The Changing Role of the Central Budget Office

By
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I. Introduction

The traditional role of the central budget office is incompatible with the management reforms enforming in various OECD Member countries. These reforms are grounded on the principle that managers must be permitted to run their operations without undue outside interference. The logic of reform is that only when managers are free to use money and other organisational resources within agreed budgets can they be responsible for the organisation's successes or failures. In countries where a culture of reform has taken hold, there is consensus that halfway measures do not suffice, that managers either are free to act or are not. It is not a matter of relaxing one or another restriction, but of reshaping the operations of public institutions and the behaviour of those who work in them. The budget process is one of the main arenas in which the machinery of government is undergoing fundamental transformation.

The traditional role of the budget office has been to function as a central command and control post, specifying the items of expenditure, monitoring compliance with regulations, ensuring that the inputs are those agreed in the budget, and intervening as deemed appropriate. This role cannot coexist with the discretion accorded managers in the new public administration. Either managers decide on the items of expenditure (personnel costs, supplies, rental fees, and so on) or others do it for them. If the latter, managers do not have genuine freedom to operate according to their best judgement.

Defining a new role for the central budget office that is compatible with contemporary managerial concepts is a difficult task, for it entails balancing the critical need of the government for financial discipline against the need of managers for freedom to act. Simple divestiture of control is not a viable option, for doing so would destroy the discipline on which all budgeting rests. This paper explores the

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role and behaviour of the central budget office in a devolved environment that shifts decision making authority with respect to the particulars of public expenditure from central institutions to line agencies, and from headquarters in these agencies to subordinate units and field offices. It discusses the changes that three basic roles of the budget office – controlling the totals, establishing priorities, and seeking efficiency – might be conducted in the new environment of devolved management.

Not all OECD Member countries have embraced a culture of reform. By “culture of reform” we have in mind innovations that uproot established practices of public administration and radiate through the public sector. Where this culture thrives, reform is comprehensive rather than piecemeal, at the core of government rather than at the periphery, institutionalised rather than pilot tested. This culture does not pertain only to budgeting, but to other managerial actions as well. In countries animated by a culture of reform, managerial discretion is not an alternative form of public administration; it is the way the government operates. The countries in the vanguard of this movement include Australia, New Zealand, Sweden, and the United Kingdom.

What about the many OECD Member countries that have not reformed public management or have taken only halting steps in this direction? Is the managerial revolution of such limited scope that it should interest only those countries that have already introduced major reforms or are contemplating doing so? I think not. Most OECD Member countries are affected by the conditions that have impelled the transformation of public institutions.

Regardless of their posture on managerial reform, central budget offices cannot ignore the powerful tensions stressing contemporary government: pressure to curtail or eliminate chronic deficits, but not by raising taxes or taking away benefits that citizens have come to expect; consensus that the era of expanding government is over, but demographic trends that harbor major spending increases in the decades ahead; demands for devolution and decentralisation, coupled with the spreading internationalisation of economic policy; a loss of confidence in the capacity of democratic governments to perform what is expected of them, but pressure to entrust government with even more responsibility for the public welfare; a rising portion of the budget allocated by statutory formula amid efforts by governments to achieve greater flexibility in allocating resources.

Governments facing these tensions cannot effectively control the budget by operating the detailed controls that served them so well in the past. Trying to do so may weaken their control of the totals, hobble efforts to reprioritise the budget, and degrade the efficiency of public expenditure. This is the paradox of contemporary budgeting: central control of the items of expenditure may not give the centre effective control of the budget.
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Contemporary pressures on public finance have weakened the efficacy of two of the traditional tools used by the central budget office to control expenditures: *ex ante* specification of the items of expenditure and allocation of the increment. In the past, itemised budgeting protected the totals, while decisions on the increments secured the government’s priorities. Itemised control has been attenuated by the growth in total spending, especially in entitlements, incremental priority-setting by the inadequacy of increments to finance the built-in growth in expenditures. Controlling the items of expenditure no longer secures control of the totals because a) the totals are so large and the individual items are so small; and b) most spending is for entitlements that are not subject to itemised control. All *ex ante* control accomplishes is to take away from managers their discretion over running costs. In fact, over the years, most OECD Member countries have relaxed *ex ante* controls by consolidating the line items into broader frames, increasing the threshold for expenditures that agencies may make without prior approval, and giving managers more flexibility in implementing the budget.

The inadequacy of spending increments also has eroded central budget control. During much of the post-war era, central budget offices influenced government priorities by concentrating on the increment – the additional amounts to be spent in the next or subsequent budgets. Although the increment may have been small relative to the totals, it was the portion that politicians and spending agencies cared about the most. By allocating the increment, the budget office determined which programmes would grow and which initiatives would be undertaken. But incremental budgeting requires increments to allocate. Whether because of weaker economic growth, the built-in rise in entitlement spending, or the reluctance of politicians to raise taxes, spending increments are not presently available in some countries and are not as robust as they once were in others.

