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Time Horizons in Budgeting

by

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Public policy-makers operate with all measures of time horizon. They make short-term decisions as well as investments intended to benefit several generations. Though popular myth and public choice theory concur that politicians have their eyes fixed on nothing but the next election, there is a great deal of evidence to the contrary. As a rule there is a blend of time-frames and perspectives in the same actor. Attention leaps back and forth between the proximate and the distant. In their time orientation, elected officials share the ambivalence and volatility of their electorates. “A week is a long time in politics”, Harold Wilson once famously claimed when accused of inconsistency. That may be true, but in politics there is also continuity and perseverance. A great many initiatives can be rewarded only over the long haul. In their solemn declarations, politicians often refer to our children and grandchildren and portray themselves as involved in a process of construction. When engaging in actual construction projects, they exhibit a manifest orientation to the future. For the builders of medieval cathedrals, the time horizon was even infinite. Their aim was eternal salvation.

In **public budgeting**, time horizons are closer and more uniform. The chronological structure is fixed and stable. Year after year, governments around the world keep proposing, Parliaments keep adopting and public agencies keep implementing **annual budgets**. The entire processing of such budgets is governed by standardised time-tables. All stages of the fiscal cycle are carefully scheduled, from preparation and examination through execution to audit and follow-up. This is a highly structured procedure in which the principal time unit for allocations, appropriations and accounting remains the 365 days of the calendar year.

The rigid time-frame of the budgetary process is intended to impose discipline on its many participants, reminding them that available resources are limited and compelling them to make the appropriate choices. In the budgetary calendar, there is a multitude of fixed dates to keep everybody in line. There are time-limits for instructions, for submissions, for comments, for proposals to Parliament, for hearings and testimonies, for committee reports, for legislative decisions, for authorisations, for partial and complete accounts. The procedure is thus sequentially compartmentalised and thoroughly institutionalised. Many actors are invited to take part in the national dialogue on the use of public resources, but only on the condition that they intervene in the appropriate form and respect the set time-table. Missing deadlines is not

advisable. For late-comers there was a rule already among the ancient Romans: *sero venientibus ossa*.

While the annual time-frame has shown a remarkable staying power as the norm for budgeting adopted and retained by public authorities all over the globe, it is not without its competitors. After a quick glance at the origins of the annual budget cycle, we shall look in turn at two rivalling positions on the suitable time horizons for budgetary decisions: i) first, the view that the fiscal year is too long; and ii) second, the view that the fiscal year is too short. Then we shall take a closer look at the different versions of medium-term and long-term budgeting that have evolved in recent years and at some techniques employed to integrate such longer term perspectives into policy-making and public administration.

1. The crop cycle and the budget cycle

Both numeracy and literacy have deep roots in public administration. Some of the earliest preserved written texts are fragments of bureaucratic messages, often inventories or records set up by agents accounting to their principals. Much later, rudimentary land registers were established to keep track of fiscal obligations, such as the Domesday Book. When an element of regularity gradually entered into the management of the public household, the first signs of an annual cycle appeared in the field of accounting. The English Exchequer introduced fixed deadlines for rendering accounts in the 12th century, followed by French fiscal authorities in the early 14th and North German regional agencies in the 15th centuries. Dates for such accounts were built into early constitutions, charters and instructions for vassals or bailiffs. The day of reckoning would typically be a particular holiday in the Winter or early Spring or an interval between such holidays.¹

In early budgeting, there was a clear link to the crop cycle. Once the harvest was in, one could make plans for the next year. Many developing countries have maintained this connection by clinging to the broken budget year. In India, the revenue for the subsequent year can only be assessed after the Monsoon season in May, June and July.² But agriculture is not the only source of income to be taken into account in the third world. Papua New Guinea changed its budget year to fit that of the donor countries, since their contributions were so decisive for the government's economic planning. In other parts of Asia, governments hesitate between the lunar and the solar calendars.³

Over time, there has been a tendency to converge on the calendar year as the most convenient basis for budgeting. While the United Kingdom has held out long with a budget year beginning in April, Sweden gave up the broken budget year to adopt the calendar year model in 1995. In the long discussion preceding this decision, it was claimed that a harmonisation both upwards

(towards the EU) and downwards (towards private enterprises, communes and regions which had long practised calendar year budgeting) would bring about greater transparency and facilitate co-ordination between different levels. But this was not uncontested. In defence of the old system, it was contended that a simultaneous budget process at the national and the subnational levels would render life more difficult for local and regional decision-makers since these would no longer know for sure how much money they would get from the national cornucopia, at least for the first half of their budget year. There were also concerns about changing the rhythm of the parliamentary year and about the reciprocal impact of the budget year and the national election campaigns.⁴

2. The fiscal year is too long

Attempts to break out of the strait-jacket of the annual budget cycle are common in all political systems. Sudden needs arise all the time, and advocates dissatisfied with the government's latest arbitrage between competing demands will often continue to press for their claims. With this constant flush of suggestions for immediate measures, interspersed with proposals of new legislation and other instant decisions with long-term financial consequences, the Budget Bureau becomes a guardian not only of the public purse but also of the established procedure, the constitutional and administrative rule-book, the rigid time format and the comprehensive character of the annual budget.

In this dialogue, various interests repeatedly argue that new programs should be considered outside the budgetary process and that *ad hoc* commitments should be made as a matter of urgency and emergency. As such engagements threaten to break up the established framework, the Budget Bureau will regularly reply that: i) new short-term demands must be met through reallocation within the appropriations already granted; and that ii) major new projects must be examined within the framework of the normal budget process, with due attention to their long-term effects. While this defence is normally effective if the government is stable and coherent, the political pressures are sometimes so strong that a revision of the current budget becomes inevitable. Some countries have a regular omnibus procedure for such additions, with a "supplementary budget" presented once or a few times during the fiscal cycle. As to the demand for costing of long-term commitments, the Budget Bureau is often less successful as so many politically attractive proposals are not amenable to precise costing.

The necessity of budget modifications during the current fiscal year will in many cases stem from the difficulty of foreseeing the exact expenditure needs in the preparatory process. With the estimates requested from subordinate bodies perhaps as much as 12 months in advance of the beginning of the fiscal year, and consequently two years in advance of its end,

there are of course significant areas in which projections must be tentative. This problem grows with any extension of the budgetary period and will evidently add a degree of uncertainty to medium-term forecasts.

