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REFLECTIONS ON OECD'S DRAFT PRINCIPLES OF BUDGETARY GOVERNANCE

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REFLECTIONS ON OECD'S DRAFT PRINCIPLES OF BUDGETARY GOVERNANCE

Budgetary principles are almost as old as budgeting itself, and serve both to codify and upgrade prevailing practices. Viewed in this light, OECD's initiative to establish "high-level principles of budgetary governance" builds on the work originated by Say and Stourm in the l9th century and by Sundelson and others in the 20th century.[1] While the traditional and contemporary statements have some common elements (such as the accuracy of budget accounts) there are three fundamental differences between previous statements of budgetary principles and the one proposed by OECD in the draft document that is currently undergoing review and comment. First, classical principles generally regarded budgeting as a self-contained administrative process and focused on procedural matters, such as the comprehensiveness of expenditure statements and the timeliness of required actions.[2] OECD's principles have an outward oriented perspective that regards budgeting as a critical component of national governance. The preamble to its 10 core principles declares "budgeting is not a standalone process, removed from the other channels of government action", and "budgeting is an essential keystone in the architecture of trust between states and their citizens." Second, OECD's principles touch on substantive issues, such as the sustainability of a country's fiscal course, not only on budgetary procedures. Third, previous principles were individual statements; the current principles bear the imprimatur of a leading international organization and have the potential to become an authoritative statement of good budgetary practice.

Before considering the OECD document, it is appropriate to reflect on why it no longer suffices to encapsulate budgeting's principles in a bundle of procedures that prescribe how revenues and expenditures should be estimated, authorized and executed. This is the task of section 1 of the paper, which explains why contemporary principles reach beyond the internal machinery of budgeting and take account of the budget's political and economic circumstances and impacts. Section 2 discusses the relationship between budgetary principles and prevailing practices. Are the draft principles based on generally-accepted practices, or are they intended to promote best or avant-garde practices that have been adopted in some but not all OECD countries. The unsurprising answer is that sound principles do both: they neither ignore existing practices nor just settle for them. They express what is regarded as good practice while also promoting further improvement. OECD's draft principles can be classified into two broad categories: budget-related economic and program policies, and governance and political issues. Section 3 comments on policy-oriented principles, such as fiscal sustainability and strategic alignment of policies and budgets. Section 4 focuses on principles that affect democratic governance, such as transparency and accountability. The concluding section reflects on the future evolution of budgetary principles: will they become enforceable standards or remain advisory guidelines that may be ignored or adapted to fit the peculiar conditions of national governments?

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1 *See* Rene Stourm, The Budget, D. Appleton & Company, 1917; and J. Wilner Sundelson, "Budgetary Principles", Political Science Quarterly, 50 (2) 1935, pp. 236-63.

2 *See* Jesse Burkhead, Government Budgeting, John Wiley & Sons, 1956, pp. 108-09 for explanation of the classical budgetary principles.

1. Budgetary Principles: From Administrative Procedures to Substantive Policies

What explains the interest in budgetary principles, and why have contemporary principles branched beyond procedural matters to substantive and political issues? In this writer's view, the What explains the interest in budgetary principles, and why have contemporary principles branched beyond procedural matters to substantive and political issue? In this writer's view, the emergence of substantive, politically-salient budgetary principles is not a haphazard occurrence, but reflects political and economic pressures that have intensified in recent decades. These trends are diagrammed in Table 1 to depict a chain of developments that spans OECD's history from the post-World War II era to the present age and includes periods of robust economic growth and stagnation, expansion of political demands, active budget innovation, and decline in citizen regard for public institutions. The diagram indicates that the trends are inter-connected; each set of developments has propelled the next. These trends have influenced the emergence and orientation of budgetary principles.

Table 1.
Economic and Political Pressures on Budgeting

(1) Postwar Economic Growth in the OECD Community

(2) Expansion of Government Programs and Expenditures

(3) Escalation in demands on government budgets

(4) Slower Growth, with Rising deficits and Debt

(5) Significant Increase in Active Budget Stakeholders

(6) More Active, independent Parliamentary role

(7) Decline in Regard for Public Institutions

(8) Major Innovations in Budgetary Practices

(9) Internationalization of Budgetary Standards and Principles

Every OECD country has its own budget story, its economic ups and downs, its blend of political tradition and change, its distinctive budget practices and innovations, and its own chronology.

Nevertheless, the sequence arrayed in this table tells a story that fits the OECD community as a whole. The story is less about causation, more about sentiments and perspectives. Economic growth (the first entry in the table) did not "cause" government expansion (the second entry) but it did encourage a political state of mind that licensed political leaders to spend more on income supports and other public activities. Similarly, slower growth during the final decades of the 20th century (the 4th entry) did not itself increase stakeholder activism (the5th entry), but it did mobilize groups to defend their budgetary interests.

The starting point for tracing the evolution of budgeting is the post-war economic boom which enriched national treasuries and enabled OECD countries to claim a growing share of economic output.

Over time, the vast expansion in both the absolute and relative size of public revenues and expenditure transformed the budget into a critical instrument for guiding and stabilizing national economies and for formulating and implementing government policies and programs.[3] As national governments expanded

[3] The transformation of national budgeting is traced in Allen Schick, "The Road to PPB: The Stages of Budget Reform", Public Administration Review, 26 (1966), pp.243-258.

their program and financial footprints, they attracted more interest and pressure from civil society organizations and other stakeholders. Government expansion begat escalation of demands on the budget, both from already powerful interests and from those that had been excluded or under-represented, thereby fueling further increases in the government's share of national output. The more government responded to organized and unorganized interests, the more budgetary demands escalated. Civil society organizations did not have formal seats at the budget table, but their collective stakes became as great as those of public agencies that bid for resources and negotiate spending allocations with central power holders. In many OECD countries, parliament became more active and independent on budget matters, providing civil society interests with alternative and sometimes more effective channels for protecting and enhancing benefits. Aided by expanded committee staffs and (in some countries) by newly-established budget offices, parliamentarians became bolder in reviewing or amending the government's budget. Rising budget expectations turned growth from an economic condition into a political necessity that provides the wherewithal for governments to finance incremental expenditures and for citizens to have rising disposable incomes. During growth years, the national budget was deployed as an annual opportunity to trumpet the largess bestowed on citizens by a beneficent government. However, economic slowdown in some countries and stagnation in others during the last quarter of the 20th century strained the capacity of national governments to fulfil their expanded roles.[4] Significantly, however, lower economic growth and declining or disappearing budget increments did not reverse the buildup in demands on national governments. Organized interests redoubled their efforts to protect existing benefits, while efforts to promote diversity and inclusion, along with efforts to open the process to broader participation and influence, multiplied the number and variety of active budget stakeholders.

One might have expected this feedback loop--more government spending in response to rising national income--- to have boosted citizen regard for public institutions. The opposite occurred, however, for greater responsiveness by government was reciprocated in most of the highly developed countries by declining public trust. This downtrend began during a period when a growing share of national budgets was allocated to social security and other payments that directly boost household incomes and protect citizens against financial adversity.

Why were recipients of public largess biting the government hand that was feeding them? The answers to this question spill beyond the boundaries of budgeting and go to the rise of individualistic norms that have elevated citizen expectations, economic trends that have been less favorable than in previous periods, the role of media and groups in monitoring and criticizing government actions, weakened party identification, and pervasive decline in trust of authoritative institutions.[5] But budget trends and practices also have contributed to disinvestment in government institutions and leaders. As government expenditure grew, so, too, did tax burdens and debt levels; these adverse trends become onerous when economic growth rates receded from their post-World War II peaks , leaving many taxpayers with stagnant or declining real disposable incomes and governments with smaller (or no) increments to spend on old commitments and new priorities. Less buoyant economic circumstances and less support for tax increases inevitably increased tension between the budget's parts – spending on particular programs – and its aggregates. Although attitudes vary greatly among OECD countries, citizens generally covet the financial benefits and public services provided by government, but are nevertheless troubled by chronic deficits, high tax burdens, and burgeoning public debt. One expedient way to cope with the obvious incompatibility of

[4] During OECD’s early years (1960-1973) real GDP per capita averaged 3.6 percent annual growth among Member countries. During the next 14 years (1973-1987) real per capita GDP growth averaged only 1.8 percent a year. See OECD, Historical Statistics: 1960-1987, Table 3.2, OECD, 1989.