If its old role no longer suffices, a budget office has to reconsider what it does and how it fits into the machinery of government. In the course of examining itself, the budget office may have to assess the efficacy of the controls it operates. What levers does it pull to assure compliance with government policy? How does it assure that the bits and pieces of public expenditure do not add up to more than the government wants to spend? How does it make room in constrained budgets for new priorities? How does its voice for fiscal discipline get heard above the din of multiple, often conflicting, demands on government? The countries that have embraced reform have been compelled to address these questions; others are likely to follow suit.

In countries that have decided to transform public administration, the incompatibility of central control of operations and managerial freedom has forced the budget office to revamp its operations. In the typical case, the budget office has divested most (or all) *ex ante* control of running costs and now leads the effort for management improvement. It has a major role in devising new institutional
arrangements, integrating budgeting with other management processes, prodding departments and other public entities to measure performance and evaluate results, developing new guidelines and methods for holding managers accountable, and installing new information and reporting systems. As they have withdrawn from the old roles, reformed budget offices have been busy with the new ones.

The full extent of this behavioural revolution often is not recognised by the newly freed managers. Despite the transformation, one still encounters the view that control is as centralised and the budget office is as interventionist as before. Managers in spending departments frequently complain that the budget office substitutes its judgement for theirs and is unwilling to entrust them with full discretion to manage their own operations. These perceptions are reinforced by instances in which spending agencies are constrained or overruled by the budget office on particular issues. For example, when the budget office imposes across-the-board cuts on running costs (as has happened in Australia, New Zealand, and Sweden) managers take that action as evidence that nothing has changed and that the budget office’s grip is as tight as ever. There appears to be a naive view among some line managers that reform means carte blanche to spend as they want, as if they were not part of a larger government. Evidently, some managers do not understand that devolution of operations must be accompanied by centralisation of policy making. Reform cannot mean that spending agencies get their way regardless of the budgetary consequences of their actions. If it did, budget offices would soon reimpose the old controls.

In withdrawing from operational control and focusing on strategic policy issues, some central budget offices have gone through an institutional identity crisis. They know what they are no longer to do, but are much less certain as to what they should do. Adjustment has been especially difficult for budget offices embedded in large, powerful finance ministries; in these cases, restructuring the budget function cannot be divorced from consideration of the ministry’s overall role. In the United Kingdom, for example, Treasury control has been a bulwark of government for generations. Some of the initiatives impacting on its operations were launched outside Treasury. Once the reforms were implemented, Treasury conducted a fundamental review of its operations and reorganised its budget (and other) work. Other countries, however, have refocused the budget office as part of the process of giving managers operational discretion.

It was noted above that some reformed budget offices have become the central outposts for managerial innovation, to the extent that this is now seen as one of the organisation’s most salient roles. In my view, this may be a transitional phenomenon. During the early reform period, there is need for central guidance and for a clearing-house on new ideas and practices. The budget office can advance the cause of reform by producing handbooks and other materials that explain the new processes and advise managers on best (or improved) practices. It also can busy itself
revising budgetary forms and procedures and evaluating the progress of reform. The transitional period is likely to be quite extended, for every country that has made the effort has found it necessary to adjust the reforms on the basis of early experience. The Australian, Swedish and UK reforms have stretched well over a decade.

Once the reform processes stabilise, efforts to direct managerial improvement from the centre will coexist uneasily with the commitment to managerial discretion. There is a limit to how much the budget office can do in prodding agencies to upgrade their operations, and there is substantial risk that if it pushes too hard, managerial initiative will dry up and a compliance mentality will return. In the long run, managerial innovation must be entrusted to the managers, not to central policy makers.

There is another reason why managerial reform is not likely to be a permanent niche. Managerial leadership is an inadequate basis for budgetary power. What has made the central budget office the powerhouse of government is not that it advises agencies on good practices, but that it allocates resources.

Managerial advice can be ignored; budget decisions cannot. Budget offices often leverage their power over resources to induce agencies to change management practices. But a budget office whose budgetary role is enfeebled will be weak in other matters as well. After reform, no less than before, the core role of the budget office must revolve around the allocation of resources and the routines of preparing and reviewing budgets.

Although budgeting must be the core budget office responsibility, this work may be conducted differently in the future than it was in the past. The basic routines of requesting and making appropriations continue, though they may require somewhat different skills, techniques, and information than once were common in budgeting. For example, reformed budget offices are likely to spend less time on implementing the budget than once was the case, but more time monitoring what agencies accomplish with available funds. This change follows from the principle that managers should have broad latitude in spending appropriated funds, but should be closely held to performance objectives.

