

Public Spending Planning under Fiscal Crises through the Annual Budget: Palestine as a case study

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Abstract

The fiscal situation in Palestine has become critical in the recent several years. The severe economic shocks experienced as a result of Covid-19 pandemic, the repetitive clearance revenue crises with the Israeli side, and the international aid declining trajectory are the main causes for the last fiscal crises. Nonetheless, the pressure on the public spending became unbearable, and the budget deficit continued to increase. Under these challenging circumstances, the importance of creating a budget tool that allows policy makers manage expenditure efficiently is a must. This paper discusses how the budget Medium Term Fiscal Framework (MTFF) was developed to manage public spending under the huge deficit gap. It focuses on protecting high priority spending, cancelling or stopping other existing services, and suggesting alternatives for new policy choices. This helps Ministry of Finance officials formulate budget proposals for decision makers. The comprehensive detailed MTFF can be used to plan spending during the year. The developed MTFF ensures the delivery of high priority services whilst budget deficits remain within the fiscal target and expenditure on arrears remains controlled

Key Words

Fiscal Crisis, Medium Term Fiscal Frame MTFF, Budget Deficit.

Introduction

The Economic and Fiscal Situation

The Palestinian economy lately has been more vulnerable to economic shocks than ever before. The lockdowns that

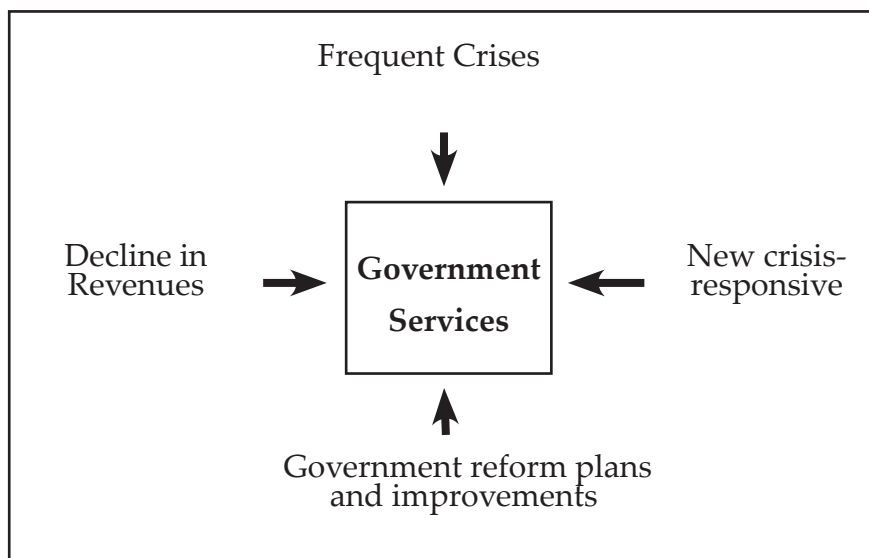
resulted from the pandemic further impacted on economic activity in 2020, as well as the withholding of clearance revenues in 2019 and 2020. As a result, the economic activity contracted sharply, which in turn resulted in higher levels of unemployment due to lower domestic demand. The overall GDP decreased by 11.3% in 2020.

Despite this, the recent economic, political and financial crisis has increasingly undermined financial sustainability. Increases in public spending have outstripped the growth in revenues leading to a corresponding rise in the fiscal deficit and arrears. For example, the fiscal deficit has increased four-fold from 2013 to 2020, standing at USD 1.1 billion in 2020, while at the same time, external support from donors and options for domestic financing have significantly decreased from levels exceeding USD 1.3 billion in 2013 to USD 0.3 billion in 2021 and bank lending limits have been reached. This required an increase in public debt by some 29%, standing at USD 3.6 billion by the end of 2020, to cover government liabilities. As most of this lending is domestic, this increases the likelihood of the public sector crowding out private sector activity, constraining economic growth.

As a result, even though the macroeconomic situation is improving after Covid-19 recovery, the fiscal situation is becoming increasingly unsustainable, with the economy in a vicious circle of increased spending, compounded by the withholding of clearance revenues, resulting in higher fiscal deficits and levels of debt and arrears, which impacts negatively on the wider economy. This indicates the need for the development of appropriate fiscal policies to limit expenditure and increase revenue mobilisation.