[5] Various explanations for the decline of trust and confidence in public institutions are examined in Susan J. Pharr and Robert D. Putnam (eds.) Disaffected Democracies: What’s Troubling the Trilateral Countries? Princeton University Press, 2000.

demanding both bigger benefits and smaller budgets is to harbor the belief that much government spending is wasteful and goes to undeserving people or purposes. It is a small step from this attitude to the withdrawal of trust in government. After all, why should taxpayers esteem government if it squanders their money, taxes them too much, doesn't provide the services they want, and appears indifferent to their needs? Populist negativism has been fed by enterprising journalists and activist groups who, thanks to modern information technology and other resources, now have greater capacity and willingness to challenge the budget's spending decisions and the economic and program assumptions on which they are based. The drumbeat of bad news and horror stories streaming from audience-seeking 24/7 media and from uninhibited, often angry bloggers drowns out government's routine delivery of services to citizens. Evidently, opening the budget to greater scrutiny has not soothed public attitudes and has not made it easier to produce budgets that protect benefits within sustainable fiscal limits.

Budget makers, including political leaders and program managers, responded to the expanded role of the budget and the conundrum of low public esteem coupled with high service expectations with a burst of major budget innovations, many of which are arrayed in Table 2. In the most innovative countries, reform sprawled across the full landscape of budgeting, loosening the CBA's grip on inputs and entrusting line managers with greater discretion in spending authorized funds, stretching time frames to the medium-term and beyond, shifting from bottom-up processes that allow unconstrained demands on the budget to top-down approaches that establish fiscal limits at the start of the budget preparation cycle, injecting performance information into the stream of budget work, establishing independent fiscal institutions to shadow the government's budget assumptions and forecasts, undertaking strategic spending reviews to assess whether programs should be scaled back or terminated, and more.

Table 2.
Major Budgetary Innovations

SUBSTANTIVE LIMITS ON BUDGET POLICIES

- Fiscal rules and Limits
- Top-Down Budgeting
- Medium-Term Frameworks
- Long-Term Fiscal Sustainability Projections
- Fiscal Risk Identification & Assessment
- Contingent Liabilities: Rules and Limits
- Baseline Projections
- Costing (Scoring) Policy Changes

RESULTS INFLUENCED BUDGETING

- Performance-Based Budgeting
- Spending Reviews
- Evidence-Based Budgeting

ACCOUNTABILITY, INTEGRITY, OPENESS

- Accrual Basis
- Prebudget statements
- Accessible Ebudgets
- Expanded Parliamentary Role and Resources
- Independent Fiscal Institutions
- Budget Codes and Diagnostics (OECD, IMF, PEFA)

All budget innovations have procedural elements because budgeting is inherently a process-driven form of policymaking that is distinguished from improvisational or ad hoc methods for deciding government policy. However, many of the innovations listed in Table 2 have explicit substantive elements that aim to limit policy options or outcomes. This characteristic is most evident in fiscal rules, medium-term frameworks and performance-based budgeting, but it appears in other innovations as well. In contrast to traditional public administration which had confidence that sound procedures would assure good outcomes, contemporary reforms target outcomes or results directly. Instead of assuming that a good process yields good results, modern public financial management assesses the utility of administrative procedures in terms of the results achieved by government.[6] Embedded in this shift from process to policy is the expectation that performance will improve and that citizens will regain confidence in public institutions.[7]

OECD's draft principles of budgetary governance are consonant with the shift from procedural safeguards to a results orientation. The classical budgetary principles formulated in the l9th and early 20th centuries gauged the government's expenditure policies in terms of the procedures used to make them. If the procedures were adjudged to be sound, the decisions and actions flowing from them were deemed to be the right ones. Due process in budgeting (and in public administration generally) resembles due process in judicial proceedings; in both, the results are judged on procedural, not substantive, grounds. However, unlike litigation, budget outcomes can be assessed independently of the procedures that give rise to them. It is feasible to evaluate the quality of budget allocations in terms of the performance of the economy, the level of public debt, the sustainability of program and expenditure commitments, the efficiency of public activities, citizen attitudes to public services, the responsiveness of budget policies to diverse interests, and the congruence of government priorities and spending decisions.

The draft principles give due regard to budgetary procedures, but they also establish guidelines for results. For example, the first principle states that fiscal policy should be managed within clear, credible and predictable limits. This objective can be operationalized by establishing fiscal rules that have both substantive elements (such as limits on deficits or on total expenditures) and procedural elements (such as methods to articulate and enforce the limits). The eighth principle, which deals with government performance, intertwines substantive criteria (including efficient public services) and procedures for generating performance information and evaluating program results.

The twin expansions discussed earlier in this section--in the scale of government and in volume and diversity of political demands --dictate that budgeting can no longer be a closed process shut off from outside political activity. Budgeting has always been a political process, as Wildavsky argued half a century ago,[8] but the difference is that politics is now more open and more adversarial, with more stakeholders joining in the fray, but with governments more constrained by past commitments and meager increments.

6 The argument that good procedures do not assure good fiscal outcomes is elaborated in Allen Schick, A Contemporary Approach to Public Expenditure Management, Economic Development Institute, The World Bank, 1998.

7 The expectation that improved performance will restore trust in public institutions is the central theme of Pedro Arizti and other (eds.) Results, Performance Budgeting and Trust in Government, The World Bank, 2010.

8 Aaron Wildavsky, The Politics of the Budgetary Process, Little, Brown & Co, 1964.

2. Principled Practices: The Best, the Good, and the Practical

Budgetary innovation has been the enabler of budgetary principles. If OECD countries were to have the same budget practices today as they had half a century ago, there would be no drive to establish new principles. If many countries had not already extended budgeting's time horizon beyond the single fiscal year, it would not be practical to devise principles for medium-term policy frameworks and long-term sustainability forecasts. Widespread availability of robust measures of outputs and outcomes have enabled framers of principles to focus on results, web-based access to budget data and documents has enabled principles that call for openness, the invention of rule-based fiscal constraints has enabled principle makers to promote top-down budget formulation.

Innovation has not taken a straight path across the OECD community. Some countries have been pioneers, others have been laggards, and some have enacted new budget laws to provide a legal basis for reform, while others have incorporated reforms into the existing legal framework. Most countries have been selective in the reforms they have adopted; few have embraced the whole reform agenda. Part of the explanation of different reform orientations is that Member countries have experienced and reacted to the developments discussed in the previous section in different ways. Not all countries have gone through the same economic ups and downs, and not all have been exposed to the same political pressures.

When it is successful, an innovation originates as a reform, but culminates in a practice. As long as it is viewed as a reform, the innovation is novel, probably provisional, not yet fully incorporated into the corpus of budget practices. One potential side-effect of OECD's principles is to accelerate the mainstreaming of key reforms into the ongoing routines of budgeting. In quite a few countries, reforms stand apart and are not integrated into the regular budget process. For example, some countries have separate annual budgets and medium-term frameworks, compile vast amounts of performance information that is not used when resources are allocated, or produce lists of contingent liabilities that are not costed in the budget. Will the principles transform innovations into routines? Not right away, but over time they might.

In budgeting, as in other fields, principles guide practices, but it also is the case that practices influence principles. The first part of this statement is obvious, the second part is less so. The essential purpose of principles is to spur improvement; they add little value if they merely restate existing practices. But principles that disregard practices risk becoming lofty sentiments that are disregarded by the practitioners responsible for putting them into effect. Nevertheless, in giving due regard to the ways countries actually manage public money, budget principles inevitably slight country-specific political and administrative arrangements and capacities. After all, they to establish general standards and do not normally carve out exceptions for non-conforming countries.

By styling its statement as 'high-level principles of budgetary governance', OECD strives for universal norms that accommodate different practices. At this level of generalization, it is feasible to reconcile distinctive country practices and universal norms. However, the guidance that elaborates each principle specifies standards or expectations that may be beyond the competence or *modus operandi* of some countries. For example, federal countries which embrace Principle 7 that the budget should present a true, full and fair picture of public finances, may nevertheless have difficulty with the statement that the national budget should present a full overview of public finances encompassing central and subnational levels of government.

In formulating budgetary principles, good practice is the rival of the best. While the line between the two approaches is fuzzy and subject to change as norms and practices evolve, "good" is a practice found in most developed countries, "best" practice in only a few. On the basis of this distinction, we can conclude that accrual reporting is a good practice because it is widely implemented, and that accrual budgeting is a best practice because it is applied in few countries. The more that principles tilt toward the best, the further they are from actual practice; the more they favor the good, the greater the influence they exert on laggard governments.

There is an understandable inclination to favor principles that reach for best practice, if only because anything less is deemed to be inferior. OECD's principles straddle the boundary between good and best, and in a few instances venture to practices that even highly innovative countries have not tried. Designating a practice as good or best does not mean that it has been effectively applied; only that it has been introduced in many or few countries. Thus, fiscal rules are rated best practice because they have been extensively applied, despite their failure to effectively constrained fiscal decisions in most countries. As discussion in the following sections show, the principles are an amalgam of good and best practice; they combine feature that have been applied widely, and some that have not.