All budget systems – reformed and traditional – have three basic budget tasks: to maintain aggregate fiscal discipline, to allocate resources in accord with government priorities, and to promote the efficient delivery of services. Fiscal discipline pertains to effective control of the budget totals. An effective budget system is one that has disciplined (in contrast to accommodating) totals. Allocative efficiency is the capacity to establish priorities within the budget, including the capacity to shift resources from old priorities to new ones, or from less to more productive uses, in correspondence with the government’s objectives. Operational efficiency is the capacity to progressively reduce the cost of producing the goods and services for which resources are provided. Although the terminology may
be unfamiliar, every central budget office is involved with maintaining aggregate fiscal discipline, striving for allocative efficiency, and promoting technical efficiency. How they go about these tasks distinguishes traditional and reformed budget offices.

Budgetary capacity can be assessed in terms of performance on each of the three dimensions. Strong fiscal discipline means that the totals do not merely rise to meet demands. Aggregate fiscal discipline refers not only to the decisions taken in formulating the budget, but also to pressures that arise during the year when the budget is being implemented. Allocative efficiency means not only that the government channels incremental resources to new priorities, but that it has the will and the procedures to transfer funds from lower to higher valued uses. Operational efficiency implies that the budget impels agencies to raise productivity and thereby reduce the cost of goods and services purchased by government.

These essential functions of budgeting are examined in the sections that follow in terms of the role of the central budget office, sanctions and incentives, and informational requirements. In the course of discussing each of these functions, I will explain how a reformed budget system differs from a traditional process.

2. Aggregate Fiscal Discipline

Control of the totals is the first purpose of every budget system. There would be no need for budgeting if the totals were permitted to float upward to satisfy all demands. Spenders would spend what they wanted without central review or constraint. But if aggregate control is fundamental to budgeting, the form it has taken has changed over the years, and along with it the role of the budget office. In most OECD Member countries each budget development was guided by a balanced budget norm. The operative rule was that in any fiscal period spending should not exceed current revenue. Countries differed in their application of this rule; some applied it only to current expenditures, others to capital investments as well. Some included funds carried over from previous periods in calculating current revenue, others did not. Inasmuch as this was a time of relatively limited government, the burden for assuring balance generally fell on expenditures. Balance was enforced through strict constraints on spending, the logic that if the parts of the budget were effectively controlled, so, too, would the total.

Strict budgetary balance was superseded after World War II by a more flexible rule that allowed the totals to accommodate cyclical changes in economic conditions and secular changes in budgetary demand. The impact of the new norm on aggregate fiscal discipline was remarkable. Government outlays in OECD Member countries averaged 28% of GDP in 1960 and about 40% two decades later, a growth rate in excess of 0.5% a year. These spending trends indicate laxity in fiscal discipline that was justified in terms of the economic and social gains achieved through
The persistence of high deficits and political resistance to tax increases induced many OECD Member countries to reassert fiscal discipline by stabilising the share of public expenditure in GDP. Some countries moved in this direction in the late 1970s, others in the 1980s; most introduced global fiscal norms that targeted medium-term reductions in deficits, spending, or taxes. In most cases, these norms were political statements of intent that were loosely related to the budget and lacked strong enforcement mechanisms. As a result, many of the norms were ineffective. Even countries which achieved temporary success in disciplining the totals when the economy was robust were compelled to relax aggregate fiscal discipline when the economy weakened. According to a report by the US General Accounting Office, four countries (Australia, Germany, Japan, and Mexico) that had extraordinary success in restoring fiscal balance during the 1980s experienced a new bout of surging deficits during the early 1990s, demonstrating that "significant structural improvement in fiscal policy is possible in modern democracies... such progress is difficult to sustain".

This difficulty has led some countries to experiment with new forms of fiscal control that lessen cyclical gyrations and make it easier to restore fiscal discipline when the economy recovers. The main difference between this and the earlier stage is that countries are linking the aggregate controls more closely to the process of budgeting. This does not ensure, however, that they will be any more successful than in the past in avoiding cyclical shocks to the budget.

The central budget office cannot impose or enforce a fiscal norm by fiat; a fiscal rule that truly constrains government spending or the deficit must be accepted by the government and strong enforcement mechanisms must be in place. But the budget office does have the lead role in maintaining aggregate discipline, and it must be strong enough to withstand pressures to evade the norm by removing some transactions from the budget and to override the rule when politicians or sectoral interests regard it as too constrictive. Several comparative studies of democratic regimes have found that success in maintaining fiscal discipline depends on the strength of the Finance Ministry and cohesion of the government. In most OECD Member countries, the position of the budget office is enhanced when it is housed in a large Finance Ministry that has broad governmental powers. But even when this occurs, economic or political circumstances may weaken the ministry's resolve to maintain fiscal discipline. Germany and Japan, for example, have powerful, encompassing Finance Ministries. The German Finance Minister may be overruled by Cabinet only when the chancellor sides against him; Japan's Finance Ministry has had extensive regulatory powers extending to banking, securities, and other sectors, in addition to a powerful role in revenue and spending policy. But even in these countries, fiscal discipline was undermined: in Germany,
by spending pressures following unification; in Japan, by the deepest recession since World War II.

