ISSN 1608-7143
OECD JOURNAL ON BUDGETING – Vol. 2, No. 2

Does Budgeting Have a Future?

by
Allen Schick*

* Allen Schick is Visiting Fellow, Governmental Studies, Brookings Institution, Washington DC and Professor, School of Public Affairs, University of Maryland, United States.

Budgeting is a work in progress. The process is never quite settled because those who manage it are never fully satisfied. To budget is to decide on the basis of inadequate information, often without secure knowledge of how past appropriations were used or of what was accomplished, or of the results that new allocations may produce. Most people involved in budgeting have experienced the frustration of having their preferences crowded out by the built-in cost of past actions. Budgeting is a deadline-driven process, in which sub-optimal decisions often are the norm because government does not have the option of making no decisions. When one cycle ends, the next begins, usually with little respite and along the same path that was trod the year before. The routines of budgeting dull conflict, but they also are a breeding ground for frustration.

Within this pressured world, those who make budgets or are affected by them yearn for a more rational and orderly process. Reform is the Holy Grail of budget people, their unending quest for a better way to parcel out money and plan the work of government. Sometimes they embrace big bang reforms, such as Planning-Programming Budgeting Systems (PPBS) and zero-base budgeting; usually, however, they strive for incremental adjustments in one or another element of the process. Tinkering is ongoing because the adopted changes rarely produce the promised improvements. In budgeting, the failure of one reform begets another reform.

If budgeting is a work in progress, does it have much progress to show? Have procedural reforms changed the way budgets are compiled or implemented? The clear evidence is that there has been significant change both in the budget practices of most OECD member countries and in their budget policies. In most countries, items of expenditure have receded in prominence and now are consolidated into broad categories. Nowadays, the budget has more information on programs and performance and its time horizon has been extended beyond a single fiscal year to the medium-term. Over the past two decades, budgeting has been more closely integrated with other financial management processes including accounting systems and financial statements. On the policy front, spending growth is slower than it was during the post-war period, but entitlements claim a larger share of central government financial resources. Nevertheless, revenues and expenditures are closer to balance in most countries, though few have managed to sustain a balanced budget through an entire economic cycle. Reform has made a difference, but not a very big one.

My task in this article is to imagine how the practice of budgeting might evolve in the years ahead. As someone trained in data and detail, I find it difficult to contemplate the future without connecting it to the present and the past. Budgeting is incurably incremental, not only in the amounts allocated for particular purposes, but also in the adjustments made from time to time in its operating rules and procedures. To comprehend where budgeting is heading, one must know where it is now and how it got there. To facilitate discussion, the launch of the OECD Senior Budget Officials Working Party (SBO) in 1980 is used as a break point in the evolution of budget systems. The establishment of SBO not only provided a forum for the exchange of ideas, but was itself part of the movement to reconsider budget practices. If budgeting has changed, it is not because SBO exists; rather, SBO exists because of the impulse to change budgeting.

In considering how budgeting has changed, it is useful to distinguish between three types of innovation: macro-budgetary, distributive and micro-budgetary reform. Macro-budgeting deals with the budget aggregates and with the maintenance of fiscal discipline; distributional issues pertain to the allocation of costs and benefits through budget decisions; micro-budgeting is concerned with the operation of government programs and agencies. This classification is similar to the three-level structure of budgeting devised by the World Bank that identifies the core functions as aggregate fiscal discipline, allocative efficiency and operational efficiency. With respect to each of these functions, the paper first describes and assesses recent innovations, and then contemplates how budgeting might evolve in the decades ahead.

My sense is that the next two decades may bring more fundamental change than occurred in the two previous decades, possibly through broad political and trans-national developments rather than through frontal efforts to alter budgetary procedures. Some changes will be the natural progression of developments already underway, others will emanate from changes in relations among governments. While discussion of the future is inherently speculative, evidence for most of the possibilities discussed here can be found in *avant-garde* ideas germinating in the fertile minds of budget scholars and practitioners.

The concluding section turns to the question in the title of this paper: Does budgeting have a future? The question may appear trite and the answer obvious, for unless governments fade away, government budgeting is here to stay. There is little reason to believe that government may be markedly smaller in the future; it is more likely to be somewhat bigger. Yet the question wells out of the analysis in the article. The trends and possibilities discerned in the article suggest a future in which budgets may be bigger but budgeting weaker. This is a prospect that should concern those to whom the processes of budgeting have been entrusted.

1. Macro-budgeting: From stimulus to constraint

When the first SBO met in 1980, it was animated by a sense that one era in public finance had ended and another had just begun. During the previous half dozen years, OECD member countries experienced oil shocks, stagflation (low growth and high inflation), rising unemployment and escalating fiscal deficits. These adverse conditions were a marked departure from the buoyant conditions that characterised the post-war boom, during which economic growth propelled government expansion.

The post-war expansion is summed up in a few statistics. In 1960, the OECD's first year, total government outlays of OECD member counties averaged 29% of GDP; two decades later, these outlays averaged 40% of GDP, an increase of more than one-half percentage point a year. Most of the growth was in Social Security transfers which doubled from 7% of GDP to 14%. The huge expansion of government was not happenstance; it was promoted by governments which reengineered their budget practices to boost spending. Some national governments discarded or revised long-standing balanced budget rules, and many embraced the Keynesian doctrine that fiscal policy should aim to stabilise the economy, even if the short-run effect was to destabilise the budget. Many governments eased the line item controls they had imposed to constrain spending, and permitted or encouraged spending departments to actively bid for additional resources in the annual budget process. Virtually all developed countries weakened budget discipline by enacting legislation mandating the expenditure of funds on various entitlement programs. Not only did governments expand programs and spend more each year, but political leaders were expected to submit expansive budgets. In fact, the vigour of their leadership was often assessed in terms of the new and expanded programs included in their budgets.

Economic expansion fuelled significant increases in government revenues, but these often did not suffice to cover expenditures. When revenues were insufficient, many governments either raised taxes or ran small deficits. Neither course of action entailed much political risk, and neither was seen as fiscally irresponsible.

When economic conditions deteriorated in the 1970s, public budgets were still on an expansionary course. There was an unsustainable imbalance between the momentum of the budget and the capacity of governments to maintain a prudent fiscal course. This writer commented on the predicament in a paper presented at the 1981 SBO "*force majeure* rules public finance".

At the early SBO meetings, the most urgent task facing budget officials was to curtail runaway spending growth. Many governments sought to constrain public spending by imposing fiscal targets in advance of the annual budget preparation cycle. Some expressed these targets in nominal terms, others did so as a share of GDP. Some targeted outlays, others focused on total revenue or the fiscal deficit. The early targets were set independently of the budget process without careful consideration of revenue capacity or spending pressure, or of the steps needed to implement them. Few were accompanied by enforcement mechanisms or other changes in budget rules. The targets were political statements whose primary purpose was to signal that the era of unconstrained growth was over. A few had the intended effect and led to smaller deficits or lower spending growth. However, many were set at unrealistic levels and had to be abandoned far short of their stated goal. In some countries, the absence of effective enforcement mechanisms spurred wily politicians, often with the assistance of budget experts, to devise creative means of subverting the targets by hiding the true volume of public spending or of the deficit.

Second generation targets that emerged in the late 1980s and the early 1990s have been somewhat more effective to the extent they are linked to budget decisions and are enforced through procedural or substantive constraints on government action. The most important recent innovations have included fiscal targets encased in medium-term expenditure frameworks, targets imposed by international treaties or organisations, accrual accounting and budgeting, baseline projections used to estimate budget impacts of current actions, codes of fiscal responsibility that require transparency in government fiscal policy and pronouncements, and a two-step budget process that separates decisions on the aggregates from those on particular items or programs. Each of these is briefly described in the paragraphs that follow.

1.1. Medium-term Expenditure Framework (MTEF)

An MTEF is an arrangement in which annual budget decisions are made in terms of aggregate or sectoral limits on expenditures for each of the next three to five years. Australia led the way in the MTEF movement during the 1980s by expanding its forward estimates into multi-year targets that rapidly gained standing as the basis on which spending departments bid for resources and the annual budget is compiled. In the Australian model, the MTEF was not grafted onto the pre-existing budget process; it became the budget process, that is, the means by which government parcels out money to spending portfolios. Most of the expenditure detail compiled in the annual estimates were devolved to departments, thereby freeing up the Cabinet for policy work on the aggregates, allocations to the main budget sectors and policy changes.

In Australia, the forward estimates (which are medium-term projections of the revenue or spending that will ensue from approved policies) are rolled ahead each year and are updated for price changes, re-estimates of revenue and of program expenditure and policy initiatives. Without the direct involvement of political leaders, the MTEF would be little more than a technical exercise, more a matter of projections than of policy decisions. Moreover, without a firm commitment to constrain future spending, the forward estimates would be regarded by government as an entitlement to more money in future years and as a weapon to wrest bigger allocations from the budget.

The reputed success of Australia's reforms has spurred interest in the MTEF. But although many countries claim to be applying a medium-term expenditure framework, few use it in the manner intended by its architects. In some countries, it is little more than a multi-year projection; in others, it is a technocratic exercise that does not involve strategic decisions by political leaders.

1.2. The internationalisation of fiscal targets

The conventional wisdom that targets are effective only when they are imposed by governments on themselves has been challenged by the emerging role of international organisations in devising and enforcing fiscal constraints. The leading development has been the application of Maastricht's convergence criteria to the fiscal aggregates of the member countries of the European Monetary Union. Although the targets were agreed in 1992, they did not become fully effective until the end of the decade when the Euro was introduced. At launch, proper enforcement mechanisms were not fully in place and opportunistic politicians manoeuvred, with some success, to outwit the new rules. But with each year that the criteria have been in place, EMU gives evidence of a stronger, more vigilant monitoring capacity. Nevertheless, the long-term effectiveness of externally-imposed rules cannot be gauged until the affected countries have gone through a full fiscal cycle. The rules took effect during an upturn in Europe's economic fortunes, thereby easing the political burden of meeting them. The true test of externally-imposed targets will come during periods of economic weakness.