3. Strengthening the Budget as a Policy Instrument

Budget policy operates on multiple governmental levels, each with its own objectives, principles and tools. The budget pertains to fiscal policy and interactions with overall economic activity, to sectoral and program allocations, and to operational policies that impact specific projects and activities. Managing these different, sometimes conflicting, functions draws on half of the principles as well as on key innovations, such as medium-term frameworks and performance measurement that seek to harmonize the budget's totals and parts, and to connect resources allocated to actual or expected results. The first principle in OECD's draft statement deals with the budget as a fiscal instrument.

Principle 1. Fiscal Policy Should Be Managed Within Clear, Credible and Predictable Limits

This principle recognizes the budget's fundamental role in economic management, a role that become increasingly prominent during the past century as the fiscal footprints of national governments expanded, and as citizens assigned them responsibility for their country's economic performance. The objective underlying this principle--fiscal discipline --has given rise to one of the most prominent budget innovations of recent times--fiscal rules that seek to constrain total revenues, expenditures, public debt or deficits. According to the 2012 OECD survey, fiscal rules have rapidly penetrated mainstream budgeting; all but two Member countries have formal rules that seek to constrain fiscal actions or outcomes.

Principle 1 does not explicitly call for preset targets or constraints, nor does it specify the fiscal elements that should be limited. It is feasible to maintain sturdy limits without recourse to formal rules; in fact, many countries regularly achieved prudent fiscal outcomes for generations through annual budget decisions. Typically, the government would set informal targets early in the annual budget preparation cycle and adjust them at the end of the cycle on the basis of updated economic information and its revenue and expenditure decisions. Evidently, this "elastic" mechanism no longer suffices because, as discussed earlier, demands on the budget have escalated, many national economies are not as supple as they once were, debt burdens have become much greater, expenditures have become more rigid, and tax increases are no longer a politically-acceptable way to stabilize fiscal outcomes.

Fiscal rules formalize what once were informal arrangements in most OECD countries. An obvious question, however, is whether the conditions itemized at the end of the previous paragraph undermine formal rules. After all, the pressures that destabilized national budgets during the pre-rule era have not disappeared now that formal rules have become commonplace. Claimants have not curtailed demands on the budget, expenditures have not become less rigid, voters, generally, have not mobilized in support of tax increases.

The argument for formal rules rests on two seemingly opposite but complementary assumptions. One is that rules constrain politicians from making bad fiscal choices, the other is that rules embolden politicians to make better fiscal decisions. The first seeks to depoliticize fiscal policy; the second relies on political action to improve fiscal outcomes. Each argument has distinctive vulnerabilities: rules tend to be ineffective when enforcement is entrusted to the very politicians who are supposed to be constrained; and rules that impair a politician's electoral prospects do not provide robust incentives for disciplined fiscal policies. These shortcomings do not fully account for the widespread failure of fiscal rules--other factors will be introduced shortly--but they do explain why rules work in some circumstances. They work when formal rules are reinforced by informal norms, that is, when politicians willingly accept the fiscal binds that deter them from taking popular but irresponsible policies; and when voters reward politicians for fiscal prudence, even when they therefore are taxed more or benefited less. Paradoxically, therefore, formal rules work best when they are least needed, and when they are reinforced by internalized norms that promote fiscal responsibility. A short list of countries have these supporting conditions; they generally have relatively low debt levels, modest deficits, and act prudently during good economic times when temptation is greatest to undertake policies that put the country's fiscal future at risk.

When political norms do not suffice and self-enforcement is weak, fiscal rules can be made to work through external enforcement exercised by supranational authorities or financial markets. The EU's Fiscal Compact aims to impose strong regional surveillance, along with the threat of sanctions, on member countries that stray from preset fiscal targets.[9] Its effectiveness cannot be fairly assessed until the Community has gone through a full economic cycle, with evidence on governmental behavior in both favorable and adverse economic conditions.

Fiscal responses to the global financial crisis suggest that economic shocks may have two contrary effects on fiscal rules. On the one hand, at the onset of the crisis fixed fiscal limits did not withstand rapid economic deterioration and spiraling deficits and debt. Standard fiscal rules, such as those codified in EU's Stability and Growth Pact provided neither barriers nor guidance to policymakers who struggled to navigate public finances through plummeting revenues and soaring unemployment. On the other hand, in the aftermath of crisis, some heavily-impacted countries took bold steps to correct severe fiscal imbalances, and other countries adopted austere, counter-indicative fiscal policies that gave priority to deficit reduction over economic stimulus. It is doubtful that austerity was inspired principally by new crisis-induced rules; elevated debt levels and fear of sovereign default and economic decline were stronger influences.

Although the jury is still out on the efficacy of fiscal rules, it is fair to conclude that although many countries have adopted rule-based limits, few have actually been governed by them. Contemporary fiscal limits generally appear to work when they are not constrictive, such as during periods of economic growth, when rising revenues expand the government's fiscal space and enable it to tax less or spend more while keeping deficits and debt within fiscal bounds. However, they may unduly constrict budget policy when economic conditions deteriorate, fiscal space shrinks or disappears, and the economy is in want of stimulus to promote growth and add jobs.

The key to rehabilitating fiscal limits is to curtail fiscal laxity in good times and to accommodate flexibility in adverse times. The OECD statement explaining Principle 1 defines sound fiscal policy as one that "uses favourable economic times to build up resilience and buffers against more difficult times." But it stops

[9] Formerly designated the Treaty on Stability, Coordination and Governance in the Economic and Monetary Union, the fiscal compact includes a structural deficit limit, a debit brake rule, an automatic correction procedure and other rules to coordinate fiscal policies.

short of endorsing cyclically-adjusted limits, noting that "there are a range of political and other factors that can impede governments from effecting such counter-cyclical or even cyclically neutral policies."[10]

The main impediment to fiscal produce during buoyant times is that politicians have strong incentives to squander the dividends of economic growth in ways that burden future budgets and undermine long-term sustainability. The simplest way to thwart this tendency is to limit real or relative (to GDP) aggregate expenditure, including tax expenditures.[11] If coupled with a parallel floor on revenues, the effect would be to compel governments to save economic dividends in reserve or stabilization funds, and to release money when economic conditions deteriorate. The fiscal effect would be similar to a counter-cyclical rule, but possibly easier to design and enforce.

Enforcement is a difficult issue, for it requires either political commitment or political constraint, both of which are sometimes lacking in electoral democracies. The two paths--commitment and constraint--lead to different rule-setting mechanisms. In one, the rule is determined annually through political or budget decisions; in the other, the rule is fixed in law and cannot be adjusted by political actors. A preset rule is indifferent to political preferences and to change in economic conditions; fiscal targets set each year are sensitive to these circumstances.

Fiscal rules have not yet matured to the point where detailed prescriptions can be formulated for how they should be established and implemented. There is still too much disparity among countries and too little evidence of what works to permit uniform standards. As noted earlier, Principle 1 advocates fiscal discipline, not fiscal rules. Nevertheless, articulation of this Principle is an important early step in the internationalization of formal standards to guide and constrain budget policy. Future iterations of this Principle will fill in some of the details.

Principle 2. Top-Down Budgetary Management Should be Applied to Align Policies and Resources

Top-down budgeting is an essential means of operationalizing and enforcing predetermined constraints on expenditures and other aggregates. It thus is better viewed as a corollary of the first principle rather than as an independent objective. But shifting from bottom-up to top-down budget structures is not just a technicality; it connotes significant change in the way budgets are prepared and in the relationship between central authorities and spending entities.

Traditional bottom-up processes give spending agencies open-ended license to bid for resources. Key fiscal parameters are set at the end of the formulation cycle, after bids have been reviewed, and negotiations between claimants and the CBO have concluded. The CBA's role in this relationship is clearly defined as the government's financial controller. It functions as spending cutter, and as protector of the government's financial interests and priorities. The relationship between spenders and the CBA is adversarial, but both sides gain from the exercise, which is why top-down arrangements persisted for so long. Agencies get to ask for as much as they want, and are assured of gaining incremental spending increases; the CBA confirms its central role as guardian of the treasury and has a lead role in deciding how incremental resources are allocated. In other words, expenditures are cut (relative to agency bids) and spending rises (relative to the previous year's level). Obviously, this happy outcome requires ample budget increments. The pressures discussed in section I have drained national budgets of sufficient increments, and made bottom-up budgeting a more contentious process with less welcomes outcomes.

[10] This and other quotes pertaining to the OECD principles are drawn from “Draft Principles of Budgetary Governance: First Orientations for a Set of Core Standards and Principles,” OECD, November 2013.

[11] Barry Anderson and Joseph Minarik argue that expenditure limits are more effective than debt or deficit rules in “Design Choices for Fiscal Policy Rules”, OECD Journal on Budgeting: 5(4) 2006, pp. 159-208.