Various studies have shown a strong correlation between the stability and cohesiveness of the government and the size of the deficit and the debt to GDP ratio. The key finding is that the more fragmented the government, the less able it is to assemble a majority in support of the tough measures required to maintain fiscal discipline. The most cohesive governments are majoritarian systems in which a single party constitutes the government (in the case of parliamentary regimes) or controls both the executive and legislative branches (in the case of presidential regimes); the weakest are those in which the governing party or coalition lacks a majority in parliament. In general, the more parties comprising the coalition, the less capacitated the government will be to establish and enforce fiscal rules. Fiscal discipline may be problematic when (as often happens in coalition governments) one party controls the Finance Ministry and another controls the social welfare portfolio.

The changed composition of public expenditure – much more spent on entitlements and relatively less on consumption and investment – has affected the manner in which the budget office maintains fiscal discipline. In the past, the budget office reviewed the items of expenditure and recommended the amount that should be made available for each. It also policed implementation of the budget to ensure that money was spent only for approved items and that the amounts spent did not exceed authorised levels. It took the position that total spending could not be controlled unless the individual items were. Contemporary fiscal control is moving in the opposite direction, however. In some countries, the budget office has disengaged from the items of expenditure and has taken the position that it can control total spending only by constraining the sub-aggregates, such as the total running costs allowed each department or the total programme spending resources allocated to each portfolio. It is willing to concede discretion over the items of expenditure to spending agencies in exchange for firm agreement as to the amounts they will have. For example, as a quid pro quo for gaining flexibility with respect to running costs, agencies must operate within firm limits. Often, as will be explained in the section below on operational efficiency, these limits are tightly constrained by across-the-board cuts and other rules that impel agencies to make choices among spending items.

Several versions of these limits have been tried in OECD Member countries. Since the 1991 fiscal year, the United States has imposed a statutory limit on total discretionary appropriations, along with procedures for allocating this total among the various parts of the budget. It has not, however, made much progress in divesting ex ante control of spending items. Australia, New Zealand, and the United Kingdom limit running costs and give managers considerable discretion in operating within these limits. Sweden curtailed central surveillance of spending items while imposing steep across-the-board cuts on operating expenditures.
In a few countries, there has been a parallel development with respect to programme expenditure. Australia has given ministers considerable leeway in reallocating resources within portfolios, though it also assigns a major role to the budget office in operating the portfolio budgeting system. But it is much more difficult to apply the new form of budget control – central withdrawal from the items, but tougher constraints on the subtotals – to entitlements. These typically are open-ended; spending is driven by exogenous factors such as demographic trends and changes in economic or social conditions rather than by explicit budget choices. Budget decisions may play an important role when an entitlement is established, as well as when marginal adjustments are made in an existing programme, but most year-to-year change in entitlement spending is automatic. The budget records the amount sent, it does not decide the amount. Not only are entitlements open-ended, but spending on them is likely to deviate from budget projections during periods of economic weakness, when other changes (such as a fall in revenues) may unbalance the budget. The problem, many governments have learned, is that fiscal balance is not easily or quickly restored when the economy recovers. The structural impact on the budget lingers for as many as five to ten years after a bout of economic weakness.

Establishing fiscal discipline in the entitlement budget may require limiting or disabling the built-in stabilisers by placing global limits on all entitlements or on particular categories, or by capping some programmes. A few countries have had some success in capping particular entitlements, such as health care, and others are likely to experiment with new controls in the years ahead. These controls are controversial and can be introduced only with a high degree of political support. Health is the sector where efforts have been most pronounced, because this has been among the most volatile and fastest growing parts of the budget. The typical limits on health spending constrain payments to providers to raise fees on beneficiaries, but they usually avoid curtailing services. It is highly probable that in the very near future, a substantial number of budget offices will be involved in efforts to restrain the growth in transfer payments and other mandated expenditures through rules that are triggered if these programmes exceed budgeted thresholds. These efforts will be highly political; they will require legislative actions that go beyond normal budget decisions.