A parallel though less structured development has been the imposition of fiscal conditionalities on financially troubled countries drawing assistance from the International Monetary Fund (IMF). Typically, IMF insists that aided countries meet specified fiscal targets and it enforces compliance by releasing each *tranche* only if it is satisfied with the affected country's performance. The targets usually demand fiscal contraction, as measured by the size of the budget deficit or by the growth of public spending. IMF conditionalities have come under strong criticism from those who believe that its fiscal demands have made matters worse for countries whose economies are already contracting. With a growing chorus of critics, it remains to be seen whether IMF will continue to obtain fiscal constraint from countries drawing assistance from it.

1.3. *Accrual accounting and budgeting*

The point has already been made that fiscal targets are meaningless if they are not effectively enforced. An essential feature of enforcement is that financial flows and condition be accurately recorded. To satisfy this condition, a government must convert from cash accounting to the accrual basis. Ideally, it should also put its budget on the accrual basis.

Cash accounting and budgeting provide abundant opportunity to misreport the government's true financial actions. Payments or receipts can be pushed back to the previous year or forward to the next; future costs, such as pension benefits can be removed from the budget; the government can sell assets and book the income as current revenue; it can hive off certain expenses into off-budget accounts; and so on. Left to their own wills, budget-pressured politicians tend to engage in as much budgetary legerdenain as they can get away with. They issue guarantees and take on other contingent liabilities which do not appear in conventional financial reports or budgets; they sweep idle cash from state enterprises into their own accounts; they shorten the fiscal year to 11 months or expand it to 13; they use unrealistic assumptions in making appropriations or in projecting future budget conditions. The opportunities are as boundless as are the imaginations of budget evaders.

The accrual basis inhibits these opportunities by requiring that revenue be recorded when it is earned (rather than when it is received) and expenditures when the liability is incurred (rather than when payment is made). A growing number of countries have adopted the accrual basis for financial statements, but barely a handful have done so for the budget. As a consequence, some governments now report budget results that differ materially from those reported in financial statements.

1.4. *Baseline projections*

One of the objectives of the MTEF is to extend the budget's horizon beyond a single fiscal year. Doing so depends on reliable projections of macroeconomic conditions, future revenue and spending if current policies were continued, and the impact of policy changes on future budgets. The conventional method for making these projections is to construct a baseline budget and to measure policy changes against the baseline. Budget organisations have been making these estimates for decades, but what is now different is that the projections are published and have become the authoritative metric for assessing the future budget effects of proposed or approved policy changes.

In the MTEF, the baseline is used both to establish the fiscal framework and to determine whether expenditure changes are consistent with the framework. Inasmuch as future conditions are not yet known, the baseline and estimates of policy change are grounded on assumptions concerning economic performance, the behavioural responses of persons affected by policy changes and other variables. Countries which use baselines to establish and enforce expenditure frameworks must have rules for how the projections are made and how policy changes are measured as well as procedures for dealing with deviations from the baseline. They must also assign responsibility for maintaining the baseline and assuring that policy changes are accurately measured against it. In a few countries, managing the baseline and related controls has become the Finance Ministry's most important budget responsibility.

1.5. *Two-stage budget processes*

In conventional budgeting, fiscal targets are perennially at risk of being overridden by spending pressures during preparation of the budget. In all budget systems, there is a tension between the budget's totals and its parts. During expansionary periods, the parts (programs, departments, accounts, etc.) usually win out, with the result that by the end of the process the government agrees to spend more than it intended at the start. One objective of the MTEF is to prevent breach of the fiscal aggregates by insulating them from upward spending pressure from particular programs. But when the budget totals are decided together with the parts, it is highly likely that total spending will be more than the government initially wanted.

To counter this tendency, a few governments, such as Sweden, have split budget preparation into two distinct phases that are several months apart. In the first stage, the government updates baseline projections, reviews current macroeconomic forecasts and the budget outlook, and establishes a medium-term expenditure framework. This framework may deal only with the aggregates or (as is the case in Sweden) with major spending sectors as well. At this point in the process, no formal consideration is given to particular claims on the budget. The macro-budget is submitted to the legislature which votes the spending totals. Several months later the government compiles the estimates for the next fiscal year. These spending amounts must be within the aggregates previously set by the government or the legislature. Rules similar to those used in maintaining the MTEF are applied to estimate the consistency of particular spending decisions with the budget aggregates.

1.6. Have the targets made a difference?

Have the fiscal targets and related innovations disciplined public finance, or are they the latest in a long list of budget reforms that have made little difference? The OECD has addressed this question by comparing spending as a proportion of GDP in countries that were members of the Organisation before the first SBO convened. The study shows marked deceleration in spending growth and more modest fiscal imbalances than in previous periods. But the rise in public spending has not been reversed; virtually every country reports that such spending is now a higher share of GDP than was the case one or two decades ago. The era of big increases is over, but government budgeting still is incremental, building the next budget on the results of the last one. As a consequence, government spending accounts for a higher proportion of GDP than when SBO was established. To meet targets, governments have trimmed some entitlement programs at the edges and have made deep cuts in subsidies to enterprises. Most have trimmed operating costs by imposing across-the-board cuts or by seeking to boost efficiency. They also have made greater use of fees and other charges to finance particular programs. From the vantage point of voter-pleasing politicians, many of the cutbacks have entailed difficult choices, but their chore may have been eased somewhat by the new rules and procedures discussed in this section. Yet a fair assessment of two decades of tinkering with the machinery of budgeting is that the process is not all that different than it was before SBO, and that the underlying pressures and imbalances of public finance have not been eliminated.

2. Macro-budgetary futures: Neutralising the political pressure to spend

There is a strong probability that public spending will continue to rise as a percentage of GDP in developed countries as their populations age. The pace of increase will depend principally on the cost of social insurance and related programs, as well as on overall economic trends. Will the rate of increase be similar to that experienced during the pre-SBO decades, or will it resemble the smaller rise of the 1980-2000 period? Of course, even a modest increase would be atop spending which already exceeds 50% of GDP in many European countries. This means that if OECD member countries do about as well in the next two decades as they did in the previous two, they will be doing worse. Moreover, the risk that they will do much worse is far greater than the probability that they might do a little better.

The vulnerability of OECD member countries pertains not only to total expenditure but also to their fiscal balance. To finance the escalating costs of social schemes and the still-rising expectations of citizens, OECD governments will have to extract more revenue from enterprises and households than they have done heretofore. As high as the tax burden already is, it may have to be considerably higher in the decades ahead.

Governments may manage to escape fiscal meltdown by reversing long-standing social policy privatising social insurance schemes or stringently targeting benefits to their neediest citizens. These moves would roll back the boundaries of the welfare state to a far greater degree than has been attempted by any democratic leader in recent times. Pushed to the wall by the reality or prospect of rising tax burdens or huge budget deficits, the next generation's politicians may accede to such Draconian measures as their only recourse.

My sense, however, is that we are in for another long spell of muddling through of chronic fiscal pressure that, like chronic back pain, gets attention but not so much as to compel a marked change in life-style. In muddling through, governments will struggle to constrain the fiscal aggregates within some acceptable, though expanding, envelope. Their task will be facilitated by changes in both the information content and procedures of budgeting, some of which are described in the paragraphs that follow. But even with rule changes that arm guardians of the public purse with new authority, fiscal discipline will be a difficult political and economic chore. Politicians will have their fingerprints on the controls, and they will garner blame for matters over which they have little genuine control.

2.1. The time-frame of budgeting

Rutted in a fiscal quagmire that seems unending, future budget-makers will regard the medium-term as inadequate for their work just as contemporary MTEF architects regard the single fiscal year as inadequate for theirs. From tomorrow's vantage point, the two to three years tacked on to the end of the annual budget cycle by the MTEF will be seen as a too modest venture that obscures the longer term outlook. The conventional MTEF is a couple of years shorter than the standard five-year planning horizon.

This time-frame was selected to assure that medium-term decisions are realistic and relevant to annual budget actions. Governments opting for an MTEF have been justifiably concerned that the longer their budget projections are extended, the greater the uncertainty they will encounter. They also are concerned that it is impractical to make longer term decisions because as each year is rolled forward, seemingly resolved issues can be reopened.

Despite these sound arguments for a medium-term perspective, my sense is that as governments face increased pressure to regulate public finance, they will lengthen the budget's time horizon to five or more years. The United States has moved to a 10-year baseline for estimating the impact of current policy changes on future budgets. The longer frame makes it somewhat more difficult for politicians to evade fiscal discipline by delaying the effective date of policy changes. In most developed countries, the longer horizon portrays deteriorating fiscal conditions, as the proportion of the population drawing pensions and other state-financed benefits rises. There is some risk, however, that lengthening the perspective might introduce greater unrealism into budget projections. If this were to occur, a 10-year term or longer horizon would undermine fiscal discipline.

2.2. Fiscal sustainability and vulnerability

The time-frame is not only a matter of years but of perspective as well. Extending the perspective from one year to several and from several to a decade transforms the central fiscal issue from the current balance to future sustainability and to the vulnerability of the budget to surprises and shocks. Sustainability refers to the capacity of government to continue on its present fiscal course in the light of prospective economic conditions and its revenue/expenditure position. Sustainability is always for the long haul; interest in it derives from realisation that although a country may appear to be in good fiscal health, future claims or conditions may adversely affect its budget capacity. For example, most EMU countries improved their budget positions during the run-up to the Euro, but they nevertheless face the question of whether the financial commitments they have undertaken will be sustainable when the percentage of the population dependent on pensions rises.

To take sustainability seriously requires that governments devise measures of their capacity to continue on the present budget course. These measures would have to gauge built-in expenditure pressure, revenue trends, sensitivity of the budget to demographic and economic changes and (if feasible) the influence of political conditions on the budget. Economists are more skilled at analysing trends than in predicting changes, especially those that occur with little advance notice. Looking back at the Asian financial crisis of the late 1990s, however, economists have concluded that there was advance evidence that several countries were headed into trouble. They believe it possible to convert hindsight into foresight through bold development and measurement of risk.