In some countries, attempts are made to divide the budget into more or less predictable areas. While firm annual or multi-year limits can be set for most types of expenditure, other fields are recognised as more volatile and therefore handled with greater flexibility. A common technique is to operate with contingency funds or reserves for unforeseen needs. Another method is to establish “control stations” at predetermined points in the fiscal year. In the United Kingdom, a certain category of outlays is known as Annually Managed Expenditure (AME) and reviewed twice a year as part of the budget process.⁵

Nor is uncertainty confined to the expenditure side. Another common problem is the unexpected shortfall of receipts. In poor countries especially, one year is often too long a period for setting economic priorities. Even if budgetary decisions are made for allocations on a full-year basis, resources tend to dry up at unforeseen and unforeseeable intervals. This problem is typically handled by a procedure that Wildavsky and Caiden (1974) have called **repetitive budgeting**.⁶ Under this system, the annual spending decisions have to be confirmed and reconfirmed throughout the year and individual budget items covered in the budget are not implemented without a subsequent authorisation. What this amounts to in practice is an intermittent reconsideration of the budget. Since the approved appropriations exceed the resources at hand and only the most urgent expenditures can be made, the Ministry of Finance must engage in constant rationing.

This procedure is of course not very different from that of a private household or an enterprise in straits. When the invoices pile up there is a natural tendency to pick and choose. Claimants with an ability and propensity to retaliate by withholding vitally important goods and services are obviously given priority in this selection. Local authorities on the verge of bankruptcy, from small communes to New York City, have their own experience of repetitive budgeting and both entrepreneurs and public employees in many countries, with contemporary Russia as a prominent example, are very much familiar with the practice of public authorities defaulting on their payments. The process of rescheduling loans to debt-ridden countries has been semi-institutionalised through the so-called Paris Club.

If lack of funds is one important reason for repetitive budgeting, lack of information, orientation and certainty may be another. Wildavsky (2001) defines this predicament in the following way:

In poor countries, we find repetitive budgeting under which budgets are made and remade throughout the year amid endless strategic by-play. Poverty leads them to delay lest they run out of money; uncertainty leads them to reprogram

*funds repeatedly to adjust to the rapidly changing scene. Poor countries do not know where they are now, and the budget does not help them learn where they will be next year. Most in need of stable budgets, the poor nations are least able to secure them. They lack redundancy – the duplication that provides a margin of safety to cope with emergencies and the overlap to compensate for imperfect arrangements that is essential for reliable performance. The combination of poverty and uncertainty are devastating; these countries have little to spend because they are poor, and they find it hard to spend wisely because they are uncertain.*⁷

Repetitive budgeting is often linked to economic or political crises. A specific type of crisis resulting in short-term budgeting is the dissent over economic decisions between the Executive branch and the legislative or appropriating branch. In such cases, the calendar for adopting the budget often breaks down as the Parliament fails to produce its budgetary decisions before the beginning of the fiscal year. Many legislatures work under tight time-tables and rely, for their final agreement on the budget, very much on the pressure of calendar constraints. Sometimes, these are linked to the convenience of the legislators as when parliamentarians feel compelled to get their work done in order to go home for Christmas.

If they do not reach the crucial decisions, however, most constitutions or budget laws offer some safety valve to prevent the collapse of the public household. Normally, such provisions permit: a) a short-term prolongation of the previous budget; or b) the continued disbursement of certain categories of outlay. In December 1979, for instance, the newly-elected European Parliament rejected the 1980 budget proposal which meant that the Commission had to operate with provisional twelfths based on the preceding budgetary figures.⁸ In the budgetary tug-of-war between the American Executive and the US Congress, parts of the administration have on some occasions been hit by temporary refusals of funds, most recently under President Clinton.

3. The fiscal year is too short

A different line of criticism levelled at the annual time-frame takes aim at a variety of problems linked to its short-term focus. With appropriations fixed for only one year at a time, how can policy-makers be encouraged to be sufficiently foresighted and forward-looking? And with objectives set for such a limited time-span, how can managers be stimulated to build sustainable capacity? Both in budgetary politics and in public administration, items and targets in the current fiscal year and in the budget under examination tend to capture almost all the attention, with longer term consequences disappearing into a haze of incertitude. This may lead to a variety of distortions, such as

over-consumption, under-investment or spending frenzy towards the end of the year. When the budget balance of each fiscal year is played up as the main criterion of failure or success, programs will be assessed on the basis of their immediate budgetary effects and easily quantifiable results, while more intangible constraints and objectives tend to be disregarded.

A common root of these problems may be found in the “fungibility” of the public receipts and expenditures.⁹ In classical budgeting, priorities are often set by comparisons of first-year costs without much attention paid to subsequent effects. An outlay of one Euro (or pound, or crown, or dollar) equals any other outlay of the same magnitude. With targets fixed in money terms, the challenge is to bring the volume under a given ceiling or limit. Yet if a one-year perspective is adopted for this exercise, several surprises may be in store for the following fiscal years: termination costs may extend over a longer period, expenditure cutbacks may lead to a decline of revenue, and deferred outlays may come back with a vengeance. Very often, what is cut on one item will sooner or later re-emerge as a cost increase somewhere else, as when ending a vaccination program eventually leads to higher expenditure for health care and sickness insurance benefits.

The “time profile” of cost increments and decrements over the long haul requires a separate analysis for each single case. Consider the following five categories of **single-year expenditure reduction**:

- When the measure is a **quality cut** – Australian budgeteers have borrowed this expression from the butchers’ language – the reduction in spending: i) has few or no adversary intra-budgetary effects in the short-term; and ii) yields more for every subsequent fiscal year. Downward adjustments of indexed benefits (such as pension, sickness compensation, etc.) are examples of such changes.
- The **one-shot cut** may give good value immediately but is of no comfort for future budget-makers. Reductions of this sort may occur when a once-for-ever investment is cancelled or a regular expenditure is skipped for one year only.
- The **vanishing cut** appears profitable at the outset, but the saving disappears gradually in the following years. This may be due either to resurgent needs and demands for the very expenditure that has been cut or to the fact that curtailment in one area of government activities entails growing demands in other areas.
- The **cosmetic cut** is appealing from an optical point of view but has no effect whatsoever on the real economy. By moving posts between the budget and extra-budgetary domains, or from one fiscal year to another, any government can achieve impressive changes in the balance of revenues and expenditures.

