

# Twenty-five Years of Budgeting Reform

*by*

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The network of senior budget officials (SBO) was launched in 1980 as an *ad hoc* response to the budget stress that beset most developed countries in the aftermath of oil price shocks, high inflation, and economic stagnation. The long post-war expansion had come to a halt, but spending pressures did not abate, leaving national governments with large structural budget deficits. Voter sentiment and fiscal realities precluded political leaders from easing their country's budget plight by boosting taxes. Their only recourse was to take a stricter line on spending, and they needed budget tools that could do the job for them. Meeting for the first time under OECD auspices, senior budget officials perceived that they faced similar predicaments and could learn from the experiences of member countries.

When they met, budget officials brought a distinctive perspective to SBO, for they bridge the political and administrative domains of government. Every budget is a statement of policy by elected leaders and an administrative plan for the ongoing operations of public programmes and agencies. Senior budget officials are brokers between these realms. They deal on a continuing basis with politicians and administrators, and they must be sufficiently agile to satisfy both constituencies. Most budget directors are drawn from the ranks of senior civil servants, but to succeed they must be alert to political demands and perspectives. This quality – managerial capacity and political astuteness – has characterised both SBO delegations and discussions at the annual meetings.

The mystery of SBO is not that it became a regular event, but that it took so long for budget officials to convene. Before SBO, budget officials lacked an international forum for exchanging views and discussing recent developments. They probably were among the few governmental professionals who did not meet periodically. This lack was due, I believe, to an inherent characteristic of budgeting that has had an impact on the content and conduct of SBO meetings. Budgeting is an inward-looking process in which officials and politicians communicate within the confines of the government. Each bureaucratic echelon talks about spending matters to the levels immediately above and below it; ministers and department officials converse throughout the year with their own budget staffs and during the budget season with the central budget office; senior budget officials discuss financial and programme issues with cabinet members and parliamentarians. For the most part, budgeting is government talking to itself, with outside interests eavesdropping and occasionally joining in. Budgeting has the village quality so well described a

generation ago by Helco and Wildavsky in their splendid study of Britain's budget practices. Each government has its particular language for these conversations, embedded in forms, classifications, and rules of the budget process, as well as in the behaviour, roles and relationships of those who make and implement budgets. There are universal elements in the language of budgeting, but every country has its peculiar ways and terminology, and these reinforce the insularity of budgeting.

Having met for the first time a quarter of a century ago, budget officials discovered that they share common interests and concerns. Breaking down the insular perspective of budgeters has not been easy, however, and did not occur immediately upon the convening of SBO. In its first decade, SBO typically began each meeting with descriptions by delegates of practices and innovations in their country. Although the presentations rarely generated substantive discussion, they encouraged budget officials to be more open in discussing budget practices. A generation later, some delegates are still guarded in sharing experiences and appear more willing to describe new reforms than to explain how past innovations have actually worked. Others, however, come to SBO eager to discuss successes and failures and to trace the evolution of budget practices from one generation of reform to the next.

Over time, SBO has secured a niche on the calendars of most OECD member countries and has become an annual routine, like the preparation of the budget. As routine, there is risk of the discussions going stale, of repeating that which was taken up in the past. There is a need, therefore, to freshen the discussion, both by pointing to future issues that budget officials may face and by broadening the scope to consider matters that have generally been outside the SBO agenda. I hope this paper contributes to invigorating future SBO meetings.

The 25th annual meeting is an appropriate occasion for assessing the practice of budgeting and for reflecting on the challenges and opportunities that may impact budgeting in the decades ahead. I am honoured to have been invited to provide a forthright assessment of SBO, and hope that my somewhat critical observations do not detract from due consideration of the important issues facing budgeting. In preparing this paper, I have benefited from attendance at more than half the SBO meetings, review of almost all the agendas, and perusal of many SBO documents accumulated by me over the years. This paper is one observer's musings on the evolution of budgeting, as viewed through the SBO framework. Other observers would undoubtedly draw different lessons from the same material.

In viewing contemporary budgeting through SBO, I am mindful that the picture which emerges is incomplete. Over the years, SBO has evolved from an annual meeting into a platform for year-round activities on the functioning of budget systems. In fact, SBO has nurtured four sub-networks, each focusing

on a particular facet of budget practice. One network deals with accounting issues and links budgeting with other financial management tasks. Another addresses the challenges of orienting budgeting (and public management generally) to performance and results. A third recognises the growing role of national parliaments in budget policy, and the fourth frames budgeting within the organisational structure of government. From time to time each network feeds into the SBO, but each has its own network of practitioners and scholars. SBO has also encouraged and sponsored a compilation of a comprehensive database on budgeting practices, as well as in-depth holistic reviews of budgeting in particular countries.

Paradoxically, SBO's greatest accomplishment has been to launch these networks while keeping the high-level meeting for themselves. They meet once a year, but research and dissemination continues throughout the year.

Section 1 of this paper provides the context for SBO by comparing the budget performance of OECD member countries before and after the convening of these annual meetings. The contrast between the two periods is striking, for there has been a fundamental reorientation of budgeting from expansion to constraint. While this shift has been spurred by SBO, changes in political and economic conditions have been more important factors than the machinery of budgeting. Budgeting has been the dependent variable; it has been remoulded from time to time to fit changing political preferences and economic circumstances.

