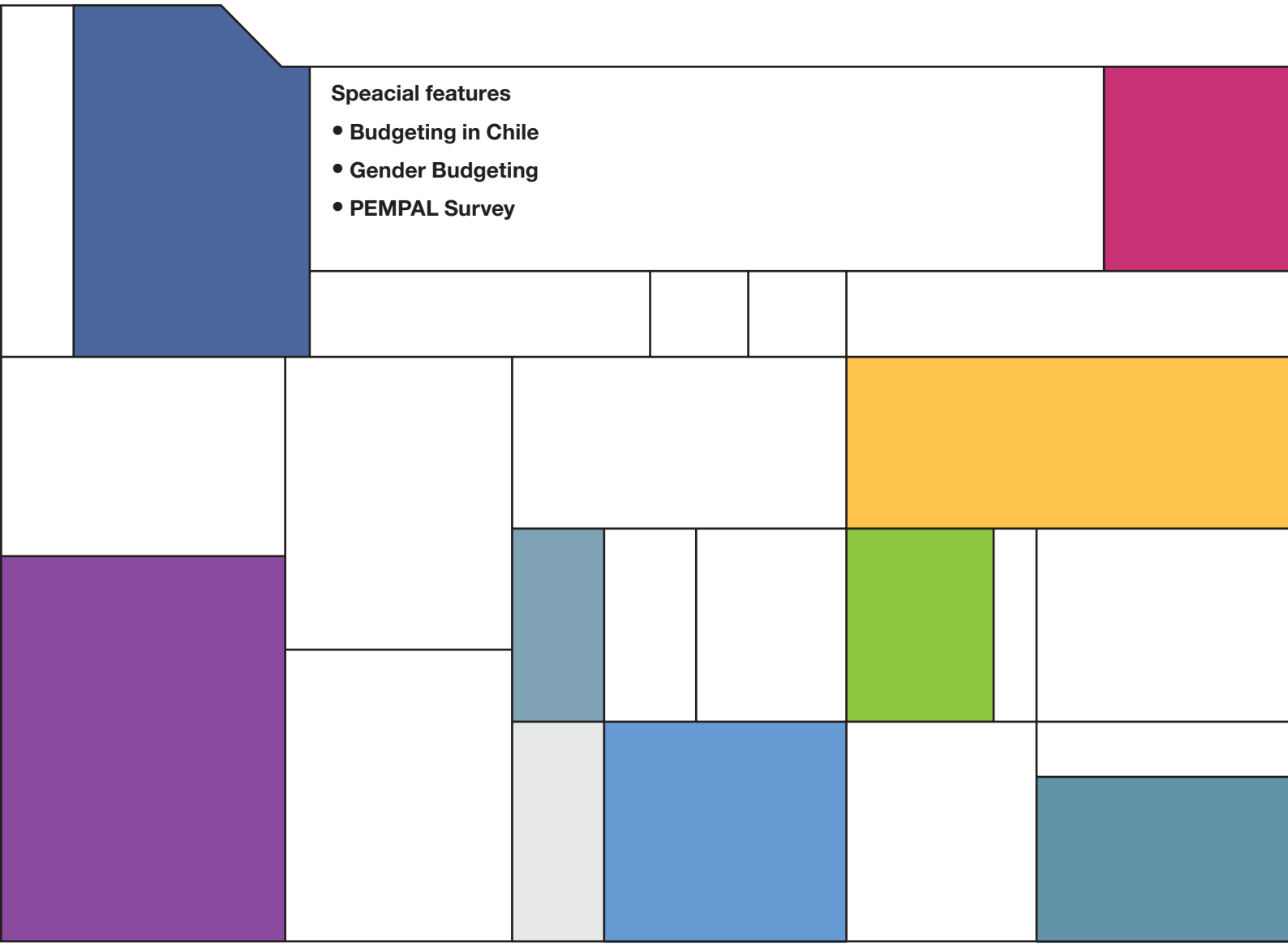
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Speacial features

- Budgeting in Chile
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OECD Journal on Budgeting

Volume 2016/3

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Foreword

The OECD Journal on Budgeting *is a unique resource for policy makers, officials and researchers in public sector budgeting. Drawing on the best of the recent work of the OECD Working Party of Senior Budget Officials (SBO), as well as special contributions from finance ministries of member countries and from other practitioners, the Journal provides insights on leading-edge institutional arrangements, systems and instruments for the effective and efficient allocation and management of resources in the public sector.*

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OECD Journal on Budgeting

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Budgeting in Chile

by
Camila Vammalle *and* Ana Maria Ruiz Rivadeneira*

Chile has achieved outstanding results in terms of fiscal sustainability, economic growth, and reduction of extreme poverty. Chile's strong budget system, was an important element in this success. The economic, social and political environments have however changed greatly in the last decade and Chile's budget system needs to adapt to the new demands this entails.

This review is the result of the collaboration between the OECD and the Directorate of Budget of Chile (DIPRES). It analyses Chile's budgetary practices and procedures in the light of the OECD Recommendation on Budgetary governance, and offers recommendations where improvements could be made.

JEL codes: H500, H610, H830

Keywords: Chile, budget process, DIPRES, fiscal sustainability, CODELCO

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Foreword

In exchanges of letters between the Chilean Directorate of Budget, DIPRES, and the OECD in 2015, it was agreed that the OECD would prepare a review of the Chilean budgeting process. The report covers the entire budget cycle – preparation, approval and implementation, providing an overview of Chile's current budgetary institutions and practices as well as offering recommendations where these could be made more effective. A previous budget review was carried out in 2004; main changes and improvements in budgetary practices are highlighted throughout the report.

An OECD mission visited Santiago in November 2015 in preparation for this report. It conducted in-depth interviews with a range of stakeholders in Chile who are in a position to put forward considered views on the subject. The mission accordingly met with a range of institutions including the Directorate of the Budget (DIPRES), the Ministry of Finance, the Ministry of General Secretariat of the Presidency, a number of line ministries, the Undersecretariat of Regional Development, the Central Bank, the Joint Congressional Budget Committee, the Supreme Audit Institution (*Contraloría*) as well as representatives from civil society, think tanks and independent experts. The OECD gratefully acknowledges the expert contributions from all of these stakeholders.

The mission would like to note its special gratitude to Mr. Jorge Rodríguez, Mr. Juan Andres Roeschmann and Mr. Rodrigo Balbontín, Directorate of the Budget (DIPRES), for their continued assistance throughout the drafting of this report.

The views contained in this report are those of the OECD Secretariat and should not be attributed to governments of OECD member countries, or to any organisation or individual consulted for this report.

This report was prepared by Ms. Camila Vammalle, Economist/Policy Analyst, and Ms. Ana María Ruiz Rivadeneira, Consultant, under the supervision of Mr. Jón R. Blöndal, Head of Division, Budgeting and Public Expenditures Division, Directorate for Public Governance and Territorial Development.

Executive summary

Chile's budget system has contributed to the achievement of outstanding results in terms of fiscal sustainability, economic growth, and reduction of extreme poverty. The system is highly concentrated in DIPRES, which is one of the most highly respected and trusted institutions in Chile. The economic and political environments have however changed greatly in the last decade and Chile's budget system needs to adapt to the new demands this entails.

On the economic side, after a decade of strong economic growth driven by high commodity prices, the structural GDP growth is expected to stabilise at a lower level than during the period 2004-12. On the political side, Chile has experienced shifts in party power for the first time since the return to democracy in 1990. On the institutional side, several

important reforms have been undertaken, including reducing the presidential mandate from six to four years. In addition, new citizen demands and higher expectations have arisen during this last decade with civil society being much more active in the political arena.

Chile's commitment to fiscal discipline is exemplified by a structural fiscal rule and the operation of a fiscal stabilisation fund whereby surpluses are saved during good economic times and drawn down during more challenging times. Fiscal risks are clearly identified and a detailed report on contingent liabilities is published each year.

However, Chile's fiscal rule does not set a specific balance target, but mandates that each President adopts its own target. While the key parameters for calculating the structural balance are given by two independent committees, the methodology is developed and implemented by DIPRES. In recent years, both the structural budget balance target adopted by the President and the methodology for calculating the structural fiscal balance has been subject to frequent changes.

The strong leadership of DIPRES helps align budgets with the medium-term strategic priorities of the President. Progress has been made in designing operational programmes using the logical framework when submitting requests for new and additional funding. However, the budget document could benefit if its programme structure was more closely aligned with these operational programmes. Medium-term expenditure frameworks (MTEFs) are only used as an internal management tool by DIPRES, and not exploited as a tool for planning.

Chile has a robust evaluation and control system, providing a great amount of performance information. This system is designed to support performance management in general. Evaluations have broad objectives with a heavy emphasis on improvements in policy, process and management. However, this evaluation system is not integrated into budget planning. There is considerable space for improvement in the way this information is used to guide resource allocation, thus enhancing the efficiency and effectiveness of public expenditure.

The Congress has built up some capacity regarding the budget in the last decade with a new Permanent Joint Committee on the Budget and the creation of a Budget Advisory Unit. However, the role of Congress in the budget discussions in Chile is still rather limited. Congress may only decrease expenditure proposed by the executive; it may not increase or reallocate expenditures. During budget execution, its approval is generally not required for reallocations carried out by DIPRES.

Chile established a Fiscal Advisory Council in 2013. However, its institutional independence is weak. For example, the current government replaced all members of the Council upon assuming office.

Chile has made great efforts to increase transparency with a full range of budget reports being published regularly. However, key assumptions and dis-aggregations are often incomplete, which makes independent replications of DIPRES's calculations often difficult to reproduce.

As a legacy of the military rule in Chile, the military receives 10% of the sales of the government-owned copper mining company (CODELCO) to finance defence material and capital goods. These transfers are kept in secret accounts. Since 2003, the information on total expenditure from this account is reported but is otherwise beyond scrutiny.

Chile faces difficulties in attracting qualified civil servants, especially at senior levels. Quality of staff in DIPRES is said to be higher than in line ministries and they are more

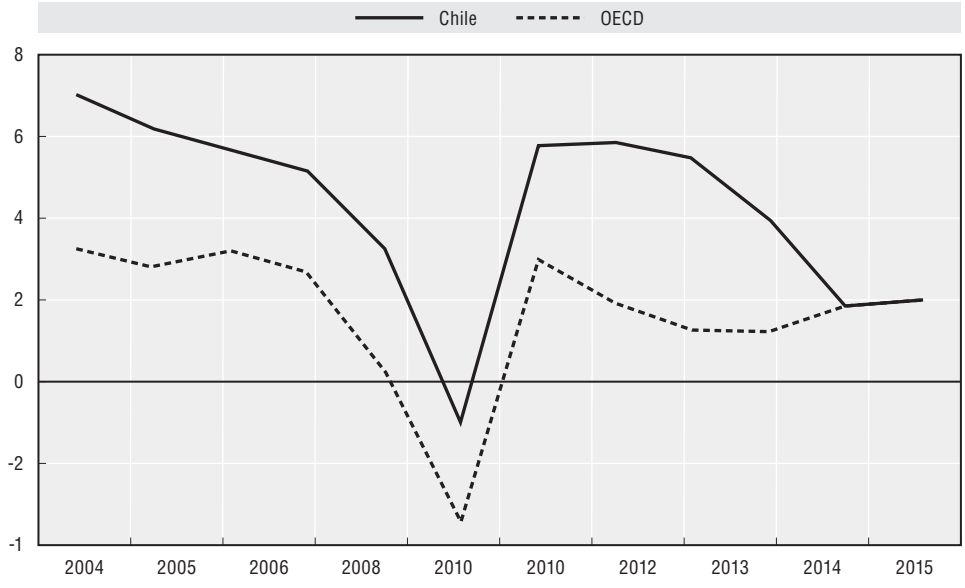
stable at changes of government. This is often used to justify centralisation of decision power in DIPRES. Efforts to transform the senior executive service into a career based one have been made but have not been sufficient to protect senior public managers from political appointments.

1. Economic and social context

1.1. Macroeconomic context: End of boom years

From 2004 to 2012, Chile maintained an outstanding annual growth rate above 5% (Figure 1), only interrupted by the global financial crisis in 2008-09. However, since 2012 this trend changed and growth slowed sharply. Business and household confidence fell, reducing investment and private consumption. The long phase of increasing commodity prices reversed, the national currency depreciated steeply, and productivity growth stagnated. The economy is in the midst of a challenging rebalancing process.

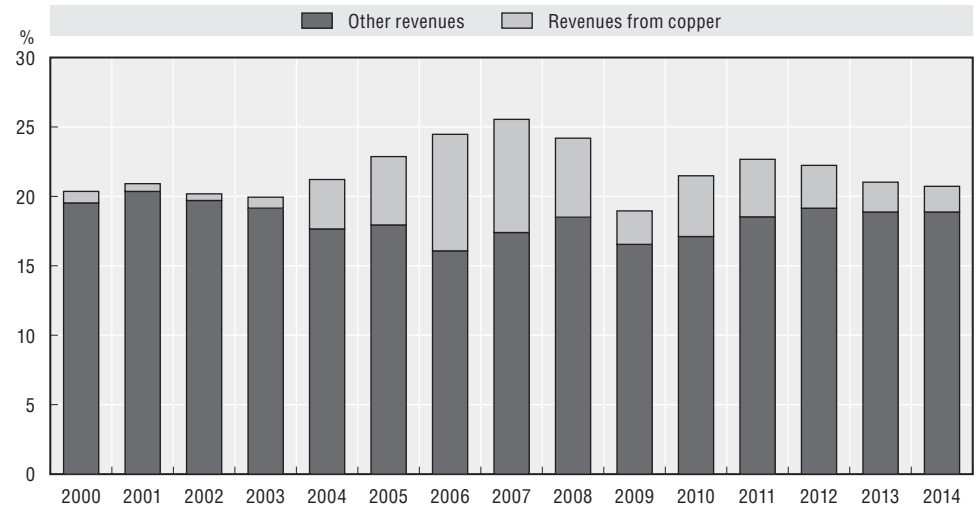
Figure 1. **Total annual growth rate (%) (2004-16)**



Source: OECD, 2015d (Real GDP forecast indicator) and Central Bank of Chile.

As the largest producer of copper in the world, Chile benefited from the upswing in commodity prices and low international interest rates during the recent commodity super cycle. Revenues from copper have represented as much as a third of total revenues in 2006 and 2007 (Figure 2). However, since 2012 copper prices have deteriorated, and will likely remain at lower levels in the future (Figure 3). The combination of lower copper prices and higher costs has affected mining profitability, sharply reducing investment. Lower terms of trade have also cut household incomes and reigned in private consumption. As a result, output growth expectations and projections have been reduced. The projection of the structural GDP growth for 2015 has decreased from 5% in the 2012 consultation to 3.6% on the 2015 consultation (Figure 4). Similarly, the last public finance report published by DIPRES projects a GDP growth of 2.25% for 2016, far below the projection made in the 2014 report of 3.6%. In response to lower expected growth, the government implemented a strong fiscal impulse in 2015 with public spending increasing by 7.4% as compared to the previous year (DIPRES, 2014b).

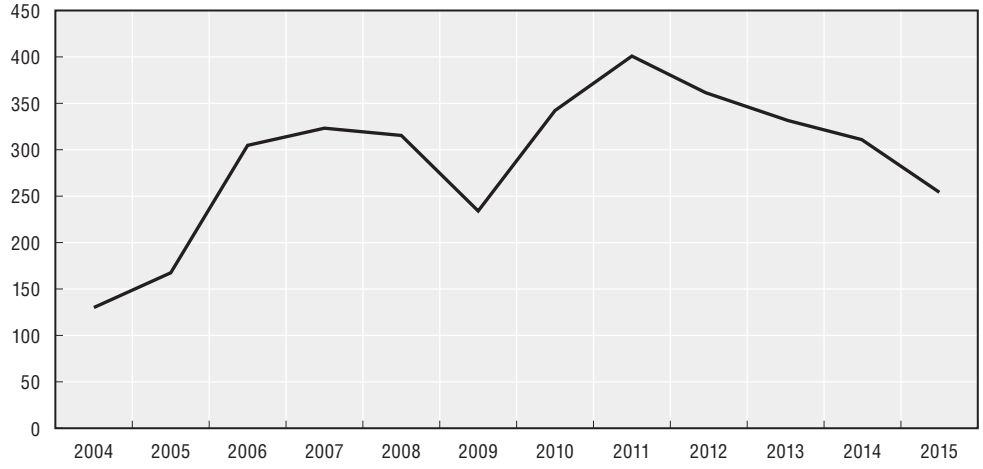
Figure 2. **Total revenues and copper revenues (% GDP)**



Source: DIPRES, 2016a (Central government state of operations) and additional data provided by DIPRES.

Figure 3. **Copper nominal price (2004-15)**

(USD cents per pound)



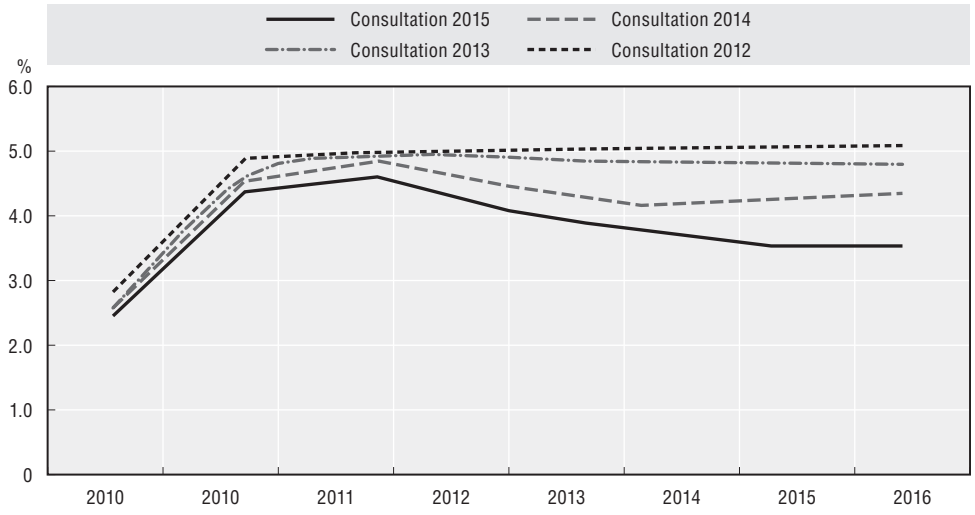
Source: Chilean Copper Commission COCHILCO, 2015.

1.2. A sound fiscal position

The sound fiscal management in the last decades, helped by a fiscal rule, have allowed Chile to run surpluses during much of the commodity boom (Figure 5). Fiscal surplus rose from 2% in 2004 to over 7% of GDP in 2007, allowing the country to save more than 10% of GDP in its investment funds (see next section). The surplus then moved to deficits as a result of the countercyclical response to the 2009 global financial crisis, reconstruction spending related to the 2010 earthquake and tsunami, and the increase in production costs in mining and the internalisation of what then seemed to be permanently higher commodity prices (OECD, 2015c). Nevertheless, the fiscal situation remains robust, notably by the near absence of net debt (Figure 6), which gave the government some room to carry out a further counter cyclical policy and sustain aggregate demand in response to the 2014 slowdown in activity.

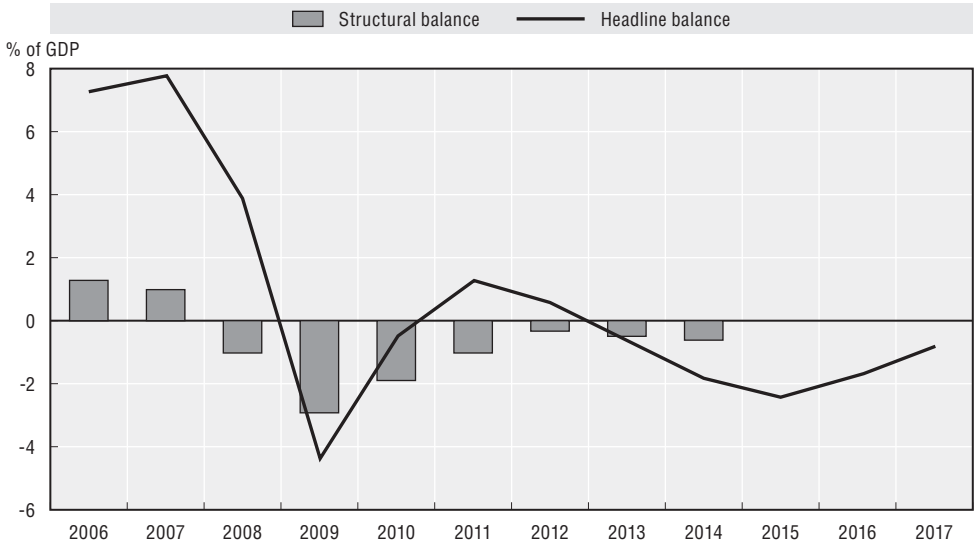
Figure 4. **Trend GDP growth in different calculations**

In %



Source: DIPRES, 2015a (Records of the structural GDP Advisory committee from different years).

Figure 5. **Headline and structural balance**



Source: OECD, 2015c (OECD Economic Surveys: Chile 2015).

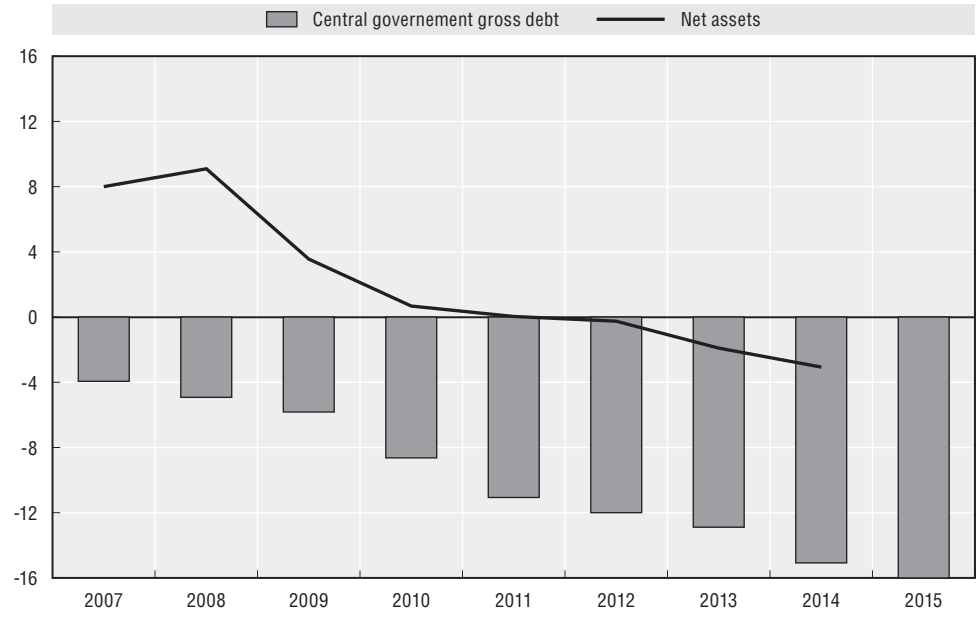
1.3. Shifts in governments

Chile returned to democracy in 1990 and for the next two decades Chile was governed by successive centre-left governments. They pursued an agenda of great prudence to demonstrate their fiscal responsibility. With democracy maturing, a centre-right government was elected in 2010 and in the 2014 elections a centre-left government was returned back to office. The main goal of the current government is to tackle inequality (Box 1).

Shifts in governments and changes in government priorities represent challenges for the budget process in terms of responsiveness and reallocation capacity. It tests the ability of the budget to adapt in a flexible manner to the needs of the governments with different policy agendas.

Figure 6. **Government financial position**

% GDP



Source: OECD 2015c, (*OECD Economic Surveys: Chile 2015*) and Ministry of Finance.

Box 1. **President Bachelet's policy priorities (2014-18)**

Education reform: The education reform aims to improve quality of education, reduce the private vs public education divide, aim for free universal education, and suppress all profit in the education system.

The government presented proposals aiming to build more inclusive schools and reduce skill gaps across socio-economic groups. Recent new legislation ended profits, tuition fees, and selective admission practices in primary and secondary school receiving state subsidies. New bills were sent to Congress to reform early childhood and pre-primary education and improve teacher career paths. To reduce financial constraints faced by students, the government aims to start providing free higher education to students from families that are in the last five deciles of the income distribution in 2016.

Tax reform: A tax reform was proposed to increase government revenues, in order to finance the increase in public expenditures due to the education reform and health care needs, without compromising fiscal stability.

In 2014, the government passed an ambitious tax reform to raise revenues (by around 3% of GDP), and improve the level of fairness in the tax code to contribute to reduce inequality. Other measures of the tax reform included modification of several aspects of the corporate tax system to mitigate distortions and opportunities for tax avoidance, and established a General Anti-Avoidance Rule, which forbids aggressive tax avoidance. More than half of the increased revenues are forecasted to come from increased income taxation, mainly from corporate income. Increases in compliance are forecast to increase revenues by 0.5% of GDP (17% of the overall reform revenue goal), while expansions in the VAT base will account for 0.3% of GDP (12% of the overall reform target).

New constitution: A constitutional reform was one of the key campaign promises of President Michelle Bachelet. In spite of multiple reforms, the current political constitution of the Republic of Chile is the one approved under the military dictatorship of Augusto Pinochet.

Box 1. **President Bachelet's policy priorities (2014-18)** *(cont.)*

In the beginning of October 2015, and after 15 years since the country returned to democracy, the government started a democratic, institutional and participative process to deliver a new constitution. It is expected that in the beginning of the second semester of 2017, the executive branch of the Government will present a first draft to the Congress. The final version of the document will be submitted to a referendum.

Along these three major reforms, the government launched an ambitious set of legal reforms to implement a "**decentralisation and development agenda**". The legislative proposals concern three main pillars: i) a constitutional reform allowing the election of the regional intendentes (keeping a gobernador as representative of the central power); ii) the transfer of competences and public services in economic development, social development, infrastructure and housing to the regions; and iii) changes to the law on regional financing and fiscal responsibility, which foresees a greater devolution of resources, to be developed at a later stage.

In 2005, Chile also undertook one of the most important Constitutional reforms since the return to democracy, curbing military power and strengthening democratic institutions. This included reducing the President's term from six to four years. Even though the roles and responsibilities of the executive in the budget formulation were not explicitly altered, shorter presidential terms are perceived as more challenging in terms of implementing a government's policy agenda.

1.4. Higher citizen expectations

Chile has witnessed a rapid increase in citizens' expectations and civil society engagement during the last decade. New social movements have been formed demanding socio-political and economic changes and using public demonstrations as an alternative mechanism for holding political leaders accountable and for them to respond to citizen demands (Meyer, 2014).

In particular, in 2011 a series of large-scale citizen demonstrations took place demanding a variety of social reforms. Initially, the demonstrations focused on the education system, demanding the right to free education and improvements in quality. Later in the year, these protest initiatives were consolidated in a strong popular discontent regarding income distribution and environmental sustainability.

Between 2006 and 2012, protests have been reported in the media for 102 days of the year on average (Fernandez, 2013). This number was as high as 176 days in 2011 (almost half the year). These figures have a special relevance in Chile where citizens were more passive in the policy making process. Nearly all (96%) were non-institutional in nature, i.e. organised through informal channels. This shows a great separation between citizens, political parties and government institutions (Fernandez, 2013).

Under these circumstances, the government faces strong pressure to deliver more and better services. Budgetary practices and procedures have a key role in allowing public administration to achieve these objectives in an effective and efficient manner.

2. Institutional characteristics of Chilean budgeting

2.1. A historically centralised budget process focused on ensuring fiscal sustainability

Chile has a good reputation with regard to its fiscal responsibility, budget surpluses and macroeconomic stability. However, this has not always been the case. Prior to 1986, Chile had recurrent budget deficits. Fiscal sustainability in Chile has been achieved by concentrating the capacity to propose and increase public expenditure in the hands of the President, and reducing the role of the Congress. This was the result of a long process of concentration of fiscal powers in the hands of the executive, which took place from the 1943 Constitution reform which gave the Executive the initiative of new public expenditure, before a 1970 law made proposing new expenditure an exclusive prerogative of the President of the Republic (Box 2).

Box 2. **Historical concentration of fiscal powers in the executive**

Historically, the Congress enjoyed a very strong role in the budget process in Chile. Starting in the 1830s, the Congress began to exert an ever-greater role, and when the President tried to circumvent the budgetary powers of the Congress in the late 19th century, a civil war ensued. Those allied with the Congress emerged victorious in the Civil War of 1891, and the primacy of the Congress was confirmed in budgetary affairs and in general vis-à-vis the executive. The Congress, however, did not use its powers in a responsible manner, and it is generally believed in Chile that the Congress is always inclined to increase expenditure and budget deficits. A long series of reforms was therefore undertaken to reduce the capacity of the Congress to propose expenditure, concentrating budgetary powers in the hands of the executive, and in particular, of the President.

The role of the Congress diminished steadily, starting with the 1925 Constitution which created a Presidential regime. In 1943, a constitutional reform gave the executive the initiative of new public expenditure. However, this was still considered insufficient, and after several failed attempts, the constitution was again amended in 1970 (i.e. prior to the military government), to give exclusive initiative to the President of the Republic to propose increases to the General Budget Law, and other crucial initiatives for ensuring fiscal sustainability.

Source: Arellano, 2006.

Fiscal Sustainability was further reinforced by the military government in 1975 with the new Financial Administration Law, which concentrates all the power of controlling revenues and expenditures in the Ministry of Finance. These laws also integrated revenues and expenditures of all public agencies into the budget of the state and eliminated nearly all revenue earmarks. Interestingly, the military itself was exempt from the law.

The new Constitution of 1980 confirmed and reinforced these features, giving the President full responsibility and power over the financial administration of the State. This responsibility is delegated by the President to the Ministry of Finance, and in particular to the Budget Office, DIPRES, for its implementation (Box 3).

In particular, the Financial Administration Law stipulates that the Ministry of Finance and the DIPRES are in charge of designing, discussing and executing the budget. The role of DIPRES in the budget process is stronger in Chile than in most other OECD countries. In particular, the balance of power between the sectoral units that shadow respective line ministries and line ministries is in favour of DIPRES, and the ability of DIPRES to reallocate

Box 3. **The Budget Office (DIPRES)**

The Budget Office is an agency of the Ministry of Finance and is headed by the Budget Director. Although formally reporting to the Minister of Finance, the Budget Director is appointed directly by the President who may dismiss him/her at any time. The position of Budget Director is generally viewed as the equivalent of a senior ministerial position in the Chilean government.

In 2016, the Budget Office staff numbered 432 (including temporary staff). It is divided in a Budget Sub-Directorate (*Subdirección de Presupuestos*), which consists of the classic sectoral divisions shadowing respective spending ministries, a Sub-Directorate for Rationalisation and Public Service (*Racionalización y Función Pública*), in charge of economic studies, statistics and long-term budget studies, and four divisions: Public Management Control (*Control de Gestión Pública*), Public Finances (*Finanzas Públicas*), Internal Administration (*Gestión Interna*), and Information Technologies (*Tecnologías de la información*).

Source: DIPRES.

appropriations during the year is great. The role of Congress is on the contrary quite limited, as Congress cannot increase or reallocate expenditure. All public debt must be authorised by the Ministry of Finance, including for publicly owned enterprises, and municipal debt is prohibited unless specifically authorised by a law.

2.2. A Structural fiscal rule

Chilean fiscal policy has operated on a structural budget balance rule since 2001, aiming to ensure fiscal sustainability while allowing counter-cyclical policy actions. The 2006 Fiscal Responsibility Law defines the target of the structural balance as "the balance that the central government would have achieved if the economy was operating at potential, excluding the effect that the cyclical fluctuations in economic activity, the copper price, and other factors of similar nature, may have on the government revenues and expenditures" (Figure 8).

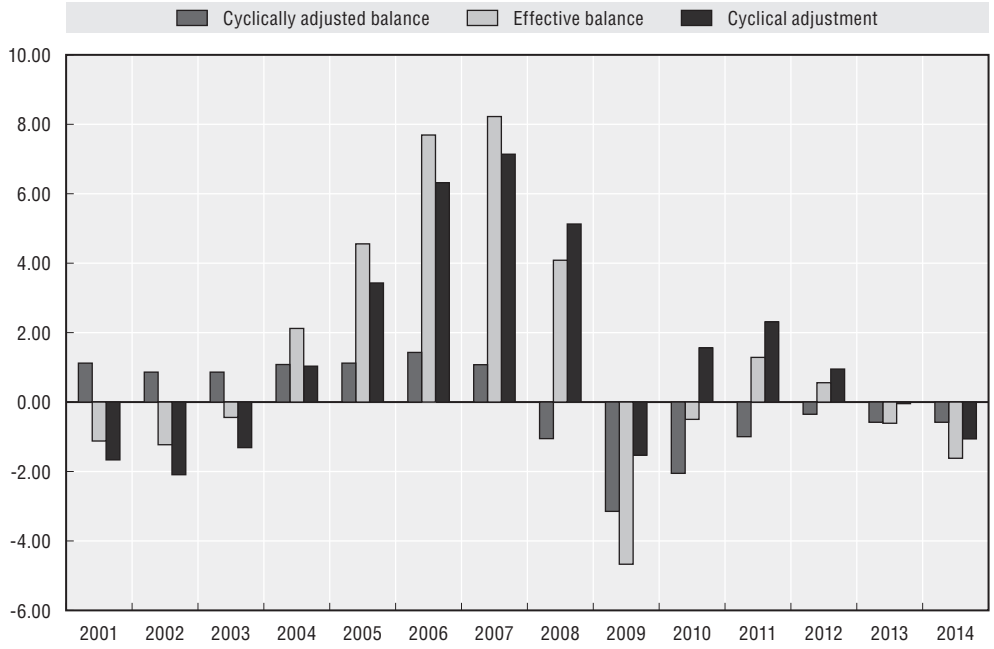
Under the fiscal rule, when the economy is performing above its long-term trend, the government should run a nominal surplus, and when the economy is performing below this trend, the government can allow a nominal deficit. This is conducted through the Economic and Social Stabilisation Fund, described in the next section. As a consequence, public expenditure is not defined taking into account the effective revenue of the government but the structural revenues, also known as cyclically adjusted revenues. The evolution of the fiscal rule and recent evolution of structural balance targets are studied in more detail in Section 3.

Key structural indicators used in the fiscal rule are calculated by two independent panels

Chile designed a mechanism very early on to ensure the independence of the two main inputs used to calculate the structural balance: the trend GDP growth and the evolution of the copper price.

In the first year of implementation (2001), the government created a panel consisting of experts to provide independent, technical inputs to estimate the effect of the economic cycle on tax revenue (the "output gap" panel). A year later (2002), the government created a similar panel to estimate the long-term price of copper (the "copper price" panel). These inputs are then used by DIPRES to calculate the structural GDP and the output gap.

Figure 7. **Cyclically adjusted balance, effective balance and cyclical adjustment (2001-14)**



Note: From 2001 to 2010 figures use 2003 national accounts, from 2011 to 2014 figures use 2008 national accounts.
Source: DIPRES, 2015b.

The "output gap" panel consists of about 15 economists appointed by the Minister of Finance for one year at a time. The same economists are generally re-appointed. The panel members are most often well-known economists from academia and research bodies, and a balance is kept between economists identified with the opposition political parties and with the ruling parties. The panel meets once during the budget season. The panel discusses methodological aspects of the model used. Then, each member of the panel submits a forecast for the various inputs required by the model. Each of the estimates is published anonymously so that each forecaster recognises his/her own. The two extremes on either side are discarded and then a simple average of the remaining forecasts is used. There is no discussion to achieve a consensus among panel members.

The "copper price" panel also consists of about 15 individuals appointed in the same fashion by the Minister of Finance. They are employees of mining companies and related enterprises, as well as academics and researchers. This committee estimates the average long-term (ten-year) price for copper as the reference price. Each panel member submits an estimate which is published anonymously. The two extremes are discarded and a simple average of the remaining forecasts is used. No consensus is sought. In most cases, panel members also send minutes and reports to support their projections.

2.3. Two Investment Funds: The Pension Reserve Fund and the Economic and Social Stabilisation Fund

The Pension Reserve Fund (PRF)

Since 1981, Chile replaced its pay-as-you-go public pension system with a private pension system. This new system aimed to be fully-funded based on individual savings that workers accumulated during their working lives. It is compulsory for all wage and salary

workers and involves the payment of 10% of gross earnings as a mandatory contribution (an additional fee ranging from 0.47% to 1.54% is charged by the pension fund manager). Individuals must select a private pension fund from a number of private companies known as pension fund managers (*Administradoras de Fondos de Pensiones*, AFPs), which are in charge of collecting the contributions and managing them.

This private pension system has been praised for providing a great amount of capital for domestic investment and reducing pressures on the public budget. However, contributions collected were lower than expected and a significant number of citizens were not entitled to receive a pension under the private pension system. The government was therefore obliged to finance poverty prevention programmes that placed pressure on the budget and these would grow significantly over time with demographic changes. The 2006 Fiscal Responsibility Law introduced a fund to finance these. In 2008, poverty prevention programmes were replaced with a new scheme of old-age and disability pensions. Under the new programme, all individuals in the lowest six deciles of income distribution who fulfil the age and residence requirements are entitled to a guaranteed basic pension regardless of their contribution history.

The Pension Reserve Fund was established with an initial contribution of USD 604.5 million. Its objective is to support financing government obligations arising from the government's guarantee to basic old-age and disability solidarity pensions. Accordingly, this fund serves as a supplementary source for the funding of future pension contingencies.

The Pension Reserve Fund's capital increases each year by an amount equivalent to 0.2% of the previous year's gross domestic product (GDP). If the actual fiscal surplus exceeds 0.2% of GDP, the Fund receives a contribution equivalent to said surplus, up to a maximum of 0.5% of GDP. This accumulation rule allows for new resources to be allocated to the fund in any given year regardless of the fiscal situation facing the country each year. The Pension Reserve Fund market value was USD 8.53 billion in March 2016.

The Economic and Social Stabilisation Fund (ESSF)

This fund was established with an initial contribution of USD 2.58 billion, much of which (USD 2.56 billion) was derived from the old Copper Stabilisation Fund that it replaces. The Fund aims to complement the fiscal rule, providing fiscal spending stabilisation. Indeed, it reduces dependency on global business cycles and revenue fluctuations due to copper price volatility by allowing government to draw from the Fund to finance fiscal deficits and amortisation of public debt.

The Fund receives each year the positive balance resulting from the difference between the effective fiscal surplus from the previous year and the contributions to the Pension Reserve Fund and to the Central Bank of Chile, discounting the payment of public debt and advances made the year before (Figure 7).

Since its creation, the ESSF has received contributions in 2007, 2008, 2010, 2012 and 2013. Some partial withdrawals have been made to finance the 2009 fiscal stimulus plan and to finance part of the contributions to the Pension Reserve Fund in 2010 and 2014 (Table 1). The ESSF's market value was USD 14.70 billion in March 2016.

2.4. Actors involved in the budget process

Chile has a strong top-down budgetary process led by the Budget Office of DIPRES (Box 3). Line ministries and some independent councils and committees participate in the

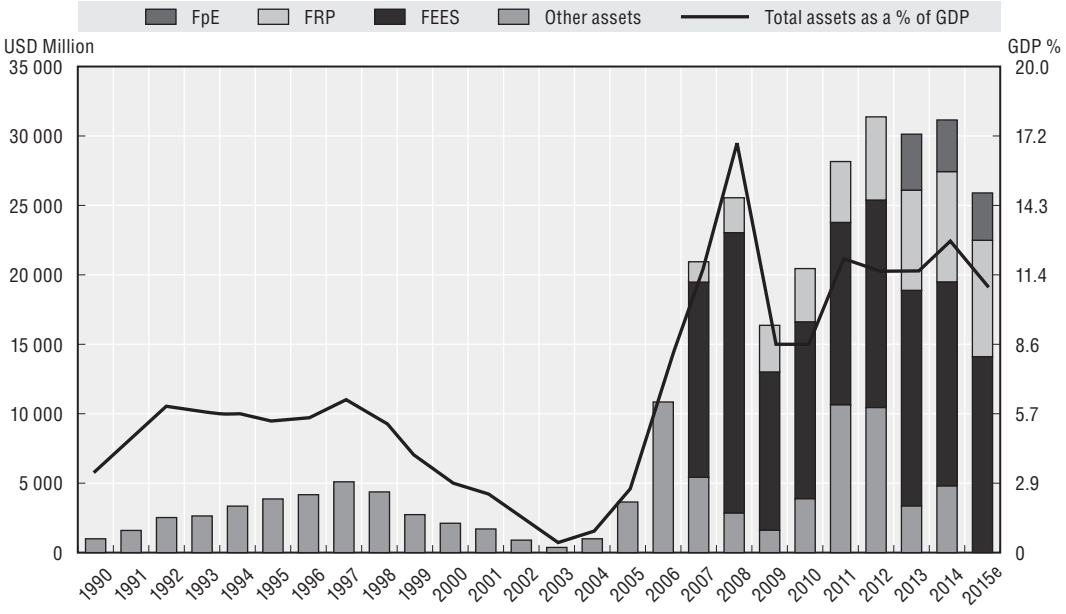
Table 1. **ESSF's Contributions and withdrawals**

USD million

Year	Contribution	Withdrawals
2007	13 100	–
2008	5 000	–
2009	–	9 278
2010	1 362	150
2011	–	–
2012	1 700	–
2013	603	–
2014	–	499
2015	–	464
Total	**21 766**	**10 391**

Source: Chile Ministry of Finance, 2014a (Sovereign Funds Annual Report).

Figure 8. **Public financial assets**



Source: DIPRES, 2015a.

budget cycle but most budgetary responsibilities and tasks are centralised in the Budget Office (Table 2). The power of the sectoral units within DIPRES – which "shadow" individual sectoral ministries is particularly strong, both during the budget formulation and budget implementation. Although the role of the Congress has increased in the last decade, it is still very limited compared with most other OECD member countries.

One particularity of DIPRES compared to most departments in other ministries in Chile is the stability of their staff. While in line ministries, there is a large turnover of staff with changes of government, staff in DIPRES are very stable during changes of government. This further increases the effective power of DIRES vis-à-vis line ministries and is often used as an argument for concentrating decision making power in the hands of DIPRES.

Table 2. **Actors involved in the budget process**

President of the Republic	• Sets fiscal targets • Presents the budget bill to the Congress
Ministry of the Presidency	• Sets government priorities according to the government programme and fiscal context
Ministry of Finance (other than DIPRES)	• Specifies the calendar for the budget law • Forecasts tax revenues, tax expenditure, fiscal risks and interest rate, aligned with central bank guidelines (joint work with DIPRES)
DIPRES	• Carries out macroeconomic assumptions for the budget parameters based on information provided by the "copper price panel" and the "output gap panel" • Forecasts tax revenues, tax expenditure, fiscal risks and Interest rate, aligned with central bank guidelines (joint work with Ministry of Finance) • Calculates spending limit in line with Presidential fiscal targets and macroeconomic assumptions • Updates expenditure baselines • Prepares detailed budget formulation instructions for line ministries • Discusses sectoral allocations with line ministries • Drafts budget bill • Advices the Ministry of Finance during the budget debate carried out in the Congress • Prepares the public finance report • Sets annual rules for budget execution • Proposes a budget execution programme to the Minister of Finance and drafts an expenditure programme defining expenditure levels and priorities • Carries out programme evaluations supported by external evaluators • Carries out *ex ante* evaluations of non-social programmes
Line Ministries	• Prepare the relevant chapters of the budget law, following the precise and detailed instructions of DIPRES • Discuss sectoral allocations with DIPRES • Define indicators to monitor performance • Execute the budget
Ministry of Social Development (MDS)	• Carries out *ex ante* evaluations of social programmes • Carries out *ex ante* evaluations of investment projects which require state funding to determine their social profitability
The "output gap panel"	• Forecast the various inputs required to estimate the output gap
The "copper price panel"	• Estimates the average long-term (ten-year) price for copper as the reference price
Fiscal Advisory Council	• Participates as an observer in the "output gap" and "copper price panels" • Provides advice to the Ministry of Finance regarding the cyclically adjusted balance rule • Assesses eventual methodological changes to the rule proposed by the authorities • Verifies mid-term projections of structural results included in the public finances report
Congress (special mixed commission)	• Approves the budget law • Follows budget execution
Comptroller-General	• Pre-approves all transactions to ensure legality • Publishes information on budget execution • Carries out monitoring and evaluation • Prepares "citizen friendly" publications on expenditure and programmes.

Source: DIPRES Website, Decree-Law 1263 (Organic Decree-Law for the Financial Administration of the State), Law 20128 (Fiscal Responsibility Law) and Political Constitution of Chile.

2.5. Budget calendar and process

Budget timeline

The timeline of the Chilean budget process is as follows: Formulation (April to September), discussion/approval (October to December), execution (calendar year) and evaluation (March to May) (Table 3).

Review of previous year's execution and evaluations

The budget formulation process is a top-down process driven by DIPRES. The budget season in Chile starts in April (Table 3). DIPRES then embarks on an internal process of reviewing the execution of the previous year's budget and evaluates the implementation of the budget into the current year. As part of these reviews, DIPRES calls meetings with the

Table 3. **Budget timeline**

April	• Review of previous year's execution and evaluations
April-May	• Baselines update
June	• Maximum amounts for ongoing programmes established • Instructions sent from DIPRES to line ministries
June/July	• Line ministries prepare relevant chapters of the budget law • Bilateral meetings between Budget Office and line ministries • Meetings of panels on economic assumptions ("output gap" and "copper price" panels)
July-August	• The budget sectors (DIPRES) study the drafts sent by line ministries • Technical commissions composed of officers from DIPRES and representatives from line ministries discuss the draft
End August	• Technical commissions present the budget bill to the Director of DIPRES and to the Finance Minister
August/September	• Copper and GDP panels issue their estimations
Early September	• The Finance Minister discusses the Budget draft with the President
End September	• Final preparation of documentation and pricing
Last day of September	• Budget proposal presented to the Congress
October-November	• Discussion of the budget Bill in the Congress
Last day of November	• Approval
December	• DIPRES prepares the budget execution programme
January	• End of the Budget year (t-1)
March-May	• Budget evaluation (t-1)

Note: Fiscal year = calendar year.

respective line ministries in order to exchange information. These reviews include an assessment based on the information provided by the evaluation process performed during the last phase of the previous budget cycle.

Updating baselines and setting sectoral ceilings

Following these reviews, DIPRES updates the baselines for on-going programmes which then serve as their initial expenditure ceilings. This amount includes a provision for wage settlements (as the negotiations finalise in December after the budget is approved), all expenditures that are mandated by law or contracts and discretionary spending that is judged as continual by its nature. This may include increased expenditures for initiatives that have been established in previous years and are being phased in. The expenditure ceilings are formulated by DIPRES in early June and are then officially communicated to line ministries.

Taking into account the ceilings and the detailed and precise instructions sent by DIPRES, line ministries prepare their submissions and relevant annotations (*glosas*). The use of annotations has increased significantly since the 2004 budget review exercise. This will be further discussed below.

Calculation of the structural (cyclically adjusted) revenues and total expenditure ceiling

Parallel to this process, the independent "output gap" and "copper price" panels meet in June/July to calculate the inputs of the structural budget balance (called cyclically adjusted balance since 2011). In August, this information is made public. Based on their conclusions, DIPRES calculates the structural (or cyclically adjusted) revenues and determines the overall level of resources available for the coming year in August/September. This information is published in October.

Defining sectoral allocations

Between July and August, DIPRES' sectoral units study the drafts presented by line ministries and prepare reports that are later presented to the Director of DIPRES and then to

the Minister of Finance. Extensive discussions will have taken place with the relevant line ministries during this time. After this internal process is concluded (around the first week of September), a draft budget law is presented to the President for his/her approval. The Ministry of Finance then communicates the final presidential decision to line ministries.

Finalising budget bill and submitting it to the Congress

The last step of the budget formulation process is for DIPRES to revise the annotations, finalise the budget documentation and put the budget on the appropriate price level, as all discussions would have taken place on the previous year's budget price levels. DIPRES also produces supplementary documents presenting additional information on performance and results for each of the 26 sectors of the government.

At the latest, the budget bill must be submitted to the Congress on the 30th of September.

2.6. The budget law

The Chilean budget law is divided into 27 portfolios (*partidas*), which correspond to the Ministries and the Treasury. Each portfolio is divided into chapters (*capítulos*), and each chapter is divided into programmes (*programas*) (Box 5). Programmes are usually followed by a large amount of annotations (*glosas*), which specify how the funds are to be spent.

Budget annotations (Glosas)

Chile's budget law has a significant number of annotations (*glosas*), which provide detailed instructions on how the funds are to be spent. Annotations are usually set by DIPRES. In some cases, they has been criticised for being used as a fast track legislative tool to introduce politically sensitive legislations (see more about this in Chapter 4).

Box 4. **Characteristics of Chile's 2015 Budget Law**

- Published on 6 December 2014.
- Projected total central government revenues: 33 356 904 CLP (21.3% of GDP).
- Projected total central government expenditure: 36 391 119 CLP (23.3% of GDP).
- Almost 800 pages.
- 26 portfolios (*partidas*).
- Almost 200 chapters (*capítulos*).
- More than 500 programmes (*programas*).
- More than 4000 budget lines (*ítems*).
- More than 2000 annotations (*glosas*).

Source: Law No. 20.798 2014.

3. Ensuring fiscal sustainability

3.1. An evolving structural fiscal rule

Since its introduction in 2001, the fiscal rule has been adjusted in terms of its base, targets, methodology, and institutional framework. Initially, the rule was based on a high-profile political commitment. It was only until 2006, with the adoption of the Fiscal Responsibility Law (FRL), that the implementation of the structural balance rule was supported by legislation.

The Fiscal Responsibility Law does not define a budget balance target. When taking office, the President defines the structural balance target for his/her administration. The President has to adopt, within 90 days of taking office, a "decree defining the fiscal fundamentals of his/her administration and the expected impact on the structural balance". From 2001 to 2007, the government agreed on a structural surplus of 1% of GDP. The target of 1% surplus was mainly linked to the Central Bank recapitalisation process (Box 5), the exchange rate risk, and the existence of liabilities from concession contracts and the pension system. In 2008, this target was reduced to 0.5%, due to the evolution of these conditions and following the recommendations of an independent study. In 2009, it was reduced to zero to confront the consequences of the international economic crisis.

Box 5. **Capitalisation of the Central Bank**

The Chilean Central Bank suffered a strong deterioration of its capital situation, as a consequence of the 1982 financial crisis and the political decision then taken to rescue the banks, using mechanisms which implied a strong subsidy

To help improve the Central Bank's financial situation, the Fiscal Responsibility Law stipulates that, for the first five years of application, if the effective surplus is higher than 0.5% of GDP, the government can spend up to 0.5% of GDP for recapitalising the Central Bank. This prerogative was used in 2006, 2007 and 2008. Despite the improvements achieved with this capitalisation measure, the capital balance continues to be negative.

Source: DIPRES (2010) and OECD (2011b).

The Fiscal Responsibility Law not only institutionalised the rule. It also authorised the re-capitalisation of the Central Bank (Box 5). It created two investment funds to manage fiscal surpluses: the Economic and Social Stabilisation Fund (ESSF) and the Pension Reserve Fund (PRF). Finally, it obliges the government to provide information on contingent liabilities and DIPRES must inform annually on the total amount and characteristics of state guarantees. Given the size of contingent liabilities, these are taken into account when calculating the structural balance target.

A "second generation" fiscal rule (2011)

In 2010, the government appointed an independent commission of eminent economists and policy makers, known as the Corbo Commission, to advise on how the fiscal rule could be improved the fiscal rule (Box 6). This process led to several changes in the fiscal rule – which became known as the "second generation" fiscal rule. In particular, the creation by law of an independent Fiscal Advisory Council – which is discussed below, the term "structural balance rule" was also replaced by "cyclically adjusted balance rule".

Latest reforms of the fiscal rule (2015)

In 2015, the government introduced two additional changes to the cyclically adjusted balance rule. First, it simplified the calculation of the adjusted balance indicator, by eliminating the adjustment for the molybdenum income.[1] Second, it decided to use the inputs calculated by the independent panels to update the cyclically adjusted balance for the *current* year (before the reform, the inputs of the independent panels were only used to estimate the indicators for the budget of the following fiscal year).

Box 6. **Key Recommendations of the Corbo Commission**

Based on the recommendations proposed by the Corbo Commission, the Budget Office, DIPRES, presented the main elements of the second generation fiscal rule. The most relevant are:

- The term "structural balance rule" will be changed to the "cyclically adjusted balance rule" to better reflect its purpose. It will only be adjusted for cyclical incomes derived from GDP and from the price of copper and molybdenum.
- Other changes in incomes due to one-off factors will not be adjusted for.
- No cyclical adjustments will be made on interest gains on government assets. No adjustment will be made to "other incomes".
- The long-term price of molybdenum will be estimated on the basis of a moving average of the actual price for the last seven years.
- The rule will be calculated on the basis of the global balance of the central government.
- Formal mechanisms must be created to ensure an *ex post* compliance of the rule. A section will be incorporated into the annual report on evaluation of the financial performance of the public sector describing the impact of adjustments and deviations from initial projections in the established policy targets.
- An independent fiscal council is to be created aiming to improve the quality of the methodology and the estimates to compute the cyclically adjusted balance.

While this adjustment allows for better comparability between structural balances of different years, it could also increase the variability of the cyclically adjusted balance and the public expenditure for the current year, which could lead to adverse macroeconomic effects.

Recent evolution of structural balance targets

Following the crisis, the government declared its intention to move back to sustainable fiscal settings over the medium term. At the beginning of 2011, President Sebastian Piñera set a medium-term objective of achieving a structural balance by the end of his term in 2014. Taking into account that the initial deficit was larger than expected, this initial target was revised and a new objective was set to achieve a 1% structural deficit by 2014.

In a similar way, at the beginning of her term in 2014, President Michele Bachelet set a target of 0% deficit by 2018. However, given the macroeconomic circumstances, in 2015 the government postponed the objective, with a plan to gradually reduce the structural deficit by approximately 0.25 % of GDP per year, and aiming to achieve a structural deficit of 0.8% by the end of 2018 (DIPRES, 2015a) (Figure 9).

3.2. Fiscal Advisory Council

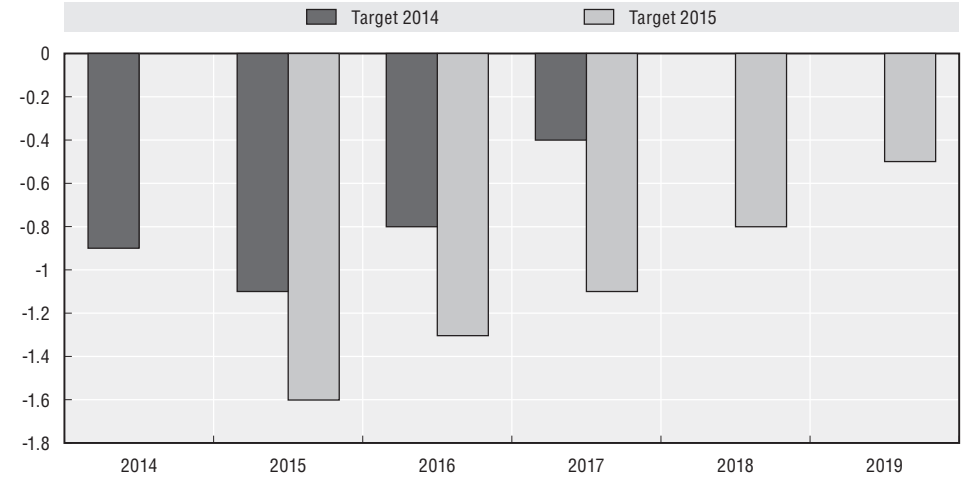
The Chilean Fiscal Advisory Council was created in 2013, following the recommendation by the Corbo Commission (Box 6). Its main mandate is to discuss, analyse and provide recommendations to the Ministry of Finance and the Budget Office, DIPRES, in matters related to the application of the cyclically-adjusted balance rule to the budget.

Specifically, the Fiscal Advisory Council has the following functions:

- Participate as an observer in the output gap and copper price panels;

Figure 9. **Structural balance target (2014 vs. 2015)**

% of GDP



Source: DIPRES, 2015a and Chile Ministry of Finance, 2014b.

- Verify that the mentioned variables are correctly reflected in the rule and its implementation, and takes position about the estimation of the cyclical adjustment to government revenue and balance prepared by DIPRES;
- Provide advice to the Ministry of Finance on specific aspects regarding the cyclically adjusted balance rule;
- Assess eventual methodological changes to the rule proposed by the authorities; and
- Verify mid-term projections of structural results included in the public finances report. The Fiscal Advisory Council issues minutes and press releases of all meetings and assessments carried out.

The Fiscal Advisory Council is composed of five members appointed by the Minister of Finance for terms of four year. They can however be replaced at any time. Members are typically academics and are not paid. It has no professional staff.

3.3. Other mechanisms for ensuring fiscal sustainability

Strong political commitment to fiscal sustainability

The political commitment towards fiscal sustainability is particularly strong in Chile, and while Presidents are free to set the fiscal target they like, they tend to be rather conservative. In addition, recent history has shown that Presidents (of different political affiliations) have not hesitated to postpone priorities or reduce their scope to accommodate for lower than expected revenues or catastrophic expenditure. For example, newly elected President Piñera changed his government programme to accommodate higher spending needs due to the 2010 earthquake, rather than absorbing this unexpected spending by increasing the deficit. In the same vein, President Bachelet had promised free education for all and is implementing a tax reform to finance this. But given the recent and foreseen structural slowdown in copper prices and economic growth, this promise has been reconsidered to only free education for the poorer 50% of the population.

Costing of new laws by DIPRES

Any new law submitted to Congress and which is expected to require funding must previously be costed by DIPRES, taking into account the medium-term financial implications

of the law. These costings are very influential given Chile's political culture in regard to fiscal responsibility.

Contingency reserve and in-year adjustments

The budget incorporates a contingency reserve. The amount of this reserve has been as high as 7.8% of total expenditures. The purpose of the contingency reserve is to fund legislation that the Congress may enact after the introduction of the budget. In particular, salary increases for government employees are finalised after the enactment of the budget in late December each year.

If financial conditions deteriorate during the year, DIPRES can unilaterally impose spending reductions and/or re-allocate funds between programmes. There is no need for Congressional approval for such in-year adjustments.

Control of Ministry of Finance over public borrowing

All debt issued by a public entity in Chile must be previously approved by the Ministry of Finance. The Ministry of Finance has full control over borrowing by public entities, including state owned enterprises and regional governments. Municipalities have budget autonomy, but need Congressional approval for borrowing, which implies approval by the Ministry of Finance as only the Executive can present laws. Finally, contingent liabilities (state guarantees) must be authorised by the Ministry of Finance. Since 2006, these are gathered in a register of contingent liabilities.

3.4. Recommendations on ensuring fiscal sustainability

The structural fiscal rule has been quite successful in smoothing public expenditure across the cycle, by forcing the government to save revenues due to cyclical upturns (such as high copper prices) Conversely, the government was able to draw from the ESSF Fund to finance a fiscal stimulus plan in 2009. The structural balance rule has also been quite successful in limiting budget deficits during short downswings, with the government taking immediate measures to counterbalance unforeseen reductions in revenues.

However, this strong emphasis on fiscal sustainability may come at the price of flexibility, which would be needed now that Chile is facing what seems to be facing the twin challenge of rising citizens' expectations and a longer-term slowdown in revenues, due to lower economic growth and a strong fall in copper prices. Changes in the fiscal targets and adjustments to the methodology for calculating the structural balance are frequent. For example, adjustments for molybdenum prices were included in the formula in 2005 and removed in 2015, adjustments for specific mining taxes were included in the formula in 2006 and modified in 2007, adjustments for the revenues of fiscal assets were included in the formula in 2008, and adjustments for other revenues were included in the formula in 2009). These changes may reflect the difficulties of calculating a structural balance, and the need of increasing room for manoeuver to overcome economic slowdowns.

Allow for clear escape clauses rather than modifying the target

In recent years, with the worsening of the economic situation, the fiscal target has been modified to accommodate the desired contra-cyclical policy. In the long term, this may reduce the credibility of the fiscal rule. It may be more desirable to have a stable fiscal target and clear escape clauses during downturns, than to change the fiscal target according to the economic situation. Such escape clauses should clearly specify the conditions under which

they can be triggered and require for the government to submit a plan on how to go back to the fiscal rule. In OECD countries which use such systems, these plans can either take the form of political commitments, or be also enshrined in legislation.

There are different reasons why countries establish fiscal rules. In some countries, which have long traditions of running fiscal deficits (even during good economic times), fiscal rules aim to limit these deficits and increase fiscal credibility. Fiscal rules are very often used in federal countries or monetary unions, to ensure policy co-ordination on public deficits and debts with sub-national governments or member countries (for example, the Maastricht rules in Europe, or the Fiscal Pact in Germany). Other countries implement fiscal rules to secure public savings and unlink public expenditure growth from cyclical variations (for example those due to the price fluctuations of natural resources).

In the case of Chile, one of the main objectives of the structural fiscal rule is to separate public expenditure growth from the cyclical variations of natural resources prices (in particular copper), and ensure that savings are carried out during booms, so that public expenditure does not need to be cut during slowdowns. Allowing for an escape clause during downturns would not threaten this objective and would increase transparency and predictability during downturns. Germany for example allows for limited exceptions to its debt brake rule (Box 7).

Box 7. **Germany's Debt Brake rule**

Prior to 2009, Germany's fiscal policy course was influenced by a long-standing constitutional requirement that "revenue obtained by borrowing shall not exceed the total of investment expenditures provided for in the budget" subject to exceptions "to prevent a disturbance of the overall economic equilibrium". The rationale for such a "golden rule" was that capital investment should promote economic capacity and thereby increase the serviceability of debt. Over the decades, however, the rule proved ineffective at slowing the build-up of debt or of dampening pro-cyclical fiscal policy.

In 2009, on the basis of groundwork by the Federal Ministry of Finance and a proposal by the Federal Commission, the proposal to replace the golden rule with a debt brake was approved by the German parliament and enshrined in the Constitution. The avowed objectives were to improve the sustainability of the national finances with strengthened fiscal co-ordination among federal and Länder levels while providing flexibility to deal with cyclical and demographic challenges. The core elements of the debt brake are as follows:

- **Balanced budgets:** Both the federal and *Länder* governments must balance revenues with expenditures in their budgets, as a fundamental principle. In normal economic circumstances (i.e. when the output gap is closed), "balance" is assumed to be met for the federal government when net borrowing does not exceed 0.35% of GDP. (This is approximately a threefold reduction in the latitude for borrowing, as compared with the former golden rule.) There is no such latitude in normal times for the *Länder*.
- **Symmetrical adjustments over the economic cycle:** Automatic stabilisers will operate freely and fully over the cycle. In other words, cyclical deficits may be run in a downturn, and cyclical surpluses must be run in an upturn. The technical determination of the stage in the economic cycle is handled in line with EU methodologies, and is dealt with (for federal purposes) under an Act and a technical ordinance. The *Länder* make their own implementation arrangements.

Box 7. **Germany's Debt Brake rule** *(cont.)*

- **Underlying, not artificial, budget position:** "Financial transactions" within government, such as the sale of an asset yielding one-off revenues, must be netted off from the figures so that the true underlying budget position is used.
- **Control and Correction:** Deviations, either positive or negative, from the permissible borrowing amount that arise during budget implementation are not simply forgotten about: They are booked to a standing "control account" which must be balanced over time. (Deviations arising from unanticipated cyclical changes are not so booked: it is assumed instead that these issues will be covered through re-calculated automatic stabilisers.) Redemption of the control account is required once it reaches 1% of GDP; however, to limit pro-cyclical effects, redemption may be deferred during a downturn, and is in any event capped at 0.35% of GDP even during an upturn.
- **Limited exceptions:** Additional borrowing is allowed to deal with natural disasters and exceptional emergencies beyond state control, and with severe consequences for the public finances. A majority of Bundestag members must ratify any such decision, along with an amortisation plan to repay the borrowings "within an appropriate time period".
- **Transitional arrangements:** Since the debt brake became effective in 2011, in the midst of the global financial crisis, additional borrowing latitude is allowed, but this must be phased out (i.e. the 0.35% limit for the federal government becomes fully effective) from 2016. For the *Länder*, the ban on structural borrowing will be fully effective from 2020 onwards.

Stabilise the methodology for calculating structural balances, and consider delegating this responsibility to an independent institution

While the projections of trend GDP and the reference (long-term) price of copper are carried out by independent committees, the methodology for calculating the cyclically adjusted GDP and balance is developed, implemented and regularly revised by DIPRES.

Variations in the methodology used to calculate the cyclically adjusted budget have been frequent in recent years, and are decided solely by DIPRES. In 2015, they were also supported by the Fiscal Advisory Council. Given the magnitude of the resulting changes in the structural balance, they have required changing the fiscal target to accommodate the new figures without incurring a severe policy change. For example, methodological changes in tax revenues and others from 2008 to 2009 had a +2.4% GDP effect on the initial year structural revenues (Marcel, 2012).

Having an independent institution responsible for the methodology – or at least, validating it – would increase the credibility of the rule. This function could be attributed to an independent Fiscal Advisory Council.

Introduce a control and correction mechanism

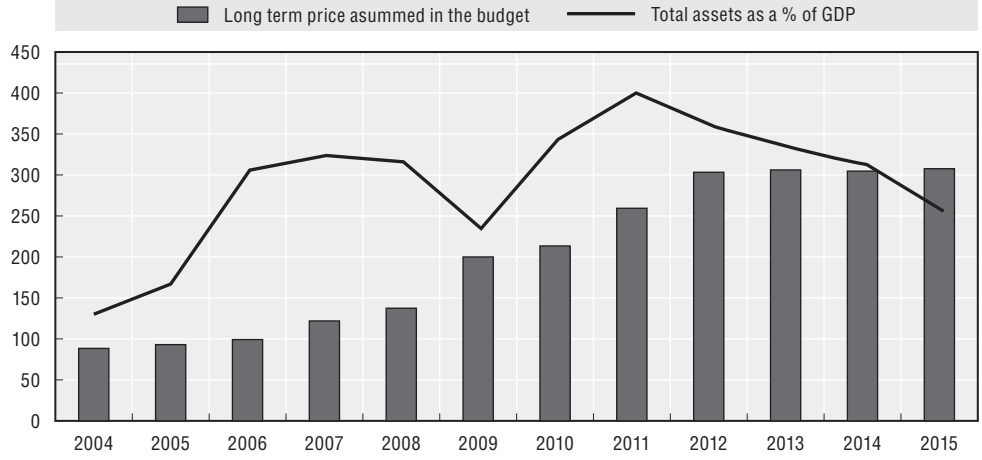
Today, there is no mechanism in the fiscal rule to correct for deviations, whether positive or negative, from the permissible deficit/surplus amount. Chile could envisage creating a "control account", on the same vein as in Germany (Box 7), to keep track of deviations and compensate them in subsequent years.

Reform the Fiscal Advisory Council to ensure its independence

Recent changes in the base and methodology for the calculation of the cyclically adjusted budget balance showed how sensitive the fiscal rule is to the estimates of the structural revenues. In particular, any overestimation of the structural revenues will translate into higher expenditures and a more expansionary fiscal position (Dabán, 2010). Given the formula used to calculate the cyclically adjusted budget, any change in key parameters, such as the estimated long-term copper price (Figure 10), will have a direct effect in the cyclically adjusted balance and in the level of expenditure. Therefore, quality and precision of the estimates, and coherence between the methodology used and the objectives of the fiscal rule are key priorities.

Figure 10. **Nominal copper price vs. long-term price assumed in the budget**

USD Cents per pound



Source: OECD, 2015c (OECD Economic Surveys: Chile 2015).

The implementation of the recommendations of the Corbo Commission, are outstanding steps towards improving the base and calculation of the fiscal rule. However, the still very young Fiscal Advisory Council, which was established by decree, remains weak with limited institutional independence. For example, the current government replaced all members of the Council upon assuming office.

Special efforts are needed to bring the Council in line with the OECD Recommendation of the Council on Principles for Independent Fiscal Institutions (Box 8). A first step would be to establish the Council on a statutory basis. The Council's mandate should be defined in law and could be broadened to include additional tasks, such as analysis of long-term fiscal sustainability, in line with common practice in other OECD countries (see Table 4). The Council should be given sufficient resources commensurate with its mandate, in particular to hire professional staff. Mechanisms should be put in place to encourage appropriate accountability to the legislature, including submission of the Council's reports to the Congress in time to contribute to relevant legislative debate, and council members' participation in parliamentary hearings (see OECD Principles 5.1 and 5.2).

The Fiscal Responsibility Law states that the budget balance target must be set by the President at the beginning of his/her mandate. There is no counterbalancing force to this decision, so the soundness of the fiscal target depends on the soundness of only one

Box 8. **OECD Recommendation Principles for Independent Fiscal Institutions**

On February 2014, the OECD approved the following twenty-two Principles for Independent Fiscal Institutions (fiscal councils and independent parliamentary budget offices). The most relevant principles for the Chilean case are summarised below:

Local ownership

1. IFIs require broad national ownership, commitment, and consensus across the political spectrum.

2. Local needs and the local institutional environment should determine options for the role and structure of the IFI.

Independence and non-partisanship

3. Non-partisanship and independence are pre-requisites for a successful IFI.

4. The leadership of an IFI should be selected on the basis of merit and technical competence, without reference to political affiliation.

5. Term lengths and the number of terms that the leadership of the IFI may serve should be clearly specified in legislation as should be the criteria and process for dismissal for cause.

6. The position of head of the IFI should be a remunerated and preferably full-time position.

7. The leadership of the IFI should have full freedom to hire and dismiss staff in accordance with applicable labour laws.

8. Staff should be selected through open competition based on merit and technical competence and without reference to political affiliation.