- The **boomerang** is an even more unfortunate version of reductions where the net result over time is negative, as when maintenance neglect leads to considerable outlays for capital renewal or when major accidents occur because inexpensive risk-reducing measures have been suppressed.

As long as the single-year perspective prevails, these five types of decrement may be treated as equivalent and interchangeable alternatives to attain budgetary targets. The temptation to resort to lower quality expenditure cuts appears to be especially strong towards the end of the annual budget negotiations, when political pressure is high, the clock is ticking and there is normally a residual gap to be filled, and towards the end of the electoral cycle when presentational ambitions tend to take precedence over the concerns for sustainability.

But if there are times for temptations, there are also times for after-thought and analysis. Both participants in the budget process and observers of public budgeting have long been aware of the fungibility dilemma. The annual budget can only be formulated in the “common currency” of single-year outlays, but these figures have their obvious limitations. They do not disclose the longer term consequences of various policy options and in many cases they do not even reflect actual costs in the short-term. With their focus on cash disbursements, classical budgets tend to conceal the extent to which government assets are increased or diminished over time. These weaknesses conspire to undermine the rationality of the annual time-frame for budgeting.

Recognising that the fiscal year is too short a time-span for many types of decision, policy-makers have long sought for ways of extending their planning horizon and building long-term considerations into the budgetary calculus.

At the macro-level, there have been efforts to supplement annual budgeting with medium-term and long-term projections and to introduce accrual or resource based accounting and various forms of cost-benefit analysis. At the micro-level, public managers have been encouraged to take a longer view through the introduction of greater flexibility, wider time-frames, more inclusive accounting techniques and output based success indicators.

4. The rise of medium-term and long-term budgeting

In addition to the annual budget, most governments present some form of projection, plan, strategy or budget for the medium-term perspective. While economists take a great deal of interest in such documents, most politicians pay them far less attention than the annual receipts and expenditures and in press reports on budgetary matters they receive very limited coverage. What is the function of such exercises in foresight? To answer this question, let us first look at the historical evolution of medium-term and long-term budgeting. The

former is by and large a late 20th century phenomenon; the latter is quite recent and can even be characterised as a 21st century innovation.

On the revenue side of the ledger, there was always an element of long-term budgeting in the guise of land registers established to pin down the taxable property of the realm. Tax exemptions or “freedoms” were often granted for an indefinite period, and the same might be true, on the expenditure side, for certain benefits or entitlements. Yet neither incomes nor outlays were summarised on a pluri-annual basis. Before 1900, there was little, if any, medium-term budgeting worth its name. In the 20th century, we may distinguish several **antecedents** to our present-day efforts to extend the budget horizon:

- **The Soviet-type planning of the 1930s.** An abstract idea of planning hovered around 19th century socialism, but there were few concrete notions of how this thought might be translated into reality. Neither Marx nor any of his contemporaries dwelt at length on the methodology of planning. When Lenin approached this topic in some of his later works, his chief inspiration was the experience of economic regulation and rationing during the World War, particularly in Germany. The Five-Year Plans initiated by Stalin were also inspired by the input-output matrices of such Russian economists Leontief and Groman, but the targets set up in these documents were more aimed at mobilisation than at the co-ordination of economic processes; hence the famous exhortation “fulfil the five year plan in four years!” which would hardly have made sense if the aim was to synchronise the flow of material resources.
- **The donor-induced indicative planning of the 1950s.** At the height of the Cold War, planning in the developing world drew only a limited part of its inspiration from the Communist countries. Far more potent impulses came from Western donors who often made their contributions conditional on the adoption and implementation of multi-annual development strategies. At an earlier stage there were similar demands stimulating the emergence of medium-term budgeting and indicative planning in Western Europe. In its initial shape as the OEEC, the present-day OECD served as a vehicle for this corollary to the Marshall Aid Program which supported the emergence of such mechanisms as the French Commissariat au Plan and several of its less authoritative counterparts in other West European countries. More recently, the World Bank and the IMF have actively promoted medium-term expenditure frameworks in developing countries. According to a recent survey, 25 states in Africa, Asia, Latin America and Eastern Europe have adopted such strategies in the last few years.¹⁰
- **The quest for rational incrementalism in the 1960s and 1970s.** Linked to this, but gathering strength a bit later was a turn to medium-term budgeting that

received its break-through with the expansion of public spending in post-war Europe. In the United Kingdom, the Plowden Report of 1961 called for more attention to the pluri-annual consequences of expenditure decisions. A variety of mechanisms were set on foot, including the Public Expenditure Survey Committee (PESC) and the Program Analysis and Review (PAR). The Federal Republic of Germany introduced its *mittelfristige Finanzplanung* (“mifrifri”) and other countries followed suit with their own version of this instrument. This effort coincided with a growing interest in “future studies” and with early, if less than successful, experiments with program budgeting (PPBS).

- **The quest for rational decrementalism in the 1980s.** The slow-down in economic growth in the subsequent decade forced governments to reconsider the sustainability of their expanding public consumption and entitlement programs. In this process, cutback strategies and methods of policy termination emerged as new government concerns. PPBS gave way to zero-base budgeting (ZBB) and *la rationalisation des choix budgétaires*. Sunset mechanisms were introduced. The US Congress increased its capacity for economic analysis through its Congressional Budget Office, and the Netherlands pioneered a form of systematic policy review through the Scientific Council for Government Policy. The pluri-annual budget targets announced by OECD governments in this period were normally aimed at reducing deficits, debt levels and the rate of inflation. By placing such targets into medium-term stabilisation strategies, governments conceded that a clean bill of financial health required lengthy and determined efforts as well as concerted action by many different partners. Most OECD member countries formulated programs for a three- to five-year time-span, with Japan alone opting for a seven-year perspective.¹¹
- **Towards Monetary Union in the 1990s.** With the efforts to enter into a Monetary Union, the experience of such stabilisation programs was translated into a common strategy. The member states of the European Union turned a new page in their history by accepting mutually agreed and supervised standards for their economic policy. In a first stage, the conditions included in the Maastricht Treaty served as a set of targets that the aspiring members of the Monetary Union were free to attain as best they pleased. The peer pressure applied from the outside to stimulate compliance was relatively mild, with special support offered to countries toiling under a heavy adjustment burden and with an occasionally liberal interpretation of the way in which conditions were fulfilled. But the Maastricht criteria nevertheless served as an important disciplining framework for the streamlining of national budgets, focusing attention on a common set of targets.
- **The Stability and Convergence Programs in the first decade of the 21st century.** The last seven years have seen a plethora of “stability pacts” in