Section 2 considers budgeting from the vantage point of the SBO agenda. It examines the main topics discussed at the meetings, and also reflects on why some important issues have been outside SBO's purview. My not surprising conclusion is that when they meet, budget officials converse on the matters that preoccupy them on the job – the techniques and processes of budgeting. These are their daily concerns, and these are what they want to learn about from counterparts in other countries. This confined agenda comes at a cost, however, for it pulls them away from the political, economic and social conditions that influence both the behaviour of budget makers and the outcomes of the process.

SBO shows evidence of breaking out of this confined agenda, though at a slower pace than this writer would like. The comprehensive country reviews are especially noteworthy, for they provide a template for taking a broad view of the forces that shape budgeting in each country.

Section 3 turns to the basic functions of budgeting and questions whether governments are adequately suited to perform essential tasks. The key functions considered here are:

- establishing a fiscal framework that is sustainable over the medium term and beyond;
- allocating resources to programmes on the basis of government priorities and programme effectiveness;

- operating government and delivering public services efficiently;
- assuring that the budget reflects citizen preferences; and
- assuring that spending units are accountable for their actions.

Some of the conclusions presented here are drawn from previous SBO (and other) work, but the focus is on overall budget capacity, not on specific reforms.

The questioning tone of this paper's perspective has been influenced by the "Beyond Budgeting" movement that has spread from the business sector to government. This movement regards budgeting as an impediment to strategic decision making and argues that firms and governments are impeded by the routines of budgeting from managing themselves effectively. Although this movement has not significantly influenced budget theory or practice, it has raised important questions that should not be ignored in thinking about the future of budgeting. Interest in the Beyond Budgeting concept has been sparked by a sense that although the process has undergone numerous reforms, fundamental limitations persist. Despite repeated efforts to uproot incrementalist tendencies, budgeting serves better as a means of continuing the past into the future than as a means of shaping the future directions of government or society. It may be that the agenda of budget reform will have to be bolder and broader if it is to significantly alter the way the process is used or the results produced.

## 1. Budget trends: 1960-2000

In 1930, during the bleak years of the Great Depression, John Maynard Keynes, the 20th century's pre-eminent economist, predicted in a mass circulation magazine that our grandchildren will enjoy economic affluence that far surpasses anything previous generations had experienced. Keynes' prediction was based solely on the arithmetic of compounding: if developed economies were to grow at a rate of about 2% per year, output would double every generation or so. Keynes' prescience was not fulfilled until the post-war period, but actual economic growth in OECD member countries turned out to be vastly higher than he had foreseen. Real GDP averaged almost 5% annual growth during the 1960-73 period, the earliest years for which the OECD publishes such data. With this growth rate, economic output in 1973 was double what it had been in 1960. Inasmuch as growth was even more buoyant in the immediate post-war period, it is likely that economic output in OECD member countries was at least four times greater in the mid-1970s than it had been a quarter of a century earlier.

The economic boom fuelled and financed a vast expansion of government. Total government outlays in the OECD community rose from an average of 28% of GDP in 1960 to almost 39% in 1980, SBO's first year. This one-half percentage

point increase per year in spending as a share of GDP is truly extraordinary in view of the post-war economic boom. Government spending in OECD member countries averaged at least six times more in 1980 than it had done 30 years earlier. Although part of the spending increase was due to the rise in the prices of goods and services produced by government relative to the overall price level, most of the spending increase was due to a real rise in public spending. The post-war era offers strong validation of Wagner's Law, the proposition that, as it becomes more affluent, a society spends a rising share of its wealth on public goods and services. With affluence, citizens demanded better roads, more teachers, additional educational services, expanded health care, stronger environmental protection, and other services. With the exception of national defence, virtually all sectors gained resources.

In the aftermath of depression and war, citizens in OECD member countries coveted economic security, and national governments responded by establishing or enlarging various income support schemes. More than half of the total rise in relative public spending was in social security transfers, which soared from 7% of GDP in 1969 to almost 13% two decades later. The resulting change in the composition of public expenditure greatly complicated the task of managing public finances. With a rising portion of the budget spent on entitlements, OECD member countries could not as easily adjust spending levels to changes in their fiscal position.

The advance in public spending was broad and relentless; in most countries, it rose almost every year. Spending increased in good times when resources were plentiful and often also increased when the economy weakened and the budget was tight. It increased in good times because government could afford to spend more, and in less favourable circumstances because government felt obliged to counter the shortfall in economic performance. Spending grew because government took on new commitments, and because of the momentum of old commitments.

Although an expanding economy fed more money into government coffers each year, revenue increases often did not keep pace with escalating demands for public goods and services. Governments frequently boosted tax rates to finance additional spending. Taxpayer resistance was low as long as disposable (after-tax) income was also rising. Consumers had more money to spend on their individual wants; governments had more to spend on collective wants.

Budget processes were contoured to serve the new political and economic realities. Some changes were formal, but the most important ones were behavioural. Budget officials relaxed the input controls they had maintained for decades and consolidated line items into broader categories that gave spending units greater flexibility in using appropriated funds. The central budget office still cast a critical eye on spending demands, but it also joined

the search for ways to enhance public services. In a few countries, efforts were made to reorient budgeting to the objectives and performance of government. Programme budgeting, planning programming budgeting systems and other reforms were attempts to adapt budgeting to the active, enlarged role of government. They failed for a variety of reasons, one of which was that budget offices were ill prepared to change their own behaviour. Yet, even though they fell short of their lofty ambitions, the reforms encouraged budget offices to move away from a control role and to explore means of using the machinery of budgeting to improve government performance.