Expenditure Demands and expectations, despite the fiscal instability crisis, there are political, civil society, and citizen demands for and expectations of continuing improvements to the scope and quality of public services and so for continuing increases in expenditures. These reasonable demands and expectations can no longer all be met by the resources available now and that can reasonably be expected in the short-to-medium term. Hard choices about what services to increase and what to maintain and what to cut are inevitable. Experience of other fiscal instability crises shows that the longer choice-making is delayed the harder and the more painful and disruptive the choices will be.

The chart below summarizes the situation of the Palestinian public finance during the recent fiscal crisis especially the one caused by Covid-19 pandemic:



The General Budget as Fiscal Policy Tool

In general, a government budget is the financial plan of a government for a given period, usually for a fiscal year. It shows how the expected resources will be generated and used over the fiscal period. The budget is the government's key instrument for promoting its socio-economic objectives. In Palestine, a program-based planning and budgeting approach had been adopted since 2011. Program budgeting bases expenditures primarily on programs regardless of objects or organizational units. It is considered a transitional form between traditional item and performance approaches. While there are sector-wide policies organized around the key pillars of the government, each program (such as the Basic Education program in the Ministry of Education) has its own program-level policies. These program-level policies must be SMART, meaning that they are specific and achievable with clear targets. The program-level policies are organized in terms of Goal (what is achievable in the long term), Objectives (what is achievable in the short to medium-term within 1-3 years), and

Outputs that are conducted through several work tasks and the total cost is estimated.

Mid-Term Fiscal Framework (MTFF)

Medium term fiscal framework has become central to medium term budgeting and fiscal planning for finance ministries. The MTFF is focused on fiscal aggregates and seeks to reconcile fiscal policy objectives (usually for the overall fiscal deficit) with aggregate expenditure and revenue estimates over the medium term. Policy measures presented are high level; for example, new tax rates, salary increases of civil servants, or introduction of significant legislation. These measures are reconciled to equate the resource envelope and fiscal targets with the top-down expenditure estimates over the time horizon of the MTFF. The MTFF consists of a spreadsheet that brings together macroeconomic and fiscal data, and projects these into the future.

Discussion

Two years after the Pandemic, the Palestinian public finance situation remains challenging despite the signs of recovery after the relaxation of precautionary measures related to the Corona pandemic. The fiscal situation is becoming increasingly unsustainable with the limited resources. If this continues, the government uses all the available revenues, and borrows as much as possible. It will also incur arrears. The aggregate spending will remain the same (maybe increase) and the budget deficit will continue to increase. There will be deficiencies in providing part of the basic and important services.

In such conditions, the appropriate fiscal policy to mitigate the severity of the crisis is to cut spending on some services in favour of more urgent services. This can be done by:

- Protecting the current essential and vital services (public safety and security, administration, and basic services).
- Accommodating new and responsive services to the health and economic crisis (health crisis management, social protection, economic protection and economic recovery).
- Including some of the government's policy priorities (sectoral plans, poverty reduction plans, industrial zones, ...)

- Temporarily switching off or cancelling some services which are not vital.

The Mid-Term budget as an important tool for fiscal policy was developed through creating a detailed MTFF that allows to make expenditure choices in a proper way that minimizes the impact of the existing fiscal crisis in Palestine. The newly developed MTFF is a comprehensive system that allows policy makers to allocate the limited financial resources on the high priority services without affecting the core function of the government. The choices can be made quickly even centrally based on the urgent decisions of policy makers.

The previously used MTFF cannot link high priority spending with information on de facto resource availability. Low priority spending is difficult to distinguish from higher priorities and it is impossible to know whether to delay or cancel spending to protect high priority services later in the year. And to solve the problem, the currently used MTFF was developed to become a crisis- responsive. This required the creation of expenditure details from scratch and a complete information on financing (borrowing) projections from each source and in detail.

The historical detailed expenditure data (6-digit level) was categorized in a way that ensures the delivery of high priority services keeping the deficit within the fiscal target. The idea was in creating a classification for all services provided from 2018 up to 2020. The suggested categorization classifies all the services delivered in the three previous years in a very detailed way. The categorization was done at the level of program, output, and economic classification of the expenditure. First of all, all government programs are based on studying the policy statement of each program. All programs were classified into four categories based of priority; (high, intermediate, low and not a priority), the second level of the categorization was based on the function of the government service of all outputs into four categories; (Safety and security, administrative, basic, and a service that can be temporarily stopped), the third level was based on the economic nature of the expenditure within the output at the six-digit level, the classification was done in a way based on the special structure of expenditure in Palestine; (wage, vital non-wage, other that can be stopped).