Mandate

9. The mandate of IFIs should be clearly defined in higher-level legislation.

10. IFIs should have the scope to produce reports and analysis at their own initiative, provided that these are consistent with their mandate.

11. Clear links to the budget process should be established within the mandate.

Resources

12. The resources allocated to IFIs must be commensurate with their mandate in order for them to fulfil it in a credible manner.

Relationship with the legislature

13. Legislatures perform critical accountability functions in country budget processes and the budgetary calendar should allow sufficient time for the IFI to carry out analysis necessary for parliamentary work.

14. The role of the IFI vis-à-vis parliament's budget committee (or equivalent), other committees, and individual members in terms of requests for analysis should be clearly established in legislation.

Access to information

15. IFI must have full access to all relevant information in a timely manner, including methodology and assumptions underlying the budget and other fiscal proposals.

16. Any restrictions on access to government information should also be clearly defined in legislation.

Transparency

17. Given that promoting transparency in public finances is a key goal of IFIs, they have a special duty to act as transparently as possible.

18. IFI reports and analysis (including a full account of the underlying data and methodology) should be published and made freely available to all.

Box 8. **OECD Recommendation Principles for Independent Fiscal Institutions** *(cont.)*

19. The release dates of major reports and analysis should be formally established, especially in order to co-ordinate them with the release of relevant government reports and analysis.

20. IFIs should release their reports and analysis, on matters relating to their core on-going mandate on economic and fiscal issues, in their own name.

Communications

21. IFIs should develop effective communication channels from the outset, especially with the media, civil society, and other stakeholders.

External evaluation

22. IFIs should develop a mechanism for external evaluation of their work.

Source: OECD (2014), Recommendation of the Council on Principles for Independent Fiscal Institutions.

Table 4. **Typical functions of independent fiscal institutions**

Country	Organisation	Functions					
		Analysis of long-term fiscal sustainability	Role in macro6 economic forecasts	Role in monitoring compliance with fiscal rules	Directly support legislature in budget analysis	Role in policy costing	Role in costing election platforms
Australia	PBO	●	○	○	●	●	●
Austria	Government Debt Committee	●	◗	●	○	○	○
Belgium	High Council of Finance	●	◗	●	○	○	○
Canada	PBO	●	◗	○	●	●	○
Denmark	Danish Economic Council	●	◗	●	○	○	○
Finland	National Audit Office of Finland	●	◗	●	○	○	○
France	High Council of Public Finance	○	◗	●	○	○	○
Ireland	Irish Fiscal Advisory Council	○	◗	●	○	○	○
Italy	PBO	●	◗	●	○	○	○
Korea	National Assembly Budget Office	●	◗	○	●	●	○
Mexico	Centre for Public Finance Studies	●	◗	○	●	●	○
Netherlands	Netherlands Bureau for Economic Policy Analysis	●	●	○	○	●	●
Portugal	Portuguese Public Finance Council	●	◗	●	○	○	○
Slovak Republic	Council for Budget Responsibility	●	○	●	○	●	○
Spain	AIReF	●	◗	●	●	○	○
Sweden	Swedish Fiscal Policy Council	●	◗	●	●	○	○
UK	Office for Budget Responsibility	●	●	●	○	●	○
US	Congressional Budget Office	●	◗	○	●	●	○
Total countries (no.)		18	18	18	18	18	18
● = Yes		16	2	12	7	8	2
○ = No		2	2	6	11	10	16
◗ = Other		0	14	0	0	0	0
Data not available		0	0	0	0	0	0
Total countries (%)		100%	100%	100%	100%	100%	100%
● = Yes		89%	89%	67%	39%	44%	11%
○ = No		11%	11%	33%	61%	56%	89%
◗ = Other		0%	78%	0%	0%	0%	0%
Data not available		0%	0%	0%	0%	0%	0%

Source: Von Trapp L., I. Lienert and J. Wehner (2016).

person. While setting the fiscal targets is seen as a political decision, they would certainly benefit from recommendations and/or approval from an independent Fiscal Advisory Council.

4. Aligning the budget with the strategic priorities of government

4.1. *Including new programmes in the budget*

Policy co-ordination

Funding of new programmes is mainly driven by presidential priorities. These are set out in the Presidential Programme. They are updated annually in the *May 21st Presidential Speech to the National Congress*, where the President presents what has been achieved in the past year and outlines the priorities for the coming year.

The General Secretariat of the Presidency (*Secretaría General de la Presidencia*), created in 1989, is in charge of co-ordination between ministries and with the Congress. Its main task consists of ensuring the implementation of the Presidential Programme, and in particular, ensuring the President's priorities are reflected in the budget. It is a key actor for co-ordinating multi-sectoral and multi-annual policies. It works closely with DIPRES and line ministries.

Ex-ante evaluation of new and reformulated programmes

In the year 2000, DIPRES introduced a standard form (*formato estándar*, FE) based on the logical framework, to standardise the information regarding programmes presented by line ministries during the budget process. During 2000-03, this form was made mandatory in order to request funds for new programmes, through a mechanism which was called the competitive fund (*fondo concursable*). Since 2003, the competitive fund is no longer used as such, but new and reformulated programmes must still be presented under this standard from and developed with the logical framework.

In 2008, DIPRES gave new impulse to *ex ante* evaluations of programmes applying for funds, through the creation of a division for providing technical assistance to institutions in formulating their programmes. During the 2008-10 period, the methodology was simplified and a web-based application was designed to provide technical assistance on-line. Objective criteria are established for the *ex ante* evaluation of programmes (diagnosis of problems, definition of the target population, objectives, strategy and use of funds).

In 2011, DIPRES implemented a further innovation: The "open window" *ex-ante* evaluation. This allows institutions to request and receive technical assistance as of April each year (i.e. two months before sending their formal request to DIPRES).

Since 2011, the Ministry of Social Development is responsible for implementing this *ex-ante* evaluation for social programmes, while DIPRES is still responsible for implementing these evaluations for the rest of the programmes. The Ministry of Social Development (MDS) was created in 2011, replacing the Ministry of Planning (MIDEPLAN) (Box 9). The main objective of this reform was to provide an institutional framework that guarantees co-ordination and coherence and hinder duplication of social development policy in government. Apart from strengthening social policy, the reform also aimed to increase evaluative information to allow informed decisions. Indeed, before any new social programme can go forward, it must perform an *ex ante* evaluation. In most OECD member countries, these functions are performed by the budget office.

Box 9. **Ministry of Social Development (MDS)**

Chile has a long history of planning, in particular in the areas of social development and social protection.

In 1990, Chile created the Ministry for Planning and Cooperation, in charge of designing national development plans, and co-ordinating policies for reducing poverty. In particular, in 2005, it was given the responsibility for creating, co-ordinating and promoting the Social Protection System in the whole country. In parallel, the Ministry of Planning started to carry out evaluations of public policies and programmes, in co-ordination with DIPRES and the Presidency.

In October 2011, the Ministry of Planning became the Ministry of Social Development (*Ministerio de Desarrollo Social*, MDS). The mission of the MDS consists of designing and implementing policies, plans and programmes for social development, with a special focus on eradicating poverty and providing social protection to vulnerable persons and groups, promoting social mobility and integration.

The MDS has two main functions: ensuring co-ordination, consistency and coherence of the policies, plans and programmes in terms of social development, both at national and regional levels; and evaluating investment projects which require state funding to determine their social profitability, and ensuring they respond to the strategies and policies of economic and social development of the country.

The MDS is divided into two sub-secretariats:

- **Sub-secretariat for Social Evaluation,** which is responsible for the design, co-ordination and evaluation of the government's social policies;
- **The Sub-secretariat for Social Services,** which co-ordinates the different social policies of MDS.

Source: Ministerio de Desarrollo Social website.

Ex-ante evaluations for social programmes, developed by the Ministry of Social Development assess three main points:

- The consistency of the programme with the government priorities (President's Programme) and the strategic objectives of the institution that presents it;
- The internal coherence of the design of the programme to achieve its stated objectives (relation between the objectives, the target population, the strategy); and
- Accountability mechanisms in place, such as the indicators which will be used to assess performance.

The Ministry of Social Development also monitors existing social programmes to ensure they comply with their objectives. Non-social programmes are evaluated *ex-ante* and monitored by DIPRES.

The results of the evaluations carried out by the Ministry of Social Development are public, and gathered in the Integrated Database of Social Programmes (*Banco Integrado de Programas Sociales*).

4.2. Medium-term perspective

In 2000, DIPRES started maintaining baseline projections of government revenue and expenditures for the next three years. The aim is to keep these projections constantly up to

date. These are formally reviewed twice a year: In May, when information on the execution of the previous year's budget is available, and in late September, when the budget bill and the official macroeconomic projections are incorporated into the projections for the following year.

However, projections are only presented to the Congress and shared with line ministries at a very aggregate level (Table 5): i) the level of aggregate expenditure permitted by the budget balance rule or (in the present context) target, given projected revenues; and ii) the level of committed expenditure (*gasto comprometido*), which is often referred to in other countries as "baseline" expenditure. The fiscal space is the difference between these two levels.

Table 5. **Medium-term fiscal projections of Central Government (2016-19)**

CLP million 2016 and percentage of GDP

		2016 Draft budget bill	2017 Projection	2018 Projection	2019 Projection
(1)	Total actual revenues	34 858 785	37 038 750	39 855 003	42 536 101
(2)	Total committed expenditure	40 277 024	42 371 429	44 193 401	45 386 623
(3)	Cyclically adjusted revenues	38 138 472	40 347 144	42 707 309	44 962 742
(4)	**Target cyclically adjusted balance (% of GDP)**	**-1.3**	**-1.1**	**-0.8**	**-0.5**
(5)	**Expenditure compatible with target**	**40 277 024**	**42 164 547**	**44 055 488**	**45 880 798**
(6)	**Expenditure difference (fiscal space) (5)-(2)**	**0**	**-206 883**	**-137 912**	**494 175**
(7)	Expenditure difference (USD million)	0	-296	-197	706
(8)	Expenditure difference (% of GDP)	0	-0.1	-0.1	0.3
(9)	Actual plan compatible with target (1)-(5)	-5 418 239	-5 125 797	-4 200 485	-3 344 697
(10)	**Effective balance compatible with target (% GDP)**	**-3.2**	**-3.0**	**-2.3**	**-1.8**

Source: DIPRES, 2015a and 2016 Budget Bill.

Indeed, DIPRES fears that sharing more disaggregated estimates would create a sense of commitment to the future budgetary funding levels for ministries and institutions concerned. For this same reason, forward estimates are largely prepared within DIPRES, with limited involvement from the spending institutions. However, it is often in the spending institutions that the greatest understanding of expenditure dynamics is to be found. Developing more of a partnership in the preparation of the estimates might therefore be a key means of improving their quality.

The medium-term expenditure projections document is not used as a tool for resource allocation: DIPRES uses it to evaluate the overall trend in public revenue and expenditure to see how the trend is compatible with the over-arching goal of maintaining the structural fiscal rule. As such, the document assists in determining the availability of total resources. The May update provides guidance on resource availability until the independent panels on the structural balance meet in August to finalise the level of resources available. There is no reconciliation between the projections from year to year in the public documents.

4.3. Programme budgeting

Format of budget submissions

In the year 2000, DIPRES designed a standard form based on the logical framework (*metodología de marco lógico*), for submitting requests for funding new programmes or increasing funding for existing programmes. This also separated baseline expenditure (*gastos inerciales*) from new programmes. This has now become a permanent requirement

of the budget formulation process, requiring ministries and agencies to provide key outcome and output information on all new programmes to be financed.

All the funding requests (both for social and non-social programmes) are scrutinized in detail by DIPRES.

Operational programmes vs. budgetary programmes

While the programmes defined through the budget submissions are defined in terms of related outcomes and outputs, the programme classification included in the budget itself is often not. Budgetary programmes pay more attention to organisational criteria than to the objectives of expenditure, and differ considerably from the classification included in the performance management system (see Section 7). These differences reduce the link between government priorities and budget allocations, and undermine the value of the budget as an instrument for expressing allocative choices.

Only a small share of the budget corresponds to programmes as traditionally understood in a programme budgeting context in the sense that these programmes do not necessarily reflect groups of related outputs which share a common outcome. For example

- The programme structure of the budget does not provide a sufficiently detailed classification of expenditure by objective. The budget programmes themselves are generally very high level, and there are no sub-programmes.
- The transparency of the allocation of resources to policy objectives is blurred by the inclusion of large amounts of money in programmes which represent transfers that are paid by the organisational unit concerned to other organisational units, for objectives which are covered by other programmes.
- The programme classification of expenditure in the budget is not accompanied by any statement of the objectives (intended outcomes) or key services (outputs) of the programmes.

The structural differences between the programmes included in the budget and the format of budget submissions have the result of separating the entity's strategic planning from its budgeting function. In a well-designed programme budgeting system, the strategic framework should be integrated with the budget via the budgetary programmes. Concretely, entities should be required to specify the objectives (intended outcomes) of every budgetary programme, and to develop performance indicators for each programme. However, in Chile performance indicators are linked to the strategic products rather than to budget programmes, and the objectives of the budget programmes are not specified.

Reforming the structure of the budget towards programme budgeting is an ambitious undertaking. France for example fundamentally reformed its budget structure, enacting in 2001 a new organic budget law structured along missions, programmes and actions (Box 10).

Box 10. **French programme budgeting system**

In 2001, France enacted a new organic budget law including a well-defined programme structure, shifting budget classification from nature of expenses to public policy objectives. According to this new approach, the budget must be divided into missions, programmes and actions:

Box 10. **French programme budgeting system** *(cont.)*

- A **mission** covers a series of programmes designed to contribute to a specific public policy. A mission can involve a single ministry or several ministries. The Parliament cannot change or adjust the Missions. It has to accept the budget allocations proposed by the executive government and has power only to vary the allocation between programmes.
- A **programme** covers a coherent set of activities of a single ministry targeted to a specific public policy objective. If more than one ministry participates in a large public policy, each of them should have a separate Programme, covering its own responsibility in that matter, and ensuring coordination. Thus a programme corresponds to a centre of responsibility. Accordingly, for every programme, a programme director is appointed. All the resources from the State Budget should be allocated and spent within a Programme. In a similar way, resources allocated by the Parliament to a particular programme cannot be spent by the ministers for another programme.
- An **action** covers a set of operational means to implement the programme. The budget breaks down resources allocated to the actions of each programme; however, this break down is indicative and not committing. There is indeed a high degree of freedom for expenditure choices for ministers, in order to allow the Programme to reach its forecasted performance. However, there is one exception to this increased freedom: Appropriations for personnel are not indicative but binding, in an asymmetrical way: Personnel appropriations can be used for other purposes, but appropriations for other purposes cannot be used for personnel costs.

The Organic Budget Law prescribes an extensive performance reporting process to integrate performance information in the budget system through the following two types of mandatory budget documents: annual performance plans (*projets annuels de performances, PAP*) and annual performance reports (*rapports annuels de performances, RAP*). For a given mission, the PAP provides a detailed description of its purpose, goals, policy targets and performance indicators. As part of the annual budget act, the PAP documents are forward looking and are meant to contribute to the public debate about the costs and benefits of public policy. The RAPs are published in the first quarter along with the budget review act; they focus on performance achievements and provide detailed information on programme implementation and results. The RAPs are thus backward looking and tend to contribute to the public debate on the administration's performance.

Source: Loi organique relative aux lois de finances 2001.

4.4. Use of budget restrictions and annotations (glosas)

The content of the Chilean budget law is very detailed compared to other OECD countries with more than 4 000 line-item appropriations (Table 6), and comprises a large amount of annotations for each budget chapter that further restrict their use.

Line-item appropriations are the most detailed level of spending mandated by the legislature. Depending on the country, the level of line-items may be as specific as financial inputs (e.g. travel), or more aggregated at the programme or agency level. The existence of many line-items often constrains managerial flexibility by detailing the specific inputs that can be used for specific areas. Relaxing central input controls can not only increases the effective use of resources, but with concomitant management reforms can foster accountability for results.

Table 6. **Number of line-item appropriations contained in the budget**

Below 300 line items	Between 300 and 1000 line items	Between 1000 and 2000	More than 2000
Austria	Australia	Denmark	Chile (> 4 000)
Canada	Czech Republic	Estonia	Spain (16 700)
France	Greece	Norway	Japan (23 000)
Italy	Finland	USA	Turkey (> 40 000)
Korea	Hungary		Portugal (> 40 000)
Netherlands	Ireland*		
Poland	Israel		
Slovak Republic	New Zealand		
United Kingdom	Slovenia		
	Sweden		
	Switzerland		

* The statistical data for Israel are supplied by and under the responsibility of the relevant Israeli authorities. The use of such data by the OECD is without prejudice to the status of the Golan Heights, East Jerusalem and Israeli settlements in the West Bank under the terms of international law.

Source: OECD, 2014.

Chile's budget is divided in 26 portfolios (*partidas*), which correspond to line ministries, the Presidency, Congress, Judicial power and Supreme Audit Institution. Each portfolio is divided into chapters (*capítulos*: Almost 200 in total) which correspond to sub-secretariats. Some large organisations with a nationwide network divide their appropriations among several regions, i.e. each region is treated as a separate chapter. Each chapter contains one to ten programmes (*programas*). Finally, each account is divided into revenues (budgetary revenues and fees or transfers received) and expenditure. Expenditures are classified into personnel expenditure, purchase of goods and services, current transfers (subdivided into all the different recipients), purchase of non-financial assets (subdivided into vehicles, machines and equipment, computer equipment and software), capital transfers (subdivided into all the different recipients), debt service and liquidity. All these add up to more than 4 000 budget lines.

Restrictions on budget appropriations

Appropriations are considered maximums, i.e. there is no obligation to spend all appropriated funds. There are a number of restrictions for each account. These are common to all accounts and include a maximum amount that can be spent on four items of expenditure: Overtime, travel, training and consultants. The amount of the restriction originates with DIPRES in the budget proposal presented to Congress. The budget also contains a ceiling on the number of staff (posts) and the number of vehicles that each ministry and agency may have.

Budget annotations

In addition to the above mentioned restrictions, Chile's budget law has an important number of annotations (*glosas*). These are restrictions for specific appropriations. They generally earmark part of a larger appropriation for specific projects. These annotations are discussed with line ministries, but usually originate in DIPRES. They refer to a broad group of subjects and include very detailed instructions on how the resources should be spent (e.g. particular information and reporting requirements, type of expenses that are covered, limit to the number of goods or services that can be purchased, and specific procurement conditions). In some cases, they also contain more substantive provisions about the characteristics and targets of the programmes (e.g. definition of recipients and type of benefits).

These annotations serve as a tool to follow up and monitor expenditure for programmes of particular relevance. They can be viewed as a pragmatic approach to the lack of true "programme budgeting" (i.e. lack of correspondence between the operational programmes and the budgetary programmes), as they describe how these resources are to be used. But even then, these annotations do not specify the causal chain between the actions and the planned results, nor provide indicators on the situation it aims to address or the targets of the policy.

The use of these annotations has increased in recent years, and it is often criticised that the budget is used as a fast track legislative tool to introduce legislations which are of particular interest to the President, minimising the possibilities of debate in the Congress. This was for example the case for the new free higher education policy: An annotation in the 2016 Budget Law determines that higher education would be free for the 50% of the population with lower income, studying in specific type of institutions (for example non-profit institutions). This trend to broaden the scope of the budget law to substantive legislation for parliamentary reasons is shared – and often criticised – in other OECD countries.

4.5. *Recommendations on aligning budget with medium-term strategic priorities*

Make better use of the medium-term expenditure framework (MTEF) as a tool to identify fiscal space

Political decisions on spending priorities are taken by the President, and the strong centralisation of the budget process in the hands of DIPRES facilitates the alignment of the budget with these priorities. The Ministry of the Presidency plays a key role in co-ordinating presidential priorities, and has extensive working relations with DIPRES. DIPRES maintains a comprehensive MTEF that is updated in real-time. However, it is only an internal document.

MTEFs can strengthen the budget office's ability to plan and enforce a fiscal path. They also help offset the annual focus of budgets, which tends to impede effective expenditure management decisions on resource allocation covering a number of years. Many policies require an extended time horizon, such as large capital projects, new programmes and organisational restructuring. The forward estimates of spending beyond the budget year make clear the medium-term implications of budget decisions. Most OECD countries have introduced MTEFs into the annual budget preparation process.

In a fiscal consolidation context, if the forward estimates show a spending increase in excess of the fiscal objectives, compensating reductions can be introduced into the forward estimates and clearly communicated to the line ministries.

While DIPRES fears that sharing the MTEF with line ministries may be understood as a commitment for future funding, in a downsizing environment, it could on the contrary be a tool for preparing line ministries to a slower growth in their budgets. This would put agency managers in a better position to plan their operations, as they have some indicative level of funding beyond the next budget. This would require a significant change in culture given Chile's historically centralised budget process.

With the prospect of slower economic growth, the challenge is now to create sufficient fiscal space to finance new priorities. This requires making better use of existing information on performance and evaluation of programmes to phase out previous priorities or inefficient programmes.

Gradually move towards a more comprehensive programme structure of the budget

Over the years, the budget has become a long and cumbersome technical document, which is difficult for parliamentarians and citizens to understand. Moving towards a programme budgeting system, with clear targets, would help giving clarity to the budget. It would also allow reducing the number of budget lines, giving more room for manoeuvre to managers in line ministries while holding them accountable for achieving the targets rather than complying with input mix.

In moving towards programme budgeting, special consideration should be given to:

- Budget programmes should be designed to be as useful as possible as a tool for expenditure prioritisation and for the integration of budgeting and strategic planning.
- Giving priority to programmes that have particular political goals;
- Ensuring the programme structure provides a detailed classification of expenditure by objective, by i) breaking up certain highly aggregate programmes into two or more programmes, and ii) by introducing sub-programmes;
- Reviewing programmes to ensure that they are defined as groups of outputs with common outcomes;
- Identifying more clearly the specific objective (intermediate outcome) of each programme;
- Linking relevant outcome and output indicators to each programme and sub-programme.

Some line ministries in Chile have successfully experimented moving towards programme budgeting, and this small scale experimentation could be used as a starting point to scale up the experience. In 2014, for example, the Ministry of National Assets (*Ministerio de Bienes Nacionales*) identified three main lines of action: Property regulation, management of public assets and land registry. It therefore created four programmes: One for each of the above mentioned activities and one for fixed and non-attributable costs. This practice can still be improved by attributing all costs to operational programmes.

Define what subjects can be regulated in the budget law, and what subjects should be in permanent legislation

While annotations are useful tools to compensate the mismatch between the programme structure of the budget and operational budgets, their use for more substantive policy making may be criticised. Chile should define what could be ruled by annotations in the budget law, and what issues should be have a separate discussion in Congress, and be included in permanent legislation.

5. Budget discussion, approval and transparency

5.1. *Parliamentary discussion and budget approval process*

Legislatures are constitutionally mandated to hold governments to account. However, the role of the legislature in the budget process, and in particular its amendment powers, varies across OECD countries (Box 11).

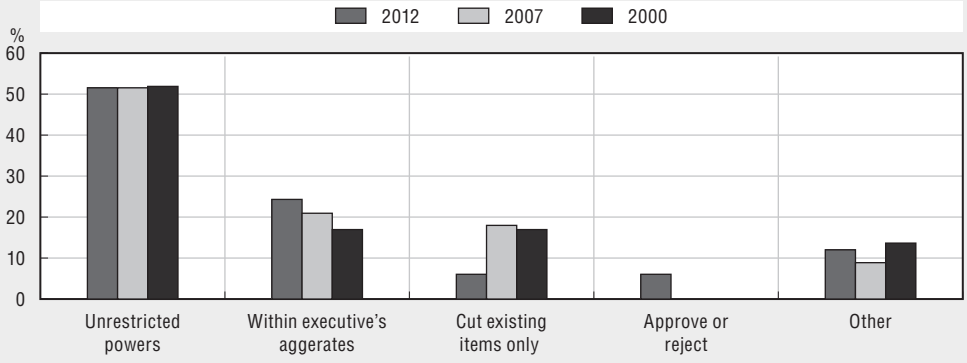
Limited amendment powers

The role of the Chilean Congress during budgetary discussion and approval is very limited despite recent reforms (Box 12). As discussed earlier, the Chilean Constitution imposes strict limits on Congress in regards to budgetary matters. The Congress only has the right to decrease expenditures proposed by the executive, and which are not determined

Box 11. **Legislature's budget amendment powers in OECD countries**

The legislature's formal amendment powers may be defined as unrestricted, restricted or prohibited.

- **Unrestricted:** The legislature may increase or decrease the level of revenues and/or expenditures without the consent of the executive.
- **Restricted:** The legislature is only able to make budget amendments insofar as the budget balance (surplus or deficit) of the executive's budget proposal is unchanged; or, alternatively, the legislature may only amend downwards any aggregates, often requiring overall reductions in expenditure.
- **Prohibited:** The legislature may not make any amendments to the executive's budget proposal, and must either approve or reject the budget in its entirety (Wehner, 2006).



Note: Percentage of participating OECD countries (33 in 2012, 33 in 2007 and 29 in 2000).
Source: OECD (2014).

It is important to distinguish between formal powers of amendment, such as those outlined in primary and secondary law, and actual practice, reflecting customs and conventions. While legislatures may have formal legal powers to amend the government's draft budget, their actual use may be curbed for reasons including fiscal rules and mandatory spending. Consultation and bargaining during the budget formulation stage may also reduce the size of the legislature's actual amendments during the approval stage. Conversely, This can also serve to increase the legislature's *de facto* amendment power. And some countries, particularly those with Westminster based systems, are effectively restrained from using amendment powers as votes on the budget are considered as a vote of no confidence in the government.

in permanent legislation. It may not increase expenditures, and it may not reallocate expenditures between programmes. Similarly, the Congress cannot amend the economic assumptions or the revenue forecasts employed in the budget proposal. The lack of an independent fiscal institution or internal body for calculating key parameters would not allow it to do so.

Budget annotations (*glosas*) can be discussed in Congress, but can only be amended with the consent of the government. The Congress can only add an "information annotation", requiring the government to report periodically on how specific appropriations are being used and progress towards any targets.

Box 12. **Chilean National Congress**

Chile's National Congress is located in the coastal town of Valparaiso. It is a bicameral institution composed of a Chamber of Deputies and a Senate.

Until 2005, the Constitution provided for former Presidents to serve in the Senate for life after they left office, as well as for nine other members to be appointed to the Senate for eight-year terms on an "institutional" basis, including four nominated by the military. Since 2005, all members of the Congress are elected by popular vote following a binomial system (i.e. two members represent each constituency), and can be re-elected. At present, the Chamber of Deputies has 120 members serving a four-year term, and the senate has 38 members serving an eight-year term.

A 2015 electoral reform increased the number of members to 155 deputies and 50 senators, and changed the voting mechanism from binomial to proportional. The reform will start implementation in the 2017 election.

Limited consultation on reallocations by DIPRES during budget implementation

Budget reallocations within ministries during the implementation phase are frequent, and in most cases do not require Congressional approval. Despite certain limitations imposed by law, the Ministry of Finance has great autonomy to make reallocations within line ministries, compared to other OECD countries. There are examples of individual budget appropriations being doubled during the implementation phase without consultation with Congress. This serves to undermine the role of parliament in the actual allocation of public funds.

A Permanent Joint Committee on Budget and five sub-committees

The President presents the budget bill to the Chamber of Deputies before the end of September each year. There is no discussion of the budget in plenary session of either chamber of the Congress. The bill is automatically referred to the Permanent Joint Committee on Budget (a joint committee of both chambers of the Congress) (*Comisión Especial Mixta de Presupuesto*) composed of 13 Senators and 13 Congressmen. In the past, this committee was a temporary *ad hoc* committee formed each year and operating only for a short period of time immediately following the introduction of the government's budget proposal. In 2003, the Budget Committee was institutionalised as one of the permanent committees of the Congress and operates year-round since.

During the first week of October, the Minister of Finance introduces the budget by making an address to the Budget Committee highlighting the state of the economy and major policy decisions contained in the budget. The following day the budget director makes an address to the Budget Committee highlighting the various technical aspects of the budget. After these introductory presentations, the Budget Committee divides into five sub-committees, each focusing on a different set of ministries. The scrutiny of the budget proposal takes place in these sub-committees. Each ministry and agency is examined during a four-week period. The sectoral minister and the heads of every agency under his/her responsibility attend the examinations. Following these examinations in sub-committees, the Committee reconvenes in plenary session and the conclusions of each sub-committee are discussed. As a rule, the Committee endorses the findings of the sub-committees.

Approval process

The budget is first referred to the Chamber of Deputies where it is discussed and then approved in a series of ministry-by-ministry votes, and then to the Senate. Traditionally, only a few topics were debated in Congress and the approval was rather fast. Today, discussions in Congress are much more extensive, and the budget is subject to significantly more negotiations than ten years ago. Numerous amendments are proposed at this stage by members of the Congress, some are dismissed as out of order and others are voted down by the government's majority. If the votes from both chambers do not coincide, a special committee of both houses is formed. This special committee will make a proposal which must be voted without amendment in both chambers.

The entire discussion and approval process cannot exceed 60 days (Table 7). If the Congress does not approve a budget by 30 November, the original government proposal becomes law. However, this has never occurred and would appear to be considered politically unacceptable. This opens the way to behind-the-scenes negotiations whereby the government itself decides to introduce amendments to the budget that are desired by Congress. Similarly, members of Congress have conditioned their vote on unrelated legislation upon desired changes in the budget, or threatened to reduce to one thousand pesos appropriations that are particularly sensitive for the government. The frequency of such behind-the-scenes interventions is, however, said to be rare. The Congress can also place restrictions on individual appropriations, for example by mandating that a certain part of the total appropriation be spent on a specified activity. This respects the constitutional provision that the total appropriation not be increased and at the same time demonstrates the will of the Congress. These restrictions are, however, also rare.

Table 7. **Congressional budget timeline**

Last day of September	Budget proposal presented to the Congress Budget referred automatically to the Permanent Joint Committee on Budget
First week of October	Minister of Finance makes policy address to the Budget Committee Budget director makes technical address to the Budget Committee
October-November	Budget Committee forms five sectoral sub-committees to scrutinise the budget proposal
Mid-November	Budget protocol signed between Budget Committee and DIPRES
1st January	Start of Fiscal year

Budget "protocols"

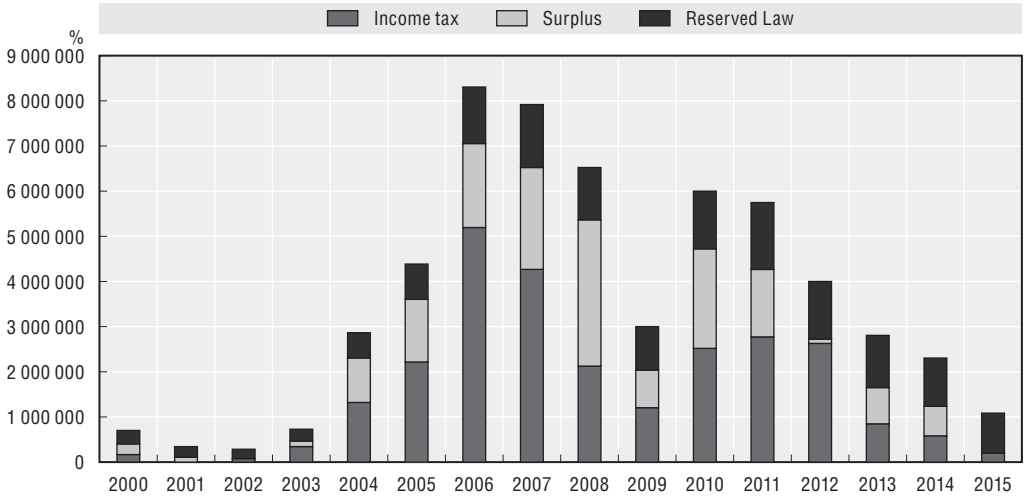
Since 1997, the Budget Committee and DIPRES have agreed on a Memorandum of Understanding (*Protocolo*) at the end of each budget approval cycle. This is not legislated but is rather a signed and formalised political document between the Congress and the government. The 2015 *Protocolo* is six pages in length and includes actions to be undertaken by the Ministry of Finance/DIPRES and specific line ministries. For example, it states that the Ministry of Finance will complement the resources available to finance investment projects for health through budgetary reallocations, and that the Ministry of Defence will present a bill to strengthen civil defence institutions. Other actions include studies, evaluations and reports to be undertaken by line ministries.

These budget protocols are not binding and cannot be enforced by the Congress. However, they are a key negotiating instrument to reach agreement during the budget approval process. The government (DIPRES and line ministries) does not carry out all the commitments included in the protocol, but a large proportion of them are implemented in order to increase support for other presidential initiatives that need Congressional approval.

5.2. Budgeting for the military

One of the legacies of military rule in Chile is that the military receives 10% of the sales of the government-owned copper mining company (CODELCO) to finance defence material and capital goods. These resources are transferred in similar shares to the army, the navy and the air force, in separate and secret special accounts. There is a minimum-revenue guaranteed by the Reserved Copper Law (*Ley Reservada del Cobre*): If resources do not reach this minimum, a budgetary appropriation must be made to cover the difference. However, there is no celling or maximum amount to be transferred to the secret accounts. This resulted in very significant transfers to the military during the boom years for copper prices (Figure 11).

Figure 11. **Total transfers from copper extraction to the central government (2000-15, USD thousand)**



Source: Data provided by DIPRES, 2016b.

These special characteristics of the off-budget earmarked funds for the military lead to inefficiencies and suboptimal allocation of resources. There is an arbitrary, permanent and invariable distribution of resources, which are not discussed or approved by Congress, and which does not take into account the real needs of the national defence sector. In addition, its rigid design does not allow effective prioritisation within the military sector and with the other sectors of the administration. There is also a complete absence of regular and objective evaluation and reviews, and there is almost no oversight or accountability for the use of these earmarked funds. In addition, resources are not managed in a transparent manner and documents are not accessible. Reserved Copper Law expenditure information is reported (aggregated in one general line item) only since 2003.

Conscious of the great limitations of the current system, the Chilean Government has attempted several times to abolish the Reserved Copper Law. In particular, the last two Presidents presented specific bills to the Congress in this regard. However, none of them were successful in their objective.

5.3. Parliamentary support and citizen engagement

The Budget Advisory Unit

One of the main obstacles for congressional involvement in the budget process is often the lack of capacity of members of parliament to understand and analyse the budget,

which is a very technical and long document. It is therefore important for legislatures to rely on experienced staff and expertise to exercise their oversight functions properly.

In 2003, together with the creation of the Permanent Joint Committee on Budget, the Senate and the House of Representatives joined forces and hired five experts specialised in budget issues to support the work of the Permanent Joint Committee on Budget.

The functions of this Budget Advisory Unit consist of providing technical support to the Permanent Joint Committee on Budget and its sub-committees, including analysing the budget proposal and related documents submitted by the government. All the reports produced by the Budget Advisory Unit are publicly available.

The work of the Budget Advisory Unit is however hampered by restrictions on access to some key assumptions and some data, especially at disaggregated levels. In addition, the Budget Advisory Unit lacks sufficient capacity, which leads to a limited scope and depth of analysis, and to some extent, a dispersion of the topics analysed.

Civil society participation in the budget discussions

As discussed earlier, the role of civil society has increased in the last decade, and many more stakeholders participate in political debates. Civil society organisations have flourished, analysing presidential programmes and monitoring their implementation. They only focus on the budgetary issues to a very limited and secondary degree. They find the budget information "too technical," and thus difficult to use. They call for a more digestible "citizen's budget".

5.4. Transparency and reporting

Chile has made great progress in increasing transparency. Since 2002 Chile committed to following OECD best practices in transparency. Documents and databases related to the costing of new initiatives and laws, the cyclically adjusted GDP and balance, the budget proposal, budget implementation, *ex post* evaluations and performance indicators are now available (Table 8).

However, key assumptions and disaggregated data are not made available in certain instances, which then make independent replication of DIPRES's calculations difficult for external analysts.

Contingent liabilities

Since 2007, DIPRES publishes a report on contingent liabilities yearly. The law does not specify a calendar. In practice, DIPRES requests information to the relevant agencies in September and the report is published in December. This report carries out sensitivity analysis on minimum income guarantee on concessions, state guarantee on debt of state owned enterprises, guarantee of higher education loans, state deposit guarantee, Chilean Economic Development Agency (CORFO) hedge fund risk and small business guarantee fund, and guarantees of the pension system.

Budget reports

A monthly report is prepared on the revenues and expenditures of the government. This is audited and is available 45 days from the close of each month (Table 8). The report specifies revenues and expenditures at a highly aggregated level. For example, expenditures are not classified by government organisations which are only published on a quarterly basis.

Table 8. **Public finances reporting**

Type of report	Content	Frequency
Budget execution monthly report	Total central government revenues and expenditures (economic classification), balance sheet	Monthly
Budget execution quarterly report	Total central government revenues and expenditures (economic classification), balance sheet, adjusted balance, tax expenditure, additional information on revenues, changes and balances of FEPP, FRP and FEES, gross public debt	Quarterly
State owned enterprises financial report	Assets and liabilities balance, by enterprise; income statement by enterprise, consolidated	Quarterly
Public finances statistics	Including municipalities, state owned enterprises and net public debt	Annually (July/August)
Public finances report	Draft budget law, public sector financial projections, central government assets and liabilities, improvements in quality of expenditures, tax expenditure	Annual (first week of October)
Contingent liabilities report	Current situation and projections, management of contingent liabilities, fiscal position analysis	Annual (December)
Central government debt	Current situation and previous years, total amounts; detail by maturity, currency, creditor; medium-term projections	Quarterly
Evaluation of the financial management of the public sector, updating of projections	Evaluation of previous year's financial management of the public sector, updating of fiscal projections current year	Annual (June/July)
Public debt report	Gross and net debt of the public sector; gross and net debt of Central Bank; explanatory notes and additional information	Quarterly
Report on financial assets of Public Treasury		Monthly
Monthly execution report on Pensions Reserve Fund		Monthly
Monthly execution report of the Economic and Social Stabilisation Fund		Monthly
Quarterly report on Pensions reserve fund		Quarterly
Quarterly report on Economic and Social Stabilisation Fund		Quarterly
Cyclically adjusted balance indicator	Methodological aspects; results of the calculation of the cyclically adjusted balance (previous year); conclusions and challenges	Annual (first quarter after reference year)

Source: DIPRES (2015a).

Additional summary information on the government's financial assets and liabilities is also presented on a quarterly basis. These reports are publicly available. An annual financial statement is prepared and is available one month following the close of the fiscal year. As it is based on the audited monthly reports, this document is not specifically audited by the supreme audit institution. The annual report is publicly available.

5.5. *Recommendations on budget discussion, approval and transparency*

Capacity of Congress on budgetary issues could be reinforced, in particular by strengthening the role of the permanent budget committee.

While still modest, the Congress has gained influence in the budget process. Debates are more comprehensive, as they now cover all aspects of the budget. For example, the legislature has begun to scrutinize the economic assumptions, asking DIPRES to provide more detailed explanations or its projections and underlying methodology.

Congress now has a permanent budget committee and budget advisory unit, but its analytical capacity and access to information should be reinforced, to better support parliament.

Legislative oversight of the budget is critical to promoting fiscal transparency and accountability. There may be concerns however as to the impact of a strong legislature on

fiscal discipline. A growing number of OECD countries have addressed these concerns by giving the legislature new influence in setting and approving overall budgetary targets while ensuring that subsequent legislative decisions adhere to those constraints.

Consider clearly defining the boundaries of the budget law

Several important pieces of substantive legislation are typically introduced in Congress as part of the budget. Transparency and democratic debate could be enhanced by clearly defining the boundaries of the budget. Other legislation should be the object of a separate legislative process, allowing for proper debate and scrutiny by the corresponding parliamentary commissions.

Improve alignment of budgetary programmes with operational programmes to increase readability of the budget document

Congress and citizens have a difficult time linking budget allocations to specific policies and targets, which reduces their capacity to deliberate them in a meaningful manner. This is due to the fact that budgetary programmes do not correspond to operational programmes. Moving towards programme budgeting and improving the alignment of budgetary programmes with operational programmes would facilitate comprehension of the budget by Congress and citizens. This would help hold the government to account. Such a reform could be carried out progressively, starting with the more reform oriented ministries for example, and gradually incorporating more areas into the new budget structure.

Fully disclose key assumptions and disaggregated data

DIPRES consistently publishes reports and the results of *ex post* evaluations, but could improve in the disclosure of underlying data, assumptions and methodologies used to carry out certain evaluations.

Integrate the budget for the military in the regular budget process

The Reserved Copper Law on the military budget was enacted during a particular moment of Chile's history. With a quarter century of democratic rule now in place, it may be appropriate for Chile to reassess this law and the special treatment given to the military budget. In addition to the lack of transparency of this process, linking the military budget to the price of copper instead of actual needs is not an efficient way of allocating resources.

6. Budget execution: Flexibility, human resource management, cash management and accounting

6.1. Budget flexibility

The budget law is effective from the 1 January to 31 December. During this period, disbursements are made to each institution, as well as monitoring, re-allocations, and reporting on budget implementation.

Budget implementation act

Each year, DIPRES publishes a book of "Instruction for the execution of the public budget" (*Instrucciones para la ejecución de la ley de presupeustos del sector público*). This brings together all decrees and guidelines for budget execution for the current year. It is a very detailed and extensive document including specific authorizations, budget classification, and other relevant regulations (e.g. human resources, public procurement, public

investment, management, and capital markets). The book also includes budget flexibility rules (*normas de flexibilidad presupuestaria*), defining the competences to modify the budget during the budget year.

Pre-approval by Comptroller-General

A noteworthy feature of the Chilean system is that all expenditure – each and every transaction – must be pre-approved by the Comptroller-General of the Republic (Box 13) in order to ensure their "legality". This pre-approval, which is quite unusual in OECD countries nowadays, is justified by the lack of trust that line ministries would spend the money in a manner consistent with the enacted budget, and the lack of sufficient *ex-post* accountability mechanisms to ensure that line ministries have incentives not to misuse the funds. Chile could consider modernising this practice by moving towards more *ex post* monitoring of results rather than *ex-ante* legalistic controls.

Box 13. **The Comptroller-General of the Republic of Chile**

The Comptroller-General of the Republic is Chile's supreme audit institution. In constitutional terms, it is not an office of the legislature, but is rather considered a co-equal branch of government. The Comptroller-General is nominated by the President and confirmed by the Senate for a period of eight years with no possibility of renewal. The Comptroller-General must be less than 75 years of age. He/she can only be removed before then by being impeached for gross misappropriations of duties.

The Comptroller-General is also very active in publishing information on budgets and budget executions, and preparing "citizen friendly" publications on expenditure and programmes in certain areas.

Budget reallocations

Budget reallocations within year are frequent, and mainly driven and approved by DIPRES. While increasing total expenditure or reallocating funds from one ministry to another requires parliamentary approval, reallocation within ministries, reducing or cancelling spending or carrying over unused funds into the next budget year only require a decree by the Ministry of Finance. The only restrictions are that overspending, borrowing from future appropriations or reallocating funds from investment to current expenditure are not allowed.

If fiscal objectives so require, DIPRES can also impose reductions in budget allocations. While this reinforces budget sustainability, it reduces the capacity of line ministries and programme managers to anticipate their level of funding, and may not lead to the most efficient reductions.

6.2. Human resource management

DIPRES staff is generally viewed as one of the most qualified in the government, which is one of the main arguments used to justify the high level of centralisation of decision making power in DIPRES. This section provides a short discussion of human resource management issues, types of contracts and attempts at creating a professional public service to shed a light on the difficulties line ministries have in hiring and retaining qualified staff.

Two types of contracts: Planta and contrata

Chile's human resources management system offers two main types of contracts. The traditional contracts, known as *planta*, are highly inflexible. Employees under these contracts are hired for life. The other category is the *contrata* contracts. Under this more flexible framework, employees are hired on one-year renewable contracts, and external staff can be recruited at higher levels of hierarchy. These contracts are generally renewed, and it is common for employees to spend their entire career in the government in such renewable contracts.

The traditional *planta* contracts involve mainly older workers. Most public employees hired in the last 20 years are *contrata* employees. In 2005, about 55% of government workers were under the *planta* system and 45% under the more flexible *contrata* system. Today, these shares have inversed, with about 60% of employees under the *contrata* system, and 37% under the traditional *planta* system (Table 9).

Table 9. **Central Government employees by type of contract**

Type of contract	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014
Planta	90 316	89 454	87 119	86 069	86 352	85 547	84 387	85 024	84 819	85 085
Contrata	73 938	79 954	88 366	97 430	106 473	113 823	119 043	125 528	131 705	138 672
Código del trabajo	2 835	2 545	2 607	3 529	3 747	3 714	4 005	4 190	4 196	4 103
Consultants (*honorarios*)	64	64	37	24	14	9	11	13	14	9

Source: DIPRES (2015c), Estadísticas de recursos humanos del sector público (2005-2015).

The Chilean budget sets numerical ceilings for public employees. These refer both to *contrata* and *planta*.

This system is criticised in Chile and the need to reform it recognised.

Difficulties in attracting qualified staff

Chile faces difficulties attracting qualified staff, especially at senior levels. There are indications that the combination of low remunerations for technically complex jobs and a politicised working environment tends to deter well-educated and skilled people from applying. The introduction of the *contrata* represented a response to this. Another response has been the development of consultants (*honorarios*), for hiring highly qualified staff for short-term (less than a year) projects, at higher salaries. However, the higher salaries of the consultants are also associated with weaker labour rights than under the *planta* and *contrata* contracts, and their number remains marginal.

Public sector wage negotiations

Public sector wage negotiations follow usual labor market practices and are not regulated specifically in law. The negotiations are carried out by, on the one side, a public sector panel (*mesa del sector público*) representing all the sectors , and 15 unions (*Central Unitaria Trabajadores*, CUT); and on the other side, the government, represented by the Finance Minister, the Labor Minister, and the sub-Director of rationalisation from DIPRES.

Wages are negotiated for all sectors (e.g. municipal employees, universities, doctors, etc.), and only apply to *planta* and *contrata* employees. Results of wage negotiations are ratified by Congress at the end of December of each year.

Professionalising higher management

In 2003, following a political agreement between the government, the opposition and other relevant partners the Senior Public Management System (*Sistema de Alta Dirección Pública*, ADP) was created. This aims to create a more professional senior civil service, with compensations based on responsibilities, and a meritocratic framework. It implied a cultural change, from a system where senior public managers were nominated based on quotas per political party.

The National Civil Service Directorate (DNSC) is responsible for the management of the Senior Executive System, with a Senior Executive Council (*Consejo de Alta Dirección Pública*) in charge of guaranteeing the transparency, confidentiality and absence of discrimination during the selection process. It is chaired by the director of the National Civil Service Directorate and composed of four members nominated by the President and confirmed by the Senate. The selection process, which takes around four months, begins with the publication of the vacancy in the media. A specialised firm commissioned by the Council assesses the applications and prepares a shortlist for the Council or a designated selection committee (under the supervision of the Council). Professional competence, integrity and probity are some of the criteria used in the selection process. The Council then interviews the best candidates and prepares a final shortlist for the final appointment. Senior managers selected through the senior public management system are appointed for a three-year term, and can be renewed twice for the same period.

While this system has been successful in increasing the professional standard of senior public managers, it has not succeeded in creating a cadre of professional senior executives, protected from political turnover. Indeed, these managers remain in a position of "trust of the President", so large turnovers of senior managers are still frequent with changes of government. In addition, the system has an "escape clause": when a position is vacant, the President can nominate a substitute, which can stay in place up to one year, until a new formal recruitment process takes place. Proposals for reforming this are under study. In addition, this system only targets higher management and does not focus in creating a professional civil servant career path.

DIPRES is an exception to this high turnover of senior public managers, with only the Budget Director and a negligible number of senior managers traditionally being replaced by a new government. Pays are higher in DIPRES than in other ministries which, helps in attracting talent. In addition, the level of expertise needed and acquired in DIPRES is considered in Chile as higher than in line ministries, making it more difficult to replace staff. Heads of sectoral budget units (which mirror line ministries) in particular, which tend to be in their positions for many years and are much more stable than their counterparts in line ministries, are seen as particularly difficult to replace.

6.3. Cash Management

All government ministries, agencies and regional offices maintain their own bank account in a government-owned commercial bank, usually the *Banco del Estado*. There are 180 accounts, subdivided into about 5,000 sub-accounts, as separate sub-accounts are opened for each programme. Each entity makes its own payments from their sub-accounts. There is no central payment system.

The Treasury transfers money from its Single Fiscal Account (*Cuenta Única Fiscal*) main account to the 180 accounts in accordance with an official monthly schedule of revenues

and expenditures (apportionment) for each government ministry and agency. This schedule is prepared in January. It is then revised each month to adjust to the execution of programmes. The schedule is not publicly available.

The balances of these accounts represented 2.3% of GDP on the 31 December 2015. A notable improvement since the last budget review was carried out in 2004 is that DIPRES now has access to the information on these balances. It receives a daily report from the banks with the balances of each of the accounts.

6.4. Accrual reporting and accounting

There have been major improvements in Chile's accounting system during the last decade – moving from a cash basis system to a fully accrual basis system of financial reporting.

In 2010, Chile formally started a process to prepare the adoption of International Public Sector Accounting Standards (IPSAS). The objective was to implement IPSAS gradually and in phases. The first phase was putting in place a legislative framework that called for accrual basis reporting; the second phase was the development of a strategy and timeline for the transition; the third phase was the official adoption of IPSAS and the performance of an analysis of the gap between current practice and IPSAS requirements; the final phase refers to IPSAS implementation, preparing the accounts for different layers of government. During the last five years, Chile has implemented the first three phases. The last phase will start in 2016, aiming to fully apply IPSAS by 2019.

6.5. Recommendations on budget execution

Improve capacity of line ministries and ensure adequate development of managerial capacities and competences

While the trend in OECD countries consists of increasing managerial flexibility and devolving decision power to line ministries during the budget execution phase, this is not the case in Chile where DIPRES plays a primary role. The Chilean system places strong emphasis on inputs and legalistic controls, due to a lack of trust in spending entities, and insufficient accountability and enforcement mechanisms. However, the weak roll of line ministries, both in the formulation and in the execution phases of the budget may reduce allocative efficiency. Line ministries are responsible for defending and implementing public policies in their sector. As such, they can use their technical capacities and information to perform a better programme prioritisation and expenditure allocation. Lack of capacity of line ministries is often cited for justifying centralisation of budgetary decision making in DIPRES. But little is being done today to correct this situation; DIPRES would appear not ready to devolve these responsibilities.

As a first step towards creating the necessary conditions to decentralise some decision power to line ministries, the senior executive service should be reinforced.

Move from ex ante input control to ex post monitoring of results and accountability, enabling and empowering managers "to manage"

Devolving power over budget execution to line ministries requires moving from *ex ante* input controls to *ex post* monitoring and accountability mechanisms. Delegating some managerial authority to line managers over the use of budget funds and human resource management would contribute to a more dynamic management of the public service.

Delegation of budget and human resource management authority is critical to empower public managers and enable them to meet organisational goals.

Chile could start designing such mechanisms, and could consider small scale experimentation of delegating more decision making authority to those ministries and institutions which prove the most capable and reliable. This could generate an incentive for capacity building in line ministries, and a virtuous circle whereby line ministries would have incentives to comply with the rules and reach their targets, in order to receive further responsibilities. Accountability frameworks and capacity in line ministries can be built, but would require improving medium-term strategic design. However, this also requires a cultural change for DIPRES, especially in the sectoral units that mirror line ministries, to accept this new role and share power.

Create a single treasury account

Cash management should be reformed, unifying all public money in a single treasury account, not only for revenues, but also for expenditure. Line ministries would then authorise payments, and Treasury would execute these. This would generate important savings in bank fees, as well as earning interest from funds overnight.

7. Using evaluation and performance to improve resource allocation

7.1. Multiple types of evaluations

DIPRES has a well-developed but complex system for obtaining information on the performance of agencies and programmes, which combines performance measurement with evaluations. DIPRES began experimenting with performance indicators in the budget process in 1994. After more than 20 years, Chile has an advanced, robust and well established system for obtaining information on agency and programme performance known as the Evaluation and Management Control System (*Sistema de Evaluación y Control de la Gestión SECG*). The system's objective is to provide performance information and improve the quality of public expenditure in particular, resource allocation, execution and transparency.

The coverage of evaluations has progressively increased over time. The programmes and organisations to be evaluated are selected by a designated interministerial committee consisting of DIPRES, the Ministry of the General Secretary of the Presidency, and the Ministry of Social Development, in consultation with the Congress. Evaluations are then carried out by external evaluators (consultants or research institutions) contracted by DIPRES, who also provides the terms of reference and methodological guidelines. The unit in DIPRES running the evaluations is the Public Management Control Division (*División de Control de Gestión*), which reports directly to the Budget Director.

All final evaluation reports are made available to the Congress and the public, and their summaries are included in the budget information papers in the form of "executive minutes". DIPRES and the relevant ministry discuss the recommendations of the evaluations and agree on the specific actions (commitments) which should be taken in response to evaluation recommendations. This then becomes the subject of a formal agreement, the implementation of which is monitored in subsequent years by DIPRES.

The system's performance management and evaluation tools can be grouped in the following categories:

Monitoring and follow-up

This programme was initially launched in 1994 on a volunteer basis. By the 2013 budget, 154 agencies were participating and produced a total of 1 035 performance indicators.

Indicators and targets are proposed by the agencies, and reviewed by DIPRES, who assesses their technical standards and ensures that targets and goals are consistent with budget appropriations. Then the Budget Office and the relevant ministry discuss the performance indicators and targets that will be included in the supporting budget documentation. The selected performance indicators and goals are incorporated in the information reports which accompany the Budget Bill presented to the Congress. These indicators seek to evaluate performance on different dimensions including economy, efficiency, and effectiveness. They include process, output, intermediate outcomes, and outcome indicators. However, around 90% of the indicators are process and output indicators (2015).

Evaluations

There are three main types of evaluation currently in place:

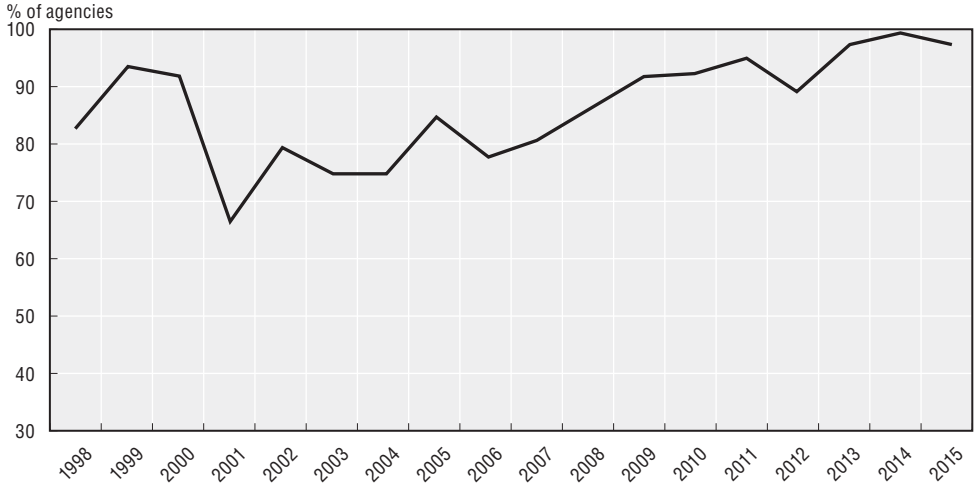
- **Evaluations of government programmes (since 1997):** The main element of these evaluations is the analysis of what has sometimes been called the "intervention logic" or causal chain of programmes. However, as will be further discussed below, the "programmes" which are evaluated are not the same as the programmes in the budget. These evaluations analyse the programmes in terms of design, processes, resource use, levels of production and short and middle term results.
- **Impact evaluations (since 2001):** The main focus of these evaluations is whether programmes have achieved their intended outcomes. This line of evaluation is strongly based on econometric methodologies (counterfactual groups) and uses primary information for this purpose (field work). **Institutional evaluations (since 2002):** which are often called "comprehensive expenditure evaluations" or "institutional expenditure evaluations" (*Evaluaciones Comprehensivas de Gasto o Evaluaciones del Gasto Institucional*). These evaluations look at specific institutions or sectoral groups of institutions. They examine a range of issues including the consistency of institutional and sectoral objectives, organisational structures, production and management processes, resource use, and service-delivery performance.

Institutional Wage Incentives Mechanisms

The Management Improvement Programme (*programas de mejoramiento de la gesión, PMG*) started in 1998 from an agreement with the public sector unions. It established a reward system for central government employees, in which bonuses are determined by organisational performance. The programme focuses on improving management processes within agencies, against a pre-established benchmark. It seeks to contribute to enhancing performance by improving the internal management processes of ministries, thus assisting agencies to achieve wider objectives and targets. In 2001, performance indicators were removed from the management improvement programme, which changed focus to assessing progress in managerial systems. These include for example: Human resources, quality of customer service, planning, control and territorial management, financial management, gender focus. Each of these areas is divided into systems, and progress in every system is measured in stages 1 to 4 or 1 to 6.

Today, about 95% of agencies achieve their goals, and receive 100% of the bonus (Figure 12). Such high achievement rates suggest that the targets are not useful and do not serve their intended purpose any longer. However, these bonuses often make an important share of civil servants' wages, (up to 8% of annual salary), and are now considered as entitlements. Reforming this would thus require creating a task group to re-think the system, without hurting civil servants' revenues.

Figure 12. **Compliance statistics**



Source: DIPRES.

7.2. Mismatch between budget programme structure and programme evaluation

Despite the well-developed evaluation and management control system, Chile still faces challenges to use the output of these evaluations to improve resource allocation and efficiency. Evaluations are mainly used to modify programme design and management, rather than for budget allocation purposes. A 2010 study shows that 37% of evaluations led to design or process modifications, 25% to "substantial" programme redesign, 24% to "minor" changes, and 7% to institutional reassignment of the programme[2] (Arenas and Berner, 2010). On the other hand, in the 2011 OECD Performance Budgeting Survey, Chile reported that budgetary consequences (budget increase or decrease, elimination of programme or budget freezes) when performance targets are not met are rare. In fact, in some cases, failing to meet the targets does not have any consequence at all.

Programme evaluation and budget formulation in Chile tend to be two separate arenas with little space for integration. Indeed, first, during the budget formulation process, little discussion takes place between budget sector analysts and line ministries about this subject. In most cases, political and technical reasons do not allow to eliminate programmes or to reallocate resources in response to programme performance. In addition, as identified in Section 4, the operational programmes that are evaluated do not correspond to the budgetary programmes. This undermines the value of evaluations as an instrument for supporting allocative choices. Moving towards a design of the budget where budgetary programmes correspond to operational programmes would allow improving the value and use of evaluations for allocation decisions.

7.3. Recommendations on evaluation and performance

Chile has a robust evaluation and control system, providing a great amount of performance information. This system is designed to support performance management in general. Evaluations which are carried out have broad objectives, with a heavy emphasis on improvements in policy, process and management. However, this evaluation system is not predominantly focused on serving the budget, and there is space for improvement in the way this information is used to guide resource allocation, having a positive impact on the efficiency and effectiveness of public expenditure.

Gradually move towards a more comprehensive programme structure of the budget

Section 4 analysed the misalignment between the operational programmes and the budgetary programmes, and the impact this has on the clarity of the budget document and the link between the annual budget and the longer term strategic objectives. This section showed that the mismatch between operational programmes and budgetary programmes also reduces the effectiveness of the evaluation system. Indeed, the conclusions of the evaluations are difficult to translate in budgetary choices. As mentioned in Section 4, moving towards a more comprehensive programme structure of the budget would also have positive impact on evaluation and performance.

Make better use of existing evaluations for budget allocations, and in particular, to identify saving options

Partly because of the misalignment between the evaluated programmes and the budget accounts, and partly because of a lack of culture for doing so, evaluations are not used in the day-to-day budget formulation process, and performance evaluations are not always used to identify saving options.

Spending reviews could be a powerful tool to strengthen the link between evaluation systems and budget allocation

Spending reviews are often used in OECD countries as a tool to give the government enhanced control over the level of aggregate expenditure, find fiscal space for new spending priorities, and improve expenditure prioritisation. Given the tight fiscal context that Chile has being facing during the last couple of years and the conservative forecasts for the years to come, such a tool could be a useful instrument to improve the efficiency and effectiveness of public expenditure. Furthermore, spending reviews could be a powerful tool to strength the link between evaluation systems and budget allocation, especially if it becomes a permanent feature of the budget process. In particular, it could have the following benefits:

1. Improve expenditure prioritisation (allocative efficiency). Spending review processes expressly recognise that substantial room for new priorities – while keeping aggregate public expenditure under control – can only be found through the willingness to prune back waste and cut ineffective, outdated or otherwise low priority services.
2. Improve control over the level of aggregate expenditure. Spending reviews are a tool specially designed to identify options and implement cuts on baseline expenditure, bringing the growth of baseline expenditure under control. A systematic spending review process could help Chile in the objective of finding adequate fiscal space for high priority new spending, such as education, while keeping control over aggregate expenditure.

3. Evaluation decentralisation and capacity building for the line ministries. DIPRES has a long experience in carrying out evaluations, but line ministries have a more precise knowledge of day-to-day activities and are in a better place to identify allocative efficiencies. A spending review, carried out by joint teams with staff from DIPRES and the reviewed ministry could help line ministries learn from DIPRES' long tradition with evaluations, and for DIPRES to build on the ministries' specific knowledge of the sector.

Even though there is no one-size-fits-all methodology for spending reviews, previous international experiences point out a common set of factors that are crucial when designing and implementing a spending review exercise (Box 14).

Box 14. **Key factors for implementing a successful spending review process in Chile**

1. Spending review should be a regular an ongoing feature of the budget process. Simultaneous consideration makes it possible for governments to adopt other high priority new spending proposals without increasing aggregate expenditure, by selecting additional savings options sufficient to fund the extra new spending. In other words, both allocative efficiency and aggregate expenditure restraint benefit from simultaneous consideration of new spending proposals and savings options. In addition, implementing a spending review as an ongoing feature of the budget process ensures that the scale of the spending review effort is calibrated to the government's budgetary objectives for aggregate expenditure (Robinson, 2014).
2. Clear definition of the scope of the spending review. There is not a unique way to implement spending reviews; they can be focused on efficiency and/or strategic savings; they can be selective (limited to a specific list of review topics) or comprehensive; and they can examine specific programmes, business processes used in the production of government services, or organisations (ministries and agencies). There is not one type of review that is *a priori* better than the other ones; they serve different purposes and have different strengths and limitations. However, a proper alignment between the objective of the government and the type of review implemented is a key success factor for the spending review exercise.
3. Political oversight and direction of the spending review process. Spending review is not a purely technical function; it should be under the direction of politically-appointed officials who are sensitive to the priorities of the Presidency. The overall management of the spending review process at the bureaucratic level by DIPRES – together, where relevant, other central agencies which play an important role in the budget process – is essential for its success.
4. Clear definition of roles in the spending review process. Taking into account the clearly centralised evaluation process currently in place, Chile could benefit from a joint spending review exercise, where line ministers can contribute with their particular knowledge of the sector and DIPRES can support and orient the process due to its long tradition with the evaluation and control system.
5. Ensure line ministries buy in. Increase efforts to promote the evaluation function within spending institutions could be a good strategy to increase engagement and support from line ministers. External evaluations are undoubtedly an essential part of the system; however, a limitation of external evaluation is that the institution being evaluated may not "own" the evaluation. Rather, it may regard the evaluation as an external imposition and, as a consequence, fail to make full use of its recommendations.

Box 14. **Key factors for implementing a successful spending review process in Chile** *(cont.)*

6. Develop standard terms of reference. Setting standard terms of reference to be followed by the spending review teams, including a defined set of questions or criteria to be applied in the search for strategic savings and whether there will be pre-set savings targets, are well known strategies to support the spending review implementation process.
7. Have a system of outcome evaluation (using existing relevant performance indicators) and efficiency analysis already in place. Chilean evaluation and control system is a strong base to build a spending review process, however improvements must be done to make this information more focused on providing information that is useful in the budget preparation process, as opposed to evaluations which are primarily focused on recommending policy and management improvements. A great emphasis is then needed on efficiency reviews to ensure their relevance for budget preparation.
8. Have a well-defined programme budgeting (see Section 4). A successful spending review depends in large extent on the MoF knowing exactly which programmes are being delivered by each spending ministry and how much is being spent on each, making the programme classification of the budget particularly relevant to programme review, and to the search for strategic savings (Robinson, 2014).
9. Implement the review at the right moment in the political cycle. Because cuts to existing programmes usually create some political resistance, the best time to carry out an in-depth spending review may be at the start of each presidential term of office. The best approach to the conduct of spending review may therefore be to carry out an in-depth spending review in the first year of each presidential term of office, plus more limited spending reviews in other years.

Source: Robinson (2014), OECD (2015a).

Improve the way efficiency issues are managed in the evaluation system

DIPRES could improve the way efficiency issues are handled in the evaluation system. Besides identifying inefficient practices and recommend steps to reform them, DIPRES could estimate the magnitude of the savings that could be achieved through improved efficiency. In a similar way, efficiency reviews should include transversal issues (efficiency issues that affect several government agencies, such as the organisation of support services or procurement practices).

Reform the management improvement programme (PMG)

This programme is now applied in all government entities, and the financial rewards constitute an important share of civil servant's annual wages. The targets are set by institution, and all public employees within an institution get the same level of reward. However, today, in spite of a complex and costly management system, most agencies achieve all their targets, and employees expect to get the full rewards, which do not act as incentives anymore. It is therefore a costly system, with very limited impact. Since these rewards have become an institutionalised part of salaries, it should be recognised for what it is.

Notes

1. As copper, molybdenum is a mineral whose price has increased considerably in the last decade, and constitutes an important share of Chile's public revenues.
2. The study did not provide any estimate of the extent to which evaluations led over time to budget savings through efficiency enhancements.

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ANNEX A

International practices on decentralisation reform

A.1. Today's Chile's decentralisation reform

Chile is amongst the most centralised OECD countries. It is composed of 15 regions and 54 provinces. Regions are headed by superintendents (*intendentes*) and provinces by governors (*gobernadores*), both appointed by the President. In the 2014 Presidential Programme, President Bachelet introduced a "decentralisation and development agenda", around three pillars:

1. A constitutional reform allowing the election of the regional superintendents (keeping a governor as representative of the central power);
2. The transfer of competences and public services in land use, economic, social and cultural development; and
3. Changes to the law on regional financing and fiscal responsibility.

This implies profound institutional and cultural changes, and experience of other OECD countries in decentralisation and the governance of intergovernmental fiscal relations could be useful for Chile when designing its new system.

An in-depth study of the decentralisation reform is currently being carried out by the OECD, where the specificities of the Chilean case will be analysed. This section only aims to provide some international benchmarks and experience which could be useful to policy makers for preparing this decentralisation reform.

A.2. Experience of OECD countries in decentralisation and design of intergovernmental fiscal relation frameworks

A.2.1. Impact of decentralisation on equity, efficiency and macroeconomic stability

There has been a trend in OECD countries in the last decade before the 2008-10 global financial crisis towards a greater devolution of spending and revenue raising capacities to sub-national governments. This followed the principle that decentralisation of spending responsibilities can improve efficiency in the allocation of resources and welfare. Indeed, local governments should have better information about local needs and preferences, and could therefore provide a composition, quantity and quality of public goods closer to the preferences of their beneficiaries.

But decentralisation also has its drawbacks, aggravating regional differences and undermining distributional equity. In addition, decentralisation makes macroeconomic management more delicate. The global financial crisis for example has shown that

sub-national governments' actions can go against central government's macroeconomic objectives and co-ordination between levels of government becomes necessary (Blöchliger et al., 2010; Vammalle and Hulbert, 2013).

A.2.2. Importance of a well-designed intergovernmental relations framework

In decentralised environments, the framework for fiscal relations across levels of government is crucial. The design of intergovernmental fiscal relations bears multiple – possibly conflicting – objectives: Macroeconomic stability, efficiency of spending and redistribution concerns. The main instruments to achieve these goals are fiscal rules, taxes and grants. To achieve its three objectives, the design of fiscal relations across levels of government has three main policy tools: 1) the share, composition and autonomy of sub-national governments' expenditures, 2) the share, composition and autonomy of sub-national governments' revenues, and 3) fiscal rules.

A.2.3. Optimising allocation efficiency

Allocation efficiency concerns are mainly addressed in the assignment of spending responsibilities. The general rule is that to increase efficiency in the allocation of resources, the responsibility for each type of public expenditure should be assigned to the level of government that most closely represents the beneficiaries of these services. Therefore, in general terms, the more spending autonomy is given to sub-national governments, the greater the allocation efficiency.

However, the efficiency benefits from spending delegation must be balanced with possible negative impacts of spending decentralisation on other objectives, such as equity (as poorer regions will not be able to provide the same level of public goods than more developed regions) and macroeconomic stability (as the addition of all sub-national governments spending might lead to over-spending on a global level). Besides, as some locally provided public goods and services might have externalities which will not be taken into account by sub-national governments; the aggregate level of public goods provided might not be optimal. An example of such goods is education or basic health care, which affect the overall stock of human capital, and therefore the potential for growth at national level.

A.2.4. Equity and the need for equalisation mechanisms

Equity (income redistribution) concerns are one of the key elements in the allocation of revenues. The main sources of financing for sub-national governments are own taxes, and inter-governmental transfers (tax-sharing and grants). The larger the reliance of sub-national governments on own taxes, the larger the potential discrepancies between poorer and richer regions. Inter-governmental transfers are thus needed to increase distributional equalisation. These can take the form of tax-sharing, where the coefficients are calculated on redistribution criteria, such as population, regional income per capita, indicators of backwardness, etc., or they can take the form of grants.