A more successful transformation occurred in the fiscal posture of government. At the start of the post-war boom, most OECD countries gave lip service to the balanced budget rule; by the end (in the mid-1970s), most had an accommodating posture that allowed government to spend more than it took in when justified by economic conditions. Balancing the economy through fiscal policies that promoted growth, stable prices and low unemployment was regarded as more urgent than balancing the budget. The budget became a pliable instrument of fiscal policy, with built-in stabilisers and discretionary tax and spending decisions shaping each year's outcome. At first, deficit spending was deemed to be justified when the economy was weak; over time, deficits came to be regarded as appropriate whenever actual or projected output was below the economy's potential. Many OECD member countries devised new fiscal tools to determine the appropriate size of the deficit. These typically distinguished between structural deficits that occur when governments spend more than a fully-employed economy would yield in revenue, and cyclical deficits which result from the economy operating below potential. As long as the economy continued on an upward course, public debt was a stable or declining share of GDP. The fact that economic growth persisted was evidence enough that modest deficits do not damage the economy. Quite the opposite, spending in excess of revenue enabled society to make fuller use of economic capacity, gave government additional resources to finance programme improvements, and enhanced the wellbeing of citizens.

The expansion in government did not crowd out private enterprise. Business boomed alongside government, and the notion took hold that each owed a good part of its success to the other. Markets supply government with money, and government establishes favourable conditions, such as an educated workforce and a fair distribution of income, for business to flourish. Government employment in OECD member countries rose 2.7% a year during the 1960-73 period, but industrial employment also advanced, though at a slower pace of 1.4% a year. Unemployment was low, averaging only 3.2% during the entire period, and productivity gains were high, with real GDP per worker rising 3.8% a year. Consumer prices advanced 4% a year, but real interest rates were very low, less than 2% in most of the countries for which data are available.

The halcyon years came to an abrupt end with the oil shocks of the 1970s. Economists conventionally mark 1973 as the close of the post-war boom. Real GDP growth slipped to 2.8% a year during the 1973-79 period, and other vital economic signs also deteriorated. Unemployment averaged 5% a year, and inflation (as measured by changes in consumer prices) exceeded 10% a year. Budget deficits climbed to 2.5% of GDP, still a manageable level, but a harbinger of worse fiscal outcomes in subsequent decades. Governments could justify deficit spending to spur their sluggish economies, but they could not muster sufficient financial resources or political support to do so. As stagnation set in, many questioned the standard prescriptions for combating economic weakness. The post-war Keynesian hegemony showed deep fissures, with dissidents challenging the efficacy of demand management and arguing that fixed rather than elastic fiscal targets and smaller tax burdens were needed to restore economic vigour. Changing course was difficult, however, for the budget model they used was asymmetrical. It was far easier to increase spending than to cut it, and easier to incur a deficit than to curtail it.

These adverse conditions were the backdrop for establishing SBO. In step with the times, early SBO meetings grappled with managing cutbacks and shifting the budget from an incremental to a decremental path. Delegates shared experiences, such as Japan's scrap-and-build policy that required spending initiatives to be offset by cutbacks, the "reconsideration" procedures introduced in the Netherlands to review existing programmes, Sweden's "cheese slicer" that pared 2% a year from operating budgets, and the United Kingdom's experience with cash limits that set hard constraints on spending. The new mood was summed up in a Canadian government report that introduced an "envelope" system for managing public expenditures and urged that budgeting be reoriented from a process that uses programme analysis to rationally expand government into a rationing system that constrains the size of government.

Viewed in the light of its original emphasis, SBO has had modest success. It has not curtailed deficits, which were higher in the 1980s than in the previous decade and, as Europe's difficulty in enforcing the Stability and Growth Pact demonstrates, still persist at an elevated level in quite a few countries. Government spending has stabilised, however, and is now only slightly higher as a share of GDP than it was two decades ago. Trend data suggest that many countries practice "status quo" budgeting. Government commitments and public expectations rule out significant shrinkage in the boundaries of the welfare state, while persistent deficits and opposition to tax increases rule out major expansions in public spending. In many OECD member countries, budgeting has settled into a process of snipping existing programmes at the margins to make room for targeted enhancements. With spending neither growing nor shrinking significantly as a portion of GDP, budgeting has been oriented to extracting greater efficiency and performance from government agencies.

There are two main exceptions to status quo budgeting. One occurs when a government has a surge in revenue that exceeds normal incremental demands on the budget; the other occurs when a financial crisis makes it difficult to sustain incremental budget policies. The quality of budget institutions is particularly important in these circumstances, and the true test of the budget office's effectiveness may come when faced with these opportunities. When windfall revenues open the door to expansion, government needs a budget process that can sift through the options and select cost-effective policies; when crisis knocks at the gates, government needs the capacity to make hard choices and to scale back government commitments in a politically acceptable way. Leadership is essential in both situations, but so too is the machinery of budgeting. A robust process enables government to put expansionary funds to good use and to pare spending to acceptable dimensions.