Even if the early measures are crude and unreliable, they may influence the fiscal posture of national governments. Medium-term projections also are often wide of the mark, but they still frame budget debate. In budgeting, questionable data are preferable to no data, because government must act. In most policy areas, government may defer action until it is satisfied with the information at hand; it does not have this option in budgeting.

Vulnerability analysis and other types of risk assessment will play an increasingly prominent role in budgeting. One can anticipate that governments with a budget horizon beyond a single fiscal year will be the most likely users of such analyses. International organisations may also become involved by assessing fiscal performance in the light of vulnerability criteria. For example, EMU might assess the budgets of member countries in terms of sustainability or risk factors rather than in terms of annual or medium-term outlooks. One can foresee circumstances in which EMU will demand that a member country revise its budget even though short-term criteria have been met.

2.3. Using the balance sheet to measure fiscal condition

Barely a decade ago, a far-fetched idea was proposed – that a country's fiscal outcomes be measured in reference to its balance sheet rather than to the budget. What seemed a novel approach some years ago may become commonplace in the future, as national governments shift from budget-based assessments to ones drawn from conventional financial statements. If this were to occur, it would be a Copernican revolution in financial management, transforming the traditional relationship between budgeting and other financial processes.

Since its emergence more than a century ago, modern budgeting has operated within a largely self-contained process. Decisions have been made, recorded and carried out almost exclusively in reference to the documentation produced by the budget process. Financial condition and performance have been measured in terms of the entries in the budget, without regard to other sources of financial information. Self-containment has walled off the budget from financial statements such as balance sheets, and the results shown in the budget often have differed materially from those reported elsewhere. In many countries, financial statements have adhered to prevailing accounting standards, while the budget has been prepared in accord with its own conventions. Financial statements have been subject to audit; budgets have not.

Several factors are pressing to break down the distinction between budgets and financial statements. One is the application of new accounting standards, including the accrual basis in government finance, another is the previously noted effort by independent authorities to assess country budget policies, and a third is the effort to strengthen financial management in government by integrating budgeting and accounting activities and standards. The natural evolution of these changes is to rely on financial statements in lieu of the budget.

In their 1991 article urging this approach, Blejer and Cheasty argued that the balance sheet is the best available measure of the fiscal surplus or deficit. They noted that the budget is not a comprehensive statement of financial flows; it is by definition limited to those transactions included in the budget, and it counts these transactions in ways that are peculiar to budgeting. Budgets do not include off-budget or extra-budgetary funds, nor do they accurately value assets, liabilities and risks. The balance sheet is a broader statement that includes all of an entity's transactions, whether or not they are included in the budget. The balance sheet recognises depreciation, deferred costs and reserves for defaults and other risks. When the government obtains revenue from the sale of assets, the budget reports a gain in revenue, the balance sheet shows no change in net assets.

In applying the balance sheet to fiscal outcomes, a decline in net worth (assets minus liabilities) would be recorded as a deficit; an increase would mean a surplus. But to use balance sheets as measures of fiscal outcomes, the government would have to publish timely financial statements. Few governments now do, but many more can be expected to do so as accounting practices become standardised across countries.

The potential displacement of budgets by financial statements has several important implications. First, it will give impetus to efforts to impose accounting standards on government budgets. If this movement succeeds, it will make little difference whether financial condition and performance are measured in reference to the budget or financial statements. Second, it threatens displacement of the central budget agency by other financial management experts in government. To retain authority, budget specialists will have to become more knowledgeable about accounting practices and they will have to pay attention to balance sheets and other statements. Third, various budget decisions are likely to be made in terms of their impact on the balance sheet rather than in terms of how they are recorded in the budget.

2.4. Budgeting for contingent liabilities

Whether from the vantage point of the budget or the balance sheet, future governments will deal more forthrightly with contingent liabilities, such as guaranteed loans and insurance programs. Conventional cash-based budgets do not properly record government exposure to various contingencies because no payment is made until a default or other event occurs. The budget does record these payments, but at this point the expenditure is beyond effective control. The failure to properly budget for contingent liabilities induces governments to substitute guarantees for conventional expenditures and to take risks that may imbalance future budgets. This temptation is especially strong when the government seeks to impose fiscal discipline by curtailing expenditure or reducing the reported deficit. Various studies have shown that fiscal adjustment invites evasion, with the result that the reported savings often are illusory. Although trend data are not available, there is reason to believe that national governments have increased their exposure to risk through various guarantee and insurance programs. Even though risk-taking by governments may be appropriate, the lack of adequate information may induce them to under estimate or ignore future costs.

As with other shortcomings in fiscal discipline, an early step must be to obtain information on the problem, following which appropriate controls may be devised. This is not a simple task because risks come in many forms and pervade modern economies. Moreover, contingent liabilities are outside the boundaries of conventional accounting. The definition and recognition criteria applied to government financial accounts pertain to direct liabilities, not to those dependent on uncertain events, such as defaults on loans or the collapse of banking institutions. There is no agreement among the countries that have sought to regulate fiscal risks on the appropriate approach, or even on whether the budget is the best instrument for this purpose. The following paragraphs describe the methods applied by New Zealand, Hungary, Canada and the United States.

As part of its reform of the public sector, New Zealand requires all departments to prepare audited financial statements. The government then produces consolidated financial statements, to which it appends statements of quantifiable and non-quantifiable contingent liabilities. The former are contingencies whose costs can be estimated. These costs are not recorded in the budget or on the balance sheet, but the information does alert government to prospective payments arising out of contingent liabilities.

In Hungary, the Public Finance Act limits state guarantees to a certain percentage of budgeted expenditures but most guarantees, including those issued by state institutions such as the Hungarian Development Bank or for various strategic purposes, are exempted from the limit. The annual budget appropriates an amount for expected calls on guarantees, and it also limits the volume of guarantees that each state institution may have outstanding during the year. When guarantees are issued, the government publishes information on estimated risk, the reasons for tendering the guarantees and other relevant matters. Although the system appears to be effective for the guarantees covered by it, some major contingent liabilities have been excluded, with the result that payments often exceed the amount set aside in the budget for guarantees.

Canada subjects loan guarantees to a budget review that is similar to the scrutiny given to direct expenditure. Each department proposing guarantees must provide an economic analysis of projected benefits and risks, including projections of cash flows and debt service. Funds must be reserved in the budget for possible losses; sponsoring departments finance these reserves from fee income or annual appropriations. New loan guarantee programs must be approved by the Finance Minister and authorised by Parliament. Finally, departments and Crown corporations must report on their contingent liabilities; these are published as notes to the government's annual financial statement.

Since the early 1990s, the United States has applied special budget rules to loans and loan guarantees. It replaced the previous practice of budgeting for these transactions on a cash basis with one in which the estimated subsidy cost of loans and guarantees is budgeted as an outlay. Subsidy cost is defined as all projected cash inflows and outflows discounted to present value. In the case of loan guarantees, the inflows may consist of origination fees and recoveries on defaults; the outflow are the payments made by government pursuant to default. Thus guarantees generate budget outlays, even though no funds may actually be disbursed until later fiscal years.

Although it may take some time, the budgetary treatment of guarantees and other contingent liabilities is likely to become increasingly standardised. Once audited financial statements become prevalent, they may evolve into instruments for reporting on the cost of contingent liabilities. Perhaps the most sensible option would be to provision for estimated losses from guarantees on the government's balance sheet. If actual losses diverge from the estimate, the amount provisioned would be adjusted to reflect this experience. Corresponding entries would be made on the government's budget, which would show estimated or actual losses as expenditures.

2.5. Fiscal policy and economic management

Steering the economy by means of the budget is one of the premier responsibilities of modern governments. Political leaders pay attention to fiscal matters because their performance often is measured in terms of the performance of the economy. In government of the future, however, major fiscal responsibilities may be entrusted to an independent authority which would be empowered to adjust tax rates and certain expenditures in response to projected or actual changes in economic conditions. As outlandish as this idea may seem, it was the subject of extended discussion at the 2000 SBO. Drawing upon recommendations by the Business Council of Australia, a paper presented at that meeting argued that an independent fiscal institution be empowered to make across-the-board adjustments in tax rates without prior legislative approval. The case for fiscal independence rests principally on two observations: *i)* fiscal policy is biased in favour of expansion; it favours increases in current expenditure, leading to future increases in taxation; and *ii)* governments are prone to fiscal drift, with serious lags in implementing policy changes. Both defects, proponents of fiscal independence argue, are due to the influence of politics on government action. The proposed solution would curtail fiscal expansion and facilitate adjustment by transferring fiscal control from politicians to independent experts.

The proposal aims to reconstruct fiscal policy so that it is conducted in a way that is analogous to monetary policy. Just as the latter is managed by an independent central bank, the former would be conducted by an independent institution that is free of direct political influence. One may argue that the parallel is not justified, that enabling independent authorities to adjust tax rates has greater political consequence than empowering them to manipulate interest rates. One also may argue that independence in tax policy would strip democratic governments of their generic power and would call into question the responsiveness of governments to voter preferences. These and other objections aside, however, it is apparent that a line has been crossed in thinking about the future conduct of fiscal policy. An idea that was hardly discussed a few years ago may foreshadow the future world of fiscal discipline.

2.6. Fiscal discipline without power

We started this section by considering how future governments might bolster fiscal discipline; we end it with a proposal that concedes the lack of government discipline and looks for relief outside the political process. Governments of the future may be compelled to account to outside authorities, to maintain their budgets in a form dictated by others, to have their budgets audited as to content and process and to have authority over key aspects of budget policy transferred to others.

In a globalised future, national governments may have bigger budgets but less effective influence over them. If they budget in a fiscally disciplined manner, it may be because they have been weakened, not because they have been empowered. To the extent their budgets impose external costs on other countries or on the international community, they may be required to submit their policies to external review. Even the biggest countries may be compelled to formulate budget policy in open economies, in which events outside their borders impinge on their fiscal capacity. National governments will be increasingly sandwiched between meta-national and sub-national governments, in which fiscal decentralisation co-exists with fiscal internationalism. Pulled in opposite directions, their budgets may be beholden to decisions taken by others.