The drawback of equalisation is that if incentives are not designed properly, it might lead to moral hazard issues, where sub-national governments will not be encouraged to increase tax pressure, as their lower revenues are compensated by intergovernmental transfers.

A.2.5. Ensuring macroeconomic stability

Decentralising expenditure capacity to lower levels of government can have positive effects on efficiency, as local governments are more aware of local needs and tastes than

central governments. But this can also undermine global macroeconomic stability, as SCGs do not always take into account the effect of their fiscal decisions on the rest of the country on the one hand, and might even have incentives to overspend on the other hand.

In 2013, sub-national governments debts represented on average 13% of GDP and 17% of total public debt in OECD countries. While the sub-national government debt to GDP ratio may be low, the ratio of sub-national government debt to their revenues, which proxies their capacity to repay, is much higher: 80% of revenues on average, but up to 200% of yearly revenues in Canada or Japan (Vammalle, Hulbert, unpublished).

Fiscal stability (macroeconomic management) issues are mainly addressed through fiscal rules such as golden rules, balanced budget rules or borrowing rules (Box A1). These fiscal rules should allow sub-national governments to provide the most efficient level of public goods, while making sure that sub-national governments' policies are consistent with national macroeconomic objectives.

Box A1. **Different types of fiscal rules for sub-national governments**

Four types of rules can be used to support fiscal sustainability and short-term stability:

- **Balanced budget requirements** in OECD countries vary according to whether they are applied to the current budget and/or the capital account (balanced budget requirement applied only to the current budget, thus allowing borrowing to finance net investments is usually referred to as the "golden rule" of public finance); whether they are set annually or multi-annually; and whether they are imposed from above or self-imposed. Most commonly, balanced budget requirements are applied to current and capital budgets, are set annually, and are imposed from above.
- **Borrowing constraints** are widely used in OECD countries, but with a substantial variation in terms of restrictiveness. They range from total prohibition (Denmark and Korea) to no restriction at all. In most cases, sub-national government borrowing requires prior approval by higher levels of government, and is often restricted to certain purposes (such as investment).
- **Tax and expenditure limits.** Overall limits on tax rates or reliefs are widely used in OECD countries, and usually take the form of an explicit limit on tax autonomy set by central government. Expenditure increase limits are usually linked to income, inflation or population growth. But explicit, binding, expenditure limits are rather rare (they exist only in Germany, Korea, Portugal and Turkey). In some countries such as Japan, the Netherlands, Poland and Spain, expenditure limits are not imposed by central government, but self-imposed.
- **Process rules** that govern implementation will determine the degree of commitment of sub-national governments to the set of rules described above (indeed, without a proper commitment mechanism, sub-national governments could either ignore, or change the rules binding their autonomy). Process rules include the obligation to produce financial accounts (transparency), monitoring and reporting, and eventual sanctions in case of non-compliance. But process rules should also allow for flexibility of response, as breaking the fiscal rules might be the appropriate response to an unanticipated shock such as large revenue shocks, downturns in the local economy, the impact of natural or other disaster, etc. This is why many countries incorporate escape clauses that allow sub-national governments to breach the rule in case of certain predetermined events.

Source: Vammalle, Charbit (2010).

A.3. Decentralisation reforms: Big bang vs. gradual processes

Decentralisation reforms may have different drivers, and it has not always been possible for countries to implement them in a gradual way. However, granting new responsibilities to sub-national governments implies the need to build the capacities to carry these out. Building such capacities takes time, and often requires cultural changes. In some regions, it may be difficult to attract and retain qualified staff. Gradual decentralisation reforms are usually a better option than big bang processes, as the cases of Indonesia and Spain illustrate (Boxes A2 and A3).

Box A2. **Decentralisation in Indonesia: A Big Bang reform**

Since the fall of Suharto in 1998, Indonesia switched from being one of the most centralised countries, to the implementation since 2001 of very ambitious decentralisation programmes. "Big bang" decentralisation began in 2001, with the transfer of 1.7 million civil servants to sub-national governments and the granting of enhanced autonomy to the two provinces.

Decentralisation had both fiscal and political components:

- Fiscal: Provincial, and particularly district, governments were endowed with wide ranging autonomy over public service provision. Provincial governments now provide inter-district services, provincial infrastructure, roads, etc.; and districts/municipalities are responsible for primary and secondary education, health services, local roads, etc.
- Political: In 2004, in response to widespread concerns over corruption and money politics, responsibility for the selection of district level heads was transferred from local legislatures to the district population.

A second big bang reform in 2006 increased transfers to sub-national governments by almost 50%. Transfers to sub-national governments represented about 34% of central government revenues during the 2001-10 period, and account for about 87% of municipal and 55% of provincial revenues during 2008-10. Transfers to sub-national governments have not decreased during the crisis, in spite of a reduction in central government revenues.

Challenges raised by decentralisation are numerous, and go beyond fiscal challenges:

- **Vertical fiscal imbalances** exist such that sub-national governments are responsible for most public services but remain highly depending on central government transfers.
- **The proliferation of districts,** largely due to the formula of central transfers has led to local government fragmentation (191 new regional autonomies were established between 1999 and 2008) with potentially negative impacts on regional development. President Yudhoyono has called for a moratorium on the proliferation of new districts.
- **Limited human and organisational capacity of sub-national governments** inhibits their ability to fully exercise their new competencies. This raises particular challenges for local public service delivery and regional development. The central government is still reluctant to release assets to the lower levels of governments, most notably state-owned corporations, arguing that most local governments are not properly prepared to manage assets.
- **Despite important institutional progress corruption remains rife,** and money politics still play an important role in local elections. As a result de facto accountability remains a concern.

Box A2. **Decentralisation in Indonesia: A Big Bang reform** *(cont.)*

- **Strategic planning for public investment presents a particular challenge.** The political decentralization has shifted the focus of spending from long-term investment needs to more popular and visible spending, leading to a change in budget compositions both across sectors (a greater focus on social spending at the expense of infrastructure) and toward highly visible spending (road building over road maintenance).
- **Co-ordination across jurisdictions is a concern.** This is particularly true in relation to investment in infrastructure. Districts are responsible for 51% of road expenditures, and often fail to internalise the benefit of adequate roads that accrues at the provincial level. Furthermore, access to revenues bears little relationship to district spending needs as central government transfers are distributed largely on the basis of the salary bill of the civil service, leaving poorer regions with inadequate resources for roads expenditure.

Box A3. **Fiscal decentralisation in Spain: A gradual reform**

After the transition to democracy, the Spanish Constitution of 1978 created a regionalised state, shifting from a highly centralised system to a highly decentralised one. The Constitution created the autonomous communities, and stipulated that they should have financial autonomy to carry out their competences.

However, in practice, the process of devolving political and fiscal power to the Autonomous Communities has been gradual over a 30 year period. This slow trend is reflected in the evolution of the share of autonomous communities in total public expenditure, which rose from 21.5% in 1995 to 35.6% in 2009 and 43% in 2014. The share of public revenues by autonomous communities also increased from 6.6% in 1995 to 24.1% in 2009 and 27% in 2014 (OECD Fiscal Decentralisation Database).

In addition, decentralisation also had to respect the constitutional principle of co-ordination with the central government, and the principle of solidarity between all Spanish citizens, guaranteed by the central government. More specifically, the solidarity principle implies the guarantee of access to basic public services in the whole territory, and the lower of income disparities between regions.

Each autonomous community established its "Statue of Autonomy", which is equivalent to a regional constitution. Both the central government and the autonomous communities have legislative powers, and their laws have the same status (in the event of a conflict, the central government laws do not prevail over that of the autonomous communities), even though each level of government can only issue laws on matters that are under its competences.

Source: Blöchliger, Vammalle (2010).

A.4. Recommendations on decentralisation reform in Chile

National fiscal arrangements between levels of government vary widely, as they necessarily incorporate local economic, but also political, social and cultural factors. However, there are some elements that must be addressed in any decentralised environment. In addition, experience of countries implementing decentralisation reform could be useful to Chile, for choosing the pace and scope of the forthcoming reform.

A.4.1. Decentralisation process

- Gradual decentralisation processes allow more time for building local capacities, and are preferable to "big bang" decentralisation processes.
- Experimentation and asymmetric decentralisation can be good tools to give incentives to sub-national governments to build up their capacities, and allow for a gradual and pragmatic decentralisation process.
- Clearly define the roles and responsibilities of each level of government, avoiding overlaps.
- Ensure that sub-national governments' revenues are sufficient to carry out their responsibilities. Given that the cost of providing public goods and services may differ from one region to another, this is by no means an easy task.

A.4.2. Multi-level governance

Decentralising responsibilities inevitably creates asymmetries of information and co-ordination needs. Therefore, it is important to design a multi-level fiscal governance framework together with the devolution of responsibilities to other levels of government.

A.4.3. Ensuring fiscal sustainability

The pros and cons of granting sub-national governments the faculty to issue debt, and the specific conditions under which this could be allowed should be carefully studied. On the one hand, allowing sub-national governments to issue debt to finance productive infrastructure could have positive development effects. However, the cost of issuing the debt and interest rates paid would be higher for smaller scale issues.

If sub-national governments are granted the right to issue debt, it is important to design mechanisms in order to ensure their fiscal sustainability. There are three main mechanisms for monitoring sub-national government debts and ensuring their fiscal sustainability. Monitoring mechanisms range from pure reliance on market discipline, with no control from central governments, to direct control by higher levels of government of the amount and purpose of debt issued by SNGs. Fiscal rules lie somewhere between these two extremes, as they set the limits and conditions for SNG spending, but do not call for an *ad hoc* examination of each loan request by SNGs.

There is a great diversity of practices in monitoring sub-national government debts across OECD countries, ranging from a pure reliance on market mechanisms to sophisticated systems of fiscal rules (Box A4). Pure reliance on market mechanisms is rarely successful, and should not be privileged in Chile if regions are granted the right to issue debt. Direct controls are only effective if they are not automatically granted, and require a large amount of information for the central government to evaluate the requests submitted. Fiscal rules are probably a better option. These should be sufficiently simple to avoid gaming, and to be easily enforceable, and should encompass a control and correction mechanism in case a sub-national government infringes the rule.

A.4.4. Lessons from OECD countries

- Ensure that all sub-national governments use the same budgeting and accounting processes and standards.
- Make sure sub-national governments regularly publish all relevant financial information. In particular, if sub-national governments own public enterprises, these should be

Box A4. **Ensuring fiscal sustainability of sub-national governments**

- In federal and quasi-federal countries, states/regions tend to rely more on market discipline or self-imposed fiscal rules than sub-national governments in unitary countries.
- There has been an increase in the control of sub-national government debts by central governments since the beginning of the decade, with fiscal rules being introduced or reinforced in a number of OECD countries. Fiscal pacts in particular, where different levels of government negotiate and agree on debt limits, have been signed in several countries (mainly federal and quasi-federal).
- There has been a move towards structural rules rather than simple rules. However, simple rules may be preferable where sub-national government revenues have a relatively low cyclicality, are not too exposed to unexpected shocks, or when sub-national governments lack capacity for implementing sophisticated rules. Applying and monitoring fiscal rules generates administrative burden and compliance costs. Sophisticated rules (for example structural budget balance rules) may be less pro-cyclical than a simple rule, but also more difficult to implement and more prone to gaming and political manipulation. Multi-year balanced budget rules may be an appropriate substitute for structural rules when sub-national government capacity is limited.
- Most countries specify fiscal targets for sub-national governments individually, rather than for sub-national governments in aggregate. Escape clauses and *ad hoc* transfers from the central government are useful tools to address the impact of significant asymmetric shocks on revenues and/or expenditures.
- Enforcement mechanisms and sanctions for non-compliance with the rules have been tightened since the early 2010's.

Source: Vammalle and Hulbert, unpublished.

consolidated with those of sub-national governments for setting (and monitoring compliance with) numerical targets.

- Sound public investment management principles would help to ensure SNGs will not face unforeseen negative consequences on future budgets (such as high operating and maintenance costs), and that the investments carried out have the greatest impact on future SNG growth. OECD forthcoming principles for effective public investment could be a useful guide.
- Direct controls are effective only if authorisation for issuing debt is not systematically and automatically granted.
- The impact of fiscal rules depends on the ability of SNGs to circumvent them and the credibility of enforcement and sanction mechanisms. If SNGs feel there are no consequences when infringing fiscal rules, these may not be respected. Automatic correction requirements (debt brake-type provisions) may be a solution for promoting sustainable sub-national fiscal behaviours. However public investment (defined in a detailed way so that it is not used to circumvent the rule) could be excluded, to protect SNG growth form the long-term effects of wide investment cuts.
- Early correction mechanisms for SNGs facing financial difficulties are useful to reduce the risk of defaults and recurring to bankruptcy or bailout. However, benefitting from such mechanisms should imply a cost to the SNG, in particular to the management team, in order to reduce moral hazard and soft budget constraints.

ANNEX B

Chile's budget system in light of the OECD Recommendation on Budgetary Governance

The OECD *Recommendation of the Council on Budgetary Governance* (C(2015)1) sets out ten principles of effective modern budgeting, based upon the experience and insights of the Senior Budget Officials and with inputs from the global community of PFM practitioners and experts. The table below provides a concise summary assessment of Chile's budget system by reference to the ten budget principles, based upon the analysis set out in this Budget Review. Chapter/section references are provided in each case.

Budget Principle	Chile's budget system	Reference
1. Clear fiscal limits	Chile has a structural budget balance rule since 2001. Until 2006, the target was 1% structural fiscal surplus. In 2006, the new Fiscal Responsibility Law indicated that each President must specify a target at the beginning of his/her mandate. Structural fiscal balance is calculated by DIPRES, based on inputs of structural GDP growth and long-term copper price provided by two independent panels. This rule has been quite successful in smoothing out the peak of revenues generated by the rise of the price of copper during the 2000s. However, it seems less efficient for coping with the current downturn: it has no escape clauses and accommodating a counter-cyclical policy requires changing the cyclically-adjusted balance target. Chile's structural fiscal balance has been negative since 2008, and the target date to return to a balanced position has been postponed repeatedly.	Section 3.2
2. Medium-term strategic alignment	The strong centralisation of the budget process in the hands of DIPRES facilitates the alignment of the budget with the President's priorities. However, the mismatch between operational programmes and budgetary programmes makes it somewhat difficult to link government priorities to budget allocations. DIPRES maintains detailed and continually-updated baseline projections of government revenue and expenditures for the next three years. This is an internal document, and projections are only presented to the Congress and shared with line ministries at a highly aggregate level.	Section 4
3. Capital budgeting framework	Chile's capital budgeting framework is characterised by strong and transparent institutions and regulations. The strict centralised budget process ensures fiscal sustainability and affordability. Chile's National Investment System has a number of well-institutionalised processes that promote value for money and transparency of the public sector, but formal criteria for investment framing choices, such as PPPs are missing. Chile misses a clear alignment of the budget and appraisal mechanisms with the medium-term strategic priorities of government to meet the national development needs. Furthermore, coordination of investment planning and execution within and across levels of governments is weak, and capacities on sub-national level are missing.	OECD (forthcoming), Review of Gaps and Governance Standards of Public Infrastructure in Chile

Budget Principle	Chile's budget system	Reference
4. Open, transparent and accessible budget documents and data	Chile has been committed since 2002 to following OECD best practices in budget transparency. Documents and databases are available relating to the costing of new initiatives and laws, the cyclically-adjusted GDP and balance, the budget proposal, budget implementation, *ex post* evaluations and performance indicators. However, some key assumptions and dis-aggregations are sometimes incomplete, which makes DIPRES's calculations difficult to replicate by independent analysts. The military still receives 10% of the sales revenues of the government-owned copper mining company (CODELCO), and these funds are maintained off-budget.	Section 5.4
5. Inclusive, participative and realistic budgetary debate	The Congress has built up some capacity regarding the budget in the last decade, with a new Permanent Joint Committee on the Budget, and the creation of a Budget Advisory Unit. However, the role of Congress in the budget discussions is still rather limited. Congress can only decrease expenditure proposed by the executive. It may not increase or reallocate expenditures.	Section 5
6. Comprehensive, accurate and reliable accounting	Chile has recently moved from a cash basis to a fully accrual basis system for financial reporting. In 2010, Chile formally started a process to prepare for the adoption of International Public Sector Accounting Standards (IPSAS). IPSAS should be fully operational by 2019.	Section 6.3
7. Active planning, management and monitoring of budget execution	Budget execution in Chile heavily relies on *ex ante* input control, rather than *ex post* monitoring. For example, every transaction must be pre-approved by the Comptroller-General of the Republic to ensure their "legality". Turnover of higher civil public managers is very high in line ministries. Higher management should be professionalised and a professional civil servant career path could be reinforced. This would improve managerial capacities of line ministries, thus creating the necessary conditions for later decentralising some decision power to line ministries.	Section 6
8. Performance, evaluation and value-for-money	Chile has a robust evaluation and control system, providing a great amount of performance information. However, as the operational programmes evaluated do not correspond to the budgetary programmes, the results of these evaluations are difficult to use for resource allocation purposes.	Section 7
9. Fiscal risks and long-term sustainability	Since 2007, DIPRES publishes an annual report on contingent liabilities, clearly identifying fiscal risks.	Section 5.4
10. Quality, integrity and independent audit	Chile created a Fiscal Advisory Council in 2013, with a mandate mainly centred upon the cyclically-adjusted fiscal rule. Its members are appointed by the Minister of Finance and can be removed at any time. The independence of the Fiscal Advisory Council could be reinforced, and its mandate expanded to include analysis of fiscal and long-term sustainability risks.	Section 3.2

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Gender budgeting in OECD countries

by
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Gender gaps persist in education, employment, entrepreneurship and public life opportunities and outcomes. Gender budgeting involves using the tools, techniques and procedures of the budget cycle in a systematic way to promote equality. Responses to the 2016 OECD Survey of Gender Budgeting Practices show that almost half of OECD countries have introduced, plan to introduce or are actively considering the introduction of gender budgeting. The OECD analysis demonstrates that a wide variety of gender budgeting approaches are practised. Only half of OECD countries can currently point to specific examples of impact, however a wider range of impacts may become more evident in the future since the introduction of gender budgeting is relatively recent in many countries. Useful areas for further study and policy action include: the routine availability of gender-disaggregated data; embedding of gender-specific approaches within the normal annual routines of budgeting; and complementing executive-led approaches with external quality assurance.

JEL codes:H54, H60, H61

Keywords: Gender budgeting, gender equality, budgetary process, budgeting practices

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The statistical data for Israel are supplied by and under the responsibility of the relevant Israeli authorities. The use of such data by the OECD is without prejudice to the status of the Golan Heights, East Jerusalem and Israeli settlements in the West Bank under the terms of international law.

Executive summary

Traditionally, most OECD countries did not design public policies with gender equality as a primary consideration. Today many disparities and inequalities between the sexes appear to have become embedded, to a greater or lesser extent, in the baseline of public policies and the allocation of public resources. The negative impacts of this legacy are evident across many policy domains, including labour market, education and health outcomes, as well as gender disparities in management and leadership. In recent decades, work has been pioneered by international organisations and others to promote "gender mainstreaming", i.e. designing all public policies, and using policy instruments, with the promotion of gender equality in mind. The 2015 OECD *Recommendation on Gender Equality in Public Life* sets out a multi-dimensional approach for advancing gender equality as a core principle of modern public governance, including the promotion of gender-responsive policies, the role of gender budgeting, and closing the gender gap in public leadership and public employment.

Gender budgeting is the application of gender mainstreaming in the budgetary process. Given that the budget process is the gateway for resource allocation, as well as a key determinant of the standards and qualities of public policy formulation, it is natural that the budget be considered for its likely impact on gender-responsive public governance. An established definition of gender budgeting refers to "a gender-based assessment of budgets, incorporating a gender perspective at all levels of the budgetary process and restructuring revenues and expenditures in order to promote gender equality" (Council of Europe, 2009).

Responses to the 2016 *OECD Survey of Gender Budgeting Practices* show that while the majority of OECD countries (59% of respondents) do not explicitly undertake gender budgeting – indeed there appears to be little consensus on what gender budgeting actually entails – most (90%) report the use of tools to promote gender equality. The nature and quality of these approaches appear quite variable, ranging from a *pro forma* statement of impacts on gender equality attached to all new policies coming before government, to more structured and systematic "gender impact assessments". A few countries reported that gender equality is "mainstreamed" in the sense that the responsibility rests with line ministries to advance this agenda within their respective policy domains, and consequently no particular role for the budget process is envisaged as necessary.

Almost half of OECD countries that responded (15 out of 34 members) report that they have introduced (Austria, Belgium, Finland, Iceland, Israel, Japan, Korea, Mexico, Netherlands, Norway, Spain, Sweden)[1], plan to introduce (Italy) or are actively considering the introduction (Turkey, Czech Republic) of gender budgeting.

Although gender budgeting practices vary across countries where it has been introduced, there are three broad categories of gender budgeting systems:

i) *gender-informed resource allocation* whereby individual policy decisions and/or funding allocations take into account the impact of the decision on gender equality;

ii) *gender-assessed budgets* where the impact of the budget as a whole is subject to some degree of gender analysis; and

iii) *needs-based gender budgeting* where the budget decisions are underpinned by a prior assessment of gender needs. This allows a detailed understanding of the extent to which gender inequalities exist and highlights the policy domains where gender inequalities are greatest.

The categories are broadly incremental, in that those which have gender-assessed budgets generally undertake gender-informed resource allocation and countries that do needs-based gender budgeting also generally have gender-assessed budgets. Two thirds of the OECD member countries that use gender budgeting fall into the first or second categories, with just four undertaking a gender needs assessment as part of the budget process.

The OECD analysis has adopted a differentiated analysis of gender budgeting, looking at each phase of the budget process and the different institutional actors in the process as potential entry-points for gender-responsive policy-making. Some key results of this analysis are as follows:

- *Wide variety of gender budgeting approaches:* There is no standard model of gender budgeting in OECD countries.
- *Gender budgeting is legally underpinned*: Most OECD countries with gender budgeting have a legal foundation for their gender budgeting practice, although the nature and intention of the legal provisions vary.
- *Evidence of systematic gender-proofing through the budget cycle:* Two of the most frequently used gender budgeting tools are *ex ante* and *ex post* gender impact assessments, suggesting a systematic continuum of gender-focused policy assessment across the budget cycle. However, the rigour and impact of these approaches appear variable.
- *Evidence of broad application of gender perspectives:* Half of the countries which undertake gender budgeting apply a gender perspective in resource allocation and performance setting. However, there is relatively limited application of gender perspective in spending review.
- *Limited use of comprehensive* ex ante *needs assessment:* Few OECD countries currently undertake a comprehensive gender equality needs assessment to gain insights into the priority gender issues arising from the current disposition of public policies and of public resources.
- *Limited evidence of positive impact:* Out of 12 countries with some form of gender budgeting, half of them could point to specific examples where the gender-budgeting tool had brought about significant changes in policy design and/or outcomes. As the introduction of gender budgeting is still relatively new in a number of countries, greater evidence of impact may appear in future.
- *Reliance on a co-ordinated approach*: The practice of gender budgeting typically involves co-ordination between a number of government departments, such as the Ministry of Finance and the Ministry of Equality.

The OECD study also encompassed some non-OECD partner countries for further insights into national practices and experiences. Brazil, India, Morocco and South Africa have some targets and gender equality considerations which overlap with the ones in some OECD countries or have reported using some of the tools and methods characteristic of gender budgeting.

Apart from the results of the OECD survey, and based upon the qualitative comments from respondent countries, some broader findings suggest themselves as useful areas for more specific future study:

- The ***routine availability of gender-specific data sets*** and statistics would greatly facilitate the evidential basis for the identification of gender equality gaps, design of policy interventions, and the evaluation of impacts.
- Especially in the context of performance-budgeting approaches pursued in many OECD countries, ***measurable outputs and clearly-linked budget allocations,*** identified by their gender-responsive character, would assist in gender equality assessment of the budget.
- For the gender-responsive approach to become an enduring feature of modern budgeting, it will need to become ***embedded within the normal annual routines of budgeting*** and of policy-making, rather than be used only as an extrinsic form of analysis.
- However, executive-led gender-budgeting should be complemented with external quality assurance ("gender audit"), as well as "civic audit" by adopting modern open-data approaches for gender-disaggregated budget information.
- Most fundamentally, gender budgeting should not be adopted as a bureaucratic compliance exercise, but should be ***intrinsically linked with the substance of policy development*** in each domain of public policy, and should be capable of ***demonstrating impacts*** in terms of informing resource re-prioritisation and re-allocation decisions.
- Gender budgeting also has potential as a tool to ***assess the pro-growth and productivity impact*** of budgetary policies, beyond traditional dimensions of economic analysis.

The challenges of effective gender budgeting are in some ways a microcosm of the challenges of modern budgeting. In particular, many of the aspects outlined above as *desiderata* of good gender budgeting, are equally *desiderata* of good budgeting and of good policy formulation: Notably the need for clear, multi-dimensional budgetary impact analyses, and the need for evaluation frameworks that feed directly into the policy and budget cycle. Accordingly, further analysis on these topics would be warranted, not just for the obvious linkages with the agenda of inclusive growth and attainment of the Sustainable Development Goals, but also for solidifying the foundations of effective modern budgetary governance. It is proposed that the gender budgeting survey, refined in light of the current experience, become a regular periodic exercise for OECD countries, partner countries, and the SBO regional networks.

1. Introduction: Gender equality challenges and gender budgeting

1.1. *The persistence of gender disparities*

Gender inequalities are evident across various public policy areas. OECD studies have demonstrated gender gaps, for example, in labour market participation, entrepreneurship, remuneration, representation in senior management positions in both the public and private sectors, health outcomes, and education (see Annex A). In part, this may reflect traditional and societal disparities in the cultural roles and expectations of women and men. Despite evidence of some recent improvements, the persistence of gender inequalities across many facets of public life suggests that these disparities have become embedded, to a greater or lesser extent, in how public resources are allocated and used. Governments face many challenges in designing and delivering inclusive and gender-sensitive public policies and measuring the impact of such policies. Where countries are attempting to address gender equality, the continued disparities also point to an implementation gap.

1.2. The OECD response to the gender equality challenge

Against the background of sustained international efforts to address the gender equality challenge (see Box 1.1), and in the framework of the OECD Gender Initiative, the OECD monitors the progress made on gender equality through data collection and analysis and identifies best practices for achieving greater equality. This work spans the areas of education, employment and work-life balance, entrepreneurship and public governance, development, health, science, taxation, and well-being. In 2013, the OECD developed the *Recommendation on Gender Equality in Education, Employment and Entrepreneurship* which included several high-level provisions related to gender mainstreaming and gender balance in both the public and private sectors.

Box 1.1. **International initiatives promoting gender equality**

International initiatives in favour of gender equality, including gender mainstreaming have been in place for over a quarter century. The 1966 International Covenant on Economic, Social and Cultural Rights, required states signatories to take appropriate measures (including budgetary measures) to realise economic rights, and to use maximum resources to do so.

Over 180 states have ratified the 1979 United Nations Convention to Eliminate All Forms of Discrimination Against Women (CEDAW). The international commitment to gender equality was further cemented through the 1995 Beijing Declaration. Points 345 and 346 of the Beijing Declaration on a Platform for Action include a budgetary commitment by signatories to allocate sufficient resources to carrying out gender impact analysis, and to meeting social needs including those of women.

The Millennium Development Goals (MDGs) established gender equality and women's empowerment as a stand-alone goal, and highlighted gender equality and women's empowerment as crucial to achieving of all the other MDGs. The subsequent 2015 Sustainable Development Goals (SDGs) include a stand-alone goal on gender equality and the empowerment of women and girls (goal 5) as well as gender-sensitive targets within other goals. The SDGs have been recognised by the OECD and by many countries as benchmarks for global progress and well-being.

Building on this initiative and the 2014 publication on Women Government and Policymaking in OECD Countries: Gender Public Policies and Leadership, in 2015 the OECD adopted the Recommendation on Gender Equality in Public Life based on the work of its Public Governance Committee and its Working Parties. This second Recommendation puts a strong emphasis on implementation mechanisms to achieve policy impact. It promotes a government-wide strategy for gender equality reform, sound mechanisms to ensure accountability and sustainability of gender initiatives, and tools and evidence to inform inclusive policy decisions. The Recommendation provides not only governments, but also parliaments and judiciaries, with clear, timely and actionable guidelines for effectively implementing gender equality and gender mainstreaming initiatives, and for improving equal access to public leadership for women and men from diverse backgrounds.

The *Recommendation on Gender Equality in Public Life* identifies tools to systematically embed gender considerations throughout the policy and budget cycle, thus envisaging a clear role for gender budgeting. The Recommendation itself advocates a dual approach to

gender equality (i.e. specific and targeted policies to foster gender equality, while also mainstreaming gender-responsiveness into all government action) to ensure that policies or budgets do not inadvertently discriminate against women. In practice however, while OECD countries are increasingly allocating budgets earmarked for women's empowerment or gender equality, the systematic integration of gender impacts throughout the overall budget cycle has proven challenging. This report is intended to shed further light on this aspect of gender equality in practice.

1.3. *The OECD's analytical framework for gender budgeting*

The budget is a central policy document of government, showing how annual and multi-annual objectives will be prioritised and achieved (OECD 2015). It is not surprising, therefore, that initiatives to promote gender-responsiveness in public policy have included attempts to incorporate a gender-sensitive dimension into the budgeting process itself.

As noted in previous OECD analysis,[2] one established definition of gender budgeting with broad international acceptance is as follows:

> *Gender budgeting is an application of gender mainstreaming*[3] *in the budgetary process. It means a gender-based assessment of budgets, incorporating a gender perspective at all levels of the budgetary process and restructuring revenues and expenditures in order to promote gender equality.* (Council of Europe, 2009)

Gender budgeting is seen as covering three stages: *a)* analysis of issues, *b)* restructuring of the budget to achieve gender equality outcomes, and *c)* embedding gender systematically within all budgetary processes. Gender budgeting initiatives have been pursued in various forms over many years. Australia pioneered and piloted attempts at gender budgeting from 1984 onwards in response to calls from women's rights activists. Over 90 countries have experimented with some form of gender budgeting over the past decade (OECD, 2014b). It is notable that some of the early adopters of gender budgeting over the years have come from beyond the OECD – including countries such as India, the Philippines and Indonesia. Among more recent examples, in 2013, Austria introduced gender budgeting as part of a broader package of performance budgeting reforms.

In practice, as shown in the survey responses presented in more detail later in this report, few OECD countries can be regarded currently as fully meeting the above definition, which is comprehensive in its scope and ambition. For the purposes of this analysis, the OECD has adopted a differentiated approach, recognising that there are multiple potential entry-points within the budget cycle, and across the network of institutional actors, for promoting a gender-responsive approach. The OECD has refrained from adopting an "ideological" preference as to which of these various approaches (or which combination of approaches) should be used. Rather, this report presents the current "state-of-play" based upon the findings of the gender budgeting survey and seeks to identify important themes for further in-depth analysis.

Against this background, we define gender budgeting for the purposes of our current analysis as follows:

> *Integrating a clear gender perspective within the overall context of the budgetary process, through the use of special processes and analytical tools, with a view to promoting gender-responsive policies.*

This definition is intended to recognise the wide scope and nature of the budgetary process, and that any tool or intervention that comes within this broad scope is in principle a "gender budgeting" approach - leaving aside the question of how effective (or ineffective)

the particular approach may prove to be. The definition also recognises that the budget process does not aim at "gender equality" directly, but rather operates to prioritise and resource policies. Policies which are "gender-responsive" are those which aim directly at gender equality outcomes.

The conclusions of the 2016 gender budgeting survey, which uses this typology as the basis for the analysis, are set out in section two.

Box 1.2. **Gender budgeting in practice: An OECD typology**

As noted above, for the purposes of this study, the OECD defines gender budgeting as "integrating a clear gender perspective within the overall context of the budgetary process, through the use of special processes and analytical tools, with a view to promoting gender-responsive policies". As the "budget process" is an annual (or indeed multiannual) event, there are several opportunities across the cycle in which the gender perspective can be brought to bear. This OECD study accordingly classifies gender budgeting interventions by the relevant stage in the process.

(a) *Ex ante* gender budgeting approaches

- ***Ex ante*** gender impact assessment: Assessing individual budget measures, in advance of their inclusion in the budget, specifically for their impact on gender equality.
- **Gender budget baseline analysis:** An analysis which is periodically conducted to assess how the existing allocation of government expenditures and revenues contributes (or otherwise) to gender equality.
- **Gender needs assessment:** A qualitative assessment, including views and opinions from stakeholders and civil society representatives, of the extent to which government policies and programmes meet gender equality needs, with a view to identifying priorities for policy action in the budgetary context.

(b) Concurrent gender budgeting approaches

- **Gender perspective in performance setting:** Requirements prescribing that a minimum proportion of budget-related performance objectives be linked to gender-responsive policies.
- **Gender perspective in resource allocation:** Requirements prescribing that a minimum proportion of overall budgeted resources be allocated towards gender-responsive policies.
- **Gender-related budget incidence analysis:** The annual budget is accompanied with an official assessment, conducted by the central budget authority (or under its authority) of the budget's overall impact in promoting gender equality, including a gender-disaggregated analysis of specific policy measures (both revenue- and expenditure-related).

(c) *Ex post* gender budgeting approaches

- ***Ex post*** gender impact assessment: Assessing individual budget measures, after their introduction/ implementation, specifically for their impact on gender equality.
- **Gender audit of the budget:** Independent, objective analysis, conducted by a competent authority different from the central budget authority, of the extent to which gender equality is effectively promoted and/or attained through the policies set out in the **annual budget**.
- **Gender perspective in spending review:** In the context of a national/"comprehensive" spending review, gender is routinely included as a distinct dimension of analysis.

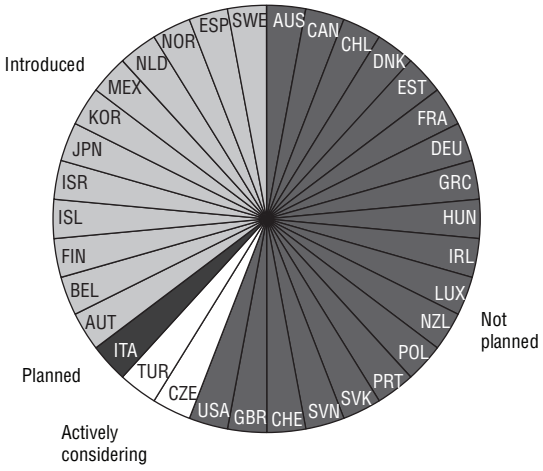
2. Results from the 2016 OECD Gender Budgeting Survey

The following section outlines the headline results from the 2016 OECD Gender Budgeting Survey and provides country case examples highlighting interesting practice.

2.1. The adoption of gender budgeting

Almost half of OECD countries (15 out of 34 members) have introduced (Austria, Belgium, Finland, Iceland, Israel, Japan, Korea, Mexico, Netherlands, Norway, Spain, Sweden),[4] plan to introduce (Italy) or are actively considering the introduction (Turkey, Czech Republic) of gender budgeting.

Figure 2.1. **Status of gender budgeting**



Source: 2016 OECD Survey of Gender Budgeting.

The vast majority of those countries which have not formally introduced gender budgeting still implement some form of gender-responsiveness into the policy-making process which may in turn impact spending. Definitional challenges surrounding gender budgeting mean that it is sometimes difficult to identify specifically when a country moves from undertaking gender-responsive policy-making to gender budgeting.

When countries are beginning to implement gender-responsiveness into the policy-making process, they often start by focussing on a few policy areas. Figure 2.2 highlights a number of broad policy areas where this is the case in OECD countries that reported not using gender budgeting. Almost all of these countries (with the exception of the Slovak Republic) appear to have gender-responsive policies in at least one broad policy area. As shown in Figure 2.3, the broad policy areas where gender-responsive policies are most likely to be seen are economic independence, the equality agenda, education, gender-based violence, and work-life balance. For example, in Portugal, the government has specific sectorial plans, aiming at the promotion of gender equality in the structure and action of public entities. In Denmark, the government's strategy on gender equality includes a strengthened assessment of citizen-oriented services, including how local authorities can use gender equality assessment to strengthen specific areas such as unemployment services, healthcare and care for the elderly.[5]

At a more advanced stage of gender-responsive policy-making, countries are more likely to be observed mainstreaming gender impact assessment into the policy-making

Figure 2.2. **Number of broad policy areas with gender-responsive policies in OECD countries *without* gender budgeting**

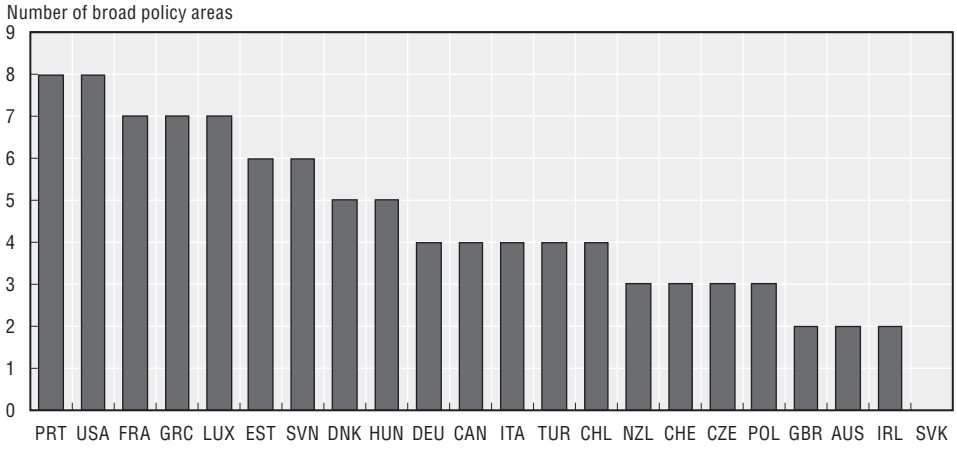
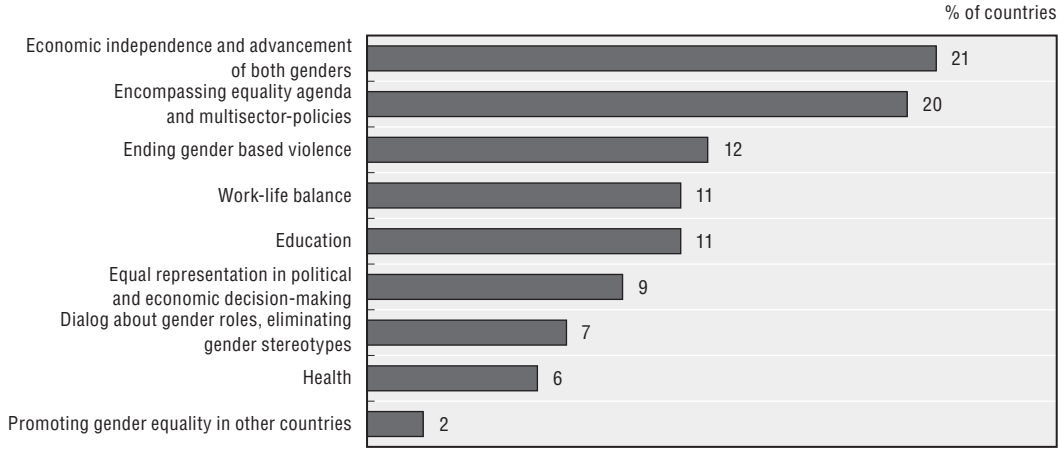


Figure 2.3. **Number of broad policy areas with gender-responsive policies in OECD countries *without* gender budgeting**



process. For example, when **UK** government officials are completing an impact assessment for government policy, they are advised to document any relevant equalities impact and attach any specific equalities impact analysis. The Government of **Canada** has committed to analysing gender-specific policy impacts on women and men before making decisions on policies, legislation, and programmes throughout its departments and agencies. Requirements for this form of analysis have become considerably more widespread over recent years.

Another current practice in relation to gender-responsive policy-making is the publication of separate gender statements at the same time as the budget. For example, in **Australia** "A Women's Budget Statement" has been published annually since 2008 providing an informative discussion of government policies significant for women and gender equality more broadly.

An interesting example from outside the OECD is provided by **South Africa**, a country where gender-responsive policy-making is being taken forward through a separate Department of Women. This Department is responsible for leading, co-ordinating and

overseeing the transformation agenda on women's socioeconomic empowerment, rights and equality.

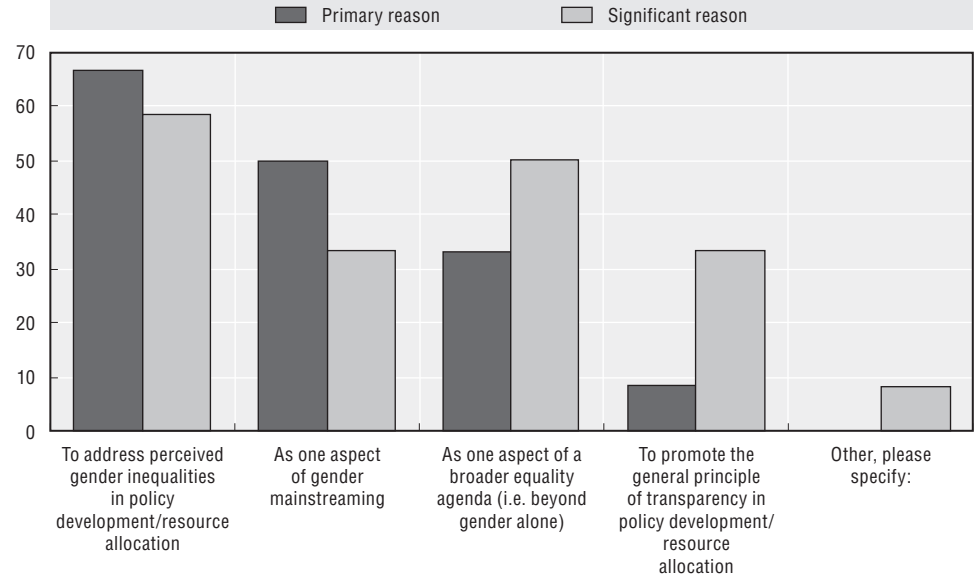
When considering introducing new tools to further gender-responsive policy making, countries may test different approaches. For example, in **Italy**, where gender budgeting is foreseen to be introduced in 2017, the current general accounting and finance law has recently been amended to introduce a gender budget on an experimental basis which assesses the impact of fiscal policy by gender.

After considering new tools to further gender-responsive policy making, there are some instances where countries have decided not to introduce them. For example, in **Germany** a National Feasibility Study was conducted in 2005-06 to identify instruments and good practices for introduction into the German Budgeting System. The Federal Government decided not to introduce gender budgeting, maintaining the position that the government departments themselves are responsible for taking gender equality objectives and gender-related impacts into account when they design policies.

2.2. Rationale for introducing gender budgeting

Gender budgeting practices have for the most part been introduced over the course of the last decade. Figure 2.4 illustrates the relative importance of different factors in the introduction of gender budgeting. **The factor cited most frequently as the primary reason for the introduction of gender budgeting is perceived inequalities** (eight OECD countries out of the 12 that have introduced gender budgeting). Half of these countries also stated that a primary factor was that gender budgeting is one aspect of gender mainstreaming (six out of 12 OECD countries).

Figure 2.4. **Relative importance of factors for introducing gender budgeting**



Source: 2016 OECD Survey of Gender Budgeting.

Although just a third of countries (four out of 12 OECD countries) cited the fact that gender budgeting is one aspect of a broader equality agenda as a primary reason for its introduction, half of the countries (six out of 12 OECD countries) cited it as a significant reason.

Interesting and contrasting cases are provided by both Austria and Korea. In **Austria**, the introduction of gender budgeting was a by-product of the introduction of performance budgeting. A special performance objective relating to gender, and the information given in the budget documents, is used as a lever to foster gender equality as a general principle in the administration in line with the broader equality agenda. In **Korea**, the gender budgeting initiative is largely a result of a domestic civil society movement combined with the international efforts towards gender mainstreaming.

2.3. Foundations of gender budgeting

OECD countries with gender budgeting have a legal foundation for their gender budgeting practice, although the nature and intention of the legal provisions vary.

Of the 12 OECD countries that reported introducing gender budgeting, five have the principles of equality enshrined within their constitution (**Austria**, **Belgium**, **Mexico**, **Norway** and **Spain**). **Austria** is unique among this group of countries because the equality provisions within its constitution are specific to the practice of gender budgeting. More details on the constitutional basis of gender budgeting in Austria are provided in Box 2.1.

Box 2.1. **The constitutional requirement for gender budgeting in Austria**

Austria's Constitution has included gender budgeting as a requirement for all levels of government since 2009. The relevant provisions state:

- **Article 13, Paragraph 3:** "Federation, States and Communes are to strive for the effective equality of men and women in their budget management."
- **Article 51, Paragraph 8:** "In the Budget Management of the Federation the fundamental principles of impact orientations, especially under consideration of the objectives of the effective equality of men and women, transparency, efficiency and the most faithfully possible representation of the financial situation of the Federation are to be observed."
- **Article 51, Paragraph 9:** "The particularities […] are to be fixed by Federal Laws […] in accord with the provisions of Paragraph 8. To be regularised in these are especially:
  1. Measures for an impact orientated administration, especially also under consideration of the objective of the effective equality of men and women;"

Half of these countries have provisions specifically related to gender budgeting within their Organic Budget Law (**Austria**, **Iceland**, **Korea**, **Mexico**, **Netherlands** and **Spain**). However, what these provisions legally oblige each country to do varies widely.[6]

For example, in **Iceland** these provisions require all ministries to undertake gender analysis of budget proposals, as well as legislative proposals. The budget bill submitted to parliament should also outline the impact of changes in revenue and expenditure policies on gender equality targets.

In **Spain**, the legal framework requires that each ministerial department sends the Secretary of State for Budget and Expenditure a report analysing the gender impact of its spending programmes. These reports constitute the basis for the Secretary of State for Budget and Expenditure to formulate an overall Gender Impact Report accompanying the General State Budget White Paper.

By contrast, in **Austria**, as gender budgeting was introduced as part of the performance based budgeting framework codified in the budget law, the provisions require each chapter

within the Annual Budget Statement to have outcome objectives, with at least one objective directly addressing gender equality. Sample objectives include; higher female participation in the labour market, improvement of the state of health of males aged above 50, reduction of the gender pay gap, and improvement of road security for males under 25.

Just three of the OECD countries that have introduced gender budgeting (**Finland**, **Japan** and **Sweden**) reported that the practice is not underpinned by any legal provisions. In their survey response, **Finland** stated that its gender budgeting is underpinned by administrative practice (e.g. the Budget Circular). **Japan** and **Sweden** stated that gender budgeting is underpinned by high level political commitment/convention. This political commitment is particularly evident in **Sweden**, where the current government has identified itself as "the world's first feminist government" (the previous administration titled itself as a "gender equality government"), building on a long tradition of concern for gender equality.

2.4. Responsibility for gender budgeting

The practice of gender budgeting typically involves co-ordination between a number of government departments. For example, in **Iceland** the Ministry of Finance and the Ministry of Equality work together to prepare a gender budgeting programme as part of the gender budgeting requirements. Additionally, a gender budgeting working group in **Spain** consists of representatives from the Ministry of Health, Social Services and Equality, the Office of the Secretary of State for Budgets and Expenditure and the Directorate General of Budgets.

However, there are a number of notable exceptions. For example, **Korea** indicated in their response that the Ministry of Strategy and Finance has the main responsibility for implementing gender budgeting. In addition, **Norway** indicated that different sectors of government have the responsibility for gender equality policies within their areas of authority (in line with the general principle in Norway that individual sector-based ministries are fully responsible for their services and policies).

Line ministries play a dominant role, relative to the central authority, in the *implementation* of gender budgeting. Three OECD countries (**Austria**, **Norway** and the **Netherlands**) also indicated that independent bodies with a specific mandate are involved in gender budgeting. For example in the **Netherlands** there is an independent institute on gender equality (*Atria*) which produces a yearly monitor on the effects on gender equality of the policies presented in the national and departmental budgets. The National Court of Audit also does some preliminary gender audits.

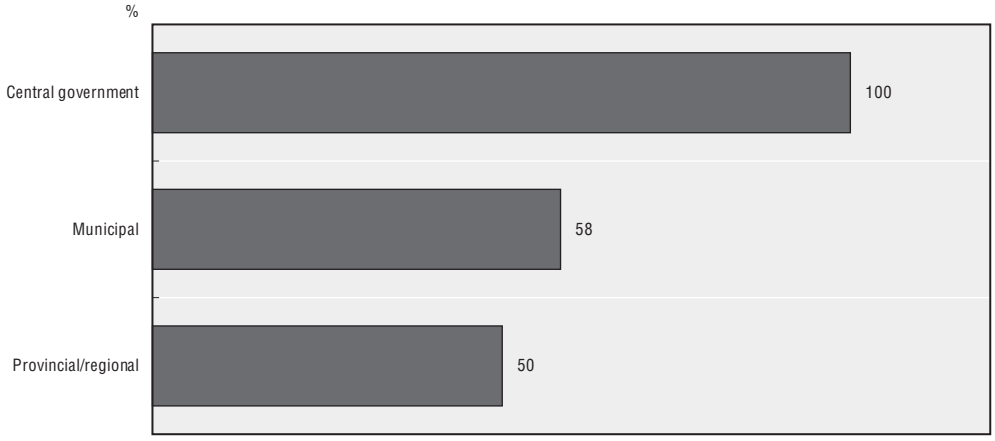
2.5. Levels of government engaged in gender budgeting

In two thirds of the OECD countries that have introduced gender budgeting at least two levels of government are involved, as highlighted in Figure 2.5.

Sub-national gender budgeting is legally required in some countries such as **Austria**, where it is a constitutional requirement, and encouraged in other countries such as **Norway**, where a key strategy in the Government's gender-equality approach is to incorporate the gender perspective into all policy-making, whether at the central, regional or local level.

In other OECD countries (including **Finland**, **Iceland**, **Israel** and **Spain**) involvement in gender budgeting at the sub-national level is taken forward on an administrative rather than mandatory basis. In these countries, gender budgeting may only be taken forward by a relatively small number of regions and municipalities. Box 2.2 provides an example of sub-national gender budgeting practices from the Andalusia Region of Spain.

Figure 2.5. **Level of government where gender budgeting is applied**



Source: 2016 OECD Survey of Gender Budgeting.

Box 2.2. **Example of sub-national gender budgeting – Andalusia**

In Spain, the gender-responsive strategy that the regional Government of Andalusia has been implementing since 2003 has gradually been extended to encompass the entire Andalusian Administration. In 2007 a methodology called the G+ *Programme* was created to identify the budget programmes with the greatest impact for improving gender equality. Gender audits, introduced in 2013 to assess the implementation of the G+ *Programme*, are the latest stage in this strategy. Gender-responsive budgeting also measures the impact of public spending on gender equality goals, allowing for adjustments to allocations to correct any imbalances.

In addition, in Andalusia a Gender Impact Report accompanies the Budget. It assesses the impact of budget policies on gender equality in Andalusian society; in other words, it examines how the distribution of budget resources affects the economic, social, and life opportunities of women and men.

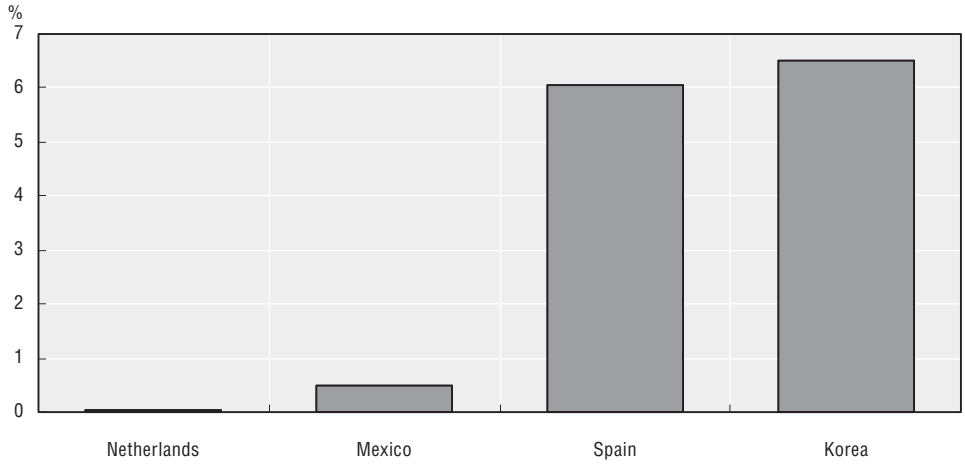
Source: Government of Andalusia 2016.

It should be noted that while some countries indicated that they do not practice gender budgeting at the national level, there may still be gender budgeting at the regional or local levels. For example, in **Switzerland**, the federal government does not practice any sort of gender budgeting but there have been various gender budgeting initiatives at sub-central levels of government.

2.6. Financial resources allocated to gender-responsive policies

The level of financial resources allocated to gender-responsive policies varies substantially among reporting countries in both absolute terms and as a share of total public expenditure, as illustrated in Figure 2.6. However, caution should be exercised in the interpretation of these results given that each country is likely to have a different definition of qualifying expenditure. It should also be noted that several OECD countries (**Austria, Iceland, Israel**) indicated that they were not able to provide details of the level of resources allocated towards gender-responsive policies due to the cross-cutting nature of their gender budgeting work.

Figure 2.6. **Level of resources in financial year 2014 allocated towards gender-responsive policies**



Source: 2016 OECD Survey of Gender Budgeting.

In general, financial expenditure relating to gender budgeting can be split into two main types; expenditure for gender-specific programmes (for example, subsidies for child care, benefits to single parents, family allowances) and expenditure for mainstreaming gender-responsive policies (for example, expenditure on gender impact assessments). Some OECD countries, such as **Norway** and the **Netherlands**, also report allocating financial resources as overseas development assistance to be used to promote gender equality in developing countries.

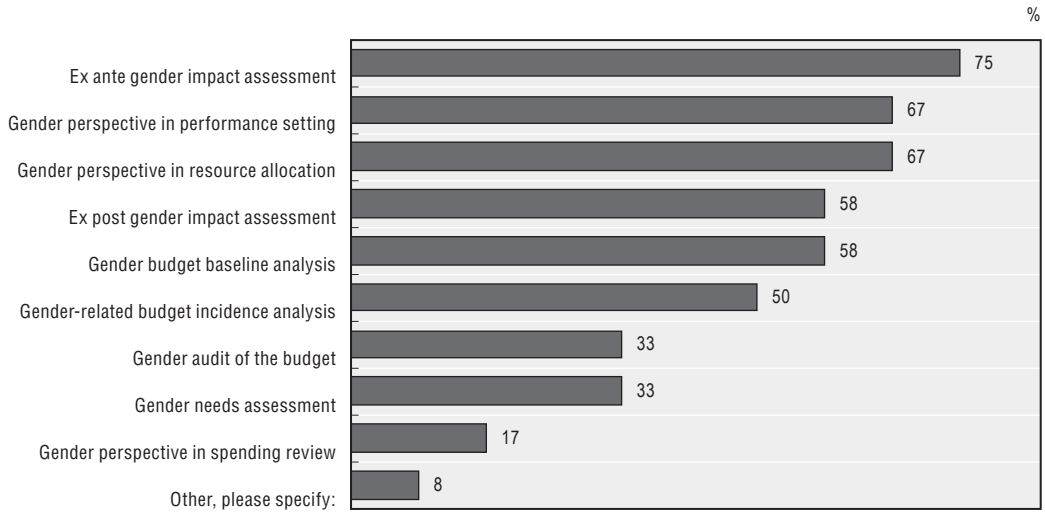
2.7. Tools of gender budgeting

A broad range of tools are used by countries in the implementation of gender budgeting, with each country using an average of five of the nine gender budgeting tools identified in the Survey. OECD countries which reported using more gender budgeting tools than others on average are the **Netherlands** (8), **Mexico** (7) **Spain** (7) and **Austria** (6). At the other end of the scale, **Belgium** and **Japan** each report using just one gender budgeting tool (*ex ante* gender impact assessment and gender perspective in resource allocation, respectively).

The frequency with which each gender budgeting tool is used by the 12 OECD countries that have introduced gender budgeting is illustrated in Figure 2.7. **Two of the most frequently used tools of gender budgeting are *ex ante*** and ***ex post* gender impact assessments suggesting a systematic continuum of gender-focused policy assessment across the budget cycle.** It should be noted that that the rigour and impact of the approaches to gender impact assessments appears variable. However, one particularly strong example is provided by **Austria** where the government is required to undertake an *ex ante* assessment of the impact on gender equality for any regulation. The new impact assessment process, introduced in 2013 for all laws and ordinances (Wirkungsorientierte Folgenabschätzung), contains an explicit set of rules for assessing impacts on gender equality, and is combined with a new handbook and training for the users and a mandatory *ex post* evaluation.

At least half of these OECD countries also use; gender perspective in resource allocation, gender perspective in performance setting, gender budget baseline analysis, and gender-related budget incidence analysis. A country example of a gender perspective in resource allocation is provided in Box 2.3.

Figure 2.7. **Use of each gender budgeting tool (in 12 OECD countries reporting as having gender budgeting)**



Source: 2016 OECD Survey of Gender Budgeting.

Box 2.3. **Example of a gender perspective in resource allocation – Sweden**

An appendix to the Swedish budget bill is published each year, entitled Economic Equality between Women and Men, showing the distribution of economic resources between the sexes. The appendix has been published since 1988, and since 2003 the appendix has been placed adjacent to the Budget Statement to emphasise its overarching importance. In some years the appendix on economic gender equality has had a thematic focus. The appendix shows how gender inequalities between women and men are expressed in economic terms, but also how welfare systems reduce the gender gap in earnings. In analysing the economic situations of women and men respectively, it examines the distribution of education, gainful employment, wages, household work and capital income. Finally, it describes disposable income by combining the various types of income and social insurance benefits and deducting taxes.

Source: 2016 OECD Survey of Gender Budgeting.

Relatively less frequently used tools are; gender needs assessment (four countries), gender audit of the budget (four countries) and gender perspective in spending review (two countries).

Through analysing the use of tools by each gender budgeting country, there appears to be three broad categories of gender budgeting systems:

1. **Gender-informed resource allocation** whereby gender assessments inform individual policy decisions and/or funding allocations;
2. **Gender-assessed budgets** where there has been a gender assessment of the budget; and
3. **Needs-based gender budgeting** where a gender needs assessment forms part of the budget process.

The categories are broadly incremental, in that those which have gender-assessed budgets generally undertake gender-informed resource allocation and countries that do needs-based gender budgeting also generally have gender-assessed budgets.

The countries that fall within each category are highlighted in Table 2.1. Two thirds of the OECD member countries that do gender budgeting fall into the first or second categories, with just four undertaking a gender needs assessment as part of the budget process (Austria, Mexico, Netherlands, Norway).

Table 2.1. **Gender budgeting systems – a typology**

Gender budgeting categories		Use of gender budgeting tools								
		Ex ante gender impact assessment	Gender perspective in resource allocation	*Ex post* gender impact assessment	Gender perspective in performance setting	Gender perspective in spending review	Gender-related budget incidence analysis	Gender budget baseline analysis	Gender audit of the budget	Gender needs assessment
1) Gender-informed resource allocation	Belgium	■	-	-	-	-	-	-	-	-
	Japan	-	■	-	-	-	-	-	-	-
	Finland	-	■	-	■	-	-	-	-	-
2) Gender-assessed budgets	Iceland	■	■	■	■	-	-	■	-	-
	Israel	■	-	■	-	-	■	■	-	-
	Korea	-	■	-	■	■	-	■	-	-
	Spain	■	■	■	■	-	■	■	■	-
	Sweden	■	-	■	■	■	-	-	■	-
3) Needs-based gender budgeting	Austria	■	-	■	■	-	■	■	-	■
	Mexico	■	■	■	■	-	■	■	-	■
	Netherlands	■	■	■	■	-	■	■	■	■
	Norway	■	■	-	-	-	■	-	■	■

Source: 2016 OECD Survey of Gender Budgeting.

2.8. Support for implementing gender budgeting

In three quarters of OECD countries that have introduced gender budgeting, the budget authority provides guidelines for implementation (Austria, Belgium, Finland, Iceland, Israel, Korea, Mexico, Norway, Spain), as illustrated in Figure 2.8. Outside the OECD, India is another country where the budget authority issues guidelines for gender budgeting in the form of the Charter for Gender Budgeting, issued in 2007.

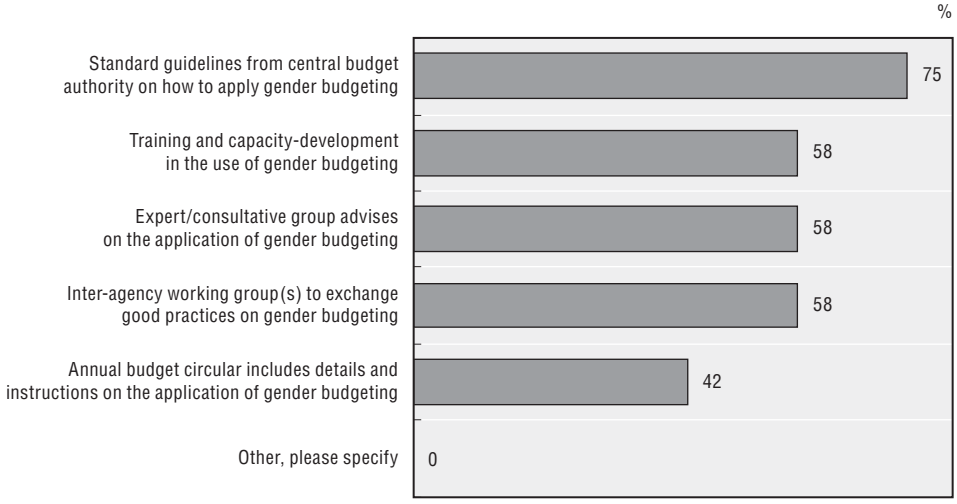
Training and capacity development, which can be a crucial factor in order to increase openness towards gender-responsive policies throughout the public sector, is also available in just over half of the OECD countries that have implemented gender budgeting. For example, government officials in **Korea** must have to attend a specific training to learn how to prepare a Gender Budgeting Statement (a document that contains information on gender budgeting targets and the beneficiaries of government spending) before they can prepare one.

Over half of the countries also report that an expert/consultative group advises on the application of gender budgeting and that there is an inter-agency working group(s) to exchange good practices on gender budgeting.

The scope of support for implementation varies. A greater range of support is available in **Austria**, **Iceland** and **Mexico**, where four out of the five administrative tools to support the implementation of gender budgeting are provided. By contrast, **Japan** provides just one of the implementation tools listed (an expert/consultative group that advises on the application of gender budgeting).

Figure 2.8. **Administrative tools to support the implementation of gender budgeting**

(In 12 OECD countries reporting as having gender budgeting)



Source: 2016 OECD Survey of Gender Budgeting.

A summary of the tools and methods of gender budgeting across the OECD is provided in Figure 2.9.

2.9. Availability of gender disaggregated data

An important development along the path of gender-responsive policy making is the collection of gender disaggregated data. Data and evidence supporting decision making are pivotal to enable governments to develop effective gender sensitive and evidence based policies and gender equality strategies for inclusive growth (OECD, 2014b). For the majority of OECD countries that have implemented gender budgeting (ten out of 12 OECD countries), gender disaggregated data is available for some selected areas of public service. There are just two countries (**Norway** and **Sweden**) where gender disaggregated data is routinely available in the required depth across all or most key areas of the public service.

In the past, the OECD has identified several challenges to gender disaggregated data collection including: limited human resources; limited capacity of the statistical offices; limited capacity in line ministries/departments/agencies to determine the need for gender disaggregated data; limited skills of producers of statistics to incorporate a gender perspective into their work; limited co-ordination mechanisms to determine the kind of data that need to be collected; lack of indicators to guide the collection of disaggregated data; and poor quality of existing data (OECD, 2014b).

An interesting example of increased availability of gender disaggregated data triggering improved gender-responsive budgeting is provided by Israel (see Box 2.4).

2.10. Methods to assess the impact of gender budgeting

Two thirds of OECD countries that have introduced gender budgeting use the development and application of gender related indicators to assess the impact of gender budgeting (Austria, Finland, Israel, Mexico, Netherlands, Norway, Spain, Sweden), as shown in Figure 2.11.

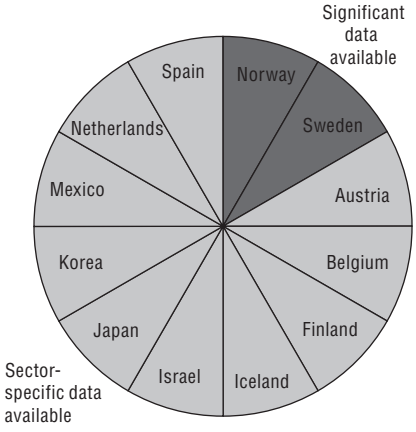
Figure 2.9. **Gender budgeting practices**

		Use of gender budgeting tools										Administrative approaches supporting the implementation of gender budgeting					
	Does your country practise some form of gender budgeting?	*Ex ante* gender impact assessment	Gender perspective in resource allocation	Gender perspective in performance setting	*Ex post* gender impact assessment	Gender budget baseline analysis	Gender-related budget incidence analysis	Gender audit of the budget	Gender needs assessment	Gender perspective in spending review	Other	Standard guidelines from central budget authority on how to apply gender budgeting	Expert/cosultative group advises on the application of gender budgeting	Training and capacity development in the use of gender budgeting	Inter-agency working group(s) to exchange good practices on gender budgeting	Annual budget circular includes details and instructions on the application of gender budgeting	Other
Australia	No	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
Austria	Yes	■	-	■	■	■	■	-	■	-	-	■	-	■	■	■	-
Belgium	Yes	■	-	-	-	-	-	-	-	-	-	■	■	-	■	-	-
Canada	No	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
Chile	No	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
Czech Republic	No[1]	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
Denmark	No	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
Estonia	No	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
Finland	Yes	-	■	■	-	-	-	-	-	-	-	■	■	-	-	-	-
France	No	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
Germany	No	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
Greece	No	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
Hungary	No	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
Iceland	Yes	■	■	■	■	■	-	-	-	-	-	■	■	■	■	-	-
Ireland	No	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
Israel	Yes	■	-	-	■	■	■	-	-	-	-	■	■	■	-	-	-
Italy	No[2]	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
Japan	Yes	-	■	-	-	-	-	-	-	-	-	-	■	-	-	-	-
Korea	Yes	-	■	■	-	■	-	-	-	■	-	■	-	■	-	■	-
Luxembourg	No	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
Mexico	Yes	■	■	■	■	■	■	-	■	-	-	■	■	■	■	-	-
Netherlands	Yes	■	■	■	■	■	■	■	■	-	-	-	■	■	-	-	-
New Zealand	No	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
Norway	Yes	■	■	-	-	-	■	■	■	-	■	■	-	-	■	■	-
Poland	No	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
Portugal	No	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
Slovak Republic	No	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
Slovenia	No	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
Spain	Yes	■	■	■	■	■	■	■	-	-	-	■	-	-	■	■	-
Sweden	Yes	■	-	■	■	-	-	■	-	■	-	-	-	■	■	■	-
Switzerland	No	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
Turkey	No[1]	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
United Kingdom	No	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
United States	No	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
Total OECD	12	9	8	8	7	7	6	4	4	2	1	9	7	7	7	5	0
Brazil	Yes	-	-	-	-	-	-	-	■	-	-	-	-	-	-	-	■
India	Yes	-	■	-	-	-	-	-	-	-	-	■	-	■	-	-	-
South Africa	No	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-

Notes:
1. Actively considering
2. Planning to introduce

Source: 2016 OECD Gender budgeting survey.

Figure 2.10. **Availability of gender disaggregated data**



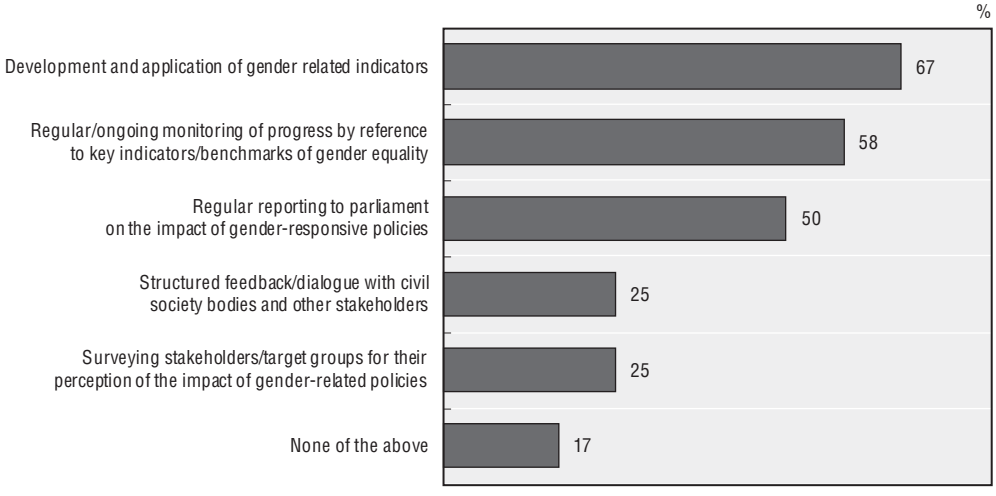
Source: 2016 OECD Survey of Gender Budgeting.

Box 2.4. **Improved gender disaggregated data and its impact on gender-responsive budgeting – Israel**

In Israel, in 2008 the Statistics Law was amended to require that every data collecting institution must analyse and publish statistics by gender. Subsequently, since 2014, line ministries have had to conduct gender analysis of the budget. In the field of science (scholarships and funds), the exposure of data on gender budgeting (*ex post*) initiated a process of a more balanced allocation of resources. In sports, the data on gender budgeting has sparked a public discussion and a legal procedure. Despite this, some ministries have continued to have difficulty obtaining the necessary data as shown in an independent study of the Ministry of Industry, Trade and labour.