## 2. The SBO agenda

There have been few surprises on the SBO agenda; most of the topics have been matters that budget officials deal with year after year. As might be expected, they have given repeated attention to the entitlements and transfer payments that now dominate the budgets of many countries, but they have not made much headway in establishing effective control of these expenditures. Every few years, SBO reflects on the timeframe of the process, yearning for a medium – or longer – term consideration of programmes and spending commitments, but unable to abandon the annual framework that drives the budget cycle. From time to time, they have grappled with off-budget accounts, state-owned enterprises, and other practices that are weakly regulated, if at all, through budget decisions. They occasionally are introspective and review changes in the role and operation of the central budget office and its relation to other governmental organs. Periodically, they get updates on developments in programme evaluation, performance measurement, and other innovations. One recent innovation has attracted considerable interest. Each year the OECD selects a member country's budget system for in-depth, critical review and discusses its findings at SBO in tandem with publication of a report on the country. These reports have consistently been of very high quality, and have covered legislative authority, financial management, and the overall performance of public management in assessing country practices. Interest in these assessments is reflected in the fact that countries now invite the OECD Secretariat to undertake a critical assessment.

Some topics have gained prominence in recent years. SBO now shows greater interest in the budget role and resources of the national legislature, and in linking budget work to accounting and other financial management operations. As already noted, SBO has established networks in these and two

other areas. The networks reflect not only a broader perspective but, more importantly, strong efforts to connect budgeting to other government activities that pertain to managing public money, such as legislative work and accounting practices. When SBO started, each country had its own budget conventions and rules; over the years, the differences have narrowed, largely because of pressure to standardise accounting practices. Although the cash basis still predominates, budget officials have studied accrual methods, as well as the relationship between budget statements and financial reports. SBO has given repeated attention in recent years to the performance management movement, especially the use of the budget to allocate resources on the basis of results. The performance and results network launched by SBO reflects the budget community's awareness that the management of public expenditure is an integral part of public management. This represents a fundamental reorientation in budgeting. When SBO was started, the prevailing view was that budget systems can be modernised independently of the management culture within which budgets are made and implemented. This perspective has been displaced by one that recognises the dependence of budgeting on overall managerial capacity.

The recurrence of certain issues lends support to the notion that there are no permanent solutions in budgeting. Entitlements will be a problem as long as budgeting is practiced, as will efforts by spending units to evade budget control. Deficits are a perennial issue, as are linking resources and results, and the timeframe of budgeting. These will still be on the SBO agenda 25 years from now, as might some issues that do not currently engage the interest of budget officials.

SBO is reform-minded, focusing on recent innovations in OECD member countries. Budget officials are genuinely interested in what counterparts in other countries are doing and why. There is usually an ample stockpile of recent innovations, and reformers are eager to display their new methods for others. Many budget officials aspire to make big, transformative changes, even though they usually settle for marginal ones. Their aspirations speak to an enduring characteristic of budgeting. Those who make and implement government budgets yearn for better ways to handle these chores. There is too much friction and not enough of the right kinds of information. Muddling through one year, budget officials know the next year will likely be as abrasive and difficult as the cycle just completed. They know that decisions are made with inadequate evidence on how money is spent or how much is needed. They strive to focus on the future, but are driven to short-term expedients that enable them to meet deadlines and patch up differences. They are powerful, but they also are aware of the limits of their power imposed by political realities and financial commitments or expectations.

Who in budgeting has not thought from time to time, “There must be a better way”? This sentiment is the wellspring of the endless, frustrating quest for innovation. Reform is the better way, or at least promises to be. It is the quest to transform budgeting into a more rational, less incremental process. And though it may lead to some new methods, most reform falls far short of the mark. The unending parade of reforms is strong evidence that budgeting is still wedded to incremental norms, that short-termism crowds out the longer run, that it is more important to get the work done on time than to get it right.

There are many reasons why budget reforms come up short, the most important of which may have to do with an over-riding need to complete budget work on schedule, no matter how inadequate the data are. Budgeting would be a more rational process if it were less essential, if politicians and officials had the option of gathering all the information they need to optimise public spending. Budgeting would pay more attention to results if it had sufficient time to measure results and feed the data into decisions; it would have a longer perspective if it were not bound by the 12 months of the fiscal year; and it might be less incremental if the decisions were taken by experts rather than politicians.

Budget reform must manoeuvre within boundaries that are largely fixed. The most limiting boundaries are political, temporal and informational. As formidable as these limits are, reform might make more headway if past reforms were systematically examined. Budget officials should strive to learn as much from the many past failures as they do from the relatively few successes. SBO gives much more play to the promise of new reforms than to the results of old ones. The old reforms just fade away, to be replaced by the next generation of innovations, which in many cases has the same objective as previous generations. Reforms come and go, but the quest to make budgeting a more rational process goes on.

SBO gives reform-minded countries a platform for presenting their new ideas; it should also encourage them to explain what they learned from past disappointments. SBO has an enormous stockpile of experience to draw from. Every area of reform is a fertile opportunity for critical analysis. The following are just a few of the many possibilities that may interest budget officials:

- Why has programme evaluation been useful at some times and in some places, but not in others? Why, for example, did Australia have more to show for its investment in evaluation than Canada?
- Under what conditions do fiscal rules, such as those promulgated by Europe’s Stability and Growth Pact and by fiscal responsibility laws, regulate the size of the deficit? Can these rules operate under adverse economic conditions?
- What is the experience of the countries that have introduced the accrual basis into budgeting? How has it affected the way resources are allocated and used?

