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**Spending Better: Post-Covid Budget Frameworks**

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This paper presents the preliminary results of the 2023 SBO Survey on Budget Frameworks and focuses on OECD countries' practices in four key areas of the OECD Spending Better Framework: clear fiscal objectives, unbiased economic assumptions, multi-annual expenditure baselines and top-down expenditure ceilings. The preliminary results of the survey show that, in contrast with the post-global financial crisis's wave of PFM reforms, only a limited number of OECD countries have thus far taken the opportunity presented by the crisis to make significant changes to their budget frameworks in relation to fiscal policy and medium-term budgeting. Reforms are needed however as all components of quality budget institutions, as defined in the OECD Spending Better Framework, are not yet present in all OECD countries. In particular, although most OECD countries implement medium-term budgeting, their multi-annual top-down expenditure ceilings are not always effective in constraining government spending. The paper concludes that medium-term budgeting practices, which are the building block for governments to fund their new policy agendas in a way that is predictable and reliable as well as fiscally sustainable, need to be further strengthened in most OECD countries. Based on the OECD Spending Better Framework, the paper outlines approaches to do so, including by preparing and updating systematically baseline projections for all government expenditures and establishing top-down expenditure ceilings both at aggregate and ministerial levels. To ensure credibility of the medium-term budget and foster responsibility, opportunities to reopen ministerial-level ceilings should be strictly limited, with flexibility achieved by, for instance, using budget margins or excluding cyclically sensitive expenditures.

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## 1. Introduction

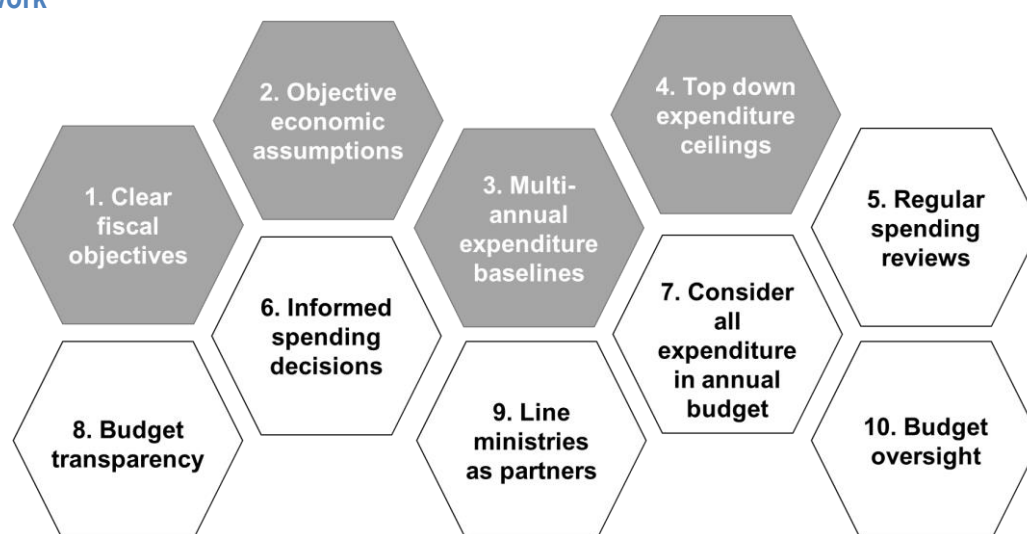
### 1.1. Budget frameworks and the post-COVID environment

1. In the wake of the COVID-19 pandemic, Russia’s war of aggression against Ukraine and energy crisis, most OECD countries are grappling with elevated debt levels. This is coupled with large spending needs in key areas such as health, social care, environment, and national security. 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 do not only constrain spending 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. To achieve this objective, the OECD Spending Better Framework is organized around ten principles defining core entities, functions, processes, and procedures for quality budget institutions.

2. 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 unbiased economic assumptions, preparation of multi-annual expenditure baselines (referred to as “baselines” hereinafter) and adoption of top-down expenditure ceilings (referred to as “expenditure ceilings” hereinafter) (Figure 1.1). These four principles relate to the concept of medium-term budget frameworks defined as the action of extending the time horizon for budgetary decision-making by defining spending ceilings beyond the annual budget in a way that is consistent with both fiscal sustainability and delivery of government policy priorities.

3. Conceptually, the key benefits of medium-term budgeting – fiscal responsibility, allocative efficiency, and predictability – have been extensively discussed in the past, including in the *OECD Recommendation of the Council on Budgetary Governance* (OECD, 2015<sup>[1]</sup>). They remain particularly relevant, and even critical, in the post-COVID environment. Assessing the financial impact of existing policies and extending the time-horizon of budgetary decision-making far enough to realistically assess the fiscal space to deliver new policies helps foster the stability of public finances and the capacity of governments in OECD countries to deliver their vital policy agendas outlined above.

**Figure 1.1. Budget frameworks and medium-term budgeting principles in OECD Spending Better Framework**



Note: Principles relating to medium-term budget frameworks are highlighted in grey.