This conclusion is highly speculative, for it would mark a retreat from an age in which legal sovereignty and political power were concentrated in the nation-state. This form of governance may prove to be more durable and adaptive than the bad case scenario in the previous paragraph indicates. It may be that the determination to maintain fiscal discipline will impel countries to re-centralise control of public money, or that international authorities limit their role to specifying accounting rules and aggregate policy, but do not play a role in substantive policy. Another possibility is that in the globalised future, national governments will become the functional equivalent of contemporary sub-national governments, articulating local interests and demanding a share of international budgets for their own use.

With so many plausible scenarios, the only thing that is certain is that the fiscal future will be different from today's fiscal arrangements.

3. Distributive budgeting: From allocation to reallocation

The second set of budget issues identified at the start of this paper pertains to the allocation of government funds to sectors or programs. This is an omnipresent concern because budgeting is inherently an allocative process. Whether it is structured in terms of expenditure items, accounts, organisations, activities or some other classification, the main issue in budgeting is how much should each entry get. This question has two dimensions: the efficiency of public expenditure and the priorities of government. The first criterion dictates that money should be allocated so as to optimise efficiency across and within programs and sectors; the second dictates that government should allocate money in accord with its objectives. There has been a tacit belief in budgeting that the two criteria can and should be reconciled, that government should frame its priorities in the light of analysis or evidence on the effectiveness of different programs. In fact, major reforms such as PPBS assume that both political priorities and allocative efficiency will co-exist if the budget is prepared on a rational basis.

Efficiency in allocation has been pursued principally through investment in program evaluation and outcome measures. In recent decades, relatively little weight has been given in developed countries to restructuring the budget along program lines. This approach is still tried in some developing and transitional countries, sometimes as a means of consolidating the detailed items of expenditure into broader categories. But there is consensus these days that changing budget classifications does not itself change budget allocations; the only difference is in the manner expenditure are reported, not in the activities to which they are allocated. Moreover, it also is generally recognised that pure program classifications which ignore or supersede organisational boundaries complicate the task of holding managers responsible for results.

3.1. Evaluation

Evaluation is an oft-tried strategy with spotty results. It has proved easier to conduct program evaluations than to use them in allocating resources, and easier to ignore or explain away adverse findings than to take tough measures to improve program performance. Evaluation gives government information; it does not require that government apply the information in budgeting. Many OECD member countries have had occasional success in conducting and applying evaluations, but (to this writer's knowledge) only two have had a comprehensive evaluation strategy. Canada organised a vast effort around the

Comptroller General in the 1970s; Australia adopted an ambitious evaluation strategy in the late 1980s. Canada's effort bore little fruit; Australia's produced significant reallocation of budget resources. Canada is thought to have failed because it centralised evaluation, thereby dampening co-operation by spending departments which may have been adversely affected by the findings. Australia is thought to have succeeded because it gave affected departments a big stake in designing and using evaluations.

Australia's evaluation strategy called for each portfolio (which consists of one or more departments) to prepare a comprehensive plan scheduling the evaluations to be conducted over each of the next several years. When a minister proposes a new program (within the forward estimates process described earlier) the proposal has to include a description of how the initiative will be evaluated. The evaluations are carried out by the affected departments, but the Department of Finance oversees the process, including methodology and design and publication of results. The Finance Department has made a sustained effort to feed evaluations into the budget process and has published an annual report estimating the percentage of that year's decisions influenced by evaluative findings.

3.2. Outcome measurement

A related development has been the systematic definition and measurement of outcomes. These indicators, which generally measure the impact of policies on social conditions, are distinguishable from output measures which are discussed later in the article. There is a burgeoning literature on the measurement of outcomes, but entrenched difficulty in applying the results to budget decisions. Outcomes usually lie beyond the direct control of the government department carrying out the program, and usually derive from a confluence of factors, not just policy intervention by the government. It is questionable whether a cause-effect relationship can be attributed to changes in policies and in social conditions.

Governments that seek to measure outcomes spend an inordinate amount of time arguing over whether a particular measure is an intermediate or end outcome, an output or an outcome, the difference between impacts and outcomes and so on. These sterile debates have impeded the application of useful measures by government. In my view, the most productive way to think about outcomes is as directional signals, not as causal statements. They should provoke government to assess whether social conditions are moving in the expected directions and whether policy changes should be considered. For example, regardless of whether it is responsible for the trend, government should be aware of whether infant mortality rates are rising or declining and it should take appropriate actions in response to the data. Even if it is not responsible for the results, government should be cognisant of them.

 OECD JOURNAL ON BUDGETING – Vol. 2, No. 2 – ISSN 1608-7143 – © OECD 2002

In view of the weak cause-effect relationship, it generally would not be useful to base performance budgeting systems on an explicit linkage of the amounts spent and the outcomes experienced. It may be useful, however, to publish outcome measures as supporting information in the budget.

3.3. *Strategic planning*

The second path taken by reform of budget allocation has been to make the budget more responsive to government priorities. It may seem obvious that government cannot budget on the basis of its priorities if it does not have them. But the long-standing tendency in budgeting has been for government to be inexplicit about its priorities, to have priorities imputed from the allocations actually made rather than to state them in advance. According to this line of reasoning, explicating priorities generates undue conflict and complicates the task of producing the budget. It is better, therefore, for government to prepare the budget without an explicit statement of objectives or priorities. If a particular program is allocated more money than another, one can infer that it is deemed to be of higher priority.

The counter argument is that if government does not know its priorities, the budget will not reflect them. In view of the entrenched claims of past decisions and the active role of spending departments and interest groups, the budget will not have much money for new priorities unless the government makes a determined effort to set aside funds for them.

Strategic planning has emerged in recent times as the main innovation in enabling government to structure its budget on the basis of missions and objectives. In contrast to earlier reforms, such as program budgeting and PPBS which sought to integrate policy planning into the budget process, strategic planning stands apart from budgeting. It is not constrained by the time or funding pressures of budgeting, but neither is it assured direct input into budget decisions. Also in contrast to past planning efforts, strategic planning focuses on government organisations rather than on programs or activities. The key question is not what government should do but what its departments and agencies should be. For example, a strategic plan might consider whether the mission of the customs agency should be to encourage trade or to interdict illegal imports. On the basis of strategic decision on missions, the agency might restructure operations and realign its budget priorities although budget issues are not foremost during formulation of the strategic plan, once the plan is approved, the agency or government would be expected to allocate resources in accord with it.

Its separation from budgeting enables the strategic plan to take a deeper look at purposes and objectives, but it potentially diminishes the probability that the plan will influence the budget. Agencies generally like strategic planning because it portrays them in a favourable light and bolsters their claim for more resources. But the more a strategic plan tries to influence the budget, the less strategic it is likely to be.

3.4. Redistributive budgeting

As with the fiscal aggregates, SBO marked a change in budgeting as a distributive process. One of the early SBOs considered a paper by D. Tarschys on budgeting as a decremental process; other meetings focused on cutback budgeting. The change in orientation has been due to the reorientation of budgeting from a process which annually allocates increments to favoured programs to one which has little margin (and sometimes none) for spending initiatives. This change in fortune has been due to the built-in claims of entitlements and other mandatory expenditure, the less robust economic growth of the past two decades and efforts to strengthen fiscal discipline. The last of these is especially important because the more successful a government is in constraining the totals, the greater the risk it runs that old priorities will be frozen into the budget and new priorities will be frozen out.

When incremental resources are available, budgeting is a distributive process in which government responds to fresh demands by allocating additional resources to them. Incremental budgeting has been lauded by some observers on the ground that it stabilises the process and reduces conflict, and has been criticised by others on the argument that it biases spending upward and rewards inefficiency. These arguments aside, there is little doubt that in the pre-SBO period, incrementalism was the norm. However, incrementalism requires increments, additional resources that can be spent on some purposes without taking money away from other purposes. In the two decades since SBO, budget increments often have fallen short of the expected growth in expenditure. To make matters more difficult for governments, they can no longer tax their way out of budget problems.

As a consequence, budgeting has been moulded into a somewhat redistributive process, in which funds are recycled from old programs to new ones. The word "somewhat" reflects the reality that redistribution fuels conflict, and budgeting is a process that must dampen conflict. Redistribution is not wholesale change; it is tinkering here and there to free up money for current needs. Redistribution is always difficult, but it has been made more so by the heightened activism of interest groups on the periphery of government lobbying to protect their budget stakes. As budgets have got tighter, groups have become more assertive, and many now have informal roles in budgeting.

Redistribution does not depend on turning budgeting into a zero-based process. Wherever it has been tried, zero-based budgeting has failed. It fails because budget-makers cannot ignore past decisions and commitments, nor can they uproot programs without regard to the impacts on the government agencies carrying them out. No matter what budget process is used, the current year's expenditure will always be the best indicator of the next year's spending. When it occurs, redistribution is only at the margins of the budget, not the wholesale termination of ongoing programs.

3.5. *Using the MTEF to promote reallocation*

In addition to promoting fiscal discipline, a medium-term expenditure framework facilitates reallocations in accord with the government's strategic priorities. The MTEF determines the margin (if any) available for spending initiatives or the net savings required to meet the fiscal targets. Proposed reallocations are measured against the pre-set margin or savings to assure that policy changes are consistent with the government's fiscal objectives. Because policy changes typically have a greater impact on future budgets than on the one immediately ahead, it is important to assure that claimed savings in next year's budget do not end up as net increases in future budgets.

Medium-term spending constraints are not self-enforcing. The drive to reallocate can open the door to ploys by spending departments to substitute more costly programs for the ones they are currently operating. Without vigilant monitoring by the Finance Ministry, spending departments may overstate the savings from program cutbacks and underestimate the cost of new programs. To thwart these tactics, it is essential that the MTEF include baseline projections of authorised spending in each of the next several years. Measuring proposed policy changes against the baseline has become one of the most important tasks of the central budget offices in MTEF countries.

