Indian Variant of MTEF
The Scope and Opportunities to Develop an Effective
Budget Planning Process

No. 185
06-Jan-17
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Abstract
The paper examines the medium-term fiscal policy (MTFP) and a more conventional medium-term expenditure framework (MTEF) adopted in India under the provisions of the fiscal rules. The MTFP and the MTEF, professed to improve fiscal discipline in the context of fiscal rules, did not promote a multi-year budget planning process. The abolition of the five-year development planning process and the subsequent decision to remove plan and non-plan classification from budget classification created a void with regard to the budget planning. This has necessitated developing a revamped fiscal architecture in the form of a medium-term framework to widen the short horizon of the annual budgeting exercise. The paper makes a case for developing structured medium-term budgeting framework (MTBF) building on the existing institutional framework both at the Central and at the subnational level and subsequently incorporating performance indicators in sector strategies.

JEL Classification: E61, E62 and H61

Keywords: Budgeting system, Multi-year Expenditure Framework, Fiscal Rules, Performance Budgeting and Strategic Planning
1. Introduction

Medium-term expenditure frameworks (MTEFs) have been implemented in many countries over the last two decades, both in developed and developing world. This is considered as one of the most popular budget innovation in recent times. The need for a medium-term perspective as compared to a short horizon of an annual budget was the compelling reason behind the rapid expansion of this instrument. The scope for better prioritization in resource allocation with multi-year budget planning increased its appeal. Initially championed by the World Bank, the MTEF became the focus of donor countries and multilateral agencies at the Central and the sectoral levels. The long-standing credibility of Australia’s ‘forward estimates’ (David Crobett, 1998) in controlling expenditure is cited as an established process of medium-term expenditure planning. While the experience from this innovation was disappointing during the early 1990s, it has received increased attention since the late 1990s. The positive perceptions regarding multi-year planning for budget from some of the developed countries seems to have influenced this surge.

India introduced medium-term expenditure framework (MTEF) in the year 2012 as part of a revision of the fiscal rules, the Fiscal Responsibility and Budget Management Act (FRBM Act). The formal adoption of MTEF followed the recommendations of the Thirteenth Finance Commission (TFC), which suggested strengthening the link between the medium-term perspective and the budget under the fiscal rules. The inclusion of the MTEF was in fact preceded by the provision for a medium-term perspective in the FRBM Act since its adoption in 2003. The FRBM Act stipulated the Government to present medium-term fiscal policy (MTFP) document by projecting major fiscal targets and explaining its fiscal stance along with the budget. Two other statements: fiscal policy strategy and macroeconomic statement accompanied the MTFP. The framework, however, was ineffective in advancing the cause of an effective multi-year expenditure planning.

The contours of MTEF introduced through fiscal rules and its role perceived in influencing the budget planning assumes significance for evolving public financial management (PFM) system in India. While there have been several intermittent attempts to bring in innovations in the PFM system, the introduction of MTEF is a significant development. It provides considerable opportunity to reform the budget management system. The abolition of the five-year development planning, which defined the economic philosophy of the country since independence, created a void with regard to the budget planning. This has necessitated a new fiscal architecture to provide a medium-term perspective to the annual budgeting exercise.

2. MTEF: Linking Policy, Planning and Budgeting

The World Bank, in its widely referred Public Expenditure Management Handbook, held the implementation of MTEF as a central element of PEM reform to counter the disconnect between policy making, planning and budget implementation, which is considered to yield poor budgeting outcome (World Bank, 1998). The countries implementing MTEF expect improvement in public financial management outcomes beyond the annual budget by establishing aggregate fiscal discipline, promoting efficiency in resource allocation, and improving operational efficiency of spending agencies. It is anticipated that MTEF would facilitate management of government policies under a budget restraint. With large number of countries opting for it, the MTEF emerged as an integral part of PEM solution to address broader performance problems of the governments.

The expectation of fiscal performance from the implementation of MTEF is due to its impact on budget quality and budget credibility (World Bank, 2013). The MTEF tends to reduce the tendency of ambitious annual spending plans based on blown up revenue projections to improve budget realism. The emphasis on sector priorities, based on objectives

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1 The Finance Commission, a statutory body, constituted every five years to determine the principles of sharing of Central taxes with the States and recommend grants to the States that are in need of resources available under various provisions. The Commission also gets terms of reference on variety of issues including fiscal restructuring measures, fiscal rules and so on.
and policies laid down by the Government rather than on annual increments, helps the resource allocation decisions and reduces the fiscal strain coming from politically-induced resource tradeoff. The MTEF helps the spending departments to become proactive while designing and costing their programmes due to increase in predictability of flow of resource in a multi-year mode. This enables them to participate in the budgeting process more meaningfully (PEFA, 2011). The focus shifts from controlling the expenditure to pragmatic spending plans and achievements of results commensurate with the objectives.

Linking policy, planning, and budgeting under MTEF is conceptualized by determining the available resource envelope to the government and allocating these resources in line with government priorities in a multi-year budgeting framework. The design features of MTEF focuses first with estimating the top-down resource envelope available to the government through a macroeconomic fiscal framework, which captures comprehensively all the resources, internal and external. The resource available with the government becomes the budget constraint that guides policy making and establishes resource allocation tradeoffs across the sectors to achieve the sector policy goals.