Top-down budgeting reverses the sequence, with key decisions made at the start of the cycle, though usually with the possibility of modest adjustments along the way. More importantly, spending units are limited in the amounts they can request, and the CBA is thereby also limited in the amounts it can pare from the requests. The idea is to transform spending units into rationers and CBA into priority-setter and policymaker. As simple as it is, this redefinition of roles is hard to realize. It requires the CBA to unlearn the control habits that gave it leverage over the spending agencies, to withdraw from many of the details of budgeting, and to function--in most OECD countries together with other central players -- as the country's strategic policy core.[12]

OECD's 2012 survey of budget practices indicates that all but five Member countries impose ceilings on the initial budget requests of line ministries. Some provide an aggregate limit, others add sublimits for sectors or programs, and a few establish ceilings for ministries or other major administrative units. In tandem with these constraints some, governments which genuinely embrace the top-down logic have significantly reduced the number of discrete line items in their budgets, but there is no uniform pattern across the OECD community. Approximately a dozen Member countries now have fewer line items than were reported in the previous (2007) survey; however, an equal number have actually increased the number of itemized appropriations. A handful of countries appropriate to fewer than 100 items while half a dozen maintain more than 3000 items each. Apparently some countries responded to the fiscal crisis by tightening central surveillance of expenditure details, while others did just the opposite.

The 2012 survey makes the case for coupling top-down budgeting with relaxation of detailed controls. It argued that "While the Central Budget Authority (CBA) works to control aggregate spending by establishing and enforcing spending ceilings, line ministries assume greater responsibility for resource allocation."[13] The counter-argument -- that central authorities cannot effectively regulate aggregate spending if they do not have sufficient sway over items of expenditure -- is the rationale for retaining traditional controls.

Regardless of the number of appropriation accounts, top-down constraints and guidance have had a major impact on budgetary behavior and guidance, and have become key elements in other budgetary innovations such as medium-term frameworks. It was not long ago that government agencies routinely approached the annual budget cycle as an opportunity to extract more resources, and political leaders treated it as their platform for expanding programs and benefits. Even when they were given spending targets in advance, claimants often treated as provisional levels that would be adjusted upward in the give-and-take of budget negotiations. Top-down budgeting has firmed up these targets and strengthened the bargaining power of central authorities.

Top-down spending limits cannot be fully buffered against shifts in economic or political conditions, they can bolster leaders who are committed to fiscal prudence, but only if the limits are realistic and can be achieved without undue economic or political upheaval. However, although it is recognized in OECD's current draft statement as a distinct principle, top-down budgeting cannot thrive on its own. It must be part of a much larger suite of budget reforms that add discipline to the process, enrich the information available to budget makers, extend time frames beyond the single year, and provide incentives for prudent policies.

A key issue in top-down fiscal management is whether spending limits should be set on a gross or net basis. While this may appear to be a technical matter, it greatly influences both tactics and outcomes. Gross

[12] Reorientation of the central budget authority is discussed in Allen Schick, "The Changing Role of the Central Budget Office", originally published in the OECD Journal on Budgeting, 1(1) 2001, republished in OECD, Evolutions in Budgetary Practice, 2009, pp. 168-84.

[13] OECD, "Strengthening Budget Institutions in OECD Countries: Results of the 1012 OECD Budget Practices and Procedures Survey, November 2013.

limits do not take account of offsets, such as revenue from trading activities; net limits allow offsets .Sweden and the United States are on the opposite ends of the spectrum on this issue. Sweden enforces gross spending levels that are not adjusted for savings or additional revenue; The United States maintains net limits, which has given rise to active search within both government and the legislature for offsets.

Top-down budgeting extends beyond the financial parameters of the budget to the government's programs and policies. Traditional bottom-up procedures enable the government to assert its priorities after spenders have submitted bids, by selectively cutting the amounts requested. The end result often is a budget stocked with preferences of spending units and sprinkled with the government's priorities. When increments are plentiful, the government may have sufficient space for its wishes; when they aren't, the government may have to put its imprimatur on a budget that contains few of the things it wants. Top-down budgeting enables government to stake its claims before agencies submit bids. It thereby promotes, but does not assure, better alignment of policies and resources.

Principle 4. Budgets Should Be Forward-Looking, Giving a Clear Medium-Term Outlook

Budget policies affect three distinct, overlapping time frames: the financial year underway or immediately ahead; the medium-term, typically the next 3-5 years; and the long-term, as much as 30 or more years in the future. The annual frame is almost everywhere the period for which authoritative revenue and expenditure decisions are made by government and voted by parliament. Classical principles emphasized the annuality of budget actions, and gave rise to a repertoire of routines that recur year after year, often with little or no change. The single financial year has retained prominence in some recent reforms, such as fiscal rules and top-down budgeting.

One-year-at-a-time budgeting has advantages which partly explain its persistence as the dominant method for allocating public funds. It facilitates political control of financial decisions, enables governments to adjust revenue and spending policies to short-term economic and political changes, stabilizes roles and expectations for participants in the process, enhances stakeholder influence in budget policy, informs administrative units of available resources and citizens of promised services, For generations, annual budgeting has been a mainstay of ex ante parliamentary control of the purse and of ex post accountability for public finances.

There is another side to annual budgeting that merits consideration. One might think that making budget decisions each year multiplies the opportunities to alter expenditure policies. In fact, budgeting's short-termism has the opposite effect: it is the basis on which incrementalism rests. When budgets are remade each year, the tendency is to look to current expenditures to decide the next year's amounts. There is neither time nor support for sharp turns in policy or for strategic assessments of established programs. In annual budgeting, program managers and CBAs typically are dealing with three or more years at once: the year in progress, the upcoming fiscal year, and the year after for which initial planning is underway. The congested timetable spurs budget makers to take small steps in navigating from one year to the next.

The annual budget frame has additional drawbacks, perhaps the most damaging of which is that decisions made for one year spillover to future budgets. One year's modest program initiative often balloons into much larger future spending commitments, thereby narrowing options for future policymakers. Inevitably, this year's deficit becomes the next year's public debt, and possibly for all the fiscal years that follow as well. Annual budgeting reinforces procyclical tendencies--to spend growth dividends when the economy is strong and to contract expenditures or boost revenues when the economy falters.

The contemporary remedy for budgetary myopia is to attach a medium-term framework to the annual budget. This innovation is the primary instrument for operationalizing Principle 4. Of course, the annual budget's financial impact extends well beyond the medium-term, especially for inter-generational commitments such as pension benefits and health services .These commitments generally are established in standing legislation rather than in annual budget laws; they thus continue in effect indefinitely unless they are superseded by new legislation. In fact, across the OECD community, mandated entitlements account for most of the year-to-year rise in national expenditures. It is no exaggeration to claim that if current policies continue without change, most of the expenditures that will be made 50 years from now have already been decided. (Principle 9, which recognizes the long-term implications of current budget policy, is discussed in the next subsection.)

The medium-term is a compromise between the annuality of traditional budgeting and the ideal of a long-term horizon. It bows to the realities of electoral and economic cycles, recognizing the difficulty of making firm commitments that extend too far ahead. The popularity of this compromise is reflected in OECD's survey which found that only four Member countries lack a medium-term expenditure framework (MTEF).

MTEF has been a vital tool of fiscal stabilization in countries that were severely impacted by the global financial crisis, and required assistance from regional and international organizations to avert default. As a condition of external aid, these countries had to prepare and implement medium-term revenue and expenditure changes to consolidate public finance and stabilize debt levels.

MTEF has been introduced in numerous developing and emerging countries. Upwards of 100 countries are said to have implemented some form of medium-term framework, either as an integral part of their budget process or as a separate activity.[14] This estimate may be a bit too high, for some countries that claim to have an MTEF only have medium-term projections .A genuine METF is an authoritative set of expenditure limits (and possibly other fiscal constraints) for each of the next several years that are congruent with the budget adopted for the year immediately ahead. Effective implementation of an MTEF is a difficult task that depends on both political commitment and technical capabilities. For MTEF to work, political leaders must give due regard to the future fiscal implications of current expenditure decisions, they must operate within preset constraints when they make the budget for the next year and when they roll forward to the year afterwards. They must base outyear budget projections on realistic economic and program assumptions that are not tainted by political considerations. The government must have capacity to reliably estimate the interactions of economic conditions and budget decisions, and to project the medium-term budget impact of current revenue and expenditure policies and of proposed or adopted policy changes. Not all countries that claim to have an MTEF have these capabilities. Introducing an MTEF is both easy and difficult: easy because it can be grafted onto the annual budget process, and can draw on available baseline projections, hard because it requires the government to constrain its budget preferences on the basis of estimated future revenue and expenditure impacts. The MTEF movement has been actively promoted by the World Bank and IMF, sometimes in countries that have difficulty managing simpler, annual budget procedures.

In this writer's observation, although many countries claim to have an MTEF few deploy it effectively to constrain budget decisions. In many developing countries, MTEF's utility has been compromised by detaching it from the annual budget process. Ideally, the annual budget should be the first year of the MTEF, not a separate process. Sometimes, however, they are distinct processes, with one office responsible for the budget and a much smaller staff assigned to MTEF work. When the two processes are separated, the MTEF functions more as a showpiece than as a constraint on budget policies.