Europe, ranging from the 1995 European Stability Pact (focused on human rights and minority problems) to the 1999 Stability Pact for South-Eastern Europe (focused on reconstruction) and such national initiatives as the *Pacte de stabilité des prix* between French industry and commerce prohibiting price increases between 1 November 2001 and 1 April 2002. The 1997 Stability and Growth Pact of the European Union introduced an important new instrument of economic policy harmonisation through the establishment of common goals for medium-term economic policy combined with certain mechanisms for mutual surveillance. The Pact requires all member states to produce annual reports on their budgetary and economic strategy and prescribes the formulation of a common response to such reports through council opinions on the policies of individual countries. The reports are called “Stability Programs” for the Euro-zone countries and “Convergence Programs” for the others, but the difference in substance along this dimension appears minimal. Much more striking is the difference between the first batch of reports (“the original programs”) in 1999 and the fourth batch (“third updated programs”) presented in 2002. Between these years, there was a real breakthrough for a long-term perspective in the analysis of public finance, based on demographic projections covering the first half of the new century. Whereas the original reports covered only stabilisation measures intended to promote medium-term targets, the updated programs extend the horizon until the middle of the 21st century and consider in some detail the objective of attaining “sustainable public finance”.

Though each and every one of these six stages represents a qualitative and conceptual step forward, the two most important innovations in European pluri-annual budgeting in the last few generations are both linked to the Stability and Growth Pact. The first of these is the fact that medium-term targets are now set collectively by several countries and implemented under the pressure of a mutual surveillance system. The second new feature is the major shift that has occurred *within* the Stability and Growth Pact with the initiation of a truly long-term analysis of projected revenues and public expenditures.

While the **medium-term objective** for EU countries set out in the Stability and Growth Pact was the magic formula of “a budget position close to balance or in surplus” and the 2002 Barcelona Summit prescribed that this goal should be attained by 2004 at the latest, discussions continue in Europe as to whether it is reasonable to fix such cyclically inflexible targets. An alternative position often defended is that the target should be fixed as an average over the economic cycle. The problem with this strategy is of course that the exact trajectory of the remainder of the current business cycle is unknown and that such flexible norms entail temptations to wishful thinking. The compromise formula reached when the Ecofin Council dealt with the Broad Policy

Guidelines in March 2002 was to lay down the rule that automatic stabilisers should be allowed to play symmetrically both in upturns and in downturns, provided that the three GDP limit was not breached, and that member states could make use of discretionary policy only if they had created the necessary room for manoeuvre – a restriction opaque enough to allow for different interpretations.

As far as the **long-term perspective** is concerned, the consensus among industrial countries – supported by analytical work at the OECD, the European Commission, Eurostat and the International Labour Organisation (ILO) – is now that the next decade or two provide a window of opportunity for adjustment of public policy before dependence ratios climb more steeply and various effects of population ageing begin to impinge more substantially on public finance. In this time-span, it is particularly important to review pension systems, examine the dynamics of health care and long-term care systems, and reconsider labour market exit rules and practices. Public debts must also be reduced in order to ensure fiscal sustainability. Once the greying process gathers momentum in or around the second decade of the new century, the European Commission predicts an average increase in the costs for public pensions of 3-5% and the OECD foresees around 7% increase in all age-related spending.

5. Extending time horizons in public administration

A second challenge is to extend time horizons in public administration. Here, too, the annual time-frame is linked to a number of well-known efficiency problems, ranging from hoarding to waste and from goal displacement to excessive paperwork. Strategies to encourage managers to take a longer view and aim for sustainable efficiency include measures to introduce: i) greater flexibility; ii) wider time-frames through pluri-annual appropriations and budgets; iii) de-coupling and contractual relationships; and iv) more inclusive accounting techniques, as employed particularly in accrual-based budgeting.

Greater flexibility. A classic effect of the budget's annual time-frame is known as "December fever". If funds have to be disbursed before a certain date, spending may be prudent or even over-prudent in the early part of the fiscal year but more frenzied towards its end. From the manager's point of view, it is not only a matter of money burning in his pocket or her purse. There is also the question of future funding. If appropriations are not expended within the fiscal year, this is easily taken as a sign that the previous assessment was too high and that the future level may be lowered. Thus, there is a strong motive to get rid of available resources in time in order not to admit the existence of a "budgetary slack".

Efforts to confirm the prevalence of the “December fever” have not been particularly successful. In an ambitious effort to measure the phenomenon, Boss and Bothe (1987) examined the monthly spending by German federal and *Länder* authorities without finding conclusive evidence of a significant increase towards the end of the fiscal year.¹² Since many types of expenditure are regular in character (such as wage-bills) or follow other types of annual rhythm, it is quite plausible that the seasonal variation is not that great. Yet anybody who has been near a public authority (or a business organisation operating under similar constraints) is well aware of the temptations linked to the end of the budget year. This is a high season for precipitating minor investments, hoarding utensils and paying bills in advance of delivery or due time-limits.

The conventional therapy against this year-end spending splurge is to allow for greater flexibility in the use of funds, either through less itemised appropriations or through the permission to make “savings” or use specific funds over a longer period than the fiscal year. This technique has been a regular ingredient in the budgetary reforms inspired by New Public Management (NPM) in the 1990s. Even before this period, some countries employed a distinction between expirable and non-expirable appropriations. In the Swedish budgetary nomenclature, the former were called “unassigned” budget items while the latter appeared in the budget as *reservationsanslag*, i.e. items that could be maintained indefinitely until spent.

Has the greater freedom of carry-over introduced through NPM-type reforms served its purpose? In spite of some positive evidence reported by pioneers in this field, it is perhaps too early to arrive at a definitive verdict. The method has been widely hailed but also met with some ingrained scepticism among managers with a somewhat seasoned attitude to promises of limit-less appropriations. Allowing managers to keep their “savings” for future needs may seem very rational, but is there any real guarantee that these funds will not ultimately be retrieved in the next budgetary squeeze or used as a measure of potential savings in the subsequent reassessment of expenditure needs? Guardians are well aware that there may be several reasons for underspending, some laudable but others less so. Given this attitude, the Budget Bureau is prone to emit ambivalent signals while implementing agencies retain their penchant to use up all available resources. As long as reserves are not well protected, depleting your accounts remains a strong visceral instinct in public administration.