Source: OECD Spending Better Framework, 2022

## 1.2. The paradox with medium-term budgeting

4. Medium-term budgeting is not a new concept. Medium-term budgeting is, in fact, among the most popular feature of budget systems in OECD countries. In 2019, following a decade of reforms in the wake of the global financial crisis, an OECD survey found that 29 OECD countries out of 34 respondents were implementing some form of medium-term budgeting (OECD, 2019<sup>[2]</sup>). Further, OECD countries are considered as both pioneers and leaders in this area. A World Bank study identifies for instance OECD countries as the group for which medium-term budgeting has had most perceptible effects on improving fiscal outcomes, in particular for those countries that implement the most advanced form of medium-term budgeting (World Bank, 2012<sup>[3]</sup>).<sup>1</sup>

5. This raises the question: is there anything left to say on medium-term budgeting in the OECD context? A fundamental paradox with medium-term budgeting, which is that its popularity also comes with substantial criticism of its effectiveness, seems to suggest so. Indeed, recent OECD budget reviews, reports by OECD countries' budget oversight bodies and academic studies mention persisting challenges in designing and implementing effective medium-term budgeting frameworks, evidenced by recurring and sometimes significant divergences between fiscal objectives, expenditure ceilings and actual spending. For instance, a recent audit office report mentioned difficulties in determining whether medium-term budgeting systems in seven European Union countries were “directing the level of expenditure or reacting to it” (Contact Committee Fiscal Policy Audit Network, 2022<sup>[4]</sup>).

6. Preliminary results of the 2023 OECD SBO Survey on Budget Frameworks (referred to as “the 2023 SBO survey” hereinafter) reinforces 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 7 countries, or a quarter of respondents, answered positively (Figure 1.2). This means that, for other countries:

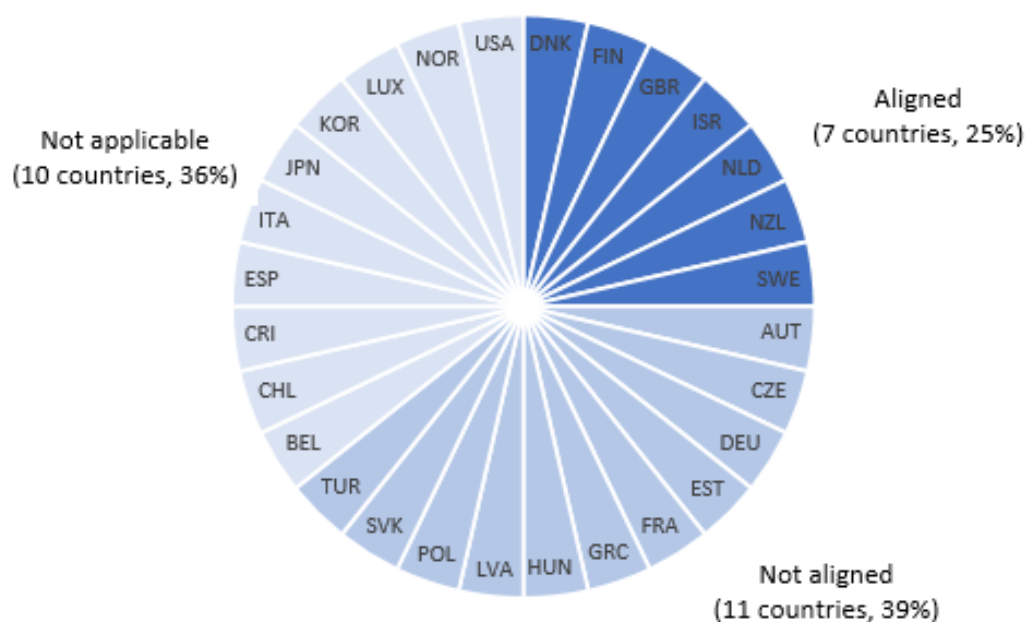
- previous year's expenditure ceilings are not effectively constraining budgetary decision-making for the next year (11 countries). This is due to various reasons, including exceptional circumstances (e.g., Germany or Greece) or the practice of expenditure ceilings being revised as part of the annual budget process, after consideration of new macroeconomic conditions and policy decisions, meaning that the budget is aligned with the revised ceiling instead of the previous year's one (e.g., Austria, Czech Republic or Estonia)
- expenditure ceilings are not used (10 countries)

7. Further, within the 18 countries that use expenditure ceilings, a smaller group of 14 countries formally scrutinize the deviations between their expenditure ceilings and actual spending, and only 8 countries within that group publish this information. Therefore, it can be concluded that medium-term budgeting remains probably “at once among the most popular contemporary innovations and among the most misapplied”, as summed up by Allen Schick already more than a decade ago (Schick, 2009<sup>[5]</sup>).

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<sup>1</sup> The World Bank identifies three types of medium-term expenditures frameworks, or MTEFs, by stage of development: (1) the medium-term fiscal frameworks or MTFs, 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 MTPFs, which present expenditures forecasts by programmes linked to medium-term outputs and outcome targets.

**Figure 1.2. Consistency between most recent approved budget and the previous year's expenditure ceiling, 2023**



Note: Countries that answered “other” have been tentatively reclassified under relevant categories by authors based on narrative information provided in the survey. Spain has been tentatively reclassified to “not applicable” based on its answer to Q16.

Source: 2023 OECD SBO Survey on Budget Frameworks, preliminary results for 28 countries, Q27.

### 1.3. The uncertainty around how to do “good” medium-term budgeting

8. In discussing medium-term budgeting, international guidance and literature uses different concepts and terminology, which has generated some confusion. For instance, the action of setting a limit on total expenditures and pre-allocating these resources to specific spending areas might be referred to as setting top-down expenditure ceilings, spending limits or using a medium-term expenditure framework (MTEF). Further, the terms medium-term budgeting and MTEF are sometimes used as synonyms. Similarly, baselines and forward estimates are used as synonyms. In this discussion paper, for clarity, medium-term budgeting, expenditure ceilings and baselines are used as generic terms, with the term MTEF referring to as a type of presentation of expenditure ceilings that is used in some but not all OECD countries.

9. More importantly, the debate over what constitutes “good” medium-term budgeting is somehow unsettled. Considerable academic literature has analysed possible features for medium-term budgeting or 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. Also, the context in which medium-term budgeting is implemented has been recognized in international studies as deeply affecting its 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<sup>[6]</sup>).