A second widespread deficiency is that many governments regard outyear expenditure limits as floors rather than ceilings. When they roll MTEF forward, the amounts previously planned for each of the next several years are routinely adjusted upward, not only for price changes but also for program enhancements,

[14] The MTEF movement is assessed in Jim Brumby and others, Beyond the Annual Budget: Global Experience with Medium-Term Expenditure Frameworks, The World Bank, 2013.

thereby undermining its purpose as a firm constraint. When MTEF is misused this way, it may be better to have only an annual budget and to avoid explicit medium-term targets that exert upward pressure on future expenditures and deficits.

A key issue in implementing MTEF is whether it should be exclusively an executive responsibility, or should engage parliament as well. Inasmuch as countries differ greatly in executive-legislative budget relationships and in parliamentary traditions, they also have different MTEF roles. Westminster countries are at one end of the spectrum, separated presidential-legislative systems are at the other end. In Westminster countries, the medium-term framework generally is regarded as adjunct to the government's budget and parliament does not have a formal role in voting future spending levels. In separated systems, an MTEF has diminished effectiveness if it is not voted by parliament. When legislative budget responsibility is distributed among sectoral committees, adoption a fiscal framework bolsters fiscal discipline.

Principle 9. Longer-Term Sustainability and Other Fiscal Risks Should be Identified, Assessed and Managed Prudently

This principle joins together two contemporary concerns in budgeting: regard for the long-term fiscal outlook, well beyond the current economic and political horizons; and the risk that fiscal outturns may diverge from planned levels because of conditions that were unforeseen or not taken into account when the budget was decided. The two issues converge because uncertainty and risk escalate when the fiscal horizon spans generations. Fiscal risks derive from multiple sources; the most prominent are that the economy will not perform in the assumed manner, that life expectancy will be longer than projected, and that the cost of public services, in particular health care, will vary from estimated levels (Contingent liabilities also generate fiscal risks, but for reasons explained later in the paper are discussed separately.)

The usual starting point for assessing a country's fiscal future is a baseline projection of the revenues and expenditures that will ensue if policies already in place are not changed. In this regard, a 30 or 50 year forecast is methodologically similar to the baseline projections used by almost all OECD countries for the annual budget and medium-term framework. Although countries differ in how they construct baselines, most assume that current policies (or laws) will continue through the period covered by the projections. The basic purpose of baselines (including long-term sustainability estimates) is not to predict the future but to project probable future fiscal consequences of continuing the program and budget policies already in effect.

Medium-term and long-term baselines are used both to estimate the budget impact of proposed or enacted policy initiatives, and to alert government and civil society to the probable consequences of inaction. The first use relies on scoring techniques, the second on fiscal gap estimates and other methods.[15] The first focuses on contemplated or completed actions, the second on inaction. The first generally restrains policy changes, the second impels change.

Although long-term fiscal projections have not yet become standardized as good practice, the OECD survey provides strong evidence of the rapid spread of this innovation. Approximately two-thirds of OECD countries project fiscal conditions 30 or more years ahead and half require that the annual budget or the medium-term framework be based on or consistent with their long-term projections, though the survey does not indicate how or whether this rule is enforced. Most countries update their projections periodically, some every year, others every 3-5 years, taking account of revised economic and social assumptions including growth rates, demographic and employment trends, and estimated health and pension

[15] *See* Allen Schick, Sustainable Budget Policy: Concepts and Approaches," originally published in OECD Journal on Budgeting: 5(1) 2005, reprinted in Evolutions in Budgetary Practice, pp. 363-403.

expenditure. Interestingly, since the previous (2007) survey, there has been a slight decline in the number of OECD countries producing projections that extend beyond a decade. Pressure to immediately correct severe fiscal imbalances may have shortened the time horizons of some countries.

Uncertainty is the nemesis of all projections, and more so for those that span generations. The risk that a 30 year or longer forecast will not unfold as projected is 100%. The biggest risk is that economic outturns-- growth, prices, exchange rates and interest rates -- will diverge from assumed levels. Risks also arise from contingent liabilities, such as government's commitment to indemnify depositors against bank insolvency or exporters against changes in terms of trade.

Because they usually provide point estimates rather than ranges, projections generally ignore risks or consign them to footnotes or background tables. The main remedy, applied in almost two-thirds of Member countries, is to publish estimates of the sensitivity of long-term projections to variant economic and other assumptions. For example, the government may estimate the sensitivity of fiscal projections to increase in life expectancy, lower fertility rates, or changes in labor productivity. However, these alternative projections rarely garner the same attention as is accorded the official point estimates.

The effectiveness of long-term projections can be measured directly in terms of impacts on current budget policies, and indirectly in terms of changes in elite consensus and public opinion. Immediate policy impacts may be more discernible, but over time possibly less salient than changes in the attitudes of political leaders and civil society organizations, When it is widely felt that the country's fiscal future is not at risk, political leaders will not sail against the wind and promote austere policies whose beneficial impacts lie decades in the future.

In all corners of budgeting, enriching the supply of information without changing other features of the process has problematic impact. The stockpile of budget-relevant information has swelled in recent decades, while the time available for policy interventions has remained constant (or possibly narrowed). Budget makers cope with the information deluge by focusing on essential data, and shunting aside information that gets in the way of completing the budget on schedule. Consciously or otherwise, they triage information into categories such as essential, good to have, and distracting. Long-term projections rarely fall in the essential category,

Several methods have been devised by policy analysts to make these projections more relevant. One is to compute the country's fiscal gap -- the quantitative difference between the present value of debt and projected (baseline) expenditures, and the present value of projected revenue from taxes and other sources, expressed in money terms or as a share of GDP.[16] The OECD survey reports that approximately two-thirds of Member countries include some form of fiscal gap analysis in long-term projections; a much smaller number include a somewhat different technique known as inter-generational accounting. By themselves, fiscal gap analysis and other tools are good-to-have information that is shunted aside when the budget is decided. It is feasible to invest this information with greater importance by barring budget (or other decisions) that would widen the projected fiscal gap. A number of technical issues pertaining to the discount rate and underlying assumptions must be resolved before fiscal gap estimates can become a regular feature of budgeting.

Even when they are deployed as analytic tools and not as decisional rules, long -term projections can influence budget policy by sensitizing government and civil society to the prospect that if continued without change budget trends will destabilize the economy. Fiscal analysis also is useful to estimate the amount of correction (as a percent of GDP) required to close the gap.

16 *Ibid.*

There is reason to believe that public sentiment is shifting in many countries, and that there is greater regard for the fiscal future than was the case during boom times. The post-crisis tilt toward austere budgets certainly is partly due to heightened awareness that hard choices are required to secure the country's fiscal future.

Principle 3. Budgets Should be Closely Aligned with Government-Wide Strategic Priorities

It has long been recognized that the budget is not only a financial statement, but also an expression of the government's strategic objectives and priorities. The principle presented here asserts that the two facets of budgeting -- money and policy -- should be congruent. Government should spend money on the programs and activities that it regards of highest value. Though pursuing this objective this may seem simple, efforts to harmonize the two sides of budgeting have had a troubled past and face a difficult future. During the past half century, a series of highly-touted reforms that promised to remake budgeting into a strategic policy process were introduced with much fanfare and quietly abandoned. Across the OECD community, budgets have remained more aligned with past commitments than with current priorities. When economies were expanding and tax rates were rising, governments managed to finance their strategic ambitions by allocating incremental resources to their priorities. The paucity, and sometimes absence, of increments now precludes or weakens this option in post-crisis countries, complicating the task of aligning resources and objectives, but sometimes spurring stressed governments to adopt innovations that have potential to expand the fiscal space available to policy initiatives.

There are good reasons why incrementalism persists as the dominant norm of budgeting. As Wildavsky argued half a century ago, it reduces both conflict and the number of decisions taken each year.[17] Every budget officer knows that the scrutiny given to existing programs and expenditures is far less than that targeted at proposed policy changes. Yet, it also is the case that within their "base" resources, government agencies often are quite innovative, terminating some activities and starting others, for example, taking advantage of IT and other technological breakthroughs to redesign services, reassign staff when vacancies occur, and to change other operational details. They innovate without fanfare, under the budget's radar, because calling attention to these kinds of shifts would raise the risk that their budget requests will be cut. Agencies also are attentive to the government's priorities, especially when they bid for incremental resources, but they obviously do so from their own vantage points, which may shortchange the government's strategic interests.