Reallocation is facilitated when the government specifies a resource envelope for each sector or major spending department. In the course of setting these envelopes, the government may reallocate across sectors by deciding that some sectors should be permitted increases above the baseline and others should be required to produce decreases. These inter-sectoral reallocations should be made at the highest level of government. In parliamentary regimes, they typically involve the Prime Minister and Cabinet. Much reallocation is likely to be within sectors, and this may be encouraged by devolving responsibility to line ministers. Arguably, more reallocation will occur if spending ministers and managers have a role in generating policy changes. Doing the job centrally at the top of government may result in much conflict and little reallocation. The threat of losing resources and programs may provoke departments to block the trade-offs demanded of them. Although they are not at the centre of power, spending departments have formidable weapons at their disposal. They can withhold information needed to make cost-effective trade-offs; they can enter into logrolling coalitions with other spenders to protect their budgets; they can rally affected interest groups to oppose reallocation.

To gain the co-operation of spending departments, it is sensible to give them a prominent voice in reallocation. A devolved arrangement would free up the Cabinet to focus on major policy changes rather than on spending details. It would give sectoral ministers the lead role in developing program changes within their portfolios, provided that the proposed changes are within the MTEF sectoral resource envelope and are consistent with overall governmental priorities. In Australia, the birthplace of MTEF, the forward estimates may be set at a level which accommodates spending increases or mandates cutbacks. Within the forward estimates, a minister may propose spending increases for some activities to be financed by savings in other activities. In this devolved arrangement, ministers have unilateral authority to approve changes below a certain amount; changes above the threshold require Cabinet approval. This system puts the Finance Minister in the role of refereeing the reallocation process; managing the trade-off system and ensuring that program changes and budget reallocations are consistent with the government's fiscal norms and policy objectives.

4. Distributive budget futures: Who will get what?

Despite the attention paid it, redistribution is a side-show in budgeting; the main event still is distributing money, usually on an incremental basis to powerful claimants. Notwithstanding the bleak scenarios which show budgets and demographics on a collision course early in the 21st century, budgeting will continue as a process for distributing spending increases to agencies, households and other beneficiaries of the government's largess. On the basis of political trends, one can expect budgeting to become more open and sensitive to demands by claimants mobilised to protect or enlarge their shares. Voters, interest groups, NGOs and others will become more assertive and the budget will become more transparent about who is benefiting and who is losing from the government's financial decisions. Thus, even as budgeting becomes more technocratic, it will be more politicised. The upshot will be more conflict in budgeting as rival interests vie for advantage. Yet because of the compelling need to resolve each year's budget, new methods will be devised to regulate friction over resource allocations.

4.1. E-budgeting

Information technology will open the budget to greater pressure from affected interests. It will give interest groups, which have multiplied in all democratic countries, both information and access, more timely data on past or pending budget action and greater opportunity to influence outcomes.

Many governments now prepare the budget in electronic form and make key documents available via the Internet. Most of this information has long been public; what is new is the ease with which it can be accessed and manipulated. Through browsers and search engines, interest groups will keep informed on budget options, the line-up of those favouring or opposing particular courses of action, the persons or offices responsible for making the decision and other details that enable them to intervene more effectively in the budget process. Moreover, as Internet use becomes commonplace, matters which once were held in confidence will be posted on the web. Governments will be impelled to relax their secrecy and the budget will become more permeable.

A key issue is whether any information should be posted before the budget has been decided. It would require only a few key strokes to make agency requests, baseline projections, proposed policy changes, spending options, budget assumptions and other relevant information available on the Internet, and only a few more to enable readers to submit comments on a message board.

4.2. Plebiscitary budgeting

Once budget information and options are widely available, government will be able to use new communication technologies to poll citizens on pending issues. The types of polls are as varied as are the forms in which governments make budget decisions. One possibility would be to survey public opinion on broad questions, such as whether the government should seek to reduce the deficit by raising taxes or cutting expenditures; another would be to present citizens with specific questions, such as whether transport spending should be increased by 3% or 5%. Other options would be to ask voters to rank various programs or sectors in order of priority or to indicate whether spending in each program or sector should be increased, decreased or maintained at the current level. Government can try to replicate actual budget decisions by asking voters how they would allocate a fixed amount of money among various claims on the budget. Polling can be interactive, with successive rounds of questioning, beginning with broad issues and then narrowing to the specific issues faced by budget-makers.

Depending on how it is conducted, a plebiscite can be either advisory or a means of making budget decisions. In the former situation, government would have timely data on voter preferences, but it would be free to take whatever budget decisions it wants; in the latter case, government would be bound to implement voter preferences in the budget. Turning budget decisions over to a plebiscite would have profound implications for democracy. Voters would have a direct channel to express their preferences, but they would also have to be more consistent on budget matters. If the ballot were properly worded, they would not be able to vote for both smaller programs and bigger government. Plebiscitary budgeting would provoke interest groups to be more active and to lobby voters for support on budget matters. Government would come to resemble a permanent campaign, in which the period between elections is filled with government-sponsored public opinion polls, year-round ad blitzes and other efforts to sway voter sentiment and budget decisions. In some countries, the extensive use of polls by government leaders has already blurred the distinction between campaigning and governing. Plebiscitary budgeting may be nearer than we think.

4.3. *Formal group participation*

On most issues, voters interact with government through the intermediation of interest groups. In all democratic countries, many more such groups now exist than did a generation ago, and the number interested in the budget is vastly greater than it once was. The proliferation of groups has been accompanied by a breakdown in corporatist institutions, in which government regularly consults with social partners (such as labour union and business leaders) before adopting major policy changes. Rather than negotiating with a handful of leaders, government now is exposed to a phalanx of groups which have conflicting agendas and demand more from the budget than it can bear.

Budgeting would break down if government gave too many groups a seat at the table. Nevertheless, one can envision a future in which political leaders formally discuss budget issues with interested groups before they act. While it is unlikely that groups will be given a formal veto over government action, an informal veto may be just as good for them.

As the number of groups multiplies, their span of interest narrows. Rather than being interested in whole sectors, groups pay attention to particular projects or activities. Accordingly, one can see a future in which more groups get something from the budget, but for most the slice they get is quite thin. Slicing the budget can be done by earmarking funds to particular geographic areas or projects. With thinner slices, more groups come away with something, but less the total claim on budget resources is.

4.4. *Class-based budgeting*

Buying off interests by giving them small amounts of money may be a sensible accommodation to the hyper-pluralism of contemporary democracy. But there still will be powerful broad-based groups more interested in overall allocation policy than in getting a little extra money for a few projects. In the past, these groups concentrated on the amounts allocated to particular sectors; in the future, they may be more concerned about whether particular socio-economic classes are getting a fair share of the budget. This interest is

 OECD JOURNAL ON BUDGETING – Vol. 2, No. 2 – ISSN 1608-7143 – © OECD 2002

reflected in compilation of a “women’s budget” or a “children’s budget” by NGOs in various countries. These types of budgets are not analytic exercises; they are advocacy statements which marshal data on the allocation of budget resources to argue that particular classes in society have been disadvantaged.

Class-based budgets will be prepared in the future covering major fissures in society; men *versus* women, rich *versus* poor, young *versus* old, one ethnic or racial group *versus* others, one region against another and so on. What will be new about them in the future is that rather than being issued by outsiders, they will be published under the imprimatur of the government, first as supplementary schedules to the regular budget documents, but over time as authoritative statements. Once this occurs, class-based budgets will become decisional classifications; in the course of producing its budget, government will decide how much to spend on rich or poor, men or women, young and old, etc.

When this comes to pass, national budgets will become flash points for social conflict, sharpening the adversarial trade-off characteristics inherent in budgeting with scarce resources. As part of this combat, the protagonists will fight over classifications and analysis of expenditure. For example, one can anticipate protracted arguments over who are the end-beneficiaries of government expenditure on higher education, and over whether this expenditure benefits the rich because a higher proportion of them attend universities, or the poor because university education gives them opportunity to improve their economic position. These debates will be truly divisive if public money is allocated on a class basis.

Implementing class-based budgets will require new accounting rules and procedures, possibly similar to those devised in recent years for generational accounting. As has been the case with respect to efforts to account for the incidence of spending and taxes by age cohorts, class-based budgeting will stir up interminable conflict over the assumptions used in estimating budget allocations. It remains to be seen, however, whether this form of budget warfare will lead to more redistribution or to higher spending. The first possibility will materialise if the various classes compete for budget allocations; the latter will occur if the classes collude to get more for each.

4.5. *Allocating national income*

Whether by sector or class, the budget battles of the future will be over how much should be allocated to each set of claimants. The shares can be expressed as percentages of total expenditure or as the proportion of incremental resources allocated to each. These types of calculations are pervasive in budgeting; the main difference is that in the future, the trade-offs may be more explicit.

But there is another possibility that is anything but conventional. Rather than allocating budget shares, the budget will allocate shares in the national income. This novel idea is rooted in a 1989 proposal by the late American economist Herbert Stein who urged that the United States should budget "not the $1 trillion in the government's budget but the nearly $5 trillion in the national income. And what has to be compared is the value of alternative uses of the national income, not of the budget. The problem is usually discussed in terms of a trade-off between defence expenditures and other government expenditures. In fact, the relevant and realistic trade-off is between defence expenditures and all other uses of the national output".

Stein's proposal illustrates the inclination of economists to turn analytical tools into decisional rules. It is analytically useful to examine the shares of GDP spent on health, defence, education and other purposes. But does this mean that the budget should be decided on this basis? Operationalising the notion that both public and private uses of national income should be budgeted would likely require a central planning apparatus that would generate the rigidities and inefficiencies rife in planned economies. It is possible, however, to envision the allocation of the government's expenditure of budget resources rather than the all-national output along the lines suggested by Stein.

One argument in favour of the Stein model is that it would force explicit trade-offs among competing claims on national income or budget resources. In contrast to conventional budgeting, in which bids for resources are decided serially, often in isolation from one another, this approach would compel government to weigh the relative merits of requests. Inasmuch as the total spent cannot exceed 100% when (as is likely) budget requests exceed that amount, some will have to be cut for others to get their shares.