10. Such conclusions, albeit fully justified, have the downside of potentially causing a feeling of powerlessness in budget offices, and may undermine over the long-term the credibility of medium-term budgeting, as well as its popularity. This might be avoided by

bringing back the discussion to the principles of the OECD Spending Better Framework - that is to the functions, processes, and procedures that budget offices need to establish to make medium-term budgeting work. These functions, processes and procedures do not address directly political and administrative behaviours that may have prevented good implementation of medium-term budgeting in the past, but they create safeguards and incentives that can progressively change these behaviours.

11. Against this background, this discussion paper uses the preliminary results of the 2023 SBO survey<sup>2</sup> to present key findings on OECD countries' practices in each of the four principles of the OECD Spending Better Framework pertaining to fiscal frameworks, with a focus on medium-term budgeting. It is structured as follows: section 2 discusses finding of the 2023 SBO survey on use of fiscal objectives; section 3 discusses approaches to avoiding bias in economic assumptions; section 4 discusses the use of baselines; and section 5 presents practices with expenditure ceilings. Finally, section 6 draws tentative policy conclusions for strengthening budget frameworks in the post-COVID context.

## 2. Fiscal objectives

12. Fiscal objectives are the numerical parameters set by the government to constrain their budgetary aggregates. They can be mandated by legislation, political decision or established custom.<sup>3</sup> A fiscal objective has two fundamental characteristics. First, it presents a constraint that binds policy decisions. Second, it serves as a concrete benchmark for the executive's fiscal management. A wide range of fiscal objectives is conceivable, and the effectiveness of a given type of fiscal objective, as well as the calibration of the numerical objective, need to be assessed in national context.

13. As of today, consistent with trends observable prior to the pandemic (OECD, 2019<sup>[2]</sup>), national fiscal objectives are set by all 28 respondents to the 2023 SBO Survey. In 14 countries, these fiscal objectives are laid out quasi-permanently in the constitution or primary legislation, and in 16 countries there is a political convention and/or legal requirement that the government sets its fiscal objectives for the duration of their mandate.<sup>4</sup>

14. The 2023 SBO Survey identifies four types of fiscal objectives: budget balance (e.g., deficit or surplus), debt, expenditures, revenues and other. Also consistent with prior-pandemic trends, the 2023 preliminary survey's results (Figure 2.1) show that:

- All OECD countries use multiple fiscal objectives, in most cases a combination of budget balance or debt objectives operationalized with expenditures objectives.<sup>5</sup> Other types of fiscal objectives, such as net worth, are used by very few countries.
- For a given type of fiscal objective, OECD countries typically set several specific numerical targets. For instance, countries with a budget balance objective may set

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<sup>2</sup> At the time of the preparation of this discussion paper, 28 responses had been received out of 38 OECD countries, which is a 74% rate of response. Annex A provides a list of answers received. The data has not undergone yet its cleaning process.

<sup>3</sup> Fiscal objectives mandated by legislation are usually called fiscal rules.

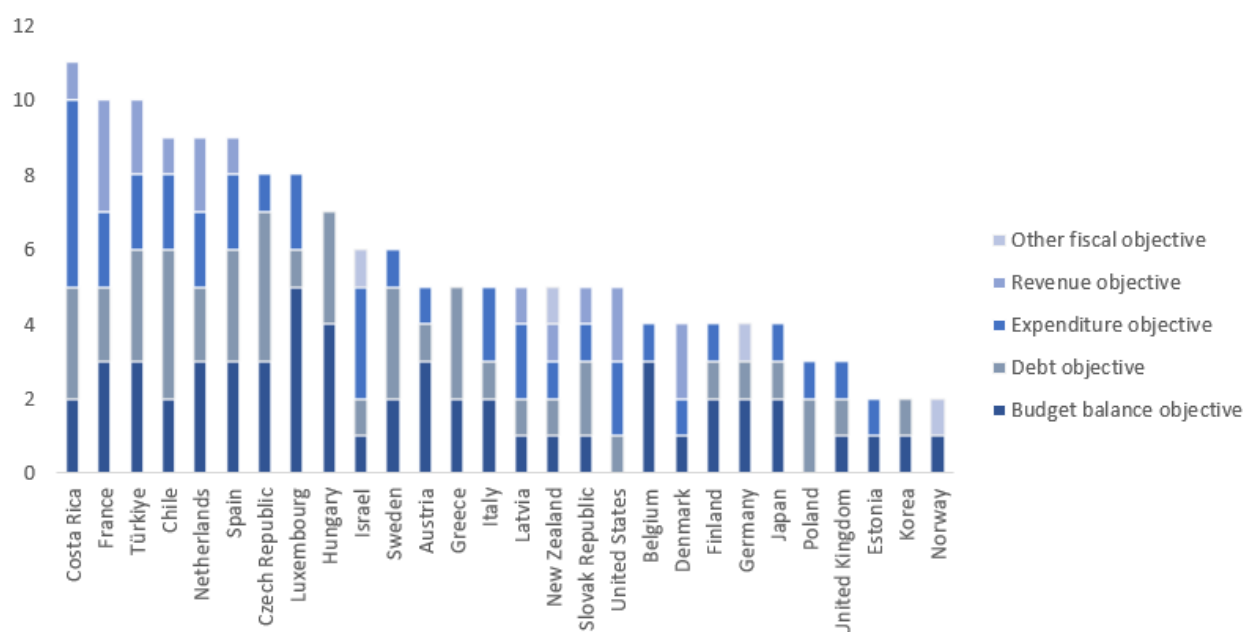
<sup>4</sup> In 4 countries, fiscal policy is guided by a combination of both quasi-permanent legal and temporary political fiscal objectives.