Explicit reallocation is the most difficult task in budgeting, though countries beset by the risk of default have had some recent successes. Program evaluation has long been the instrument of choice in advanced budget systems to promote the shift of resources from less to more effective uses and from lower to higher priorities. With a few notable exceptions, such as the Netherlands reconsideration exercise and Australia's evaluation strategy during the l980s, evaluation has been targeted much more on program initiatives, not on the established programs that account for the bulk of public expenditures. On the whole, evaluation has been more useful in rearranging activities within programs than in reallocating from existing programs to policy initiatives.

Three contemporary innovations have potential to stimulate strategic alignment--medium-term frameworks, performance indicators, and spending reviews. MTEF was discussed previously as an instrument of fiscal discipline; it doubles as a means of aligning government programs and policies with fiscal limits. MTEF has potential to promote strategic prioritization in at least three ways: by encouraging government to budget for the incremental resources that will be available over the medium-term; by focusing central budget review on policy changes rather than on expenditure details; and by giving line

[17] Wildavsky, *op cit*. Wildavsky regarded incrementalism as both a description of how budget resources are allocated, and as a norm for rational decision making.

agencies incentive and opportunity to reallocate within preset expenditure subceilings. The OECD survey does not indicate the extent to which countries have exploited MTEF's potential for strategic alignment.

MTEF has been more effective as an instrument of allocation than of reallocation. It is a useful process for allocating fiscal space for each of the next several years within a medium-term constraint. In design, MTEF has potential to facilitate reallocation by altering the division of power between central budget authorities and spending units. In blueprint, it enables spenders to shift resources within their medium-term budgets, subject to the CBA's assessment of the expenditure impacts of proposed reallocations and conformance to government objectives and priorities. The expectation is that reducing the risk that spenders will lose resources if they propose reallocations gives them incentive to reprioritize their budgets. It may be, however, that the strongest disinclination to reallocate comes from unwillingness to challenge the stakeholders who would be disadvantaged by the loss of resources.

During expansive times, the fact that much expenditure is misaligned may not concern political leaders because they are able to channel additional money to their priorities. This opportunity is foreclosed when the budget is tight and increments are scarce. With a paucity of resources for policy initiatives, established programs embedded in past decisions crowd out new priorities. One might assume that this is the perfect circumstance for MTEF-driven policies, but the opposite is the more likely outcome. When budgets are tight, expenditure decisions tend to be opportunistic, not strategic.

Performance indicators may be another spur to strategic alignment, but only if the information they generate is more than an adornment to the budget. One should not be too excited about how this information is used, for the latest OECD survey reports that since 2007 "performance information is generally less used for strategic planning and to a growing extent not at all" in negotiations between line ministries and central budget authorities.[18] While it is not the only factor, the difficulty of aligning resources and results partly explains the limited use of performance budgeting in prioritizing budget allocations. (Performance budgeting is more fully discussed with respect to Principle 8 below.)

Rigid budgets with little fiscal space, the financial crisis, and adverse long-term fiscal projections have motivated some countries to undertake strategic reviews of spending policies and programs. Spending reviews were not covered in the recent OECD study of budget practices, but this emerging practice was surveyed by Marc Robinson in a paper presented at the 2013 SBO meeting.[19] Though they typically aim to slow or reverse the rise in public expenditures, these reviews can also be deployed to free up resources for allocation to new priorities.

Spending reviews come in different varieties. Some countries scrutinize all major programs within a compressed time frame or over several years, others focus of programs singled out by government for intensive evaluation. Some countries conduct reviews on a fixed schedule; others do so only when political or financial conditions impel leaders to question existing practices. Some focus on operational efficiency, most are strategic investigations into the purposes of programs and their contribution to government priorities.

Recognition that the ongoing decisional routines of budgeting and standard program evaluations do not suffice has spurred countries to undertake tough, critical spending reviews that openly aim to reduce expenditures while bolstering strategic alignment. Some countries have had considerable success. Canada reduced expenditure as a share of GDP by five percentage points pursuant to a strategic review in the l990s, and the Netherlands has had ongoing success over several decades in recalibrating public expenditures.

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[18] 2012 Survey, p. 52.

[19] Marc Robinson, “Spending Reviews”, presented at 2013 meeting of Senior Budget Officials.

In contrast to program evaluations which tend to be technocratic exercises, spending reviews rely on the commitment and participation of political leaders in setting expenditure targets and program priorities, and to follow through with budget and legislative actions. Without strong support, spending reviews rapidly become political orphans, disowned by their nominal sponsors and disregarded when budgets are decided.

Spending reviews differ from program evaluations in yet another way. For the latter, the key questions are "is the program effective" and "how can it be improved?" For the former, key questions include, "why does the program exist", "should it be a public responsibility", and "Should the program be continued?" The different questions produce different answers and different budget outcomes.

Principle 8. Performance, Evaluation, and Value for Money should Be Integral to the Budget Process

Linking resources and results has been a perennial objective of budget reform for more than half a century in some OECD countries and for decades in others. Its prominence and persistence on reform agendas reflect two clashing features of budgeting--the logic and lure of performance, and the difficulty of predicating budget decisions on evidence (or expectation) of results. National governments have not been able to abandon the ideal of performance, but neither have they been able to proclaim victory. The pursuit of performance-driven budgeting is a fragile endeavor; it sprouts in some venues and seasons, withers in others, but rarely becomes integrated into the ongoing routines of budgeting and is no longer viewed as a novelty.

The 2012 survey found that more than half of OECD countries have a comprehensive program budgeting framework, while a quarter have ministerial or agency specific frameworks. To interpret this finding, it is useful to recognize that there long have been two rival conceptions of how performance budgeting should link resources and results.[20] One emphasizes a direct connection, with increments in resources explicitly linked to increments in results; the other relies on the availability of information on performance to influence policymakers. In the first model, evidence on results is determinative, in the second; it is one of multiple types of information taken into account when budgets are made. In theory, program classifications bolster the determinative model; in practice, it is very much part of the "informative" model. In almost all countries, the program structure is more a means of organizing budget information than of allocating financial resources .Notably, the statement explaining this principle tilts toward the performance-informed version; it asserts that performance "information should be routinely presented alongside financial allocations in the budget report." It urges that performance information…

> *should be clear and easily understood, should allow tracking of results against targets and for comparison with international and other benchmarks; and should make clear the link with government-wide strategic objectives.*

The triumph of performance-informed budgeting (PIB) is manifest in the many countries that publish quantitative measures in their budgets, even though they do not expressly base expenditure decisions on these indicators. It is relatively easy to generate output indicators, and to establish and monitor performance targets, but much harder to allocate incremental resources on the basis of incremental results. Common sense, the weight of past decisions, the need to calm the budget process while satisfying diverse interests, and other legitimate political considerations stand in the way of giving successful programs more money and unsuccessful ones less.

Almost all OECD countries have PIBs, but they vary in quality and usefulness. Many concentrate on outputs, which are easier to measure but less revealing than outcomes or impacts, some set *ex ante* targets,

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[20] *See* Allen Schick, "The Metamorphoses of Performance Budgeting", forthcoming OECD Journal on Budgeting.

and many do not. Few systematically measure results against targets, even fewer account for variances between planned and expected results. Inevitably, assessing the extent to which countries have fulfilled Principle 8 by making performance information integral to budgeting depends on the criteria applied

The 2012 OECD survey provides support for the argument that information alone may not suffice to orient budgeting to results. It concludes that compared to the previous (2007) survey more countries report that performance information is "not used" in budget negotiations. When performance targets are not used, oftentimes there are "no consequences." This would seem to suggest that performance information is not easily transformed into actions.

Although it is not the basis for budget negotiations, performance information generated by government entities may nevertheless be useful. The survey notes that performance information is widely used within agencies to manage activities, improve services and operations, and to redeploy resources to more productive uses. What spending units don't do is to bring performance issues into budget negotiations with central authorities. Apparently, agencies are eager to draw on performance data when it serves their interests, but not when it puts their budget allocations at risk.

This is good news, with important implications for budgeting and public management. Well-managed agencies continuously seek means of improving information, they are opportunistic in shifting resources from less to more effective uses, and they do strive to perform better. What matter are the quality of services and the effectiveness of programs, not the form or the content of budgets. As implausible as it may seem, governments across the OECD community continually upgrade the quality and effectiveness of public services (even though many citizens believe otherwise.) and shift resources within their budgets based on internal assessments of priorities and results. To do so, they routinely rely on performance information. In public management, the drive to perform thrives, even when performance budgeting falters.

4. Integrity and Accountability in Budgeting

Budgeting operates in two domains, within government as a means of allocating resources and financing public activities, and between government and citizens as a means of responding to individual and group interests and holding spenders accountable for their actions. The principles discussed thus far pertain mostly to practices within government, though some spillover to relations between government and the governed .Fiscal policy and program performance and a country's economic condition and prospects are not solely within-government matters settled behind closed doors without regard for the preferences and interests of the citizens impacted by public policies. Though they may be made in cloistered venues, budget decisions have public consequences. They have the potential to uplift people or hold them back, to benefit some and disadvantage others. In addition to distributing gains and losses, budgeting is a key elements in the checks and balances vital to democratic order, and to the integrity of public finances and public officials.