Source: OECD 2014b and 2016b OECD Survey of Gender Budgeting.

Figure 2.11. **Tools and approaches to assess the impact of gender budgeting**



Source: 2016 OECD Survey of Gender Budgeting.

In addition, half or more of these OECD countries regularly monitor progress by reference to key indicators of gender equality and regular reporting to parliament.

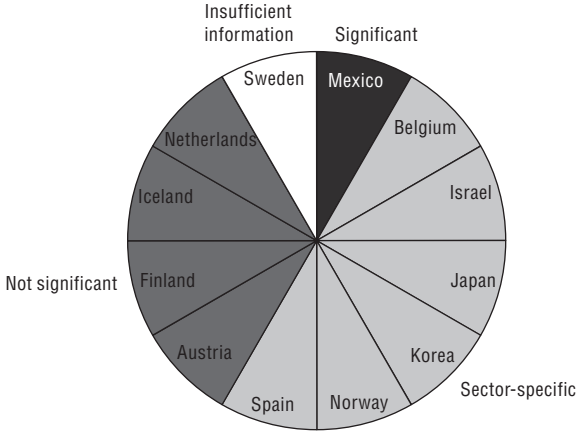
Just a quarter of these OECD countries undertake structured dialogue with civil society to assess the impact of gender budgeting (**Mexico**, **Netherlands**, **Israel**). Similarly, a quarter ask stakeholders for their perception of the impact of gender-related policies (**Austria**, **Netherlands**, **Iceland**). From outside the OECD, **Morocco** is an example of a country which regularly communicates with civil society and stakeholders in relation to gender budgeting. Inter-agency groups exchange good practices, expert groups are asked for their advice, and there is a structured dialogue with civil society and other stakeholders.

2.11. Effectiveness of gender budgeting

The effectiveness of gender budgeting can be measured in a number of different ways. A useful guide to the types of impact that may be expected is provided by **Korea**, where gender budgeting aims to: Increase the amount of budget share earmarked for gender equality, increase awareness of gender equality among government officials, and bring changes to the budget and policy making.

Survey responses show that countries' self-assessment of the effectiveness of gender budgeting varies widely, even in those countries with strong gender budgeting practices. Half report sector specific results, as illustrated in Figure 2.12.

Figure 2.12. **Effectiveness of gender budgeting in policy development and resource allocation**



Source: 2016 OECD Survey of Gender Budgeting.

In particular, a number of countries reported that gender budgeting has stimulated the adoption of policy developments to improve gender equality, specifically in the following areas:

- Education
- The labour market
- Income inequality
- Welfare
- Childcare and family care
- Citizen security
- Health
- Foreign and development policy

For example, in **Mexico**, gender budgeting has resulted in special attention being given to diseases affecting women (such as cervical cancer, ovarian and breast cancer, as well as teen pregnancy prevention) in the health sector. Similarly, in **Japan**, increased focus on gender policies has led to measures to reduce maternity harassment in the workplace. An example from outside the OECD is provided by **Brazil**, where gender budgeting has resulted in a comprehensive care programme related to women's health.

In the **Netherlands**, gender budgeting has been seen to bring changes to how funding is allocated. For example, an agreement was made between the Dutch universities, research institutes and the Minister of Education in 2015 on the conditions for receiving subsidies. To receive full payment, the number of women professors, associate professors, and women in the governing boards of research institutes and universities had to be at least 30% before 2020.

In addition, an interesting example of how gender budgeting has impacted parliamentary scrutiny of legislative proposals was provided by **Iceland** (see Box 2.5).

Box 2.5. **Example of gender budgeting impact – Iceland**

In 2015, the budget committee of the Icelandic Parliament (Althingi) proposed a significant change in a legislative proposal on changes to income tax. The aim of the legislative proposal was to simplify the income tax system, moving from three bands to two and abolishing permission for the higher income partner of a couple to benefit from unused tax credit of the lower income partner.

The budget committee initially proposed a continuation of the permission to use tax credit of lower income partner which mainly benefits men since they are the higher income partner in 75 out of 100 marriages. However, owing to the introduction of gender budgeting, the Ministry of Finance and Economic Affairs was able to point out to the committee that this would mean that men would receive tax benefits based on the work and salaries of women and so their disposable income would increase as would the gender income gap, contrary to the goal of economic equality between men and women. Thanks to this information the initial proposal of the budget committee was amended.

Source: 2016 OECD Survey of Gender Budgeting.

Sweden reported that since the introduction of gender budgeting is relatively new, it is too soon to present any results that have been achieved through gender budgeting. This is a point that is relevant in relation to gender budgeting in a number of countries, and as such, a wider range of impacts may become evident in future.

2.12. Summary

Almost half of OECD countries (15 out of 34 members) have introduced, plan to introduce, or are actively considering the introduction of gender budgeting. The vast majority of those countries which have not introduced gender budgeting still implement some form of gender-responsiveness into the policy-making process which may in turn impact spending.

Gender budgeting practices have for the most part been introduced over the course of the last decade. Perceived inequalities are cited as the primary driver for introducing gender budgeting. Its contribution towards the wider objective of gender mainstreaming has also

been an important factor. Where gender budgeting has been introduced, it is usually legally underpinned, although the nature and the intention of the legal provisions vary. Governments rely on a co-ordinated approach to guide and deliver gender budgeting, with government departments, such as the Ministry of Finance and the Ministry of Equality, working together.

A wide variety of gender budgeting approaches are practiced, with no standard model of gender budgeting in OECD countries. Focus ranges from gender impact assessment of spending programmes to the monitoring of gender performance indicators. The two most frequently used gender budgeting tools are *ex ante* and *ex post* gender impact assessments, suggesting a more systematic continuum of gender-focused policy assessment across the budget cycle. Countries also frequently apply a gender perspective in resource allocation and a gender perspective in performance setting. There is more limited use of tools such as gender needs assessment, gender audit of the budget and a gender perspective in spending review.

Only half of those countries with some form of gender budgeting could point to specific examples where the gender budgeting tool had brought about significant changes in policy design and/or outcomes. Where impact was reported, countries often cited examples of where gender budgeting has stimulated the adoption of policy developments to improve gender equality. There were more limited examples of instances where the introduction of gender budgeting has brought about changes to budget allocations. Since the introduction of gender budgeting is still relatively new in a number of countries, a wider range of impacts may become more evident in the future.

3. Gender budgeting: Lessons and implications for budgeting and public governance

Gender budgeting is a specific example of a broader trend in budgeting, whereby the budget is considered as something more than a neutral, process of resource allocation, but as a value-laden process that embodies – and potentially informs and influences – long-standing societal choices about how resources are deployed. Current practice suggests, however, that there is far from universal acceptance among OECD countries about the necessity or usefulness of gender budgeting as an instrument for promoting gender equality policy; and even in those countries that apply gender budgeting, the specific approaches used vary widely. This section takes the gender-budgeting findings from Section 2 as a starting point, including the qualitative issues raised in country responses, and highlights some issues of relevance for broader OECD work in budgeting and public governance.

3.1. Inclusive growth: Gender budgeting and Budget Impact Assessment

The OECD defines inclusive growth as "economic growth that creates opportunity for all segments of the population and distributes the dividends of increased prosperity, both in monetary and non-monetary terms, fairly across society". The concept is based upon the recognition that economic growth is an important but not sufficient condition to foster the development of people's "well-being", as understood in the OECD framework, and that observed outcomes across many policy areas show persistent inequalities, in areas that go beyond income alone."[7]

In the context of its ongoing work on wellbeing and quality of life, the OECD has proposed[8] a set of factors to measure the concept of inclusiveness, such as income and wealth, jobs, skills and education, health status, environmental quality, personal security,

infrastructure and housing – many of which would expect to feature as dimensions of analysis in the context of gender budgeting. Thus, the concept of inclusive growth has a multi-dimensional nature which overlaps and intersects with the horizontal approach of gender budgeting.

In its recent work on inclusive growth, the OECD has placed importance on the role of the budget as the central system of resource allocation, with a related key role in determining the quality of the associated policy analysis – which includes the capacity of policy analysis to cater for multi-dimensional themes. Table 3.1 illustrates the potential for "Budget Impact Assessment" to expand beyond its traditional areas of coverage – household income impacts arising from budget policy changes – to a broader range of issues including poverty, environmental sustainability and well-being, in addition to impacts on gender equality.

Section 2 outlined how "gender-proofing" of budget policies – i.e. ensuring that all policies which are brought forward for consideration in the budget context are assessed in a structured and meaningful way for their impact on gender equality – is just one element of gender budgeting. From the perspective of inclusive growth, gender-proofing is similarly just one element of the range of thematic assessments that can inform the quality of policy-making. This raises the question of where governments should direct their future attention, in seeking to advance the analytical quality and relevance of budget-related policy analysis. It is notable that similar issues arise in the area of regulatory policy, where the traditional "Regulatory Impact Assessment" tool is being re-purposed and broadened to address the requirements of modern public governance.

Table 3.1. **Gender and other dimensions of inclusive growth in budget impact assessments**

Budget assessment dimension	Description
Household income	Increase/decrease in net take-home financial position across the salary/benefit scale; classified by household type (single, one-parent, two-parent, number of children, number of other dependants, housing status)
Well-being impacts	Effects of budget measures on a range of well-being indicators, such as access to and quality of healthcare; housing status; access to education; cultural and community life
Environmental impacts	Effects and costing of budget measures as to their impact on production of CO^2 and/or other environmentally deleterious emissions
Gender impacts	Relative quantified net impacts of budget measures by gender
Ethnic impacts	Relative income and other impacts of budget measures on particular ethnic groups in society
Poverty impacts	Effects of budget measures, including income, material deprivation indicators and other well-being indicators, on the position of underprivileged and/ or marginalised sections of the population

Source: OECD (2016a), *The Governance of Inclusive Growth*.

3.2. Learning from other horizontal budget themes: The case of Green Budgeting

As table 3.1 illustrates, a multi-dimensional approach to budgeting could include a range of horizontal themes beyond traditional income impact assessment, and beyond gender budgeting, to include issues such an environmental impacts. In fact, environmentally-responsive or "green" budgeting has its origins in the 1987 report of the Brundtland Commission (World Commission on Environment and Development) which recommended that "the major central economic and sectoral agencies of governments should now be made directly responsible and fully accountable for ensuring that their policies, programmes, and budgets support development that is ecologically as well as economically sustainable".

As in the case of gender budgeting, there is currently no single international standard for green budgeting, and its practice is relatively limited. However, since the time of the Brundtland Report, countries have developed a range of tools for "greening the budget" including the following:

- **Climate Budget Tagging** has been used in some countries across Asia to highlight and monitor how money disbursed through their budget contributes to achieving climate change goals (Governance of Climate Change Finance, 2016)
- A more comprehensive approach is the use of a **Climate Change Financing Framework** (CCFF) which aims to engage all relevant stakeholders toward the mobilising, managing, and targeting of domestic climate finance resources (UNDP, 2015). For this purpose, the CCFF determines what constitutes "climate-related finance allocations" in the budget and accounts for how they are used. The intention is to create an institutional framework for climate change policy and its mainstreaming across sectors.
- A direct way to make public expenditures greener is to introduce environmental requirements for public procurement (**"green procurement"**). This approach does not require that all public procurement decisions pass an environmental test, but allows for an informed consideration of environmental impacts in balance with objectives such as to deliver necessary public goods and services in a timely, economical and efficient manner that allows for fair competition (OECD, 2015).
- In similar vein, the activities of **state owned enterprises (SOEs)** and the design of **public private partnerships (PPPs),** both potentially at high risk of damaging the environment, can be designed to prioritise environmental protection (UNDP, 2015a).
- More generally, the tool of **Environmental Impact Assessment** (EIA) – a specialised form of Regulatory Impact Assessment – has become standardised across many OECD countries. In particular, the European Union has a long record in this area, dating from the initial EIA Directive of 1985 (85/337/EC) through to the consolidated 2011 Directive (2011/92/EU). Since 2001, the EIA concept has been extended to the assessment of plans and programmes by the **Strategic Environmental Assessment (SEA)** Directive (2001/42/EC).
- **Budget ear-marking:** It is also notable that, under its seventh Environment Action Programme (EAP) for the period 2014-20, the EU has ear-marked a minimum share (20%) of its overall budget towards climate change mitigation and adaptation.

3.3. Data-sets for evidence-based budgeting: "Gender-specific by default?"

As Section 2 shows, the quality and nature of the data-sets and statistics available represent a limiting factor on the development of gender budgeting. There has been a sustained emphasis over recent years on the availability of "big data" and "open data" as aids to evidence-based policy-making, with a focus on the extension of these approaches from the private to the public sectors.[9] Within the broad area of digital government, it is accepted as good practice that government information frameworks should be "open by design" and that government data should be "open by default", allowing for the use and re-use of data elsewhere within the public sector and within civil society more generally.

However, to provide a grounding for evidence-based decision-making and for civic engagement on policy issues, the content of the data is just as important as its open nature. The survey results point to a systematic lack, across many OECD countries, of the necessary gender-disaggregated data that would allow for the gender aspects to be properly taken into account in policy design, and for gender outcomes to be properly evaluated. It may be that the

non-availability of this data reflects assumptions that the "default" allocation of resources is gender-neutral, and that gender-disaggregation should only be sought where there are *prima facie* grounds for believing that a non-gender-neutral policy issue is in question. However, as Annex A illustrates, gender inequalities seem to be significant and persistent across many policy domains, suggesting that the social dynamics of gender inequality are more subtle and deep-rooted than might appear based on a superficial assessment of individual policy areas.

Accordingly, there seems to be a case for a more systematic and thorough-going approach to collecting data on a gender-disaggregated basis. The example from Israel (see Box 2.4) points to an appreciation of the importance of such data availability as a key element in a national gender equality strategy. It seems plausible to suggest that the routine collection of gender-disaggregated across OECD countries could also yield new policy insights from comparative analysis across countries.

3.4. Open, participative and inclusive budgeting: Gender aspects

The OECD Recommendation on Budgetary Governance (2015) calls on governments to "provide for an inclusive, participative and realistic debate on budgetary choices, by a) offering opportunities for the parliament and its committees to engage with the budget process at all key stages of the budget cycle, both *ex ante* and *ex post* as appropriate; b) facilitating the engagement of parliaments, citizens and civil society organisations in a realistic debate about key priorities, trade-offs, opportunity costs and value for money; and c) providing clarity about the relative costs and benefits of the wide range of public expenditure programmes and tax expenditures."

Throughout the OECD and in other countries, at both national and sub-national levels, more inclusive and participative approaches to budgeting are being put into effect. A clearer and more structured approach to "needs assessment" is one element of an inclusive agenda. Citizens and civil society organisations involved in women's advocacy often have the most direct experience and insights into the potential impacts of budget decisions on individuals and vulnerable groups. There is potential therefore for the quality of policy-making to be improved by including these voices within the policy-development and budget cycles. New technologies allow for the opening up of the policy-making process, including social media and "crowdsourcing" approaches. However, participation in the design, implementation and monitoring phase of the budget process is also possible using traditional tools such as citizen consultations, "deliberative dialogue" (a structured engagement between stakeholders and policy-makers designed to elicit views and insights and complex policy issues) and engagement in parliamentary hearings related to the budget.

In practice, however, the survey results indicate that the opportunities for civic engagement on gender budgeting issues – e.g. via the conduct of "gender audit" or "gender needs assessment" by bodies independent of government – are limited across OECD countries. In addition, the survey results showed limited use of a structured dialogue with civil society to assess the impact of gender budgeting. The general lack of gender-disaggregated data may be a factor which inhibits such broader discourse and critical engagement on the gender implications of resource-allocation decisions.

3.5. Gender budgeting and performance budgeting

The OECD has defined performance budgeting as budgeting that links the funds allocated to measurable results. Governments are increasingly incorporating performance

information in the budgeting and governance processes as a means of achieving better results, promoting greater value for money, and increasing the transparency of spending decisions.

Performance budgeting is at a more advanced stage of adoption amongst OECD countries than gender budgeting. In a number of OECD countries, performance budgeting is providing a favourable environment for the pursuit of cross-cutting policy issues such as gender budgeting, inclusiveness and environmental sustainability. Information from the 2016 OECD Performance Budgeting Survey highlights that gender-sensitive measures form part of the performance information provided in budget submission in nine OECD countries (Austria, Belgium, Estonia, Israel, Korea, Mexico, Slovenia, Sweden, Switzerland). Gender indicators are collected much less frequently in budget submissions than other types of analytical information, such as efficiency indicators. However, the rates are in line with other cross cutting policy issues like inclusiveness and environmental sustainability (OECD, 2016 forthcoming).

As mentioned in Section 2, an illustrative case of the way in which advances in performance budgeting can trigger advances in gender budgeting is provided by Austria. As the practical application of performance budgeting increases, it will be interesting to note whether it continues to support the development of gender budgeting practices. Measurable outputs and clearly-linked budget allocations**,** identified by their gender-responsive character, would support the development of gender budgeting in tandem with performance budgeting.

3.6. Strategic planning and medium-term budgeting: Relevance for gender objectives

The OECD Recommendation on Budgetary Governance (2015) calls on governments to "closely align budgets with medium-term strategic priorities", and recognises the potential role of a medium-term expenditure framework (MTEF) in this regard. By their nature, many high-level goals of government – including gender equality goals – may only be achieved over a multi-year period, and it is appropriate that the programmes and matching resources to achieve these goals should be given expression in the national MTEF.

The UN Sustainable Development Goals (SDGs) were adopted in 2015 as a means of co-ordinating global action on key policy imperatives - from ending poverty (Goal 1), ending hunger (Goal 2), promoting health (Goal 3) and education (Goal 4) through to all the major priorities of modern government as expressed in the 17 Goals. A distinguishing feature of the SDGs is that they have been designed and agreed as being relevant for all countries, whatever their level of development, and that they can thus motivate a common vision for action whereby countries can benefit from one another's experiences.

Goal 5 ("Achieve gender equality and empower all women and girls") is one of the central, cross-cutting goals in the SDG framework, that is relevant for the quality, legitimacy and inclusiveness of policy-making in all other areas. Within this Goal, Target 5.a calls for "reforms to give women equal rights to economic resources"; Target 5.b calls for "enhanced use of enabling technology to promote the empowerment of women"; and Target 5.c requires governments to "adopt and strengthen sound policies and enforceable legislation for the promotion of gender equality". The development of effective gender budgeting approaches, underpinned by modern digital government strategies, is consistent with – if not, indeed, required for – compliance with this aspect of the SDGs.

Progress under this agenda could also inform budget-related responses to other SDGs such as Goal 13 "Combat climate change" – which includes a target to "Integrate climate change measures into national policies, strategies and planning" – as well as Goals 14 and 15 which relate to environmental protection: All three of these measures would potentially come within the ambit of "green budgeting" as described above.

3.7. Gender budgeting and gender mainstreaming: Towards an integrated policy-development approach

The approach to policy prioritisation and target-setting that is embodied in the SDGs points to an appreciation that achieving policy goals in one area is dependent, to a greater or lesser extent, in promoting compatible and supportive goals other areas. This holistic and integrated approach to policy development seems particularly relevant for advancing the gender equality agenda, and for establishing an enduring, meaningful role for gender budgeting.

Past gender budgeting initiatives have often aimed at securing specific funding for targeted activities for women, as opposed to ensuring that resource allocation is based on full knowledge of how current policies and programmes may impact women and men. Funding for targeted gender equality activities may be necessary but an *ad hoc* approach alone will not ensure that countries meet the goal of increased gender equality across sectors. Indeed such an approach risks leading to a marginalisation of efforts and weaker overall impact. Initiatives which focus only on adding resources for targeted activities for women risk resulting in "separate budgets" or being carried out in isolation from the regular budget and policy-development processes.

Similarly, *ad hoc* initiatives risk missing opportunities to mainstream gender into ongoing budget reform processes. For example, the shift in many OECD countries towards some form of performance-based budgeting often involves significant changes in instructions and guidelines; introduction of gender related output and outcome indicators, and monitoring and evaluation of these indicators. The linkage of performance-informed policy approaches with stronger and more multi-dimensional evaluative frameworks – both *ex ante* and *ex post* of the budget process – is increasingly seen as necessary for supporting inclusive growth policies (OECD 2015, *Policy Making and Policy Shaping: The Public Governance of Inclusive Growth)*.

As noted earlier, many countries that have not explicitly embraced gender budgeting report the use of gender mainstreaming initiatives in policymaking, whether as an alternative or as a precursor to gender budgeting. Some countries report significant sector-specific impacts of gender budgeting without the use of gender-budgeting tools at every stage of the budgeting cycle. Yet efforts are still needed to ensure that policy commitments in health, education, and other sectors are matched with resources. Mainstreaming gender "visibility" throughout the budget cycle – from formulation to monitoring and reporting – ensures accountability for policy commitments to gender equality. A clear continuum should be established between the policy development cycle (from needs-assessment through to the design of policy interventions, implementation and *ex post* evaluation) and the budget cycle, with a strong sense of how these two cycles interact and overlap; well-defined linkages between the evaluative and impact-assessment requirements that underlie both cycles; and a clear "line of sight" between the outcomes of these analyses and their specific use in policy implementation and resource-allocation.

Line ministries are at the frontlines of gender mainstreaming and gender budgeting, but central budget authorities, in partnership with national machineries for the advancement of women, can play a critical role in ensuring that line ministries adequately reflect gender mainstreaming initiatives in resource allocation. Central budget authorities can also ensure that gender budgeting initiatives are accompanied with system-wide resources such as a central resource of expertise, clear guidelines, training for personnel, and routine availability of gender-disaggregated data and statistics. Parliaments can also ensure gender equality is taken into account in the budgetary approval process and in holding government to account for the promotion of gender equality in activities and investments across all sector areas.

Such a co-ordinated and integrated approach should not add to the administrative burden for the line ministries and agencies, but should aim to re-structure and re-focus existing preparatory work to better inform decision-making, and to ensure that policy proposals with (inadvertent or negligent) negative impacts on gender equality can be identified and averted. In other words, gender budgeting needs to be seen not as a procedural compliance tool, but as an instrument of good and impactful policy design that bears directly upon the substance of specific policies across all sectors of government. A test of the success of gender budgeting will be whether this approach yields new insights into the design (and re-design) of policy areas, which might not otherwise have been viewed as "gender related" or "gender sensitive" policies. The systematic use of *ex ante* gender budgeting assessment tools might expand the scope of gender budgeting beyond areas where data are available by default, or areas well-known for gender inequalities.

Finally, while beyond the scope of this report, an interesting area of further focussed research is the potential for gender budgeting, and for gender equality approaches more generally, to contribute to strengthened economic growth and development (See e.g. Stotsky, 2007).

Notes

1. A previous OECD survey, the 2011 Survey on National Gender Frameworks, Gender Public Policies and Leadership showed ten countries as conducting gender-responsive evaluations for their central budgets, with Switzerland doing so in some cases (OECD, 2014b).
2. See Women, Government and Policymaking in OECD Countries: Fostering Diversity for Inclusive Growth (OECD, 2014b).
3. Gender mainstreaming is defined as the (re)organisation, improvement, development and evaluation of policy processes, so that a gender equality perspective is incorporated in all policies at all levels and all stages, by the actors normally involved in policy-making.
4. See again, Footnote 1.
5. Figures 2.2 and 2.3 are drawn from initial research into publicly available government documents.
6. The previous OECD 2011 Survey on National Gender Frameworks, Gender Public Policies and Leadership showed five countries as having provisions specifically related to gender budgeting within their Budget Law.
7. OECD (2013), OECD Workshop on Inclusive Growth, OECD Publishing, Paris; OECD (2014), *All On Board: Making Inclusive Growth Happen*, OECD Publishing, Paris.
8. OECD (2015), *How's Life? 2015*, OECD Publishing, Paris.
9. See OECD, 2014a, *Recommendation on Digital Government Strategies*.

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ANNEX A

Examples of the persistence of gender inequalities in OECD countries

While there have been some improvements in the past decade, gender inequalities persist in various areas of public life in OECD countries. Examples can be found in labour market participation, entrepreneurship, remuneration, representation in senior management positions both in the public and private sectors, health outcomes, and education.

In labour market outcomes, differences between male and female participation rates have narrowed from 19 percentage points to 14 percentage points across OECD countries in the period 2000-14 (Figure 1.B), but remain high in most countries. There is a significant wage gap associated with gender, even for the same occupations and even when controlling for individual characteristics, such as education. The gender wage gap has decreased in most OECD countries between 2000 and 2013 although its variation remains significant among OECD countries (Figure 1.A).

Gender differences in paid working hours and participation in part time work remain significant, with women less likely to work full time. Involuntary part time employment is higher among women than men, and the gap has grown by 55% between 2000 and 2014 in OECD countries (Figure 1.C). In many advanced economies, tax systems impose disincentives for female labour-force participation through high tax wedges on secondary earners. Some OECD countries such as Japan and Korea have introduced a significant increase of the length of paternity leave, as an incentive to offset and reverse trends in female labour-force participation. But while the average length of maternity leave has grown from 16 to 19 weeks between 2000 and 2015, the average length of paid father-specific leave has only grown from 3 to 9 weeks, less than half of maternity leave (Figure 1.D).

In the area of entrepreneurship, female representation across many OECD countries remains low. Women are under-represented with regard to business-ownership and entrepreneurship. When asked about the feasibility of starting an enterprise within the next five years, 29% of women in OECD countries answered positively in 2012 compared with 39% of men, although the gap slightly decreased between 2009 and 2012 (Figure 2.A). On average, women represent 25% of business-owners with employees. The earning gap in self-employment has slightly decreased between 2006 and 2012 in OECD from 36 to 32% (Figure 2.B); however, it is more than twice as high as the gender wage gap in OECD countries.

The representation of women in senior positions lags behind that of men across various sectors of the economy. There are 80% more male managers than females in employment and the gap persisted between 2011 and 2014 (Figure 1.F). In the private sector, women

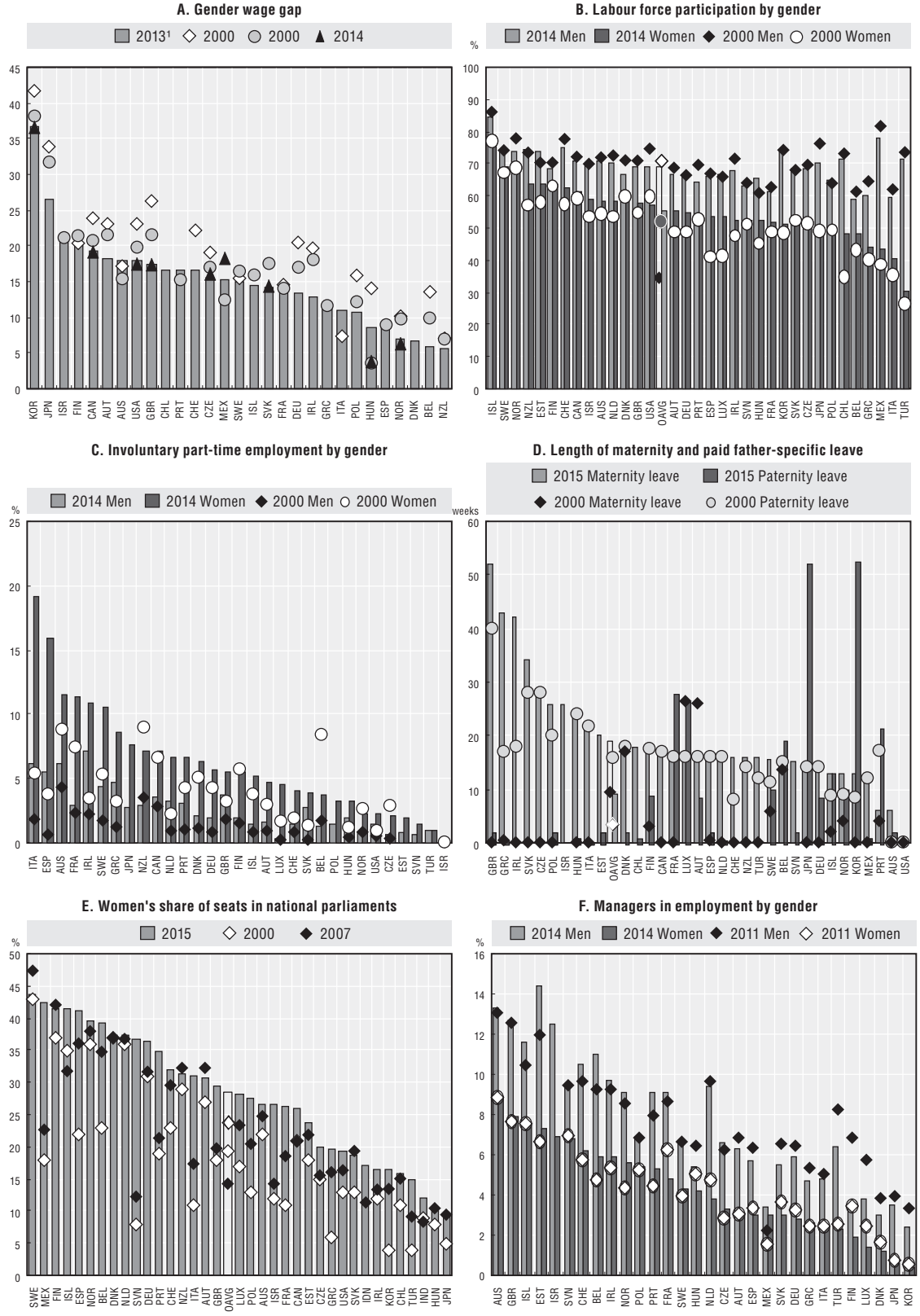
account for 41% of the workforce in the largest companies, but only for 19% of executive level positions and for 12% of board seats. Women hold less than 5% of CEO positions and less than a quarter of senior management roles in S&P 500 firms (OECD, 2016e).

In OECD countries in 2015, on average, only 34% of the highest-ranking civil servants were women. In terms of the number of women holding public office, some improvements can be seen in lower houses of parliament, with an increase of women holding 20.6% of seats in 2002 and 28.6% in 2015. But there are significant differences among individual countries, for example, Sweden (44%) and Mexico (42%) are leading; while Hungary and Japan have barely a 10% share of women in parliament (Figure 1.E).

OECD countries typically have high life expectancies which are mostly in line with biological norms characteristic of both genders. However, health outcomes are also indirectly affected by public policies of other areas such as employment or education. When asked about their health status, a lower share of women reported good/very good health in 2013 than in 2007. This gender gap – albeit while going from positive to negative for women between 2007 to 2013 – is smaller than the gap among groups of women or men who also reported low educational attainment (Figure 3). These indicators point to a complex, multi-dimensional set of factors where gender is important, although not always predominant.

In education, although young women in OECD countries are now more educated than young men on average gender gaps in educational attainment persist. Female and male students have very different shares among graduates in different fields, and the differences are more pronounced at higher levels of education. While women graduates represented 57% of Masters degrees in 2013, they accounted for only 30% of engineering degrees. At the Doctorate level 47% of graduates were female but again received only 28% of doctorate degrees in engineering (Figure 4.B). Occupational segregation appears to prevail in a complex environment with differing incentives, social norms, and lack of role models. At the same time, while men are overrepresented in engineering, they continue to be underrepresented in caring professions such as nursing.

Figure 1A-F. **Gender inequalities in the labour market and public life**



Source: OECD (2016), *Social Protection and Well-Being* database.

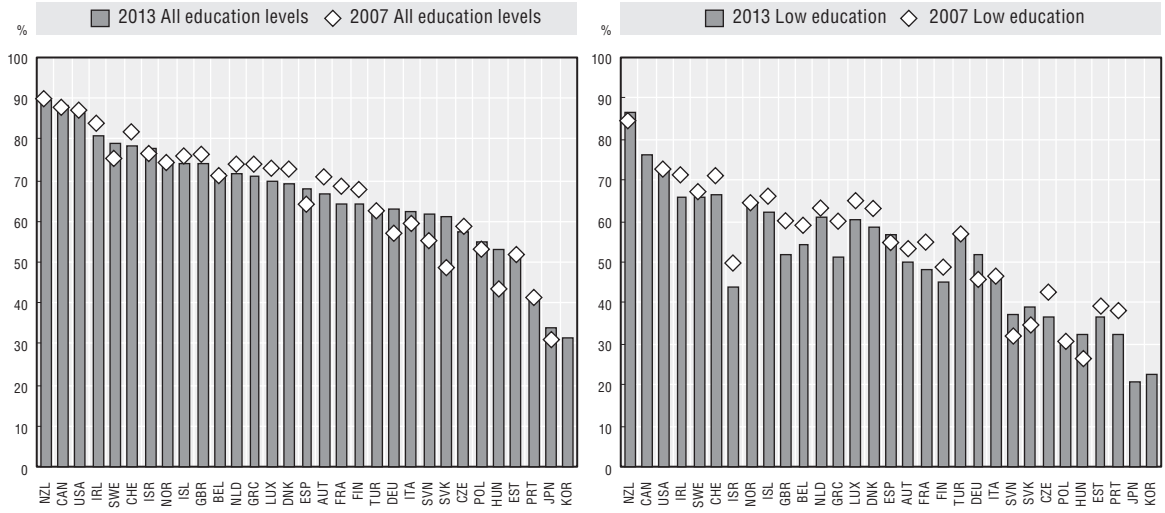
Figure 2A-B. **Gender inequalities in entrepreneurship**



1. 2012 or latest available year (2011 for Germany and Greece).
Source: OECD (2016), *Gender* database.

Figure 3A-B. **Share of women reporting good/very good health with different educational attainment**

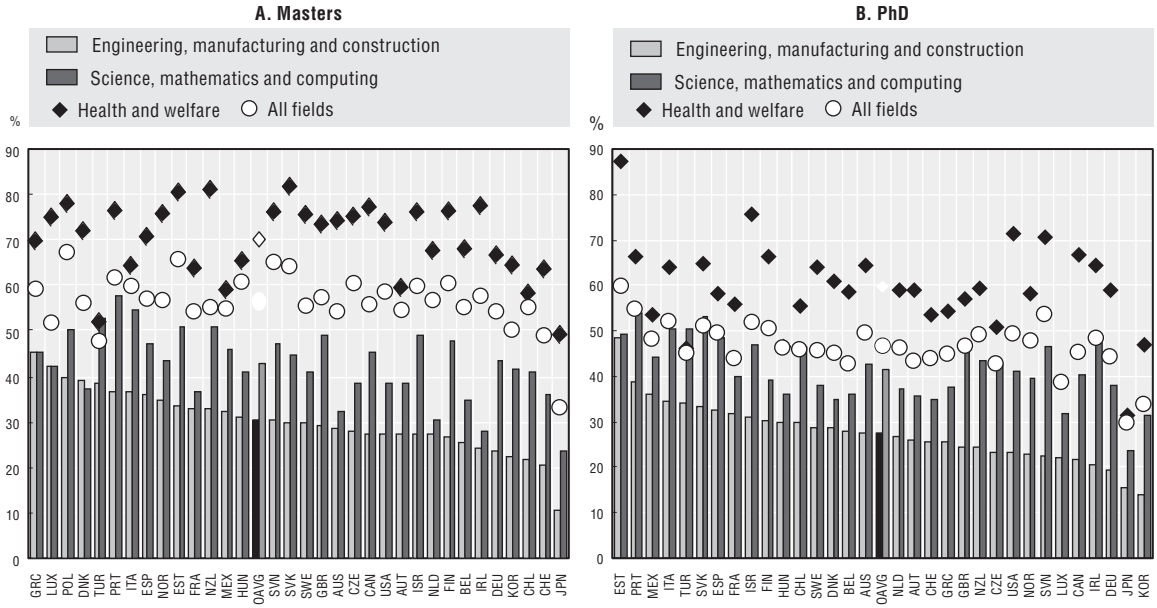
Women aged 15+



Source: OECD (2015), *OECD Health* database.

Figure 4A-B. **Graduation in tertiary education by gender**

2013



Source: OECD (2015), *OECD Education at a Glance 2015* database.

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Strengthening budget institutions in Public Expenditure Management Peer Assisted Learning (PEMPAL) countries: Results of the 2013-14 OECD PEMPAL Budget Practices and Procedures Survey

by
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This report is the result of a survey conducted in 2013 and finalised in 2014. The survey was based on self-reporting by 33 OECD and 13 PEMPAL countries and involved the participation of OECD and World Bank staff. This report is organised according to 7 main dimensions of the budget process. These 7 dimensions is addressed in greater detail in sections 2 to 8.

JEL codes: H11, H50, H60, H70

Keywords: PEMPAL, Fiscal sustainability, MTEF, capital budgeting, budgeting techniques, performance budgeting, budget transparency, budgetary governance.

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The statistical data for Israel are supplied by and under the responsibility of the relevant Israeli authorities. The use of such data by the OECD is without prejudice to the status of the Golan Heights, East Jerusalem and Israeli settlements in the West Bank under the terms of international law.

Foreword

The OECD Budget Practices & Procedures Database (the OECD Budget Institutions Database) is updated approximately every four to five years and provides a comparative set of data on developments in budget practices and procedures across OECD countries. In 2013, the OECD entered into a joint collaboration with the Budget Community of Practice (BCOP) of the Public Expenditure Management Peer Assisted Learning network (PEMPAL)[1] to extend the survey to countries within the World Bank classified Europe and Central Asia region. PEMPAL creates networks of government practitioners within three distinct communities of budget, treasury and internal audit who meet regularly in workshops, study visits and meetings to discuss common reform issues. There are 22 country members in the Internal Audit COP, and 21 country members in the BCOP and Treasury COP.

The survey is based on self-reporting from governments. Thirty-three OECD countries responded to the survey. For PEMPAL countries, 13 countries decided to participate. The PEMPAL countries are: **Albania, Azerbaijan**, Armenia, **Belarus**, **Bosnia and Herzegovina**,[2] Bulgaria, **Croatia**, Georgia, Hungary (Internal Audit only), Kazakhstan, Kosovo, **Kyrgyz Republic**, **Macedonia**, Moldova, **Montenegro**, Romania, **Russian Federation**, **Serbia, Tajikistan**, **Turkey**, Ukraine and **Uzbekistan** but only the countries in bold participated in the OECD survey. The results are presented in this report, including comparisons between OECD and PEMPAL countries who participated in the survey over the same period. Turkey, being both an OECD and a PEMPAL country, was included in the analyses for both groupings. The Russian Federation, although mentioned in tables related to OECD responses, was included in this grouping for information only and was not counted as part of the 33 countries for the purposes of the analyses. Although Iceland is mentioned in all data tables, its response was incomplete so is therefore excluded in the analyses.

Survey participation also included a data cleaning process whereby country responses were checked for internal consistency and comparison with other data from the IMF and previous survey results. The data cleaning process, including the preparation of graphs and charts, was completed by Joung-Jin Jang from the OECD under the supervision of Jón Ragnar Blöndal and Ronnie Downes of the OECD Budgeting & Public Expenditures Division at the Public Governance & Territorial Development Directorate. Deanna Aubrey, contracted by the World Bank to work with PEMPAL, prepared the report draft. Where required, the survey and responses were translated into the official languages of PEMPAL: English, Bosnian-Croatian-Serbian and Russian with translation and administrative support being provided by Tamara Maisuradze Simic and Živa Lautar from the Center of Excellence of Finance in Slovenia. The contribution of the BCOP Resource Team (Maya Gusarova, Deanna Aubrey and Naida Čaršimamović) of the World Bank is also acknowledged including supporting participation in a peer review workshop that was held in 26 June 2013 to assist countries to fully understand the questions, and to facilitate dialogue with countries where needed. Materials from this workshop are available at *www.pempal.org/event/read/87*. The contribution of Knut Klepsvik of the Ministry of Finance

of Norway is also acknowledged, as he played a key role in the design of the survey in 2013 before his departure from the OECD.

In the figures and throughout the text of this report, the OECD average refers to the unweighted, arithmetic mean of the OECD countries for which the data are available. The report includes two composite indicators on medium-term expenditure frameworks (MTEFs) (Box 3.2) and performance budgeting (Box 7.1).

Preliminary results were presented to all PEMPAL countries by the OECD at the annual BCOP plenary meeting held in Turkey in early March 2014. A preliminary version of this report was also discussed at the OECD annual CESEE SBO meeting in the Hague on 26-27 June 2014. The respondents were also given the opportunity to review their data and make amendments to this report, where needed in the lead up to this meeting and until end July 2014.

The OECD and PEMPAL would like to acknowledge and thank the following members of PEMPAL for their time and efforts in participating in this survey, most for the first time:

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Ertan Eruz	Ministry of Finance, Turkey
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The sharing of their expertise and knowledge was greatly appreciated and it will not only benefit other PEMPAL countries but other countries around the world as well. We hope that this report provides a valuable reference for these countries, and will provide baseline information to monitor and report on progress in reforms over time.

Executive summary

The report provides a selective overview of country responses on the OECD Budget Practices & Procedures Survey 2012-13 sent out to the OECD countries in November 2012 and PEMPAL countries in the first half of 2013, with responses for the latter received up until October 2013. For OECD countries, the 2012 data are compared, where possible, with 2007 data drawn from the OECD Budget Practices & Procedures Database. The report is organised according to seven main dimensions of the budget process.

1. This report highlights *fiscal sustainability issues* that create an important context for the medium-term and annual budget process, focusing on long-term fiscal projections,

macroeconomic estimates, sensitivity and fiscal risk analysis, and fiscal rules that constrain the budget. Public fiscal sustainability is the ability of public governments to maintain the public finances at a credible and serviceable position over the long run, in the light of the prevailing mix of spending and revenue policies, and taking into account debt servicing costs and future socio-economic and environmental factors that challenge the public budgets. About two-thirds of OECD countries produce fiscal projections covering a time span of more than 30 years; of these countries, most revise their projections every 3-5 years or following a new government. Twenty-seven percent of responding OECD countries do not produce long-term fiscal projections, slightly more than in 2007 (Figure 2.2). Most (11) PEMPAL countries produce long-term fiscal projections covering a time span of up to 5 years only; revising these projections every year. Albania produces such projections between 6 to 10 years, revising them every 7 years, as part of its national strategy. The Russian Federation is the only PEMPAL country which prepares fiscal projections between 11 to 30 years, which it revises every year (Figure 2.2).

Most OECD and PEMPAL countries specifically evaluate the potential fiscal risks associated with entitlement spending (e.g. if the take up rate of various entitlement programmes is higher or lower than assumed in the budget), though the comprehensiveness of evaluations varies (Figures 2.8). Thirty percent of OECD countries and 77% of PEMPAL countries take risk into account for all entitlement spending while an additional 42% of OECD countries take such risk into consideration in one way or another. Compared to the country responses of the 2007 survey, the OECD countries increasingly perform risk analysis of entitlement spending; the number of countries not conducting such analysis has fallen from 34% to 27% which represents the countries of Estonia, Finland, Germany, Italy, Japan, Korea, Slovenia, Switzerland and USA. The Kyrgyz Republic is the only PEMPAL country which does not conduct such an analysis.

While the Central Budget Authority (CBA) initiates the budget formulation process, the macroeconomic estimates may be developed by other actors within the public sector. In 2012 more OECD countries have assigned the responsibility to prepare macroeconomic estimates to other government bodies than the ministry of finance (including CBA), up 15 percentage points to 36% of responding countries (Figure 2.4). However, this role change has not significantly involved more use of independent institutions for preparing the estimates. Similarly, PEMPAL countries are assigning such functions to other government actors with 54% (seven countries) doing so. Dedicated units within the CBA or other departments of the Ministry of Finance are in charge of developing the macroeconomic estimates in over half of OECD countries compared to only in 38% of PEMPAL countries (Montenegro, Russian Federation, Serbia, Croatia and Macedonia) (Figure 2.4). The remaining PEMPAL countries indicated the function is undertaken by another government body mainly the Ministry of Development or Economy.[3]

The percentage of OECD countries using fiscal rules has increased from 82% to 94% (Figures 2.9) with only New Zealand and Turkey without such rules; the number of fiscal rules in each OECD country has increased on average from 2.5 to 3.6 (Figures 2.10) and more countries have enshrined the rules in national law (Figures 2.17). The dominating type of fiscal rule in OECD countries relates to the budget balance: Almost 50% of the fiscal rules are budget balance rules and 85% of the responding countries have adopted such a rule. Debt rules and expenditure rules are followed by 70% and 64% of the responding countries, respectively (Figures 2.13).

Only 54% of PEMPAL countries have fiscal rules (i.e. 7 out of the 13 countries participating in the survey). Six PEMPAL countries have no such rules (Albania, Azerbaijan, Bosnia and Herzegovina,[4] Montenegro, Turkey and Uzbekistan).[5] Similar to the OECD, the most widely adopted fiscal rules are budget balance rules and debt rules both being used by five out of the seven countries who adopt fiscal rules. Budget balance rules have been adopted by Croatia, Kyrgyz Republic, Macedonia, Serbia and Tajikistan. Debt rules have been adopted by Belarus, Croatia, Macedonia, Serbia and Tajikistan. In comparison, expenditure rules are only used by three countries (Croatia, Russian Federation and Tajikistan), and revenue rules by two countries (Russian Federation and Tajikistan). Of the total 19 fiscal rules adopted by PEMPAL countries, 32% (6 each) are budget balance or debt rules, 21% (4) are expenditure rules and 16% (3) are revenue rules with 80% of all rules being based in legislation. The average number of fiscal rules in PEMPAL countries is lower than in OECD countries at 2.7 (Figures 2.10, 2.12).

2. This report presents OECD countries' growing use of *medium-term expenditure frameworks* (MTEFs). A well-designed MTEF forces stakeholders to deal with the *medium term perspective* of budgeting and budgetary policies rather than adopt an exclusively year-by-year approach. MTEFs typically cover a period of three to four years and aim to improve the quality and certainty of medium-term fiscal planning by combining prescriptive yearly ceilings with descriptive forward estimates. Almost all OECD and PEMPAL countries report to have a medium-term expenditure framework in place. Only four countries that participated in the survey from OECD (Belgium, Hungary, Israel[6] and Luxembourg) and two countries from PEMPAL (Macedonia and Uzbekistan) do not. This is a significant increase since 2007 when only 72 % of the OECD countries reported a MTEF in place (Figures 3.1).

In OECD countries, there is also a tendency to establish ceilings on levels below total expenditure, such as programmes, sectors or organisational level (Figures 3.6). Since 2007, the length of ceilings is more concentrated at 3-4 years (Figures 3.7). However, most countries still revise their ceilings annually (Figures 3.8). Most PEMPAL countries in contrast, have expenditure ceilings at the overall/total expenditure level and the organisational level. However, Azerbaijan, Croatia, Russian Federation and Tajikistan also have sub-aggregate ceilings at the programme or sector level (Figures 3.6). Most PEMPAL countries have length of ceilings at three years only (except Azerbaijan which has four) and do more revisions within year than OECD countries (45% compared to 16% by OECD countries, Figures 3.8). According to the OECD composite indicator for MTEFs, Denmark, the Netherlands and the Russian Federation have established the strongest MTEFs (Figure 3.9 and Box 3.2).

3. This report focuses on *capital budgeting* together with a snapshot of the use of Public-Private Partnership (PPP) for capital investment. More OECD countries prepare separate capital and operational budgets in 2012 than in 2007, up from about 45% to 61% of the responding OECD countries (Figures 4.1). Also, more countries are funding capital projects up-front (Figures 4.2). Amongst PEMPAL countries 62% prepare separate capital and operating budgets, with only Bosnia and Herzegovina, Croatia, Turkey and Uzbekistan integrating them. For PEMPAL countries only 23% appropriate funding for the total project cost up-front (Belarus, Macedonia and Serbia), whereas the capital budgets for most other countries are funded incrementally each year (Figures 4.2).

Given the complexity of PPPs and their somewhat infrequent use, critical skills to ensure value for money may need to be concentrated in a PPP Unit that is made available to the relevant authorities. Eighteen out of 33 OECD countries (55%) and 7 out of the 13 PEMPAL

countries (54%) have established one or more PPP units in their central government (Figures 4.4). Most OECD and PEMPAL countries have only one or two PPP units. Of the seven PEMPAL countries with PIP units, two countries have units both within the Ministry of Finance and a line ministry, with most of the remaining countries having them within a line ministry or other unit. About half of the OECD countries do an absolute value-for-money (VfM) analysis such as cost-benefit analysis for all Public-Private Partnerships (PPP) projects and about two-thirds of the countries do such analysis for projects above a certain threshold. This is the case for 56% of traditional infrastructure projects. Most of the rest do such analysis on *ad hoc* basis (Figures 4.6). Absolute VfM analysis is used more by PEMPAL countries than relative VfM analysis for both PPP and Traditional Infrastructure Procurement (TIP) projects, with it applied more to TIP projects, with net present value the most common tool used (Figures 4.6). Far fewer PEMPAL countries do such analyses on an *ad hoc* basis or for projects above a certain threshold compared to OECD countries.

4. *Top down budgeting techniques* are described in several sub-sections focusing on: The role of the CBA, the budget circular, level of ceilings for the line ministries' initial budget request and resolving of budgetary disputes. Typically in top-down budgeting, the executive first determines aggregate public finance targets (spending and revenue levels) given medium-term fiscal objectives and prevailing economic conditions. Within this aggregate sectoral ceilings are set (and approved by cabinet) reflecting existing commitments, political priorities in general and key new policy initiatives. The detailed allocation decisions are typically delegated to individual line ministries. To be implemented effectively, top-down budgeting requires rigorous and prudent economic forecasts and should be combined with complementary fiscal management practices such as MTEFs.

The CBA is the hub of the central government budget process. A large majority of OECD and PEMPAL countries have localised the CBA with the Ministry of Finance and/or Economy (Figures 5.1), although in some countries the expenditure policy and control functions are assigned to a specialised ministry or functions are split between ministries. For both OECD and PEMPAL countries, the most common responsibilities of the CBA are drafting the budget circular, developing the Executive Budget proposal, negotiating with the line ministries, producing supplementary budgets, determining ceilings for line ministries, and producing mid-year and end-of-year reports (Figures 5.3).

Over the years since 2007 more OECD countries have introduced top down budgeting. More countries set ceilings for line ministries' initial budget request and only five countries (Australia, Canada, France, Hungary and USA) do not issue such ceilings. Most PEMPAL countries (nine) set overall ceilings for line ministries in the initial budget request with some of these countries also setting sub-ceilings (Russian Federation and Tajikistan). Over a quarter (33%) of the OECD countries set ceilings on sector or programme level in the initial budget request while 12% apply ceilings of agency or other organisational levels. This compares with only 23% of PEMPAL countries setting ceilings on a sector or programme level (Russian Federation, Tajikistan and Turkey) with 23% setting ceilings at the agency or other organisational levels (Bosnia and Herzegovina, Kyrgyz Republic, Russian Federation). Uzbekistan is the only country to report it sets no such limits.

There has been a change towards more collective power of resolving disputes in the budget process (Figures 5.6) in OECD countries as allocation disputes are resolved by the cabinet in 39% of countries, up from 12% in 2007. This compares to only 23% of PEMPAL countries (Croatia, Serbia and Uzbekistan). For PEMPAL countries, the rest (54%) is largely

resolved by the President (Azerbaijan, Belarus, Bosnia and Herzegovina,[7] Russian Federation) or the Prime Minister (Kyrgyz Republic, Macedonia, Turkey) with only 15% being resolved by the Finance Minister (Albania and Montenegro). Tajikistan is the only PEMPAL country that resolves issues in a ministerial committee.

5. This section, *relaxing central input controls* highlights the number of line items in the approved budget, to what extent agencies receive lump-sum appropriations, regimes for the executive's reallocations when the budget is approved, regimes for carry-over of unused appropriations and permissions for the executive to borrow against future appropriations. Introducing more budget flexibility for the budget holders is a feature of budget reforms in many OECD countries aimed at enabling government organisations to achieve their objectives efficiently and effectively.

The existence of many line-items often constrains managerial flexibility by detailing the specific inputs that can be used for specific areas. Since 2007 five OECD countries have significantly reduced the number of line items in the budget: Austria, Israel, Slovak Republic, Slovenia and United Kingdom. However, several OECD countries have reported the contrary, pushing the OECD average from 2 417 to 4 732 line items (Figure 6.1). For PEMPAL countries, the number of line-items contained in the Executive Budget Proposal varies from 43 000 for Azerbaijan, 40 000 for Turkey, down to Montenegro who has 133 economic (with 189 functional) classifications, Albania with 128 programme classifications, and the Kyrgyz Republic with only 26 line items. Other countries within this range include Russia with 12 000, Croatia with 7 300, Serbia with 6 000, Macedonia with 1 888, Belarus with 1 026, and Bosnia and Herzegovina with 1 450.

Government organisations may receive lump sum appropriations, giving them a high degree of flexibility to allocate public funds in order to maximise their performance. Seventy percent of OECD countries use lump sum appropriations for operating expenditure compared to 92% of PEMPAL countries (Figures 6.2 and 6.3). Turkey is the only PEMPAL country who does not adopt such appropriations. Those that do, distribute monies across different time scales. For OECD countries, there is no significant change on practices since 2007 with the limits on lump sum operating appropriations largely applied to wages (with some capital and other), whereas for PEMPAL countries, the limits are mostly applied to wages, capital and travel. Belarus is the only country that provides lump sum appropriations for operating expenditure without any limits (Figures 6.3).

Almost all (31 out of 33) OECD countries allow ministries to reallocate funds within their responsibility, with some restrictions (Figures 6.4 and 6.5), a slight reduction from the 2007 position. In 2012, the ministry of finance is more involved in approving reallocations than in 2007 (Figures 6.6). Similar to OECD countries, almost all PEMPAL countries (11 out of 13) allow ministries to reallocate funds within their responsibility, with all requiring *ex ante* approval of the Ministry of Finance or Economy. Albania, Montenegro and Uzbekistan also require *ex ante* approval of the legislature, with Tajikistan requiring *ex post* approval. Only Bosnia and Herzegovina and the Kyrgyz Republic do not permit reallocations (Figures 6.4).

Most OECD countries permit the carry-over of unused funds, mostly subject to *ex ante* approval from the Central Budget Authority. Compared to the situation in 2007 more countries do not permit carry-over of operating expenditures. Also fewer countries allow a carry-over without an approval (Figures 6.13 to 6.15). In PEMPAL countries, it is more common for carry-overs of unused funds to be disallowed. Only the Russian Federation allows for all three categories of expenditures (discretionary, operating and investment) to be

carried-over for funds up to a certain threshold subject to approval by the Ministry of Finance and in accordance with the Budget Code. The Russian Federation and Tajikistan are the only countries that allow carry-overs of discretionary expenditures with Tajikistan also not requiring any approvals. For operational expenditures, Croatia allows carry-overs. For investment expenditure, Albania and Turkey allow carry-overs, with line ministries in Albania having the right to carry over the unused funds for multi-year contracts but for no longer than three years. In Bosnia and Herzegovina, carry-overs are allowed but only for ear-marked funds (e.g. grants, donations) and multi-annual capital investments – these funds are carried over in such way that the budget users submit requests and the Ministry of Finance and Treasury then carries the funds over into the next budget year after reconciliation of the specific amount.

Since 2007, more OECD countries have a restrictive approach to borrow against future appropriations. A vast majority of OECD countries do not allow ministers or governments to borrow against future appropriations, regardless of the type of expenditure: 88% in 2012 (78% in 2007) for operating expenditures and 85% (75% in 2007) for investments (Figures 6.16). For PEMPAL countries, borrowing against future appropriations is not permitted in all countries except for the Russian Federation where it is allowed up to a certain threshold.

6. This report highlights the results of a parallel survey on *performance budgeting* (not covering PEMPAL countries except for Turkey and Russian Federation). Although performance budgeting practices are widely used in OECD member countries, there are vast differences in the approaches taken and there is no consensus on the optimal type of regime that should be applied. In most countries that use performance information in budgeting, there is a loose or indirect link between performance information and funding. Since 2007 it appears that in negotiations between line ministries and CBAs performance information is generally used less for strategic planning and to a growing extent not used at all (Figure 7.2). Performance budgeting is generally a decentralised practice within the central/federal government. The OECD Performance Budgeting Index gives highest score to Korea, Mexico, Canada and Switzerland. The Russian Federation and Turkey ranked fifth and eighth respectively (Box 7.1, Figure 7.4).

7. *Budget transparency* is discussed in a chapter providing examples of available budget information and reporting in OECD and PEMPAL countries. This final section also highlights practices promoting an effective role for the Legislature, including a brief update on independent fiscal institutions in OECD countries.

Budget transparency – openness about policy intentions, formulation and implementation – is increasingly seen as central to a good governance agenda. A key aspect of transparency is the extent to which the executive's budget discloses the underlying assumptions (macroeconomic and others) that set the fiscal framework within which government organisations formulate their spending proposals. Of the countries who responded to the Budget Practices & Procedures survey, 82% of OECD countries and 69% of PEMPAL countries publish the macroeconomic assumptions and the methodology used to establish them in the budget and in supporting documentation (Figures 8.1). This is an improvement of 18 percentage points for OECD countries since 2007. However, only 24% of OECD countries and 8% of PEMPAL countries (i.e. Turkey only) include a long term perspective on total revenue and expenditure in the budget document presented to the legislature. More PEMPAL (77%) than OECD (48%) countries present a comprehensive financial plan, reflecting reforms being implemented in this area in the region in relation to public sector accounting

and reporting including the adoption of national accounting standards and elements of International Public Sector Accounting Standards (IPSAS).[8] However, only 62% of PEMPAL countries compared to 94% of OECD countries include medium term fiscal policy objectives and only 85% of PEMPAL countries compared to 94% of OECD countries include budget priorities (Figures 8.3).

While nearly all OECD countries include the executive's medium-term fiscal objectives in the published budget documentation, only 79% include a medium-term perspective on revenue and expenditure but this disclosure practice has increased by seven percentage points since 2007. Other main changes from 2007 are seen in non-financial performance targets included in the budget document (increased from 48% to 73% of respondents), in written text of policy legislation in the budget document (increased from 24% to 58%) and in clearly defined appropriations to be voted by the legislature (increased from 73% to 88%) (Figures 8.3).

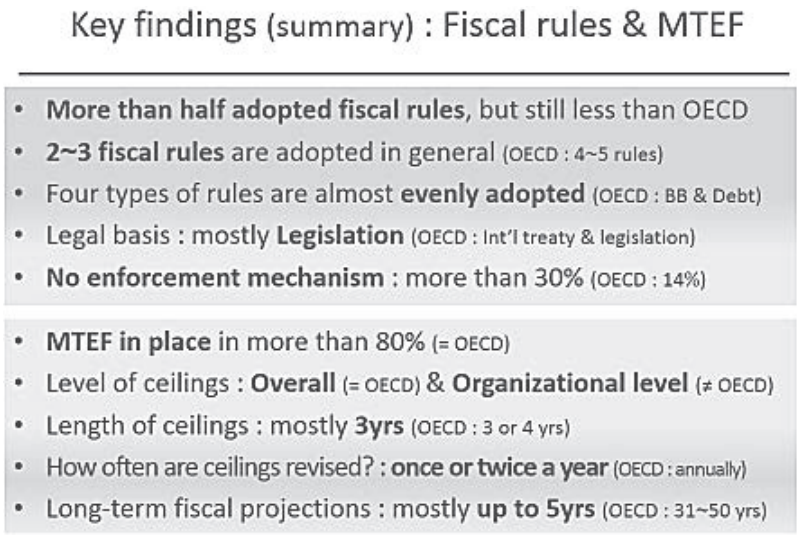
The percentage of OECD countries where the legislature holds unrestricted amendment power has stood still at 52% since 2000 (Figures 9.1), slightly below that of PEMPAL countries at 54%, taking into account that some countries are effectively constrained from using amendment powers as votes on the budget are considered as a vote of no confidence in the government (Figures 9.2). Those PEMPAL countries where the legislature holds such unrestricted amendment powers include Azerbaijan, Belarus, Bosnia and Herzegovina, Kyrgyz Republic, Montenegro, and Uzbekistan. Some of these legislatures made changes in the last budget ranging from under 1% to 3.2% of the total budget. For OECD countries, the percentage of countries that the legislature can amend the budget within executive's aggregates has slightly increased to 24% (compared to 38% of PEMPAL countries).

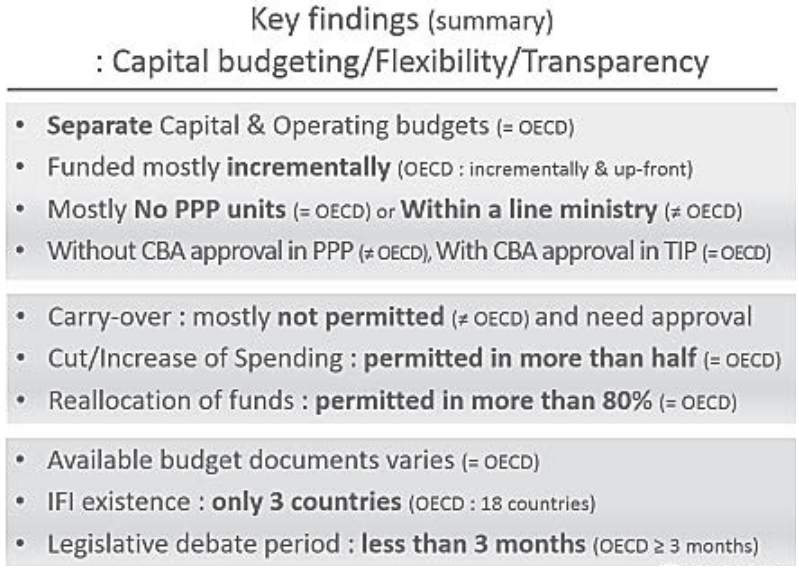
The effectiveness of a given legislature in the budget process is also influenced by the time available for legislative debate and the level of resources that the legislature has at its disposal. In 61% of the OECD countries and only 38% of PEMPAL countries, the budget is presented to the legislature at least three months before the start of the fiscal year, and the vast majority of OECD countries also approve the budget prior to the start of the fiscal year. For OECD countries, legislative debate on the budget ranges from one month in Greece, Portugal and United Kingdom to four months in Canada, Denmark, Germany and Poland and eight months in the United States. The range is not so wide for PEMPAL countries with Russian Federation and Montenegro allowing only one month; Bosnia and Herzegovina two months;[9] Azerbaijan, Belarus, Turkey and Uzbekistan, 2.5 months; the Kyrgyz Republic 3 months; and Tajikistan allowing the maximum of all the PEMPAL countries at 3.5 months. In comparison, in a little less than half of OECD countries the legislature has at least three months to debate the budget, in 14 countries it has two months and in three it has only one month (Figures 9.3 and 9.4).

Despite the diversity among methods, all OECD and PEMPAL countries have mechanisms in place to deal with the possibility of delays to the approval of the budget with last year's budget taking effect on an interim basis as the most common in both country groupings (Figures 9.5). Consequences if the budget is not adopted before the start of the fiscal year tend to favour the legislature in 2012 more so than in 2007 in OECD countries (Figures 9.5). Furthermore, in a decade, the number of specialised legislative budgetary research units has more than doubled in OECD countries, and in some cases their size has increased. In 2010-12, several new bodies have been established in countries such as Australia, Austria, and Greece, bringing the total number of such units to 16 in 2012 (Figures 9.6). In contrast, such specialised budget research offices are not common in

PEMPAL countries, with only three countries having them (Azerbaijan, Kyrgyz Republic, and the Russian Federation).

As of 2013, most OECD countries (18) have established or are establishing an independent fiscal institution (IFI) up from eight in 2007 and 16 in 2012 (Figure 9.7). The role and structure of these bodies varies considerably across countries regarding relations to the executive and the legislature, budget and staffing as well as mandate (e.g. forecasting and monitoring). According to the IMF database on fiscal councils however,[10] out of the 21 BCOP PEMPAL member countries, the following have such institutions: **Croatia**, Romania, **Serbia**, and Georgia. **Bosnia and Herzegovina** also has a fiscal council. Thus, three countries from the group (in bold) who participated in the survey have an IFI or fiscal council. In addition, Azerbaijan, Kyrgyz Republic and Russian Federation indicated they have a specialised budget research office or unit attached to the legislature which conducts analyses of the budget. In closing the key findings are summarised below.





1. Introduction

The OECD Budgeting Practices and Procedures Surveys are carried out by the OECD Secretariat every four to five years – with the first survey executed in 2003 and a revised, more comprehensive questionnaire distributed in 2007. The overarching objective of the survey is to provide a publicly-available, internationally comparable set of data that allows for the analysis and benchmarking of good budgeting practices over time.

Country coverage has been wide – with both OECD member and non-member countries taking part. The 2012-13 Budgeting Practices and Procedure Questionnaire is directed specifically to members of PEMPAL and covers the entire budgeting process – from formulation, to approval, execution and reporting. The questionnaire also addresses cross-cutting and topical issues such as fiscal sustainability, budget transparency and Parliamentary Budget Offices.

The co-operation between PEMPAL and OECD has expanded the OECD Budget Database to additional countries in Eastern Europe and Central Asia. The PEMPAL Secretariat and the World Bank BCOP Resource Team liaised closely with the OECD to prepare the survey for release including providing translation into the official languages of the network (English, Russian and Bosnian-Croatian-Serbian), providing the appropriate contacts in the Ministries of Finance of PEMPAL countries (based on BCoP membership), and promoting the value of the survey to members. OECD's "Glossary of Key Terms for completing the 2012 OECD Budgeting Practices and Procedures Survey" was also translated by PEMPAL to assist its members in the survey's completion.

Responses collected via this survey were used to update the existing OECD International Budget Practices and Procedures Database, which is available online free of charge. It is important to note that, prior to publication or being included online, all data and methodologies were reviewed and a peer review meeting was also held on 26 June 2013 in Latvia which was funded by PEMPAL and attended by country representatives who took a major role in completing or co-ordinating the information. Members of the World Bank BCOP Resource team and the OECD also attended this meeting and were available to answer questions on terminology, intention of question etc.

Because select questions from 2007 had to be adapted for the 2012-13 version, some newly collected data had to be modified (e.g. used as a proxy for previous variables) in order to allow for comparison of OECD results over time. All such instances are clearly annotated.

The 2012-13 data that are presented in this report are based on the country responses on a questionnaire sent out to the OECD countries in November 2012 and PEMPAL countries in the first half of 2013 as most countries required approval from Ministers of Finance to participate in the survey for the first time. The questionnaire was first piloted (by Canada, Germany and Korea) before being rolled out to all OECD countries. The OECD Secretariat performed a quality control of the country responses that includes a comparison with 2007 data and other international datasets like the IMF Fiscal Rules Database. During the quality control process the countries were invited to clarify and verify any changes from the earlier data. A preliminary version of the report provided an opportunity for the PEMPAL participants to comment and validate the results. More detailed data on the country responses is set out in the Data Annex. The complete survey provides an even richer data set than is covered in this report and annex, the focus of which is limited to core budgeting themes and principles. All survey data will be made available in an updated online OECD Budget Institutions Database.

The existing budget database (2007 data) covers 97 OECD and non OECD countries across the world. The OECD has entered into agreements with other international organisations in order to update the database also for other countries across the world. These regional budget surveys will eventually feed into the on-line budget database. On this basis, the OECD database will present a truly comprehensive overview – in terms both of international coverage and of in-depth analysis – of how countries manage and implement their budgets, and will allow for continuing high-quality analysis and knowledge-sharing on effective and innovative practices.

2. Fiscal sustainability

Public fiscal sustainability is the ability of public governments to maintain the public finances at a credible and serviceable position over the long run, in the light of the prevailing mix of spending and revenue policies, and taking into account debt servicing costs and future socio-economic and environmental factors that challenge the public budgets. Prudent macro-economic assumptions, sensitivity and risk analysis and appropriate fiscal rules would help to orient spending and revenue policies within sustainable levels in the short run and over the medium term. For the longer perspective, long-term fiscal projections (incorporating demographic and socio-economic trends) could be a necessary analytical tool.

2.1. Coverage of long-term fiscal projections (Q.14-16)

Long-term fiscal uncertainty is a challenge for most countries. For OECD countries, a growing elderly population, higher longevity and increased demand for health services, and in some cases simultaneous reductions in the government's tax base, are some factors that create long-term challenges. Persistent fiscal deficits in recent years, a high debt level and off-budget contingent liabilities in several OECD countries require an adequate policy response in terms of fiscal planning. Such long-term challenges can be addressed, for example, through structural reforms of the public sector and entitlement programmes: the benefits from such reforms typically only have a limited impact on public budgets in the short- to medium-term, but yield greater benefits over the longer term. Long-term fiscal projections can play a useful role in identifying the expected future costs and associated debt of current policies in light of forecast demographic and economic developments.

Long-term projections of the public sector's role in the economy would also contribute to the informed political and public discussion of a broader reform agenda, to ensure that the costs of the public sector are proportionate to the benefits delivered to society, and to issues of affordability. The size and structure of the public sector in several OECD countries pose challenges in terms of long-term sustainability. Some governments also present long-term fiscal challenges in a cross-generational perspective, in order to distribute benefits and cost in a reasonable way over generations.

PEMPAL countries fall within the World Bank classified Europe and Central Asia (ECA)[11] region which is a highly diverse region at varying levels of development with a combined population of 480 million people. It includes new EU members that have joined the euro area and the OECD, as well as the low-income countries in Central Asia, the Balkans, and CIS countries.