To complement top-down resource envelope, bottom-up estimate of the current and medium-term costs of the policy initiatives are estimated by developing spending plans for the sectors. Sector studies consist of strategies for the sectors and the estimated costs of running and new programmes. The expenditure implications of the sector policies are estimated by using costing techniques. The available resources to the government become the basis to set medium-term sector ceilings and the sectors accordingly design their budgets. In situations where the needs far exceed the available resources, MTEF can provide a mechanism for allocation of limited resources between sectors and specific activities within sectors by prioritizing the activities. The MTEF can be used to highlight the opportunity costs of various policies and programmes that need to be foregone if additional resources are allocated to a particular programme.

The countries adopting medium-term approaches do not practice a standard form of MTEF. The MTEF is often considered as an umbrella framework with interconnected frameworks or sequence of stages (Castro and Dorotinsky, 2008; OPM Review, 2000; and World Bank, 2013). Presenting simple projection of revenue and expenditure along with the budget can be considered as some form of medium-term approach. The design and practice of the medium-term approach is important to understand the role played by it in the budgeting process.

A medium-term fiscal framework (MTFF) constitutes specifying a top-down aggregate resource envelope and allocation to major category of expenditure items. It shows the fiscal stance of the Government through a set of integrated medium-term macroeconomic and fiscal targets and projections. The medium-term budgeting framework (MTBF), the more popular variant of the existing medium-term frameworks, develops further by including bottom-up resource requirements prepared by the spending departments and reconciling with the resource envelope available with the Government. In this framework, budget estimates for individual spending departments indicated in a medium term and resource allocation follows the strategic priorities. The medium-term performance framework (MTPF) takes this process further by shifting the focus from inputs to outputs. This is basically output-outcome type budget in which performance indicators can be worked out for each sector programmes and through them sector outputs are defined.

Improved expenditure planning involves specifying objectives that is determined by the policymaking, indicating organizations and financial instruments to carry out specific tasks, and devising a detailed activity plan covering tasks, process, and responsibilities of every unit engaged in the activity. Efficient and effective implementation of a programme to achieve the desired objectives thus depends, apart from funding, on specification of strategy to carry out the programme and operational and management process (Premchand, 2008). The strategic resource allocation in the budget planning system becomes meaningful with improving credibility of fund flows and associated performance indicators.
3. The Evolution of MTEF and its Experience

The MTEFs became popular in developing countries during the early nineties, with a positive push given by the World Bank and other donor agencies as an effective expenditure management instrument in their poverty eradication programmes. The early experience with the implementation of MTEFs in developing countries, particularly from African region, showed several weaknesses (Le Houerou and Taliercio, 2002; Homes and Evans, 2003). The MTEF was found to be ineffective in influencing environment of the annual budget due to lack of political ownership and often resulted in unrealistic projections (Jim Brumby, 2008). The basic objectives of achieving fiscal discipline, setting priority in resource allocation, predictability in fund flows, and efficiency gain in budgetary operations were not clearly visible.

Discouraging experience with the implementation of MTEF, however, did not repudiate the idea of formulating a medium-term perspective for the annual budget. The MTEF and its variants continued to prosper since the late nineties. The consistent use of MTEF in Australia to plan and finance spending initiatives and positive experiences from other industrial countries sent out positive signals (Brumby and Hemming, 2013). The efforts to strengthen public financial management systems both in the developed and emerging markets to successfully address the fiscal policy challenges, in a more integrated world economy included MTEF as one of the important instruments, to modernize budget planning process.

A recent study (World Bank, 2013) over the period 1990-2008, shows that the number of countries adopting the MTEF has enlarged and its impact has been perceived as being positive. The study shows that there has been widespread adoption of MTEF and shifting from basic MTFF to MTBF and MTPF among the advanced countries. Many low-income and emerging market countries also implemented MTEF to ensure better utilization of public resources to achieve development goals. Among the variants the MTFF is expected to have positive impact on fiscal discipline, the MTBF improving the allocative efficiency, and the MTPF is supposed to improve the performance orientation. According to the World Bank study, steering through cross-country data showed strong evidence that the variants of MTEF promote fiscal discipline. While the impact of efficiency gains in allocation of resources and operations are not conclusive, there are instances of improvement.

4. Fiscal Rule Guided Medium-Term Frameworks in India

The development planning process in India was stated to have provided a multi-year perspective to the planning and budgeting systems. The five-year plan was close to the concept behind the MTEF as the plan (investment) and non-plan (spending on existing programmes and recurrent expenditure) expenditure is planned based on projected resources. The integration of annual plans to the budget was considered as an innovation (Thimmaiah, 1984).

The plan-budget linkage, however, was not smooth and there were several disconnects in practice (Jena, 2016). The economy and sector-wide plan consisting of both private and public sectors, despite the claims, was not adequately linked to the annual budget. Planned goals, objectives, outputs, and resources allocated to achieve them were not adequately integrated into the annual budgets (Planning Commission, Expert Committee on Expenditure Management, 2011). The divergences between plan expenditure and budget were evident in the resource mobilization, allocation, and organizational structures (Premchand, 1983). The practice of making classification between plan and non-plan expenditures, an accounting development to keep a tab on plan investment, led to expanding the plans beyond the resource limits and resulted in neglect of existing assets both at Central and sub-national levels (Ministry of Finance, 2008).

The abolition of the Planning Commission in 2014 formally put to rest any misgivings regarding scope for a perceived multi-year budget planning within the five-year development planning process. The Planning Commission was considered to be not suitable to India’s economic aspirations in a more globally integrated environment with higher participation of private sector. The capacity of the Commission to make an economy-wide investment plan involving the Centre, States and the private sector was believed to be limited. The NITI Aayog, constituted as successor to the Commission in 2015, was
given the responsibility of long-term strategic planning and to provide technical support to the Central and State Government in different areas².