Principle 5. Budget Documents Should Be Open, Transparent and Accessible

For generations, budgeting has been structured to serve the interests of the spending units that bid for public funds, and of central agencies that allocate financial resources and manage the process. Principle 5 argues that it is not sufficient to publish the final budget submitted to Parliament, for at that point most, if not all, major decisions have been made, and citizen input is futile. Rather, government should make relevant information available "in advance of the final budget providing enough time for effective discussion and debate on policy choices...." In addition, budget documents "should be presented in open data formats which can be readily downloaded, analyzed, used and re-presented r55 by citizens, civil society organizations and other stakeholders."

The revolutionary idea embedded in this principle is that submission of the government's budget to parliament should be the beginning of public debate, not the end. This ideal may fit more comfortably in systems that allow the national legislature wide scope in voting the budget and appropriations, but it can be harmonized with countries that constrict parliamentary action by treating its consideration of the budget a question of confidence.

Timely publication of the government's budget is routine across the OECD community, but issuance of a draft or prebudget is not yet standard practice .Countries that formally publish advance documents do so to signal their budget plans, not to launch public discussion on what those plans should be. Nevertheless, the interval between the prebudget and the budget has the potential to stir debate on contemplated tax and spending priorities, to look beyond the next fiscal year to the medium-term and longer, to raise alternatives to the government's plans, and to give the opposition fuller opportunity to question past results and future policies.

It has become common for OECD countries to publish their budget documents in electronic form, thereby enabling interested citizens and groups to create their own formats and spreadsheets, and to structure and analyze budget data in different ways from those presented in the budget. However, most countries fall short of the norms promoted by the Open Budget Initiative, which evidently has exerted significant influence on practices in developing and emerging countries, and has actively campaigned for more openness in developed countries.[21]

It is fair to conclude that post-budget debate is now more robust and challenging than was the case a few decades ago. Journalists, bloggers, interest groups, and others spin and rearrange official revenue and expenditure data as they see fit, and promote alternatives to the budget. For example, independent analysts armed only with access to the internet can assess the amounts distributed to different geographic regions, age groups, income classes, genders, and so on.

Will openness in budgeting be a safety valve that generates debate, but does not itself change outcomes, or will it be a battering ram that pries open the budget's secrets and gives outsiders genuine voice on budget policies? The prevailing practice among Member countries is that internal discussions, including memos, working papers, and other communications among ministers, remain privileged and confidential after the budget has been published. Secrecy is justified as essential for frank exchange of views and to maintain party or coalition discipline. Budgeting is a process that must limit and manage the conflicts that arise out of competing demands, resource limits and political disagreements; arguably, therefore, closing the process during the period that the government is making difficult decisions is an appropriate means of limiting the scope of conflict.

However, Principle 5 embraces a different norm, that encouraging robust discussion both before and after decisions have been made is a superior means of ensuring political stability, because it gives voice to diverse interests and promotes democratic values.

Principle 6. The Budget Process Should be Inclusive, Participative, and Realistic

This Principle casts its lot with the argument that an essential purpose of enriched information is to enable citizens to participate in the budget debate and thereby influence public policies. The Principle stops short of endorsing "participatory budgeting" procedures that empower citizens to directly decide how portions of the budget should be spent. It suggests a more active role for parliament in deciding the budget and reviewing government actions. The statement explaining this Principle urges government to facilitate

[21] The Open Budget Initiative is a project that advocates broad public access to budget information. Its work is promoted through surveys of country practices and an index that rates countries on dimensions of openness.

engagement by legislators, citizens and civil society organizations "by making clear the relative costs and benefits of the wide range of public expenditure programmes and tax expenditures."

This Principle is both as a call for more informed debate by interested parties outside government, and for government itself to be more forthright about options, tradeoffs, analytic findings and program evaluations. The Principle runs counter the notion that there are no alternatives to the government's budget, that the decisions recorded in are based on judicious and prudent consideration of all the evidence, and that reasonable people would agree on the course selected in the budget. The notion that the budget is the only viable option stifles debate, makes performance information little more than an adornment, and establishes obstacles to genuine participation.

Principle 6 stands for an alternative view, that all budgets entail choices and tradeoffs, and that democracy is well-served when citizens intelligently discuss options that were not selected in the budget. It is not the job of government to set out the tradeoffs it faced in compiling the budget, but it is government's responsibility to publish available information that enables civil society to construct its own options.

Informed public discussion is valuable, even when there is little opportunity for parliament to amend the budget. Public debate can sway the government to modify its budget and influence policies in the next budget. In robust democracies, it can feed into political campaigns and affect voting patterns and election campaigns. The impact of informed debate is obviously more immediate when parliament acts independently and has authority to make substantive changes to the budget. But the Principle does not expressly endorse the idea that countries should alter constitutional arrangements to enlarge parliament's capacity to amend the budget.

Principle 6 hints at a larger role for budgetary information--to make the budget process more inclusive and participatory by encouraging public discussion before the government finalizes its budget. In many countries privileged citizens and groups have access to policymakers while the budget is being formulated. Access usually is informal, which means that it is not open to all citizens or groups. Because access is limited and key decisions are made behind closed doors, those who gain entry can influence budget policies on matters that concern them. Obviously, those who don't have the means to lobby budget makers have significantly less opportunity to influence policies before they are hardened into revenue or expenditure decisions. Prebudget information on the economic outlook, key budget issues and policy options would not quite level the playing field, but would give outsiders a better glimpse of what is happening inside and modestly more favorable opportunity to participate in budgetary discussions.

This may be all that the Principle connotes in urging a participatory process, but it also is possible to take the idea a big step further by opening parts of budget decision making to active participation by interested citizens and groups. Formal participatory budgeting has had limited application, mostly pertaining to local projects.[22] It is hard to open national budgets to direct participation, but there may be other means, such as web-based polls, to inject public preferences into the stream of budget decisions. Fulfilling Principle 6 does not require direct participation, but it does contemplate a budget process in which discussion of options and tradeoffs is widely encouraged.

As laudable as the concept of open budgeting is, the process is prone to be closed off when crisis strikes and the government is stressed to produce a package of revenue and expenditure reforms to calm financial markets and stabilize the country's fiscal position. It is during crisis, when major policy changes are in the air, that informed discussion is most beneficial, but also most lacking. When a crisis package is assembled

[22] Participatory budgeting had its genesis in municipal governments in Brazil, in particular Porto Alegre. See Frank Gold, "Lessons for Latin America's Experience with Participatory Budgeting," in Anwar Shah (ed.) Participatory Budgeting, The World Bank, 2006.

in absolute secrecy and thrust into the public square without prior discussion, citizens and groups might be cowed into silence, and passively accept the view that there are no other viable options or that opposition would be futile. Sometimes, however, the cloistered manner in which a crisis package is assembled and the far-reaching policy changes it contains provokes opponents to openly confront the government in an effort to derail or modify the package. Principle 6 should encourage budget makers to ponder whether structured public discussion might produce a better package and a more favorable political response.

Principle 7. Budgets Should Present True, Full and Fair Picture of the Public Finances

Comprehensiveness in budgeting serves two basic objectives: fiscal discipline and competition for scarce resources. Governments cannot effectively enforce fiscal constraints on deficits, debt or other aggregates if they lack a full account of financial transactions. And they cannot deploy the budget to determine expenditure priorities if certain programs or transactions are protected in extrabudgetary accounts. The first objective is especially critical in countries that have elevated deficit and debt levels, and must remedy fiscal imbalances to reenter capital markets. Achieving the second objective is impeded when revenues are earmarked for specific purposes, and are ring fenced from other claims on the budget.

The notion that the budget should be a comprehensive statement of public revenues and expenditures is among the classical principles of budgeting, but many countries nevertheless maintain offbudget or special accounts. In its contemporary formulation, the principle has been extended to matters that often have been regarded as outside the scope of the national budget. Thus, while recognizing that financial relationships between the central and subnational governments vary among countries, Principle 7 envisions national budgets that present a full "overview of the public finances--encompassing national and subnational governments..." The Principle breaks new ground in urging that the budget account for full costs and benefits. It does not explain how benefits are to be stated in the budget, but it does stipulate that costs should be presented on the accruals basis or, for countries budgeting on the cash basis, in supplementary schedules. If implemented, this Principle would eliminate or substantially narrow accounting differences between financial reports and budget statements. Pursuant to this Principle, the budget would provide salient information on liabilities that do not entail outlays in the current fiscal period, but may compel disbursements in the future.