According to the recent World Bank study "*Stocktaking on PFM Reforms in ECA Countries*", collectively the region scores well compared to other World Bank regions on the quality of budget and financial management, and on the efficiency of revenue mobilisation. However,

the ECA average masks considerable sub-regional differences in Public Financial Reforms (PFM) performance. Low income ECA countries perform significantly worse than their middle-income neighbours on all PFM dimensions. Large variations in natural resource endowments have a major impact on the public finances of ECA countries. Several countries, such as Russia, Kazakhstan and Azerbaijan, continue to be highly dependent on natural resource revenues. This presents both risks and opportunities. Strong commodity prices and prudent fiscal policies (fiscal rules and sovereign wealth funds) allowed these countries to protect budget expenditures during the financial crisis, but they face challenges in dealing with market volatility, declining natural resource output and diversifying their economies. Other countries such as the Kyrgyz Republic and Tajikistan both have a large, but mostly unrealised, natural resource potential, while fracking has raised the possibilities of shale gas extraction in several countries. Ensuring that these resources are developed and the benefits are shared equitably is a huge opportunity and a challenge. There is, however, little difference in PFM performance between the lower and upper middle-income countries of the region, which suggests that upper middle-income countries are not performing to their potential.

The recent financial and euro area crises have put public finances under severe pressure in many ECA countries. A number of EU member states face moderate to severe fiscal challenges as result of large budget deficits, shrinking economies and stricter fiscal rules. Key challenges for these countries include improving the effectiveness of tax administration, management of entitlements and the public sector wage bill, reform of State Owned Enterprises (SOEs) and a range of budget reforms to drive greater spending efficiency as well as modernising antiquated PFM institutions and systems that impede effective responses. Countries in the Western Balkans face similar long term structural budget problems as well as short term liquidity problems. These effects are compounded by spill-over effects from the euro area debt crisis, in the form of lower export revenues, decline in remittances and a lack of credit available from the banking sector, in which euro area banks play a large role. At the same time future growth will depend on productive investment in infrastructure and education, and an improved business environment. More attention needs to be given to prudent fiscal policy including the use of fiscal rules. Tax policy, expenditure policy and budget management reforms will all be important key tools for achieving budget sustainability and protecting essential public services and investment over the long term.

A large number of ECA countries also face a shrinking working population and rising dependency ratios. The share of older people (65+) is projected to rise in all ECA countries over the next few decades, and by the year 2050, it is projected that one in five individuals will be older than 65. These changes will significantly affect the dependency ratios throughout the region and will make existing entitlement programmes unaffordable in the absence of significant reforms. Many ECA countries also continue to have a large SOE sector that periodically presents serious budget risks. During the crisis, several electricity companies and banks required substantial budget support in the form of government loans, subsidies, or tax write-offs. SOEs also provide opportunities for extra-budgetary spending and patronage, as their oversight is generally not well-developed, monitoring is often weak and political connections have shielded some SOEs from close scrutiny. Finally successful adaptation to climate change has implications for PFM. It will require changes to both tax and spending policies to create incentives for sustainability and to redirect public investment towards adaptation of the economic infrastructure.

In most OECD countries (Figure 2.1a) the CBA is responsible for long-term fiscal projections. In some countries this responsibility is located in other departments of the

Ministry of Finance than where the CBA is located or in other core ministries: in Belgium, Czech Republic, Finland, Greece and Portugal this responsibility is carried out by other departments of Ministry of Finance; in France, Japan and Spain by another ministry or Cabinet Office. Only four OECD countries have assigned this responsibility to an independent institution (Austria, Germany, Netherlands and United Kingdom).

In PEMPAL countries (Figure 2.1b) the CBA or finance ministry is responsible for long-term fiscal projections in 9 of the 13 participating countries. In Albania it is the responsibility of the Prime Minister's office and in Belarus, Bosnia and Herzegovina and Croatia it is the responsibility of another government body. For Bosnia and Herzegovina, the responsibility is shared with the Macroeconomic Analysis Unit within the Indirect Tax Authority which prepares indirect tax revenue projections for the country (from where the largest revenue source comes in terms of both budget of State level and total general government sector in BiH), with other revenues of the State level being forecast by the Ministry of Finance and Treasury of BiH.[12]

Figure 2.1a. **Actors responsible for long-term fiscal projections (Q14a): OECD**

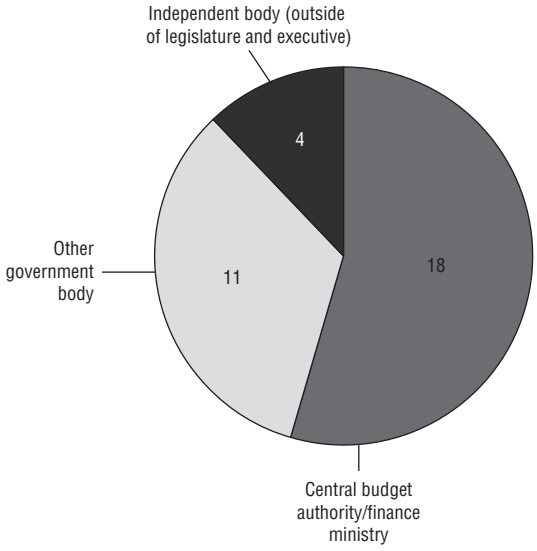
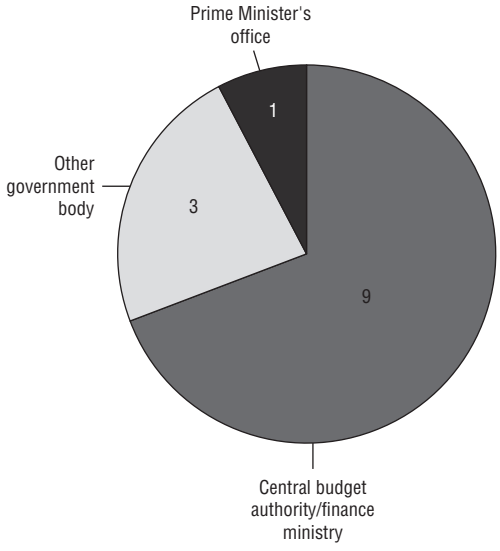


Figure 2.1b. **Actors responsible for long-term fiscal projections (Q14a): PEMPAL**



About two-thirds of OECD countries produce long-term fiscal projections covering a time span of more than 30 years; of these countries, most revise their projections every 3-5 years or following a new government. Chile and Japan are the only countries with fiscal projections covering 11-30 years, which are revised every year. Since 2007 the number of countries that do not produce long-term (more than 10 years) fiscal projections has risen slightly by 3 percentage points to 27% of responding OECD countries. Those countries produce fiscal projections that cover a time span of up to five years and revise the projections every year, except for Israel where the fiscal projections cover 6-10 years with no regular revision frequency (Figure 2.2).

Most (11) PEMPAL countries produce long-term fiscal projections covering a time span of up to five years only; revising these projections every year. Albania produces such projections between 6-10 years, revising them every 7 years, as part of its national strategy. The Russian Federation is the only country which prepares fiscal projections between

11 to 30 years, which it revises every year (Figure 2.2). Within these projections, the Russian Federation includes economic growth rate, unemployment trends, exchange rate forecasts, fiscal gap projections, demographic changes (aging, population growth), oil and gas sector projections (prices, volumes of export, production), capital investment, real sector statistics and amortisation.

Half of OECD countries and all of the PEMPAL countries require that the annual budget or medium-term framework shall be either based on, or consistent with, the long-term fiscal projections (Figures 2.3).

Figure 2.2. **Time span and revision frequency of long-term fiscal projections (Q14b-c)**

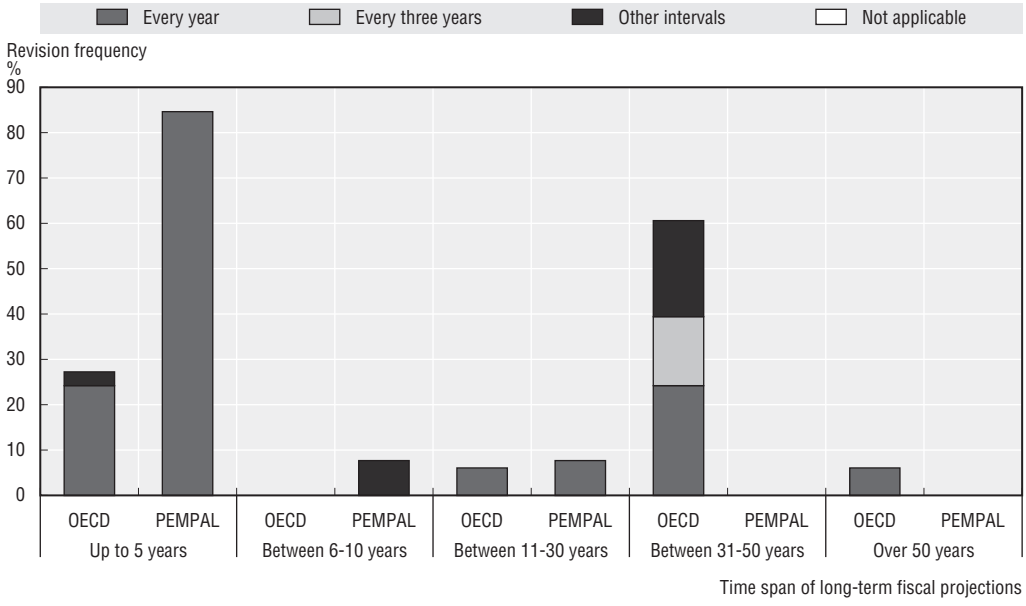


Figure 2.3a. **Links between long-term projections and the annual budget (Q14d): OECD**

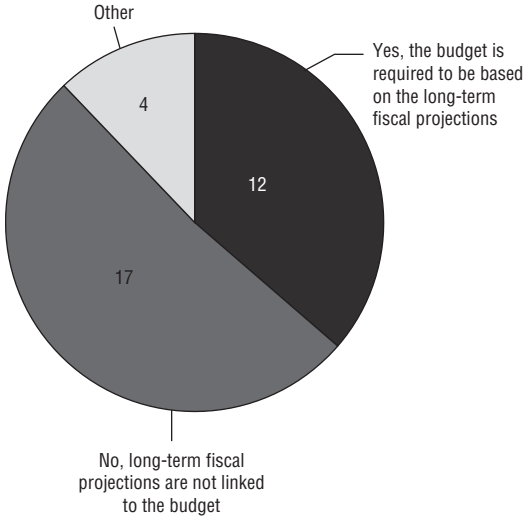
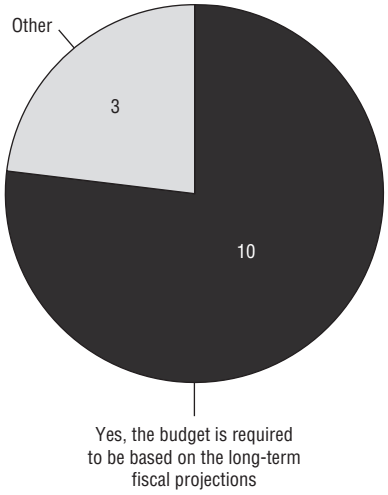


Figure 2.3b. **Links between long-term projections and the annual budget (Q14d): PEMPAL**

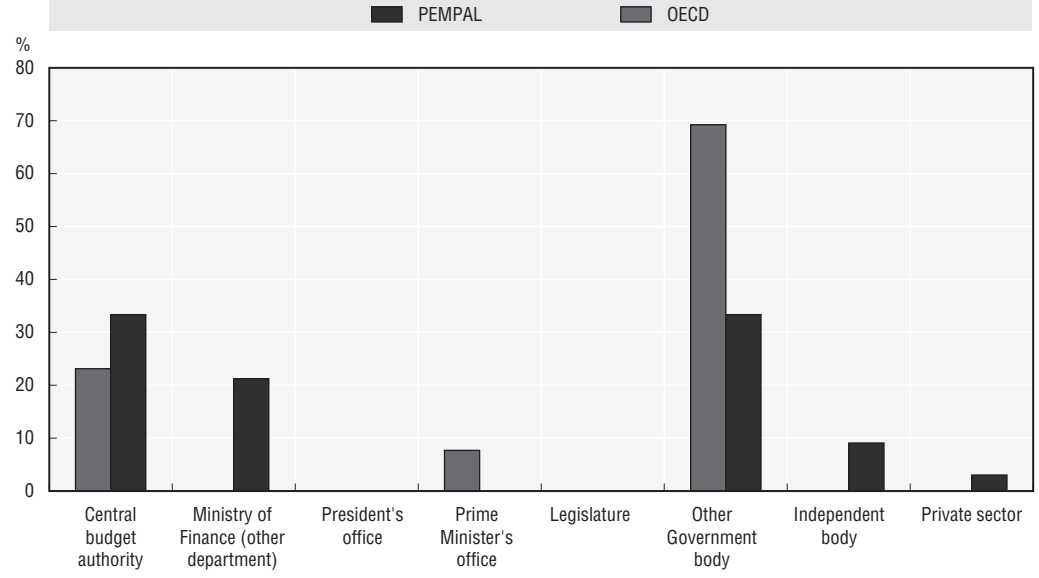


2.2. Prudent macroeconomic estimates (Q.12-16)

Prudent and properly made economic forecasts should form the basis for the assumptions and estimates used in the budget, including the issue of the fiscal stance. In a time of fiscal consolidation, in particular, weak or over optimistic economic assumptions can too easily undermine the fiscal adjustment path and erode market confidence in the government's commitment to sound fiscal policy. Transparency measures regarding the economic assumptions strengthen quality and credibility.

While the CBA initiates the budget formulation process, the macroeconomic estimates may be developed by other actors within the public sector. Amongst OECD countries, 33% have assigned this responsibility to other government bodies (up 12 percentage points since 2007). Similarly, 54% (7 countries) of PEMPAL countries have assigned such functions to other government actors. In comparison, dedicated units within the CBA or other departments of the Ministry of Finance are in charge of developing the macroeconomic estimates in over half of OECD countries compared to 38% of PEMPAL countries (Montenegro, Russian Federation, Serbia, Croatia and Macedonia) (Figure 2.4). The remaining PEMPAL countries indicated that this function is undertaken by another government body mainly the Ministry of Development or Economy (except Bosnia and Herzegovina, which has the Directorate of Economic Planning, an independent body of the BiH Council and also the Department for Macroeconomic Analysis which is under the Indirect Taxation Authority) and Albania where it is undertaken by the Prime Minister's office in close collaboration between the Ministry of Finance Departments of General Budget, General Macroeconomic and General Treasury, with the macroeconomic projection being presented to the Cabinet through the Minister of Finance. In Belarus, the Central Bank and the Ministry for Taxes and Fees is also involved. Tajikistan also involves its Central Bank.

Figure 2.4. **Actors responsible for macroeconomic estimates (Q12)**



Note: For PEMPAL countries preparing estimates within MoF, for Croatia, it is in the Macroeconomic Analyses and Planning which is a part of the Ministry of Finance but is not a part of the State Treasury. For Macedonia, estimates are prepared by the macroeconomic department of the Ministry of Finance.

Of the OECD countries, five assign the responsibility to other core ministries: Denmark, Germany, Japan, Spain and Turkey. An alternative approach is to assign responsibility to an entity independent of the executive. In Switzerland, for example, a group of experts with representatives from various ministries and the Central Bank are responsible for formulating the macroeconomic estimates.

The Netherlands Bureau of Economic Policy Analysis (Central Planning Bureau or CPB) has the status of an independent agency under the Ministry of Economic Affairs. It maintains an independent external advisory board and has established good working relationships with both the cabinet and with opposition parties. Luxembourg and the United Kingdom have also established independent public agencies responsible for preparing the budgetary forecasts.

In Canada, official macroeconomic estimates are based on the views of major banks and private sector forecasting firms. The Department of Finance conducts a quarterly survey of approximately 20 private sector forecasters to collect estimates of labour market variables, real GDP, inflation, interest and exchange rates. Averages of these external estimates are used as the basis of official government revenue and expenditure forecasts.

Over half or 58% of OECD countries and 92% of PEMPAL countries develop macroeconomic estimates that cover a time span up to five years. The majority of the rest of OECD countries use macroeconomic estimates that cover between 31 and 50 years (Figures 2.5). The Russian Federation is the only PEMPAL country that develops macroeconomic estimates over five years, preparing forecasts between 11 and 30 years.

Figure 2.5a. **Time span of long-term macroeconomic estimates (Q13): OECD**

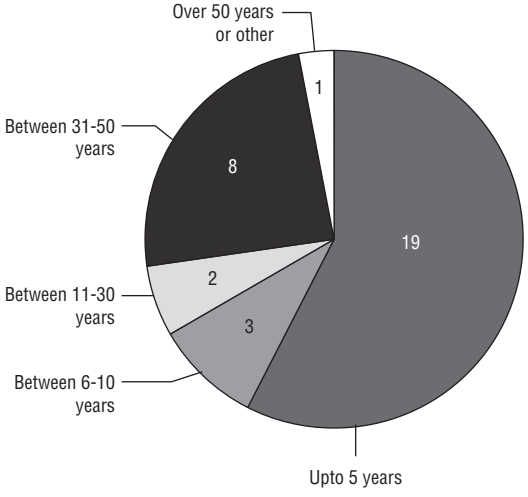
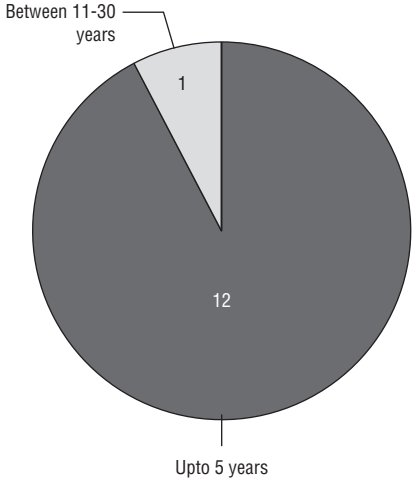


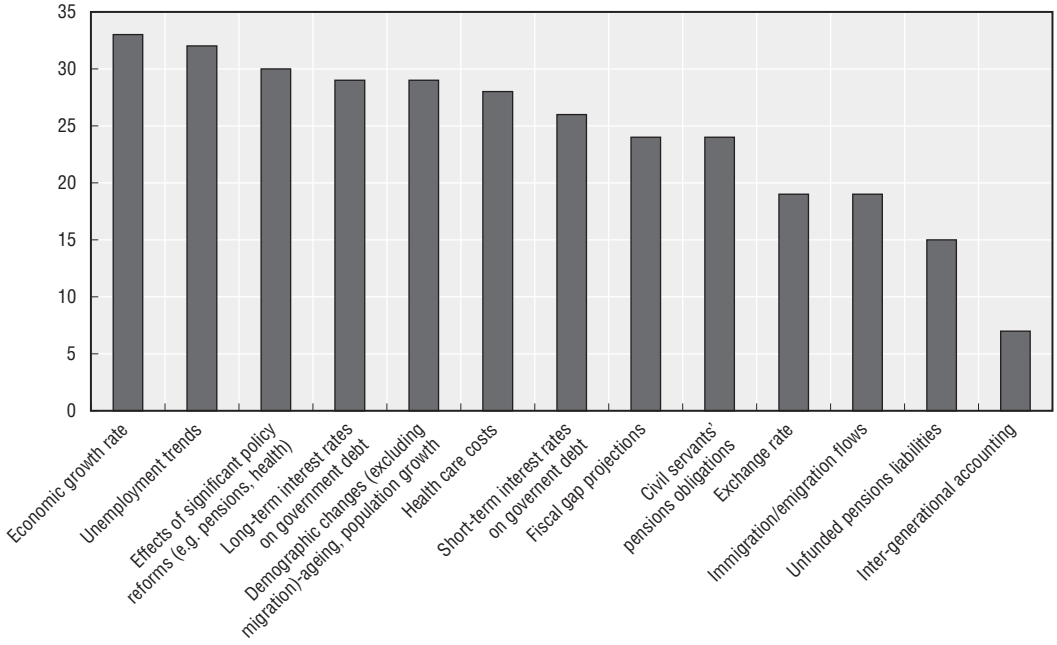
Figure 2.5b. **Time span of long-term macroeconomic estimates (Q13): PEMPAL**



When developing long-term projections most OECD and PEMPAL countries consider factors like interest rates, economic growth rates, unemployment trends, fiscal gap projections and effects of significant policy reforms, e.g. pension and health reforms. Also demographic changes, exchange rates and health care cost are factors that a majority of countries consider for long-term fiscal projections. Inter-generational issues are rarely included in the estimates. Civil servants pension obligations are considered by almost

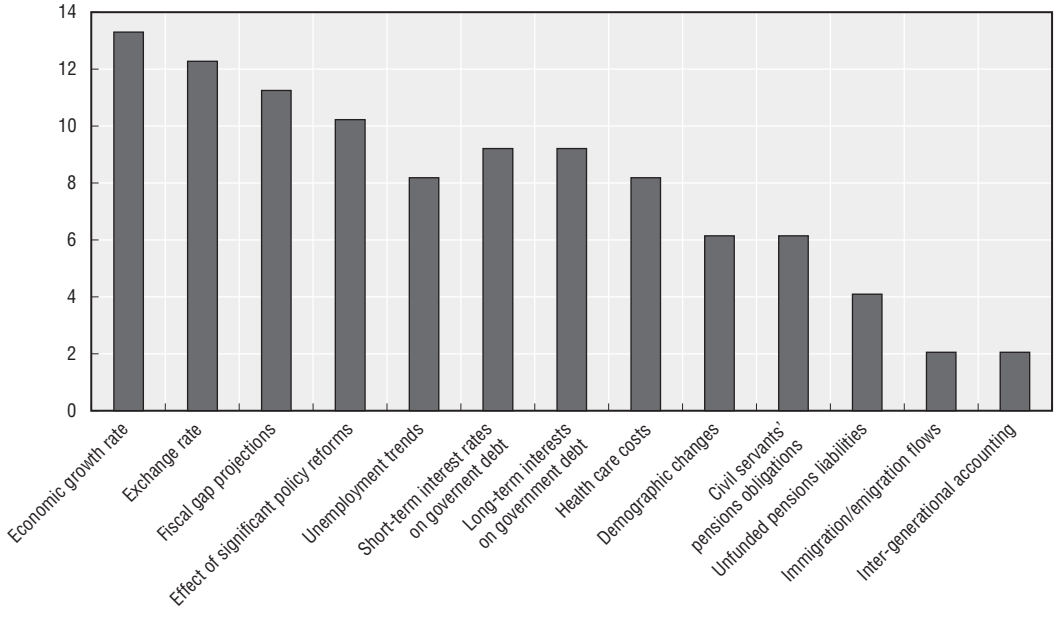
three-quarters (24 of the 33) of OECD countries and almost half (6 of the 13) PEMPAL countries. Unfunded pension liabilities are only considered by 4 PEMPAL countries and 15 OECD countries (Figures 2.6).

Figure 2.6a. **Factors considered in the long-term fiscal projections (Q16): OECD**



Note: Number of OECD countries, out of 33 participating OECD countries.

Figure 2.6b. **Factors considered in the long-term fiscal projections (Q16): PEMPAL**



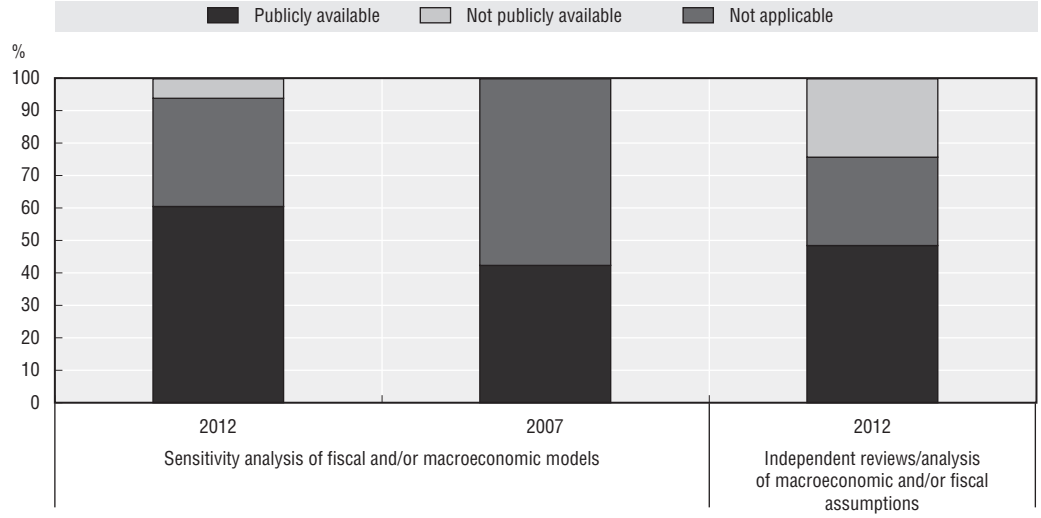
Note: Number of PEMPAL countries, out of 13 participating PEMPAL countries.

2.3. Sensitivity and fiscal risk analysis (Q.51, 15)

Sensitivity analysis is a "what-if" type of analysis used in quantitative modelling to test the sensitivity of outcomes to changes in parameters or underlying assumptions. If a small change in a parameter results in relatively large changes in the outcomes, the outcomes are said to be sensitive to that parameter (IMF, 2007). Sensitivity analysis is one way to factor in uncertainties associated with forecasting macroeconomic variables that are important to the budget as a whole or to individual expenditure items. It is used to test the importance of different assumptions to the projected performance of a government intervention. For example, sensitivity analysis could be used to test the extent to which projected revenue growth is affected by changes in the price of key export commodities on the world market.

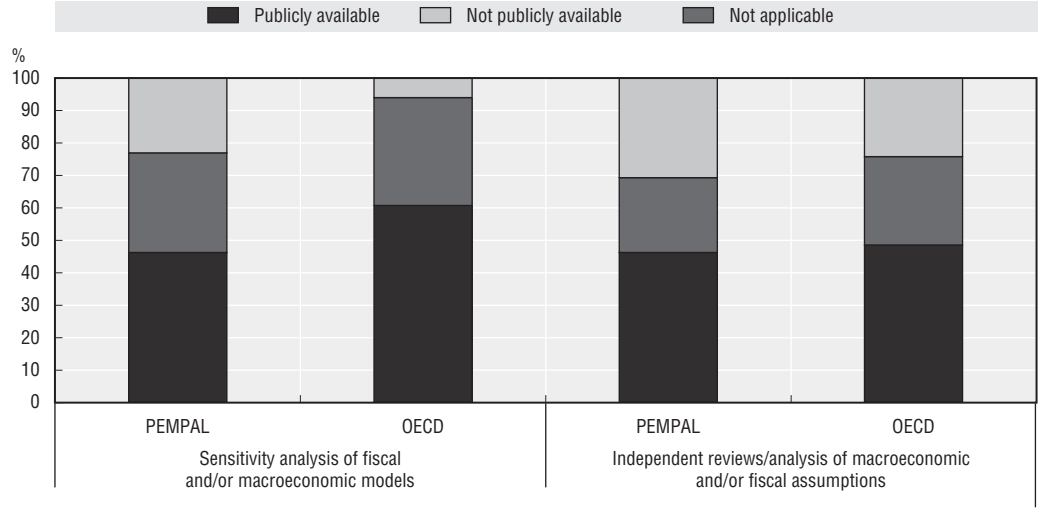
Almost half or 46% of PEMPAL countries and 61% of the OECD countries include fiscal sensitivity analysis in their publicly available budget documentation (Figures 2.7), with OECD countries up from 42% in the 2007 survey. Only three PEMPAL countries (Azerbaijan,[13] Bosnia

Figure 2.7a. **Available sensitivity analysis and reviews of assumptions (Q51a)**



Note: Percentage of participating OECD countries (33 in 2012 and 33 in 2007)

Figure 2.7b. **Available sensitivity analysis and reviews of assumptions (Q51a)**



and Herzegovina and Montenegro) and two OECD countries (Belgium and Greece) report that sensitivity analysis is not made publically available.

Another method of taking uncertainty into consideration in fiscal projections and macroeconomic assumptions is to identify and assess specific risk elements that would negatively influence the assumptions and projections if they materialise. Actions should be taken in accordance with the risk elements' probability and consequence.

Most OECD and PEMPAL countries specifically evaluate the potential fiscal risks associated with entitlement spending (e.g. if the take up rate of various entitlement programmes is higher or lower than assumed in the budget), though the comprehensiveness of evaluations varies (Figures 2.8). Risk is taken into account for all entitlement spending in 30% of OECD countries and 77% of PEMPAL countries while an additional 42% of OECD countries take risk into consideration in one way or another.

Figure 2.8a. **Risk taken into account for entitlement spending (Q15a)**

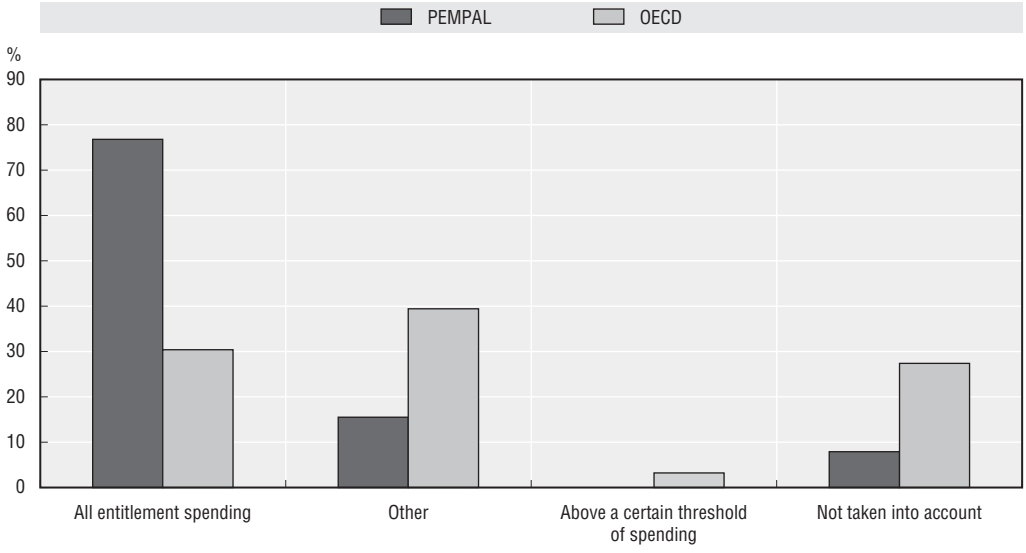
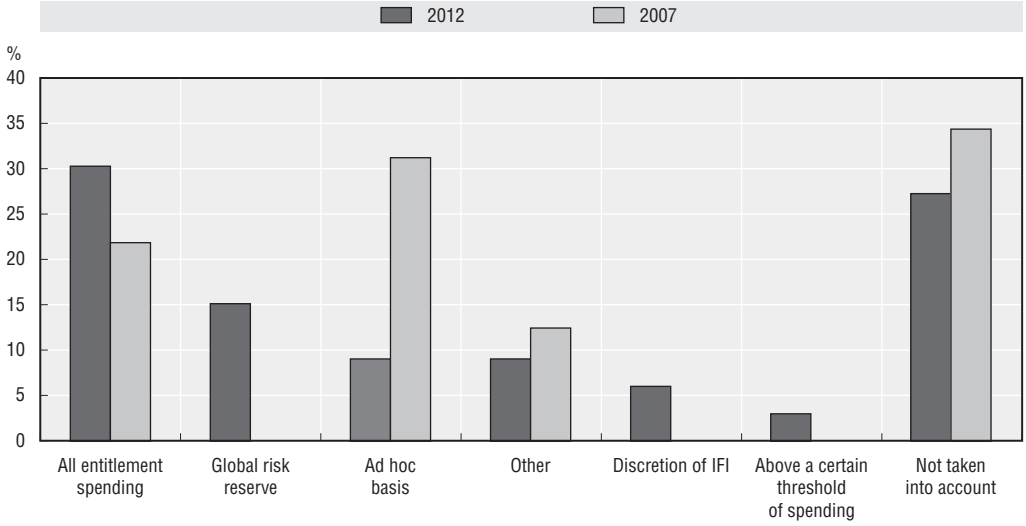


Figure 2.8b. **Risk taken into account for entitlement spending (Q15a): OECD**



Note: Percentage of participating OECD countries with an answer to the question (33in 2012 and 33 in 2007)

In 27% of OECD countries, risk is not taken explicitly into account for entitlement spending (Estonia, Finland, Germany, Italy, Japan, Korea, Slovenia, Switzerland and USA) and similarly one PEMPAL country reports the same (Kyrgyz Republic). Finland notes that the budget process itself includes elements of flexibility, such as supplementary budgets and budget margins in the spending limits. Although the Kyrgyz Republic does not take into account entitlement spending risks, it does consider possible risks of revenue shortfalls, which are reflected in the budget.

Austria and Portugal allocate unreserved funds and Canada makes a global/general risk adjustment to cover risks/shocks to entitlement spending. Denmark and Sweden apply a budgeting margin, which is a buffer between the expenditure ceiling and the capped expenditures. In Sweden, the budgeting margin should amount to at least 1% of the capped expenditures in the current year increasing by 0.5 percentage points for each of the out years. Australia notes that risks/shocks are incorporated where they can be predicted. Greece reports that risks are taken into account in particular cases, while Poland explains that in certain cases risks may be taken into account only to a limited degree, dependent on the particular programme. Belgium, Ireland and Luxembourg evaluate risks on an *ad hoc* basis. Netherlands and United Kingdom reports that the budget is based on projections provided by their independent institutions, CPB and OBR, respectively. Risk assessment is at the discretion of these institutions.

Bosnia and Herzegovina indicated that BiH institutions do not have entitlement spending, within the meaning of social benefits (pensions, health care, unemployment benefits). Such spending is managed by extra-budgetary funds, e.g. pension and health funds, at the entity level (in Republic of Srpska and the Federation of BiH), which were not covered by this Survey (only in BiH institutions taken into account). As for other risks, most PEMPAL countries consider risks as part of the budget, particularly the impact of potential changes in revenue levels. For example, Bosnia and Herzegovina identify potential positive and negative changes on projected indirect tax revenues from external and other factors. Belarus reports that it also considers technology related risks and natural disasters as well as entitlement spending risks. For Montenegro, a budget reserve is planned for urgent and contingent outflows during the fiscal year and for Tajikistan, all budget risks are included in the executive note on the budget for the next fiscal year and are provided separately for revenues and expenditures.

Compared to the country responses of the 2007 survey it seems that the OECD countries have increased their practices of risk analysis of entitlement spending; the number of countries not conducting such analysis has fallen from 34% to 27% (to Figure 2.8a).

2.4. Fiscal rules that limit the budget (Q.18-24)

A fiscal rule is a permanent constraint on fiscal policy expressed in terms of a summary indicator of fiscal performance (Kopits and Symansky, 1998). A fiscal rule has two fundamental characteristics. First, it presents a constraint that binds political decisions made by the legislature and by the executive. Second, it serves as a concrete indicator of the executive's fiscal management. Budgeting in democratic countries is inherently biased towards expansionary outcomes (Schick, 2003). If observed, fiscal rules constrain politically-motivated spending to improve macroeconomic stability in the short-term, while contributing to long-term fiscal sustainability. Fiscal rules also signal a government's credit worthiness and provide justification for making tough fiscal decisions. Finally, fiscal rules can control the negative spillovers and externalities that arise within a federation or union (Inman, 1996).

There is no one-size-fits-all fiscal rule. Four broad yet distinctive categories of rules exist, namely: expenditure rules, fiscal balance rules, debt rules, and revenue rules.

1. **Expenditure rules:** limit the amount of government spending and can be expressed in nominal or real terms as limits on spending levels or expenditure growth, or as an expenditure-to-GDP radio.
2. **Fiscal balance (i.e. deficit or surplus) rules:** directly target the fiscal balance (i.e. the gap between government spending and revenues), e.g. a requirement to run a balanced position; not to exceed a defined deficit limit; or a requirement to attain a defined surplus at minimum. Such rules can be expressed in nominal or cyclically-adjusted terms, usually by reference to a percentage of GDP.[14]
3. **Debt rules:** limit the amount of government debt that can be accumulated and can be expressed in nominal terms, as a debt-to-GDP ratio, or as an explicit reduction of the debt-to-GDP ratio.
4. **Revenue rules:** impose constraints on the tax-to-GDP ratio and place restrictions on government revenues raised in excess of projected amounts.

Where they are used, fiscal rules and targets should be clearly stated and explained, with specific attention paid to their design. Rules should be based on appropriate summary indicators and be simple and transparent so as to facilitate management and monitoring activities. Further, they should be responsive to cyclical fluctuations and should include provisional mechanisms to deal with revenue windfalls. Fiscal rules should involve all levels of government where possible. However, the OECD Budget Survey only covers central government fiscal rules.

While evidence suggests that fiscal rules can assist governments to achieve fiscal consolidation, practices vary and there is no academic consensus on what design features are most effective. It is notable, however, that countries that fail to enforce or renew are unlikely to achieve fiscal discipline (for example, the United States after the expiration of its 1990 Budget Enforcement in 2002). Strict rules may induce fiscal gimmickry, including one-off measures and creative accounting (Koen and van den Noord, 2005). Milesi-Ferretti (2003) illustrates the importance of budget transparency for effective fiscal rules for its ability to mitigate and detect such practices.

The effectiveness of fiscal rules is also linked to other budget practices and procedures. According to Schick (2003), these include: Medium-term budget frameworks; top-down budgeting; long-term fiscal projections; policy change impact assessments; monitoring and follow-up procedures; and enforcement mechanisms. Recent literature also highlights the supportive role of independent enforcement bodies (Schaechter et. al., 2012).

In evaluating the effectiveness of fiscal rules, attention has focused on their design features and fit with various goals, especially those related to economic policy. Recent literature advocates structured flexibility by including well-defined escape clauses in the fiscal rules design (Schick 2010, IMF 2009); comprehensive coverage of aggregates with limited possibilities of exclusions (Schaechter 2012); and embedding of fiscal rules in national law (European Commission 2010). Anderson and Minarik (2006) argue that deficit rules can hinder counter-cyclical policies; they consider expenditure rules that govern discretionary spending and tax expenditures (but exclude automatic stabilisers) to be a superior alternative because they:

- are more transparent for monitoring purposes and reduce opportunities for creative accounting;
- are inherently counter-cyclical and allow automatic stabilisers to function properly;

- provide firm guidance to policy makers regardless of economic conditions;
- increase the predictability of resources, most notably for annual appropriations related to core government functions and public investments; and
- reduce the risk of adding to tax burdens (when combined with expenditure ceilings).

The IMF has also compiled a dataset[15] covering national and supranational fiscal rules in 81 countries from 1985 to end-March 2012, which presents details about the rules' key design elements (Schaechter, 2012). This information is summarised in a set of fiscal rules indices. From compiling the dataset, the IMF conclude that: *i)* many new fiscal rules have been adopted and existing ones strengthened in response to the crisis; *ii)* the number of fiscal rules and the comprehensiveness of the design features in emerging economies has caught up to those in advanced economies; and *iii)* the "next-generation" fiscal rules are increasingly complex as they combine the objectives of sustainability and with the need for flexibility in response to shocks, thereby creating new challenges for implementation, communication, and monitoring.

The OECD Survey examines five aspects of fiscal rules, namely:

- **the type of fiscal rules adopted:** Whether measured against expenditure, budget balance, debt or revenue;
- **the design of fiscal rules applied**: What the fiscal rule targets and relates to for example cyclicality and GDP;
- **the legal basis of fiscal rules:** Whether established in primary law (*i.e.* the constitution or legislation) or political commitment/agreement between the governing coalition;
- **the duration of fiscal rules:** Whether established for a temporary period of time or on a permanent basis; and
- **the enforcement procedures in cases of non-compliance with the fiscal rules:** Which type of correction and accountability mechanisms are in place.

The number of OECD countries that have adopted fiscal rules has increased substantially since the survey in 2007. Most 94% of the OECD countries that participated in the 2012-survey reported to have adopted at least one fiscal rule, up 12 percentage points from 2007 (Figures 2.9). This is compared to only 54% of PEMPAL countries who have fiscal rules (i.e. 7 out of the 13 countries that participated in the survey). The only two OECD countries that do not apply fiscal rules are New Zealand and Turkey whereas six PEMPAL countries have no such rules (Albania, Azerbaijan, Bosnia and Herzegovina[16], Montenegro, Turkey and Uzbekistan).[17] One reason for the rise in use of fiscal rules in OECD countries is the recent development of enhanced fiscal governance measures in the European Union: among other things the pre-existing fiscal constraints under the Stability & Growth Pact are more clearly specified, there are established convergence procedures towards the medium-term budgetary targets and the euro area countries are obliged to include the fiscal rules in national law (Box 2.1).

The developments in the EU may also be one reason behind the increase of the number of fiscal rules with the average number of fiscal rules in OECD countries increasing from 2.5 to 3.6. The average number of fiscal rules in PEMPAL countries is 2.7. (Figures 2.10), In 2007, most OECD countries had 2-3 fiscal rules while most OECD countries in the 2012 survey, reported to apply 4-5 fiscal rules (Figures 2.11). France, Greece and Tajikistan have adopted six fiscal rules including all types; expenditure rules, budget balance rules, debt rules and revenue rules. Of those countries which have adopted fiscal rules, all PEMPAL countries (except Tajikistan) and ten OECD countries have less than four fiscal rules,

namely Belarus (2), Croatia (3), Kyrgyz Republic (1), Macedonia (2), Russian Federation (3), Serbia (2), Germany (3), Chile, Israel and USA (2), Canada, Japan, Korea, Mexico, Norway and Switzerland (1 each).

Figure 2.9a. **Percentage of OECD countries using fiscal rules (Q18)**

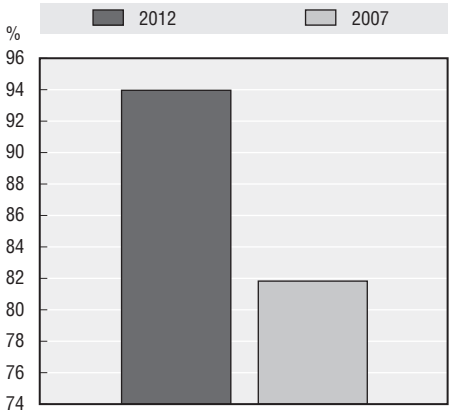
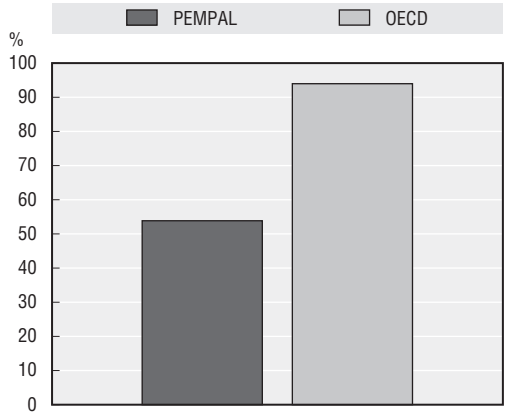


Figure 2.9b. **Percentage of countries using fiscal rules (Q18)**



Note: Figure 2.9-2.11: Percentage of participating OECD countries (33 in 2012 and 33 in 2007).

Box 2.1. **OECD-EU members and the Stability and Growth Pact Fiscal Rules**

The euro area is a currency union of 17 of the 28 European Union (EU) member states that have adopted the Euro as their sole legal tender. There are currently 15 OECD countries in the euro area: Austria, Belgium, Estonia, Finland, France, Germany, Greece, Ireland, Italy, Luxembourg, Netherlands, Portugal, Slovak Republic, Slovenia and Spain. Furthermore, six OECD members are EU members outside the euro area: Czech Republic, Denmark, Hungary, Poland, Sweden and United Kingdom.

The Stability and Growth Pact (SGP) is a rule-based framework for the co-ordination of national fiscal policies in the EU. The Pact consists of a preventive and a corrective arm, of which the latter is focused mostly on the euro area members. The SGP imposes a limit of 3% of GDP on the budget deficit and a limit of 60% of GDP on the gross national debt, as well as convergence paths towards these main fiscal objectives with associated sanctions for deviation. In December 2011 the SGP was strengthened by a new set of regulations known as the six-pack.

The corrective arm of the SGP governs the excessive deficit procedure (EDP) that is triggered by the deficit breaching 3% of GDP or the debt in excess of 60% of GDP. An EDP may also be launched if an overrun of the debt reference value over the past three years was not reduced by at least 1/20 on average per year or the European Commission does not forecast any similar reduction for the past year and two subsequent years, taking into account the effect of the cycle. The Council (the Economics and Finance Ministers of the EU member states) issues recommendations to correct the excessive deficit within a specified time frame. The interest-bearing deposit imposed under the preventive arm (see below) can be changed into a non-interest-bearing deposit. If no effective measures are taken in line with the Council recommendations, a fine of 0.2% of GDP may be imposed on euro area member states. Sanctions recommended by the European Commission may only be rejected by a qualified majority of the Council (subject to reverse qualified-majority voting). There is an escape clause related to "severe economic downturn for the euro area or the Union as a whole".

The preventive arm of the SGP provides for annual stability or convergence programmes to be submitted to the European Commission, including country specific medium-term budgetary objectives (MTO) of a structural budget balance rule (a structural deficit of no more than 1% of GDP for euro area and Exchange Rate Mechanism (ERM-II) countries). If the structural deficit significantly exceeds the MTO (a deviation of 0.5%

Box 2.1. **OECD-EU members and the Stability and Growth Pact Fiscal Rules** *(cont.)*

of GDP in one year or 0.25% in two), the country is committed to following an adjustment path towards an annual average reduction of the structural deficit of 0.5 % of GDP and an expenditure benchmark requires that the expenditure growth may not exceed medium-term potential growth. Expenditure excludes interest, unemployment benefits and EU matching payments. Expenditure financed by discretionary revenue or by statutory increases in revenue is also excluded. The Council, on the basis of a proposal by the Commission, can address an early warning to prevent the opening of an excessive deficit and impose sanctions on euro area member states of payment of an interest-bearing deposit of 0.2% of GDP. The Council may block a recommendation by the European Commission only with a qualified majority.

In March 2013 the European Parliament and the Council have agreed on two further regulations (the two-pack) to strengthen the preventive aspect for euro area member states by introducing a common budgetary timeline and common budgetary rules. Among other things, the regulations provide that the European Commission can require that Member States revise their budgets in cases of serious non-compliance with the SGP.

Moreover, the Eurostat provides quarterly statistical government data reported by member states as a basis for the Commission's surveillance. The Commission will have the power to investigate where there are "serious indications" of possible manipulation of statistics, which may be sanctioned with a fine of up to 0.2% of GDP.

The Treaty on Stability, Coordination and Governance in the EU (the Fiscal Compact) entered into force on 1 January 2013 after ratification by 12 euro area member states (signed by EU25 – all but UK and Czech Republic at that time). The Treaty is mandatory for euro area member states and requires the establishment of a balanced budget rule expressed in structural terms and implemented in national law through provisions of "binding force and permanent character, preferably constitutional". The Fiscal Compact requires contracting partners to respect convergence towards the country-specific medium-term objective (MTO), with a lower limit of a structural deficit of 0.5% of GDP (1.0% of GDP for member states with a debt ratio significantly below 60% of GDP or with low sustainability risk). National correction mechanisms should ensure automatic actions to be undertaken in case of deviation from the MTO or the adjustment path towards it, with escape clauses for exceptional circumstances. Compliance with the rule should be monitored by national independent institutions. The European Court of Justice (CoJ) may impose financial sanctions (0.1% of GDP) if a country does not properly implement the new budget rules in national law and fails to comply with a CoJ ruling that requires it to do so.

Source: European Commission and OECD (2012b), *OECD Economic Surveys: Euro Area 2012*, OECD.

Figure 2.10a. **OECD average number of fiscal rules when applied (Q18)**

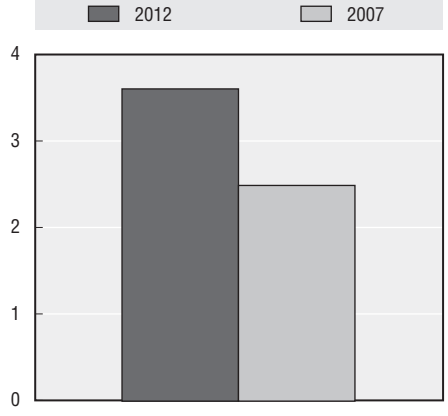
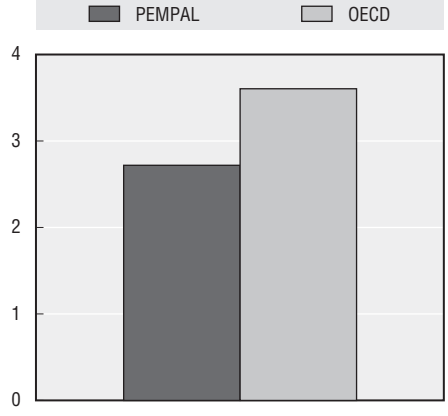


Figure 2.10b. **Average number of fiscal rules when applied (Q18)**



2.4.1. The type of fiscal rules adopted

Figure 2.11a. **Percentage of countries using fiscal rules according to number of rules applied (Q18)**

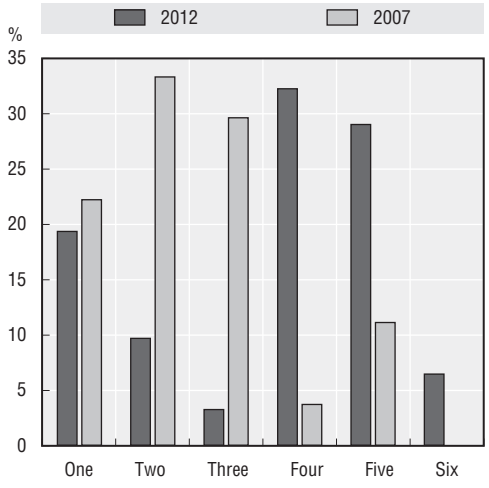
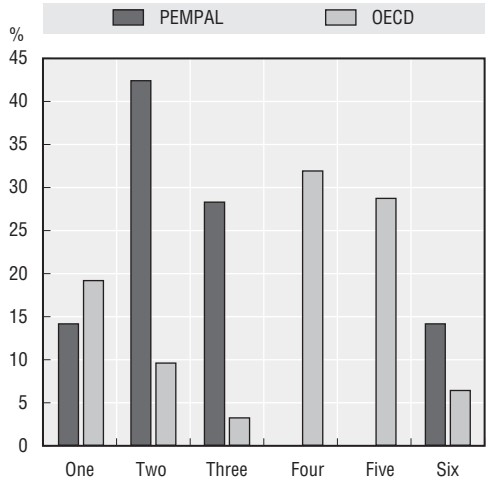


Figure 2.11b. **Percentage of countries using fiscal rules according to number of rules applied (Q18)**



Since 2007, the percentage of OECD countries using fiscal rules has increased for all categories of fiscal rules: budget balance rules, debt rules, expenditure rules and revenue rules. The most substantive development has been within expenditure rules as almost two-thirds of the OECD countries now apply an expenditure rule while only one-quarter of the countries had such a rule in 2007 (Figure 2.12a). Notwithstanding, the most widely adopted fiscal rules are budget balance rules and debt rules that 85% and 70% of the OECD countries have adopted, respectively. These rules are also the most widely adopted by PEMPAL countries, both being used by five out of the seven countries who adopt fiscal rules. Budget balance rules have been adopted by Croatia, Kyrgyz Republic, Macedonia, Serbia and Tajikistan. Debt rules have been adopted by Belarus, Croatia, Macedonia, Serbia and Tajikistan. In comparison, expenditure rules are only used by three countries (Croatia, Russian Federation and Tajikistan), and revenue rules by two countries (Russian Federation and Tajikistan).

Of the total 19 fiscal rules adopted by PEMPAL countries, 32% (6 each) are budget balance or debt rules, 21% (4) are expenditure rules and 16% (3) are revenue rules (Figure 2.12b).

Several OECD countries have adopted more than one fiscal rule of a category. According to the Stability and Growth Pact (SGP) and the Fiscal Compact, all euro area member countries are obliged to apply both a structural and a nominal budget balance rule and a debt rule. In addition these countries may have other national fiscal rules. Italy has adopted four budget balance rules while Belgium and Sweden have three budget balance rules. Since 2007, the number of fiscal rules has increased on all categories of rules regardless which country. In percentage of the total number of fiscal rules in the participating countries the use of balance rules has increased by five percentage points to almost half of all fiscal rules applied (47%, Figure 2.12c).

Figure 2.12a. **Percentage of OECD countries using fiscal rules, according to type of rules (Q18): OECD**

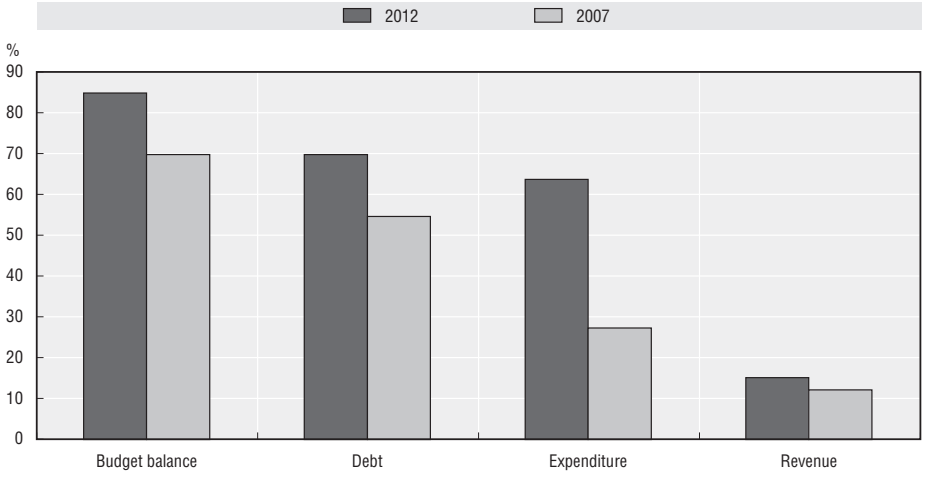
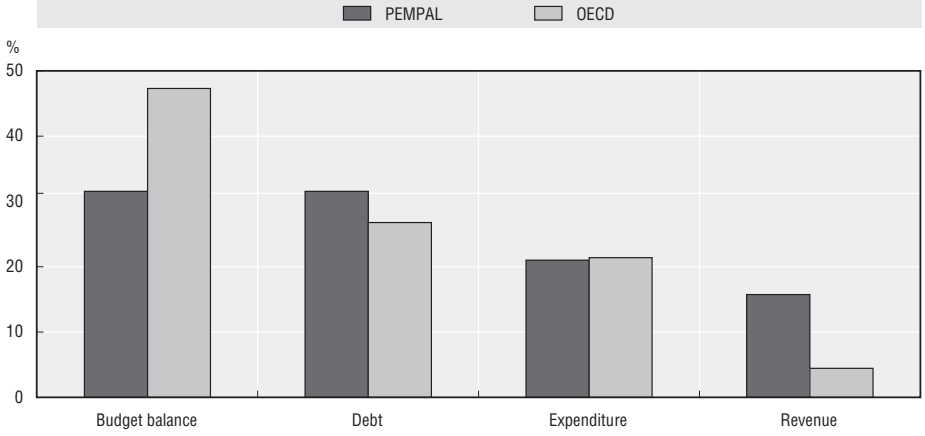


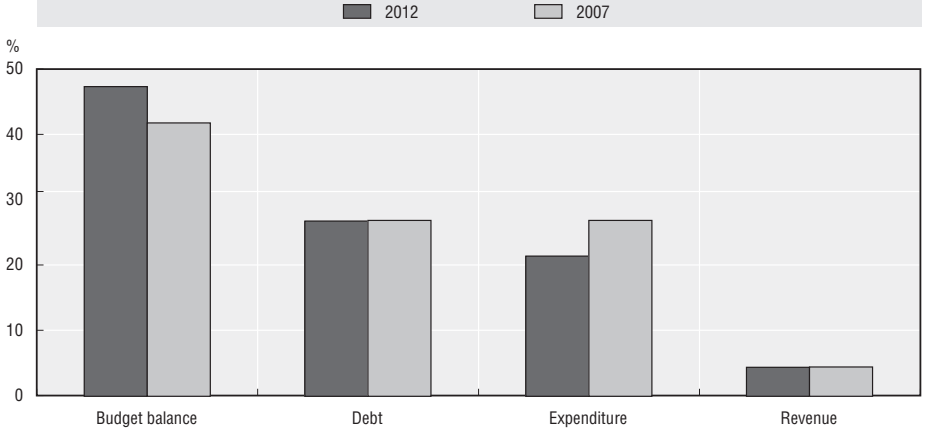
Figure 2.12b. **Fiscal rules used by countries, according to type of rules, as a percentage of total number of fiscal rules (Q18)**



Notes:

1. Figure 2.12a: Percentage of total number of fiscal rules in participating OECD countries (33 in 2012 and 33 in 2007).
2. The 2007 data are retrieved from the *OECD Budget Database* and other OECD sources.

Figure 2.12c. **Fiscal rules used by OECD countries, according to type of rules, as a percentage of total number of fiscal rules (Q18)**



2.4.2. The design of fiscal rules applied

There is no international consensus on the optimum design of fiscal rules. About 85% of all budget balance rules (53 in total) adopted by OECD countries, target a specific budget balance as a percentage of GDP (43%) or a specific budget balance as a percentage of GDP in cyclically-adjusted or structural terms (42%). For PEMPAL countries, 50% of all budget rules (3 out of 6 in total) target a specific budget balance as a percentage of GDP (Figure 2.13a).

Around half of the debt rules used by both OECD and PEMPAL countries establish a ceiling for the Government debt in level or as a percentage of GDP. Further for OECD countries, almost one-third target a given reduction in the debt-to-GDP ratio, whereas such reduction targets are not used by PEMPAL countries. However, one-third of the rules target a specific debt-to-GDP ratio as used by PEMPAL countries (compared to only 14% by OECD countries) (Figures 2.13b).

Figure 2.13a. **Kind of balance rules applied (Q21): OECD**

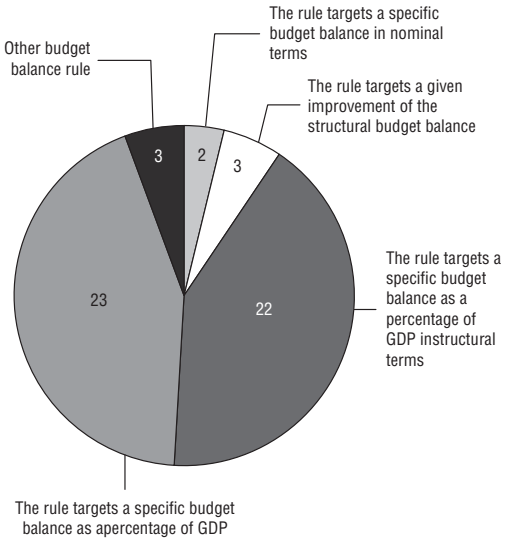


Figure 2.13b. **Kind of balance rules applied (Q21): PEMPAL**

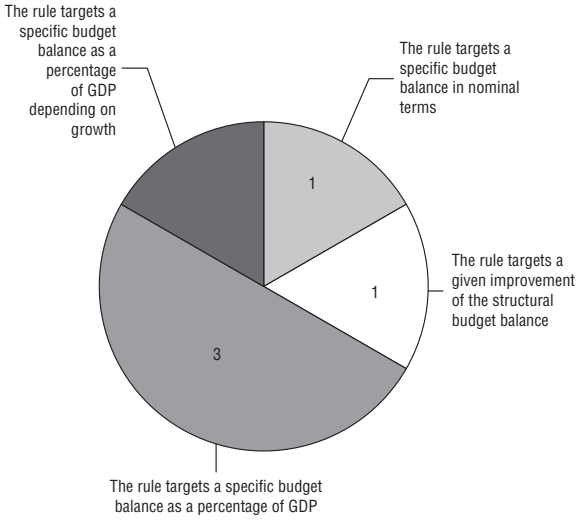


Figure 2.13c. **Kind of debt rules applied (Q22): OECD**

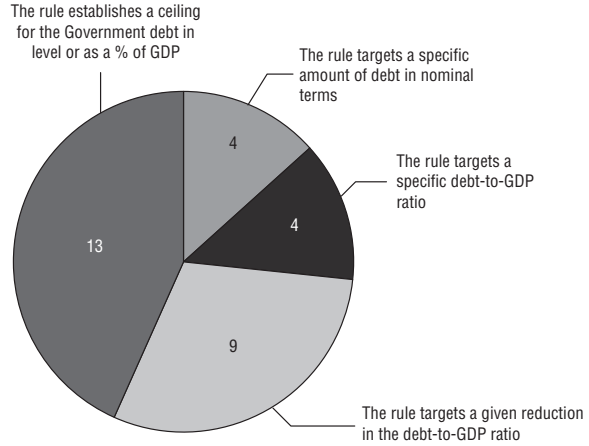
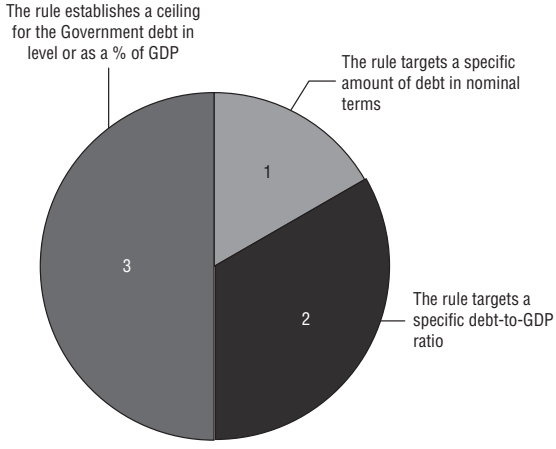


Figure 2.13d. **Kind of debt rules applied (Q22): PEMPAL**



Many of the expenditure rules are designed to target an expenditure ceiling in nominal terms (46% for OECD and 50% for PEMPAL) while only 17% for OECD and 0% for PEMPAL target a real expenditure ceiling. For OECD countries only, 25% of expenditure rules target a real expenditure growth rate. Half (50%) of rules in PEMPAL countries and 8% in OECD countries target a specific expenditure-to-GDP ratio (Figures 2.13).

Figure 2.13e. **Kind of expenditure rules applied (Q19): OECD**

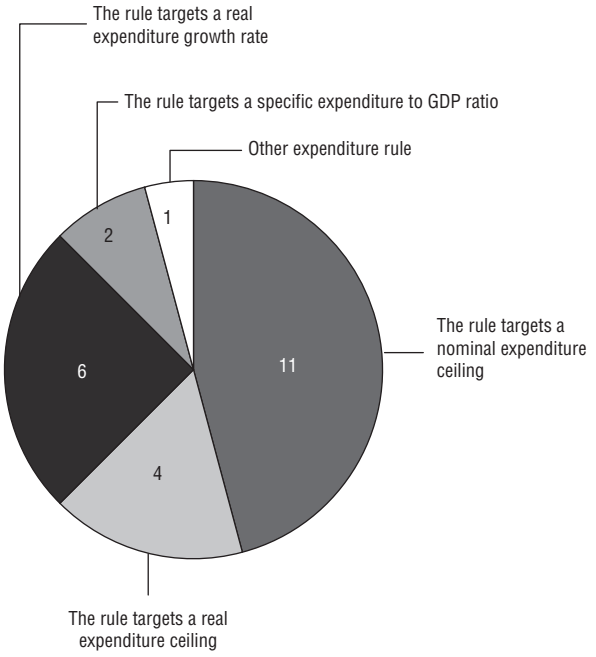


Figure 2.13f. **Kind of expenditure rules applied (Q19): PEMPAL**

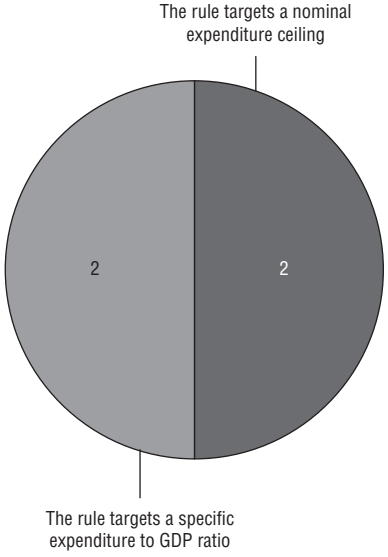


Figure 2.13g. **Kind of revenue rules applied (Q20): OECD**

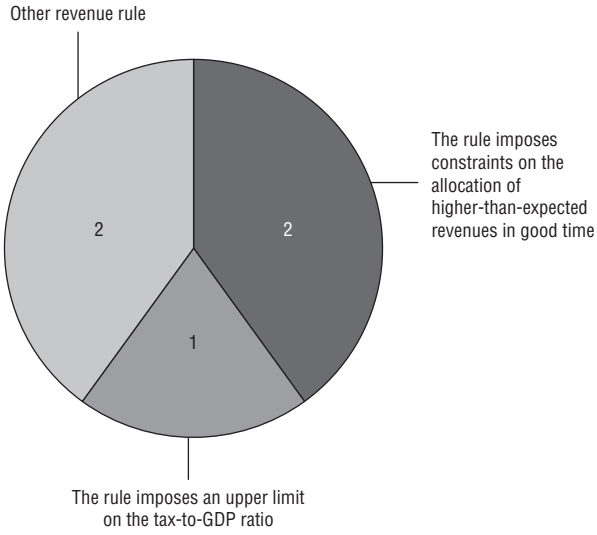
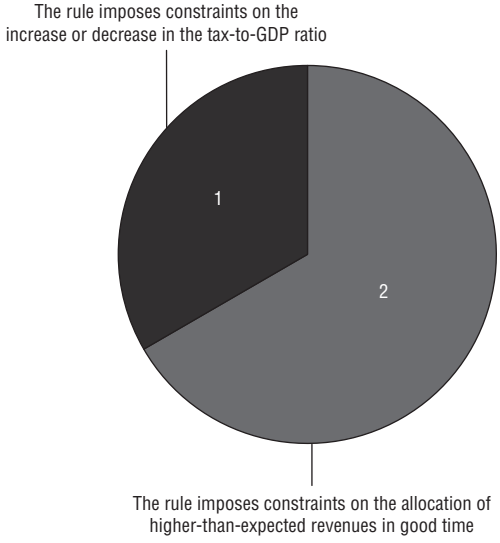


Figure 2.13h. **Kind of revenue rules applied (Q20): PEMPAL**



Examples of fiscal rules from PEMPAL countries are as follows: Croatia has a rule whereby total expenditures of the general budget expressed as a share in the estimated GDP shall annually be reduced by no less than one percentage point, until a point when the primary fiscal balance for the general budget shall be equal to nil or positive in nominal terms (as specified in the Fiscal Responsibility Act, Article 5). For the Russian Federation, budget expenditures must not exceed budget revenues (based on five years moving average of market oil price) more than 1% of GDP. If actual revenues exceed approved revenues based on base oil price, they must be accumulated in the Reserve Fund (sovereign fund) until it reaches 7% of GDP level. For the sub-federal budget, debt must not exceed over 15% of approved revenues in the sub-federal budget. For the municipal budget, debt excluding uncompensated receipts must not exceed over 10% of approved municipal revenues. Serbia has special fiscal rules on pension and salary trends, whereby the pension and salary share in GDP much reach 10% and 8% of GDP respectively, to achieve medium term targets. Under the Budget Code of Belarus, if the annual budget revenue falls short by more than 10% of the forecast, the Ministry of Finance must inform the Government. The Government then provides proposals to the President on cutting or blocking budget spending. Rising or decreasing revenue of the budget is done through decrees and orders of the President of the Republic of Belarus. Belarus also has a ceiling of up to 25% of external government debt to GDP; a ceiling of up to 10% for internal government debt to GDP; a ceiling of up to 20% of servicing payment for government debt to budget revenues; and a ceiling of up to 10% for external government debt servicing and settlement to currency revenues. The budget law for 2013 also sets nominal internal debt limits and external debt limits.

About 90% of expenditure rules in OECD countries cover both discretionary (92%) and mandatory spending (88%) while less than half cover social security funds (38%) and interest on debt (33%). Only three PEMPAL countries have expenditure rules (Croatia, Russian Federation and Tajikistan). All these rules are applied to both mandatory and discretionary spending (except for those rules applied by Tajikistan which doesn't apply them to discretionary spending). In terms of the types of spending these rules cover in PEMPAL countries, there are two rules applying to social security funds (in Tajikistan and Croatia), one rule applying to interest on debt (in Croatia), and one rule applying to public corporations (in Tajikistan). Extra-budgetary funds are only covered in 29% of the expenditure rules in OECD countries and not at all in PEMPAL countries.

For OECD countries, while almost all budget balance rules and debt rules are permanent rules and most of them designed with flexibility for handling fiscal crisis, only 54% of expenditure rules and 20% of revenue rules allow flexibility during fiscal crisis and about half of those two rules are temporary.

For PEMPAL countries, there is more flexibility in budget balance rules with 4 of the 6 rules being flexible, and the same amount being temporary in nature. In contrast, there is less flexibility with expenditure rules with only 1 of the 4 rules being flexible, and 3 of the 4 being permanent in nature. All 3 revenue rules and 4 of the 6 debt rules in use are permanent, with a mix of flexibility indicated (Figures 2.14 and 2.15). An example of how a country has modified a fiscal rule in the face of an economic downturn is Albania, which recently revised its organic budget law, to remove the debt ceiling of 60% of GDP, because it wanted to stimulate economic growth through the expansion of investment. Another is from the Russian Federation, where in 2012 new fiscal rules were announced in order to enhance macroeconomic stability and to allow budget soundness. The overriding priority is to minimise the budget dependency from oil and gas price fluctuations, to improve the

accuracy of long-term budget forecasting and to achieve target values of sovereign funds. For example, during recession periods, the Reserve Fund (which has a regulatory value of 7% of GDP) can be used to cover the deficit of the federal budget.