While the FRBM Act explicitly did not refer to the objective of establishing a medium-term framework, the requirement of presenting a medium-term fiscal policy (MTFP) provided such opportunity. This was expected to progressively develop into a medium-term framework in the budgeting system. The MTFP contained projection of the fiscal variables like revenue deficit³, fiscal deficit⁴, tax revenue, and outstanding liabilities relative to GDP as targets for three years in a rolling manner. The MTFP also contained a macro-framework and fiscal stance of the Government aligned with the budget⁵. Over the years, the projection of the target fiscal variables became the core activity of the MTFP facilitating tracking of macro numbers rather than any expenditure planning. The preparation of MTFP and progress towards achieving the fiscal targets are all monitored by the Ministry of Finance with spending departments having no role.

Achieving fiscal discipline, recognized with adherence to fiscal rules in recent times, depends upon the relative strength of the PFM system. The effectiveness of the fiscal rules can be enhanced by stretching the annual budget from one year to three years with an effective MTEF or its variant MTBF (Holger van Eden et al., 2013). A well-formulated medium-term strategy in budgeting, depicting budget impact of policy changes, is considered as a key element in this regard. The usefulness of the MTEF on effectiveness of the fiscal rules, however, will depend upon its capacity to establish a hard constraint on future expenditures (Allen Schick, 2013).

The MTFP, laid down under the fiscal rules, can be compared to the basic level of medium-term expenditure framework – the MTFF. There are departures that reduce the efficacy of the MTFP in establishing a medium-term framework. It was not developed into a system to prepare top-down resource envelope through an unbiased projection process and to allocate resources to major spending categories. Although, the MTFP elaborates on macroeconomic challenges and prospects, it lacks a medium-term macro-fiscal framework for improving efficiency of the budgeting system. It is not an adequate document to assess the future year fiscal impact of the Government policies. The State Governments, depending heavily on the Centre for funds, have to deal with the unpredictability of fund flows while formulating their MTFPs⁶. Until 2014-15, a large part of the Central grants for several flagship schemes used to flow directly to the implementing agencies outside the State budget⁷. This was to obviate the scope for the State Governments to delay the release of funds to the agencies and divert it for other purposes.

The Thirteenth Finance Commission (TFC) suggested strengthening the MTFP to make it a useful instrument for the budgeting. The MTFP, according to the TFC, should be made as a statement of commitment rather than a statement of intent (Report of the TFC, Govt. of India, 2009, pg. 146). The TFC recommended revising the existing MTFP statement to provide a detailed framework containing three-year forward estimates of revenues and expenditures, with detailed breakup of major items that form part of the revenue and expenditure. The objective was to provide a fiscal roadmap for three years into future and use the MTFP as an operational policy document. The TFC reasoned that the benefits of fiscal consolidation would benefit the country more if the policy decisions are taken keeping the medium-term impact in consideration. The recommendation was based on the rationale that an efficient medium-term framework would support

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² The National Institution for Transforming India, NITI Aayog, established in 2015 and considered as a premier policy ‘think tank’ of the Government of India, will design strategic and long-term policies and programmes and provide both directional and policy inputs. NITI Aayog is not meant to engage in approving or funding the plans prepared by the sub-national governments like the Planning Commission.

³ Revenue deficit in the Indian budget classification refers to recurrent deficit. It is the difference between revenue receipts and revenue expenditures, which increases the liabilities without any corresponding increase in assets.

⁴ Fiscal deficit is the excess of total disbursements (excluding debt repayments) over the total receipts (excluding debt receipts) during a fiscal year.

⁵ The MTFP sets forth a three-year rolling target for prescribed fiscal indicators like deficits and debts. As these are fiscal outcomes projected for a medium term, the fiscal strategy of the Government to achieve them is elaborated in another statement called ‘Fiscal Policy Strategy Statement’. It is supposed to give strategic priorities for the ensuing budget year. To provide a macroeconomic background to the fiscal stance, the fiscal rule also stipulates to present a ‘Macroeconomic Framework Statement’ containing assessment of the growth prospects.

⁶ The State Governments receive a share in Central taxes, grants from the Centre, and funds for several centrally sponsored schemes. The tax devolution is a predictable source of revenue as the share of the States are determined by the Central Finance Commission. The discretionary elements are high in other sources of funds and many a times depends on the fiscal health of the Central Government.

⁷ The CSS fund flows under many big schemes were routed directly to the implementing agencies outside the State budget. This arrangement, done to facilitate faster implementation, was found to be weak in accountability. From the fiscal year 2014-15, the Central Government started to route funds for all the CSS through State budgets.
effective implementation of the fiscal rules by imposing a hard constraint on future expenditure (Schick, 2010). What is obvious in this recommendation is that the medium-term framework should be anchored in the fiscal rules legislation. The Government of India introduced MTEF in 2012 following this recommendation.

5. The Indian Variant of MTEF

The MTEF contains forward estimate of expenditure commitments in various sectors viz. Education, Health, Rural Development, Energy, Subsidies, and Pension etc. (Tables 1 and 2). Expenditure commitments are shown separately for Revenue and Capital expenditure. The MTEF is designed based on broad functional categories of expenditure and does not go deep into the details of the functional categories shown in the budget. It shows the expenditure indicators projected for three years in a rolling manner, which includes the budget year and two outward years. The MTEF consists of descriptions relating to the assumptions while making the projections.