<sup>5</sup> This is partly due to the European Union setting a ceiling on annual growth of primary spending for its member countries, which has led member countries to mirror this with an expenditure rule in their national framework.

both nominal and structural numerical targets (13 OECD countries: Austria, Belgium, Chile, Czech Republic, Finland, Greece, Hungary, Italy Luxembourg, Netherlands, Poland, Sweden and Türkiye).

Therefore, on average, an individual OECD country uses more than 3 fiscal objectives and 5 numerical targets.

Figure 2.1. Types and number of national fiscal objectives used in OECD countries, 2023



Source: 2023 OECD SBO Survey on Budget Frameworks, preliminary results for 28 countries, Q3.

15. Concerning mechanisms for enforcing fiscal objectives, a small group of 6 countries do not have any mechanism in place. However, within this group of countries, 3 indicated that governments have a proven record of strong political commitment and implementation of corrective measure, in the absence of any enforcement mechanism. Other countries use systems of automatic correction (11 countries), require that the government provide reasons for deviations (8 countries) and/or propose corrective actions to the legislature (9 countries). Only 5 countries use a system of automatic sanction. Within countries that use systems of automatic correction, it is especially notable that Poland has a system of progressive “preventive triggers” for fiscal adjustment when debt level rises closer its ceiling.

16. The COVID-19 pandemic has called greater attention to the need for flexibility in fiscal rules, so that they can adapt to sharp changes in macroeconomic conditions. Escape clauses are the flexibility measure most used by OECD countries. 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 (12 countries). Escape clauses also exist in some countries where the government has a legal requirement to define their fiscal objectives at the start of their mandate (e.g., Finland,

Germany and the United States). These escape clauses were put to use during the COVID pandemic in 18 countries.<sup>6</sup>

17. In addition, flexibility may be embedded in the fiscal rules themselves. For instance, some countries use a cyclically adjusted budget balance objective that account for the economic cycle (19 countries) and or a debt anchor (17 countries) rather than a debt ceiling (14 countries).<sup>7</sup>

18. In restoring fiscal policy frameworks after the pandemic, amongst the 28 respondents to the survey, so far only a minority of 11 OECD countries have chosen to modify their pre-pandemic framework while a majority of 17 countries have decided to stay 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 could trigger changes to both supra-national fiscal rules and national fiscal objectives for some OECD countries.<sup>8</sup>

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

- In some countries, numerical targets set for certain fiscal objectives have been recalibrated to account for a new macroeconomic and fiscal situation.
- In other countries, more substantial revisions to fiscal policy frameworks are undertaken or considered based on lessons learned from the pandemic. For instance, in Korea, the government proposed to embed for the first time in legislation a fiscal rule, along with flexibility measures.
- Finally, challenges with the use of multiple and complex fiscal objectives, which include a lack of clarity vis a vis citizens that feed into the wider issue of trust in governments (OECD, 2022<sup>[7]</sup>), as well as difficulties in monitoring compliance and enforcing accountability (Davoodi et al., 2022<sup>[8]</sup>), are also being considered in revising fiscal policy frameworks. This was the case for instance during discussions on potential reforms to the European Union's Stability and Growth Pact.

### 3. Economic assumptions

20. Macroeconomic projections are the bedrock of fiscal forecasts because the economy's cyclical position drives tax collection and expenditure developments. Unbiased macroeconomic forecasts are one of the requirements for producing, in turn, reliable fiscal forecasts and credible expenditure ceilings. Consequently, adoption of medium-term budgeting requires that governments simultaneously cement the credibility of the medium-term macroeconomic forecasts, which are prepared by the ministry of finance in a very large majority of OECD countries (Figure 3.1).

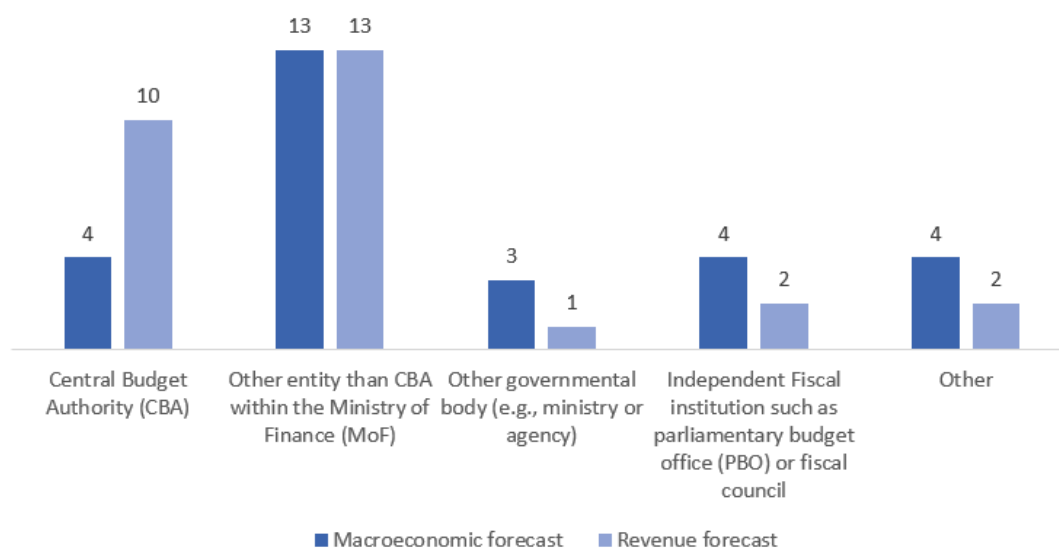
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<sup>6</sup> It is to be noted that where such escape clauses did not exist (or did not apply to all fiscal objectives), governments resorted to *ad hoc* suspensions of their fiscal objectives during the COVID-19 pandemic (6 countries).