Figure 2.14a. **Flexibility of fiscal rules during fiscal crisis (Q19-22): OECD**

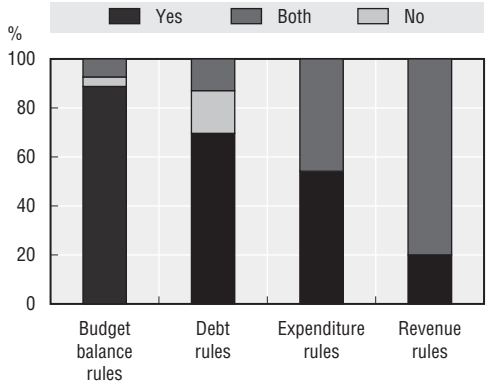


Figure 2.14b. **Flexibility of fiscal rules during fiscal crisis (Q19-22): PEMPAL**

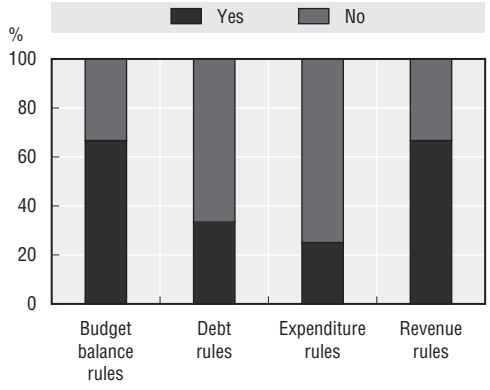


Figure 2.15a. **Time limit for fiscal rules (Q19-22): OECD**

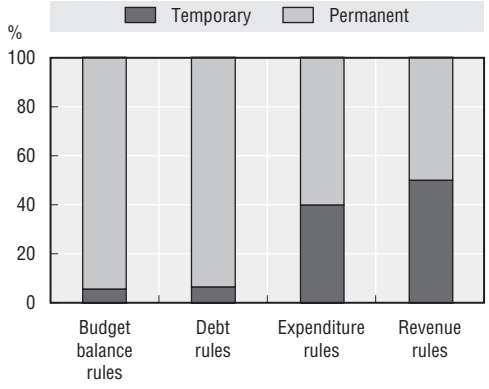
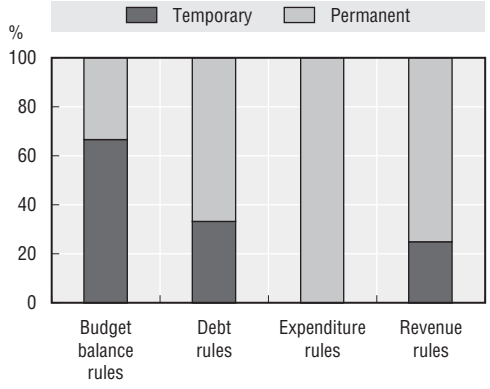


Figure 2.15b. **Time limit for fiscal rules (Q19-22): PEMPAL**

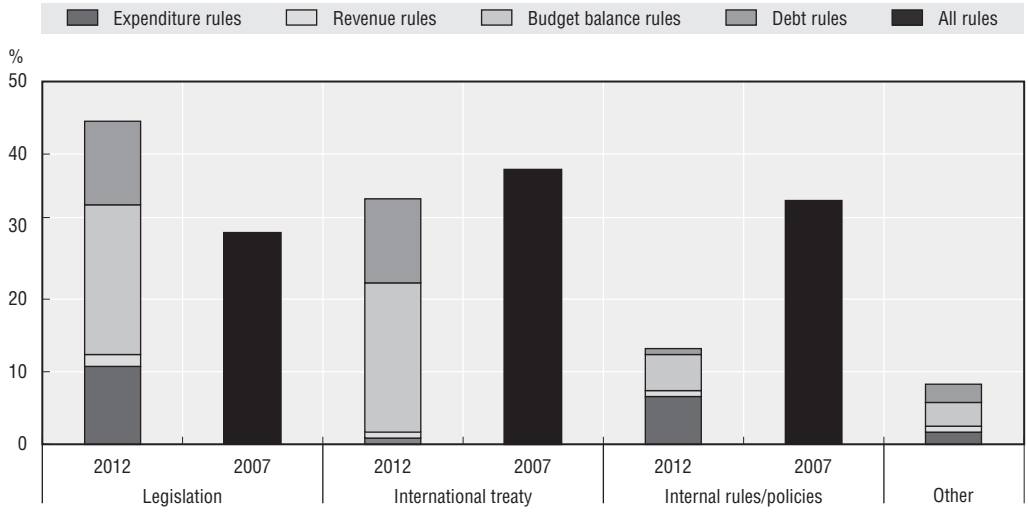


2.4.3. The legal basis of fiscal rules

Since 2007, more OECD countries have taken on board fiscal rules anchored in international treaties (i.e. the strengthened SGP and the recent Fiscal Compact of the European Union). In 2012, one-third of all fiscal rules in the OECD countries are based in an international treaty, down five percentage points from 2007. There is a large increase of national law bases for fiscal rules over the last five years as 45% of all fiscal rules in the OECD countries are based in national laws. Both these developments reflect the situation in the EU as member countries are in the process of complying with the new regulations and the Fiscal Compact that requires a national legal basis for fiscal rules in euro area countries. Following these two changes there is a significant reduction in the number of fiscal rules grounded upon internal rules and policies, falling from one-third of the total number of rules to just 13% in 2012. In Australia the basis for the fiscal rules is a Government commitment as part of the Fiscal Strategy Statement required by the Charter of Budget Honesty Act 1998. Austria refers both to primary law, the SGP (EU) and an internal stability pact within Austria (Figure 2.17a).

Not surprisingly, in OECD countries, it is the budget balance rules and debt rules that dominate among fiscal rules with a basis in international treaty (i.e. EU). These two types of fiscal rules are also based in national law together with expenditure rules. Expenditure rules and budget balance rules dominate among internal rules/policies as basis. Some OECD countries report more than one basis for the fiscal rules (Figure 2.16a).

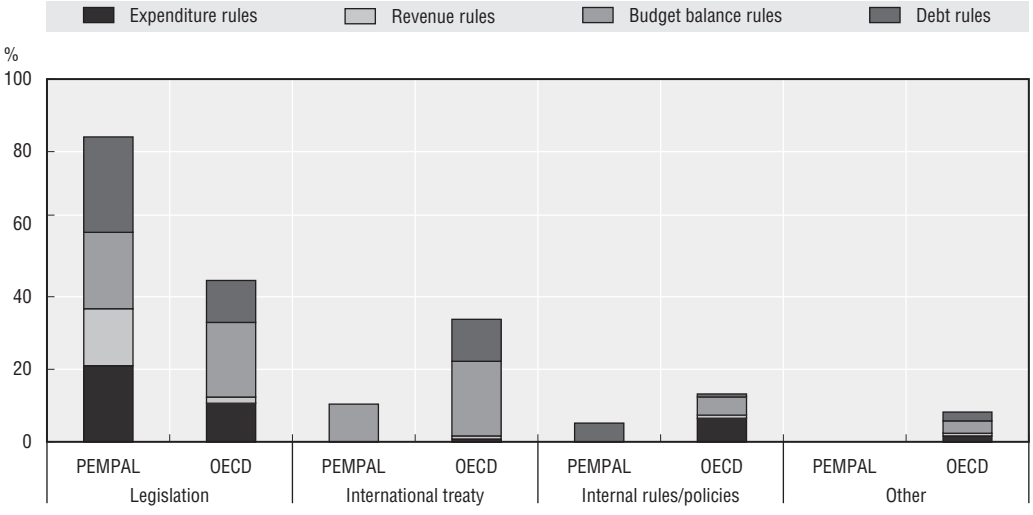
Figure 2.16a. **Legal basis for fiscal rules (Q19-22): OECD**



Note: Percentage of the total number of legal basis in participating OECD countries (33 in 2012).

For PEMPAL countries, over 80% of fiscal rules are based in legislation, with some rules also based on international treaties (in the Kyrgyz Republic and Macedonia it is related to the budget balance). For the Kyrgyz Republic, the government has made a commitment to fiscal consolidation under an IMF Extended Credit Facility[18] and for Macedonia, it has adopted the Maastricht criteria for public debt to be 60% of GDP and the deficit capped at 3% of GDP (although it is currently higher than 3.5% due to the implementation of large infrastructure projects to stimulate economic development such as construction of roads and railways).

Figure 2.16b. **Legal basis for fiscal rules (Q19-22)**

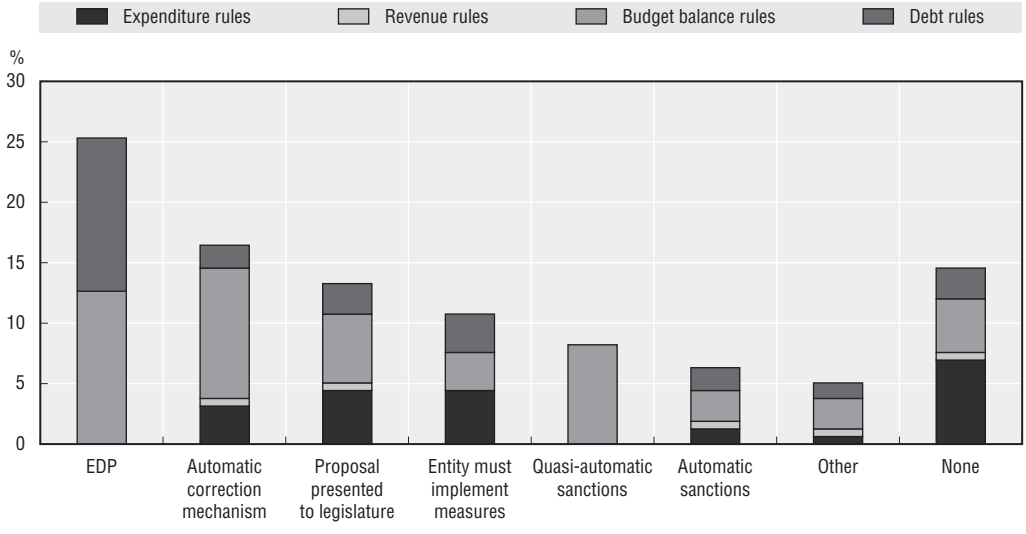


Four OECD countries (Canada, Japan, Korea and Norway) have adopted fiscal rules based solely in internal rules and policies (principles-based fiscal rules) instead of legislated or constitutional rules. Also Estonia bases most of its fiscal rules on internal rules/policies. Under the principles based approach, governments present their financial strategies fiscal objectives and often develop a system for reporting and monitoring fiscal performance against these objectives. Increased flexibility is a key advantage of the principles-based approach, which allows governments to accommodate exogenous shocks and changing economic conditions. This is seen to be advantageous in times of economic volatility where the government may need the capacity to deliver economic policy in a timely manner without having to change the law or wait for the next election for a mandate to vary a fiscal rule. On the other hand, the EU requirement for a legislative basis of fiscal rules also includes escape clauses for severe economic downturns.

2.4.5. *Enforcement procedures if non-compliance with the fiscal rules*

A longstanding issue concerning fiscal rules has been how to implement enforcement mechanisms in cases of non-compliance. The European Union has developed a set of enforcement procedures for the euro area countries, e.g. a non-interest-bearing deposit or a fine (Box 2.1). In general, the enforcement procedures in OECD countries are mostly related to budget balance rules and debt rules as 54% of the expenditure rules and 20% of the revenue rules are not linked to a pre-designed enforcement mechanism. The most common enforcement procedures (25% of all enforcement procedures) are the excessive deficit procedure (EDP) of the SGP (for non-compliance of the nominal budget balance rule or the debt rule of the Stability and Growth Pact in the European Union) followed by automatic correction mechanisms (17%) and presentation of correction proposal to the legislature (13%), mostly related to budget balance rules (Figures 2.17). Some of the Independent Fiscal Institutions in OECD countries are mandated to monitor compliance of fiscal rules (Section 8).

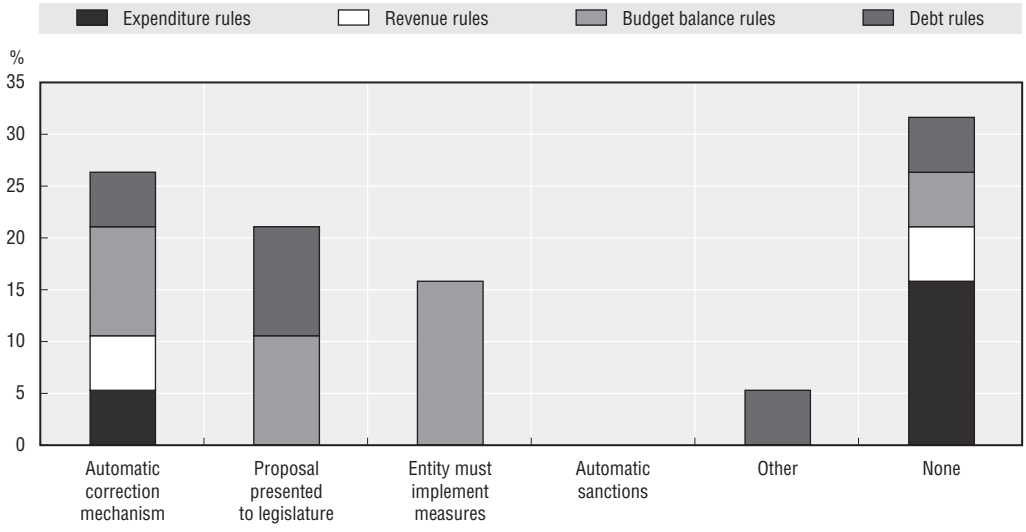
Figure 2.17a. **Enforcement mechanisms for fiscal rules (Q19-22): OECD**



For PEMPAL countries, 32% of rules have no enforcement mechanisms (compared to under 15% for OECD countries), with the most common mechanisms being automatic correction (26%), presentation of correction proposal to the legislature related to debt and budget balance rules (21%), with budget balance rules also subject to the entity having to

implement measures (16%) (Figure 2.18). In Serbia, the Government may, under exceptional circumstances and for a limited time only, deviate from the fiscal principles and rules specified in the law, in cases of natural disasters and external shocks that may have an impact on the human health, national safety and drop in economic activities, upon reaching a decision on such a deviation. For other deviations, the Government must submit a report to the National Parliament, clearly stating the reasons and corrective measures including the time period expected to get back on course.

Figure 2.17b. **Enforcement mechanisms for fiscal rules (Q19-22): PEMPAL**



3. Medium-term expenditure frameworks (Q.25-30)

Medium-term expenditure frameworks (MTEFs) strengthen the ability of the Government collectively, and the Ministry of Finance in particular, to plan and enforce a sustainable fiscal path. If properly designed, an MTEF should force stakeholders to deal with the *medium term perspective* of budgeting and budgetary policies rather than adopt an exclusively year-by-year approach. MTEFs typically cover a period of three to four years and aim to improve the quality and certainty of multi-annual fiscal planning through combining prescriptive yearly ceilings with descriptive forward estimates. 'Estimates' in this context are calculations of how expenditure, revenue and the aggregate fiscal position will turn out under certain assumptions. By their very nature, high-level fiscal ceilings are set in a medium-term context. Ceilings are targets or limits set by the government regarding aggregate or policy area spending for each year of the multi-year frame of reference. The ceilings may be updated annually or fixed for a period. For the medium-term framework to work effectively, estimates and ceilings need to be reconciled within the context of a forward-looking approach to budgetary planning and policy formulation. Accordingly, a medium-term framework should clearly state the government's medium-term fiscal objectives in terms of high-level targets such as the level of aggregate revenue, expenditure, deficit/surplus, and debt; and should facilitate stakeholders in identifying the policy choices and trade-offs that will be necessary in light of the estimates of what would happen in the following 3-5 years based on unchanged policies. The level of detail of such frameworks varies from country to country and a corresponding vocabulary describing the various forms of medium-term frameworks has developed.

An expenditure framework can be rolling as in Austria, Germany and Sweden, or it can be periodic as in France and the United Kingdom. In a rolling framework, an additional year is added at the end of the framework period when the first year expires. In a periodic framework, a new sequence of ceilings is drawn up at certain timely intervals, for instance at the beginning of every new cabinet period.

MTEFs are increasingly relevant in a context where the multi-annual character and implications of certain policies need to be more clearly presented. Many policies require an extended time horizon, such as large capital projects, new programmes, and organisational reform and restructuring. The forward estimates make clear the medium-term implications of budget decisions. This is particularly important when: i) capital projects are launched with changing operating costs; ii) programmes come into effect late in the budget year, thus not exposing their full costs in the initial year; iii) programmes' spending implications are not fully reflected under the circumstances prevailing during the budget year, but will become so in out-years. These are all classic examples of budgeting "games", which the medium-term frameworks aim to mitigate. From the point of view of managers in line ministries and agencies, medium-term frameworks put them in a better position to plan their policies and operations, to the extent that they have some level of visibility regarding the likely level of funding beyond the next budget. This is especially relevant in a context of fiscal consolidation. Many savings options involve more than one year in order to reap their full benefits. Prior to the advent of medium-term frameworks, such options were often not considered as the time horizon only extended to the next budget year.

3.1. Basic characteristics of medium-term frameworks (Q.25-30)

Almost all OECD and PEMPAL countries report to have a MTEF in place. Only four OECD countries that participated in the survey (Belgium, Hungary, Israel and Luxembourg) and two PEMPAL countries from (Macedonia and Uzbekistan) do not have a MTEF in place. This is a significant increase since 2007 when 72 % of OECD countries reported a MTEF in place (Figures 3.1).

Figure 3.1a. **Percentage of OECD countries with MTEF in place (Q25)**

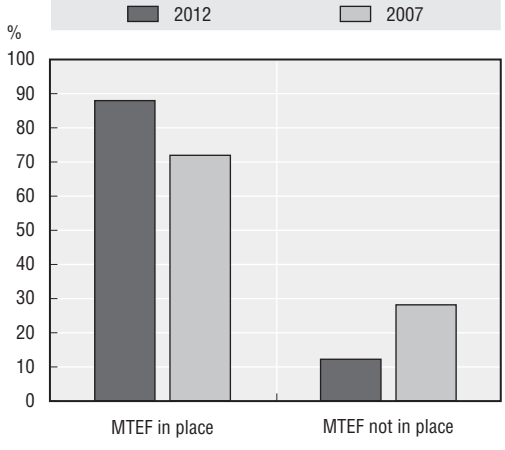
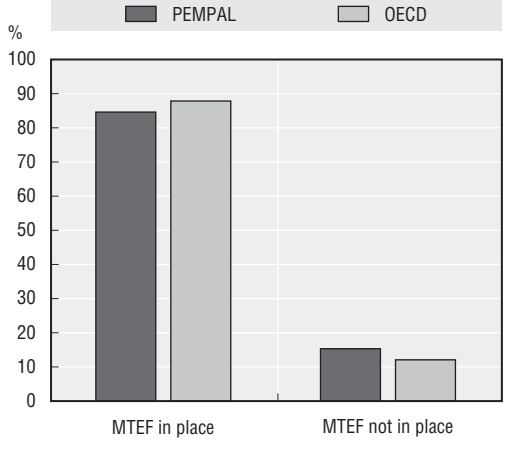


Figure 3.1b. **Percentage of PEMPAL countries with MTEF in place (Q25)**



Note: Percentage of participating OECD countries with an answer to the question (33 in 2012 and 32 in 2007).

Box 3.1. **Success factors for MTEF to work:**

1. Conservative forecasting of expenditure and revenue (better to have more good surprises).
2. Provide ministers with incentives to under-spend.
3. Complete coverage of the MTEF increases its credibility.
4. Keep it simple: the public (and Parliament) need to understand the MTEF to support it.
5. Compliance with the MTEF needs to be a binding consideration in the design of sectoral policies.
6. Deviations from previously-set ceilings should be reconciled transparently each year.

Half of the OECD countries have enshrined MTEFs in law and most of the rest have established the framework in a policy or strategy decided by the government or through other arrangements. Enshrining MTEFs in law is more common in PEMPAL countries with 64% of countries who have MTEFs, adopting this approach (Figures 3.2). Most of the OECD (52%) and PEMPAL (55%) countries approve the MTEF in the Cabinet. The MTEFs in 34% of OECD countries are also approved by the Legislature, compared to only 18% in PEMPAL countries (Figures 3.3).

Figure 3.2a. **Legal basis for MTEF (Q26): OECD**

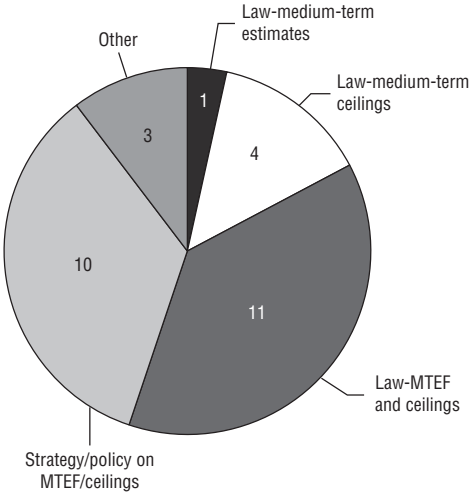
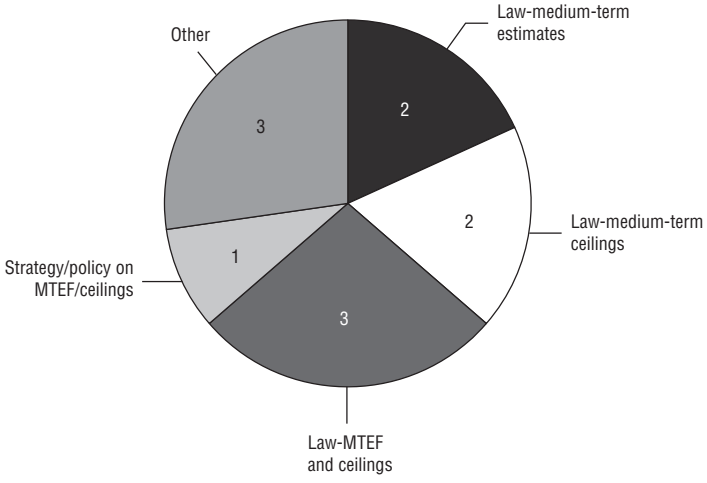


Figure 3.2b. **Legal basis for MTEF (Q26): PEMPAL**



3.2. Comprehensiveness and level of ceilings (Q.27a)

It is necessary to find a good balance between *predictability* and *flexibility* of MTEFs. Predictability favours comprehensiveness and a fixed framework. The major advantage of a fixed expenditure framework over a flexible framework is predictability as it is (more) effective in realising multi-year expenditure targets. Precisely because the overall ceiling cannot be changed from year to year, the target is bound to be realised as long as the framework is maintained. In addition, a fixed framework contributes to automatic stabilisation because autonomous fluctuations in tax revenues are not allowed to affect the expenditure level. Only a few OECD countries work with a fixed expenditure framework

Figure 3.3a. **Who approves the MTEF? (Q28): OECD**

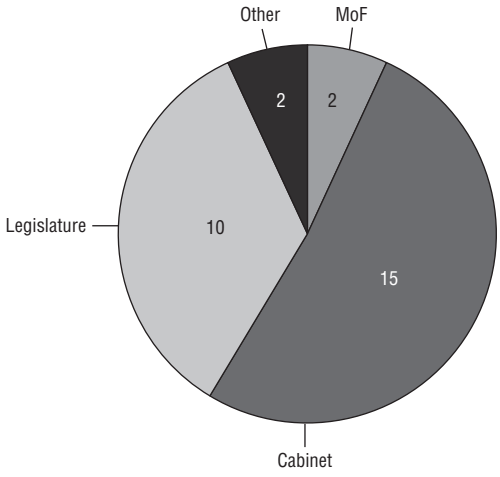
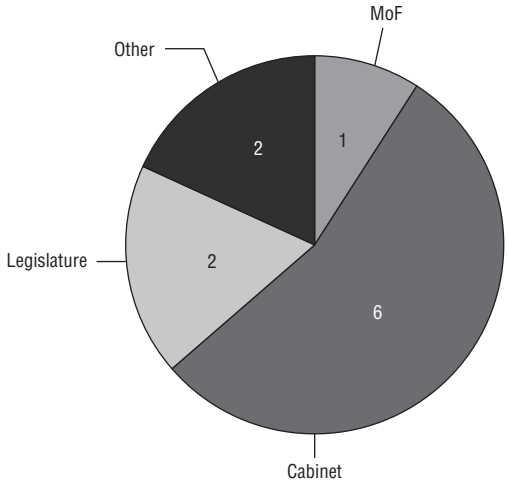


Figure 3.3b. **Who approves the MTEF? (Q28): PEMPAL**



(e.g. France), while many others seek to keep their expenditure framework as stable as possible from year to year without formally committing to a fixed framework.

A comprehensive coverage of expenditure in the MTEF (i.e. the share of expenditures subject to the ceiling) lends itself to greater credibility. A broad-based MTEF allows for the budget discussions to be broadened covering all items, including the mandatory spending which might otherwise fall outside of consideration, with a focus falling instead on discretionary items. Almost all OECD countries and all PEMPAL countries include mandatory expenditures in the MTEF (Figures 3.4). Some governments have exempted particularly volatile items or items determined by entitlements from the ceilings (for instance, the United Kingdom has exempted interest payments and social security expenditure).

Figure 3.4a. **Are mandatory expenditures included in the MTEF? (Q29): OECD**

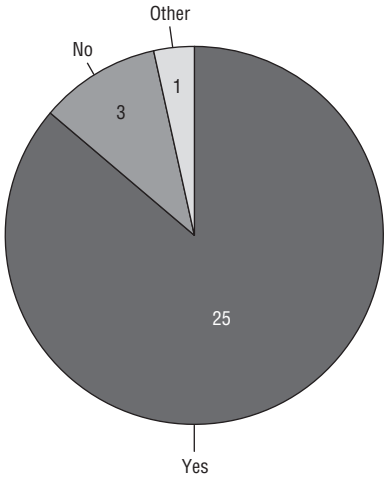
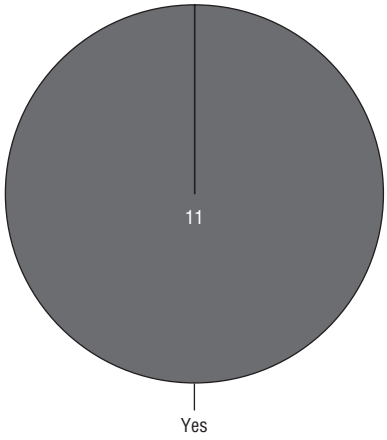


Figure 3.4b. **Are mandatory expenditures included in the MTEF? (Q29): PEMPAL**



Most PEMPAL countries have expenditure ceilings at the overall/total expenditure level and the organisational level. Azerbaijan, Croatia, Russian Federation and Tajikistan also have sub-aggregate ceilings at the programme or sector level (Figures 3.6). In Croatia for

example, the Legislature passes the budget on the level of subgroup (third level of economic classification) for the next budget year and projections on the level of division (second level of economic classification) for the following two years. It is also more common in PEMPAL countries (55%) to have no formal monitoring of the MTEF, compared to OECD countries (21%) (Figures 3.5). Only 45% of OECD countries and 36% of PEMPAL countries monitor MTEFs by reporting to the Legislature and an independent institution conducts the monitoring in only three (OECD) countries (Figures 3.5).

Figure 3.5a. **Monitoring of MTEF (Q30): OECD**

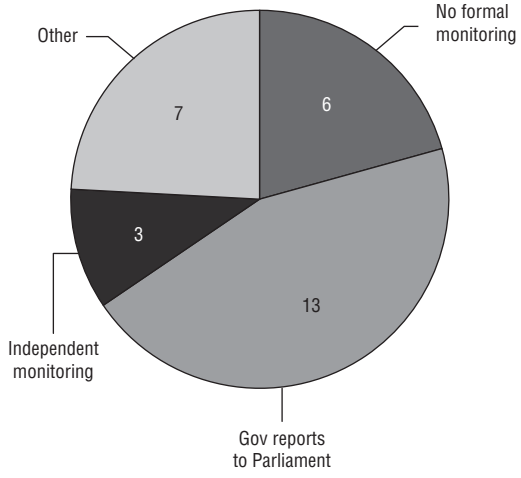
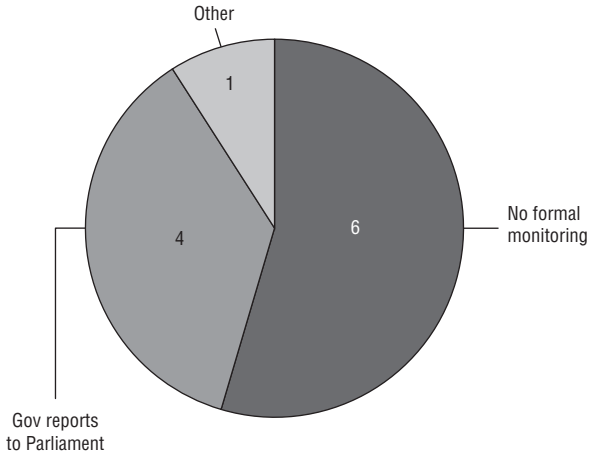


Figure 3.5b. **Monitoring of MTEF (Q30): PEMPAL**

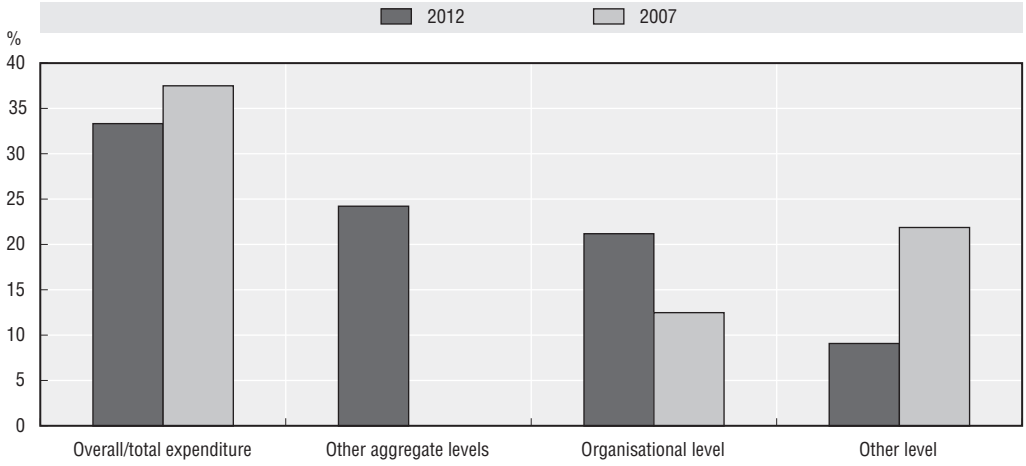


For maximum budgetary flexibility, aggregate ceilings may be set, with more or less room for reallocation below that level from year to year. Most OECD countries have expenditure ceilings either at an overall level similar to PEMPAL countries but also at a programme/sectoral level, of which Australia, Chile, Finland, Italy, Japan, Mexico, Slovenia, Spain, Sweden and Switzerland have ceilings only at an overall expenditure level. On the other hand, Estonia, Greece, Ireland, Slovak Republic, Turkey and United Kingdom have expenditure ceilings at an organisational level, e.g. ministries or agencies. Germany's MTEF is a planning instrument of the government on a line item level but reported to Parliament on an aggregate level. Norway specifies in their fiscal policy guidelines a limit on use of oil revenue that together with a ceiling for the tax level implies an indirect ceiling for expenditures. Poland prepares the MTEF with a performance budget classification of expenditures; ceilings are set for overall/total expenditures and broken down into 22 functions of the state (Figures 3.6). Since 2007, there has been an increase of OECD countries setting their ceilings at an organisational level and at other aggregate levels (i.e. programme) (Figures 3.6).

3.3. Length of ceilings and frequency of revisions of the ceilings (Q.27b)

In terms of future budget years covered, the dominant trend among OECD countries is multi-year expenditure ceilings to cover between three and four years compared to PEMPAL countries who have ceilings that mostly cover only three years (except for Azerbaijan with four years). Many frameworks cover a three-year period (e.g. France, Sweden) or a four-year period (e.g. Finland, the Netherlands). Four countries produce five-year expenditure ceilings (Canada, Greece, Korea and Mexico). Only Norway and the USA report to set ceilings for six years or more (Figures 3.7).

Figure 3.6a. **Levels of ceilings of MTEF (Q27): OECD**



Note: Some countries have more than one level of ceilings, notably Austria, Germany, Korea, Netherlands, New Zealand and Portugal. In such cases only one sub-aggregate level of ceiling is counted per country. Percentage of participating OECD countries with an answer to the question (33 in 2012 and 32 in 2007).

Figure 3.6b. **Levels of ceilings of MTEF (Q27)**

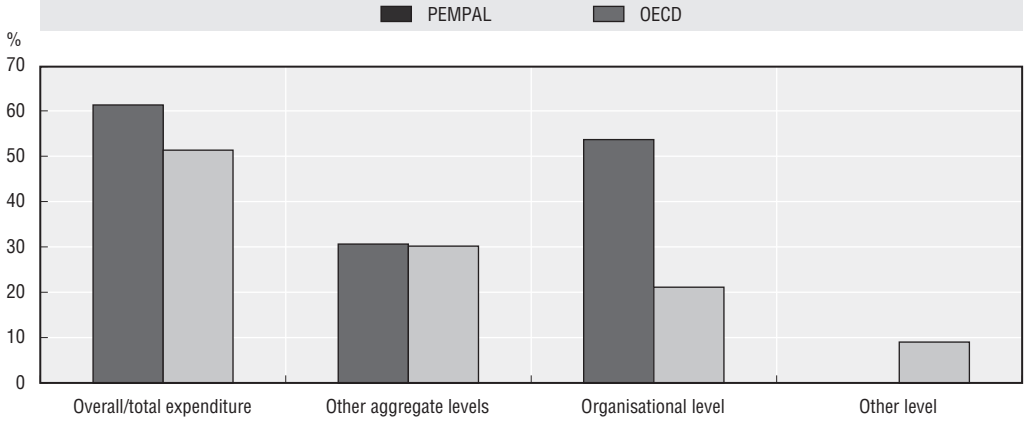
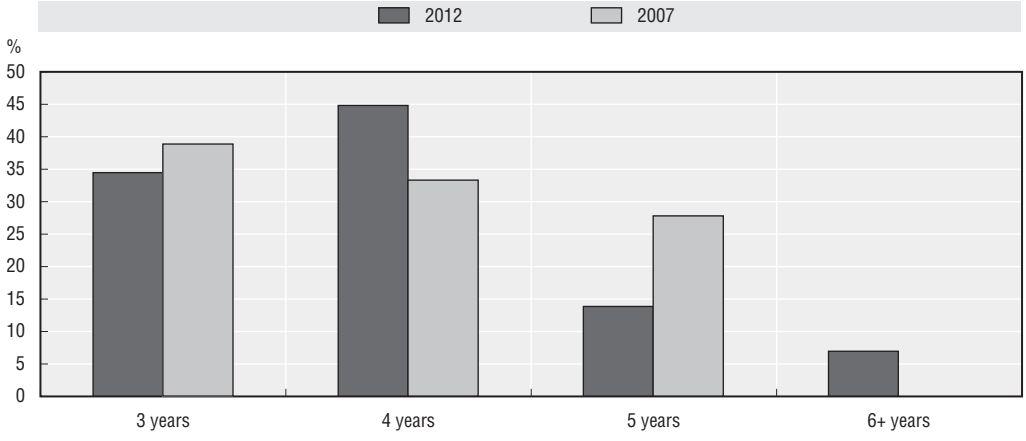


Figure 3.7a. **Length of ceilings (Q27b)**



Notes: Some countries have a different length for the different levels of ceilings, notably New Zealand that has 4 years on overall level (included in the figure) but 2 years on other aggregate levels. Percentage of participating OECD countries with a MTEF (29 in 2012 and 18 in 2007).

Figure 3.7b. **Length of ceilings (Q27b)**

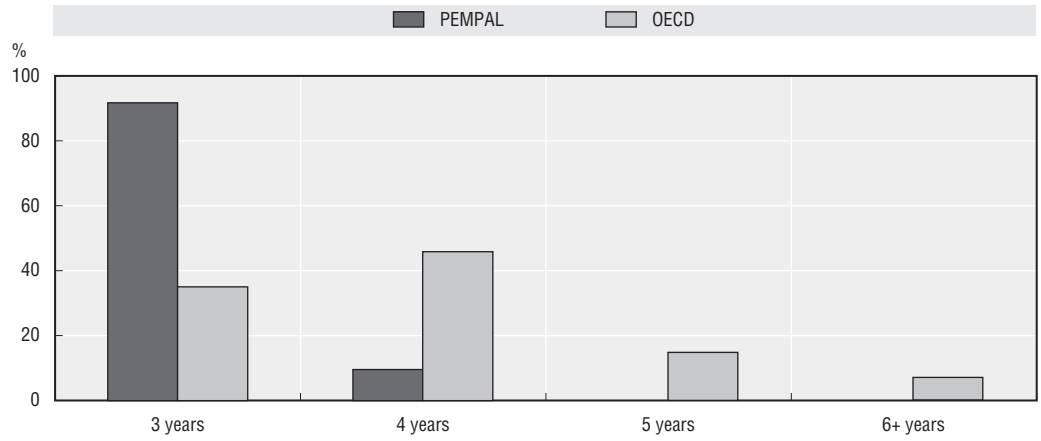
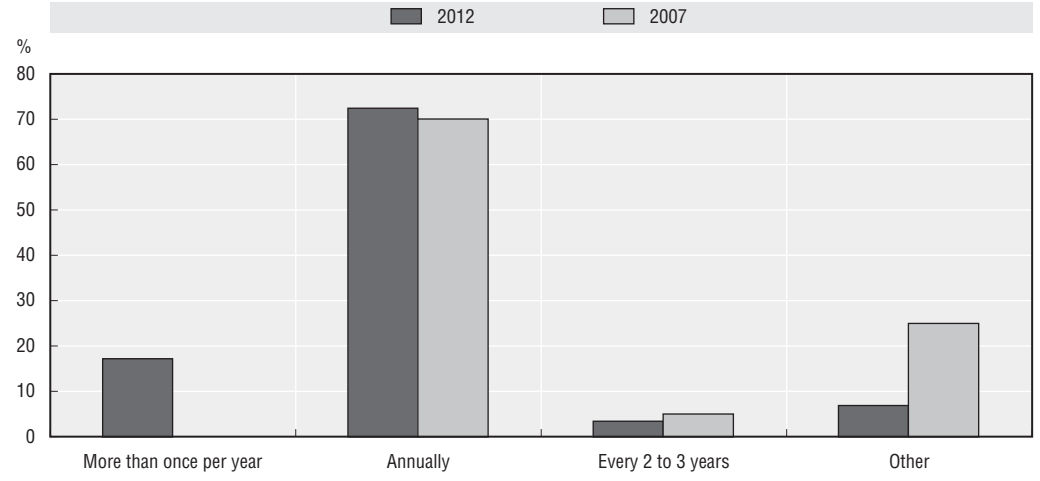
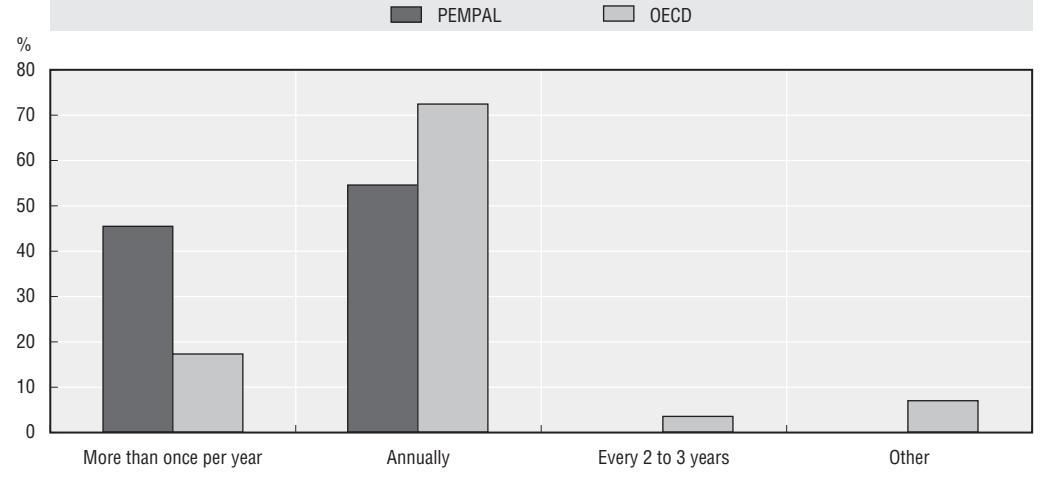


Figure 3.8a. **Frequency of revision of ceilings (Q27b)**



Note: Some countries have a different revision frequency for the different levels of ceilings, notably New Zealand that revises annually the overall level (included in the figure) but more than once a year for "other levels". Percentage of participating OECD countries with an answer to the question (29 in 2012; and 20 in 2007).

Figure 3.8b. **Frequency of revision of ceilings (Q27b)**



Of revisions made to the ceilings, 72% (OECD) and 55% (PEMPAL) are done so annually. Furthermore, 45% of revisions in PEMPAL countries (compared to only 16% in OECD countries) are done more than once per year (Figures 3.8). France reports to have fixed expenditure frameworks with revisions of its aggregate ceilings on the policy area level only every 2-3 years. The Netherlands and United Kingdom revise the ceilings only after a fixed four year period.

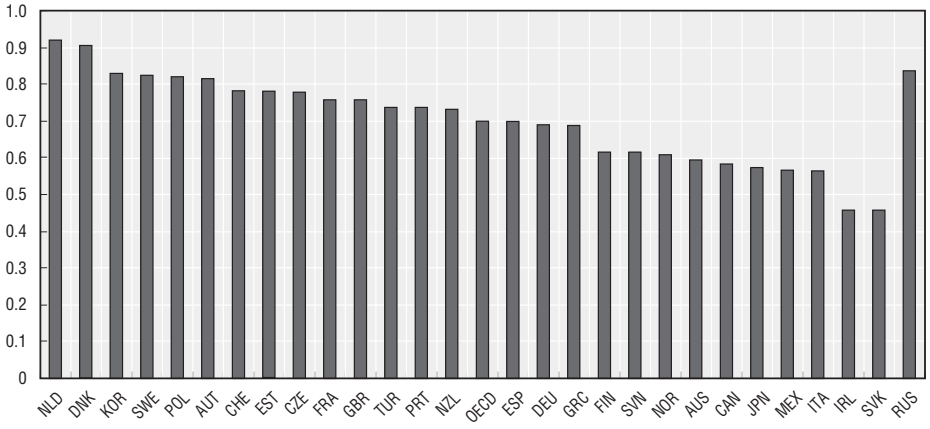
Box 3.2. **Index of the medium-term perspective in the budget process**

As a way of capturing the above mentioned institutional components the OECD has developed a composite index. The index measures the extent to which countries have developed a medium-term perspective in their budget process. The index map out the countries' adoption of MTEF, its design of ceilings (coverage in years, level of detail and substance), frequency of revision, flexibility over year-ends and monitoring. The logic that is incorporated in the index is that the MTEF's effective character increases with a strong legal basis; the coverage of ceilings should be at least 3-4 years with ceilings on some sectoral or organisational levels in addition to an overall ceiling. The MTEF framework would be more binding and resilient with infrequent revisions and with monitoring by an independent body. The index does not, however, measure the effectiveness of each MTEF by reference to fiscal performance.

The index accordingly contains the following variables (weights in parentheses): whether countries have a multi-year expenditure framework in place (8.3%); the legal basis for the multi-year expenditure framework (16.7%); the level of medium-term ceilings set in the budget (11.1%); the number of years the ceilings cover (11.1%); whether mandatory expenditures are included in the ceilings (11.1%); how often ceilings are revised (12.5%); whether carry-over is allowed over year ends (12.5%); and how the medium-term expenditure framework is monitored (16.7%). The index ranges between 0 (no medium-term perspective) and 1 (highly developed medium-term perspective). The composite index does not capture whether the framework includes performance information, or its impact on budget outcomes such as fiscal discipline and allocative efficiency. See Annex for a description of the methodology used to construct the index. Further information on the index can be found in Government at a Glance (OECD, 2013). The variables comprising the index and their relative importance are based on expert judgments.

The 2012 index gives highest credit to the Netherlands, Denmark and the Russian Federation with Korea, Sweden, Poland and Austria following suit (Figure 3.9).

Figure 3.9. **Medium-term expenditure framework index**



Notes:

1. This index measures the extent to which countries have developed a medium-term perspective in their budget process. However, it does not evaluate whether this perspective has been effective at achieving budget outcomes such as fiscal discipline and allocative efficiency.
2. The OECD average is based on 27 member countries in 2012. Belgium, Hungary, Israel and Luxembourg do not apply a MTEF. Chile, Iceland and USA did not respond.

4. Capital budgeting (Q.34-35, 40-47)

4.1. Capital budgets and multi-year funding practices (Q.34-35)

Capital budgeting means different things in different countries. Capital budgeting can mean that the government has a divided budget, with one budget for investment and another for current expenditures. It can also mean that government accounts for investment and current expenditure separately, but then integrates them into a single budget with budget charges for depreciation and write offs on capital assets. Alternatively it can mean separate decisions, which are then combined into a single budget.

Over half or 62% of PEMPAL countries prepare separate capital and operating budgets, with only Bosnia-Herzegovina, Croatia, Turkey and Uzbekistan integrating them. Similarly, 61% of OECD countries prepare separate capital and operating budgets, while most of the other countries have integrated capital and operating budgets (except Denmark and Canada). In Denmark, cost of capital is incorporated into the operating budget as part of the accrual budgeting system but major investment projects are appropriated separately. Canada reports that the CBA requires line ministries to indicate operating and capital costs and the years in which costs are to be incurred; separate capital appropriations are required only for total planned annual expenditures on capital greater than CAD 5 million. Compared to the situation in 2007, more OECD countries prepare separate capital and operational budgets, up from about 45% to 61% of the total number of OECD countries that participated in the survey (Figures 4.1).

Figure 4.1a. **Capital budgets in central governments (Q34): Pempal**

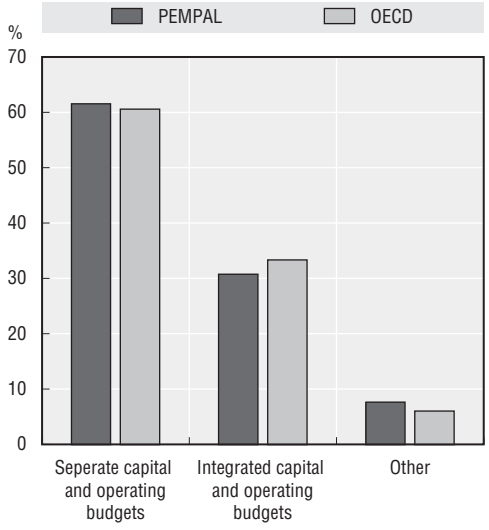
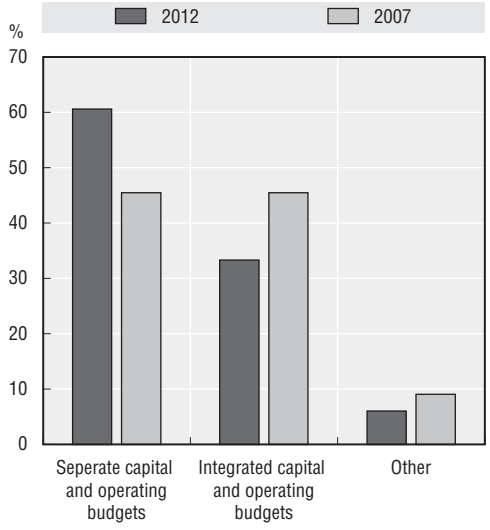


Figure 4.1b. **Capital budgets in central governments (Q34): OECD**



Moreover, more OECD countries appropriate funding for the total project cost up-front (39%) than in 2007 (13%). Three countries determine funding on a case by case basis: Austria, Slovak Republic and United Kingdom. For PEMPAL countries, 23% appropriate funding for the total project cost up-front (Belarus, Macedonia and Serbia) whereas the capital budgets for most other countries are funded incrementally each year. For Turkey, the Council of Ministers distribute total appropriations to projects in investment programmes (Figure 4.2a).

Figure 4.2a. **Funding of multi-year capital projects (Q35)**

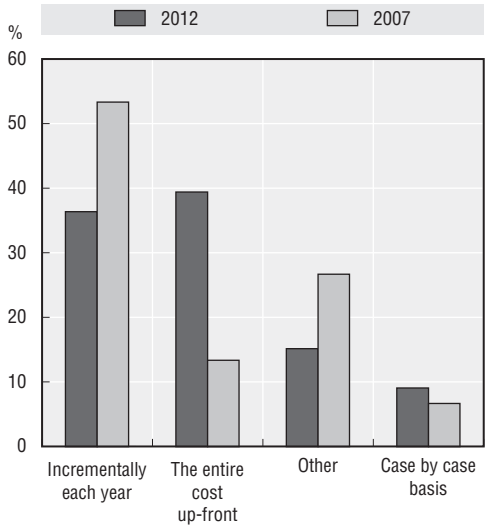
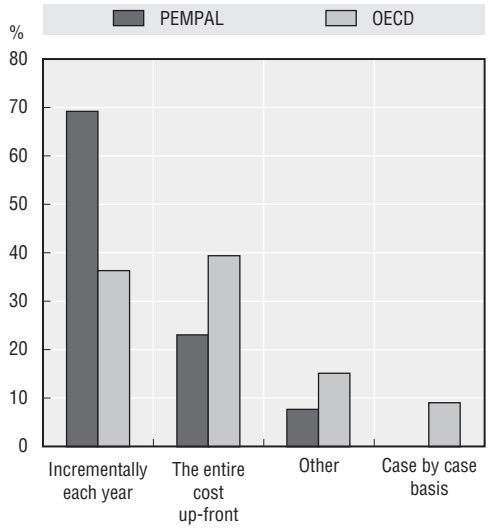


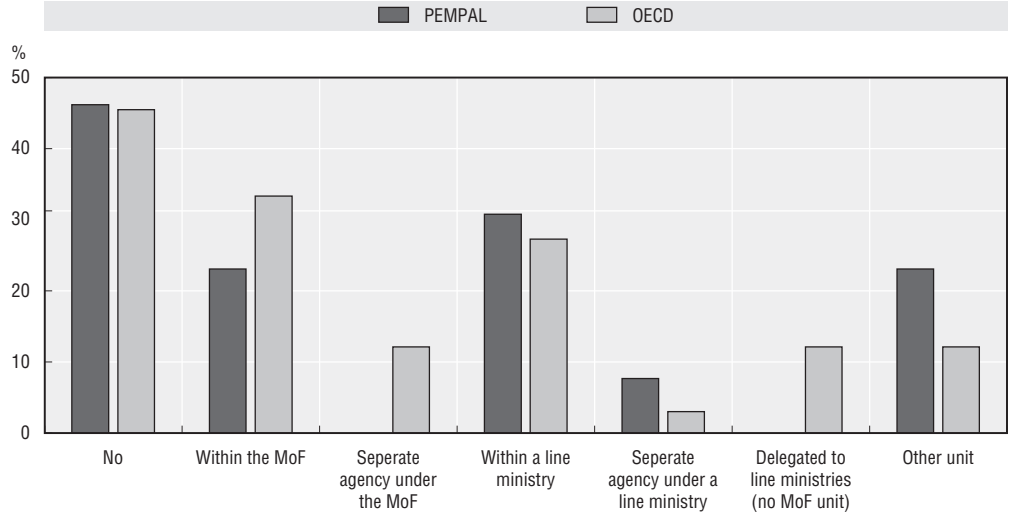
Figure 4.2b. **Funding of multi-year capital projects (Q35)**



4.2. Public-Private Partnership (PPP) practices (Q.40-42)

Since the early 1990s, and increasingly throughout the 2000s, there has been a significant increase in the use of PPPs by OECD countries. Countries such as Australia, France, Germany, Korea and the United Kingdom increasingly use PPPs to deliver services that they previously delivered through traditional public procurement. For most of the last decade, PPPs in the United Kingdom constituted approximately 12% of total annual capital expenditure (Burger and Hawkesworth, 2011).

Figure 4.3. **Capital budgets in central governments (Q34)**



Note: See Table 4.3. Those responses that indicate units being a "separate agency under a line ministry", or an "other unit" above, represents sub-categories, thus the total % share adds up to more than 100%.

Given the complexity of PPPs and their somewhat infrequent use, critical skills to ensure value for money may need to be concentrated in a PPP Unit that is made available to the relevant authorities. Over half (55%) or 18 out of 33 OECD countries and 7 out of the

13 PEMPAL countries (54%) have established one or more PPP units in their central government (Figures 4.4). Most OECD and PEMPAL countries have only one or two PPP units. Of the 7 PEMPAL countries with PPP units, two countries have units both within the Ministry of Finance and a line ministry, with most of the remaining countries having them within a line ministry or other unit. For the Kyrgyz Republic and the Russian Federation, they have units within both the Ministry of Finance and a line ministry. For the Russian Federation there is also an additional unit responsible for state support to PPP projects: the Ministry of Regional Development Investment Fund (with several other ministries playing a role such as those responsible for transport, sport, energy, air transport, border services, roads and rail). For Azerbaijan and Tajikistan, they have units only within line ministries with the function in Tajikistan being placed in the State Committee on Investments and State Property Management. For Azerbaijan, the unit is within the Ministry of Economic Development (within the Department of Entrepreneurship Development Policy). For Turkey, there are two units with responsibilities for PPP: the Ministry of Finance is responsible for public procurement policy and the Ministry of Development is responsible for Public Investment Policy (with the Treasury plying a role for financing policy). For Croatia, there is a separate agency that answers to a line ministry that is responsible for PPPs. Serbia has an inter-ministerial commission called the Commission for Public-Private Partnership which was established by government decision. Most of the OECD countries have established the PPP unit in the ministry of finance or in a subordinate unit of this ministry. Seven OECD countries have more than one PPP unit, meaning PPP units in line ministries in addition to the unit in the ministry of finance (Figures 4.4). Four countries (Chile, Denmark, Hungary and Japan) have PPP units only in line ministries and one country (Greece) has a PPP unit in another body.

Figure 4.4a. **Number of PPP units in central governments (Q40a): OECD**

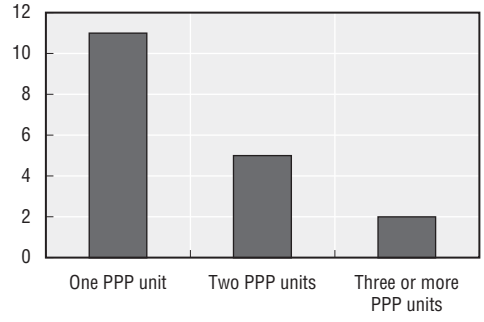
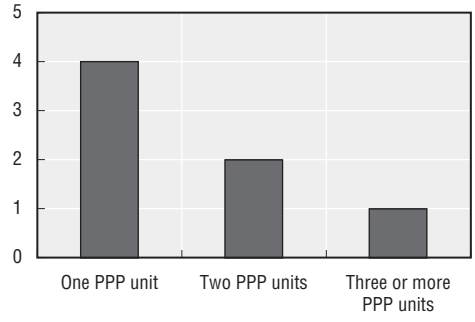


Figure 4.4b. **Number of PPP units in central governments (Q40a): PEMPAL**



For OECD countries, the CBA is more frequently required to approve PPP projects than TIPs whereas the reverse exists for PEMPAL countries. Fourteen out of the 33 OECD countries (42%) require that the CBA approve all PPP projects compared to four out of the 13 (31%) of PEMPAL countries. Comparatively only 18% of OECD countries require that the CBA approve all TIP projects, compared to 69% of PEMPAL countries. Half of OECD countries require that the CBA approve TIP projects above a certain threshold where no such thresholds exist in PEMPAL countries (Figures 4.5).

4.3. Value for money (VfM) assessment (Q.43-45)

Value for money can be defined as what a government judges to be an optimal combination of quantity, quality, features and price (i.e. cost), expected (sometimes, but

Figure 4.5a. **Is CBA required to approve capital projects in line ministries? (Q42): OECD**

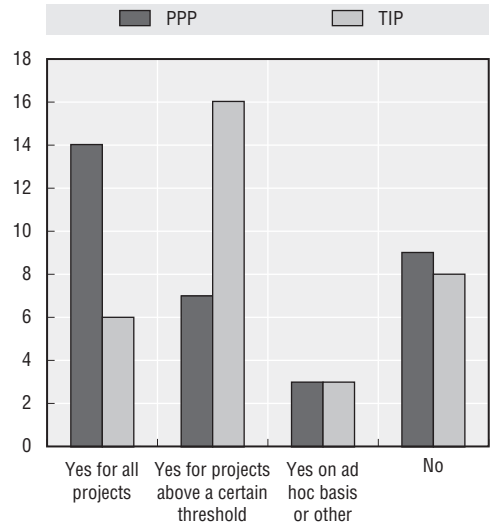
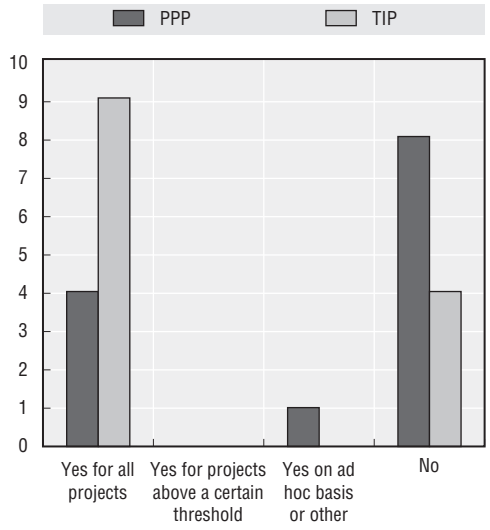


Figure 4.5b. **Is CBA required to approve capital projects in line ministries? (Q42): PEMPAL**



not always, calculated) over the whole of the project's lifetime. Thus, the value-for-money concept attempts to encapsulate the interests of citizens, both as taxpayers and recipients of public services. As such, value for money should in principle also be the driving force behind traditional infrastructure procurement. Therefore, any project, whether it is a PPP or a traditionally procured project, should be undertaken only if it creates value for money (Burger and Hawkesworth, 2011).

There are several techniques for assessing value for money. Cost-benefit analysis is a systematic process for calculating and comparing benefits and costs of a government policy. It has two purposes: *a)* to determine if it is a sound investment/decision (justification/feasibility); *b)* to provide a basis for comparing different government policies. It involves comparing the total expected cost of each option against the total expected benefits, to see whether the benefits outweigh the costs, and by how much. Cost-benefit analysis is related to, but distinct from cost-effectiveness analysis. In cost-benefit analysis, benefits and costs are expressed in monetary terms, and are adjusted for the time value of money, so that all flows of benefits and costs over time are expressed on a common basis in terms of their "net present value." Cost-effectiveness analysis is a form of economic analysis that compares the relative costs and outcomes (effects) of two or more courses of action. Cost-effectiveness analysis is often used in the field of health services, where it may be inappropriate to monetize health effect. Common measures include "quality-adjusted life years". Other relative analysis methods could be for example public sector comparators.

About half of the OECD countries do an absolute value-for-money analysis such as cost-benefit analysis for all PPP projects. Two-thirds of the countries do such analysis either for all PPP projects or projects above a certain threshold. This is the case for 56% of traditional infrastructure projects. Most of the rest do such analysis on an *ad hoc* basis. Only one country (Slovak Republic) reports that they do not perform absolute value-for-money analysis on TIP projects. Five OECD countries report that an absolute value-for-money analysis is not applicable for PPP projects while more than two countries report that an

absolute value-for-money analysis is not applicable for TIP projects, of which Switzerland reports not applicable for both types of projects (Figure 4.6a).

Absolute VfM analysis is used more by PEMPAL countries than relative VfM analysis for both PPP and TIP projects. For PEMPAL countries, over 58% do an absolute value-for-money such as cost-benefit analysis for all PPP projects compared to 75% for TIP projects. In comparison only (42%) use relative value-for-money analysis for all PPP and similarly 42% use it for TIP projects (Figures 4.6). Far fewer PEMPAL countries do such analyses on an *ad hoc* basis or for projects above a certain threshold compared to OECD countries.

Figure 4.6a. **Use of value-for-money analysis on capital projects (Q43): OECD**

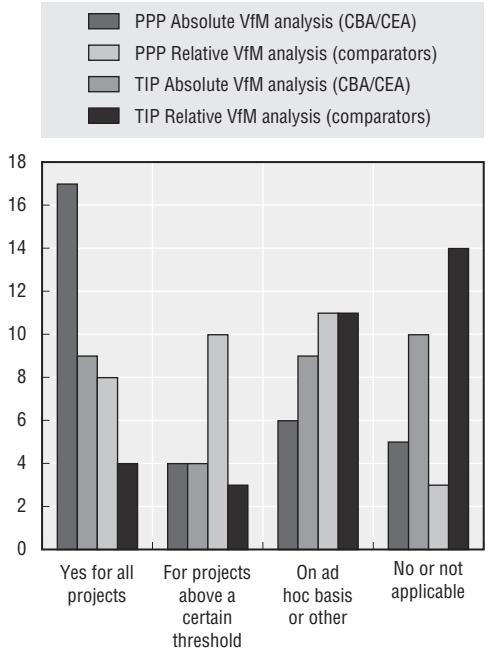
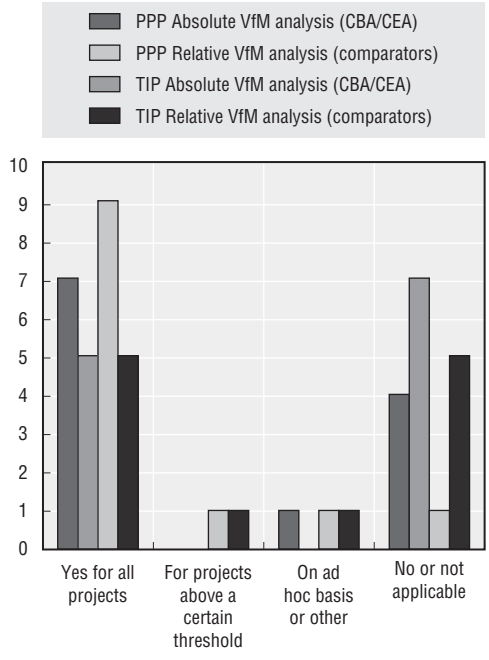


Figure 4.6b. **Use of value-for-money analysis on capital projects (Q43): PEMPAL**



Note: Number of OECD countries out of 33 participating countries and number of PEMPAL countries out of 13.

The net present value methodology is used by almost two-thirds of the OECD countries followed by the internal rate of return methodology (48% on PPPs and 39% on TIPs) and qualitative expert opinion (42% on PPPs and 33% on TIPs). Between 15% and 18% of the OECD countries do not use such specific tools (Figures 4.7). For PEMPAL countries, net present value is the most common tool used with 46% of countries using it for PPPs and 54% of countries using it for TIPs. Next most common tool is the internal rate of return which is used by 39% of countries for PPPs and 46% of countries for TIPs. Qualitative expert opinion and analysis of capacity of users to pay is used by around 31% of countries for both PPP and TIP projects (with analysis of capacity to pay used by slightly more countries (39%) for TIP projects). Use of payback period and residual income is applied by 46% and 31% of countries for TIP projects. One country reports that it uses no tools on either type of projects (Montenegro) whereas Albania and Belarus report that they do not use any tools on PPP projects only, and Serbia on TIP projects only. However, in Belarus, it does not have PPPs and the corresponding legislative framework governing this area therefore it is not possible to compare PPPs with traditional infrastructure projects in this case.

Figure 4.7a. **Specific tools used in value-for-money analysis (Q45): OECD**

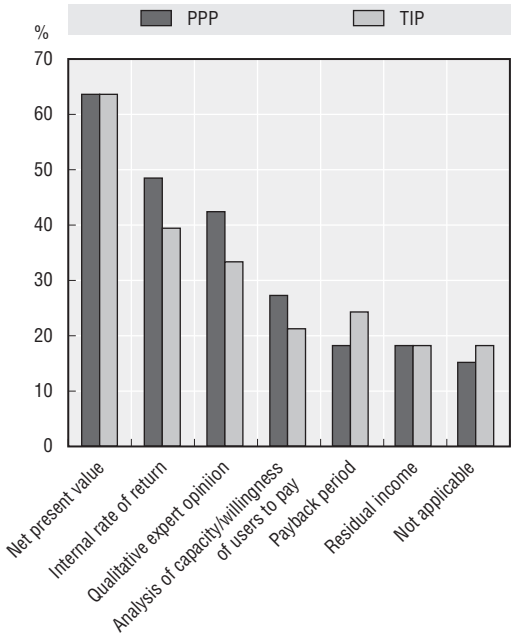
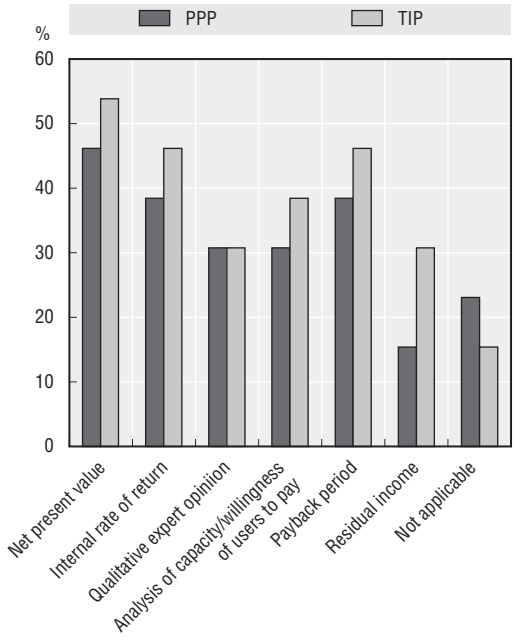


Figure 4.7b. **Specific tools used in value-for-money analysis (Q45): PEMPAL**



Note: Percentage of participating 13 PEMPAL and 33 OECD countries.

5. Top Down Budgeting techniques (Q.3, 31-33)

'Top-down budgeting' refers to the budgeting practice whereby the fiscal targets are determined from the outset, with annual and multi-annual budgetary policies subsequently determined in conformity with these overall levels. Typically in top-down budgeting, the executive first determines aggregate public finance targets (spending and revenue levels) given medium-term fiscal objectives and prevailing economic conditions. Within this aggregate, sectoral ceilings are set (and approved by cabinet) reflecting existing commitments, political priorities in general and key new policy initiatives. The detailed allocation decisions are typically delegated to individual line ministries. To be implemented effectively, top-down budgeting requires rigorous and prudent economic forecasts and must be combined with complementary fiscal management practices such as medium-term expenditure frameworks.

Many OECD countries began to adopt top-down budgeting practices in the 1990s in an effort to control deficits and constrain expenditure growth (Kim and Park, 2006). Top-down budgeting marks a shift not only in the sequence of budget decisions but also in budgetary roles, responsibilities, and relationships. While the CBA works to control aggregate spending by establishing and enforcing spending ceilings, line ministries assume relatively greater responsibility for resource allocation. This delegation of authority requires close working relationships between the two: line ministries use their superior knowledge of operational issues to determine the most efficient allocation of resources in their policy area but may require advisory and technical support from the CBA to understand how programme spending will evolve over time and to develop expenditure projections.

Top-down budgeting marks a significant reorientation of the budget process as compared to the traditional bottom-up approach (Table 5.1). Bottom-up budgeting is a

reactive, expenditure-driven process that imposes no up-front constraints on ministerial requests; total spending is determined as the residual sum of individual appropriations and remains unknown until the final stages of budget preparation. The detailed appropriations characteristic of bottom-up budgeting foster agency-specific programme ownership and make it difficult to reallocate in accordance with new policy priorities. Top-down budgeting, on the other hand, should encourage joint-ownership of proposals across line ministries and create space to reallocate resources according to shifting priorities and economic conditions.

Table 5.1. **Top-down budgeting vs. bottom-up budgeting**

Primary Focus	Policy-driven process that aligns spending with key priorities (proactive)	Expenditure-driven process (reactive)
Role of Finance Minister	Set aggregate spending level based on fiscal management target and monitor compliance	Negotiate details of individual spending proposals to control detailed allocations
Role of Spending Ministers	Allocate financial resources to individual programmes within assigned spending ceilings	Submit budget requests and negotiate itemized appropriations
Economic Forecasting	Aggregate fiscal analysis that takes into account economic forecasts.	Ministry by ministry analysis that largely ignores economic forecasts
Efficiency	Streamlined process reduces inefficient practices excessive requests	Inefficient and time-consuming negotiations process
Timeframe	Multi-year perspective	Annual appropriations process

Source: Adapted from Kim and Park (2006).

Box 5.1. **Budgetary framework requirements in OECD-EU member countries**

The main components of fiscal frameworks in EU countries are 1) numerical fiscal rules, 2) independent fiscal institutions (i.e., specific public bodies acting in the field of budgetary policy), and 3) budgetary procedures governing the preparation, approval, and implementation of budget plans.

Multi-annual numerical fiscal rules for general government shall be in compliance with the reference values of deficit and debt in EU and with adherence to the national medium-term budgetary objective (Box 1.3).

Compliance with the rules for euro zone countries shall be monitored and analysed by a national independent fiscal institution (IFI) structurally independent or endowed with functional autonomy vis-à-vis the fiscal authorities of the country. Moreover, these countries' IFIs shall produce or endorse macroeconomic forecasts used for the preparation of draft budgetary plans and medium-term fiscal plans.[1]

The national budgetary procedures[1] should include the following elements:

- Comparative macroeconomic and budgetary forecasts shall be prepared, evaluated and published, including the methodologies, assumptions and relevant parameters.
- A credible, effective medium-term budgetary framework of at least 3 years shall provide transparent targets on fiscal indicators in compliance with the fiscal rules and projections on major expenditure and revenue items based on unchanged policies. The annual budget legislation shall be consistent with the provisions of the medium-term budgetary framework.
- Extra-budgetary funds shall be presented in the framework of the annual budgetary processes and the medium-term budgetary plans, and tax expenditures and major contingent liabilities shall be published.