Central budget offices have had few enduring success stories in maintaining aggregate fiscal discipline when spending has been driven by entitlements. Nevertheless, the elements of a control system have been introduced in various countries. The main elements include the following:

a) A medium-term framework for stabilising the budget aggregates. The medium-term is essential because it is easy to evade budget controls when they pertain only to the current or the next fiscal year. The typical framework includes projections of future budget aggregates, budget norms
(see next paragraph), and means of enforcing the norms. Developing and operating this framework is likely to be a major preoccupation of the budget office in the twenty-first century, perhaps superseding work on the annual budget. In the future, annual budgets will be even more driven by multi-year constraints than they have heretofore.

b) Medium-term norms must be realistic, that is, they must be achievable through politically acceptable actions. Yet they also must be constrictive, for if they merely accommodate prospective demands on the budgets, there would be no gain in having them. Developing the norms must engage key political actors – Cabinet, the head of government, perhaps the political parties, and, in the case of coalition governments, a formal agreement among the governing parties. They must also have some built-in enforcement – that is, some budgetary change occurs if the norms have been breached.

c) Aggregate norms are not likely to be effective if they pertain only to the totals; there must be a means as well of controlling the main subtotals. These may include limits on operating costs and other discretionary spending. These limits constrain the portion of the budget that is most amenable to cutbacks; they demonstrate that the government is willing to retrench its own operations in the quest for fiscal discipline. If the government cannot constrain the growth in discretionary spending, it is not likely to have much success in controlling other, more politically sensitive expenditures.

d) As noted previously, limits on mandatory spending are likely to be part of the toolkit of future budget offices. It is unlikely that democratic governments will go so far as to disable built-in stabilisers – doing so would disadvantage dependent persons at times of economic adversity – but they may be willing to take steps that slow the growth of these expenditures and reduce their volatility.

To enforce fiscal discipline, the budget office may need an enriched supply of information. Most central budget offices are skilled in macroeconomic analysis; most also work with models that relate demographic trends and economic changes (such as changes in prices and employment rates) to demands on the budget. Many have experience in constructing baselines and estimating the impacts of policy changes on projected revenues and spending. Some already use these data in medium-term frameworks; more will do so in the future.

Budget offices are evolving into entities that deal more with assumptions than with hard data. In the future, the actualisation of the revenue and spending levels set in the budget will depend on whether the underlying assumptions are realised. Accordingly, budget offices will have to even more closely monitor the economy and society to detect changes that may have major budgetary impacts.
In other words, the budget office of the future will devote more of its resources to looking at what is happening outside government and less to what is happening inside. In looking outward, some budget organisations may investigate the feasibility of developing leading indicators of budgetary change to assist their early identification and assessment of cyclical changes in the economy and in other conditions affecting revenues and expenditures.

Fiscal norms are not self-enforcing; the government must have the capability to enforce fiscal norms and to correct any breaches that have occurred. Absolute prohibition against violating the norms may be too rigid to withstand political pressure for spending initiatives or tax cuts, or the force majeure of economic circumstances, but governments may have more success with flexible norms that permit trade-offs within budget constraints – for example, rules that require any additional spending that causes the deficit to rise to be offset by cuts in other expenditures or by revenue increases. A version of this rule has been applied by the United States since 1991 to revenue and spending legislation. The rule only covers deficit increases resulting from legislative action; it does not apply to automatic spending or deficit increases resulting from changes in economic conditions.

Flexible rules have two main advantages: they provide a safety valve for political pressures to expand programmes or provide tax relief, and they enable government to change budget priorities. But flexible rules require a vigilant and powerful budget office that can estimate the impact of proposed policy changes on future budgets and can intervene when the changes breach fiscal norms. Whether rigid (like the Treaty of Maastricht) or flexible (like those currently applied in the United States), fiscal norms set the stage for an ongoing battle between claimants on public resources and guardians of the purse. The central budget office will not win every battle against wily and politically potent claimants whose arsenal of tricks include proposals that hide the full cost of policy initiatives, efforts to take programmes off budget, and bookkeeping arrangements that underestimate budgetary impacts. In the future, no less than in the past, the budget office will be engaged in a struggle to guard the budget against these and other gimmicks. The irony is that the more effective fiscal norms are, the more claimants will seek to evade them. Over the long run, one cannot be certain that central budget offices will be able to uphold fiscal discipline unless they have steadfast political support.

3. Allocative Efficiency

Aggregate fiscal discipline can be a mixed blessing. While it stabilises the totals and makes them congruent with government policy, a fiscal norm that constrains spending below the total that would otherwise occur tends to freeze old programmes and priorities into the budget and new ones out. The more austere the norms and

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the longer they are maintained, the greater the risk that budget priorities will be rigidified. The risk is greatest when fiscal increments are lacking and the only way for the government to accommodate programme initiatives is to take resources away from current budget holders. How does the budget remain fresh and supple when there is little or no money for emerging priorities? How can the government think strategically and allocate resources to fulfil its vision? These and similar questions point to the importance of allocative efficiency in formulating the budget.