<sup>7</sup> 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.

<sup>8</sup> [https://ec.europa.eu/commission/presscorner/detail/en/ip\\_22\\_6562](https://ec.europa.eu/commission/presscorner/detail/en/ip_22_6562)

Figure 3.1. Responsibilities for development of forecast



Source: 2023 OECD SBO Survey on Budget Frameworks, preliminary results for 28 countries, Q6.

21. To cement the credibility of their medium-term macroeconomic and revenue forecasts, OECD countries can use a range of approaches detailed in the OECD Spending Better Framework, which include greater 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).

22. In practice, the preliminary 2023 SBO survey's results show that (Table 3.1):

- Transparency is considered paramount by OECD countries for reducing bias in medium-term forecasts: most OECD countries publish their forecast in the budget documentation, as well as disclose assumptions underpinning these forecasts and analyse related risks.
- Other approaches to help ensure objective forecasts include ex post analysis of forecast accuracy, following international/best practice professional standards and giving a role to other institutions, such as independent fiscal institutions (IFIs).

23. A majority of the 28 respondents to the 2023 SBO Survey recognise the IFIs' prominent role in cementing the credibility of government medium-term and revenue forecasts: out of 28 respondents, 21 OECD countries give a formal role to the IFI in relation to macroeconomic forecasts and 16 OECD countries give them a formal role in relation to revenue forecasts. In both cases, the most frequent mandates are i) endorsing the government forecast or assessing its reasonableness and ii) publishing an ex-post evaluation of its accuracy. Very rarely, the IFI is mandated to prepare the macroeconomic or revenue forecast itself or publishes an alternative forecast.

24. A small number of OECD countries do not have IFIs but have a country-specific approach to ensuring objectivity of 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 attesting that all policy decisions or circumstances with material economic and fiscal implications known to the government have been communicated to the Treasury and have been included and that the Treasury has used its best professional judgment in their preparation.

**Table 3.1. Approaches to prevent forecasting bias**

	Macroeconomic forecast	Revenue forecast
Forecasts are publicly disclosed in the budget documentation	25	26
Risks to the forecasts are discussed and/or quantified	25	16
Differences between successive versions of the forecasts are quantified and explained	20	20
Variables, components and assumptions for the forecasts are disclosed in the budget documentation	20	17
Formal role for IFI	21	16
Requirement that forecasters commit formally to follow international/best professional standards	11	10
Institution producing the forecasts required to take account of forecasts produced by other institutions	8	5
Other	2	1

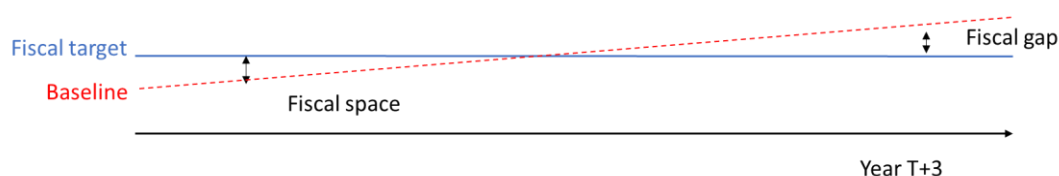
Source: 2023 OECD SBO survey on Budget Frameworks, preliminary results for 28 countries, Q7.

## 4. Baselines

### 4.1. What are baselines

25. The term 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 (Figure 4.1).

**Figure 4.1. What are baselines**



Source: Author

26. The formulation of baselines requires that several prerequisites be met – e.g., a clear budget nomenclature, reliable accounting for establishing an accurate starting point, capacities for policy costing, etc. (Rahim, Wendling and Pedastsaar, 2022<sup>[9]</sup>). Additionally, an important characteristic of the baselines' formulation process that it should involve both top-down and bottom-up inputs – that is a combination of methodological inputs from the ministry of finance and knowledge of policies and programmes at budgetary entity level (e.g., applying cost drivers determined by the ministry of finance to demographic and macroeconomic variables identified by a line ministry for social programmes).

27. Baselines formulation is often considered by governments as an internal process, leading to transparency benefits being overlooked. Such a perception should be resisted. Baselines are in fact 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.

#### 4.2. 2023 SBO Survey's findings

28. Preliminary answers to the 2023 SBO survey suggest that all OECD countries maintain baselines.<sup>9</sup> This needs however to be considered with caution as i) public information on the approach to preparing baselines, including the definition of what is considered “no policy change”, is extremely limited and ii) expenditure forecasts, which include estimates of costs for new policies, and baselines, which do not, do not seem to be always clearly delineated.<sup>10</sup> There are however exceptions. The United States have a public and detailed methodology for the development of “baselines estimates”.<sup>11</sup>

29. In a majority of countries (20 countries), the requirement is that baselines be updated only once a year. In other countries, updates may be required two to four times a year, with some updates required ahead of the preparation of budget documentation and other updates for internal purpose only (e.g., Sweden). Overall, the predominant practice of a single annual update suggests that baselines may not be used yet in most OECD countries to their full potential – i.e., as a tool showing in quasi-real time financial implications of policy decisions, allowing anticipation and appropriate action if expenditure ceilings are at risk of being breached.

30. Finally, answers to question 8 of the 2023 SBO Survey suggest that baselines' update is in a majority of cases a joint responsibility of the ministry of finance and line ministries. However, answers to question 29 provides a different picture: only 14 countries, or half of respondents, indicate that “coordinating and monitoring multi-annual expenditure baseline updates” is a role of line ministries' finance function, in contrast with coordinating budget requests which is a role of line ministries' finance function in virtually all countries. This suggests that baselines' annual update and annual budget request's formulation follow separate processes in most countries, and that bottom-up inputs to baseline preparation may in practice be limited.