Arguably, making budget trade-offs more explicit and transparent will do more to politicise allocations than to improve their efficiency. Looking to an uncertain budget future, one can foresee political pressure to allocate portions of the budget in percentage terms. For example, Parliament may decree that not less than a specified percentage of GDP or of total expenditure must be allocated to health, education or some other program. Quite likely, claims entitled to a fixed share would have a preferred position in the budget, while those not receiving such allocations would have to compete for any remaining resources. Obviously, this double standard will motivate strong groups to seek legal entitlement to fixed budget shares. If they succeed, budget allocations will be both politicised and rigidified.

4.6. International norms

Entitling certain sectors to shares in the budget or in national income would be consistent with the trend to base allocations on normative rules rather than on the discretion of political leaders. At present, most normative allocations are concentrated in mandatory transfers to households and grants to regional or local governments. These two categories now account for well over 50% of national government outlays in industrialised democracies. They will account for an even higher percentage in the future.

Nowadays, national governments operate two parallel budget systems. One is organised around recurring (typically, annual) budget decisions, the other is driven by normative rules which specify eligibility standards and payment formulas. The former is legally discretionary; the latter is mandated by standing law. Although annually appropriated funds garner most of the attention during preparation of the budget, they cover a shrinking portion of total expenditure. Rule-driven spending usually is prescribed in permanent law that continues in effect unless it is modified by new legislation. These expenditures are controllable, but most carry over from one year to the next without substantive change. One may confidently predict that many governments will be impelled by fiscal and demographic pressures to cut back normative expenditures in the decades ahead. If they succeed, they will merely slow, not reverse, the growth of these expenditures.

Most current normative allocations are country-specific; each government adopts its own rules. In the future, however, many will be determined by norms that cross national boundaries. International and regional organisations will prescribe minimum standards of expenditures for various social programs – such as health, education and environmental protection. They will promulgate convergence criteria in either money or program terms. For example, they may dictate student-teacher ratios or require that a minimum percentage of GDP be allocated to public education. They may establish standards which compel governments to allocate certain amounts to particular programs. For example, they may decree that a government must have at least 500 child care places for each 1 000 children between the ages of one to five, or that all schools offer certain courses. The variety of norms is as boundless as the interests of affected groups.

At the outset, many criteria will be advisory or indicative; over time they will become binding and governments will be required to account for expenditures in ways that enable international monitors to audit compliance.

One particularly burdensome set of norms will pertain to revenue sharing between the national and local or regional governments. The former will have responsibility for extracting taxes from citizens, the latter will be the real spenders. Under the banner of fiscal decentralisation, national governments will be put in the politically difficult position of being blamed when things go wrong, but will have inadequate authority to put them aright.

4.7. Budgeting without allocating

Since its inception, budgeting has been depicted as a process for allocating funds among alternative uses. Many of the decisions have pertained to the allocation of incremental resources, but the increments normally have been of sufficient consequence to invest budgeting with political and financial importance. Budget decisions have mattered because they have determined how these resources were spent.

Over time, however, the decisional capacity of budgeting has been chipped away by statutory requirements, international treaties and obligations, changing fiscal relations between the central government and sub-national governments, the shift in fiscal risk from enterprises and households to governments and the demands of interest groups. The cumulative effect of these developments has been to transform much of budgeting into a means of accounting for past decisions. The scenario drawn in this section indicates that an even a greater portion of expenditures will be budgeted in this manner in the future. As unsettling as this conclusion may be, it may be an appropriate condition for mature democracies whose voters want neither big expansion nor big retrenchment of government and where the most important issues have been settled (at least for the time being) by decades of policy adjustment and program accretion. In these countries, most voters are clustered near the centre and the political parties fight loudly but over small matters. Democratic stability is no minor accomplishment and it is due in part to the dulling of political conflict by budgetary stasis.

The loss of budgetary flexibility was a recurring concern of the early SBOs and has appeared on the agenda in various forms over the past two decades. Entitlements are a growing part of national budgets and they are here to stay. The damage they do to the budget is compensated by the security they bring to households. Anyone who bemoans the spread of the entitlement state must marvel at the economic well-being it has brought to its citizens. The two developments are inter-linked, making the budget the dependent variable in the political relationship between citizens and state. But what is new and somewhat alarming, if the future envisioned here is credible, is the rigidification of heretofore discretionary expenditures. The big allocative questions still in the hands of national governments – how much to spend on services – will be decided by norms and formulas in future budgets. The last preserve of budgeting is threatened by the same logic that has made entitlements so popular and pervasive. Ensure interests and class their share in the budget by making allocation a matter of legal right rather than of discretion. Give cities and communities their shares, the old and the young, the schools and the health clinics. Budgetary choice may be weakened, but all for the good of society.

Perhaps this scenario will turn out to be another false alarm and budgeting will persist as a robust allocative process. But if normative budgeting materialises, it will be necessary to stop thinking of it as an allocative process and to recognise that it has metamorphosed into something that appears to be the same, but is not.

5. Operational budgeting: From control to performance

Fiscal discipline and financial allocation are principal concerns during preparation of the budget. The third objective of budgeting – promoting efficiency in the provision of public services – focuses largely on the implementation of the budget. While the first two objectives get most of the attention in big bang reforms, operational matters consume most of the work time of budget staff. The flow of communications during budget execution and the sheer number of actions that are reported and controlled dwarf other work demands of budgeting.

Despite its sometimes lowly status, operational budgeting is important because it affects the cost and quality of services, the volume of government expenditure, the size of the civil service and relations between citizens and government. Citizens know their government through the services they receive from it.

Operational issues were not prominent at the early SBOs because the agenda was dominated by the big issues discussed in the previous sections. But they gained attention in the second half of the 1980s as innovative governments in Australia, the United Kingdom, New Zealand, Sweden and elsewhere sought to improve public performance. Each of these countries moved boldly to shift budgeting from compliance to performance by giving managers freedom to run their operations as they deemed appropriate. Several forces stimulated this transformation, including the importation of novel managerial practices from the business sector, recognition that the persistent rise in operating costs was compelling government to spend a higher share of national output, the ability of politicians to take credit for cutting expenditures without drawing blame for cutting programs and realisation by budget officials that they were over-controlling the most controlled portion of the budget.

The operational budget agenda parades under a number of monikers: New Public Management, managerialism, performance-based budgeting and marketisation. The names reflect different approaches to the same issue. Some use market-type mechanisms, others rely on managerial skills and judgement, others on strong accountability arrangements. All recognise that transforming operational budgeting requires major changes in the managerial systems within which budgeting is embedded. In contrast to past reforms which sought to change budgeting without regard to public management, recent innovations have been grounded on the presumption that budgeting is a subset of management and cannot be reshaped in isolation from other processes to which it is linked.

Most OECD member countries have made little progress in dismantling managerial control mechanisms, though most appear interested in improving operational performance by easing budget controls. There is no single model for moving in this direction, nor a single innovation that will accomplish all the sought changes in government operations. The handful of innovations discussed below have been selected because of their breadth and wide application.

5.1. *Managerial discretion*

An essential step in shifting operational budgeting to performance has been to dismantle many of the operational controls that have been applied for generations. The typical controls pertain to inputs and operate through the detailed itemisation of different objects of expenditure, such as travel, supplies, utilities and personnel. Each type of control has its own rules and procedures which are enforced by controllers at the centre of the government or in departmental headquarters.

In response to the vast expansion of government, many countries have partly decontrolled public spending by consolidating the items into broad categories and by giving spending units some discretion in shifting funds among the items. Many also have placed greater reliance on internal controls, in which the spending agency is responsible for assuring the legality and propriety of expenditure, in contrast to external control which vests this responsibility in central agencies. A few have gone much further and have eliminated virtually all centrally-maintained controls over operating expenditure. Instead of splitting the operating budget into numerous pockets of money, they now give agencies a lump sum for all running costs. Within this operating budget, managers decide how much to spend on travel, salaries and other items. The operating budget is cash limited, barring agencies from spending or requesting more than was provided, even if inflation outruns the estimates on which the budget is based. Moreover, some countries subtract an "efficiency dividend" from the operating budget to reflect expected gains in productivity. This dividend is typically in the 1-2% a year range and pressures agencies to be more efficient in using operating resources.

Where decontrol is taken seriously, it is not confined to the centre of government, but is devolved down to operating and field units. Each field unit or local office gets its operating budget and, within certain restrictions, has freedom in spending these resources. Thus, managerial flexibility redefines both the relationship between central agencies and departments, and between department headquarters and field units. The logic of this strong commitment to decontrol is that managerial improvement can occur only if managers are free to use their skills and professional judgement in running their operations. They are either free to manage or not. If they are, services are likely to be more efficient and delivered in a more flexible, responsive manner; if they aren't, managers will stress compliance, even if some controls have been eased.

But this logic has not triumphed everywhere. In some influential OECD member countries, a premium is still placed on uniformity in services and central control still predominates, though not to the full extent it did a generation or two ago. In some, there is concern that managerial discretion will undermine the civil service system and lead to the replacement of career officials with short-term appointees, as has occurred in New Zealand and the United Kingdom. In fact, attitudes toward the civil service sum up key differences between the reform-minded and *status quo* countries. The latter sense the loss of a civil service ethic, the former see rigidities in the traditional public service. This is an issue for which there can be no final resolution, nor any single best way.

Central agencies have been deeply affected by the march of managerialism. As recently as a generation ago, their main function was to maintain administrative controls, especially those regulating personnel and finance. In some countries, various control agencies have been abolished, for example, the personnel agency in Australia and the Accommodation Board in New Zealand. But governments do not have the option of doing away with their Finance Ministries or their budget departments. Some Finance Ministries have led the drive for managerial reform, others have gone along reluctantly. All have to go through a period of adjustment, unlearning old roles and relationships and defining new ones. They must decide how to draw the line between letting operating managers manage and intervening with advice or restrictions. They must decide how much control should be thrown overboard and exactly what should be retained. And they must figure out how to retain power at the centre of government when much of their power base has been surrendered.