- How do countries reconcile a multi-year framework with the annual budget process? Do they keep to the multi-year plan or remake the budget each year?

Addressing these types of questions would provide governments a firmer basis for deciding whether and how to restructure their budget practices.

### **2.1. SBO's non agenda**

Budget reform is typically framed within the boundaries of the process: how will particular procedures or requirements be altered if one or another change is introduced? Budget reform is rarely considered within the broader context of government economic and social policy. Because of this confined perspective, much that has happened during the SBO years has been absent from its agenda. The effect has been to treat reform as a technocratic exercise, rather than a means of repositioning the process to better serve contemporary socio-political ends. Nevertheless, many reforms on the SBO agenda have been driven by the political and economic contexts of budgeting. When governments seek to impose fiscal rules, for example, they almost always have been influenced by concern over economic conditions. Similarly, when governments strive for better performance, they are responding to citizen concerns over the efficiency and results of government programmes.

During the past quarter of a century, commerce and culture have been increasingly globalised, making countries more interdependent and less in control of their own budget fate. Interdependence has not yet run its full course; by the time it does, matters that now are domestic will have been internationalised. Agricultural policy and social expenditure are two such issues, but certainly not the only ones. New transnational structures, such as the European Economic and Monetary Union, have been established and more are likely to emerge in the decades ahead. It is not far-fetched to foresee income redistribution defined as a regional or global issue, and for international courts to prescribe or proscribe particular expenditures. The Cold War has ended, allowing defence's overall share of national budgets to decline, but the scourge of terrorism has spread, putting future budgets and underlying socio-economic conditions at grave risk. The revolution in information technology has boosted efficiency in both business and government, and has taken much of the rote work out of compiling and implementing the budget. It also has opened the door to much greater transparency in budgeting, giving citizens access to data that were previously unavailable or withheld. In almost all member countries, the population is ageing and, along with it, the national budget as well. There will be less money in future budgets for programme initiatives. Budgeting risks becoming an accounting of past decisions rather than a means of making new ones.

Less dramatic, but certainly important, trends in the conduct of politics have affected budgeting. In most OECD member countries, citizens now have less trust and less confidence in government and its political leaders, and are less attentive to political matters. The ideal that the best and the brightest seek careers in the public service has faded, and making a career in government is less attractive to young people. Citizen disengagement has been accompanied by a vast increase in the number, activism and influence of interest groups and NGOs, which operate across all sectors and (in most countries) pay considerable attention to budget matters. Interest groups and NGOs vigilantly guard their interests, demand more from government, and campaign against cutbacks. Contemporary national governments also are pressured by global and local entities, and have less space for independent action than before. Under the banner of fiscal decentralisation, quite a few national governments have transferred money and power to regional and local authorities.

In most developed countries, the state has become the risk holder for society, sheltering citizens against the financial wounds of illness, old age, unemployment, disability, and other conditions that reduce personal incomes below a legally defined level. The pooling of risk via government has brought many advantages, including greater economic stability and a fairer distribution of income, but it has taken a bite out of budget control. As risk holder, the government's budget is swayed by social and economic developments that are largely beyond its control, especially within the frame of a single fiscal year. The transfer of risk to government has fed citizen expectations that public benefits are a matter of entitlement. High expectations and low trust in government create budget pressures with which political leaders have difficulty coping.

Although budgeting has been greatly impacted by changes that have unfolded over the past 25 years, SBO has not offered a window onto these developments. With few exceptions, it has tended to its own business, centred on the machinery of budgeting. This confined perspective may be due to the insularity of budgeting discussed earlier. The budget has, however, assumed the status of the pre-eminent policy document of governments. In the days of expanding government, substantive policy decisions could be made outside of the context of the budget as the necessary resources would be readily available. Nowadays, all substantive policy decisions must be made in the context of the budget. It is therefore high time for the SBO to take a wider perspective on budgeting.

There is nothing awry with SBO focusing on internal budget processes, but the discussion would be enriched by framing it within the larger movements that drive public spending. It is understandable that the revenue side of the budget has received scant attention because tax policy and administration are in the jurisdiction of other government units. It would be useful to discuss revenue projection methods, tax expenditures, and other

features of revenue that have a direct bearing on expenditure management. In a similar vein, it would be useful to have fuller discussion of intergovernmental fiscal relations, which affect both the revenue and spending sides of the budget.

### **3. Budgeting's future agenda**

Future SBOs will concentrate on matters that budget officials deal with year after year. But it also behoves them to view issues in terms of the overriding purposes that contemporary budgeting serves. While practitioners and observers may disagree on the particular end of budgeting, there is agreement that a sound budget system serves multiple, coexisting purposes. I find it useful to define good budgeting in terms of the following criteria:

- The budget should establish a stable, sustainable fiscal position for the medium term and beyond.
- The budget should facilitate the shift of resources to more effective, higher priority uses.
- The budget should encourage spending units to operate efficiently.
- The budget should be accessible to citizens and responsive to their interests.
- The budget (in tandem with other financial management practices) should assure accountability in the expenditure of public money.