Pluri-annual budgets. A different way of extending the perspective of public managers and making them more concerned with the medium-term consequences of their decisions has been to prolong the planning and budget period for individual agencies or programs. This is a standardised procedure which may be used selectively for particular activities or more uniformly for broader areas of public policy. In the latter case, there is sometimes a link to

the electoral cycle or the mandate of the Executive. In the European Union with its six- to seven-year perspective periods for budgetary planning, policy programs have sometimes been linked to this general medium-term cycle but often enacted for a shorter time-span.

Pluri-annual goal-setting for managers is often linked to the phasing out of operations, the pursuit of efficiency and productivity objectives or other forms of restructuring. Here, the longer view may be employed to mitigate pains through phasing-out periods, provide lead times for necessary changes, promote rationalisation efforts and maintain morale in shrinking organisations. In one version of this technique, there is also a nexus to the appointment period and possible reappointment of the manager.

A generalised system of pluri-annual budgeting was tried in Sweden in the late 1980s and early 1990s. Under this model, agencies were divided into three cohorts, each of which would be subjected to a thorough examination one year out of three and a more cursory review in the intervening years. In preparation of their appropriations for the years singled out for in-depth analysis, agencies were requested to submit a substantial amount of information about their activities, while off-year submissions were intended to be scaled down. The experiment was no great success. Neither the ministries nor Parliament showed much interest in performing the in-depth analysis and the burden of presenting submissions was not much lighter in the off-years. The normal asymmetry of the budgetary process prevailed: much work in the agencies and little response from the ministries. In addition, many agencies found it difficult to project and predict expenditure needs for such a long period as four years from the date of submission.

Under the UK system of three-year budgeting, introduced in 1998, most spending is now defined within departmental expenditure limits and tied to performance targets for each department. Year-end flexibility is provided for under these plans which are reviewed every second year. The limits are set in nominal terms, with further compensation for cost increases foreseen only if inflation varies substantially from forecast.¹³

The three-year perspective is often employed in demands directed towards management in public administration. The Greek Ministry of Finance reports: "All grant receiving agencies are required to submit a provisional program which would result in a grant reduction over the next three years. This program must include a plan of how they are going to improve their budget position by increasing their own revenues or reducing expenditures or both."¹⁴

Other countries have advanced towards multi-annual budgeting on a more selective basis. Under its new *Flexibilisierungsprogramm* introduced in 1999, Austria has granted a special "flexibility and accountability" status to two prisons and two research institutes. This is attained through contracts

covering a period of four years during which certain key targets such as increased productivity must be met. Under these contracts there is a delegation of authority to the agencies, but the minister retains his hierarchical powers and is still politically and legally responsible for the activities. A limited number of objectives have been established for each agency relating to such aspects as economy, efficiency and quality. A mid-term review is foreseen as well as an *ex post* evaluation.¹⁵

Outsourcing, privatisation and contractual arrangements. Whereas the Austrian model of “free agencies” is based on the maintenance of service production within the public sector, another prominent line of reform in the recent decade has been to convert public institutions into private enterprises operating either entirely on market conditions or within certain specific restrictions. In line with the demonopolisation of public utilities, such key functions as railroads, telecommunications and post offices have largely been converted into joint stock companies and opened up to competition. In this process, specific regulatory agencies have been set up to exercise oversight.

Several countries have turned over the ownership and maintenance of public buildings to particular companies. One motive for this is to promote efficiency in services, or what the French call *la professionnalisation de la gestion immobilière*. Another important objective is to give agencies better incentives to reconsider their needs and costs for premises, opting for less expensive solutions. Contractual arrangements fulfil the double function of enhancing flexibility and cost consciousness. The same function is served by the introduction of internal payments inside agencies for the use of various services, but here there is often a downside in the form of increased paperwork. If the additional bureaucracy burden is too heavy, intended economy gains may dwindle.

Accrual based accounting. A fundamental idea in the philosophy of New Public Management is to increase both the freedom and responsibility of managers in public administration. Under such slogans as “let managers manage!”, choices previously made at the top through detailed budgets, central approval or “visa” requirements and numerous specific restrictions on resource utilisation are now decentralised and entrusted to increasingly de-coupled agencies. To achieve this end without losses, however, there is a strong need to reduce the range of resources which was previously put at the disposal of lower units free of charge or without adequate coverage in their budgets, such as the use of capital. The method does not work without a realistic assessment of real costs and the continuous changes in asset balances.

To advance in this direction, several governments have moved from cash-based budgeting to introduce more or less complete forms of accrual accounting (or “resource budgeting” in the UK terminology). Under this system, agencies are allowed to determine more freely the combination of

inputs needed to attain their outputs. But they must also pay for depreciation of capital through charges added to their current expenditures. While various forms of accrual-based accounting and budgeting have long been used in the private sector and in government-owned companies, the recent trend has been to adapt it to core government institutions. The model presupposes a thorough review of the reporting system between agents and principals. The 1995 UK White Paper introducing resource budgeting foresaw five different audited financial statements: i) a summary of resource out-turn; ii) an operating cost statement; iii) a balance sheet; iv) a cash flow statement; and v) a statement of resources identifying the costs of achieving the department's aims and objectives.

Accrual-based accounting and budgeting can be expected to extend time horizons in two directions, both forwards and backwards. Advocates of the method put particular emphasis on its potential to enhance foresight and pro-active planning. By inducing managers to assess both present and future costs in a more realistic and comprehensive manner, the method provides incentives for a more careful analysis of the resource mix. But by the same token they are also given strong reasons to review the past. Under the accrual system, cost levels are partly determined by assets stemming from previous investments. This renders it imperative to consider whether such resources should be retained or divested, leading to greater efficiency in handling the capital stock.

6. Towards “sustainable public finance” and “quality in budgeting”

Short- to medium-term stabilisation concerns were always in the forefront of the European Monetary Union. Yet 10 years after the adoption of the Maastricht Treaty, there is also a clear trend towards extending the time horizons even further in European economic policy-making. Two concepts that were rare only a few years ago but are now rapidly gaining currency are **sustainable public finances** and **quality in budgeting**.