Allocative efficiency refers to the capacity of the budget system to distribute resources on the basis of the government's priorities and the programme's effectiveness. Allocating resources is the stock in trade of the central budget office; this is what the office does when it reviews agency bids for resources and recommends how much each should receive. In traditional budget arrangements, the process is open ended; agencies can ask for as much as they want. Invariably, the total demanded is in excess of available resources, thereby giving the central budget office the lead role in deciding where increments should be allocated and whether any reallocations should be made. In fact, the greater the excess of bids over resources, the greater the role of the central budget office in operationalizing the government's priorities.

There are a number of strong reasons for centralising reallocations in the budget office: 1) the budget office can reallocate more broadly among sectors than can a line department or ministry; 2) the budget office has a more comprehensive and possibly more objective view of the government's strategic interests and programme priorities than a single department that is likely to be beholden to sectoral interests; 3) the budget office can promote reallocations based on evidence of programme effectiveness rather than subjective criteria; 4) the budget office can establish rules and procedures to guard against evasion of fiscal discipline by underestimating the future cost of programmes to which resources are to be reallocated; 5) without strong pressure from the centre, departments may protect existing programmes rather than reallocate resources to new ones; 6) departments have incentives to launch programmes at low cost while building in spending increases in future budgets. If permitted, this behaviour would undermine both aggregate control and the government's capacity to establish programme priorities.

Despite these justifications of centralised resource allocation, the current condition of budgeting—fiscal constraints, inadequate increments, and pressure to make room in the budget for new priorities—may argue for a new approach in which spending departments are encouraged to generate policy changes. This would entail a fundamental re-orientation of the central budget office; it would act more as the referee of the reallocation system than as the reviewer of departmental budgets. The reasons for re-orienting the budget office in this direction need to be carefully considered. A useful starting point is the observation made above that traditional budget formulation was organised around allocation of incremental
resources. Incremental budgeting enabled the government to respond to fresh demands while maintaining a relatively low level of intra-governmental conflict. Conflict was low because explicit trade-offs generally were avoided: winners gained by claiming incremental resources, not by taking from those who already had shares in the budget. Priorities were rearranged by awarding different growth rates to the various parts of the budget. As noted above, the budget office was at the hub of this incremental process; by allocating the increments, it influenced the future direction of the budget.

Although policy makers concentrated on the additional resources to be allocated, the budget process was structured to facilitate comprehensive review of expenditures. Spending departments submitted detailed justifications of all items of expenditure, not just of the increment. The budget office had a licence to review and challenge the items and to seek the cutback or elimination of those it considered unproductive or of lesser value. Formally, the process was highly adversarial; in outcome, however, the process was relatively calm. Conflict was mitigated by the availability of incremental resources and by the tendency to continue almost all ongoing programmes. Although all of the budget was nominally reviewed, almost all escaped serious review. Few changes were made, except for those financed by additional resources.

Incremental budgeting suited the times, but it was a flawed means of allocating scarce public resources. It tolerated allocative inefficiency and it contributed to the creeping enlargement in the relative size of the public sector. It weakened aggregate fiscal discipline by making the totals accommodate the parts. Aggregate spending was the sum of approved demands on the budget; it was not fixed independently of those demands. Spending agencies proposed numerous programme initiatives, but these generally were means of bidding for more money, not means of trading off within fixed budgets.

The perceived need for fiscal discipline may tempt the central budget office to tighten its grip by forcing reallocations from old to new programmes. This would seem to be a logical response to the contemporary budget predicament, for if the spenders won’t make the trade-offs, the budget office can do the job for them. Nevertheless, the end result may be much conflict and little reallocation. The threat of losing resources and coveted programmes may impel spending departments to resist the trade-offs and savings demanded of them. These departments have formidable weapons at their disposal. They can withhold the information needed to make rational trade-offs; they can enter into logrolling coalitions with other claimants to protect their respective budgets against cutbacks and reallocations; they can mobilise support among affected interests and within government. Judging from the past, it is by no means certain that the budget office will win the battle for reallocation. It may end up instead with status quo budgets.
The budget office operates at a disadvantage vis-à-vis the spending departments when it aggressively seeks to reallocate resources. It may lack sufficient programme information and political support to do the job. Departments know a lot more about their programmes – what works and what doesn’t – than does the budget office. They also know a lot more about the political risks of changing programmes and policies. This asymmetry is due to the high cost of obtaining programme and political information, as well as to the understandable reluctance of departments to cast their preferred programmes in an unfavourable light. In other words, the budget office is beholden to the spending departments for much of the information it needed on how well programmes are working. It can ease this dependency by establishing its own evaluation capacity or by installing a performance measurement system, but if it wants reliable performance data to inform budget choice, it will have to give departments a prominent voice in the process. If it does not, the budget office may face a familiar predicament. Although many evaluations are completed, few are used in allocating resources.

