Budgeting in Estonia

Prepared for the

4th Meeting of Senior Budget Officials From
Central Eastern and South-Eastern European Countries

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Introduction (1)

- Small population – 1.34 million people.
- 10% annual real growth – highest in EU.
- 5.9 per cent unemployment in 2006.
- Inflation 6.6% in 2007 (CPI).
- Euro exchange rate fixed – Currency Board Arrangement.
- Balanced budgets since 2002.
A government without debt
Introduction (2)

• A recent Concept Note by the Ministry of Finance outlines six areas of further changes:
  1. Strengthening performance-based budgeting
  2. Introduction of accrual-based budgeting
  3. Reporting as a management instrument linked with planning
  4. A more stable medium-term planning framework
  5. Developing accountability and strengthening internal control
  6. Developing internal audit
Formulation (1)

- Separated into two distinct phases:
  - Compiling a multi-year strategy
  - Compiling an annual budget

- No numerical fiscal rule, but coalition agreements provide important guidelines:
  - ‘…continue pursuing a strict budgetary policy with a budget surplus and reduction of the government debt.’
Formulation (2)

- Macro-economic forecasts by the Economic Analysis Department of the MoF (spring and summer).

- No macro-economic model, since data time series are too short and many structural changes.

- Reports directly to the Secretary General of the MoF.
# Timetable for budget formulation

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<tr>
<th>Date</th>
<th>Activity</th>
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<tr>
<td>January</td>
<td>The Ministry of Finance (MoF) issues the budget circular to line ministries with a time table.</td>
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<td>March</td>
<td>Line ministries submit a four-year Organisational Development Plan together with a financial plan to the MoF.</td>
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<td>March</td>
<td>The Economic Analysis Department of the MoF publishes the spring macro-economic forecast.</td>
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<td>April</td>
<td>The MoF negotiates with line ministries and prepares the draft State Budget Strategy for discussion in the Cabinet.</td>
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<td>May</td>
<td>The State Budget Strategy is approved by Cabinet and published. The MoF issues the budget decree with official annual budget envelopes for line ministries.</td>
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<td>June</td>
<td>Line ministries submit next year’s budget bids and Organisational Operational Plans to the MoF.</td>
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<td>August</td>
<td>Budget negotiations between MoF and line ministries.</td>
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<td>August</td>
<td>The Economic Analysis Department of the MoF publishes the summer macro-economic forecast. Finalisation of budget estimates and memorandum.</td>
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<td>September</td>
<td>Cabinet approves the draft budget.</td>
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<td>By 1 October</td>
<td>Budget presented to Parliament and budget memorandum published.</td>
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<td>December</td>
<td>Parliament adopts the budget.</td>
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Formulation (3)

- Since 2003, first step is the preparation of 4-year Organisational Development Plans with financial plans.
- Divided into programmes and sub-programmes.
- Consolidated by MoF into State Budget Strategy, which includes cross-cutting programmes.
- Does not provide fixed sectoral envelopes, but is remade every year.
- Concept Paper recommends using the Strategy for a fixed 4-year term linked to the electoral period.
Structure of the State Budget Strategy

Family and population policy

Goal: To achieve a growth of the population of Estonia through an increase in the birth rate and life expectancy and improvement of living standards.

Sub-goal 1: To provide children with better development opportunities and protection of health.

Key activity 1: Extension of the period of payment of parental benefit until the child is 18 months old. To implement this activity, additional funds to the amount of EEK 1.77 billion will be allocated from the budget of the area of government of the Ministry of Social Affairs through 2008-2011.

Result expected 1: The difference between the poverty rate of children and the poverty rate of the population will fall from 3.6% (2006) to 3.2%.

Based on the State Budget Strategy approved by Cabinet, ministries prepare 1-year Organisational Operational Plans.

Budget bids / appropriations use organisational and economic classification – 925 line items in 2008.

Concept Paper proposes appropriations on a programme basis, aligned with the State Budget Strategy.

Coverage generally comprehensive – two extra-budgetary funds (health and unemployment insurance).

