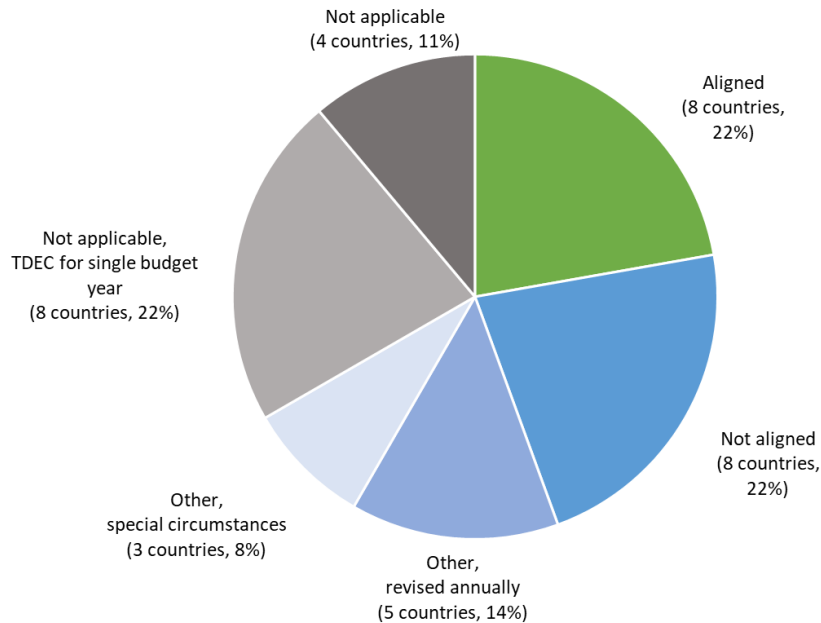
Because of the difficulties in calibrating the size of a budget reserve and risks to dilute fiscal discipline, some countries such as Germany or the Netherlands, do not use them. In other countries, reserves are set in a way that is limitative enough that it does not open the door to new spending requests from budgetary entities. In the case of Sweden, for instance, the government uses an official guideline for the minimum size of the budgeting margin, which is primarily aimed at providing a buffer for adverse changes in macroeconomic developments. The United Kingdom sets for instance a reserve for “genuinely unforeseen contingencies.” In the case of Denmark, only the subceiling for transfers includes a reserve (set at 1% of total transfers).

4.2.4. Effectiveness of expenditure ceilings

At the time of the 2023 SBO Survey, expenditure ceilings set in a given year are in a majority of cases not complied with beyond the budget prepared that same year and executed the next year. Indeed, as already noted above, to the question “is the most recent approved budget consistent with the multi-annual top-down expenditure ceilings set in the previous year?,” only less than a quarter of respondents (8 countries) answered positively (Figure 5). This means that, for other respondents (28 countries), previous year’s expenditure ceilings are not effectively constraining budgetary decision-making for the next year.

This suggests that budgetary decision-making processes, budget calendars, as well as forecasting techniques, including in relation to baselines are not always effective in supporting the top-down and multi-year budgeting system. Additional reasons are reported by respondents, including exceptional circumstances (3 countries) and the fact that ceilings (binding or indicative) are revised annually, meaning that the budget is aligned with the revised ceiling instead of the previous year’s one (5 countries). In the latter case, a fundamental objective of an expenditure ceiling system, which is to separate decisions on expenditure levels to the extent possible from variations in macroeconomic and fiscal forecast, therefore does not seem to be achieved.

Figure 5. Consistency between most recent approved budget and the previous year's expenditure ceiling, 2023



Note: TDEC stands for Top-Down Expenditure Ceilings. Countries have been classified under relevant categories by authors based on answers and narrative information provided in the survey. Data for Lithuania and Mexico are not available.

Source: 2023 OECD SBO Survey on Budget Frameworks, preliminary results for 36 countries, Q27.

Further, answers to the survey reveal that, within the group of 24 countries that use expenditure ceilings, only a smaller group of 19 countries formally scrutinise the deviations between their expenditure ceilings and actual spending, and only 12 countries within that group publish this information. This, coupled with the finding that only a limited group of country has recently complied with their expenditure ceilings, highlights that the “robust monitoring and enforcement mechanisms [to ensure] that actual spending is in line with the expenditure ceilings” advised in the OECD Spending Better Framework are not yet widespread practice.