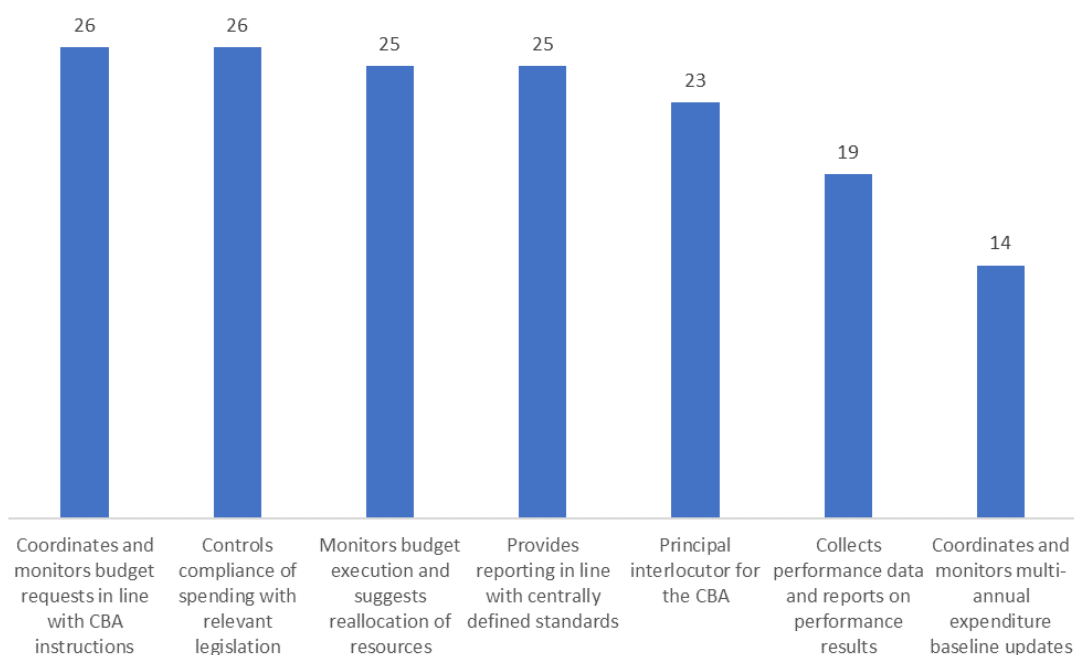
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<sup>9</sup> Two countries specified that their baselines are only indicative in nature.

<sup>10</sup> For some countries, answers to Q13 “Is the multi-annual expenditure baseline published?” include links to the medium-term forecast.

<sup>11</sup> Baselines are defined as “The baseline is 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.” <https://www.whitehouse.gov/wp-content/uploads/2018/06/s80.pdf>

Figure 4.2. Roles and responsibilities of line ministries' finance function



Source: 2023 OECD SBO survey on Budget Frameworks, preliminary results for 28 countries, Q29.

## 5. Expenditure ceilings

### 5.1. What are expenditure ceilings

31. Expenditures ceilings are a target or restriction, an “envelope,” on spending levels established in advance of the start of preparation of budget. Expenditure ceilings may be a restriction on total level of spending or on ministerial or sectoral expenditures. The setting of expenditure ceilings is necessarily a top-down process, in that it is an early announcement by the government to budgetary entities on the maximum level of expenditure to ensure consistency with the country’s fiscal targets. In the context of medium-term budgeting, expenditure ceilings should be set on a multi-year basis to channel and constrain spending decisions during the preparation of successive budgets, in a way that is both fiscally responsible and offering predictability to budgetary entities.

32. In using an expenditure ceiling, in essence, governments separate decisions on expenditure levels from variations in macroeconomic and fiscal forecast. In other words, once an expenditure ceiling has been set against unbiased macroeconomic and revenue forecasts, changes to the macroeconomic outlook and revenue projections should not affect, or affect only in a limited way, the ceiling. Therefore, to manage adverse changes to the macroeconomic and revenue outlooks as well as other fiscal risks (Moretti, Boucher and Giannini, 2021<sup>[10]</sup>), governments need to use budget margins or reserves within their expenditure ceilings.

## 5.2. Key decisions on expenditure ceilings

33. To operate a system of 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 i) whether expenditure ceilings should be binding or indicative; ii) whether the ceilings should be fixed or revised on a rolling basis (i.e., adding a new annual ceiling every year); and iii) which period the expenditure ceilings should cover.

34. In making these decisions, a country needs to make a candid assessment of its national circumstances, both political and technical. For instance, in theory, setting fixed and binding expenditures ceilings for a relatively long period would bring higher benefits with fiscal responsibility and predictability. In practice, this would require early political decision-making on future spending and full adherence by cabinet to these decisions, made possible by line ministries' capacity to put forward reliably costed multi-year spending proposals, which few countries would be able to effectively deliver.

35. Whether expenditure ceilings should be set at aggregate level or at ministry or programme level is another key decision to make for countries, and has been the subject of academic discussions.<sup>12</sup> These two types of ceilings have complementary functions: i) the aggregate ceiling operationalizes the government's high-level fiscal objective(s) and is a collective responsibility of the government and ii) the organizational-level ceilings provide individual ministers with a clear idea of how they are expected to contribute to the collective effort. Organizational-level ceilings also provide a concrete starting point for the next year's budget discussion.