This is an ambitious agenda that cannot be fulfilled, for standards are continually being adjusted upward. The paragraphs that follow set out issues in each of these areas that may be grist for future SBO meetings.

#### **3.1. Sustainable fiscal policy**

The fiscal posture of government will be at issue as long as budgeting is practiced. The contemporary role of government and its entanglement in economic matters rule out application of a strict balanced budget norm. But open-ended, unconstrained deficits that result because politicians have incentive to tax less and spend more, or from swings in economic conditions, are likely to be unsustainable and to diminish a country's future economic prospect. It is now widely accepted that political incentives bias budgets toward higher deficits, as politicians favour current voters over future taxpayers. When political leaders behave this way in less developed countries, they may destabilise the economy and provoke a run on capital markets. The adverse effects are likely to be less apparent in affluent countries and may not emerge for some time. In fact, there may be short-term benefits as deficit spending stimulates demand and thereby veils the long-term costs. The political bias to spend in excess of current revenue may be reinforced by short-term economic gains.

These conditions greatly complicate the task of stabilising fiscal policy in OECD member countries. The favoured contemporary solution has been to set fixed fiscal rules, such as those prescribed by the Stability and Growth Pact, and to entrust enforcement to an outside or independent entity that is not swayed by domestic political pressures. But recent difficulties in enforcement of the Stability and Growth Pact call into question the staying power of fixed fiscal rules, even those that allow a modest deficit. These rules may be effective in the short run, as they were in the run-up to the European Economic and Monetary Union. But the longer they are in place, the weaker the rules become, especially when the economy swings from growth to stagnation. Fixed rules which permit modest deficits may be as unworkable as fixed rules which prescribe balanced budgets. The only alternatives, within the framework of fiscal rules, are pliable rules that are adjusted in response to changes in actual or projected economic conditions. Of course, this would return OECD member countries to the situation that prevailed during the post-war “Keynesian” period, but with two big differences. One is that the economies of most OECD member countries are not booming, the other is that enforcement of the rules may be in outside hands. It remains to be seen whether fiscal limits are more stringent when compliance is monitored and enforced by a regional or international body.

Establishing and maintaining a workable fiscal regime should preoccupy SBO in the years ahead. While fiscal rules have received some attention at recent SBOs, economists have colonised these issues as their own. The vast literature on fiscal institutions produced over the past decade attests to the confidence economists have in their capacity to explain why some countries incur deficits and others do not, and to design rules that would constrain deficits. I am not sure that economists have a comparative advantage on this issue. Their models tend to be simplistic and self-fulfilling, and they know less than budget officials about the political and bureaucratic pressures that drive public spending. Budget officials certainly have a deeper understanding of how procedural rules affect spending outcomes. They have a lot to contribute to the design of effective fiscal rules.

### **3.2. Effective allocation**

At its core, budgeting is a process for allocating resources among competing demands for public money. Anyone who has worked in budgeting knows that this is not a fair competition, that old claims on the budget have an advantage over new ones. Now matter how it is structured, budgeting decisions are anchored in the past, varying usually only in small increments from one year to the next. It is time to call a halt to the reformist war against incrementalism and to acknowledge that this is one feature of budgeting that will not and (according to some) should not be abandoned.

If budgeting is inherently incremental, can governments keep spending fresh and responsive to changing priorities? This question is urgent because an ageing society will make national budgets even more rigid, while a changing society will require that budgets be more adaptive. Contemporary budget developments address this problem in quite different ways. One approach arises out of the “Beyond Budgeting” argument referred to earlier in this paper. It considers budgeting in both business and government to be rigid and confining, and urges strategic policy makers and programme managers to devise alternative processes such as strategic plans and operational goals for steering large organisations. The Beyond Budgeting advocates claim that these methods have been applied in some business firms, but that the applicability to government is questionable. Budget reformers, by contrast, have not given up on the process, but are continually searching for means to inject a capacity for change into resource decisions. Contemporary change-oriented reforms include a longer timeframe, more programme evaluation, and fuller use of performance targets and outcome measures. A third approach seeks to transform budgeting by coupling it to other change-driving processes, such as strategic and programme planning, that facilitate policy adjustments. The three paths differ fundamentally in their assessment of budgeting’s capacity for effective allocation. The first gives up on budgeting, the second has confidence that conventional reforms will suffice, the third makes budgeting dependent on other processes. In my view, none has sufficient promise to materially enlarge government’s scope for change.

To finance emerging financial demands, future governments may be impelled to increase taxes if economic growth does not provide sufficient new money. Governments will be able to spend more on new priorities only if they have more to spend. Alternatively, they may continue to make incremental policy adjustments to finance marginal reallocations from lower to higher priorities. One likely tactic will be to tinker with entitlement formulas and user charges in order to save some money on pensions or health care. While such savings will not derigidify budgeting, they will enable pressured governments to muddle through from one year to the next. This is a common way of pacifying the budget. Dealing with budget pressures one year at a time, the future will take care of its problems.

### **3.3. Efficient operations**

Over the years, SBO has devoted more attention to the operational performance of government than to the other core functions of budgeting. This is not surprising because budget officials are involved on a continuing basis with the operations of government. Although transfer payments may claim the largest share of the budget, operational issues claim the largest share of budget officials’ time. Expenditures for running operations and delivering services are

the portions of the budget decided each year and the areas that budget makers look to for short-term savings to align revenues and expenditures.