The idea of **sustainable public finances** is an offshoot of a broader trend to pay greater attention to the long-term impact of political and economic choices. The notion of *sustainable development*, which originated in a preoccupation with ecological threats, was launched in the 1987 Report by the Brundtland Commission. With the 1992 Rio Environment Summit and its Agenda 21, it received a prominent place on the global political agenda. Further momentum was added by the reorientation of the international financial institutions from their earlier prescription of “structural adjustment programs” for heavily indebted nations to a wider set of objectives, often presented as elements in strategies for sustainable development.

Thus, the concept gained a firm foothold in the discussion on the economy of poor countries. Somewhat later, it was also integrated into the discourse on economic development in the industrialised world. At the 2000 European Council in Lisbon, the heads of state and government proclaimed it to be a goal of the European Union “to become the most competitive and dynamic knowledge-based economy in the world, capable of sustainable economic growth with more and better jobs and greater social cohesion”.

The subsequent transfer of the notion of sustainability to the specific domain of *public finance* was stimulated by a growing awareness of the demographic challenges threatening to block this ambition. With population pyramids and dependence ratios foreseen to shift significantly over the next half-century, it seemed imperative to give more attention to the long-term perspective in considering such policy areas as health care, pensions, labour supply, employment, migration, family policy, education, research and innovation.

Already the Maastricht Treaty (in Article 2 of the Protocol on the Excessive Deficit Procedure) contained a passing reference to the need for sustainable public finances. But it took considerable time for this idea to surface in substantial discussions. In its report to the 1999 Helsinki European Council, the Ecofin Council called for “a broadening of the scope of public finance issues covered in the stability and convergence programs and more emphasis on medium- to longer term sustainability issues”.¹⁶ Before the 2001 Brussels European Council, the Economic Policy Committee presented a report on the budgetary challenges posed by ageing populations. This led the Ecofin Council to put an even greater stress on the imperative of sustainable public finances, declaring this to be a crucial challenge that member states must address as soon as possible. In its report to the 2002 Barcelona European Council, the Ecofin Council combined the notions of quality and sustainability in the following statement:

- *More effort and co-ordination are required concerning the long-term quality and sustainability of public finances:*
 - ❖ *quality means achieving the appropriate structure of government revenues and expenditures to ensure sound and sustainable public finances while raising the potential growth of Union economies. In this light, tax and spending reforms must aim at creating the conditions to foster employment and investment, while adhering to the medium-term objective of a budgetary position close to balance or in surplus;*
 - ❖ *sustainability demands a multi-disciplinary strategy which can address the impact of population ageing, including health care needs, while ensuring the long-term solvency of European public accounts. The strategy should be built upon further reductions of public debt, increases in employment rates and reforms of pension systems themselves.*

The idea of **quality in budgeting** expresses the insight that public expenditures and receipts cannot be measured simply in single-year cost terms and that the perennial pursuit of quantitative targets is not a sufficient ambition. Fischer and Giudice put it in the following way: “While the size of budgetary adjustment matters, there is growing evidence that its composition is the most important factor determining its success, both in terms of sustaining an improved balance budget and achieving a positive growth.”¹⁷ Whether a budget is in deficit, in balance or in surplus is not a conclusive indication of the financial health of the given country or territorial unit. In addition to single-year quantitative variables, there is a need to consider also such aspects as the time structure and political dynamics of programs and commitments, the buoyancy or vulnerability of revenue bases and the linkage of entitlements to a set of demographic and economic variables.

The “fungibility” of public expenditures is thus misleading. Beneath the surface of seemingly comparable figures, there are many intricate patterns to discover.¹⁸

If budget offices have long been aware of this diversity concealed by apparently equivalent numbers, they have been less than successful in communicating their understanding of the complexity of public commitments to other participants in the budget process. To experts in public finance, the differences between sound and unsound outlays are all too obvious. Their experience helps them to distinguish between expenditures promising reasonable returns and commitments threatening to cost dearly in subsequent years, between investments with well-charted long-term benefits and political gestures calculated mainly to secure short-term popularity for the decision-makers. The internal memoranda of budget offices are replete with more or less cautiously worded analyses highlighting such distinctions.

Yet in the examination of the annual budget, such insights are often swept under the carpet. The long-term impact is difficult to assess in hard figures and is therefore not accorded appropriate weight. Efforts to quantify the range of possible future effects through sensitivity estimates, cost-benefit calculations under various assumptions and other more sophisticated forms of analysis are often only partly understood by the politicians and, even if grasped, such information is not always easy to handle. When priorities are discussed among political decision-makers, an inordinate degree of attention tends to be paid to the **first-year costs** of various options.

Will it be possible to overcome this inherent short-sightedness in the budgetary process and gain more recognition for the long view? Can time horizons in public budgeting be extended? Beyond the consensus at the European level, there are some moves in this direction at the national level. The third updates of the Stability Programs for the various Euro-zone

countries and the Convergence Programs for the other EU countries produced in late 2001 all include sections on the quality and sustainability of public finances, based on the demographic projections for the first half of the new century.

This joint recognition of the problem is an important step in itself and the estimates of future population shifts and their impact on government receipts and expenditures may well influence a wide-range of policy analyses in the years to come. But there is a long way to go from word to action. Lofty international declarations easily dissolve into thin air unless there are specific mechanisms for monitoring their implementation, sanctions against non-compliance and political incentives to put longer term considerations into the spot-light in national politics. Just as there is no automatic transmission belt conveying the priorities of the European Council to the member state level, there is no automatic transmission belt between the abstract principles in government reports sent upwards and the concrete government policies conducted downwards. If the prospects are still uncertain for the mutual surveillance system of **medium-term** targets which has been established through the Stability and Growth Pact, the outlook may therefore seem even dimmer for the pledges of sustainable public finances. As far as the **long-term** perspective is concerned, European states have not yet moved very far beyond the stage of questionnaires, scoreboards, comparative policy studies, common follow-up meetings and declaratory “soft law”.

What additional steps could be taken to translate this commitment to the long view into action? Two directions in which further efforts might be deployed would seem to be: i) the analysis of trends in public finance; and ii) the introduction of institutional and procedural arrangements giving added weight to longer term considerations in the budgetary process.

7. Quality in budgeting: The analytical dimension

The concept of **quality in budgeting** is linked to a general upsurge of interest in quality issues in the recent years. “Quality management”, “quality control” or even “total quality control” have become fashionable buzz words. In the literature on production and business organisation, there has been an avalanche of publications on such topics.¹⁹ When it comes to “quality in budgeting”, however, there is as yet little meat on the bones. The definition suggested by the Ecofin Council in March 2002 does not add much clarity. To advance further in this direction, there would seem to be a need for more conceptual and methodological work, deepening our understanding of both the structural properties of various spending programs and the long-term dynamics of public finances.