## 5.3. 2023 SBO Survey's findings

36. The 2023 SBO survey shows that a group of 10 OECD countries do not use multi-annual expenditure ceilings as part of their budget systems. First, 2 countries (Belgium and Chile) publish multi-annual expenditure forecasts that are not ceilings in nature. Second, 7 countries (Costa Rica, Japan, Korea, Luxembourg, Norway, Spain and the United States) establish expenditure ceilings, but these ceilings are either only for the next year's budget and or for the next year's budget plus one outer year, which cannot be considered medium-term budgeting. Finally, 1 country (Italy) indicates that although legislation authorises the use of expenditure ceilings, these have not been used yet in practice.

37. Within the group of 18 OECD countries that use multi-annual expenditure ceilings (Table 5.1 and 5.2), it is notable that most countries use binding ceilings set at organizational or total expenditure levels for the upcoming budget year. For outer years, however, the approaches that are used are varied:

- 14 countries use rolling ceilings and 4 countries use fixed ceilings;
- 7 countries set expenditure ceilings over a 3-year period; 10 countries over a four-year period; and 1 country over a five-year period.

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<sup>12</sup> Proponents of detailed ceilings argue that ministerial responsibility will be greater if a clear and strict spending envelope for each ministry is set as part of the medium-term budgeting process. A global ceiling on spending will be perceived as a problem to be solved by others – that is by the Government and by other ministries. Opponents to this approach make the point that it makes limited sense to set ceilings at ministerial or sectoral levels in advance and before ministries have had the opportunity to present new spending proposals (Robinson, 2023<sub>[12]</sub>).

- 8 countries use binding ceilings; 2 countries use indicative ceilings; 8 countries use a mix of binding and indicative ceilings.
- 2 countries set ceilings only at organizational level; 2 countries use ceilings only at total level; 1 country sets ceilings at total and programme level; 4 countries use a mix of total and organisational levels ceilings; 5 countries use a mix of total, organisational and programme levels ceilings.

38. In addition, sub-ceilings for selected expenditure areas are sometimes used, in a majority of cases for wages (12 countries) and operating expenditures (8 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 have 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.

**Table 5.1. Types of multi-annual expenditure ceilings**

Country	Time period	Rolling	Fixed	Binding	Indicative
CZE	3-year	Yes		T1 + 2	
SWE	3-year	Yes		T1 + 2	
LVA	3-year	Yes		T1 + 2	
FRA	3-year	Yes		T1	T1 + 2
HUN	3-year	Yes			T1 + 2
POL	3-year	Yes		T1	T1 + 2
TUR	3-year	Yes		T1	T1 + 2
AUT	4-year	Yes		T1 + 3	
DNK	4-year	Yes		T1 + 3	
EST	4-year	Yes		T1	T1 + 3
FIN	4-year		Yes	T1 + 3	
DEU	4-year	Yes		T1 + 3	
ISR	4-year	Yes		T1	T1 + 3
NLD	4-year		Yes	T1 + 3	
GRC	4-year	Yes		T1 + 1	T1 + 3
NZL	4-year	Yes			T1 + 3
SVK	4-year		Yes	T1	T1 + 3
GBR	5-year		Yes	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.

Source: 2023 OECD SBO Survey on Budget Frameworks, preliminary results for 28 countries, Q16 and 19.

**Table 5.2. Granularity of multi-annual expenditure ceilings, 2023**

	Time period	Total expenditure level	Organisational level	Programme level	Other
CZE	3-year	T1 + 2	T1 + 2	T1 + 2	
SWE	3-year	T1 + 2			
LVA	3-year	T1 + 2		T1	
FRA	3-year	T1 + 2	T1 + 2	T1 + 2	
HUN	3-year		T1 + 2		
POL	3-year	T1 + 2	T1 + 2	T1 + 2	
TUR	3-year	T1 + 2	T1 + 2		
AUT	4-year	T1	T1 + 3		
DNK	4-year				T1 + 3 (a)
EST	4-year		T1 + 3		T1 + 3 (b)
FIN	4-year	T1 + 3			
DEU	4-year	T1 + 3	T1 + 3		T1 + 3 (c)
ISR	4-year	T1 + 3	T1 + 3	T1	
NLD	4-year	T1 + 3	T1 + 3		
GRC	4-year		T1 + 3		
NZL	4-year				T1 + 3 (d)
SVK	4-year	T1 + 3	T1 + 2		
GBR	5-year	T1 + 4	T1 + 1	(e)	

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 Denmark: Ceilings by sectors (state, municipality, regions) and type (expenditure, transfers). (b) 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. (c) Other for Germany: Additional restrictions for line ministries in top down -decision are possible. (d) Other for New Zealand: Operating Allowances (for decisions impacting operating revenues and operating expenses) and Capital Allowances (for decisions impacting capital expenditure). (e) 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.

Source: 2023 OECD SBO Survey on Budget Frameworks, preliminary results for 28 countries, Q17.

39. Although these various approaches reflect different national circumstances, they are not all equal in their outcomes: as noted above, in several cases, the previous year's expenditure ceiling is not systematically constraining budgetary decision-making for the next year. Interestingly, some similar features can be observed within the group of 7 countries whose most recent budget was consistent with the multi-annual top-down expenditure ceilings set in the previous year:

1. First, these countries generally use binding ceilings at least up to one year after the upcoming budget year, which provides credibility to the medium-term budgeting process.
2. Second, these countries typically set expenditure ceilings at organizational level, either directly or indirectly. The “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.

3. Third, these countries have clear processes in place to allow for early political decision-making on spending envelopes. Different approaches are used, reflecting each country's political circumstances. For instance:
  - In the Dutch system, ceilings are anchored in a coalition agreement between the parties forming the government.
  - The United Kingdom differentiates mandatory and discretionary expenditures with only the latter estimated as part of the expenditure ceilings' formulation process which is simultaneously a spending reviews phase.
4. Finally, all countries have 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 take appropriate measures to comply with her or his ceiling for the current year. Ceilings can however be redistributed between sectors (state, municipalities, regions) as part of the yearly budget negotiations within the limits of the aggregate ceiling.