5.2. *Performance targets and reports*

There are two sides to the new managerialism. One is summed up in the phrase "let managers manage" and revolves around the divestiture of input controls; the other is implied by the phrase "make managers manage" and has to do with the imposition of strong accountability measures to assure that managers are not abusing their discretion and are producing the intended results. In every reformist country, it has proven easier to move ahead on the first agenda than on the second. But the countries which have progressed the most in freeing up managers have also been the most creative and demanding in introducing new accountability regimes.

Accountability deals both with money and performance, and in the guise of performance budgeting tries to mould the two together. On the spending side, accountability entails the accrual basis which purports to hold managers accountable for the full cost of operations and audited financial statements. A few countries have broken new ground in the costing of services. New Zealand has been the most venturesome, charging operating budgets both for depreciation and for the use of capital (computed as net worth on an entity's balance sheet). Managerial-minded countries also require departments or agencies to publish annual reports discussing their operations and comparing planned and actual results. On the performance side of the ledger, managerialist governments generally require that performance targets be specified in advance and that actual results be measured against the targets. These countries have invested heavily in developing performance measures and compiling relevant data, though some of the effort has been wasted in sterile debates on the differences between outputs and outcomes or between intermediate outcomes and end outcomes and so on. The approaches taken by various countries appear to differ, but all emphasise comparison.

The United Kingdom favours a small number of targets for each agency; these are compiled in an annual report issued by the government in a single document that compares targets and results for the past year and provides new targets for the year ahead. The advantage of targets is that they are tightly focused; the disadvantage is that they may exclude important elements of performance. The United States provides for each department and each major agency to produce an annual performance plan discussing what it hopes to accomplish in the year ahead and an annual performance report discussing what was actually accomplished in light of its plans. New Zealand and Sweden generally rely on annual reports to assess results.

As performance measures and reports become more common, these will likely be subject to review by auditors who may comment on the accuracy of the data or on the interpretations drawn from them. It also is probable that some standards will emerge on compiling and analysing performance information. It is unlikely, however, that these standards will be as authoritative as those which govern the reporting of financial results. The future evolution of performance measures will depend as much on how the data are used as on how they are collected and presented. Performance measurement rests on the questionable assumption that measuring and publishing results will make a difference in the results. The managerial movement rests, however, on a different proposition: that unless managers have strong incentives to be efficient and productive, generating data will make little difference. This is why performance measurement is seen as a subset of managerial reform rather than as the main event.

5.3. *Performance contracts*

One way to increase the use of performance information is to incorporate it into contracts which specify the results to be achieved. While the term performance contract is sometimes applied to relations between government as a purchaser of services and outside vendors, recent developments in contracting pertain to relationships within government. Contracts are now formalised in some countries specifying the pay and responsibilities of senior and middle managers. The chief executives of New Zealand departments are employed under term contracts (for up to five years) which specify the key results expected of them. Similar employment contracts are negotiated between senior and middle managers, and on down the administrative chain-of-command. These contracts enable managers to negotiate their own pay and terms of employment without regard to standard civil service rules. A similar arrangement prevails in the United Kingdom for the chief executives of government agencies.

Performance contracts have also been introduced to specify the outputs or services to be provided by government entities. In the United States, department heads (who are political appointees) negotiate performance agreements which indicate the steps they will take to improve operations, introduce services or make other changes. Rather that being comprehensive statements of all the results to be achieved, these agreements concentrate on matters that the government and department heads deem to be of particular importance. In New Zealand, ministers negotiate annual performance agreements with the chief executives of their departments specifying the services and other outputs to be provided during the fiscal year and the resources that will be made available for these purposes.

These and similar contract-like documents are not genuine contracts. For one thing, the relationship between the parties to the agreement is not truly arm's-length; for another, the government does not normally have effective redress if managers fail to perform. If the school principal does a poor job, she or he can be dismissed, but the government rarely has the option of closing the school or cutting its budget. Moreover, the contracts rarely specify all the services or outputs to be provided; rather, they identify those matters of particular interest to one or both parties. It may be fruitful to think of the contracts as establishing an ongoing relationship and a basis for discussion between the respective parties. They can use the terms of the agreement as checklists to review progress in achieving particular milestones or as talking points in periodic meetings between the two sides. They are signalling devices which spur managers to focus on certain aspects of performance and put them on notice as to what is expected of them.

5.4. *Autonomous agencies*

For decades, efforts to improve public management involved the integration of activities and series into broad departments, each with a broad swath of responsibilities. There was a department for transport, another for education, another for health, on down the standard list of government responsibilities. In creating functionally integrated departments, government strove to eliminate free-standing agencies and to place those that survived within the departmental structure.

Managerialism has given rise, however, to the dismantling of cohesive departments by removing operating units and giving them broad independence to carry out their assigned responsibilities. While this development has occurred in only a few countries, others may join the agency bandwagon in the years ahead. Typically, when an agency is established, the government (sometimes through the parent department or ministry) defines the matters over which it has operating discretion, its duties and functions and the manner in which it will be accountable for financial and substantive performance. The government appoints a chief executive who has full authority to run the agency.

Britain and New Zealand provide alternative models of agencification. Britain created independent agencies to free service providers from central control; New Zealand created agencies to free policy-makers from undue influence by service providers. In Britain, approximately 75% of the civil servants employed by central government work in the 130 Next Steps agencies which have been formed during the past decade. These agencies were established pursuant to a government study which found that previous budget and management reforms, such as the financial management initiative launched by the Thatcher Government in 1982, had failed to improve the provision of services. The report recommending independence for service agencies was titled *Next Steps*; hence the entities created pursuant to its recommendations are commonly referred to as Next Steps agencies.

Before it launches an agency, the government defines its responsibilities and assesses its capacity for self-management. It then recruits a chief executive and draws up a framework document which spells out what the agency is to do, its relations with the parent department and the discretion it will have. The government publishes annual performance targets for each agency and, as noted earlier, compares results to the targets. Approximately every five years, the government commissions an independent review of the agency's operations and performance and decides whether it should be continued, terminated or restructured. The Next Steps process is widely regarded as having brought significant improvement in the efficiency and quality of services. It has both reduced compliance costs and enabled agencies to be more flexible and responsive in delivering services. Despite the origin of Next Steps in the Conservative Thatcher Major Government, it has been continued by the Labour Government headed by Tony Blair.

In contrast to Britain which was motivated to free up service providers from the clutches of Whitehall, New Zealand separated service provision from policy advice to give ministers freedom in defining policies and in purchasing services. In New Zealand, appropriations are made by classes of outputs and are voted to ministers who may purchase services from their own departments or from alternative providers. This formal distance between them enables ministers and departmental chief executives to negotiate the purchase agreements mentioned earlier. Each department's chief executive has discretion in hiring staff, using available resources organising work and producing the required services. Accountability is maintained through annual report and audits, output measures and evaluation of the chief executive's performance.

The reputed successes of the British and New Zealand models have spurred other countries to create independent agencies. But as agencies have become entrenched, both Britain and New Zealand have become concerned that the number and independence of these entities impedes efforts to co-ordinate policies and programs that cross organisational lines. Both countries have sought to develop a "whole-of-government" perspective which may diminish the operating independence previously granted agencies.

5.5. *Market-type arrangements*

Manageralism relies on the skill, judgement and professionalism of those who produce government services to improve operating results. Without this premise, it would make no sense to decontrol public management and empower civil servants to act as they see fit. But not all reformers agree that entrusting managers with operating discretion will improve results. Some hold that nothing short of customer sovereignty through competition and choice will make governments responsive to citizens in designing and providing services. In contrast to managerialism where choice is vested in service providers, a market-type approach gives choice, through vouchers, price mechanisms, user charges and other devices to those who receive services. And in contrast to managerialism which introduces contracts within government, the market approach uses privatisation and contracting out to promote genuine competition.

At its core, the market approach is predicated on the argument that as long as government has monopoly power in the provision of services, it will be wasteful and indifferent to the interests of those it serves. Accordingly, government should either privatise services or open them up to competition.

The market strategy has little appeal to those who believe there is inherent advantage in having public services provided directly by government. Arguments and evidence that citizens can get a better deal if they are free to purchase services are irrelevant to those who believe it wrong to privatise public responsibilities, such as schools, or to subject them to market-type competition. It is likely, therefore, that marketisation will be confined in most countries to commercial activities, such as telecommunications and other trading activities, and will not significantly penetrate core public services.

6. Operational futures: Government as a producer

In view of the clashing position on public *versus* market provision of services, it is difficult to envision how government operations may be carried out in the future. But on the assumption that efforts to privatise or contract out basic services will continue to be resisted and that market penetration will be marginal, this section considers a number of innovations that may extend the boundaries of managerialism and bolster market-type arrangements within government. In other words, government will continue to budget for and provide services, but will do so in ways that heighten sensitivity to the cost and quality of services.

6.1. Performance budgeting

Allocating resources on the basis of services to be provided is an old, appealing and elementary idea that has made surprisingly little headway. Many governments include performance information in their budgets, but doing so does not mean that they systematically make spending decisions on this basis. The concept of performance budgeting intended here is one in which each increment in expenditure is expressly linked with an increment in output or performance. Implementing this concept requires that government has reliable data on the unit cost of services and that bids for resources be structured in a manner that facilitates the marginal analysis of costs and outputs. Few governments currently have this capability, though many compile performance information.

In conventional budgeting a sum of money is exchanged for the total output or work of a spending unit, in performance budgeting, the outputs are desegregated into units, costs factors are attached to each unit and the total exchanged depends on the volume of units and the amounts paid for them. Implementing this strict version of performance budgeting requires governments to have cost accounting systems which distinguish between fixed and variable costs of government services and measures the marginal cost of changes in the volume or quality of services. While this technical feat is presently beyond the capacity of most governments, the main impediments to performance budgeting are bureau-political. Spending agencies are uncomfortable with breaking down their work into standard units, and also uncomfortable with the notion that the amount they get should depend expressly on the amount they produce. This, more than the technical problems, is the reason why performance budgeting, which was a leading budget reform half a century ago, has made so little headway.