Box 5.1. **Budgetary framework requirements in OECD-EU member countries** *(cont.)*

- The public accounting system shall cover all sub-sectors of general government and generate accrual data with a view to preparing data based on the ESA 95 standard, and be subject to internal control and independent audits. Cash-based fiscal data shall be published monthly for central and state government and social security sectors and quarterly for local governments.

As from 2011, at EU-level discussions on fiscal policy, macroeconomic imbalances, financial sector issues, and structural reforms take place jointly during the "**European semester**"[2] that is a yearly cycle of economic policy co-ordination during the first six months of the year. First, the European Commission provides broad guidance on priority actions to be taken at EU and national level. Then EU Member States' submit their programmes of economic and structural policies (Stability and Convergence Programmes and National Reform Programmes) to the Commission, which undertakes a detailed analysis. The European Council and the Council of Ministers provide country specific policy advice at the conclusion of the European Semester. The "two-pack" EU regulations[3] require in addition that the euro area Member States shall submit their draft budgets to the Commission and the Eurogroup before 15 October, along with the independent macro-economic forecast on which they are based. The Commission analyses if the draft budget is in line with the Stability and Growth Pact (SGP) and the recommendations from the European Semester. In case of serious non-compliance with the SGP, the Commission can require a revised draft budgetary plan. Otherwise it may address an opinion to the Member States concerned which would also be discussed by the Eurogroup leading to an increasing peer pressure. The recommendations from the European Semester (which the country has received in May/June) and the Commission's opinion on the draft budget (which the Commission may adopt by 30 November) will guide the national parliamentary debate in the second half of the year (the "national semester"). The budgets should be adopted by national parliaments by the end of December.

Notes:

1. Based on two legislative instruments: (1) the Directive 2011/85/EU of 8 November 2011 on requirements for budgetary frameworks of the Member States and (2) the Regulation 473/2013 of 27.05.2013 on common provisions for monitoring and assessing draft budgetary plans and ensuring the correction of excessive deficit of the Member States in the euro area.
2. Regulation (EU) No 1175/2011 of the European Parliament and of the Council of 16 November 2011 amending Council Regulation (EC) No 1466/97 on the strengthening of the surveillance of budgetary positions and the surveillance and coordination of economic policies.
3. Regulation (EU) No …/2013 of the European Parliament and the Council on common provisions for monitoring and assessing draft budgetary plans and ensuring the correction of excessive deficit of the Member States in the euro area, ref. also COM(2011)821 final.

5.1. *Role of the Central Budget Authority (CBA) (Q.1-3)*

The CBA is the hub of the central government budget process. Almost all OECD and PEMPAL countries have localised the CBA with the Ministry of Finance and/or Economy. The CBA may be located to one directorate (department) of the ministry, normally the Budget Department as is the case in for example Austria, Estonia, Finland, France, Netherlands, Slovenia, Spain and Sweden, or to a combination of several departments within the ministry, for example Greece has located CBA to the General Secretariat of Fiscal Policy, the General Accounting Office and the General Directorate of Treasury and Budget within the Ministry of Finance. Norway has split the CBA between the Budget Department and the Economics Department. In Poland the CBA is composed by five departments of the Ministry of Finance. Three OECD countries and one PEMPAL country has split the CBA between ministries:

Australia has split the CBA between the Department of Treasury and Department of Finance and Deregulation, Canada has split the CBA between the Department of Finance and the Treasury Board Secretariat while Ireland has split the CBA between the Department of Finance and the Department of Public Expenditure and Reform. The Russian Federation has split the CBA between the Ministry of Finance and the Ministry of Economic Development. The CBA in Belgium is located at the Federal Public Service Budget and Management Control, while the USA has located the CBA at the President's Office (Figures 5.1).

Figure 5.1a. **Location of CBA (Q1): OECD**

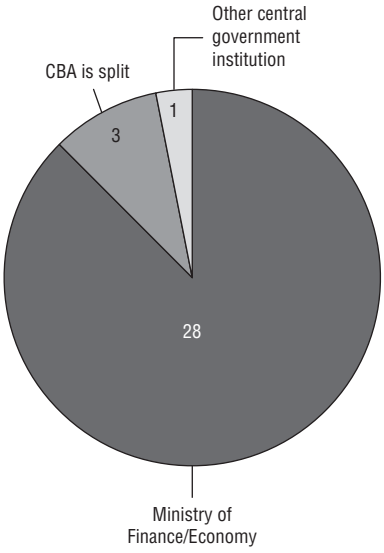
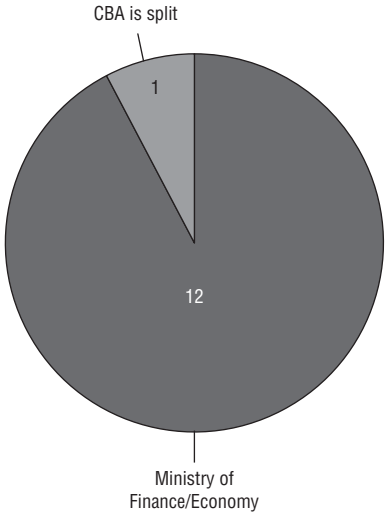


Figure 5.1b. **Location of CBA (Q1): PEMPAL**



In most OECD countries the head of the CBA is a senior civil servant, i.e. a government official who ordinarily remains in this position when there is a change in Government. On the other hand, in most PEMPAL countries and in Chile, Greece, Hungary, Italy, Korea, Mexico, Poland, Slovak Republic, Spain, United Kingdom and the United States the head of the CBA is a political appointee, i.e. a person who generally does not remain in this position when there is a change in Government. Denmark does not have a clearly defined CBA within the Ministry of Finance therefore there is not as such a head of the CBA other than the Minister of Finance and the Permanent Secretary (Figures 5.2).

The CBA takes care of a variety of tasks concerning the budget process (Figures 5.3). For both OECD and PEMPAL countries, the most common responsibilities of the CBA are drafting the budget circular, developing the Executive Budget proposal, negotiating with the line ministries, producing supplementary budgets, determining ceilings for line ministries, and producing mid-year and end-of-year reports. Some tasks are generally a shared responsibility with others, like methodology for fiscal projections, monitoring performance of line ministries and communication with the public.

5.2. *Budget circular (Q.32)*

Issued by the CBA, the budget circular (sometimes called a memorandum or instructions) contains procedural and/or policy-oriented information that guides government organisations in the preparation of their expenditure proposals. All OECD and PEMPAL countries use the budget circular to communicate procedural information, including the rules and forms, while

Figure 5.2a. **Head of CBA (Q2): OECD**

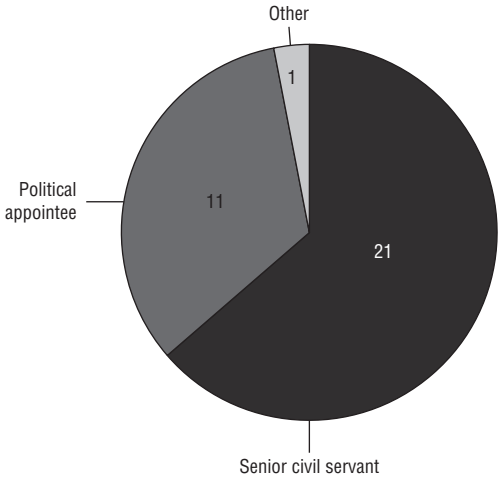
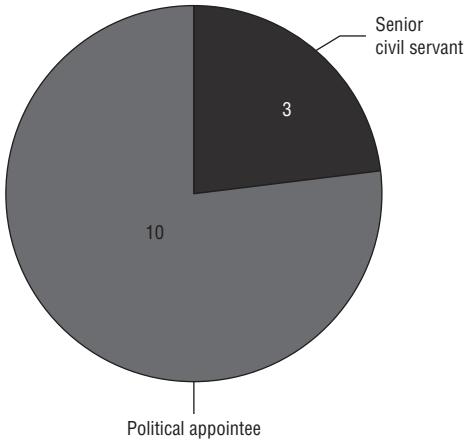
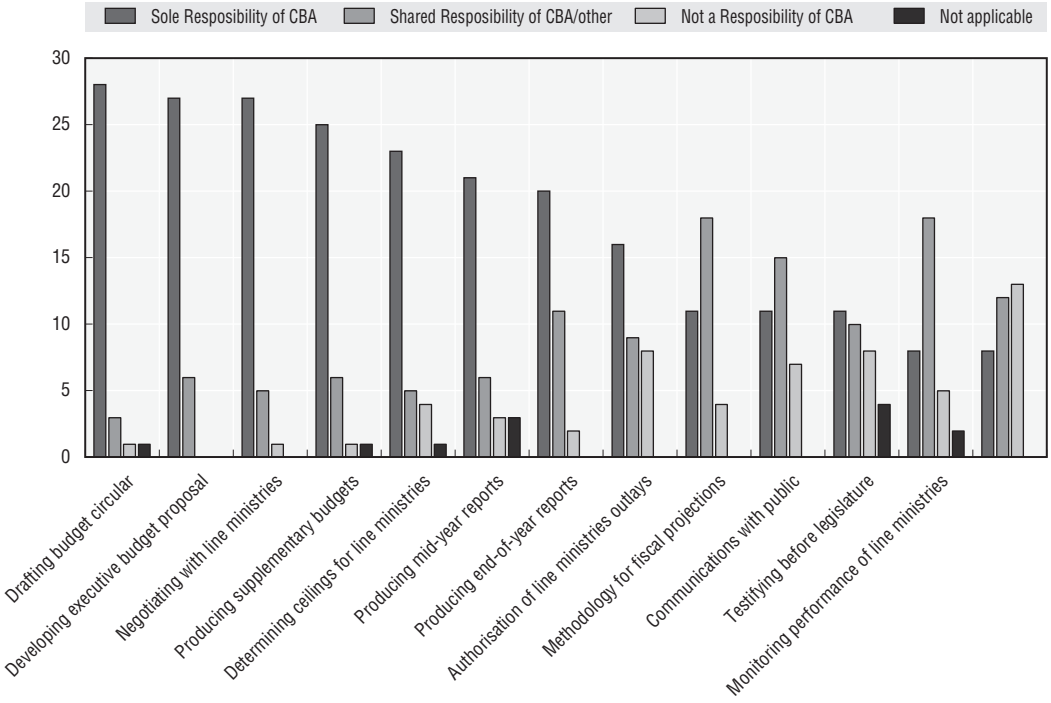


Figure 5.2b. **Head of CBA (Q2): PEMPAL**



Note: Number of countries with different type of responsibilities, out of 33 participating OECD country in the 2012 Budget Survey.

Figure 5.3a. **Responsibility of CBA (Q3): OECD**



macroeconomic assumptions to be used in preparing budget estimates are included in the case of under half of all the countries in both groupings (Figures 5.4).

OECD countries convey policy-oriented information by specifying expenditure ceilings (60%) or outlining government priorities (45%) in the budget circular. This is even more so for PEMPAL countries with 77% specifying expenditure ceilings, and 54% outlining government priorities in the budget circular. The practice of the budget circular seems to be well established and an increasing number of OECD countries include more elements in the circular from 2007 to 2012 (see Figure 5.4 above and Table 5.2 in the Data Annex).

Figure 5.3b. **Responsibility of CBA (Q3): PEMPAL**

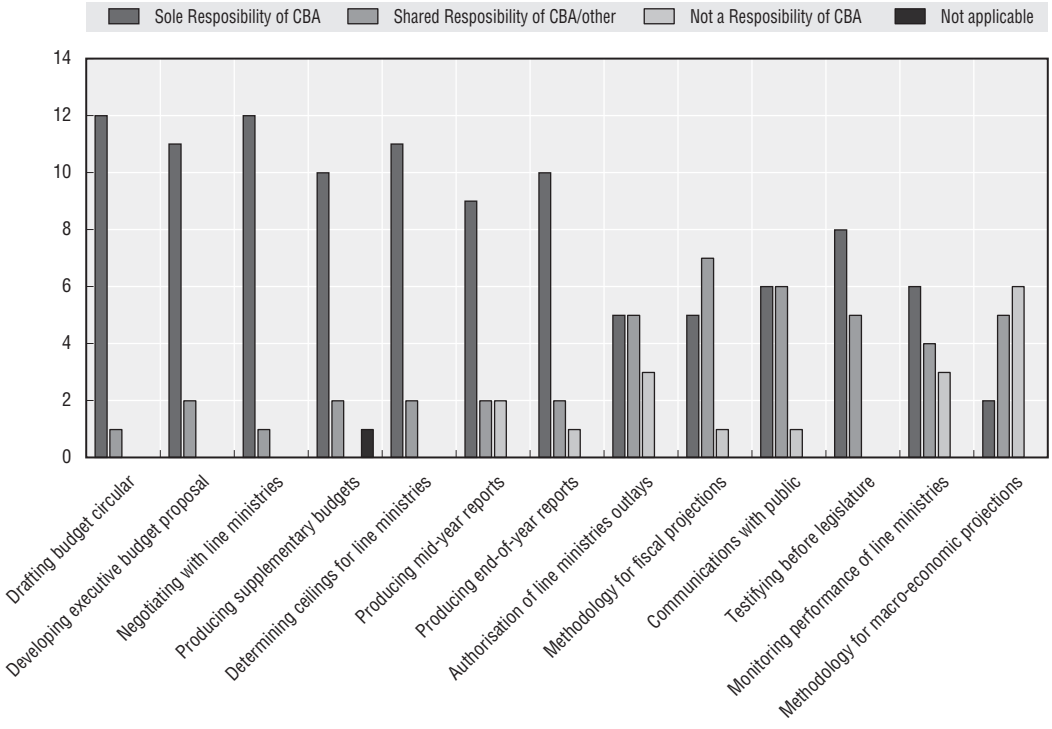


Figure 5.4a. **Content of the annual budget circular – selected items (Q32): OECD**

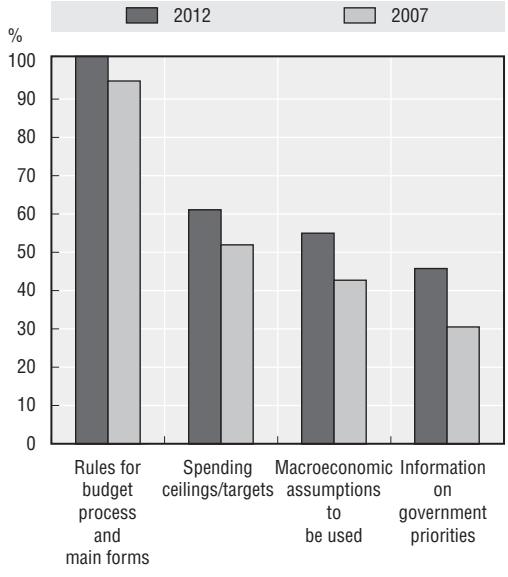
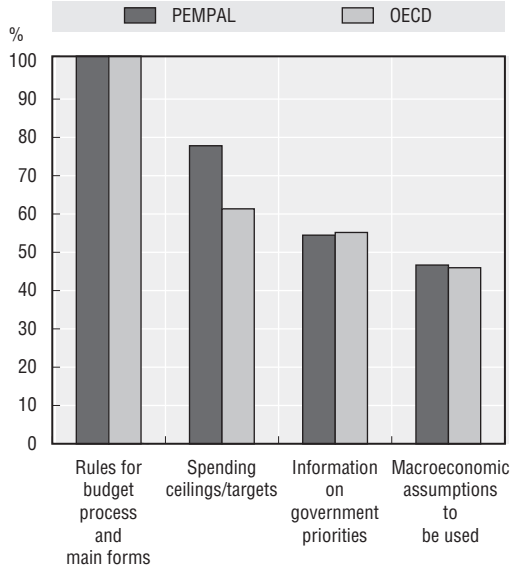


Figure 5.4b. **Content of the annual budget circular – selected items (Q32)**



Note: Percentage of participating OECD countries (33 in 2012 and 33 in 2007). Note: Percentage of participating 13 PEMPAL and 33 OECD countries with an answer to the question.

5.3. *Level of ceilings for the line ministries' initial budget request (Q.31)*

The government must take into account both economic forecasts and fiscal targets in setting the aggregate spending level for the annual budget. Budget ceilings are then set at a chapter (i.e. ministry), other aggregate levels (sector, programme or organisations) or line-item level (i.e. smallest level of spending subject to parliamentary approval) in order to allocate aggregate spending across government. Once confirmed, ceilings become rules that are binding upon every cabinet member throughout the budget process.

Sectoral ceilings provide broad allocations to major policy areas (e.g. agriculture, health, defence, etc…). Sectoral ceilings are an indication of the government's policy priorities and should take into account existing programmes, previous policy commitments, and new initiatives that the government intends to launch. Ceilings at a line-item level are commonly associated with traditional bottom-up budgeting systems and the use of input controls by the Ministry of Finance. The more sub-ceilings are defined, the less top-down the system becomes; ministries lose the ability to apply their expertise as the Ministry of Finance becomes involved in more points of detail.

The comparison of budget systems on the basis of top-down and bottom-up practices can be difficult because of the underlying budget classifications. In some countries, the line-items presented to parliament are themselves a form of aggregate. France, for example, only has 180 line-items (programme level) that cover 32 government "missions" (Figure 6.1). Sweden has established spending ceilings for 27 broad spending areas, with indicative sub-ceilings in each. In addition, ceilings may stipulate specific (economic) expenditure categories, such as the operating costs, investment, transfers and subsidies. Entitlement programmes, such as unemployment benefits, are often exempt from budget ceilings as they act as automatic stabilisers and reflect economic and demographic fluctuations.

Since 2007 more OECD countries have been applying top down budgeting. More countries set overall ceilings for line ministries while there is no such trend to set ceilings on

Figure 5.5a. **Ceilings on the line ministries' initial request (Q31)**

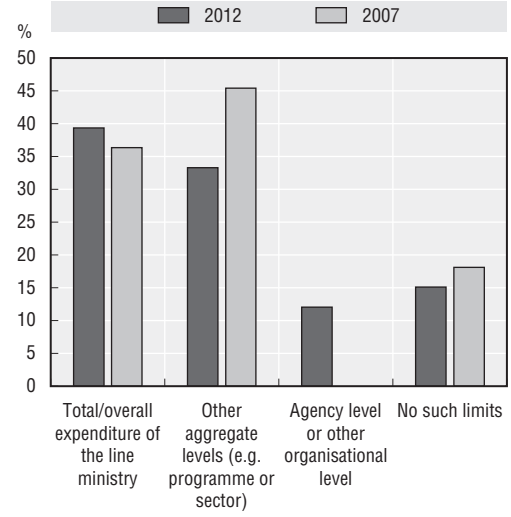
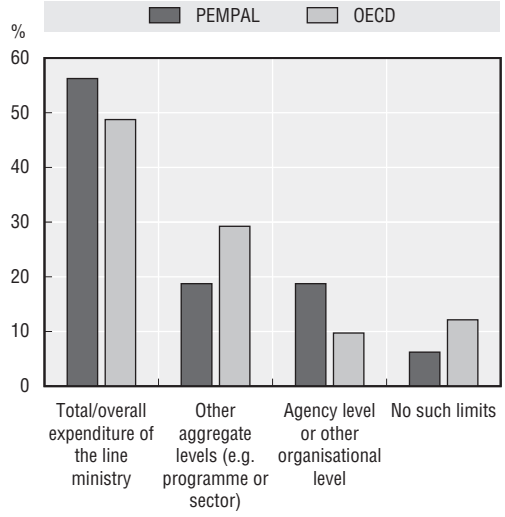


Figure 5.5b. **Ceilings on the line ministries' initial request (Q31)**



Note: Some countries have more than one level of ceilings, notably Chile, Denmark, Germany, Italy, Korea, Luxembourg, Poland and Slovenia. In such cases only one sub-aggregate level of ceiling is counted per country. Similarly, for PEMPAL countries for Russian Federation and Tajikistan. Percentages represented above are out of total number of ceilings adopted.

more detailed levels and only five OECD countries (Australia, Canada, France, Hungary, USA) do not issue ceilings for the line ministries initial budget request (Figures 5.5; see also the discussion on ceilings of MTEF in Section 3).

Most PEMPAL countries (9) set overall ceilings for line ministries in the initial budget request with some of these countries also setting sub-ceilings (Russian Federation and Tajikistan). In OECD countries, 33% set ceilings on sector or programme level in the initial budget request while 12% apply ceilings of agency or other organisational levels. This compares with only 23% of PEMPAL countries setting ceilings on a sector or programme level (Russian Federation, Tajikistan and Turkey) with 23% setting ceilings at the agency or other organisational levels (Bosnia and Herzegovina, Kyrgyz Republic, Russian Federation). Uzbekistan is the only country to report it sets no such limits. Some of the OECD countries that impose expenditure ceilings do so for selected group of expenditure types, for example Luxembourg sets specific ceilings for some spending categories (e.g. travel costs). In New Zealand, the Government sets aside new spending allowances that can be allocated to certain sectors or programmes (e.g. Health or Education). The UK government imposes a limit on the non-cyclical/non-volatile part of departmental spending as part of the spending review and issues an expected level of cyclical/volatile spending. In Chile, each agency provides an initial budget for its sector, and then, after the evaluation from the CBA, a ceiling is set to which the agency must adjust their programmes.

5.4. *Budgetary disputes (Q.33)*

Resolution of budgetary disputes takes place at various levels and through various mechanisms across OECD countries. As the significance of the disputed issue increases, resolution tends to move up through the ranks of the civil service hierarchy to reach the ministerial level and, finally, the office of the head of government. The preferences of high-level decision-makers can influence lower-level negotiations where, in practice, most disputes are resolved. The stronger the minister of finance, for example, the stronger his or her civil servants will be in interdepartmental negotiations. A strong institutional role may grant the finance minister the 'final say' in budget disputes; lacking this individual authority, however, collective mechanisms such as the cabinet or committees may be required to resolve disputes.

Ultimate authority for dispute resolution varies across OECD countries. There has been a change to more collective power of resolving disputes in the budget process (Figures 5.6). Allocation disputes are resolved by the cabinet in 39% of the OECD countries compared to only 23% of PEMPAL countries (Croatia, Serbia and Uzbekistan). For PEMPAL countries, the rest (54%) is largely resolved by the President (Azerbaijan, Belarus, Bosnia and Herzegovina[19], Russian Federation) or the Prime Minister (Kyrgyz Republic, Macedonia, Turkey) with only 15% being resolved by the Finance Minister (Albania and Montenegro). Tajikistan, is the only PEMPAL country that resolves issues in a ministerial committee. For OECD countries, the rest is almost equally divided on the minister of finance in seven countries (Denmark, Israel, Italy, Korea, Slovenia, Spain, United Kingdom), the chief executive (i.e. president or prime minister) in seven countries (Australia, Chile, France, Greece, Japan, Turkey and USA), and a multilateral process in which disputes are jointly resolved by the Prime Minister and the Minister of Finance (Canada) and by meetings of government parties' chairpersons (e.g. Finland where during this parliamentary term the meetings includes prime minister, minister of finance and 4 other ministers). In Ireland disputes are resolved partly by the chief executive, partly by cabinet and partly by the finance minister. In Belgium such issues are sent to a ministerial committee.

Figure 5.6a. **Resolution of disputes between ministries in the budget formulation process (Q33)**

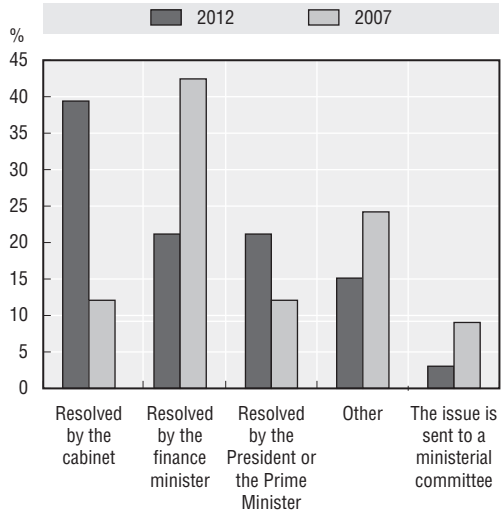
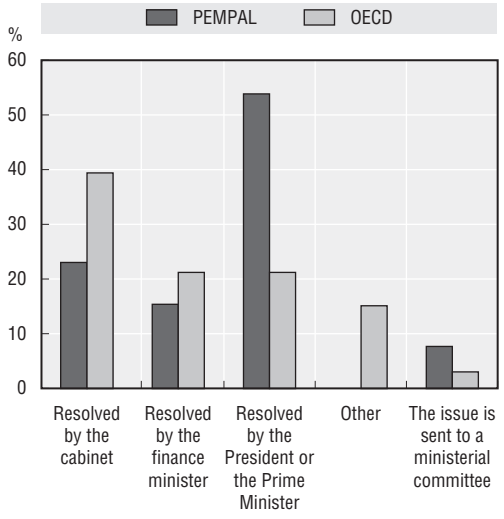


Figure 5.6b. **Resolution of disputes between ministries in the budget formulation process (Q33)**



Note: Percentage of participating OECD countries (33 in 2012 and 33 in 2007); Percentage of participating 13 PEMPAL and 33 OECD countries with an answer to the question.

6. Relaxing central input controls (Q.50, 70-84)

A feature of budget reforms in many OECD countries is the relaxation of input controls to give government organisations greater flexibility and autonomy to achieve their objectives efficiently and effectively. It is based upon the premise that heads of individual government organisations are the best positioned to achieve their policy and programme objectives ("let managers manage"). The CBA sets the top down budget constraints, often based on medium-term expenditure considerations, while organisations are given responsibility for the use of the funds. With such freedom also comes greater accountability and use of performance management. This can enhance efficiency and effectiveness in light of new priorities, new circumstances and new knowledge. It also strengthens the incentive for politicians to focus on outputs and outcomes rather than inputs alone. Flexibility is in this context defined as the extent to which an organisation can adjust appropriations – i.e. decide and adjust the input mix. However, a distinction should be made between flexibility of the executive (whole of government), line ministry and agency level.

This section discusses a number of elements that determine the degree of flexibility and agency autonomy. The number of line items, lump sum appropriations, the ability of government organisations to reallocate and *virement* (i.e. transfer) budget resources between programmes and expenditure types, borrow from future appropriations and carry-over appropriated funds between fiscal years. Together these issues indicate line ministries' and agencies' ability to adjust appropriations to their needs.

6.1. Number of line-items (Q.50a)

The number of line-items in the budget provides an indication of the level of detail to which the executive and legislature control the execution of the budget. At an agency level this may also relate to lump-sum appropriations and the ability to retain any savings, in whole or in part, from efficiency gains.

Box 6.1. **Agencies and decentralised management**

Agencies are government organisations that have been given some autonomy and/or independence from the ministries to which they report. Agencies may be subject to different management and budgetary rules than entities vertically integrated within ministries.

Three main categories of agencies can be identified:

- **Departmental agencies:** Part of ministries, they do not have a separate legal status, but their internal governance is generally differentiated from that of their parent ministry;
- **Public law administrations:** Created by a public statute, they have a separate legal identity under public law (they may or may not have a governing board); and
- **Private law bodies:** Identifies a variety of organisations including corporations, trusts and other organisational forms recognised in private law. They usually have a governing board, and the relevant minister has only indirect control of it.

Although agencies have a long history in many OECD countries, the number of autonomous bodies has grown significantly in the last decade. The change has also corresponded with an increase in management authority delegated to core government departments.

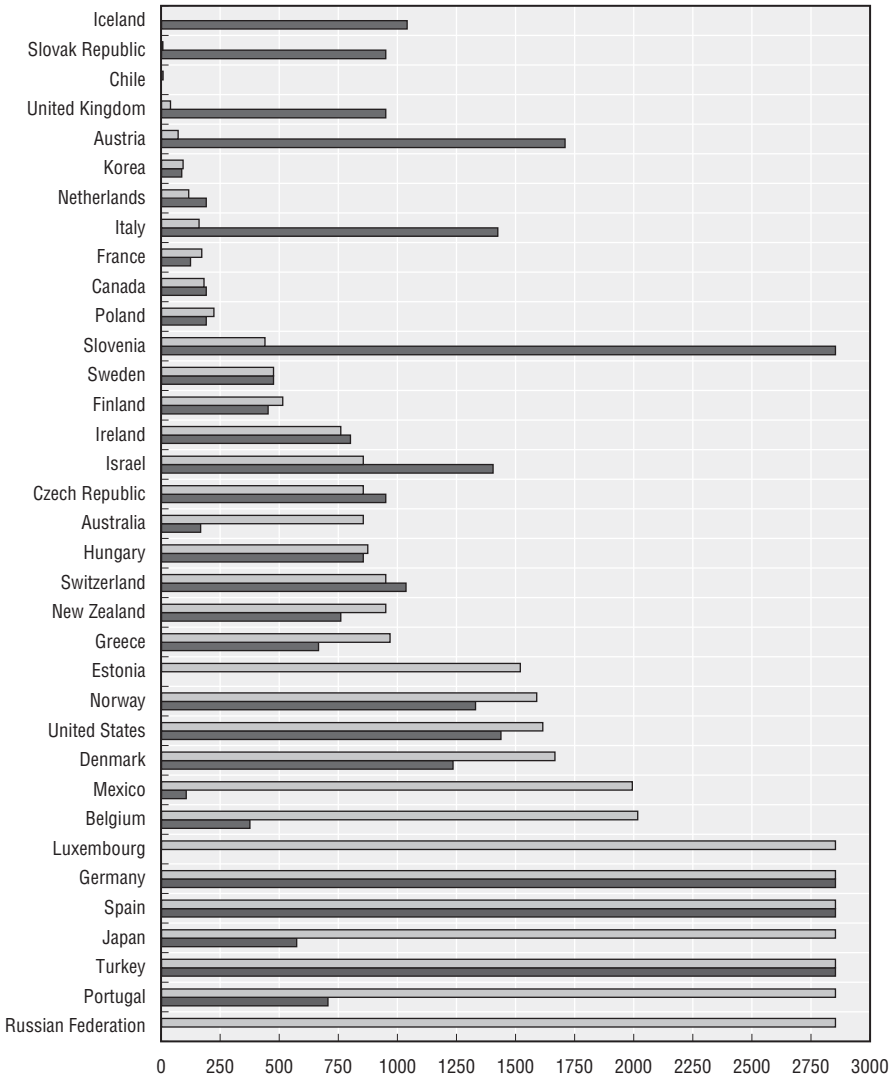
A line-item appropriation is the most detailed level of spending that is mandated by the legislature. The level of line-items may be as specific as financial inputs (e.g. salaries) or more aggregated at the programme or agency level. The existence of many line-items often constrains managerial flexibility by detailing the specific inputs that can be used for specific areas. The presence of an excessive number of line-items can also hinder other practices designed to strengthen fiscal discipline, such as top-down budgeting. Relaxing central input controls not only increases the effective use of resources, but can also foster accountability – to some extent eliminating excuses for not delivering agreed outputs and outcomes. In such systems the legislature might be better equipped to oversee the process by shifting its attention from input to output considerations.

Figure 6.1 presents the number of line-items appropriated in the budgets of OECD countries. Ten countries have below 300 line items (Austria, Canada, Chile, France, Italy, Korea, Netherlands, Poland, Slovak Republic, United Kingdom). Ten countries have between 300 and 1 000 line items (Australia, Czech Republic, Finland, Hungary, Ireland, Israel, New Zealand, Slovenia, Sweden and Switzerland). Five countries have between 1 000 and 2 000 (Denmark, Estonia, Greece, Norway, USA) while eight countries have 2 000 line items or more, of which Spain has 16 700, Japan has 23 000 and Turkey and Portugal have more than 40 000. There are some remarkable changes since 2007: Austria, Italy, Slovak Republic, Slovenia and the UK report that they have reduced the line item numbers considerably. On the other hand, Belgium, Japan, Mexico, Portugal and Spain have increased the number of line items substantially pushing the OECD average from 2 417 to 4 732 line items.

For PEMPAL countries, the number of line-items contained in the Executive Budget Proposal varies from 43 000 for Azerbaijan, 40 000 for Turkey (as mentioned above), down to Montenegro which has 133 economic (with 189 functional) classifications, Albania with 128 programme classifications, and the Kyrgyz Republic with only 26 line items. Other countries within this range include Russia with 12 000, Croatia with 7 300, Serbia with 6 000, Macedonia with 1 888, Belarus with 1 026, and Bosnia and Herzegovina with 1 450.

It should be emphasised that there is not necessarily a direct correlation between the number of line-items and the degree of flexibility. A limited number of line-items could be

Figure 6.1. **Number of line item appropriations contained in the budget (Q50a): OECD**



Notes: Iceland did not provide data in 2012. The following countries have more than 3 000 line items: Germany (6 000), Japan (23 000), Luxembourg (4 400), Portugal (46 000), Spain (16 700), Turkey (40 000). Russian Federation has 12 000 line items.

made less flexible by restrictive rules on reallocation, carry over and other input controls. In Korea, for instance, there is a central control of staff allocated to various tasks, which clearly limits the managers' ability to change the input mix.

6.2. Lump sum appropriations (Q.70a)

Government organisations may receive lump sum appropriations, giving them a great deal of flexibility to allocate public funds in order to maximise their performance. Lump sum appropriations may be applied to capital and/or operating expenditures[20]. However, the use of lump sum appropriations by itself does not necessarily imply the existence of a more efficient resource allocation system. Clear agency objectives, adequate procedures, and an effective evaluation framework are required to foster good performance, accountability, and to hinder abuse.

Lump sum appropriations for operating expenditure are used in 70% of OECD countries compared to 92% of PEMPAL countries (Figures 6.2 and 6.3). Turkey is the only PEMPAL country which does not adopt such appropriations. Those that do, distribute monies across different time scales. For example, Croatia provides agencies with the total appropriation, whereas Tajikistan provides quarterly appropriations, and Bosnia and Herzegovina and Azerbaijan provide monthly appropriations according to a monthly breakdown of expenditures. For OECD countries, there is no significant change in practices since 2007.

Figure 6.2a. **Do agencies receive lump sum appropriations for operating expenditure? (Q70)**

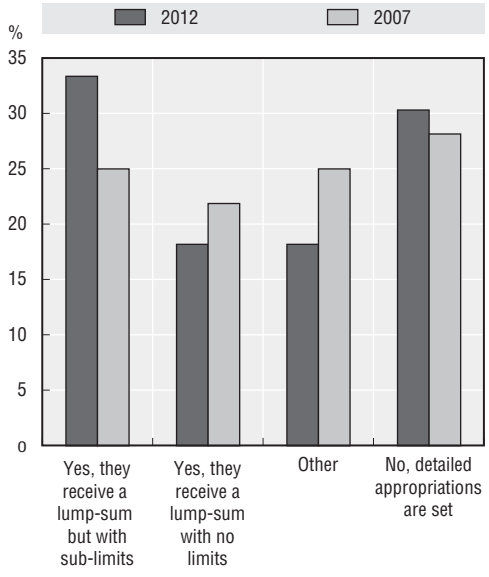
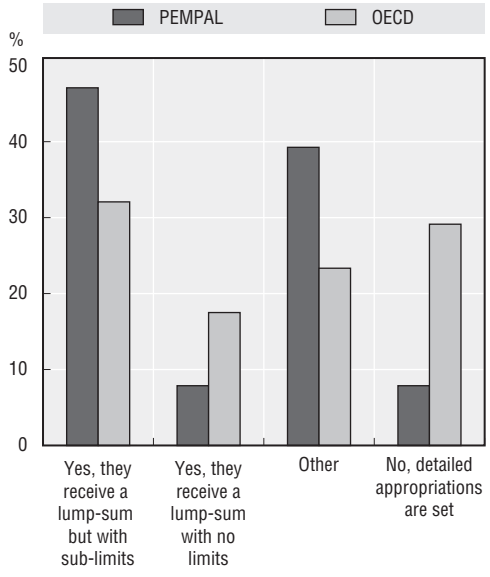


Figure 6.2b. **Do agencies receive lump sum appropriations for operating expenditure? (Q70)**



Note: Percentage of participating OECD countries (33 in 2012 and 33 in 2007).

Figure 6.3a. **Sub-limits on lump sum appropriations (Q70b): OECD**

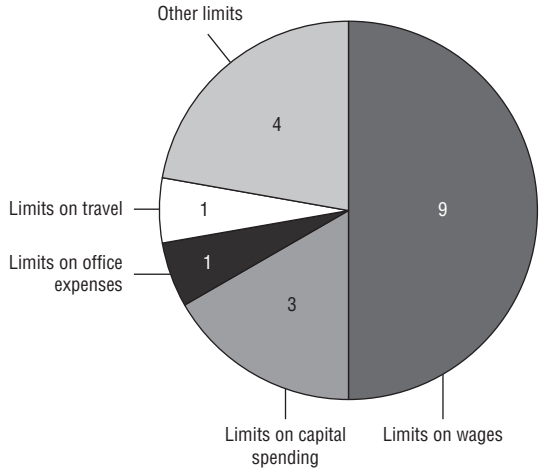
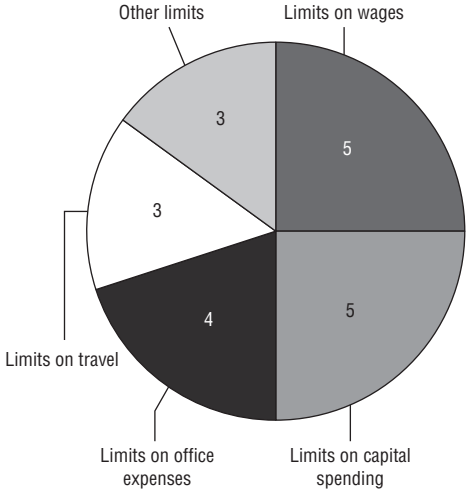


Figure 6.3b. **Sub-limits on lump sum appropriations (Q70b): PEMPAL**



Note: Some countries practice more than one sub-limit on the lump-sums.

Eleven of these countries (Belgium, Canada, Czech Republic, Denmark, Estonia, Finland, Hungary, Italy, Luxembourg, Portugal, and Slovak Republic) use one or more sub-limits on the lump sum appropriation. In addition, Slovenia reports partial use of lump sum appropriations with sub limits on wages. For OECD countries, the limits on lump sum operating appropriations are largely applied to wages (with some capital and other), whereas for PEMPAL countries, the limits are largely applied to wages, capital and travel. Belarus is the only country that provides lump sum appropriations for operating expenditure without any limits (Figures 6.3).

6.3. Reallocation of appropriations (Q.72)

Almost all (31 out of 33) OECD countries allow ministries to reallocate funds within their responsibility, with some restrictions (Figures 6.4). By contrast, in Norway and Sweden the in-year reallocation is run by the legislature. Norwegian and Swedish agencies are highly autonomous and can freely decide their input mix for operational expenditures so reallocation needs are more limited than in most countries. Compared to the situation in 2007, the percentage of OECD countries that allow reallocations has changed slightly downwards. Similar to OECD countries, almost all PEMPAL countries (11 out of 13) allow ministries to reallocate funds within their responsibility, with all requiring *ex ante* approval of the Ministry of Finance or Economy. Albania, Montenegro and Uzbekistan also require *ex ante* approval of the legislature, with Tajikistan requiring *ex post* approval. Only Bosnia and Herzegovina and the Kyrgyz Republic do not permit reallocations (Figures 6.4).

Figure 6.4a. **Reallocation regimes in 2012 and 2007 (Q72a): OECD**

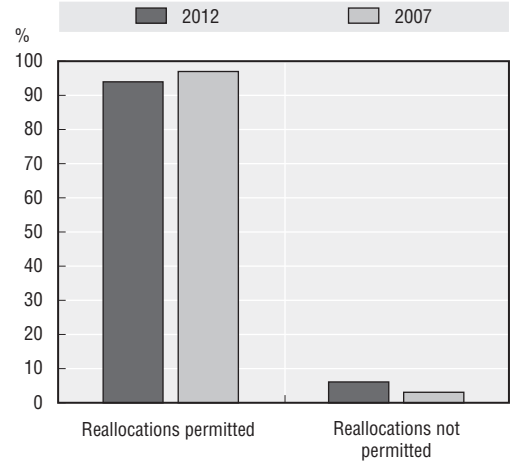
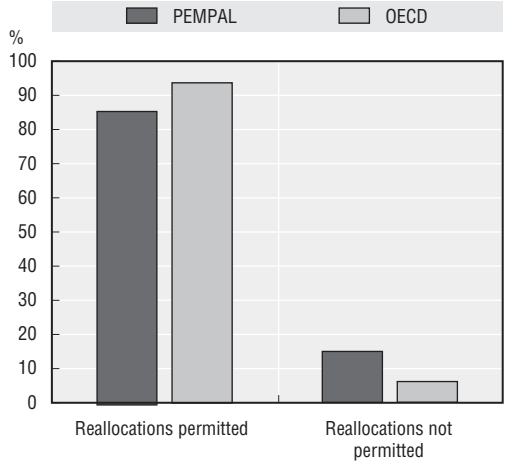


Figure 6.4b. **Reallocation regimes in PEMPAL and OECD (Q72a)**



Note: Percentage of participating OECD countries (33 in 2012 and 33 in 2007).

In 9 PEMPAL countries (Figures 6.5) reallocations are permitted up to a certain threshold. For example for Croatia reallocations are allowed up to 5% of expenditures, subject to the approval of Ministry of Finance. In Serbia, funds may be reallocated under a programme up to 10% of the appropriation and between programmes up to 5%. In Albania, the line ministries or budgetary institutions are allowed to reallocate between the same programme and the same category of expenditure (current and capital expenditure) and within the same article between the expenditure units. With Ministry of Finance approval

Figure 6.5a. **Restrictions on reallocations in OECD (Q72a)**

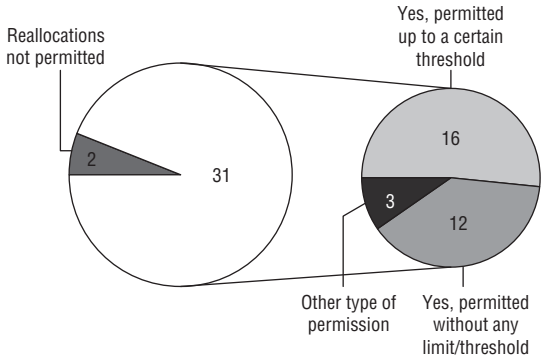
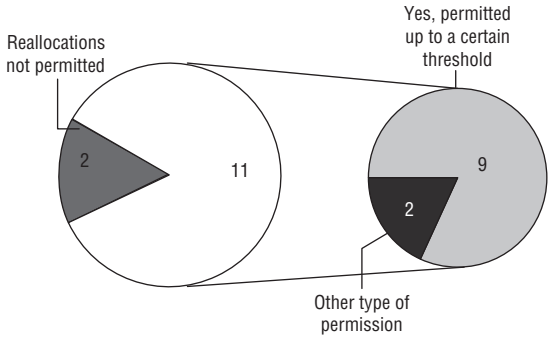


Figure 6.5b. **Restrictions on reallocations in PEMPAL (Q72a)**

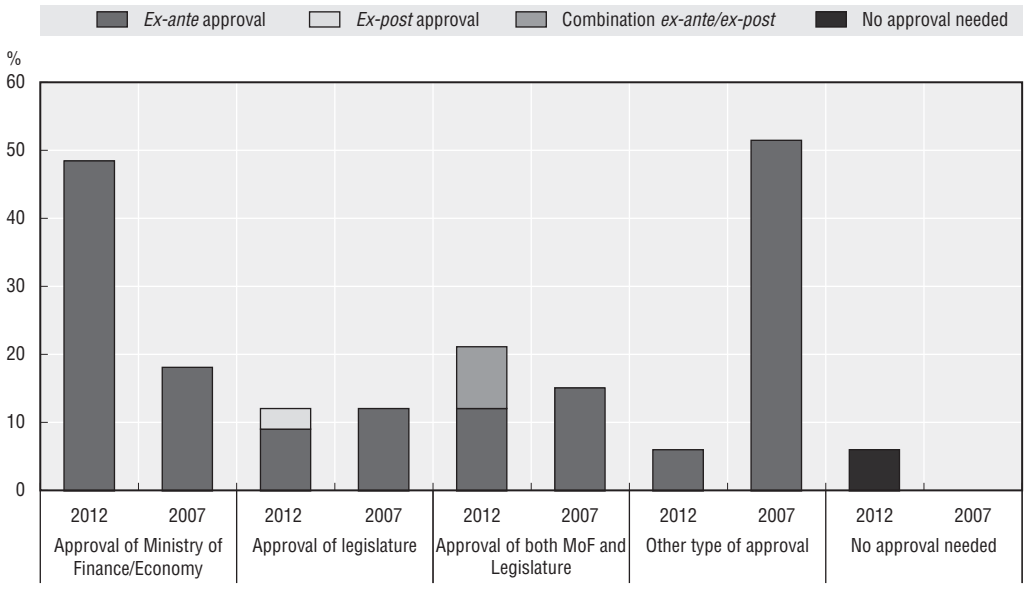


they can reallocate between articles in the same programme and in the same expenditure category. With Council of Ministers decision, they can reallocate from one programme to another up to 10% of the total of the affected programme. Azerbaijan and the Russian Federation indicated they needed other types of permission for reallocations. For Azerbaijan, according to legislation, (Law on Budget System, article 18.4), the Ministry of Finance has the right to make reallocations but it should be under the same sectional level (top level) of functional classification and within the same organisations. For such reallocations, first line ministries officially have to ask Ministry of Finance, after that Ministry of Finance checks their request and gives permission. For the Russian Federation, line ministries are allowed to reallocate funds between line items only in certain cases outlined in the Budget Code (e.g. if supplementary law is adopted; if there is a shortage of budget assignments on financing public obligations; authorities (functions) are formally changed; coverage of judicial act demanded spending increases; or total assignments increase by cost on rendering public services).

In 16 OECD countries (Figures 6.5) restrictions are placed on the type of expenditures via certain limits on amounts. Some examples are listed here: In Denmark line ministries are allowed to re-allocate funds between operating appropriations when annotated in the annual budget, which is often the case. In Estonia the government can reallocate inside the appropriations set in the budget law. In Spain line ministers can re-allocate funds according to limits established by law. In Turkey, appropriations can be reallocated up to 20% of a line item. In Greece and Slovenia line ministries can reallocate between different programmes within their competence, in total per year limited to 10 % of the programme appropriation in the adopted budget and except reallocations between salary budget items and other budget items. Budget users are authorised to reallocate between budget items in the same sub-programme in their competence. In Switzerland, reallocations are accepted only in three specific areas and with limits (in percentage and absolute terms). These include: Between personnel and consultancy expenditure (maximum 5% of personnel expenditure or CHF 5 million); between current and investment budgets of agencies with lump sum budgets (maximum 5% of current expenditure or CHF 5 million); and between ITC operating expenditures and ITC investment spending.

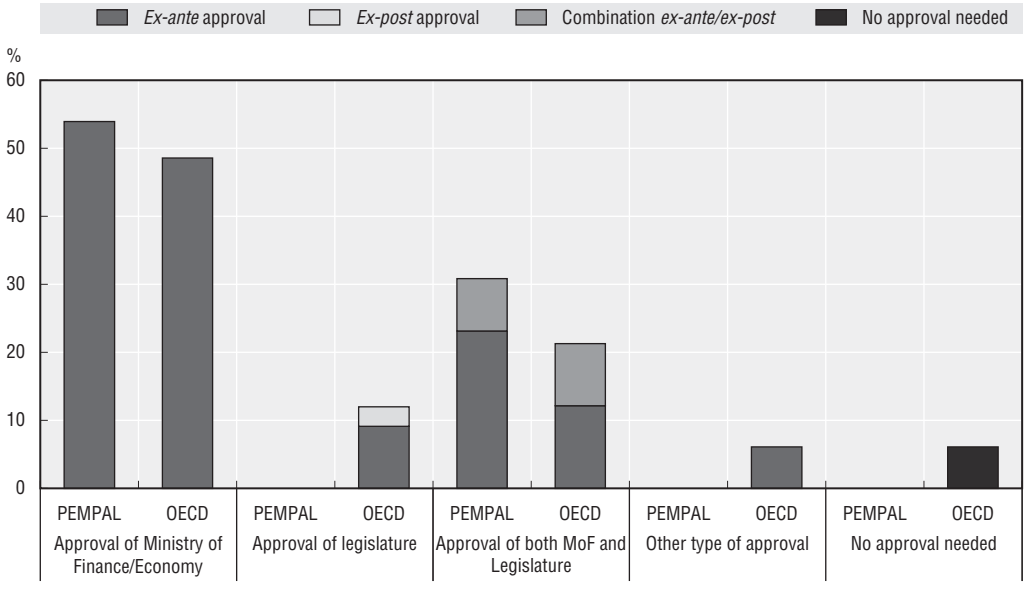
Several OECD countries (Figures 6.6) grant the executive wide reallocation power but establish some procedural limitations. In United Kingdom there are some ring-fenced programme budgets and a control on re-allocating from front line services to back office to

Figure 6.6a. **Type of approval of reallocations (Q72b)**



Note: Percentage of participating OECD countries (33 in 2012 and 33 in 2007). In this graph, "Other type of approval" in 2012 is recognised only when neither MoF nor legislature is required to approve.

Figure 6.6b. **Type of approval of reallocations (Q72b)**



protect public services. In Canada and Finland reallocations between operating, capital and transfer payment appropriations are subject to parliamentary approval. In the Czech Republic the Minister of Finance must approve reallocations below 10% of the line item within line ministry or between line ministries; the Budget Committee approves reallocations above 10%. In New Zealand reallocations with significant policy implications must be approved by Cabinet; line minister and the Minister of Finance can jointly approve other transfers between appropriations. In Germany, reallocations can be done between certain main budget groups and in cases of budget notes; besides this, in the case of unforeseen and compelling needs it

is possible to reallocate with approval of the Ministry of Finance. In France reallocations within a programme are granted provided the payroll ceiling is respected as it is subject to parliamentary authority. Between programmes within a department, a reallocation is allowed within 2% of the appropriation provided approval by the Finance Minister and after informing the Parliament (a heavy procedure in practice). In Ireland the Parliament must approve reallocations above a certain level. In Mexico and Slovak Republic there are no limits on reallocations provided approval of the Ministry of Finance.

Compared to the survey in 2007 the ministries of finance have taken a more prominent role on re-allocation regimes in OECD countries at the expense of others, not reducing the requirements for legislative approval (Figures 6.6). When the MoF is involved in approval of reallocations it is done by *ex ante* procedures (Figures 6.6, data on split of *ex ante* and *ex post* approval is not available for 2007). Only two OECD countries allow reallocations without any approval procedures, notably Estonia and the United Kingdom.

6.4. Authority to increase or cut appropriations after the budget is approved by the legislature (Q.74-83)

The executive's flexibility could also include an authority to *increase* or reduce spending after the budget has been approved by the Legislature. Most OECD countries allow the executive to increase spending after the budget has been approved. Only five OECD countries (Chile, France, Israel, Korea and Poland) and four PEMPAL countries (Albania, Bosnia and Herzegovina, Croatia and the Kyrgyz Republic) have a totally restrictive practice of not permitting any type of spending increases. Belarus restricts all types of increases but operational which can be increased up to a certain threshold before requiring approval. Azerbaijan restricts investment spending but allowing increases in other spending subject to MoF and other approvals. Tajikistan restricts discretionary spending and Turkey restricts only operational spending (Figures 6.7). Three countries have a restrictive practice for some areas combined with large delegated authority without approval in others, i.e. the Netherlands (increase of mandatory spending whilst budget execution is permitted without a threshold and without approval); Norway (increase of operational and investment spending is permitted without a threshold and without approval); and USA (increase of mandatory spending is permitted without a threshold and without approval). In general, the OECD countries are more restrictive on discretionary, mandatory and operational spending than on investment whereas for PEMPAL countries, there are slightly less restrictive practices on all categories i.e. 7 to 8 countries out of 13 do not have restrictive practices (Figures 6.7).

Notwithstanding the practice of permitting an increase in spending after the budget has been adopted, very few OECD and no PEMPAL countries allow such increases without a threshold and/or without requiring any approval. In addition to the Netherlands, Norway and the USA mentioned above, this applies only to Denmark (mandatory), Estonia (mandatory), Mexico (discretionary, operational and investment) and the Slovak Republic (investment) (Figures 6.7 and 6.8).

Most OECD countries and all PEMPAL countries require approval by the Ministry of Finance/Economy (mostly *ex ante* except for Tajikistan which requires *ex post* approval of any investment spending increases). A number of the OECD countries also require an approval by the legislature, either *ex ante* (in three-quarters of cases) or *ex post* (one-quarter) of countries (Figures 6.8). For PEMPAL countries, in addition to MoF approval, Montenegro, Russian Federation and Uzbekistan also require *ex ante* approval and Turkey

Figure 6.7a. **Regime for executive's increase of spending after the budget has been approved by the legislative (Q74/76/79/82): OECD**

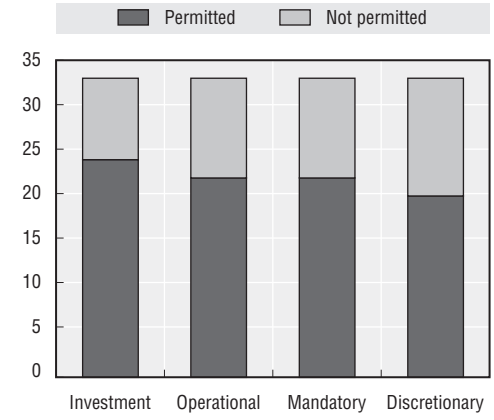


Figure 6.7b. **Regime for executive's increase of spending after the budget has been approved by the legislative (Q74/76/79/82): PEMPAL**

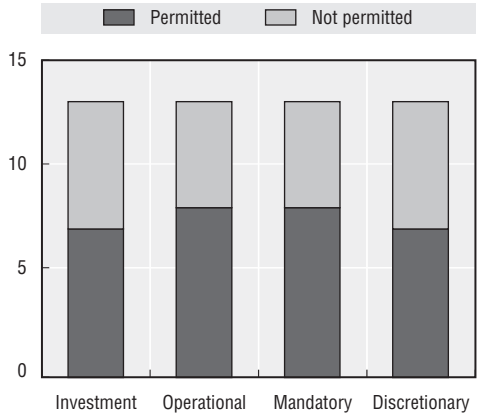


Figure 6.8. **Permission for the executive to increase spending after the budget has been approved by the legislative (Q74/76/79/82): OECD**

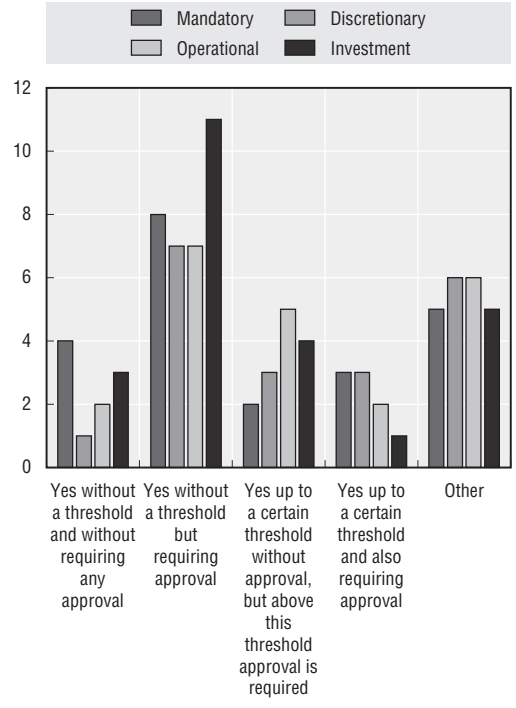
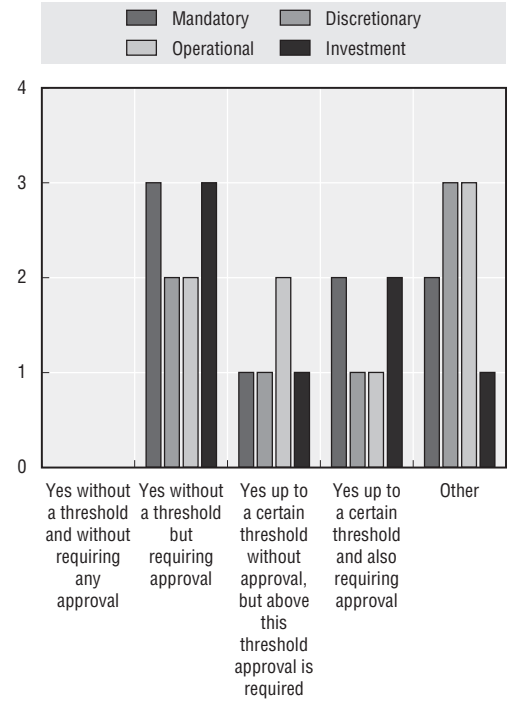


Figure 6.8. **Permission for the executive to increase spending after the budget has been approved by the legislative (Q74/76/79/82): PEMPAL**



ex post approval of the legislature for discretionary spending increases. For mandatory spending increases, Montenegro, the Russian Federation, Tajikistan and Uzbekistan requires *ex ante* approval of the legislature whereas Turkey requires *ex post* approval. For investment spending increases, the Russian Federation and Uzbekistan require *ex ante* approval by the legislature, whereas Turkey and Tajikistan require *ex post*.

Most OECD and PEMPAL countries also allow the executive to *cut* spending after the budget has been approved, except for mandatory spending for OECD countries. Only five

OECD countries have a totally restrictive practice of not permitting spending cuts (Finland, Netherlands, Norway, Switzerland and the USA) and only four PEMPAL countries (Albania, Belarus, Croatia, and Kyrgyz Republic). Turkey restricts only mandatory spending allowing no carry over after the budget has been approved by the legislature whereas Tajikistan does the same for only discretionary spending. Seven OECD countries have a restrictive practice for cutting mandatory spending combined with large delegated authority without approval to cut the other three spending areas, i.e. Austria, Belgium, Denmark, Estonia, Luxembourg, Portugal and Sweden. On the other hand, three countries do not require a threshold or approval on any of the four types of spending (Mexico, Slovak Republic and Spain). The OECD countries are considerably more restrictive on cutting mandatory spending than on cutting discretionary, investment and operational spending. Actually, most OECD countries do not accept cuts in mandatory spending after the budget has been approved in the legislature whereas the PEMPAL countries are less restrictive across all spending categories (Figures 6.10).

Figure 6.10a. **Regime for executive's cut of spending after the budget has been approved by the legislative (Q75/77/80/83): OECD**

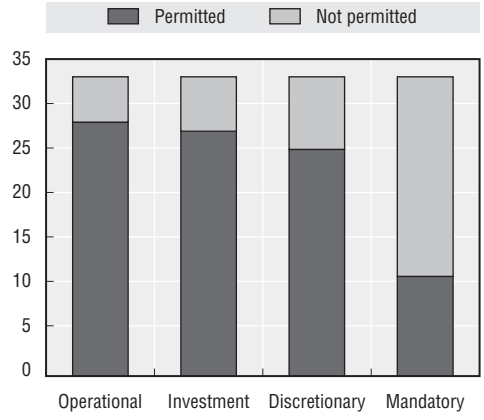
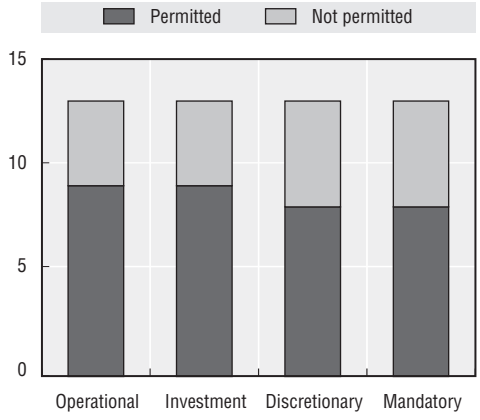


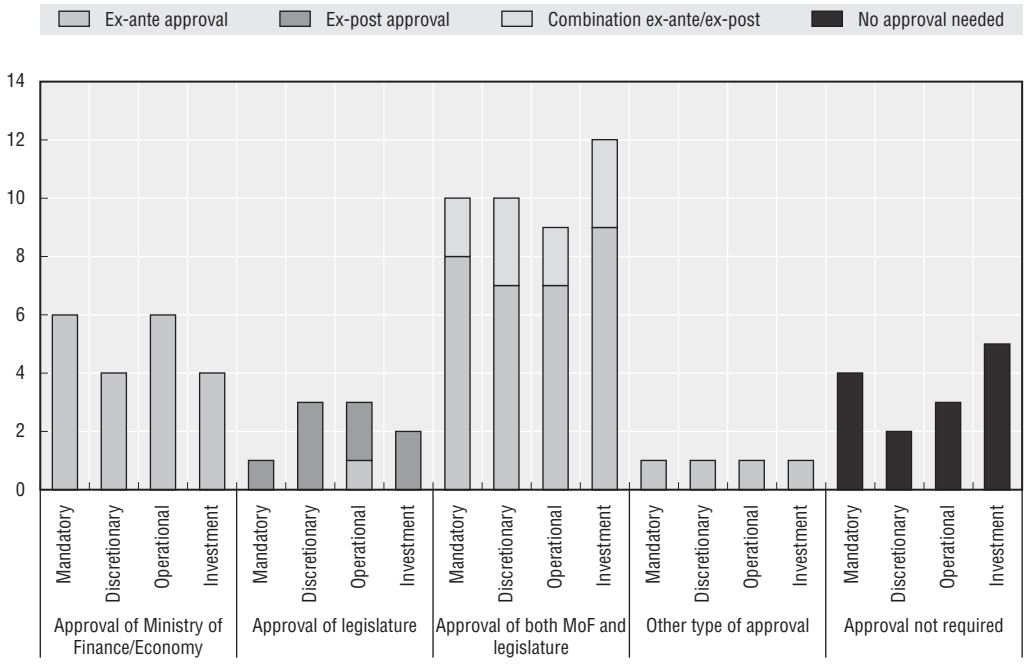
Figure 6.10b. **Regime for executive's cut of spending after the budget has been approved by the legislative (Q75/77/80/83): PEMPAL**



Contrary to the approval regime on increasing spending after the budget has been approved, the executive allows spending cuts without any approval in about half of the OECD countries compared to only one PEMPAL country (Turkey which allows such cuts in investment and discretionary spending without any approval). Most of the other OECD countries allow cuts in spending without a threshold but require approval (Figures 6.11 and 6.12). For OECD countries, when approval is required, the ministry of finance is required to approve *ex ante*. The legislature is less frequently involved in the approval regime on cutting expenditure and when the legislature is involved it is about two-thirds on *ex ante* and one-third on *ex post* basis, except for mandatory spending where only one in four is *ex post* (Figures 6.12).

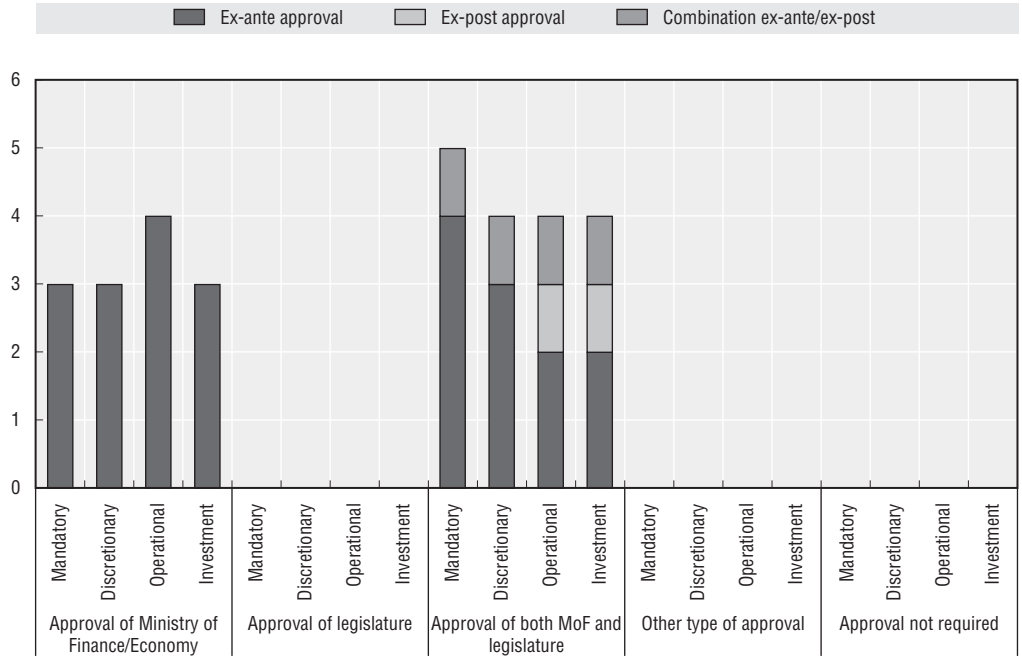
For PEMPAL countries, Albania, Belarus, Croatia, and the Kyrgyz Republic do not allow spending cuts after the approval of the budget, on any expenditures types and Tajikistan does not allow it for discretionary spending and Turkey for mandatory spending. Those countries that do allow such spending cuts require *ex ante* approval of the Ministry of Finance/Economy except Tajikistan who requires *ex post*. Approval by the legislature is only needed in a few cases, except for cuts in mandatory spending where four countries require *ex ante* approval (Montenegro, Russian Federation, Tajikistan and Uzbekistan). However, for the Russian Federation after the budget has been approved by the Legislature, it must be

Figure 6.9a. **Type of approval of an increase in spending after the budget has been apporved by the legislative (Q74/76/79/82): OECD**



Note: In this graph, "Other type of approval" is recognised only when neither MoF nor legislature is required to approve.

Figure 6.9b. **Type of approval of an increase in spending after the budget has been apporved by the legislative (Q74/76/79/82): PEMPAL**



approved by the President. During this period no changes can be made by the Executive. Afterwards, all changes in budget can be made only through a new federal act (i.e. a Supplementary Budget), presented by the Executive and approved by the Legislature.