#### **5.4. Expenditure ceilings and macroeconomic uncertainty**

40. During the COVID-19 crisis, in some OECD countries, governments had to remove or modify expenditure ceilings for the budget year, as well as relax or suspend fiscal rules to create the fiscal space required by new spending. Denmark, for instance used an exemption clause to remove the annual expenditure ceiling embedded in its Budget Law to fund its initial responses to COVID-19.

41. In the post-Covid environment, the ongoing effects of Russia's invasion of Ukraine, energy crisis, financial sector turmoil, and trade tensions continue to generate obvious challenges in producing accurate economic and revenue forecasts, which perpetuate in turn challenges in setting expenditure ceilings.

42. This is particularly true for the very large majority of 24 countries that use nominal expenditure ceilings. In "normal times", nominal ceilings allow indeed for simpler implementation and monitoring, they become however more difficult to set and comply in a high inflation environment. Only 3 countries (Chile, Finland and the Netherlands) set their expenditure ceilings in real terms, under which deviations from the underlying fiscal forecasts due to inflation will not affect the spending envelope.

43. For countries that use nominal expenditure ceilings, revisions of ceilings are in most cases authorised. These revisions are authorized once per year in 9 countries and as needed in response to macroeconomic and revenue forecasts in 1 country. Only 4 countries do not authorise such revisions. The benefits of expenditure ceilings may however be undermined by too frequent and/or ill-timed revisions. Therefore, in order to address the competing demands of flexibility and stability, OECD countries may follow two main approaches:

- Expenditure ceilings may exclude cyclically sensitive spending. For instance, Sweden is using such an approach under which upward variations of expenditure affected by external factors, such as entitlements, will be funded outside of the frame for a given spending area. Finland has a similar approach.

- 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.

44. 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 ministerial responsibility, 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. 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. In Latvia, the reserve is expressed as a percent of GDP and linked to size fiscal risks.

## 6. Conclusion

45. Budget systems of OECD countries have been put to test during the COVID-19 pandemic: fiscal objectives and expenditure ceilings have been suspended in many countries to allow for emergency spending and the operation of the automatic stabilisers (OECD, 2020<sub>[11]</sub>). However, in contrast with the post-global financial crisis’s wave of PFM reforms, the preliminary results of the 2023 SBO Survey signal that only a limited number of countries have thus far taken the opportunity presented by the crisis to make significant changes to their budget frameworks in relation to fiscal policy and medium-term budgeting.

46. The 2023 SBO Survey’s preliminary shows reforms might be needed as all components of quality budget institutions, as defined in the OECD Spending Better Framework, are not yet present in all OECD countries. A minority of OECD countries do not have yet a system of medium-term budgeting, leaving it unclear how the government intends to meet fiscal objectives. A small group of countries prepare expenditure forecasts but do not use expenditure ceilings. Finally, a majority of OECD countries establish expenditure ceilings as part of their medium-term budgeting framework, but within this group of countries, the ceilings are not always effective in achieving the objective of constraining spending in a way that is consistent with both fiscal sustainability and delivery of government policy priorities.

47. Against this background, OECD countries could consider the following:

- Where expenditure ceilings do not have a track-record of effectiveness, countries should explore ways to strengthen their processes and approaches for setting these ceilings. Successful approaches include using both aggregate ceiling to operationalize the government’s high-level fiscal objective(s) and organizational-level ceilings to provide individual ministers with a clear idea of how they are expected to contribute to the collective effort. Opportunities to reopen the organizational-level ceilings should be limited to foster responsibility, with flexibility achieved with ceilings set in real terms, or reserves, or exclusion of cyclically sensitive expenditures, etc.
- For strengthening their medium-term budgeting systems, OECD countries should also systematically formulate of baselines based on relevant guidance and policies, including costing methodologies, and updated these baselines often enough that they reflect impacts of key policy decisions and implications vis a vis fiscal objectives. Baselines formulation necessarily needs to be a joint work of the

ministry of finance and budgetary entities. Both baselines' updates and expenditure ceilings setting rely on inputs from line ministries, including costings over a multi-annual period. Delegation of responsibilities to line capacities and genuine collaboration with the ministry of finance are therefore crucial to any implementation of medium-term budgeting.

- In addition, in an environment of high macroeconomic uncertainty, OECD countries should use the full range of approaches to reducing bias in macroeconomic and revenue forecast, including widening the mandates of IFIs and imposing stricter quality requirements for government forecasting, such as consideration of forecasts by other institutions and application of international/best professional standards.

## Annex A. 2023 OECD SBO Survey on Budget Frameworks: List of answers received as of 9 May 2023

Table A A.1. 2023 OECD SBO Survey on Budget Frameworks: List of answers received as of 9 May 2023

OECD countries	ISO
Austria	AUT
Belgium	BEL
Chile	CHL
Costa Rica	CRI
Czech Republic	CZE
Denmark	DNK
Estonia	EST
Finland	FIN
France	FRA
Germany	DEU
Greece	GRC
Hungary	HUN
Israel	ISR
Italy	ITA
Japan	JPN
Korea	KOR
Latvia	LVA
Luxembourg	LUX
Netherlands	NLD
New Zealand	NZL
Norway	NOR
Poland	POL
Slovak Republic	SVK
Spain	ESP
Sweden	SWE
Türkiye	TUR
United Kingdom	GBR
United States	USA
<b>Total</b>	<b>28</b>

Note: The International Organization for Standardization (ISO) defines three-letter codes for the names of countries, dependent territories and special areas of geographical interest. For the geographical display of figures, the ISA codes are used.

Source: Authors.

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