In the same way that independent input into the forecasting process can serve to bolder its credibility, there is the suggestion that independent input could also serve to bolster the credibility of government spending plans. For this reason, the European Union may introduce an enhanced role for its member countries' IFIs, which would require them to provide an independent opinion on compliance with the net public expenditure path set out annually by EU countries in their “national medium-term fiscal-structural plan.” It is also notable that, in France, the mandate of the IFI was extended in 2021 to include the provision of an opinion on the consistency between the government's Public Finances Programmatic Law, which is a MTEF in nature, and planning laws enacted for sectors such as justice or defence.

5 Conclusions and policy recommendations

5.1. Conclusions

Budget systems in OECD countries have been put to the test during the COVID-19 pandemic: fiscal objectives and top-down and medium-term budgeting systems have been suspended in many countries to allow for the operation of automatic stabilisers and emergency spending (OECD, 2020_[15]). Accordingly, debt and deficit levels have soared. However, in contrast with the wave of PFM reforms post-global financial crisis and Eurozone debt crisis's wave of PFM reforms, the preliminary results of the 2023 SBO Survey signal that only a limited number of OECD countries have thus far taken the opportunity presented by the crisis to make significant changes to their fiscal frameworks.

Nonetheless, the paper's findings suggest that such changes might be needed as:

- Fiscal rules or objectives are used by all OECD countries, but sometimes lack credibility due to recent breaches or frequent changes. Their multiplicity can in some cases generate a complex and suboptimal web of constraints for budgetary management and can also impair clarity over the government's fiscal intentions.
- While nearly all OECD countries develop medium-term budgets, there is room for improvement in the forecasting processes underpinning them. According to the 2023 SBO Survey results, some countries lack clear definitions underpinning their baselines; updates are too infrequent; baselines are prepared at aggregated level, making them irrelevant for budgetary management; and there are noted limitations regarding transparency.
- A majority of OECD countries set multi-year expenditure ceilings with the objective to operationalise their fiscal strategy. In many cases, these ceilings are embedded in MTEFs which, despite being conceptually sound, are not effective in practice in constraining spending beyond one budget year.

Overall, this points to a possible risk of over-reliance for fiscal policy on a myriad of fiscal rules and objectives, as an antidote to weaknesses in top-down and medium-term budgeting practices. This would be problematic because fiscal objectives are stating an intention, but it is top-down and medium-term budgeting that ultimately make these intentions concrete.

Further, issues of effectiveness with top-down and medium-term budgeting appear to come down to two reasons:

- The first one is structural. Budgetary decision-making processes, budget calendars, as well as forecasting techniques, including in relation to baselines as noted above, are not always effective in supporting the top-down and multi-year budgeting system. Maybe more importantly, the various processes of the budget frameworks are not properly integrated. Expenditures ceilings may be decided even in the absence of reliable multi-year baselines; expenditure baselines may be

calculated aggregated level making them an irrelevant input for the budget formulation process, etc.

- The second one is conjunctural. Fiscal objectives and expenditure ceilings have been suspended in many instances during the COVID-19 crisis. As new crises unfold, decision-makers may be reluctant to reinstate immediately and fully systems and processes that constrain their capabilities to act and spend.

Finally, more generally, budget institutions as whole are experiencing increased pressures due to the conflicting requirements of lowering debt and spending more in crucial areas. Fundamentally, budgeting is about defining a set of rules and procedures for spending decisions and, accordingly, to prevent such spending decisions outside the boundaries of these rules and procedures. However, recent trends may make it more difficult for ministries of finance to enforce this core budget principle, which in turn weakens top-down and medium-term budgeting processes. These trends include i) growing reliance on non-standard policy instruments, such as loans, guarantees or special funds¹¹, which may not be included in multi-year spending estimates (Moretti, forthcoming^[16]) and ii) major policy decisions made outside of the budget process, for instance through sectoral planning law or framework laws, which are in some cases not clearly defined in budgetary terms.¹²

5.2. Policy recommendations

Against this background, strengthening medium-term and top-down budgeting will be critical for countries to navigate the fiscal challenges of the post-COVID environment. This is because:

- Extending the time-horizon of budgetary decision-making, and therefore committing resources over a multi-annual basis, is necessary to deliver policy agendas that have medium to long-term implications. Climate-related disasters, and public investment for the green and digital transition are some of these longer-term policy agendas that medium-term budgets can help to address (Radu, 2023^[17]).
- Defining spending limits based on the economic forecast, estimates of future spending on current policies (or baselines) and the government's fiscal objectives fosters effective expenditure prioritisation aligned with both the government fiscal strategy and policy priorities.