Nevertheless, performance budgeting is an idea whose time will come. Progress in measuring and costing outputs and demands for both efficiency and quality in the provision of services will impel governments to allocate on this basis. Of course, once budgets explicitly link increments in resources and services, it will be a simple task to outsource government work and to exchange resources and output on a commercial basis through market mechanisms. Thus, performance budgeting which seeks to implant managerialism in government, has the potential to uproot it.

6.2. Price-based budgeting

Once a government has the cost and output data needed to formulate a performance budget, it may take bolder steps to improve public management by budgeting on the basis of price rather than cost. A price-based budget is one in which government authorises expenditure in terms of the amount agreed to be paid rather than on the basis of the cost of producing the services.

For generations, governments have prepared budgets by adding up the cost of the inputs purchased by agencies. But if government appropriates more, agencies have more to spend on inputs; if it gives them less, they must spend less. If civil servants win pay increases, or if more staff are added to an agency's payroll, the government votes more money, regardless of the volume of output produced. This behaviour means that in budgeting, the cost of inputs always equals the price of outputs. If the cost of inputs rises, so too does the price of outputs; if government reduces the price of outputs, it thereby also reduces what agencies spend on inputs.

As conventional as this pattern is in government budgeting, it is alien to most economic exchange. A customer typically is indifferent to the cost borne by the supplier. As a consequence, an efficient supplier may profit by economising on inputs; an inefficient supplier may lose money because the cost of inputs exceeds the price charged for outputs. Significant gains in operating efficiency can be reaped in government by severing the relationship between cost and price. Government would negotiate a price without regard to the cost borne by affected agencies in producing the agreed services. Assuming, however, that services are supplied in-house by government agencies and are not out-sourced to commercial vendors, there would have to be strong assurance that the price is right, that it is reasonable and that an efficiently run agency can supply the services for the amount that it will be paid. Without this assurance, there is substantial risk that the price will be too low, resulting in hidden reductions in output (or in quality) or inability of the agency to pay its bills. It would be quite different for a commercial vendor to close its doors because it undercharges for services than for a government agency to be insolvent because it cannot operate at the agreed price. It is the difference between firms going bankrupt and schools shutting down. One is a common occurrence, the other is truly rare.

Except in areas where output is contracted out, governments do not presently have the know-how to budget on the basis of price. Governments lack cost accounting systems to measure what particular services should cost, nor are most of their basic services subject to competitive tenders. Yet, significant progress has been made in reparating price from cost. When government allocates a running cost budget to an agency without tallying up the cost of inputs, it moves in the direction of the price basis. Similarly, when it cash limits this budget or subtracts an efficiency dividend from the amount provided, government weakens the link between price and cost. Price-based budgeting will be a difficult feat, but it is feasible.

6.3. *Variable budgets*

Performance- and price-based budgeting are associated with another practical innovation – a shift from fixed budgets in which total spending does not depend on the amount produced to variable budgets in which the amount paid by government is determined by the volume and quality of output. As alien as it may seem to government budgeters, variable budgeting is standard business practice. Although some portions of their budgets may be fixed, firms allocate production costs on the basis of the volume produced and many tie expenditures on research and developments or other variables. Governments do not, however, because they regard appropriations as fixed limits on the amounts that may be spent. In effect, government buys all the output of its spending agencies at a fixed price; it does not spend more or less if the amount produced deviates from the budgeted level.

Arguably, the amount paid should depend on volume; if it doesn't, the government will overspend when output falls short of the budget and it will risk hidden cuts in services when output exceeds the budget.

A critical difference between fixed and variable budgets is that the latter are inherently performance budgets and the former are non-performance budgets. After all, in a variable budget, spending varies because performance varies. But when expenditures are fixed, the budget is indifferent to performance even if the government professes to have a performance budget. Devising a variable performance budget entails three adjustments in budgeting. First, expenditures have to be based on price rather than cost. Ideally, a price should be set for each unit of output rather than for total output. Second, the concepts and methods of cost accounting have to be utilised to distinguish between fixed and variable costs as well as between marginal and average costs. Without adequate cost accounting, the government will not have sufficient information to set a fair price for services. Third, it is necessary to distinguish between expenditures which should vary with volume and those which should not. As a general rule, variable budgeting should be applied only to those services when the demand for services is exogenous; it is not directly influenced by the entity providing the services. The passport agency should have a variable budget because it has little immediate control over the number of applications. But the police agency should have a fixed budget because it decides how many patrols to undertake. If its budget varied with volume, it would be able to boost its budget by providing more services. Variable budgeting would require a case-by-case determination of funding arrangements. Within an agency, some services may have fixed appropriations while others may warrant variable expenditures.

6.4. Citizen (customer) rights

In the future, government performance will be a right of citizens. In the same way that citizens are entitled to health care or income support, they will be entitled to performing schools, on-time transport, courteous civil servants, prompt handling of applications and other public services. When this occurs, performance will have been transformed from a means of measuring and assessing services into assurance that services will be provided as set forth in the budget.

Services as rights of citizenship will not happen all at once. These rights will be tried in some areas, then extended to others. At first, the rights may be poorly defined, with inadequate specification of qualitative features; over time, the rights will be elaborated, as they have been in so many areas of social conduct. The early rights may have no or weak redress; they will be rights without remedy. But remedies will be introduced gradually, including compensation for sub-par services. One practical remedy would be to empower citizens to obtain services from alternative providers when government fails to meet the standards. Another would be to give citizens vouchers enabling them to purchase services from any eligible provider. If this were to occur, citizens would be empowered as customers, with the right to take their business elsewhere when they are dissatisfied.

Prototype citizen's rights models are emergent in the Citizen's Charter idea pioneered in Britain and imitated elsewhere. Although the Citizen's Charter was alleged to have started as a political stunt, it matured into a serious effort to spur qualitative improvements in services. Entitling citizens to certain services may be an effective, attractive option for those who believe that public services should not be privatised or contracted out. Of course, entitling citizens will be efficacious only to the extent they get the promised services. As in other entitlements, the objective is not to compensate to failure but to assure performance. If performance is not forthcoming, defining services as entitlements will be a hollow gesture.

6.5. *Receivership*

Under the best of circumstances, not all agencies will provide citizens with the services to which they are entitled. Shortfalls in performance may be due to improper management of agency finances, lack of skills needed to carry out assigned responsibilities, an uncaring attitude or citizens who are indifferent to the quality of services or do not know how to obtain improvement. In these circumstances, the most appropriate remedy may be to place operations in the custody of a receiver who is authorised to replace staff, manage the budget and take other actions needed to raise performance to acceptable levels. An alternative would be to give citizens the option of obtaining services from other providers, but this may be of little value for citizens trapped in poor communities.

Receivership is not a new idea, though it is rarely applied to public programs. It typically refers to situations where the entity is insolvent and unable to pay its expenses. But the concept can be readily adapted to governmental programs where money is ample but performance is below minimum levels.

The future shape of government operations is highly uncertain, more so than forth two other budgetary functions discussed in this paper. With equal plausibility one can envision government yielding to markets or governments digging in and protecting their traditional ways. The probability is that governments will move in different directions, with some making broad use of contracts and others relying on rules and controls. Almost all will pursue improved performance, but they will take different paths.

Doing nothing will not be an option, however, because citizen expectations will continue to rise. governments will be confronted with a choice: improve performance, spend more on operations or degrade services. Most will opt for performance, but they will succeed only if they are willing to dismantle many of the control and compliance systems which shape the structure of government and the provision of services.

7. Does budgeting have a future?

Of course, the answer is "yes" if the question refers to procedures for preparing and implementing budgets. No less than now, future governments will compile budgets that account for revenue and expenditure. National legislatures will appropriate funds, spending agencies will file reports and carry out authorised programs, auditors will review financial reports and on and on. Procedurally, budgeting will be in robust health.

The answer may be "no", however, if what is implied is that budgeting will be less capacitated to decide the finances and direction of government. Many of the developments already underway as well as those that may lie in the future will remake budgeting into the dependent variable in government finance and policy. Rather than driving decisions on money and programs, budgeting will be swept along by powerful tides. The budget will duly register what has been decided already or elsewhere whether by formula or by others, but it will not be the forum for making many of the decisions.

The following paragraphs sum up major developments underway in budgeting's fiscal, allocative and operational roles. The list is not complete, but it nevertheless adds up to a strong case that budgeting will be displaced from its favoured position.

- **Sandwiched budgeting.** National budgets will be influenced by international rules and requirements which prescribe how they manage their finances and what they spend money on, as well as by local or regional governments which will have claim to much of the nation's tax revenue.
- **Normative budgeting.** An increasing portion of national budgets will be allocated by fixed norms, which will govern transfers to households, grants to sub-national governments and program allocations.
- **Exogenous budgeting.** Revenues and expenditures will be increasingly dependent on outside influences – economic and social conditions, capital flows, exchange rates, the age and income structure of the population, medical technology, child-rearing practices and service levels. Changes in these factors will compel automatic adjustments in national budgets.
- **Government as financier.** The national government's main budget responsibility will be to levy taxes that finance spending by others – international organisations, households and sub-national governments. The services it directly provides will account for a declining share of the budget. The separation of taxing and spending authority will generate both political and budgetary stress.
- **Balkanised government.** National governments will be fractured into numerous independent agencies, each with its own budget and each empowered to operate and manage its resources as it deems fit. Ministries

or departments will still be responsible for developing policies and co-ordinating programs, but they will have weak leverage *vis-à-vis* the independent agencies.

- **Higher expectation, less trust.** Budgets will be made in a political environment in which citizens demand much more from government but have low confidence that it will perform well. High expectations will pressure government to spend more and improve services, low trust will make it difficult for government to extract more revenue from its citizens.

Budgeting has a future, but what will be determined by what government becomes. Budgets and governments are inter-twined together; it is not possible to envision robust budgeting unless government is strong and capacitated and it is not possible to have strong government if its budget lacks the capacity to regulate public finance. The key question therefore is how government will evolve in the decade ahead. Answer that question and the question in the title of this paper also will be answered.

Table of Contents