Although a handful of countries now budget on an accruals basis, cash budgeting remains the dominant practice across the OECD community .However, accruals (usually in modified form)have become the norm for financial reports , such as the balance sheet, which often reports different financial results from those stated in the budget. Several factors explain the persistence of cash budgeting: a country that shifts to accruals must still pay attention to cash flows; accruals require complex socioeconomic assumptions -- such as life expectancy, economic trends, and interest and discount rates -- that do not have to be made in cash budgeting; cash budgets are much easier to prepare, and for politicians and citizens to comprehend. While there are many differences in their treatment of revenues and expenditures, accrual and cash budgeting do not always generate significantly different fiscal results.

Offbudget accounts come in many forms; their common element is that they are outside the ambit of the national budget. Some are purposely walled off from the budget to evade fiscal controls or to earmark revenues for designated purposes. Others are outside the budget to accommodate novel financial arrangements, such as public-private partnerships (PPPs). One simple way to assess whether significant financial flows are excluded from the budget is to compare year-over-year changes in public debt with the budget deficit. An increase in public debt larger than the reported deficit would indicate that some transactions have been excluded from the budget.

A comprehensive budget that presents a full account of public finances would include tax expenditures and contingent liabilities, the former because they ha important characteristics of direct expenditures, the latter because they impose costs on government and may generate claims on future budgets. Budgeting for these transactions opens the door to valuation problems that do not vex traditional budgeting which accounts only for cash disbursed by government.

Governments have taken two approaches in recognizing the revenues forgone through tax expenditures. One is to list and estimate the revenue losses of all tax subsidies, the other is to integrate direct and tax expenditures in the budget. It is much easier to settle for listings than to tradeoff between direct and tax expenditures. Many OECD countries publish tax expenditure information; few integrate direct and tax expenditure.

Contemporary governments are awash in contingent liabilities; these include guarantees tendered by government to individuals and enterprises, obligations incurred through public-private partnerships, indemnification of depositors for bank insolvency, and relief provided to victims of natural disasters. When budgeting for contingent liabilities, it is useful to distinguish between explicit and implicit liabilities.[23] Explicit liabilities derive from contracts and other formal obligations, implicit liabilities on expectations of how government should or will respond to events such as natural disasters. OECD countries have made uneven progress in budgeting for explicit contingent liabilities. The OECD survey found that three-quarters of Member countries include information on loan guarantees in their budgets, but only half report other types of guarantees and fewer than one-third record liabilities deriving from public-private partnerships. Governments have been cautious in recognizing contingent liabilities because doing so would increase moral hazard and their exposure to these risks. Less than 20 percent of OECD countries include liabilities arising from disasters or environmental degradation.

Countries have taken four main approaches to disclose or mitigate the risks that contingent liabilities impose on public finances. The simplest is to identify these liabilities in the budget or in a separate statement, and when feasible, to estimate their probable or potential cost. This approach adds information, but does not change the budgetary treatment of contingent liabilities. Second, some countries limit the volume of outstanding guarantees or the amount of new commitments that can be issued during the fiscal year. These limits usually are applied to credit guarantees, not to other contingent liabilities .Third, some countries reserve funds in the budget for contingent liabilities that may come during the year. The reserve sets aside space in the budget for contingencies but, as the global financial crisis demonstrated, does not effectively limit the amount the government actually spends to make good on its commitments .Finally, a few countries integrate contingent liabilities into the expenditure budget. The United States pioneered this approach in the early l990s, but applies it only loans, not to other contingent liabilities.

Principle 10. The Integrity and Quality of Budgetary Forecasts, Fiscal Plans and Budgetary Implementation Should Be Promoted Through Rigorous, Independent Quality Assurance

The budget has been characterized by this writer and others as a social contract between citizens and the state. It thus plays a vital role in shaping relationships between the governed and their government, and in forming civic attitudes about the conduct of politics and the performance of public institutions. In almost all OECD countries, public opinion polls report that trust and confidence in public leaders and organizations has deteriorated. Although budgetary policies and processes are only part of the story, it is reasonable to assume that some portion of the erosion is due to the management of public finances and the activities of government entities. It is unlikely that improved budget capacity will itself restore public trust and confidence, but it is not likely that governments will perform well if budgets are viewed by organized groups and ordinary citizens as misleading, opaque and confusing.

[23] This distinction is discussed in Hana Brixi and Allen Schick (eds.) Government at Risk: Contingent Liabilities and Fiscal Risk, The World Bank, 2002.

Integrity and accountability are bedrock principles of democracy that reinforce one another, but also tug in different directions. Integrity is an internalized norm that is realized through the actions of political leaders and public officials; accountability is an external process that is realized through independent oversight and review. In budgeting, both serve the same ends -- which public statements should be truthful and accurate, the budget should be a true and fair statement of public finances and prospects and the economic and program assumptions on which the budget is based should be objectively reliable.

There is risk, however, that the more these norms are enforced by external guardians, the less likely that they will internalized by those who spend public money and manage government activities. When the fear of an adverse audit exercises greater sway than does a sense of probity and public mindedness, financial statements may be accurate, but efforts to stretch the rules may proliferate. The more good behavior depends on formal procedures and oversight, the weaker it may be as a moral imperative.

Principle 10 aims to strike a balance between internal norms and external enforcement, calling for both integrity in budgeting through reliable forecasts and accurate financial statements, and quality assurance by independent monitors. The argument is sometimes made that integrity in budgeting (and in other government actions) will build trust and confidence in public leaders and institutions. The Principle enunciated here views probity in budgeting as a value in its own right. It reflects the notion, that the budget office should be a bastion of neutral competence, serving the government of the day by speaking truth to power.

Well-governed countries have reliable machinery in place to assure the integrity and quality of budgetary information. They have sufficiently resourced and qualified central budget staff, modern IT systems, robust internal controls, including internal audit, and a professional audit authority that reviews financial reports and other relevant information. These practices provide ex post assessment of the legality and propriety of financial management systems. Principle 10 goes further by calling for independent ex ante review of budgetary projections and plans. This review has traditionally a responsibility of parliament, but in a growing number of countries it is entrusted to an independent fiscal institution that is attached to parliament (such as in Canada) or is a free-standing entity. The OECD survey reports that 18 Member countries had IFIs in 2012, more than double the number in the previous survey. Although the resources and responsibilities of these new entities vary, a common feature is their objective review of fiscal projections and assumptions.

The Principle recognizes that the world of budgeting has become more politicized in many countries, engages the attention of more stakeholders, and has diverse aims and pressures that sometimes put a premium on expedience. When the economy is underperforming and demands on the budget are escalating, excessive buoyancy in macroeconomic or program assumptions can ease the path to finalization of the budget. It is at this point, that integrity and honesty in the estimates may be compromised, and independent scrutiny of the budget may be most beneficial.

Unduly optimistic fiscal assumptions and forecasts are costly. Not only do they degrade confidence in public institutions, they induce politicians to make fiscally irresponsible decisions, in particular to launch spending initiatives whose costs will not be covered by forecasted revenues, and to trim taxes in the unwarranted expectation that revenues will nevertheless be boosted by economic growth. The risk that fiscal outcomes will veer off course multiples when forecasts systematically err on the side of optimism.

5. Budgetary Principles: From Guidelines to Standards

The formulation of principles will impact the practice of budgeting, probably not immediately but certainly over time. Stakeholders within and outside government will be armed with widely-shared norms for assessing current practices and promoting reforms. Each Member country will move on its own pace, especially with respect to opening the process to greater outside scrutiny and participation. Many countries will require relatively minor adjustments to meet the standards, but a few may have to introduce significant changes in the conduct of budgeting.

It is important to note that the principles have not been pulled out thin air; most are anchored in innovations that have been underway for several decades across the OECD community. However, there has been a noticeable gap in most countries between the promise and the reality of budget reforms. Fiscal rules have not often bolstered budgetary discipline, medium-term frameworks have not assured longer time horizons, performance-based budget have not effectively linked resources and results. Because they emphasize purposes rather than mechanics, the Principles have potential to improve the effectiveness of budget innovations.

The further evolution of budgetary practice will depend on at least three considerations. First, within the OECD community, will the principles be advisory or authoritative? It is not uncommon for OECD pronouncements to begin as recommendations to ultimately become standards. Second, will future versions of the Principles have more demanding standards? The current version strikes a balance between the practical and the ideal, between the systems and capacities already in place and those that may be regarded as better or best practice. It is highly probable that as conventional practices improve, the Principles will be revised to spur further improvement. Third, will budgetary principles spread beyond OECD? It bears noting that the International Monetary Fund (IMF) is in the final stage of revising its fiscal transparency code, and that PEFA (the Public Expenditure a and Financial Accountability) project is revising the indicators it uses to grade country practices. Although the three organizations differ in their main foci, they do have some overlapping elements. The three statements are generally consistent, but differ in tone. The IMF and PEFA instruments are widely used as diagnostic tools; this is not currently the intended purpose of OECD's Principles, but one can readily foresee them deployed to guide assessments of country practices.