How does the budget office give spending departments a prominent voice in the reallocation process without jeopardising the government’s fiscal and programme priorities? Australia provides an interesting example in this regard. In Australia, reallocation is promoted by shifting the initiative for proposing policy changes from the centre of governments to the spending departments and by encouraging these departments to initiate trade-offs among their programmes within prescribed budget constraints. In this model, the focus of budgeting shifts from the items of expenditure to policy changes, and from nominal review of the entire budget to concentration on proposed additions and subtractions. The trade-off becomes the main unit of decision in budgeting. Trades are made explicitly, that is, by having departments nominate the programmes to be cut or expanded and by having the government decide which of the proposed savings and additions are to be incorporated into the budget. Departments are free to propose trade-offs within their area of responsibility; the broader their portfolio, the more robust the programme changes can be. It probably would be a good idea to allow departments to implement minor changes unilaterally so that the government can focus on those policy initiatives that have major programme and financial impacts.

In such a reallocation scheme, the role of the central budget office is different, but still quite important. It has a lead role in operating the trade-off system and in ensuring that the policy changes are consistent with the government’s fiscal norms and programme objectives. The budget office establishes guidelines and procedures for proposing and reviewing policy changes, maintains baselines and data bases for measuring the budgetary impacts of policy changes, advises ministers and the cabinet on policy proposals, and either operates or promotes the ongoing evaluation of programmes and measurement of performance. As it undertakes these vital tasks, the budget office reduces its involvement in (or withdraws from)
some traditional budgetary activities. It no longer reviews detailed items of expenditure; rather the items (those pertaining to running costs as well as those concerning programme operations) are handled by the affected departments within guidelines set by the government or the budget office. This devolution of traditional budgetary tasks promotes managerial efficiency (discussed in the next section) and frees the budget process for programme decisions and policy changes.

A budget system oriented to reallocation is likely to have most of the following elements:

a) The government establishes medium-term fiscal objectives and, assisted by the budget office, determines the margin (if any) available for programme initiatives or the net savings required to meet its fiscal target. The margin is calculated on a net basis: new spending minus savings from programme cutbacks.

b) The margin is allocated among ministries, in accord with the government's strategic priorities. Within its target, a ministry can increase the resources available for programme enhancements by proposing cutbacks in other parts of its portfolio.

c) The budget office maintains a baseline for projecting future budget conditions if current policies are continued and for measuring the budgetary impact of policy changes. The baseline is projected for three or more years beyond the year for which budget decisions are being made, so that the medium-term impacts of policy changes can be assessed.

d) The budget office demands that policy changes be advanced in terms of their expected programme effectiveness. Ministries should propose changes in the light of evaluation findings, and they should specify in advance how programme initiatives are to be assessed. Ministries also should systematically relate data on programme outcomes and effectiveness to their budget proposals.

e) Cabinet actions on the budget concentrate on policy changes, not on the items of expenditure. Policy changes (subtractions and additions) are incorporated into the baseline, which is then rolled forward one year and becomes the starting point for the next annual budget cycle.

These elements have been the central features of the Australian budget system since the mid-1980s. Annual budget decisions are made in reference to forward estimates, the baseline of authorised spending for the budget year and the three following years. The forward estimates are not just projections of future spending; they are the spending levels that will be approved in future budgets unless revisions are made as a result of policy changes or changes in underlying economic or programme conditions (such as changes in price levels or in programme participation rates). By definition, therefore, a policy change is a revision to the
forward estimates. Proposed policy changes are considered in a prescribed sequence that includes identification of policy options, the costing of policy changes in discussions between the affected department and the Department of Finance and Administration, trilateral negotiations between the Treasurer, the Minister for Finance and the Portfolio Minister, consideration of policy proposals by a Cabinet Committee, and final Cabinet decision. As noted, the budgetary impacts of these decisions are entered into the forward estimates.

It would be beyond the scope of this paper to provide a full description or assessment of Australia’s reformed budget system. A recent evaluation concluded that the reforms greatly increased the likelihood of savings options being adopted by ministers. Moreover, savings measures in a particular ministry are much more likely to be adopted when the ministry itself is arguing for them rather than when they are presented by the central budget office, with the knowledge and skills of the programme agency being devoted to criticism and obfuscation.

4. Operational Efficiency

The distinction between programme costs and operating costs is often made in budgeting for government programmes, with different decision rules applied to each of these expenditure categories. During periods of budgetary constraint, for example, the government may approve modest increases in programme expenditures while freezing or imposing across-the-board cuts on operating expenditures. This “double standard” may ease the budgetary predicament of cross-pressured politicians, who often face voter demands for reduced government spending (or taxes) and for enriched programme benefits. But what makes sense for harried politicians may complicate the work of programme managers who must maintain a high level of programme output while making do with less resources.