Concerning medium-term budgeting, countries should aim at strengthening processes and increasing transparency over baselines, as these constitute the building block for credible expenditure ceilings. They may consider in particular the following:

- **Publishing baselines and the methodologies underpinning them with appropriate level of detail**, so that baselines can play their full role in the determination of expenditure ceilings, budget formulation as well as accountability mechanisms.
- **Implementing infra-annual updates of baselines**, so that these can provide an early warning on fiscal impacts of policy decisions made outside of the budget process, which have increased during and in the wake of the COVID-19 pandemic as noted above, and their implications vis a vis fiscal rules or objectives.

¹¹ An example of this is Germany's special fund for Federal Armed Forces introduced in 2022 (<https://www.bundesregierung.de/breg-en/news/special-fund-federal-armed-forces-2047910>)

¹² An example of this is Scotland's National Care Service Bill introduced in 2022 (<https://digitalpublications.parliament.scot/ResearchBriefings/Report/2022/10/10/c38bdb32-ae66-4d36-9c35-7a39ee2e52fc>).

Concerning expenditure ceilings, across the group of countries whose most recent budget was consistent with the multi-annual top-down expenditure ceilings set in the previous year, a shared objective is the *credibility* of the ceilings. How this credibility is achieved varies, but almost all countries within this group have frameworks that have strong clarity and coherence, stability over time and embedded but limited flexibility. Common features in how these countries set their expenditure ceilings, which may be considered by countries that aim to strengthen their own processes, are as follows:

- **Using binding ceilings at least up to one year after the upcoming budget year**, which provides credibility to the medium-term budgeting process.
- **Setting ceilings at both aggregate and detailed level.** While establishing a binding expenditure ceiling at aggregate level is an important signal for fiscal responsibility signal, indicative sectoral ceilings, set with appropriate flexibility, are also useful in that they allow that i) a decision-maker, typically a minister, can be made responsible for enforcing the ceiling and ii) they can also be used to frame the annual budget discussions.¹³
- **Defining clear rules with regards to compliance with ceilings and approaches to reopening or revising these ceilings**, which fosters responsibility, discipline and collective rationality. For instance, in the case of Denmark, each minister is legally obliged to act appropriately to comply with her or his ceiling for the current year, although a general compensation mechanism can be used in exceptional cases.¹⁴
- **Committing to early political decision-making on spending envelopes.** Different approaches are used, reflecting each country's circumstances. For instance, in the Dutch system, ceilings are anchored in a coalition agreement between parties in government. In the United Kingdom, the formulation process for discretionary expenditures ceilings is simultaneously a spending reviews phase.
- **Ensuring credibility of the ceilings**, which requires considering trade-offs between various parameters including comprehensiveness of the ceilings, exclusion of expenditures that are cyclically sensitive and/or would be challenging to manage and restrict, the size of the budget margin or reserve, etc.

Equally crucially, countries need to **design their medium-term and top-down budget processes in a way that is fully integrated**. Typically, baselines should be updated at key stages of the budget cycles; be detailed enough that they are the main input to the annual setting of expenditure ceilings and budget negotiations; etc. For instance, in Sweden, baselines updates are the building block for adjustments to sectoral expenditure ceilings presented in the mid-year budget bill.

Finally, by reinforcing their top-down and medium-term budget systems, countries may find opportunities to **strike a better balance between the use of fiscal rules and objectives, medium-term budgets and expenditure ceilings in their fiscal frameworks**. This would help them to avoid relying excessively on the former. Countries should also consider using the full range of approaches to reducing bias in macroeconomic and revenue forecast, including i) strengthening the role of IFIs and ii) imposing stricter quality requirements for government forecasting, including benchmarking with relevant external forecasts.

¹³ An "indirect approach" is for instance followed by Finland and Sweden. In Finland, an aggregate, fixed and binding expenditure ceilings is set for the 4-year parliamentary term, but indicative "spending limits" are also defined for each ministry over the same period on rolling basis. In Sweden, an aggregate and binding expenditure ceiling is set for 3 years on a rolling basis by Parliament. These ceilings are then divided into "frames" that are equal to the sum of appropriations for a given spending area. The frames form the basis for annual negotiations between the ministry of finance and ministries and may be revised as part of the annual budget discussion.

¹⁴ Ceilings can however be redistributed between sectors (state, municipalities, regions) as part of the yearly budget negotiations within the limits of the aggregate ceiling.

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