Baseline projections purport to shed light on the expected evolution of budget revenues and expenditures, given constant policies and certain assumptions about demographic trends and labour market participation. A standard method of illustrating the uncertainty in such extrapolations is to bifurcate the prognosis by introducing high-growth and low-growth scenarios. The resultant two curves are then supposed to give an idea of the likely budgetary development under more or less favourable circumstances, if no further action is taken.

If the main function of such projections is to serve as wake-up calls alerting policy-makers of the need for long-term considerations, a few percentage points up or down may not seem so important. Only the younger statisticians will anyway live to know whether their projections of the budget stance in 2050 will overshoot or undershoot the target. But in grappling for solutions and palliatives to our future budget problems, it may nevertheless be crucial to pay more attention to the different types of uncertainty linked to various categories of expenditure:

- The costs of **entitlement systems** (such as pensions, sickness insurance, unemployment insurance, etc.) are influenced not only by macroeconomic trends but also by a multitude of factors linked to social attitudes affecting the individual propensity to make use of existing rights. Changes in the design of such systems are also subject to dynamic political pressures. To arrive at a more realistic prediction of probable future expenditure needs, we would have to integrate such variables into the calculus.
- The impact of ageing on **public health expenditures** and **long-term care** costs is an area with several forms of incertitude. A cardinal question relates to the effects of longer life expectancy. Does this shift lead to longer periods of old age illnesses or merely to a postponement of the needs for terminal care? With some diseases genetically coded to appear more frequently in old age, how will changes in morbidity affect the demands on the health system? Another uncertainty revolves around the cost consequences of new discoveries in medicine and pharmacology. Can increased efficiency be translated into cost savings or will it merely stimulate demand for even more expensive treatments? There is contradictory evidence on this that need to be carefully sifted.
- A third issue relates to **migration**. While the various national projections presented thus far treat the population pyramids of each country in isolation, it does not seem very far-fetched to anticipate that the free mobility inside Europe will have some impact and that further flows may be added from other parts of the world.

To get a better grasp of the evolution of public budgets, it would seem important to look not only forwards but also backwards. Projections of future

expenditure needs might usefully be supplemented by studies of historical development patterns. Such analyses might serve as a useful basis for developing “quality indicators” measuring the sustainability of various programs or budget items. Another interesting format is the attempt to measure the contributions and requirements of different age cohorts through “generational accounting”, a form of analysis developed particularly in the United Kingdom.²⁰

8. Quality in budgeting: The institutional and procedural dimensions

Les absents ont toujours tort, says the French expression. The problem with future generations is just that: they are conspicuously absent in the budgetary process, while the advocates of immediate needs are all too present and vociferous. When individual aspirations are translated into political attitudes and aggregated into group interests, there may even be a loss of farsightedness and forward orientation if uncertainty about future power relations induces the electorate to place proximate and certain gains before distant and less certain ones. While voters and politicians alike are perfectly capable of considering the long view from time to time, parties and candidates emphasising future-oriented requirements at the expense of current concerns do not fare too well in elections. The hypothesis that young people today have turned into a post-materialist generation has hardly been confirmed.²¹ The propensity to concentrate on immediate and self-centred matters seems particularly strong in economic downturns. But even in normal times, there appears to be strong sympathy with Groucho Marx’s rejoinder: “they always ask me to think of posterity, but what has posterity ever done for me?”

Giving “posterity” a greater weight in the arbitrage between the present and the future is hardly achieved merely by better knowledge about expected expenditure needs or by sonorous political pledges. A serious commitment in this direction must furthermore be anchored in institutional and procedural innovations, giving longer term considerations a stronger entrenched position in the political and budgetary process. A far from conclusive list to exemplify such innovations might include: i) efforts to forge a broad national consensus on pension reform; ii) funding arrangements to lock in foreseen budgetary surpluses in preparation of the future bulge of pension commitments; iii) procedural rules concerning the place of long-term projections in the budgetary process; iv) more emphasis on longer term effects through program evaluation; and v) further steps to induce line managers in public administration to consider the longer term effects of their activities:

- i) Current reforms of public pension systems include efforts to move from fixed promised benefits to growth-related benefits and from complete

pay-as-you-go models to partially funded models. To gain acceptance for such sensitive steps and forge a durable national consensus, governments have embarked on consultation procedures with a broad segment of interests. Thus, Sweden's pension reform was prepared by an all-party committee and the active involvement of all labour market organisations. In Luxembourg, an inventory of problems within the country's largely private-based pension system has been performed by the *Rentendesch*. The Austrian Government has created a *Pensionsbeirat* to monitor developments in the public insurance sphere. The German Government leans heavily on a Study Commission on Demographic Change set up by the *Bundestag*.

- ii) Many governments have concluded that the future funding needed to meet expected shifts in the dependency ratio requires public finances to be in surplus over an extensive period of time. But how can such an ambition be defended when it comes under permanent and heavy cross-fire from two different sides, the tax-cutters mainly on the right and the benefit-raisers mainly on the left? A budget surplus is always a tempting prey for political assaults, with the advocates of divergent proposals normally agreeing that their particular prescriptions are not only fair in the short-run but also germane to the pursuit of long-term growth and therefore, as it were, *gratis*. One answer to this problem is to make the surplus less visible by locking it in, e.g. in a particular fund for future needs. Norway has long practised this model with its famous Oil Fund. More recently, Spain has established a Social Security Reserve Fund protected by the General Law on Budgetary Stability. In 2001, Belgium adopted a law projecting the continuous reduction of public debt and creating a special Ageing Fund, to be financed through future budget surpluses, Social Security surpluses, non-fiscal revenues and investment revenue. The Ageing Fund's reserves cannot be used until 2010 and then only if the public debt ratio is less than 60% of GDP.
- iii) A technique by which long-term considerations may be placed on the political agenda is the introduction of reporting requirements into budget laws and budget procedures. The European Union has taken an important step in this direction by its recent prescription that the annual convergence and stability reports contain separate chapters on quality in budgeting and the sustainability of public finances. Similar reporting is required in many national budgets, but few Parliaments have given much attention to the information provided in such chapters. The introduction of procedural rules on obligatory reporting and statutory debates on such matters may be worth considering. In Belgium, the 2001 law requires the government to present an annual memorandum on ageing.
- iv) In the early part of the post-war period, and especially from the mid-1950s to the mid-1970s, many OECD member countries had a tendency of piling one expansionary plan on top of the other, on the implicit assumption that