Performance budgeting has long been the favourite instrument for getting governments to operate more efficiently and to improve public services. As one whose Ph.D. dissertation some 40 years ago was on performance budgeting, I expect this subject to absorb the attention of budget officials for a very long time. Budgeting on the basis of actual or expected results is a simple but elusive objective. It is simple because the idea has universal appeal; it appeals to common sense and should be what budgeting is about. It is elusive because linking resources and results is difficult and complicates the task of producing the budget.

The impediments to budgeting on the basis of results are numerous; the ones outlined briefly here pertain to the budget's role in managing government programmes and agencies. To begin with, performance-based budgeting comes in so many varieties that the term does not offer much guidance on how budgeting is to be structured. At one end of the spectrum, it may connote only that the budget contains supporting information on the outputs and activities of spending units; at the other end, it may indicate that each increment of resources buys an increment of results. The former is so undemanding that just about any government that has workload or output data can claim to budget on this basis; the latter is so challenging that few governments can meet its standards. It is tempting for governments that want to take credit for aligning resources and results to settle for the least demanding version. When they do, just about the only thing changed is the appearance of the budget. Resources and results continue to go their separate ways.

Although it is beyond the current reach of most governments, the demanding version offers useful clues about what it takes to budget on the basis of results. To budget for results, governments must also manage for results; that is, they must organise administrative operations and deliver services to optimise the outputs that agencies produce. It is naïve to think that a government can manage on one basis and budget on an entirely different one. If management is regimented, with administrative actions centrally controlled and managers evaluated on the basis of compliance with procedural rules, it will be futile to try to budget for results. If managers do not care about results when they go about daily tasks, the budget will not care about results either. The practice of budgeting is encased in public management, and it is only when spending units are mobilised to perform well that government will be able to budget for performance. Government's dependence on transforming management vastly increases the difficulty of orienting the budget process to results.

Linking resources and results is also a technical challenge, for it requires data on the cost of producing outputs that are presently unavailable in all but a

few countries. Getting cost data requires managerial accounting systems that break down output into standard units and distinguish between fixed and variable costs and between average and marginal costs, and thereby enable government to estimate the cost of producing each increment of output. Linking resources and results may also require two more fundamental changes: a shift from budgeting on the basis of the cost (or expenditure) of operations to budgeting on the basis of the price paid for services; and a shift from fixed operating budgets (in which the volume of resources does not vary with the volume of output) to a variable budget. Inasmuch as neither of these transformations is underway, most governments that seek to link resources and results end up with performance budgets that resemble conventional budgets.

A government can manage for results without having a full-blown performance budget, either by introducing market-type arrangements that enable recipients of public services to select their suppliers or by enabling providers of these services to operate efficiently. If performance improves through either of these ways (or, more likely, through a combination of both), government will be better primed to budget for results.

### **3.4. Democratising the budget**

The history of budgeting is the history of democratic institutions. From Magna Carta hundreds of years ago, through the emergence of legislative assemblies in the Middle Ages to the development of modern budgeting, the aim has been to limit the power of those in elected or appointed office to spend public money. This is the main reason why budgeting has for so long been grounded on rules and procedures that control the actions of spenders.

This model of budgetary democracy no longer serves the people sufficiently well. In fact, critical features of budgeting may retard democracy and thwart the capacity of the public to decide how public money is spent. The insularity of budgeting, noted at the outset of this paper, veils most spending discussions from public view. At best, budgeting practices a form of *ex post* democracy, with the public informed only after decisions have been taken. Genuine public participation has been impeded by the growth of government and the elaboration of complex budget rules as well as by the emergence of strong political parties and the enforcement of party discipline in national legislatures. On the periphery of budgeting, interest groups and others sometimes join in the discussions, especially in countries with corporatist or pluralistic tendencies, but their influence is uneven and may come at the expense of under-represented interests.

Redemocratising the budget will have higher rank on the SBO agenda in the decades ahead than it has had thus far. It is highly probable that the standards of “democratic adequacy” will continue to rise, opening the process

more, giving a more diverse array of interests the opportunities to influence budget decisions. One channel of discussion might be the legislature's role and capacity in modifying the budget submitted by the government; another might be the opportunities opened up by the information revolution for e-budgeting and other new forms of dissemination and decision. Greater attention might be given to: the distributive effects of national budgets; which groups or sectors get benefits and which do not; and the means by which certain stakeholders might participate more actively in allocating public funds. One should not be surprised if budget officials debate the lack of transparency in compiling the budget and question whether the veil of secrecy ought to be lifted from the process.

At future SBO meetings, voices will be heard arguing that opening the process to outside scrutiny or participation will greatly complicate the task of making ends meet. It is hard enough to reject claims behind closed doors; it may be impossible to do so in the open. The more constrained future budgets are, the greater will be the insistence of affected interests that they have a seat at the table. A strong dose of budgetary democracy will hobble the always difficult task of reallocating money from some uses to others. It may be that the only prudent way to redemocratised the budget is to combine it with measures that safeguard fiscal discipline.

### **3.5. Genuine accountability**

It is an article of faith and practice in OECD member countries that spenders must account for their use of public funds. Toward this end, financial reporting and auditing systems have been established in each country. These generally are regarded as reliable and in compliance with standards prescribed by accountancy and audit groups. In recent years, SBO has examined the spread of accrual standards and has considered whether these are suitable for the budget, which traditionally has been on a cash basis.