The assumptions relating to projections do not give a clear insight into the derivation of the numbers and thus their utility. The assumptions are the key features of the MTEF as these are supposed to explain the expenditure requirements in the medium-term. It was prescribed that the projections should be made taking into account the expenditure commitments of policy changes, contingent liabilities, and grants given for capital assets. Leaving aside the committed expenditures like salary, pension, and interest payments, where guidance has been given for their estimation and projection, there is hardly any clarity on the assumptions behind the projections of spending items. The assumptions regarding these spending innocuously indicate that the projections have been carried out 'keeping in view the availability of resources and financing requirement for various programmes of Government in line with various decisions and commitments' (Medium-term Expenditure Framework Statement, 2015, pg. 6). The document does not elaborate on the linkages between the spending commitments and the policy decisions. It may not be possible to verify the data as the document does not give any lead as to how the aggregate spending amounts are derived from myriad heads of accounts.

The projections presented after the budget shows a strong annual budget bias, where the spending on development and capital outlay become residual after meeting the committed spending. Bulk of the spending, to the tune of 87 percent, in Government goes towards revenue expenditure. Nearly two-third of this is spent on grants to States, interest payments and subsidies. The other major components are spending on defence, railways, salaries, pensions, and others (Report of the CAG, 2015). The large committed expenditure in this projections show an increasing trend. The projected expenditure trends in social and economic sectors and in capital outlay do not show a consistent behavior vis-à-vis the earlier years. The grant to the State, which is the composition of many development programmes of the Center implemented at the State level, has declined during this period.

The MTEF, structured around aggregate spending variables of the departments, is not an outcome of prioritized spending preferences revealed by the departments constrained by accompanying resource forecast. The departments negotiate with the Finance Ministry for resources based on bottom-up approach of resource requirements and they usually do not get an indication of availability aggregate resources early in the budget-making process (Ghosh and Jena, 2008). The expenditure forecast is done at the Ministry of Finance is unrelated with priorities involved in resource allocation. The projections are suggestive and are framed on annual budget estimates. They do not necessarily show the medium-term implications of policy decisions taken in the budget. It is more of a document that satisfies the requirements of the FRBM Act. However, some of the committed spending items like salary, pension, and interest payments could follow the path of the projection, unless drastic spending restructuring is carried out.

The Indian variant, combined with already existing MTFP, could be considered as close to what is called a 'Forecasting MTEF' (Salvatore Schiavo-Campo, 2009). However, it does not indicate resource availability to different ministries, a crucial factor in budget planning in the medium term. As the exercise looks like a mechanical extrapolation of annual budget,
structured around major spending items, there is no accrual of benefit to the budgeting system. Indeed, the MTEF, which comes after the budget, does not attract any serious debate regarding the requirement of resources in the medium term.

**Table 1: Revenue Expenditure (Recurrent) Part of the MTEF**

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<td>1. Salary</td>
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<td>866</td>
<td>951</td>
<td>906</td>
<td>996</td>
<td>1196</td>
<td>1006</td>
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<td>2. Interest</td>
<td>3707</td>
<td>4144</td>
<td>4576</td>
<td>4270</td>
<td>4684</td>
<td>5153</td>
<td>4561</td>
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<td>778</td>
<td>856</td>
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<td>902</td>
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<td>885</td>
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<td>2514</td>
<td>2460</td>
<td>2550</td>
<td>2274</td>
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<td>a. Fertiliser</td>
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<td>623</td>
<td>636</td>
<td>730</td>
<td>760</td>
<td>850</td>
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<td>b. Food</td>
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<td>1350</td>
<td>1150</td>
<td>1200</td>
<td>1300</td>
<td>1244</td>
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<td>c. Petroleum</td>
<td>650</td>
<td>350</td>
<td>200</td>
<td>634</td>
<td>500</td>
<td>400</td>
<td>300</td>
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<td>5. Grants to States</td>
<td>1544</td>
<td>1687</td>
<td>1878</td>
<td>1253</td>
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<td>1479</td>
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<td>58</td>
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<td>8. External Affairs</td>
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<td>100</td>
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<td>11. Finance</td>
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<td>223</td>
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<td>697</td>
<td>814</td>
<td>902</td>
<td>720</td>
<td>768</td>
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<td>13. Health</td>
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<td>14. Social Welfare</td>
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<td>16. Commerce and Industry</td>
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<td>18. Rural Development</td>
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<td>19. Dev. of North East</td>
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<td>20. Planning and Statistics</td>
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<td>22. Energy</td>
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<td>23. Transport</td>
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<td>24. IT and Telecom</td>
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<td>25. UT</td>
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<td>26. Others</td>
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<td>246</td>
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<td><strong>15496</strong></td>
<td><strong>16860</strong></td>
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<td><strong>16744</strong></td>
<td><strong>18139</strong></td>
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**Source:** MTEF Statements, Relevant Years, Government of India

**Note:** BE is budget Estimates
Table 2: Capital Expenditure Part of the MTEF

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<td>946</td>
<td>1164</td>
<td>982</td>
<td>1177</td>
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<td>2. Home Affairs</td>
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Source: MTEF Statements, Relevant Years, Government of India
Note: BE is Budget Estimates

6. Government’s Plan to Revise the MTEF

The Government of India has planned to revise the MTEF following the inputs provided by the Expenditure Management Commission (EMC). The MTEF will be expanded consistent with the Demand for Grants of the Expenditure Budget and give demand-wise projections of revenue and capital expenditure for the two outward years (MTEF Circular 2016-17, Govt. of India). The existing aggregate spending-wise information also will continue to exist. The initial projections taken from the ministries and departments will have a growth factor in the range of 5 to 10 percent; a higher growth factor should be accompanied by reasons for it. These inputs and fiscal stance taken in MTFP will be used by the Ministry of Finance to finalize a demand-wise projection of revenue expenditure and capital expenditure. The whole exercise will be carried out on web-based digital process through which the ministries and departments will be communicated with the approved spending projections. This exercise will be done during May and July, past the budget month of February. It is proposed that this data after being categorized into a format based on schemes, will be used in the interaction between the departments and the Ministry of Finance.