Tight operating budgets have become the norm in OECD Member countries. Retrenchment in this portion of the budget has become a recurring phenomenon as financially stressed governments have sought savings in their most controllable and least politically sensitive expenditures. Cutbacks in operating expenses rarely suffice to close the budget gap, but they convey the appearance that the government is doing something to correct fiscal imbalances. In budgeting, there are two easy ways for the government to obtain these savings. One is for it (via the central budget office) to closely control the items of expenditure and to restrict the authority of departments to spend on personnel, supplies, and other operating inputs; the other is for the government to give departments greater operating discretion within fixed budgets. The two approaches point in opposite directions. The first gives the budget office greater involvement in the details of expenditure; the second requires it to withdraw from most of the details. The first approach
emphasises legality and propriety in public expenditure; the second seeks efficiency in the use of public resources.

Over the years, central budget offices have differed in the extent to which they have intervened in operating decisions. Some have required that operating expenditures be approved in advance by central controllers; others have given substantial discretion to operating managers. In many countries, the squeeze on operating expenses has spurred the budget office to relax the controls and to seek means of improving managerial efficiency. Where this has occurred, the budget office has been compelled to re-examine its role and operations. It is no exaggeration to say that in the past, involvement with operating details was the main preoccupation of the budget office, especially during implementation of the budget. In a growing number of OECD Member countries, most operating matters are now in the hands of departmental managers. What is the appropriate role of the budget office in this new environment? How does it translate managerial discretion into managerial efficiency? Where does it fit in now that it no longer dictates the terms of expenditure?

The new role of the central budget office revolves around maintaining a system of accountability for the government. This entails prescribing information systems and reports, sharpening the capacity of spending departments to measure productivity and output, comparing results against expectations, and (as previously discussed) managing the process of change. This is a different role than the one budget offices became accustomed to play during the century-long evolution of government budgeting, but it is an important role, and one that can keep them both busy and in the thick of resource allocation.

The problem with the role is that accountability for results may be difficult to enforce in public institutions, and trying to do so may impel the budget office to recapture some of the controls it surrendered in the name of managerial freedom. In every country that has moved in this direction, devolution of managerial control has advanced much further than has the assimilation of new accountability methods. The *quid pro quo* of giving managers more freedom in exchange for making them accountable for results is asymmetrical: the former is much easier to accomplish than the latter. Even in New Zealand, where extraordinary progress has been made in installing new accountability measures, the budget office is in a relatively weak position to demand improvement when results fall short of the mark.

If the main purpose of managerial freedom is to improve efficiency in the delivery of public services, it is essential that productivity gains be measured and not just assumed. Governments need objective, systematic, and reliable means of measuring the volume and cost of output across a range of public services. It does not suffice that just a handful of selected performance targets be measured. What
will be required is sufficient information that the government can report with confidence on trends in public sector productivity.

One can expect, therefore, that reformed budget offices will devote considerable resources in the years ahead to strengthening the accountability of spending entities. This may entail overhaul of the accounting and information systems, stronger sanctions and incentives to perform, tougher demands on managers to act as change agents in their organisations, new contractual means of specifying and monitoring outputs, greater use of net appropriations and market-type mechanisms to drive productivity improvement, more extensive application of the logic and techniques of managerial and cost accounting to the public sector, ongoing redesign of the budget documents and appropriations measures, and more. This is a full agenda, more than many budget offices will be able to handle.

Although it is possible that some reformed budget offices will reverse course and recapture previously surrendered controls, the greater likelihood is that additional budget offices will join the bandwagon for reform. Unless there is widespread discrediting of the managerial revolution, today's reforms will become tomorrow's norms. There may be a few holdouts – countries which for cultural or political reasons retain command and control management – but these will be outnumbered by the countries which embrace devolution. Some will do so wholeheartedly, others with a degree of reluctance; some will decentralise as little as they can get away with, others will drive devolution as far as it can go.

5. Conclusion

Aggregate fiscal discipline, allocative efficiency, and operational efficiency are complementary tasks in budgeting. A well-developed budget process should serve all three objectives. Moreover, accomplishing one of these tasks advances the others as well. Nevertheless, in the practice of budgeting, the three roles may get in one another's way. They require different types of information, work orientations, and skills. Getting all three to work in tandem may entail enormous transaction costs, more than a government may be willing to bear. The more typical approach may be to emphasise aggregate fiscal discipline because it is vital to the political interests and financial stability of the government, operational efficiency because it comports with the contemporary value orientation of private and public management, but to go slow on change in the allocation system because it entails a fundamental reconsideration of the role of the central budget office. As appealing as this approach may be, it should be recognised that over the long run the greatest payoff of reform is likely to be in improved programme allocations.
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