No official definition of tax expenditures, but use is limited.
Formulation (5)

- Review recommendations:
  - Reducing overlap and redundancy
  - Consistent classification
  - Strengthening sectoral planning and evaluation
  - Firm ceiling during budget preparation
  - A more meaningful multi-year approach
  - Consider options for accruals budgeting
Approval (1)

- Unicameral Parliament (*Riigikogu*) with 101 seats – six political parties represented.

- Amendment motions cannot increase the deficit, and there are further procedural restrictions after the second reading.

- Three readings in the plenary, each preceded by deliberations in the Finance Committee (not public).

- No specialised research service, but the Finance Committee has some analytical support.
Approval (2)

- Few amendments (affecting ~ .2% of spending) – increases typically financed from the contingency reserve.

- In practice, approval has always been in time.

- No established procedure for dealing with the State Budget Strategy – 2008 Strategy not discussed.

- Concept Paper proposes that line ministers defend their budgets directly in front of Parliament (currently MoF).
Approval (3)

• Review recommendations:
  – Programmatic scrutiny
  – Engagement with the State Budget Strategy
Execution (1)

- Cabinet session early in the year breaks down line items into more detailed items – capital spending in particular.
- Line ministries responsible for execution.
- Treasury Single Account system with three main accounts in three commercial banks – 700 budget holders.
- Changes to line items require supplementary budget laws (if they affect totals) or amendments (if limited to reallocation).
- Since 2003, 3% carry-over of current expenditures and unlimited for capital spending.
Execution (2)

Several funds for in-year flexibility:

1. Reserve Fund provides a contingency reserve
2. Stabilisation Reserve Fund (SRF) for macro-economic management, but has almost never been used – de facto savings vehicle.
3. Cash Reserve Fund to facilitate liquidity management.

1. Budget holders prepare weekly cash plans for every account they hold in the TSA.
2. No penalties for deviations, e.g. internal interest charges.
Execution (3)

• Service delivery through different types of agencies, as defined in the Government of the Republic Act.

• Just under 90% of central government personnel is employed in agencies.

• 37 public enterprises, mainly in energy and transportation sectors – major privatisation completed.

• Single-tier local government system with 227 municipalities.
Execution (4)

• Local income from five sources: tax sharing (48%), local taxes (12%), equalisation grant (7%), earmarked grants (23%) and non-tax revenues (10%).

• Local debt may not exceed 60% of annual own revenue (excl. earmarked grants) plus ceiling on interest payments.

• Debt rule circumvented by creating foundations as well as PPPs (value estimated at one third of local own revenues).

• Public procurement procedures modernised in 2007.
Execution (5)

- Review recommendations:
  - Avoid supplementary budgets
  - Carry-over involving negotiations with the MoF
  - Define role of Strategic Reserve Fund
  - Balanced budget rule for municipalities, but address issue of PPPs
Accounting and auditing (1)

- Quarterly financial statements with a delay of four months plus annual report.
- For 2008, also monthly reports with programme and sub-programme data and outputs as cost indicators.
- Monthly cash-flow reports published on internet, and daily data on cash transactions available via internet.
Accounting and auditing (2)

• In 2000, introduction of modern internal audit procedures with IAU in all central government ministries and agencies.

• Intention to introduce internal performance audits in 2009, training programme in preparation.

• Concept Paper envisages further development, e.g.
  – Discontinuing requirement for declaration of reliability
  – Greater role of Cabinet in deciding IA priorities
  – Publication of an annual overview of internal audit findings.
Accounting and auditing (3)

- External audit based on the 2004 National Audit Act.
- National Audit Office headed by the Auditor-General appointed by Parliament for a renewable term of 5 years.
- Produces annual report by 31 August, plus 50-60 special audit reports (incl. 25-30 performance audits).
- Broad mandate covering entire public sector.
- NAO reports considered by the State Budget Control Select Committee in Parliament – could be more effective.
Accounting and auditing (4)

- Review recommendations:
  - Remove requirement for IAU to issue a declaration of reliability
  - Involve Cabinet in priority-setting for internal audits
  - Strengthen follow-up and monitoring of corrective action in response to external audit recommendations