The MTEF revision plan shows positive intent. The proposed changes in the projections indicate features of both the MTFF and MTBF. Unlike the MTFP, where the ministries and departments have no role, the revised MTEF suggests to get an initial input from them. Thus, the role of the administrative departments in developing a multi-year expenditure plan has been acknowledged. The second round changes in the projections by the Ministry of Finance based on the fiscal stance of the MTFP and communicating this back to the departments is like preparing expenditure ceilings under the MTBF. This exercise will be of use for expenditure control and will serve the purposes of the fiscal rules. The medium-term projections of line items at the ministry level and an aggregate view taken at the Ministry of Finance level will facilitate expenditure control.

9 The Government constituted the Expenditure Management Commission (EMC) in 2014 to suggest major expenditure reforms that will enable the government to reduce and manage its fiscal deficit at more sustainable levels. The EMC was supposed to make recommendations on institutional changes relating to budgeting process, fiscal rules, and fiscal discipline.
10 Demand for Grants is part of the budget document and shows the estimates of expenditure from the Consolidated Fund, included in the annual financial statement and required to be voted upon in the Parliament. Generally, one demand for grant is presented in respect of each ministry or department. However, for large ministries and departments, more than one demand is presented.
The revision in MTEF, if conforms to the plan, will make it a work in progress. It still does not clarify whether the spending departments will prepare a medium-term sector plan, negotiate for resources for the budget based on this plan, and prioritize the programmes based on the spending limit. The projections on all the line items is not the same as giving a ceiling on the resources to the departments and allow them the flexibility of choosing their programmes to achieve the sector goals of the Government. The MTEF will remain as an instrument to serve the objectives of the fiscal rule through the budget restraint. It will not bring a multi-year expenditure perspective to the programmes implemented by the spending departments.

To develop into a useful instrument for the budget planning and to improve efficiency of resource allocation and expenditure efficiency in the medium-term, the MTEF needs to be built on a sound macroeconomic framework with unbiased estimates of availability of resource. The MTEF should provide robust indication of resource allocation to the ministries and departments to enable them to prioritize their spending plan keeping in consideration the requirements for ongoing and the newly initiated programmes. The bottom-up expenditure programmes formulated by the line ministries based on the fiscal space provided through top down approach will ensure ownership and facilitate better achievement.

8. Change in Expenditure Classification to Remove Plan and Non-plan Classification

Following the decision to abolish the Planning Commission, the Government has also decided to remove plan and non-plan classification in expenditure starting from the budget year 2017-18. This is expected to facilitate the programme expenditure of the spending departments being treated in a holistic manner and provide comprehensive idea about resource availability for programmes. The change in expenditure classification is stated to facilitate better formulation of MTEF and performance budget. The policy decisions, particularly relating to investments, will be based on both capital and operating costs together in a unified manner by the spending departments.

The plan and non-plan classification in the expenditure was considered artificial and a constraint on efficient management of public expenditure. After decades of its use, the divide supposedly distinguishing desirable spending on development from bad or unproductive spending has lost the clarity. There is very little now to differentiate between the two kinds of expenditure except that of an accounting difference (Planning Commission, Expert Committee on Expenditure Management, 2011). The plan and non-plan classification only created a fragmented budgetary allocation involving two different authorities such as the Planning Commission and the Ministry of Finance (Ghosh and Jena, 2008). The tendency to favour the plan spending has created a situation in which the assets already created are neglected for funds to maintain them. With the dissolution of Planning Commission, the classification was not required anymore.

One big change in the fiscal regime post the dissolution of the Planning Commission is the Ministry of Finance becoming the only decision-making agency for resource allocation. This was expected to unify the fragmented resource allocation process and help the spending departments taking expenditure decisions in a multi-year mode. The departments have to submit the budget proposals following the revised expenditure classification.

With the removal of plan and non-plan nomenclature, the Central government expenditure will be classified into four categories (Draft Report on Merger of Plan and Non-plan, Govt. of India, 2016):

i. Central government schemes/projects
ii. Establishment and obligatory expenditures
iii. Expenditure on autonomous bodies/implementing agencies
iv. Expenditure on centrally sponsored schemes (CSS – transfers to States)

The proposed classification gives the impression that while the budget will not contain any plan and non-plan
classification in the details of expenditures, the broad categories will still resemble the plan and non-plan divide. Establishment and obligatory expenditure (ii) representing the establishment related spending and obligatory spending like interest payment and debt servicing, and expenditure on autonomous bodies and implementing agencies (iii) are of non-plan type spending. The Central government schemes/projects (i) contains spending heads, which are part of plan expenditure in the existing classification. It also includes some non-plan spending like subsidies and police modernization. The fourth, the CSS, are part of plan spending in the existing expenditure classification and implemented at the State level. Ease of resource allocation seems to be at the heart of the proposed expenditure categories.