A complete, comprehensive categorization for all outputs and expenditure details was developed. The newly classified historical data was the fundamentals of the new MTFF. It was used to draw projections for the 2021-2023 medium term

budget through linking all spending categories to the direct affecting indicators. Prices, demographic changes, wages indexes, and other related indicators were used for projections with the possibility of modifications based on the updates of the economic forecasts.

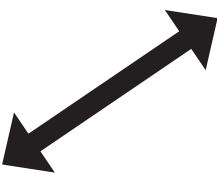
Results and Conclusions

The final MTFF system that was developed is very helpful where policy choices can be directly altered to fiscal choices and then to budget ceilings. Also, the system can be used in the cash management where the Ministry of Finance can prioritize financial orders based on the importance of the service being delivered. The ministries of finance officials can also use such MTFF systems for government arrears management by giving priority in arrears repayments to suppliers of basic goods and services, and thus managing the cash flow process in an optimal way that guarantees financial sustainability especially during fiscal crises.

In 2021, the ministry of finance in Palestine was able to reduce the budget deficit through cutting the low priority expenses. The year-end deficit stood at 757 million USD, a 27% improvement from the previous year level of 1.03 billion USD, and 20% better than the budget forecasts of 945 million USD deficit. Some of the improvement in the budget deficit was due to the deferment in the investment plans. The future development projects will be in favour of those projects that targets citizen's needs and that would reduce the budget deficit later.

Another advantage of developing the MTFF is the introduction of expenditure reform plans. In the Palestinian case, the main identified expenditure issues are in the wage bill, the healthcare system expenditures, and the cost of water and electricity utilities.

The chart below summarizes how the detailed categorization of government services helps to compare total expenditure and total resources for making decisions:

Expenditure Type	Category		Resource Type	Category
- Compensation of employees	W		- Revenue	R
- Projected cost of all security services	A1		- Grants	G
- Projected cost of essential government administration	A2		- Borrowing	B
- Projected cost of essential public services	A3			
Sub-total "Core Expenditure" (CE)	(W+ A)		Total Resources	R
-Projected cost of less important services that can be switched off	A4			
- Crisis responsive services (CRS)	CRS + GP's			
- Government priorities (GP's)				
Total Expenditure	E			

The presentation of expenditure in a detailed manner makes it easy for policy makers to compare the total expenditure (E) with total resources (R). If $R > E$, the reintroduction of some CRS & GP's expenditure is possible. While if $E > R$, then expenditure policy options should be suggested including deciding which essential parts of Government to switch off.

The newly developed MTFF helps the Ministry of Finance to:

- Manage budget policy by deciding which public services to fund and which public services to switch off within available resources. This means assembling actual expenditure by responsibility centre, by programme and by six digit economic item in an Excel spreadsheet file.

- Understand whether a new policy can be introduced by catering for additional spending on a 3, 4, 5 or six digit item for a given programme in a given responsibility centre.

- Manage policy when revenues fall- which 3, 4, 5 or 6 digit items should be reduced in which programmes /responsibility centres.

- Determine budget preparation ceilings. The detailed MTFF information can be used to plan expenditure policy across all sectors discuss expenditure options by breaking expenditure down by responsibility centre, programme and by 3, 4, 5 or 6 digit economic item.

- Assess spending options within a fully-funded MTFF to project expenditure details. It is also used to adjust budget allocations when revenues change during budget execution.

- Manage a severe fiscal crisis. Using the MTFF the government can identify real resource availability then plan which parts of government can continue and which will need to be switched off (and for how long) – if the most high priority spending on core government, health, social protection and economic recovery is to be protected.

- Protect budget support through demonstrating commitment to a detailed plan built on a detailed MTFF.

- Help the Ministry of Finance plan the management of its cash budget during a severe fiscal crisis to ensure the most high priority spending is protected. It will also help the Ministry of Finance plan future budgets as Palestine moves out of its current emergency situation and into recovery.

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