Accruals versus cash opens the door to a larger question: the operation of the budget process within the government's financial management framework. To my knowledge, SBO has not examined integrated financial information systems which use advanced information technology to connect the myriad financial operations of government. Although the main selling point of integrated systems is that they improve efficiency and reduce error, tying the budget into them is likely to change both its content and the manner in which it is prepared. Rather than having its own way of counting and compiling the numbers, budgeting will be beholden to accounting rules.

## **4. SBO 2029**

The mood was somber as delegates from the 107 member countries gathered in Qatar for SBO's 50th annual meeting. Fewer than a handful of

countries were absent, and those represented at the meeting came in delegations of 5-10 political leaders and experts. Some years earlier, SBO was formally disbanded and a meeting of senior budget ministers took its place. But out of habit or nostalgia, the meeting was still universally referred to as SBO. Budget directors were members of the country delegations, but with few exceptions each country sent a minister to speak on its behalf and vote on the matters before the body. The switch from officials to ministers was due to the transformation of SBO into the OECD's legislative body for establishing standards of good budget practice. Inasmuch as each country's financial condition was implicated in these decisions, first a handful and over time almost all countries entrusted the work to political leaders who were authorised to speak and vote for their government.

As a standards-setting body, SBO had a full agenda that no longer accommodated abstract papers by academics. The agenda was congested, with barely enough time during the two days to handle the weighty questions that had to be resolved. Some countries urged that SBO be lengthened to as much as a week, but ministers protested that two days were all they could spare. To assure that these days were efficiently organised, SBO had restructured itself around a handful of formal committees, each with a defined jurisdiction and each empowered to make authoritative recommendations to the plenary. In each country, executives and parliamentarians had already been briefed on the agenda, and instructions were issued as to how delegates should vote. The main committees treated accounting rules, fiscal integration, budget procedure, social rights, and legal matters. The Legal Committee was the only one that did not make formal recommendations. Rather, it was responsible for advising the SBO on the budgetary consequences of recent rulings by the International Court of Social and Economic Justice.

The report of the Accounting Rules Committee had been presented months earlier in a disclosure document that evoked widespread criticism. It recommended that the standards applied to country budgets be revised to cover new types of financial instruments and downstream liabilities. The existence of these standards was no longer controversial, though it had been about 15 years earlier when budget directors fought a losing battle to allow each country to set its own budget standards. The majority, however, determined that national economies were so interdependent that it was essential to prescribe budgetary accounting rules. The issue before SBO in 2029, as in most previous meetings, was whether to prescribe additional standards in response to the invention of new financing arrangements. On the basis of statements issued by the leaders of many countries, it was expected that the proposed standards would occasion robust discussion at the SBO meeting but that they would be approved by an overwhelming majority. After all, no political leader wants to be exposed to accusations that the official budget reports are false or misleading.

The Fiscal Integration Committee is making yet another effort to fine-tune deficit and debt rules in response to cyclical changes in economic conditions. This is a perennial issue, for which there is no permanent solution. This year's report deals with a particularly troublesome issue, the fiscal destabilisation arising from shocks and other major disturbances. At one time, it was thought that shocks were problems only in less developed countries, but the globalisation of terrorism and other factors have brought this risk to some of the most developed countries. The initial draft called for a waiver of fiscal rules in case of fundamental shocks, but some countries objected that this was too permissive and would open the door to wholesale evasion. A compromise was reached to suspend fiscal rules for affected countries for as many as three years, but it is certain that this question will be on future SBO agendas.

The Budget Procedure Committee is grappling with a question that has vexed democratic governments for the better part of a decade. Pursuant to an international court ruling, SBO decided years earlier that representatives of key groups should have the right to attend all budget negotiations, including bilaterals between the finance minister and each sectoral minister. SBO has dragged its feet on opening the process, but the courts have given it a deadline by which it must designate eligible groups. If it fails to act in time, the courts will impose their own decision. The Budget Procedure Committee has proposed that each government be authorised to make its own selection. This artful compromise may buy time, but it is likely that the courts will revisit the issue.

The Social Rights Committee is the only committee with members from non OECD countries. Its charter is to prod developed countries to redistribute resources to citizens of less developed countries. The first such redistribution was done under the auspices of the Millennium Development Goals for the year 2020. The second occurred during the past decade, pursuant to the second-generation goals, and the Social Rights Committee has devised a formula for the latest set of goals which run to the year 2040. A close vote is expected on a motion to defer consideration of this issue for at least a year.

The Legal Committee produced an annual compilation of court decisions that have a material impact on government revenue or expenditure. During the past year, 853 such rulings were issued by courts in member countries and another 17 by international panels. The net impact is estimated to exceed 2% of GDP in the OECD area.

During the delegates' lunch, the OECD Secretariat arranged for a retired budget director to reflect on SBO's 50 years. She delighted the assembled delegates by recalling the long-forgotten debates about performance budgeting, multi-year targets, and the like. "We took it all so seriously, then", she concluded.

The archives of SBO contain a variant set of minutes on the 2029 meeting. According to this version, in 2029, SBO discussed budgeting for results, getting a longer-term perspective, and the legislature's growing role. No votes were taken, and no conclusions were reached.

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