In the pre-budget negotiations, the Ministry of Finance will first provide ceilings for the spending categories given in (ii) and (iii). These are pretty much the same non-plan spending items in the existing framework. Only tentative ceilings can be discussed relating to the budget proposals given in (i) and (iv), which are clearly the plan spending. These tentative ceilings, probably, will be linked to the projections contained in the MTEF. The final ceilings will be given towards end of the budget negotiations.

While the rearrangement in expenditure classification and unifying the resource allocation decisions in the hand of the Ministry of Finance provides opportunities to further the MTEF, inability to firm up the resource envelope and provide ceilings to spending departments obstructs the process. To assume that the projections of expenditure variables under the existing MTEF will provide the spending departments with indications regarding resource availability is far-fetched. Indication of ceilings following a top-down approach gives the spending departments a sense of predictability regarding the flow of funds in the medium term.

8. Looking at the Basics

The pre-conditions for a successful introduction of MTBF are a credible annual budget, accurate medium-term macroeconomic and demographic projections, established fiscal objectives and rules, and a comprehensive, unified top-down budget process (Harris et al., 2013). It is indeed difficult to achieve a high-level stability and consistency in the performance of PFM institutions, which are complex in nature and are interlinked in a dynamic manner.

- A credible annual budget, enabling the Government to implement the policies voted in the Parliament in a predictable manner, forms the basis for the multi-year decision making process. The expectation regarding assured flow of funds as approved by the legislation and strong control over budget execution are crucial features of this budgeting practice. From Table 3, it is evident that the aggregate revenue receipt performance during 2011-12 to 2014-15 remains reasonably good, the deviation from budget estimates declining to about 4 percentage points in 2013-14 before rising in 2014-15. The PEFA ranking on budget credibility for India for the period 2007 to 2009 was also very high (Jena, 2010 – PEFA India)11. Expenditure outturn as compared to the budget estimates shows better results for revenue expenditure, the deviation remaining below 5 percent until 2013-14. The capital expenditure seems to have become residual in the system and takes a setback depending upon the demands of committed spending. While there is a need for tightening the budget outcomes, the realized revenue and spending do not show wild deviations.

11 The aggregate revenue collection during the period from 2006/07 to 2008/09 exceeded 97 percent of the budget estimates in two of the three years for which the PEFA ranking for revenue outturn was a high of ‘A’.


Table 3: Deviation from Budget Estimates

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<td>Revenue Receipts</td>
<td>-4.87</td>
<td>-6.03</td>
<td>-3.94</td>
<td>-7.43</td>
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<tr>
<td>Tax Revenue</td>
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<tr>
<td>Non-Tax Receipts</td>
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<td>-16.56</td>
<td>15.45</td>
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<td>-6.45</td>
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<tr>
<td>Capital Expenditure</td>
<td>-1.24</td>
<td>-18.53</td>
<td>-18.09</td>
<td>-13.27</td>
</tr>
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</table>

Source: Budget documents, Government of India, relevant years

To build a successful MTBF, the basics of PFM institutional structure and macro-management needs to be on strong footing. The macroeconomic and fiscal management in India has been showing stability in recent years despite the presence of considerable volatility in the international economic environment. In the continuing gloomy global scenario, the Indian economy has been considered as one of the brightest spots. The country is projected to grow at 7.6 per cent in 2015-16 and with low inflation and robust external position (Economic Survey, 2015-16). The task, however, is to maintain the momentum in a difficult global environment. A stable macroeconomic environment helps to prepare realistic forecasting to apply in the medium-term budget framework.

Fiscal rule for the country defines the stance of the Government in the medium-term with regard to key variables like deficit, tax, and debt. The target fiscal outcomes in the medium-terms put a limit on the fiscal behavior of the Government. When the MTBF is built, its contours in terms of programme financing are accommodated within such limits. India has the experience of more than a decade of fiscal rules, during which the country went through initial success and failed to achieve the targets during the global financial crisis in 2008-09. Post crisis, the country has been trying to strengthen fiscal consolidation12 and a major revision to the fiscal rules is underway13.

A unified top-down budgeting process is the crucial element of budgeting process, which facilitates expenditure discipline and helps the spending departments prioritize within their limits. The abolition of Planning Commission in India has ensured a unified decision making process to the Ministry of Finance. As the fiscal architecture has been evolving with several changes, the need for taking a comprehensive view of budget process and making all expenditure decisions at one time has become necessary. The existing practice and the proposed changes in expenditure classification, however, may not lead to a resource allocation decision in a holistic manner for the medium-term framework.

9. Moving ahead with MTBF First

The medium-term expenditure framework should move towards adopting the features of the medium-term budgeting framework (MTBF). Nomenclature should not be a hindrance; it can continue to be named as MTEF. The core theme of this should be to improve predictability of flow funds, reflect the future costs of policy decisions adopted in the annual budget through multi-year revenue and expenditure estimates, and improve service delivery mechanism. The existing annual budget is incremental in nature and the advent of a forecasting type MTEF has not changed the practice to reflect these features.