economic growth would continue at the same pace indefinitely. The subsequent economic slow-down led to the discovery of the many forms of automaticity and escalator effects built into various policy programs and entitlements. This stimulated the invention of mechanisms intended to promote policy review and policy termination, such as sunset clauses and evaluation requirements integrated into the formulation of new programs. New budgeting techniques such as PPBS, ZBB and MBO were tried in succession and some of their ingredients calling attention to long-term effects now survive under the new conceptual and methodological umbrella of NPM. Yet so do some of their weaknesses. The evaluation industry has reached significant proportions in recent decades, but its political impact remains limited. Public institutions and public policy programs have developed impressive survival skills, sometimes in spite of very modest results.²² Integrating performance evaluation into the budgetary process has proved to be difficult.²³ When political interests are strong, audit and evaluation reports are all too easily filed and never heard of again. Strengthening the nexus between political decision-making and the universe of evaluation, auditing and policy review would seem to require institutional and procedural changes, reinforcing the position of review bodies and placing their observations firmly on the political agenda. Several countries have revised their procedural legislation to include compulsory reporting on expected long-term effects of proposals under consideration.²⁴

- v) The principal idea behind many recent reforms in public administration has been to offer agents more freedom in exchange for increased accountability while pushing the focus of attention forwards from inputs to outputs and from cash expenditures to costs and results. In-line with the idea of “reinventing government”, a variety of contractual techniques have been adapted to the public sector and traditional budgeting methods supplemented by more business-like forms of accounting. Many such innovations purport to make public managers more aware of long-term consequences and give them a stake in the results achieved. If successful, they may thus serve to extend time horizons in the implementation of policy programs.

Yet counter-vailing tendencies have also been observed. Relaxing input controls is easier than establishing efficient output indicators.²⁵ The formulation of objectives furthermore seems to follow two different logics. On the one hand, there are the ideals formulated within the managerial sphere, often summarised in the acronym SMART: targets should be specific, measurable, accepted, relevant and timed. On the other hand, a different set of characteristics seems to prevail for goal-setting in the political sphere. Politicians interested in gaining broad support and building coalitions for agreement on particular policies are drawn to objectives that are suggestive but also open to different interpretations, at the

same time emphatic and ambiguous. Their motives may also be more complex than the goals explicitly recognised.

This gap between two cultures within the public sector complicates the transmission of competence needed to give managers more leeway. In many countries we can see pendular movements between *tight governance* and *loose governance*.²⁶ If the former approach generates complaints about over-regulation, red tape, government failures and intrusive bureaucracies, the latter strategy now in vogue entails other risks: trust may turn into gullibility and flexible arrangements give room for laxity, waste and corruption. Though NPM-type reforms certainly stimulate forward thinking and extended time horizons, there are no absolute guarantees that the wider elbow-room provided for managers by such mechanisms will serve public rather than private interests.

9. Conclusion

Budgets are summative documents recording the effects of previous decisions.

By adding up the sequels of all obligations incurred in the past, they provide indispensable information for decisions about the future. The inclusion of medium-term projections in most budgets has given policy-makers a better basis for making informed choices. Further important data have been added in recent years with the elaboration of 50-year projections based on demographic predictions.

Whether, and to which extent, this information is utilised in the policy process depends very much on institutional conditions and procedural rules. That present and proximate pressures are accorded greater weight in economic policy-making than distant and often uncertain effects is nothing new and any shift in the balance between current and future concerns is likely to be modest. Yet with increasing awareness of long-term trends, both demographic and ecological, there is nevertheless a new resolve to look forwards and give early attention to the challenges ahead.

As far as the age pyramid is concerned, these challenges are twofold. First, the *greying economic system* which is reflected in recent long-term extrapolations. The main uncertainty in this field consists of the migratory flows that may result from developments both in the industrial and agricultural parts of the world. Second, there is the prospect of a *greying political system*. What new priorities will emerge when the elderly become a much larger part of the electorate? What inter-generational tensions are in store? Gero-politics is still a largely uncharted territory.

The emerging consensus within the EU and the OECD on the need for sustainable public finances and quality in budgeting is encouraging. Yet much work remains before we have tools to attain these objectives.

Notes

1. Dahlerup (1969), p. XIV:7.
2. Premchand (1983), p. 137.
3. *Ibid.*
4. Swedish Parliament (1993/94), Reformera riksdagsarbetet! Riksdagsutredningen 1993/94:TK1, Chapter 4.
5. OECD (2000), p. 31.
6. See also Wildavsky (2000), Chapter 9.
7. Wildavsky (2000), p. 188.
8. Brigid Laffan, *The Finances of the European Union*, Houndmills: Macmillan, 1997, p. 77f.
9. On fungibility, see Hood and Wright (1981), p. 213 ff and Rose and Peters (1978), p. 25.
10. Le Houerou and Taliercio (2002), p. 1.
11. Tarschys (1985), p. 26f.
12. Alfred Borr and Adrian Botke, *Ausgabenkürzungen im öffentlichen Sektor*. Tübingen: JCB Mohr, 1987.
13. OECD (2000), p. 31.
14. *Ibid.*, p. 11.
15. *Ibid.* p. 4f.
16. Cf. Fischer and Guidice (2001), pp. 173-182.
17. Fischer and Giudice (2001), p. 174.
18. Further on the need for a qualitative analysis of public expenditures, see Perotti et al. (1998) and Tarschys (1984).
19. Of 5 783 book titles containing the word "quality" listed in the Libris database (comprising all books in Swedish libraries), some two-thirds have been published since 1990.
20. Cardarelli, Sefton and Kotlikoff (2000); Auerbach, Kotlikoff and Leibfritz (1999).
21. A thesis developed in several works by Ronald Inglehart, for instance Inglehart (1990).
22. For a further discussion of this topic, see Bovens et al. (2001) and Persson (1979).
23. OECD (1997c).
24. Chapter 3 Art. 2 of the Standing Orders of the Swedish Parliament (the Riksdag Act) was thus amended in 1981, following a private member's bill by the author.
25. For a further discussion of this problem, see Blöndal (2001).
26. More on these concepts in Tarschys (2001).

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