Adopting MTBF will be demanding for three main reasons. First, providing strong indication of resource allocation to spending departments for the outward years will need a realistic picture of resource envelope. Second, making distinction between ongoing and new-initiated programmes and providing higher fiscal space to high priority programmes in a politically influenced resource trade-off will be a complex process. Third, the MTBF will be more challenging for the spending

12 See the report of the Comptroller and Auditor General of India 2016 on “Compliance of the FRBM Act”
13 The government formed a committee in 2016 to review the working of the 12-year-old FRBM Act and suggest changes.
departments, who have to overcome the conflicting pressures to prepare a sectoral plan and prioritize within the resource limit. However, the experience of preparing medium-term fiscal policy to adhere to the provisions of the fiscal rules, formally starting to adopt a form of MTEF where the expenditure items are projected for three years, and planning to revise the MTEF to take it forward are positive developments in the recent years that will make the task easier.

In the MTBF, the fiscal space has to be filled up by the spending departments with their prioritized programme structure. This will give them flexibility to adjust with the level of funding and increase the ownership. The Ministry of Finance has to prepare a robust estimate of revenue consistent with the macroeconomic outlook and provide expenditure ceilings. Although this is a rolling system which will be revised based on the economic situation and revenue projection, the initial indication should be a robust one not prone to wild variations. The departments need to improve their institutional capacity to achieve the goals of prioritizing the programmes within the budget constraints. This process further requires distinguishing the cost of ongoing and new programmes proposed in the budget and integrating the medium-term plan with the annual budget.

Unlike an incremental system, the departments have to focus on government policies and cost of the programmes as the basis for prioritizing. The programmes have to be identified, which will outline the contours of the medium-term planning (Schiavo-Campo, 2009). Major divisions in a ministry like primary education or secondary education can be considered as broad programmes to define the objectives and indicators. Such broad definition of programmes to ensure accountability is appropriate in a government where the autonomy and flexibility to design and implement the budget is high for departments and ministries. In the Indian budgetary system, the functional classification of expenditure is elaborate and the flexibility to re-appropriate is limited. The expenditure categories included in the existing forecasting type MTEF, introduced under the fiscal rules, show broader categories like education, health and so on. This can be considered as useful classification for the MTBF.

The proposed expansion of projections to the detailed line items given in the ‘demand for grants’ of the departments will provide a narrower definition of programmes to form a basis of MTBF. While the line item based annual budget facilitates financial compliance, the narrow interpretation of budget will not satisfy the service delivery standards required from a programmatic MTBF. The MTBF in India should attempt to build the fiscal space realistically keeping the efficiency of the expenditure programmes in consideration to provide public service and from the point of view of ensuring managerial empowerment to execute the programmes. The principles guiding the MTBF should be the consistency between sector plans and priorities with the resource allocation.

10. Further Progress: Aiming at MTPF

The MTBF can be taken forward using the output type budgeting with performance indicators to prepare what is known as medium-term performance framework (MTPF). This will shift the focus from inputs to outputs and to measuring the performance. Although, the MTEF does not specifically need a performance budget and can be adopted in a cash-based line item budgeting environment, promoting results and encouraging better performance from the sector programmes is always considered as improvements in the system. The MTPF in India should attempt to build the fiscal space realistically keeping the efficiency of the expenditure programmes in consideration to provide public service and from the point of view of ensuring managerial empowerment to execute the programmes. The performance indicators are considered for the resource allocation decisions and the basis for evaluating the efficacy of the programmes of the spending agencies.

The performance budget has been the part of the Indian budgeting system since 1968. It would then seem logical to include the performance indicators in the sector strategies. The performance budget in the country, however, remained a routine document without being able to link the budget decisions to the performance indicators (Premchand, 1969; Cutt, 1972 and Toye, 1981). Dismal run of this early innovation over the decades had prompted the Central Government to adopt the functional classification shows the functions and activities of the Government for which the expenditure has been incurred. The functional classification system comprises of a six-tier structure with a hierarchy that explains the major functions, objectives of spending, specific activities, details of components of the schemes, and the object head of the expenditure.
a revised version called outcome budget in 2005.

The outcome budget is yet to emerge as a useful instrument to influence the budgetary decisions in both programme formulation and resource allocation. The factors like lack of appropriate and acceptable performance indicators, focusing on quantifiable outcomes instead of more acceptable outputs, inadequacies in costing process, stretched performance chain with gaps in information with regard to Central schemes, absence of an effective monitoring system to evaluate the results proved obstacles (Jena, 2012). As the expenditure management system in the country has been going through several changes, although with discontinuities, the outcome budget is also expected to become relevant. The intervention of the 14th Finance Commission (FFC), to strengthen the outcome budget, shows the intents of the Government15.

11. The Subnational Context

The expenditure planning at the State level fundamentally revolves around the annual budget with plan and non-plan components. The non-plan expenditure, which is committed in nature, is estimated first and the plan expenditure is determined residually depending upon the availability of resources. The fiscal targets of the FRBM Act limit the deficit and the borrowing option. The budgetary support to the State plan includes resources left after meeting the non-plan expenditure and plan assistance from the Central Government. The contact with medium-term expenditure perspective happens mechanically through the MTFP and approval of the annual and the five-year plans by the Central Planning Commission facilitating budgetary support from the Central Government.

The changes in fiscal architecture due to abolition of Planning Commission and cessation of Central plan grants to the States after the recommendation of FFC left the States with a crucial need for a medium-term budget planning process16. As the practice of plan approval from the Planning Commission ended, the focus has shifted to the ability of the State Governments to manage their own development path. Given the large functional responsibilities, consequent expenditure requirements, and the resource constraint faced by the States, a multi-year expenditure plan with clear priorities with budget constraint is necessary17. The indicators of sustainable development goals (SDGs) have been emerging as the new focus of development in the government policies. Long-term SDG indicators have to be conceptualized and implemented by the spending departments through medium-term spending plans within the available resources.

Some States attempted to prepare MTEF at sectoral level supported by the multilateral agencies. The sector MTEFs remained attached to the plan and non-plan classification and failed to provide a holistic expenditure profile for the programmes. In most cases, external agencies were drafted to prepare the MTEF without active participation of the stakeholder departments. Post fiscal rules18, the State Governments have shown maturity in fiscal management to overcome the fiscal imbalance and improved fiscal consolidation (Rao and Jena, 2009). The fiscal changes now make the case for MTEF stronger.

MTEF will be a useful instrument for the States to address some of the basic PFM issues at sub-national level19. The contemporary challenges faced by the States, judged from the basic objectives of the PEM system, are the issues related to the allocative and operational efficiency. Ensuring value for money and effective utilization of public money to

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15 The 14th Finance Commission in its report recommended to formulate appropriate indicators for measurement of outputs (See Report of the 14th FC, pg.237)
16 The 14th Finance Commission (FFC) considered tax devolution to be the primary route of transfer of resources to States. The FFC enhanced the States’ share in central taxes (untied transfers) to 42 percent from the present 32 percent to enhance the flexibility of the States to take expenditure decisions based on their own priorities. Consequent to the enhancement of share of the States in the divisible pool of Central taxes, the Central Government has discontinued the central assistance to the State plans.
17 The State governments in India bear major portion of expenditure responsibilities and provide basic services in the field of health, education, water supply and sanitary services, electricity, transport and communication, agriculture and also have the responsibility of maintaining law and order and provide wide range of judicial services. The Constitution of India demarcates the functional responsibilities between the Central and the State Governments.
18 The State Governments adopted FRBM Act separately through their own State Acts. The Central Government incentivized the States through debt restructuring facilities to adopt the fiscal rules.
19 For some of the expenditure management issues at the State level, see Jena, 2016 and Jena et al., 2016
achieve desired results remained as the problem areas. The tendency of expanding the budget size, spreading resources thinly, and bias towards short-term goals adversely affected resource allocation in a prioritized manner. The issues relating to inadequacies in designing and implementing the programmes, project appraisal and approval processes, and planning and monitoring mechanism remained as common themes across the States affecting the operational efficiency in service delivery.

12. Institutional Support at Central and State Levels

The NITI Aayog, which replaced the Planning Commission, is designed as a think tank and as an advisory body to the Government of India. The NITI Aayog has been positioned as an overarching institution to partner with all stakeholders in the federal structure including the State Governments. It also has the responsibilities to prepare strategic and long-term policies and to monitor the effective government policies. Being a think-tank, the Aayog is also supposed to provide knowledge support and ideas of innovations to the ministries and departments. The NITI Aayog needs medium-term perspective on sector programmes and spending plans in its quest to provide a long-term policy framework to both the Central and State Governments. To support the long-term vision of the Government, the Aayog should provide institutional support to all the ministries and departments in preparing and monitoring MTEF process.

With the removal of plan and non-plan classification, some uncertainty has arisen over the future role of the State-level planning bodies, usually the planning departments. The need for separate resource allocation for plan side of the budget will be no longer needed in the State budget. Thus, the Planning Departments should be effectively used as a coordinating agency among the departments to formulate appropriate strategies, policies and processes in a medium-term framework. The planning departments can become repository of knowledge regarding public policies to facilitate capacity building of the spending departments in the areas of sector planning and performance management. They can help the spending departments in project appraisal to select the programmes, costing, and strategies to achieve the programme goals. The existing planning bodies, due to their long years of experience in preparing perspective planning for all the sectors will be able to provide institutional support to the MTEF process at the State level.

13. Concluding Remarks

The medium-term expenditure framework (MTEF) in India needs to shed the mechanical approach to make it an efficient budgetary instrument. Decades of development plan and medium-term projections of fiscal variables under years of fiscal rules could not change the short horizon of the annual budget. The projection of expenditure variables in the existing process does not sufficiently inform the budgetary implications of policy changes sufficiently. The need for investment and development of human and physical infrastructure many a times leads governments both at central and sub-national level to plan more than that they could support. The Government needs to strengthen the MTEF process to establish a hard budget constraint in the budgeting process, improve the predictability in the flow of resources to ministries and departments, and improve the strategic priorities in resource allocation.

The existing public financial management practice favours a sound medium-term framework to enhance the quality of spending. With the end of the planning era, the Governments at national and sub-national level require a credible medium-term framework. The long-term economic vision and the objective to integrate the indicators of SDGs in economic policies need an effective medium-term frameworks in budget management process. The NITI Aayog at the Central level and the Planning Departments at the State level should provide the institutional support required for coordinating and monitoring the implementation of the ministries and departments.

The Government should move ahead with medium-term budgeting framework (MTBF) by indicating availability of resources to the departments in a medium-term to provide them with the flexibility of prioritizing their expenditure plans to
achieve the sector goals. This should be a forward-looking process where the medium-term expenditure projection is updated consistent with the resource availability. Both the Ministry of Finance and the spending departments need to coordinate for resource allocation and programme management within a medium-term framework. As the output and outcome-type budget has been getting renewed attention in India, the MTEF can further develop into medium-term performance framework (MTPF) by including performance indicators in the sector programmes. It is important, however, to allow the MTBF to stabilize and show positive impact on fiscal discipline, resource allocation and service delivery.
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