Figure 6.11a. **Permission for the executive to cut spending after the budget has been approved by the legislative (Q75/77/80/83): OECD**

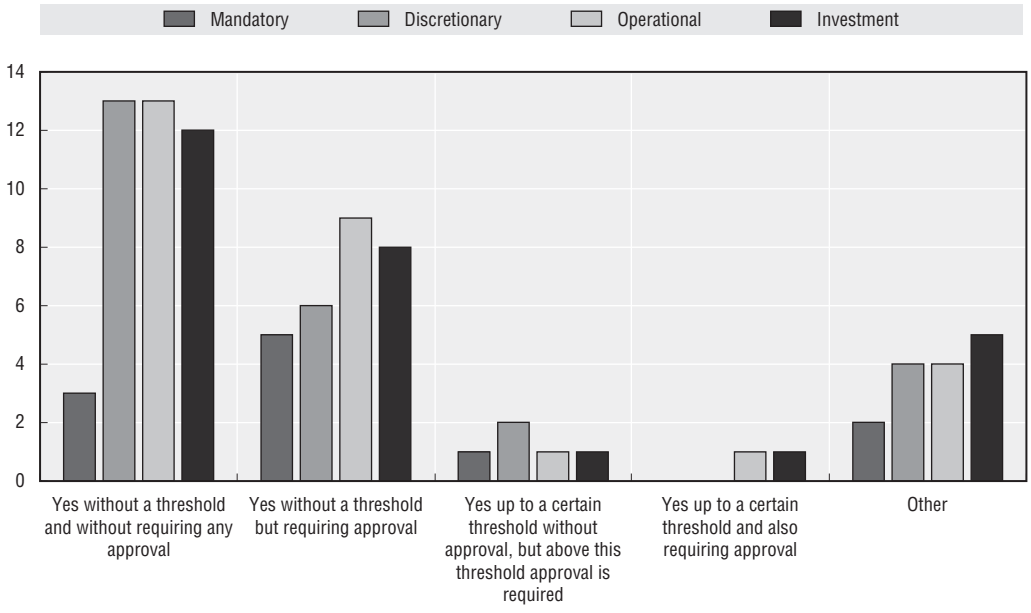
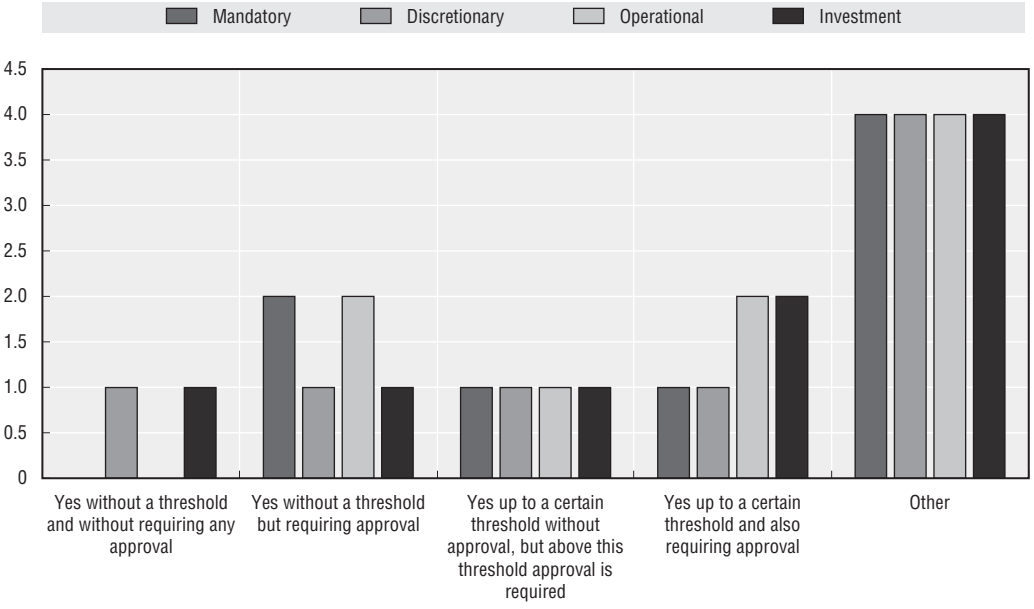


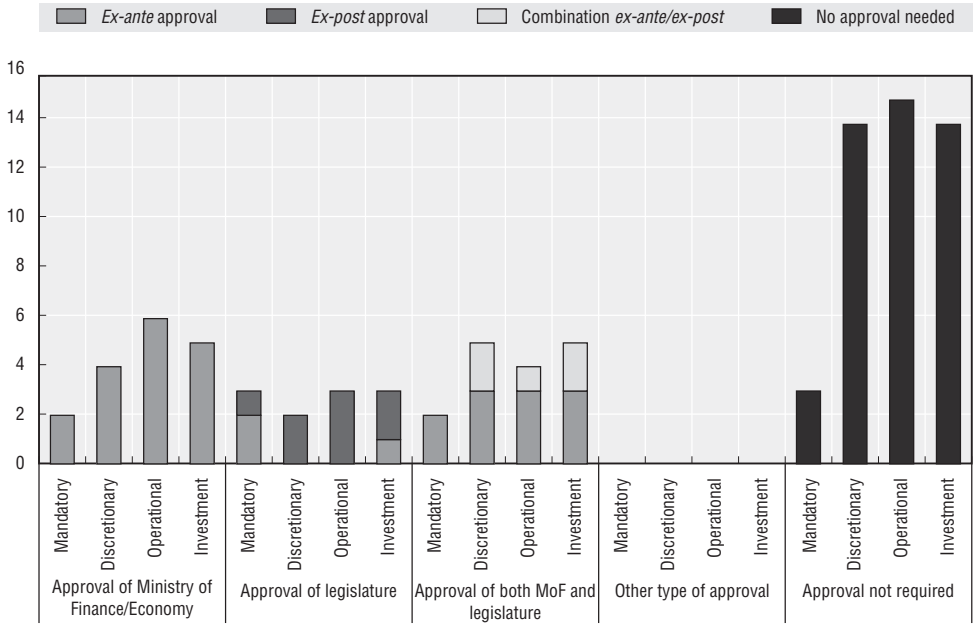
Figure 6.11b. **Permission for the executive to cut spending after the budget has been apporved by the legislative (Q75/77/80/83): PEMPAL**



6.5. Carry-over of unused appropriations (Q.78, 81, 84)

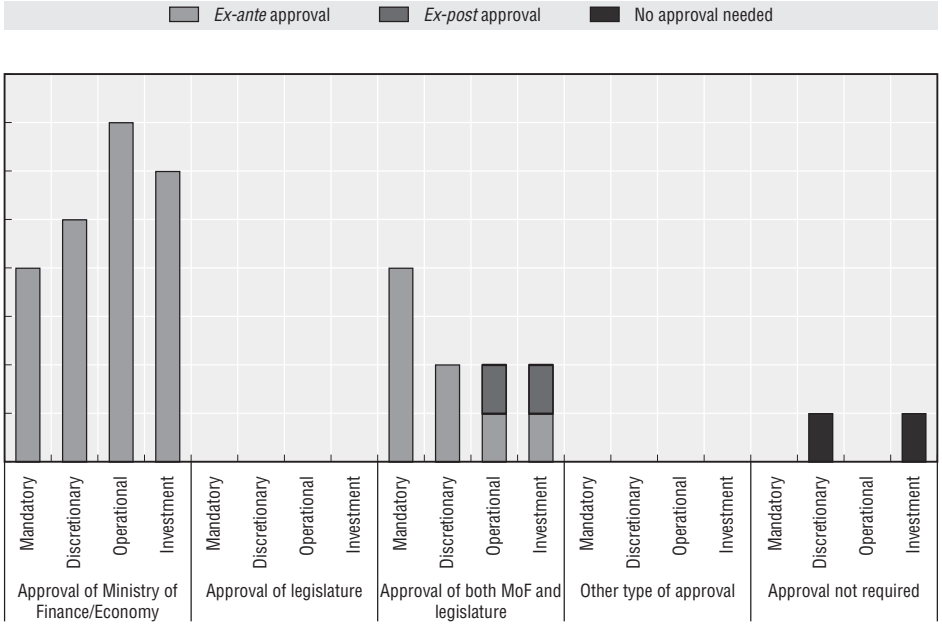
A carry-over right allows government organisations to use a portion or all of an unspent appropriation beyond the time period for which it was originally granted. This is necessary because budget appropriations are normally granted for the fiscal year. By using a "carry-over", an organisation may use unspent money in the next fiscal year. Carry-overs may be allowed after a qualitative evaluation and/or with quantitative restrictions. As part of an

Figure 6.12a. **Type of approval of a spending cut after the budget has been apporved by the legislative (Q75/77/80/83): OECD**



Note: In this graph, "Other type of approval" is recognised only when neither MoF nor legislature is required to approve.

Figure 6.12b. **Type of approval of a spending cut after the budget has been apporved by the legislative (Q75/77/80/83): PEMPAL**



evaluation, the CBA would approve or reject requests by ministries or agencies to carry-over funds on predefined expenditures programmes. Quantitative restrictions used include: a limit on the amount of carry-over allowed in any given year; a ceiling on the amount of accumulated carry overs; or limits on the draw-down of accumulated carry-overs.

The appropriateness of carry-over rights has been subject to debate. Proponents emphasise that carry-overs help to compensate for rigidities in budget execution procedures, provide additional flexibility and opportunities for efficiency gains for government organisations, mitigate the "December rush" to use up unspent funds (often at some cost to value-for-money), and may help to reveal the real cost of programmes (Table 6.1). However, others consider that carry-overs result in the accumulation of unspent appropriations, and limit the CBA's control of the budget system. For carry-overs to be most effective and to limit their misuse, budget systems should have a medium-term budget framework, devolved budget management powers, well-developed accounting and reporting systems, and sound internal control and external audit procedures.

Table 6.1. **Arguments for and against the use of carry-overs**

	Arguments for carry-overs	Arguments against carry-overs
Fiscal Discipline	While carry-overs typically account only for a small amount of government spending, they enable budgeted resources to be used more cost effectively.	Carry-overs limit the executive's discretion over the timing of expenditures (e.g. fiscal stimulus and fiscal constraint).
Allocative Efficiency	Carry-overs avoid having to make repeated revisions to the budget and encourage active management of the overall rather than annual cost of a project.	Carry-overs encourage over-budgeting, conflict over the allocation of resources and, where necessary, may be better addressed through the use of multi-annual appropriations for certain programmes or capital expenditures.
Operational Efficiency	Carry-overs compensate for delays attributed to procurement procedures and/or *ex ante* spending controls and may promote more active and durable cost saving initiatives.	Where budget execution procedures are unnecessarily onerous they should be simplified, and carry-over should not be seen as a substitute for reforming an excessively rigorous control system.

Source: Adapted from Lienert and Ljungman (2009).

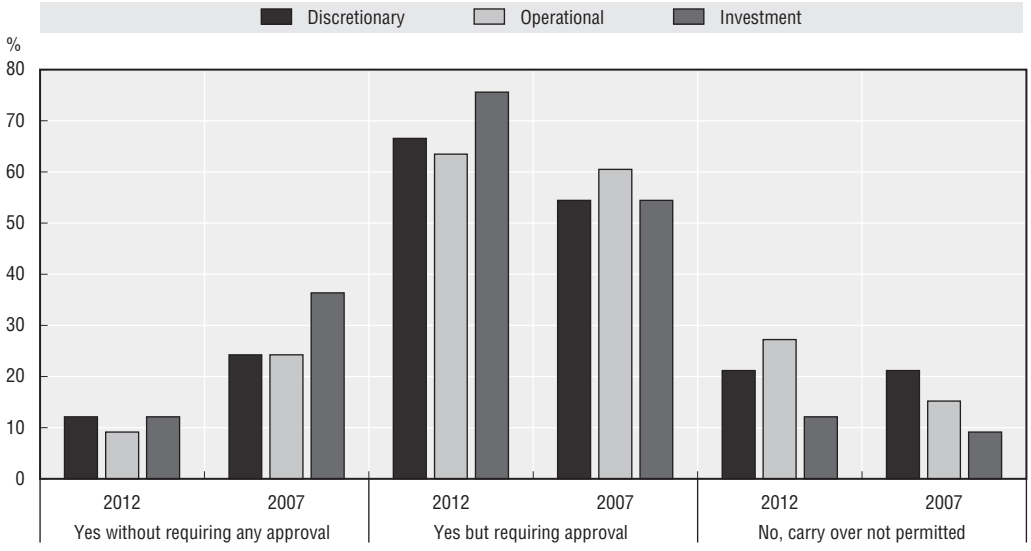
Most OECD countries permit the carry-over of unused funds, mostly subject to *ex ante* approval from the Central Budget Authority (Figures 6.13-6.15). Only four countries (Belgium, Chile, Greece and Mexico) do not permit carry-overs whatsoever and a further three countries (Ireland, Italy and Luxembourg) do not permit carry-overs for discretionary and operational expenditures, while another two countries (Slovak Republic and Turkey) do not permit carry-overs for operating expenditures. On the other hand, three countries do not require a threshold or approval for carry-over of any of the three types of expenditure (Austria, Czech Republic and Denmark), of which Austria requires approval by the ministry of finance to use the carried-over funds.

In PEMPAL countries, it is more common for carry-overs of unused funds to be disallowed. Only the Russian Federation allows for all three categories of expenditures (discretionary, operating and investment) to be carried-over for funds up to a certain threshold subject to approval by the Ministry of Finance and in accordance with Art. 217 of Budget Code (i.e. it must be within the budgetary framework in accordance with current law on federal budget). The Russian Federation and Tajikistan are the only countries that allow carry-overs of discretionary expenditures with Tajikistan also not requiring any approvals. For operational expenditures, Croatia also allows carry-overs. For investment expenditure, Albania and Turkey also allow carry-overs, with line ministries in Albania having the right to carry over the unused funds for multi-year contracts but for no longer than three years. For Croatia, only unspent funds from earmarked revenues can be carried over whether they are operational or investment expenditures. For Turkey, such carry overs can only occur if they are specified in the Budget Law (Figures 6.13 below). In Bosnia and Herzegovina, carry-overs

are allowed but only for ear-marked funds (e.g. grants, donations) and multi-annual capital investments – these funds are carried over in such a way that the budget users submit requests and the Ministry of Finance and Treasury then carries the funds over into the next budget year after reconciliation of the specific amount.

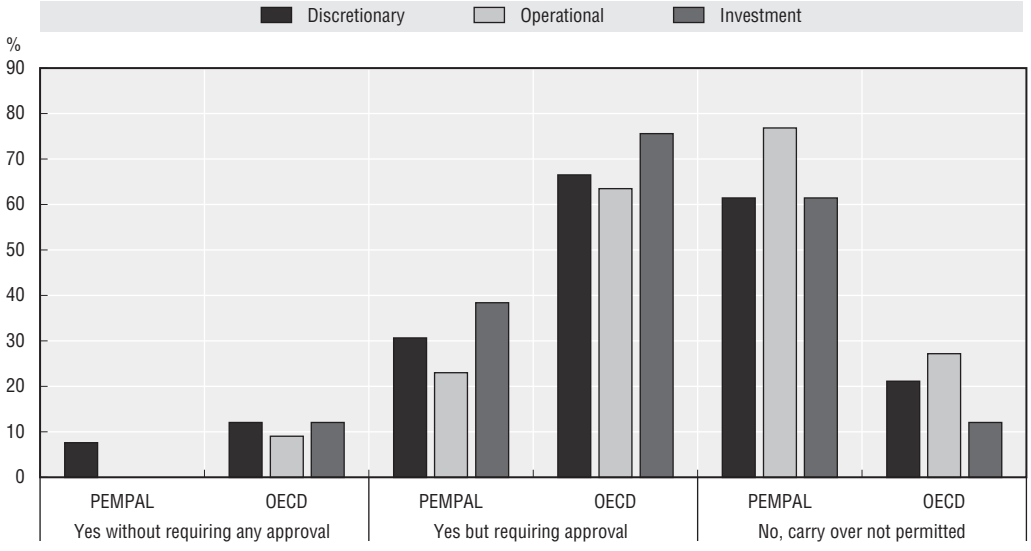
Compared to the situation in 2007 more OECD countries do not permit carry-over of operating expenditures. Also fewer countries allow a carry-over without an approval (Figures 6.13).

Figure 6.13a. **Carry-over regimes in 2012 and 2007 (Q78/79/84): OECD**



Note: Percentage of participating OECD countries (33 in 2012 and 33 in 2007).

Figure 6.13b. **Carry-over regimes in PEMPAL and OECD (Q78/79/84)**



Two OECD countries (Israel and Slovak Republic) allow carry-over of discretionary expenditures and investment expenditures respectively without approval from the Executive or Legislature and without a threshold. In addition, three countries (Finland,

Figure 6.14a. **Restrictions on carry-over in OECD (Q78/79/84)**

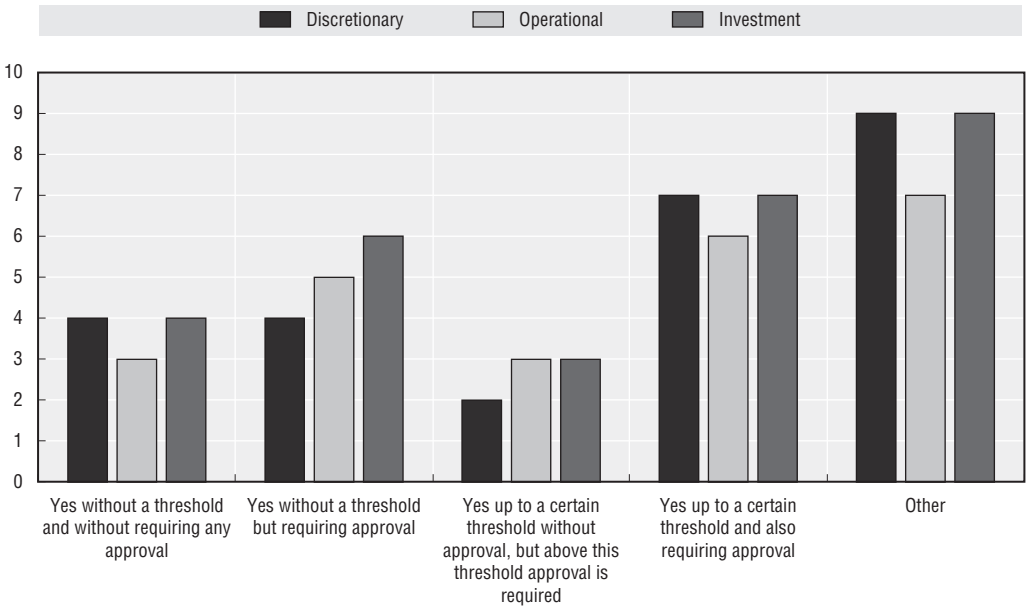
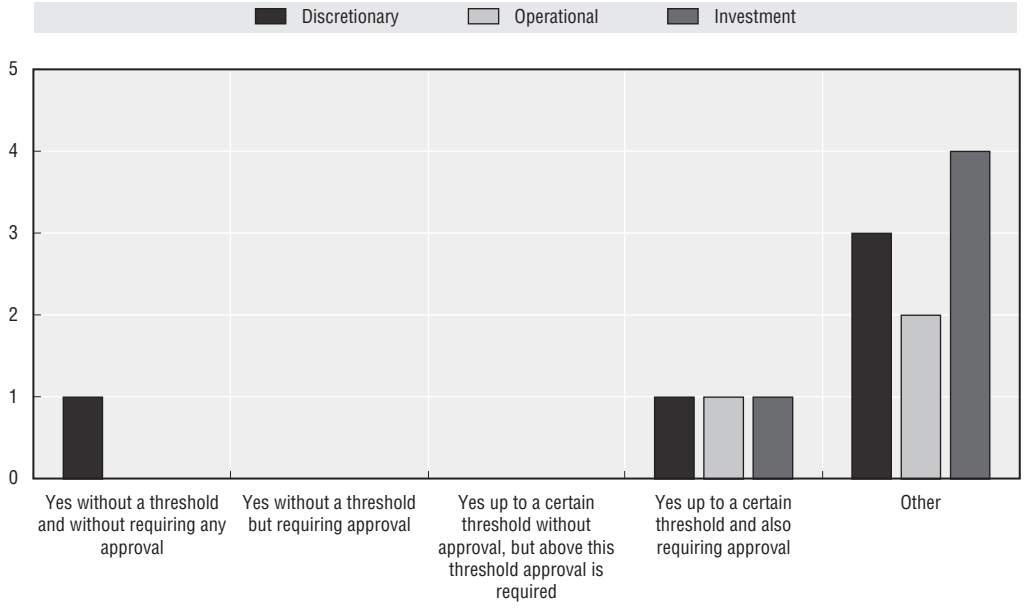
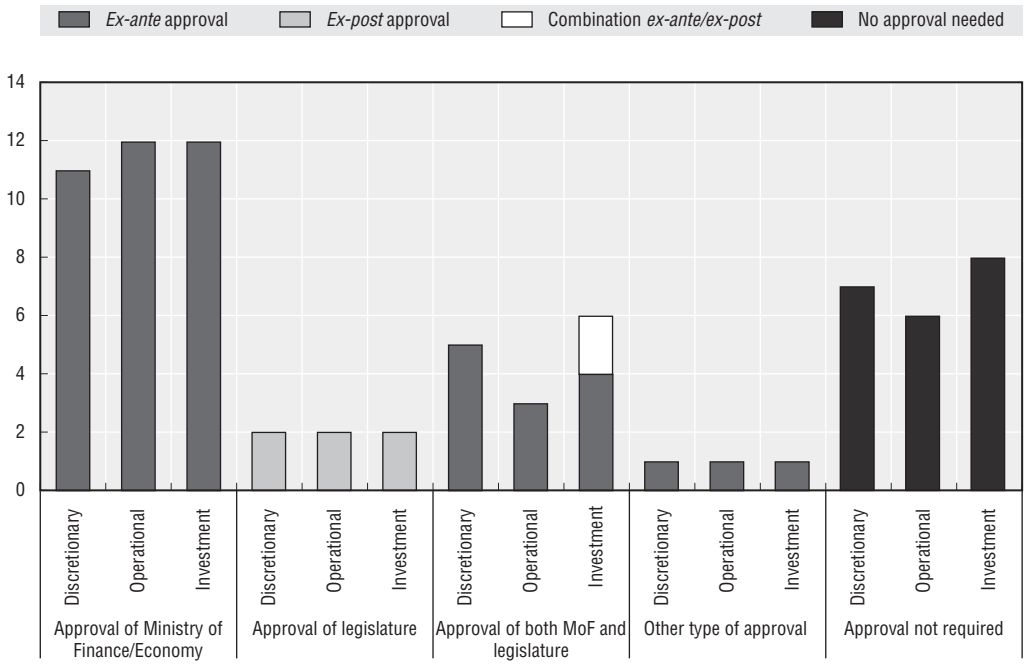


Figure 6.14b. **Restrictions on carry-over in PEMPAL (Q78/79/84)**



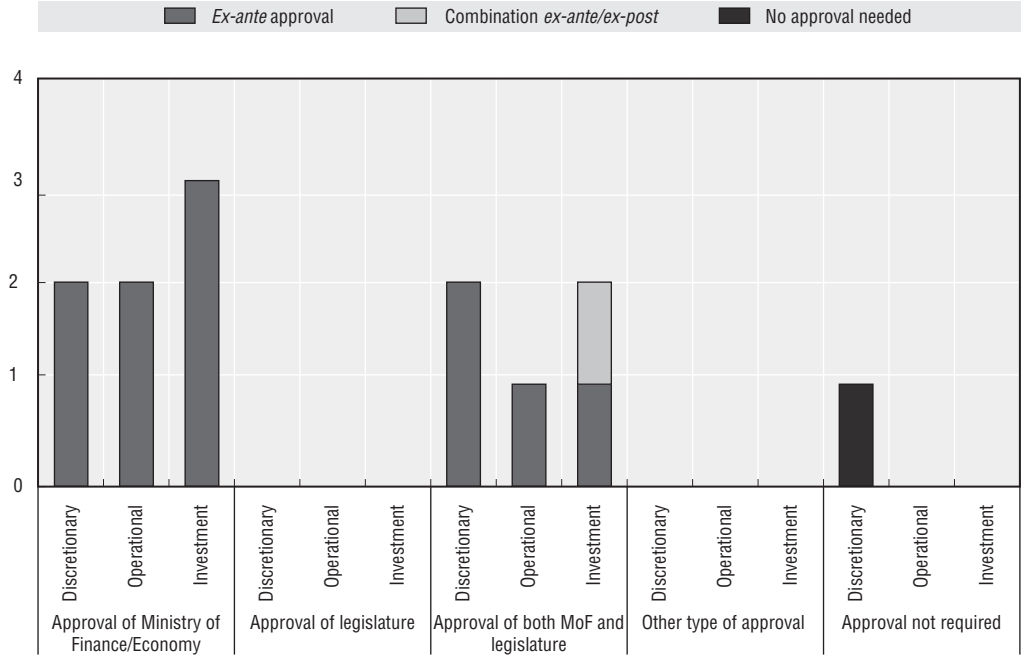
Korea and USA) do not require approval as carry over is only allowed when specified in the budget law and in Luxembourg most of the investment spending is managed via funds allowing unused funds to be transferred from one year to another (without approval). Only one PEMPAL country (Tajikistan) allows carry-overs of discretionary expenditures without approval, as previously mentioned. In the remaining OECD and PEMPAL countries some sort of approval is required from either the executive (Ministry of Finance, joint ministers or Cabinet), the legislature, or both, and for PEMPAL countries it is usually *ex ante* in nature (except in Turkey where *ex post* approval of the legislature is also required on investment

Figure 6.15a. **Type of approval of carry over on spending (Q78/79/84): OECD**



Note: In this graph, "Other type of approval" is recognised only when neither MoF nor legislature is required to approve.

Figure 6.15b. **Type of approval of carry over on spending (Q78/79/84): PEMPAL**



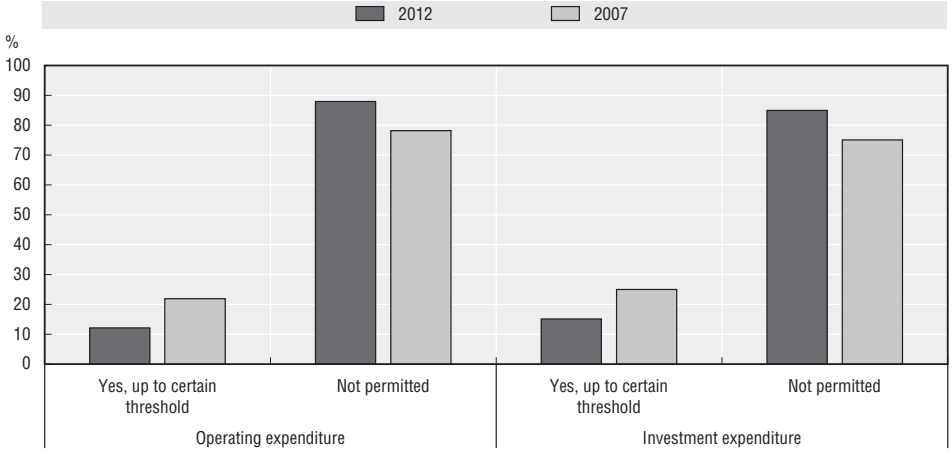
expenditure carryovers.). In OECD countries, almost all approvals by the executive are according to *ex ante* procedures while a few countries use an *ex post* approval from the legislature in combination with an *ex ante* approval by the executive (Hungary, Italy and New Zealand). A few countries also require *ex ante* approvals from both the executive and the legislature (Australia, Canada, Ireland, Japan, Poland and for some part, Turkey).

6.6. Borrowing against future appropriations (Q.73)

Borrowing against future appropriations is another practice that increases managerial flexibility. It allows agencies to spend their appropriation for the year in the knowledge that they will be able to borrow from next year's appropriation if unexpected spending needs arise. Opponents of this argue that this flexibility undercuts budgetary discipline and the CBA's control of spending as well as going against the principle of annual appropriations sanctioned by the legislature. A vast majority of OECD countries do not allow ministers or governments to borrow against future appropriations, regardless of the type of expenditure: 88% in 2012 (78% in 2007) for operating expenditures and 85% (75% in 2007) for investments. Only Germany (with some limitations), New Zealand and Sweden allow such borrowing for both operating and investment expenditure, while Denmark allows it for operational expenditure and Hungary and Luxembourg allow it for investment expenditure. In most OECD member countries, budget-related laws prohibit borrowing against appropriations for future years, and the authority of the legislature to approve government borrowing is typically found in the constitution (Figures 6.16).

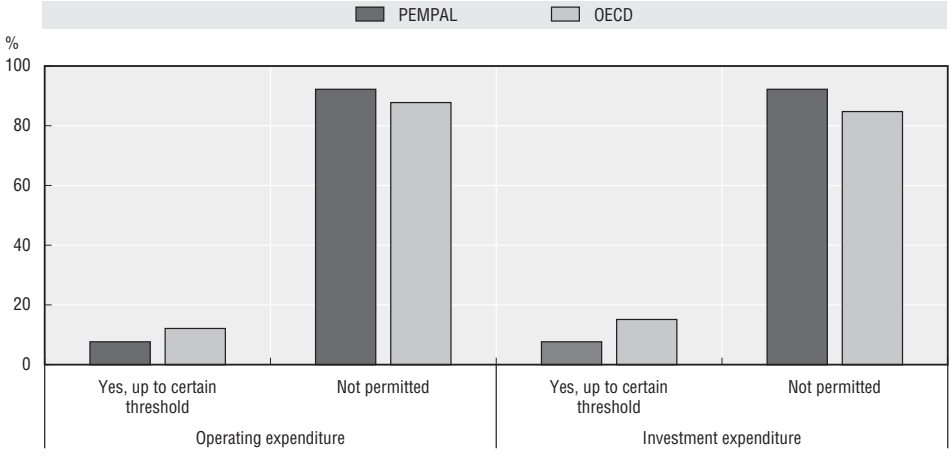
For PEMPAL countries, borrowing against future appropriations is not permitted in all countries except for the Russian Federation where it is allowed up to a certain threshold.

Figure 6.16a. **Permission to borrow against future appropriations (Q73)**



Note: Percentage of participating OECD countries (33 in 2012 and 33 in 2007).

Figure 6.16b. **Permission to borrow against future appropriations (Q73)**



7. Focus on results – performance budgeting

Programme budgeting applies to cases where expenditure is classified in the budget by objectives (outcomes and outputs) rather than solely by economic categories (i.e. inputs such as salaries) and organisational category. Performance budgeting (or performance-informed budgeting) refers to a wider set of initiatives intended to strengthen the links between the funds provided and the results achieved through ensuring performance information is used in resource allocation decision making. Programme and performance budgeting reforms should, therefore, provide information in a way that informs choices about spending alternatives and should improve transparency and accountability of government.[21]

The public sector has traditionally been held to account for compliance with rules and procedures, including accounting for financial appropriations. However, in the last 20 years OECD countries have increasingly sought to develop a focus on the results achieved with the appropriations allocated through various approaches under the heading of "performance budgeting". This area is the subject of a lot of activity across many OECD countries at present, including revisions and re-assessments of established performance budgeting models, and there is currently no settled consensus on the optimal way of using performance information within the budgeting context. The issues arising range from a) the level of information being used (with a more recent focus upon streamlining and focusing performance information, and retreating from a tendency to "over-engineer" performance budgeting products); b) the problems inherent in measurement of public performance and c) a broader question of whether the budgeting process lends itself well to performance monitoring, or whether other mechanisms of governance and accountability should play a more significant role.

The IMF advises that simply generating performance information is not sufficient to influence budget decisions. Systematic performance reviews need to be implemented to evaluate the impact of programmes on beneficiaries and citizens. Such comprehensive reviews which evaluate the effectiveness of major government spending programmes can help provide evidence for expenditure rationalisation and programme improvements. Regular programme monitoring and evaluation is also important to ensure that programme performance information is used to improve allocative and operational efficiency of expenditure.[22] In the context of fiscal consolidation, the IMF recommended that improving performance and programme budgeting capacity is not enough and other fiscal institutions have to be developed as part of a wider PFM reform process.

Performance information should form only part of a broader performance management framework. For example when considering reducing or cancelling a programme, all possible impacts (e.g. external, structural, managerial, technical, cultural, and behavioural) should be considered.[23] Furthermore, performance indicators should be used in conjunction with other data. If performance indicators are used in isolation, they could give a distorted picture of actual performance or could actually distort public servants' behaviour so that targets are met, but with a negative impact on citizens.[24]

The OECD[25] has categorised the approaches to integrating performance information into the budget process, ranging them from the weakest to strongest forms. In the weakest form, performance information is included in budget documents as background information and has no role in decisions on budget allocations. In the moderate form, performance information is used to inform, but not determine, budget allocations. This form is the most commonly used in the OECD. In the strongest form, resource allocation decisions are directly and explicitly based on units of performance, and appropriations are

based on formulas or performance contracts. This form of performance budgeting is only used in specific sectors (e.g. the health sector) and in a limited number of OECD countries.

This section provides a quick overview of the results of the 2011 OECD Performance Budgeting Survey. The objective of the survey was to obtain updated data on the types of performance information and instruments employed throughout the budgeting process, and to ascertain how specifically this information is being used in budgetary decision-making. For details, see OECD (2012a). It was decided at this stage for PEMPAL countries to not participate in this survey. All PEMPAL Budget Community of Practice members are currently implementing program budgeting in some form, and it has been the topic of two major plenary meetings and one peer review study visit over the last two years. This has included two surveys to ascertain the status of development of reforms in the 21 BCOP member countries.[26] Most PEMPAL member countries have implemented elements of programme budgeting including defining and identifying programmes, formulating programme objectives, allocating expenditures between programmes, and selecting performance information. However, the quality of performance information remains generally poor, is in many cases not systematically monitored, and has limited influence on budget decision making.[27] There is a wide range of progress however, with some countries well advanced in the reforms (e.g. the Russian Federation scored very well in the Performance Budgeting Index presented in Box 7.1) with others still at the stage of piloting reforms in key line ministries. Reports on these meetings can be found in the links provided below.[28]

The key findings or the Performance Budgeting Survey for OECD countries was:

- Comparing responses in 2011 and 2007 it appears that in negotiations between line ministries and CBAs performance information is generally used less for strategic planning and to a growing extent not used at all.
- Compared to 2007 results in 2011 show a marked increase in the role of Line Ministries and agencies as the main institutions responsible for setting performance targets.
- Performance budgeting frameworks are abundant in the OECD, but are generally flexible and not linked with allocation decisions.
- Performance budgeting is generally a decentralised practice within the central/federal government. The exceptions are Spending Reviews, where CBAs and Chief Executives play a more central role.
- Line ministries (e.g. different sectors) all generally use performance information in the same way. to increase spending and to reduce it or eliminate programmes to a lesser extent.

Performance budgeting frameworks are widely found in OECD countries and are generally flexible in nature. More than half of the countries have a standard performance budgeting framework in place that applies to all central government Line Ministries and Agencies. About a quarter answered that there is no standard framework but that Line Ministries/Agencies do have their own budgeting frameworks (Figure 7.1). Aggregated results (Figure 7.2) show that the different policy sectors use performance information mainly for setting allocations for programmes, for strategic planning, for proposing new areas of spending, for setting allocations for line ministries and agencies, and to reduce spending. However, in about a third of cases performance information does play a limited role in the budget negotiations with the CBA. In general it appears that that line ministries in 2011 use performance information less than in 2007 and more countries report that performance information is "not used" in budget negotiations. When performance targets are not met, oftentimes there are "no consequences" (Figure 7.3). This would seem to suggest that performance information is not easily

transformed into actions. When comparing 2007 to 2011 more intense monitoring appears to have decreased as a widely used consequence but the elimination of the programme appears to have increased slightly, even if it is still rarely the case. Interestingly bad performance is made public occasionally in 2011. No data exists for this for 2007.

Figure 7.1. **Does the CBA have in place a standard performance budgeting framework which is applied uniformly across central government organisations?**

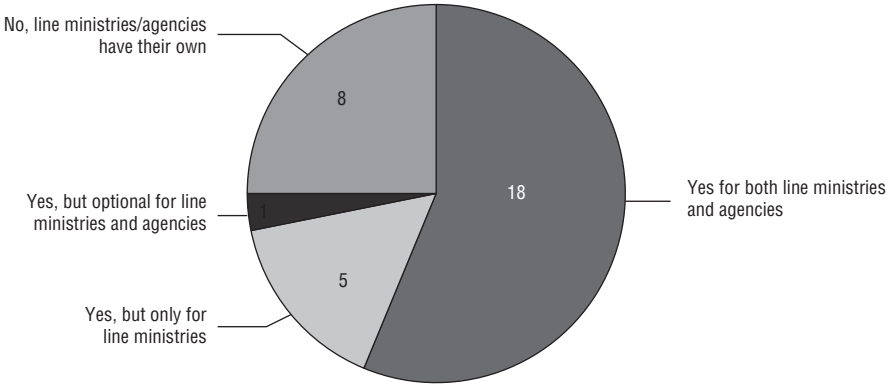


Table 7.1. **Types of performance measures**

Performance measures	Input measures	What goes into the system? Which resources are used?
	Output measures	What products and services are delivered? What is the quality of these products and services?
	Outcomes measures	Intermediate: What are the direct consequences of the output? Final: What are the outcomes achieved that are significantly attributable to the output?
	Contextual measures	What are the contextual factors that influence the output (e.g. processes, antecedents and external developments)
Ratio Indicators	Efficiency	Cost/Output
	Productivity	Output/Input
	Effectiveness	Output/Outcome (intermediate or final)
	Cost-effectiveness	Input/Outcome (intermediate or final)

Source: Adapted from Streck et al. (2006).

Figure 7.2. **How is performance information generally used by line ministries in their negotiations with the CBAs?**

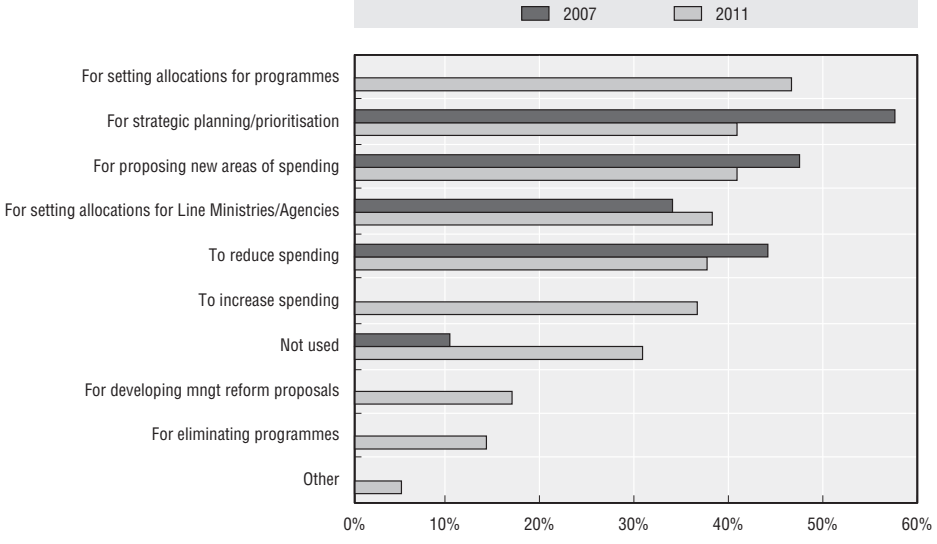


Figure 7.3. **What happens when performance targets are not met?**

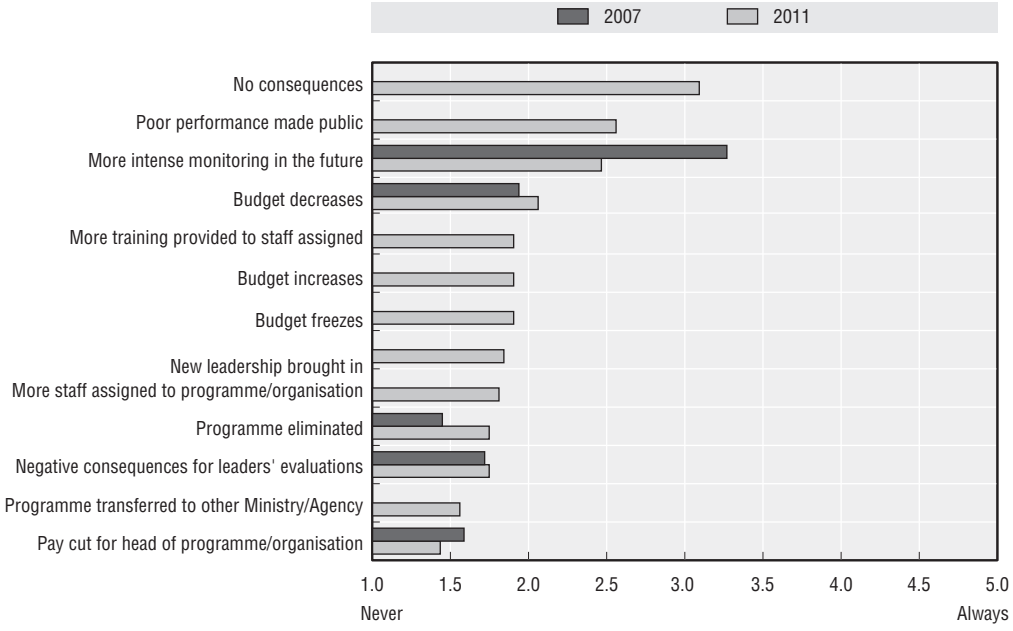
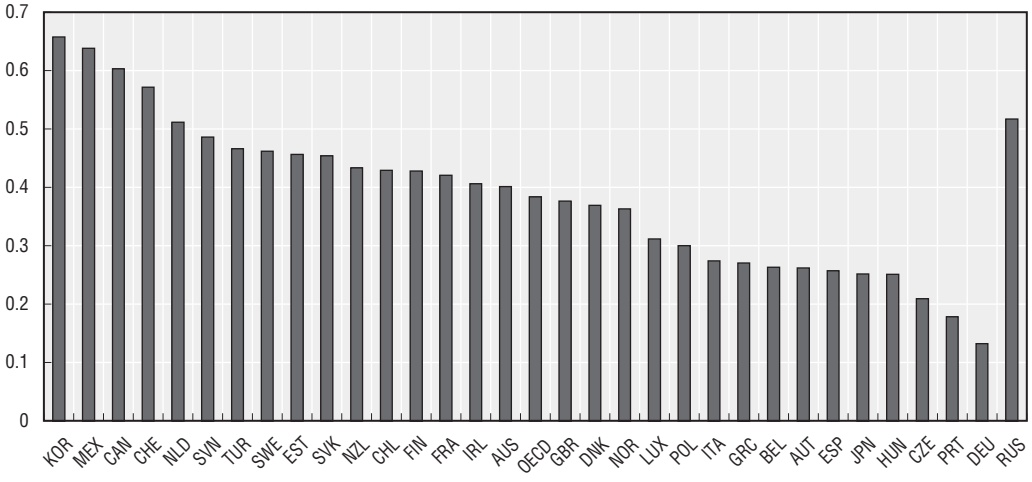


Figure 7.4. **Performance budgeting index**



Box 7.1. **Performance budgeting index**

The approaches to developing and using performance information in the budget process vary across OECD countries and there is no one single dominant model. For example, in most countries that use performance information in budgeting, there is a loose or indirect link between performance information and funding. These countries use performance measures and evaluations along with information on fiscal policy and policy priorities to inform, but not determine, budget allocations. Since 2007 it appears that in negotiations between line ministries and CBAs performance information is generally used less for strategic planning and to a growing extent not used at all. The same period also shows a marked increase in the role of Line Ministries and agencies as the main institutions responsible

Box 7.1. **Performance budgeting index** *(cont.)*

for setting performance targets. Performance budgeting is generally a decentralised practice within the central/federal government. The exceptions are Spending Reviews, where CBAs and Chief Executives play a more central role.

The index examines both the existence of a performance budgeting system, the use of performance information and consequences if the performance is not in line with targets. While most OECD countries have adopted one or other system of providing performance information, there is as yet no settled international consensus of how to use the information and what consequences should follow from non-compliance with performance targets. Therefore the weightings used emphasise aspects of the existence of a framework more than the specific use of it. Countries that receive a high score have created a comprehensive, government-wide framework for developing performance information (evaluations and performance measures), integrating performance information into budget and accountability processes, using it in decision making, and monitoring and reporting on results. However, this index does not measure how successfully any given system operates in practice. Success is better evaluated by examining whether policy execution is achieving the stated objectives. This cannot be captured in this index.

This composite index contains ten variables that cover information on the following aspect of performance information (weights in parentheses): whether the countries have a performance budgeting framework in place (21.7%), type of target setting (10.9%), responsible actors for reporting on results (10.9%), type of performance information used (10.9%), presentation of performance information to the legislative (10.9%), whether (and how) performance information is used in budget negotiations between the central budget authority and the line ministries (2%) and between the line ministries and the agencies (5%), how the performance information is used in the budget negotiations (13%) and to what degree non-achievement of targets trigger any consequences (15%). The index ranges between 0 (no performance budgeting system) and 1 (a comprehensive performance budgeting system). The variables comprising the indexes and their relative importance are based on expert judgments. They are presented with the purpose of furthering discussion, and consequently may evolve over time.

The performance budgeting index gives highest scores to Korea, Mexico, Canada, and Switzerland (Figure 7.4). The Russian Federation and Turkey participated in this survey, and ranked fifth and eighth respectively out of 33 OECD countries.

Note: This index examines the degree to which OECD member countries have put a performance budgeting system in place. However, it does not measure how successfully these systems operate in practice. The OECD average is based on 31 member countries. Chile, Iceland and USA did not respond.

8. Budget Transparency (q.6, 39, 51, 60-67)

The budget is the principal policy document of government, where the government's policy objectives are reconciled and implemented in concrete terms. Budget transparency – openness about policy intentions, formulation and implementation – is therefore at the core of a good governance agenda (OECD, 2002). The OECD (2002) Best Practices for Budget Transparency define budget transparency as *the full disclosure of all relevant fiscal information in a timely and systematic manner.* These Best Practices, which are based on the collective experiences of OECD countries, are organised in three parts. Part 1 lists the principal budget reports that governments should produce and their general content. Part 2 describes specific disclosures to be contained in these reports. This includes both financial and non-financial

performance information. Part 3 highlights practices for ensuring the quality, integrity and usefulness of the reports, including an effective role for the legislature and civil society.

Copies of OECD Best Practices for Budget Transparency in the official languages of PEMPAL (English, Russian, Bosnian-Croatian-Serbian) are available at the following link: *www.oecd.org/gov/budgeting/best-practices-budget-transparency.htm*.

The OECD has also developed 'Principles on Budgetary Governance' which were finalised in February 2015 after an extensive consultation period. The Principles provide a concise overview of good practices across the full spectrum of budget activity, taking account in particular of the lessons of the recent economic crisis, and aim to give practical guidance for designing, implementing and improving budget systems to meet the challenges of the future. The overall intention is to provide a useful reference tool for policy-makers and practitioners around the world, and help ensure that public resources are planned, managed and used effectively to make a positive impact on citizens' lives.[29] This document is available at: *www.oecd.org/gov/budgeting/principles-budgetary-governance.htm*.

8.1. Examples of available budget information and reporting in OECD and PEMPAL countries (Q.6, 39, 51, 61)

Apart from the budget and supporting documentation, a variety of government reports exist which can contribute to transparency. The year-end report may be the government's main measure of accountability, but in-year (monthly, quarterly and semester) reports are also important to help identify budget implementation issues and develop appropriate responses in a timely manner. The OECD Best Practices on Budget Transparency also establishes guidelines for the timing and content of these reports.

8.1.1. Disclosure of underlying assumptions and publicly available budget documents (51)

A key aspect of transparency is the extent to which the executive's budget discloses the underlying assumptions (macroeconomic and others) that set the fiscal framework within which government organisations formulate their spending proposals. Key assumptions include estimates of GDP growth, the current account, inflation and the interest rate. These estimates underlie forecasts for tax and non-tax revenues, and government debt-servicing obligations and requirements. Arguably there is no single factor more responsible for "de-railing" budget outcomes and projections of deficits or surpluses than the use of weak macroeconomic assumptions.

The majority or 82% of OECD countries and 69% of PEMPAL countries that participated in the Budget Practices and Procedures survey indicated that they publish the macroeconomic assumptions and the methodology used to establish them in the budget and supporting documentation (Figures 8.1), while 18% of remaining OECD and 15% of PEMPAL countries do not make this information publicly available. Compared to the data from 2007 this is an improvement of transparency in OECD countries by 18 percentage points. Amongst PEMPAL countries, 15% (Azerbaijan, Bosnia and Herzegovina, and Montenegro) chose "not applicable" stating that such assumptions are not produced or not produced by government.

All the participating OECD countries make the executive's budget proposal that is submitted to the legislature publicly available except the United Kingdom (not applicable). Similarly, all PEMPAL countries except two (Kyrgyz Republic and Belarus) do the same. On the other hand, only around half of the OECD countries produce a pre-budget report of which 14 countries make it publicly available. This is also the case for a citizens' budget which is

publicly available in 15 OECD countries. For PEMPAL countries 69% (9 countries) produce a pre-budget report of which 6 countries make it publicly available. For citizens' budget 62% (8 countries) produce them, of which 6 make them publically available (Figures 8.2).

Figure 8.1a. **Are the economic assumptions underlying the budget and the methodology used to establish them published/publicly available?(Q51a): OECD**

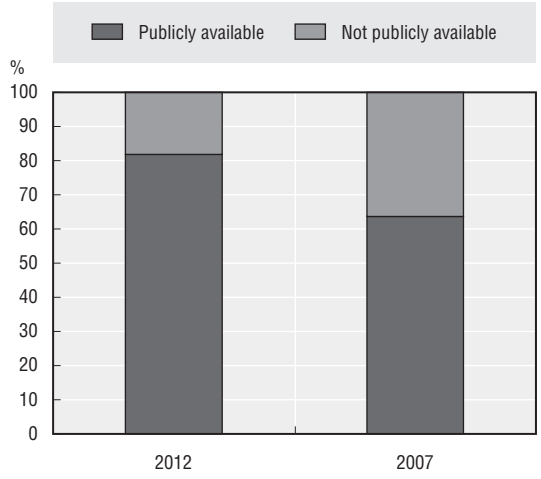
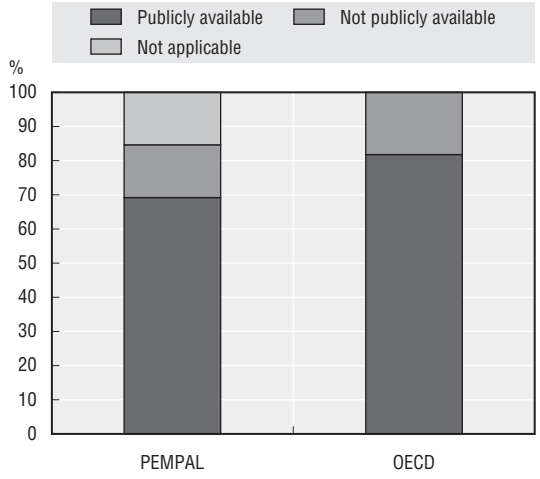


Figure 8.1b. **Are the economic assumptions underlying the budget and the methodology used to establish them published/publicly available?(Q51a)**



Note: Percentage of participating OECD countries (33 in 2012 and 33 in 2007); Percentage of participating 13 PEMPAL and 33 OECD countries.

Figure 8.2a. **Publicly available budget documents (Q51): OECD**

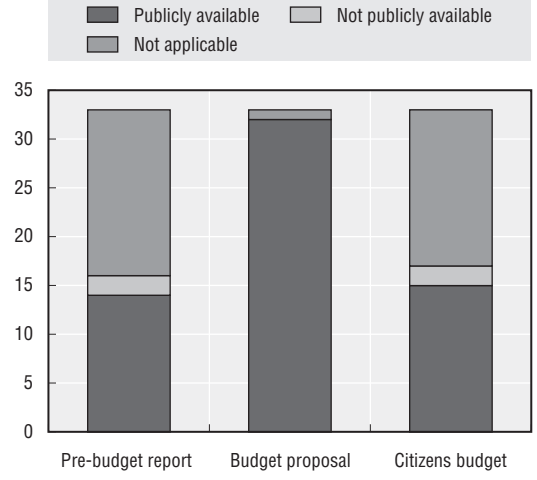
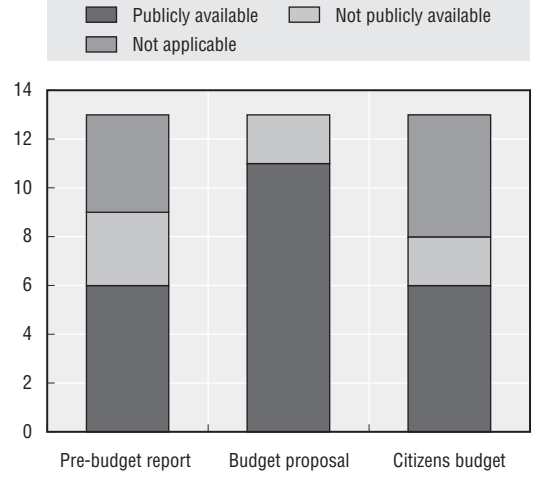


Figure 8.2b. **Publicly available budget documents (Q51): PEMPAL**



8.1.2. Comprehensiveness of budget documentation (Q.39, 61)

It is important that comprehensive information is presented in the budget to enable policy debate. In addition to the economic assumptions underlying the budget, the OECD (2002) Best Practices on Budget Transparency states that the budget should include, among other things: A medium-term perspective; a detailed commentary on each revenue and expenditure programme; appropriations by administrative unit (e.g. ministry, agency); and

non-financial performance data, including performance targets. In addition, the Draft IMF Fiscal Transparency Code (2014) recommends that the budget should include a description of major expenditure and revenue measures, and their contribution to policy objectives. Copies of this code are available at: *www.imf.org/external/np/fad/trans/*

Below is a list of information that should be included in the budget and supporting documentation. Also important, are off-budget expenditures and public contingent liabilities.

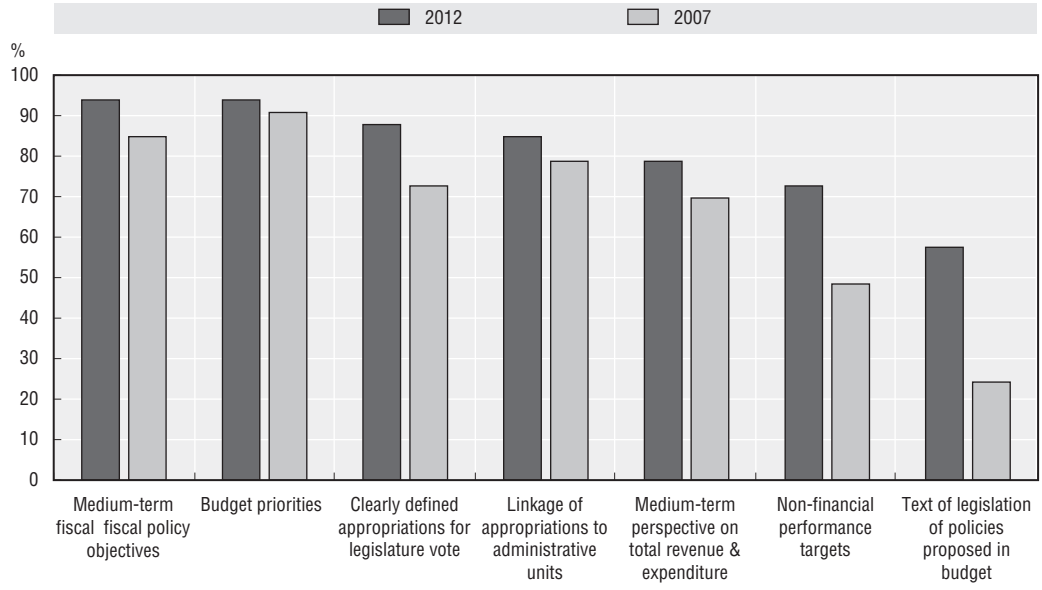
- **Medium-term fiscal policy objectives (or statement):** Specifies the government's desired fiscal position articulated either in legislation or as part of a political commitment. It may also include commitments to fiscal transparency. A successful medium-term budget framework should include medium-term policy objectives.
- **Budget priorities:** Reflect the executive's strategic priorities for expenditure allocations for the budget year (and often the medium-term). It does not just include those related to specific government programmes, but also frames many macroeconomic policy decisions.
- **Medium-term perspective on revenue and expenditure:** An integral part of the Medium-term Budget Framework. However, it focuses more on estimating revenue receipts and expenditure rather than linking the two.
- **Text of legislation of policies proposed in the budget:** Differentiates between existing and new policies within the executive's budget documentation, as well as describing the legislation for policies proposed for the new fiscal year.
- **Clearly defined appropriations (linked to administrative units):** Are the authority granted under law by the legislature to the executive to spend public funds to a set limit and for a specific purpose. Annual appropriations are made through annual budget laws or, in some countries, separate appropriation acts.
- **Non-financial performance targets for programmes and/or agencies:** Refers to specific outputs and outcomes that are to be achieved by government organisations. They can usually be accomplished in a shorter time period than goals and objectives, and are often an intermediate step in achieving the latter. Note, that no consensus exists on the way non-financial performance information should be used nor the degree to which it should be integrated into the budget process.

Almost all OECD countries (94%) present information on the executive's medium-term fiscal objectives and budget priorities. This compares to only 62% of PEMPAL countries presenting medium-term fiscal objectives and 85% presenting budget priorities. Denmark is the only OECD country that does not include either of the two. Croatia and Kyrgyz Republic are the only PEMPAL countries that do not include budget priorities, whereas Belarus, Bosnia and Herzegovina, Macedonia,[30] Tajikistan and Uzbekistan do not present medium term fiscal policy objectives (Figures 8.3). Spain includes only medium-term targets while Italy includes only budget priorities. Only 24% of OECD countries and 8% of PEMPAL countries (i.e. Turkey only) include a long term perspective on total revenue and expenditure. More PEMPAL (77%) than OECD (48%) countries present a comprehensive financial plan, reflecting reforms being implemented in this area in the region in relation to public sector accounting and reporting including the adoption of national accounting standards and elements of IPSAS.[31] PEMPAL countries also include more macroeconomic assumptions in the budget documents presented to the legislature, with 100% providing this information compared to only 91% of OECD countries (Figures 8.3).

Belgium, Finland, Israel, Luxembourg, Norway and Spain include the objectives but no MTEF while Italy includes a MTEF perspective but no medium-term objectives. Notwithstanding,

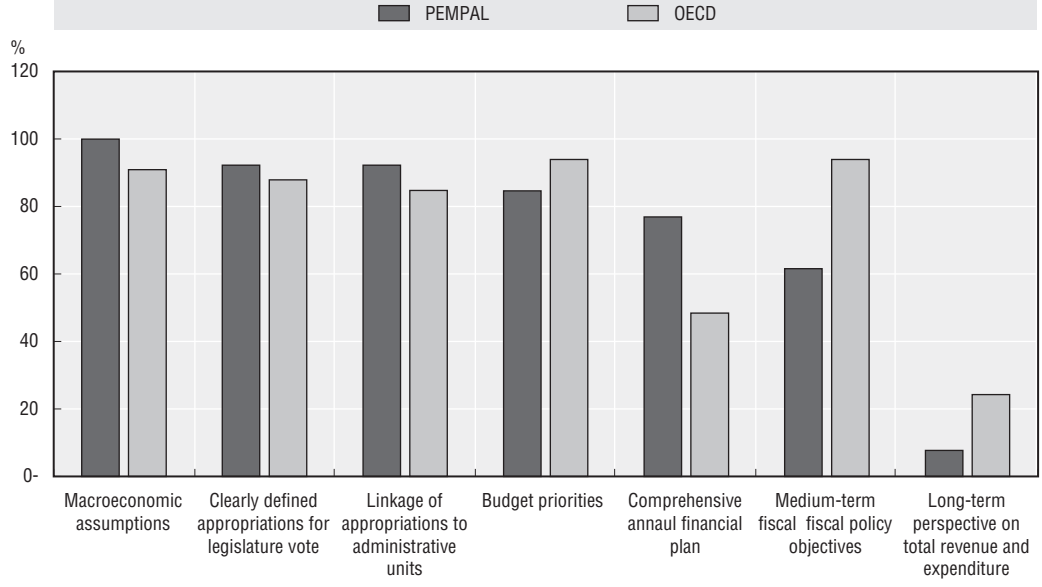
the percentage of OECD countries that include a MTEF perspective has increased by nine percentage points from 2007. Austria, Canada, Greece, Japan and the United Kingdom now report to include a medium-term perspective on total revenue and expenditure, while Belgium, Denmark and Norway report to have omitted the medium-term perspective in the budget (Figures 8.3).

Figure 8.3a. **Elements included in the budget document presented to the legislative (Q61)**



Note: Percentage of participating OECD countries (33 in 2012 and 33 in 2007).

Figure 8.3b. **Elements included in the budget document presented to the legislative (Q61)**



Other main changes from 2007 are seen in non-financial performance targets included in the budget document (increased from 48% to 73% of respondents) and in written text of policy legislation in the budget document (increased from 24% to 58%). Amongst OECD countries, 88% present clearly defined appropriations to be voted by the legislature, and with clear linkages between appropriations to government organisations (e.g. ministries and agencies).

For most PEMPAL countries, off-budget expenditures exist. Off-budget funds or extra-budgetary funds are defined by the OECD Glossary of Statistical Terms[32] as "sets of government transactions that are not included in the annual budget presentation. These may not be subject to the same level of scrutiny or accounting standards as the annual budget." Examples include social security, road and commodity funds. These funds can be financed through revenues earmarked for specific purposes or through foreign aid for example. They generally cover those transactions that are not legally appropriated as part of the Government's annual budget process. Extra-budgetary funds account for between 40%-45%[33] of central government expenditures worldwide (with two-thirds of those being social security funds). According to the OECD, there are benefits of extra-budgetary funds such as greater decision-making autonomy in countries that have effective and well-established financial management and governance systems in place. However, the costs of EBFs far outweigh any benefits, according to the IMF.[34] There are a total of 33 EBFs that exist in PEMPAL countries. Most common are social security funds and public health care funds which exist in 8 and 6 of the 13 countries, respectively. A range of other funds exist such as expenditures financed by funds that are fed by proceeds from natural extraction (e.g. oil and gas, etc.) which are used by Azerbaijan and Uzbekistan and expenditures made from donor funds and grants which are used by Belarus and Uzbekistan. Uzbekistan has the most off-budget funds with nine, followed by Belarus and Serbia with six. In some cases these funds do require some form of authorisation and are included in the budget documentation (for example, expenditures financed from the State Oil Fund of the Republic of Azerbaijan are approved by Presidential Decree). In Serbia, the social insurance funds and Health Insurance Funds collect mandatory social insurance contributions from citizens. The financial plans of these organisations are not included in the Government's budget and funds are transferred from the Government's budget to the Pension Fund if pension contributions are insufficient to cover pensions. The financial plans of these organisations are first adopted by their managing boards, after which the Government proposes to the National Parliament to approve the financial plans. Such funds operate in a similar way in Bosnia and Herzegovina with the largest funds being the pension funds at the Entity (Federation of Bosnia and Herzegovina and Republika Srpska) government levels. At the BiH Institutions (State) level – the only level covered by this Survey- the Parliament approves the budget and report on budget execution of the State Electricity Regulatory Commission, Agency for Air Navigation Services, and Public Broadcasting Service of BiH, but it is not consolidated with the budget and report on budget execution of BiH Institutions. These organisations are established by the Parliamentary Assembly of BiH, but operate as financially independent non-profit institutions, set up as legal entities. The Central Bank of BiH consolidates fiscal data on budgets and off-budget social protection funds at all levels of government in BiH.

Most OECD and PEMPAL countries identify expenditure items that are considered as contingent liabilities. From a transparency perspective it is also important that those elements are disclosed in the budget documentation submitted to the legislature and that the documentation is made publicly available. A majority of OECD countries or 84% and 85% of PEMPAL countries consider loan guarantees as contingent liabilities, of which about nine

Figure 8.4a. **Expenditure items considered as contingent liabilities (Q39)**

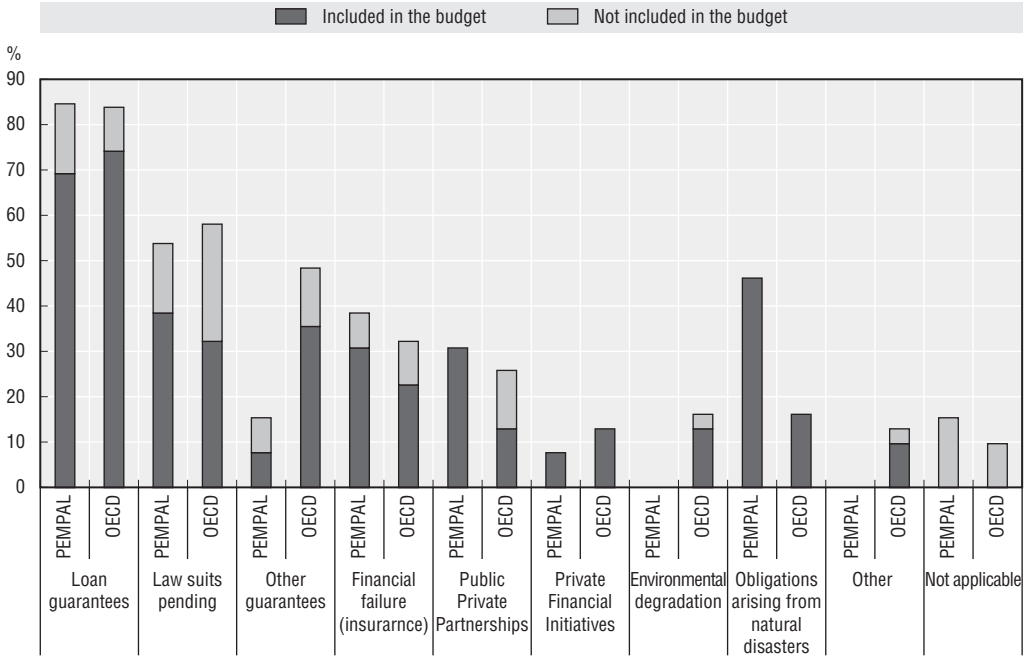
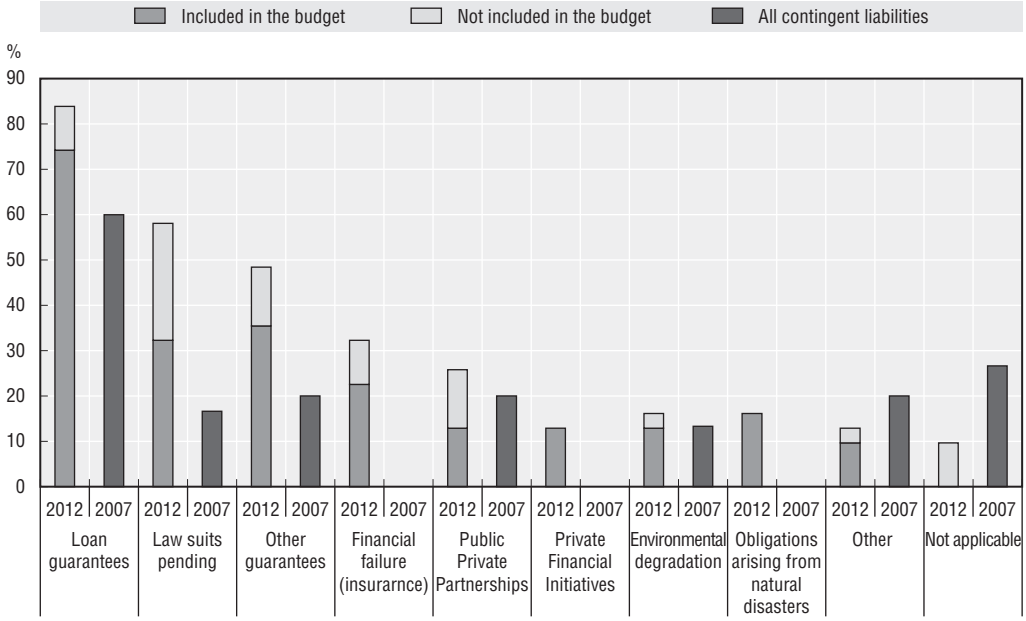


Figure 8.4b. **Expenditure items considered as contingent liabilities (Q39): OECD**



Note: Percentage of participating OECD countries (33 in 2012 and 33 in 2007). "Included in the budget" refers to items listed as a line item or otherwise included in the approved budget.

of ten OECD and 9 out of 11 PEMPAL countries include this item in the budget, either as a line item in budget documentation or otherwise. Over half or 58% of OECD countries and 54% of PEMPAL countries also identify law suits as contingent liabilities, of which about half is included in the budget documentation for OECD whereas five of the seven PEMPAL countries include the information in the budget documentation. Almost half of OECD countries

consider "Other guarantees" as contingent liabilities (compared to no PEMPAL countries), mostly included in the budget documentation. Only three OECD countries (Belgium, Ireland and Spain) report that contingent liabilities are not applicable, down from eight countries in 2007. Only two PEMPAL countries report that contingent liabilities are not applicable (Croatia, and the Russian Federation) although this is because the term is not defined in the public sector. However different elements of such liabilities are identified and included in the budget documentation, in the case of Croatia (Figures 8.4).

8.1.3. In-Year Reporting (Q.6k)

Periodic in-year reporting on budget execution and revision of budget estimates helps to detect and manage the impact of economic developments on the budget in a timely manner. This includes information on tax and non-tax revenues and spending on programmes and public services. Such reports identify any changes in the assumptions underlying the budget, as well as other relevant events that have transpired during the fiscal year. According to the OECD (2002) Best Practices for Budget Transparency, the economic assumptions underlying the budget should be reviewed and the impact of any changes on the budget disclosed at least every six months.

Three-quarters of the participating OECD countries and 85% of PEMPAL countries issue a consolidated mid-year report. Countries that do not issue such reports include Belgium, Finland, Germany, Israel, Japan, Korea, Portugal, and Spain in the OECD and Montenegro, and the Russian Federation in PEMPAL countries. This may be a small reduction for OECD countries from 2007 but the questions are not completely comparable over year. The 2007 data includes data on monthly reporting which may be less comprehensive than a mid-year report (Figures 8.5).

Figure 8.5a. **Existence of a consolidated central government mid-year report (Q6k)**

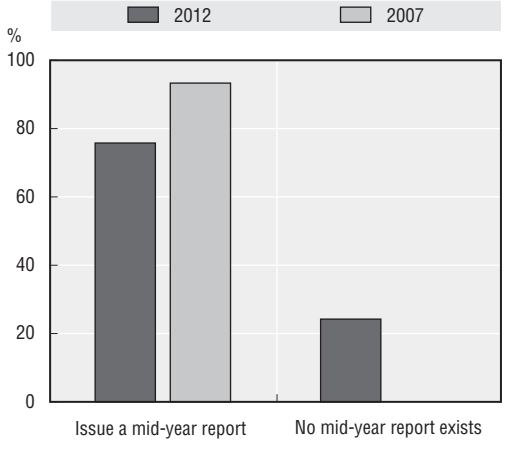
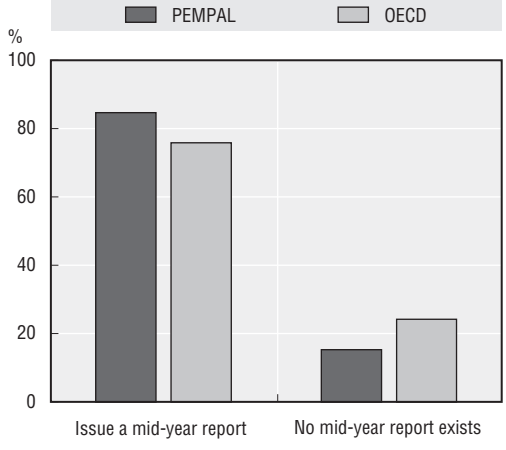


Figure 8.5b. **Existence of a consolidated central government mid-year report (Q6k)**



Note: Based on the number of participating OECD countries (33 in 20012 and 30 in 2007). 2007 data are drawn from the OECD Budget Practices and Procedures Database, Q.56, and include data for monthly, quarterly and bi-annually reporting.

8.1.4. Year-end report (Q.6o)

The year-end report is a government's key accountability document. The Best Practices recommend that it should be audited by the Supreme Audit Institution in accordance with generally accepted auditing practices, released within six months of the end of the fiscal

year, and scrutinised by parliament. All OECD member countries have an institution mandated with auditing government accounts; however, there is great variation within OECD and PEMPAL countries as to the time by which the audited annual report is disclosed after the end of the fiscal year (Figures 8.6). For example, while Mexico, the United States, Azerbaijan and Croatia produce an audited year-end report within three months of the end of the fiscal year, the Russian Federation, Montenegro, Germany, Greece, Portugal and United Kingdom's year-end reports are published 11-12 months after the end of the fiscal year. Spain published the audited report 16 months after the end of the fiscal year (six months after the audit institution receives the accounts). Chile and Korea note that publishing the audited accounts is not applicable as do Serbia and the Kyrgyz Republic. The OECD average of number of months after year-end that audited accounts are publicly disclosed has been reduced by a third of a month, to seven months after the end of the fiscal year. This compares with an average of 6.5 months for PEMPAL countries (Figures 8.6)

Figure 8.6a. **Number of months after year-end that audited accounts are publicly disclosed (Q60): OECD**

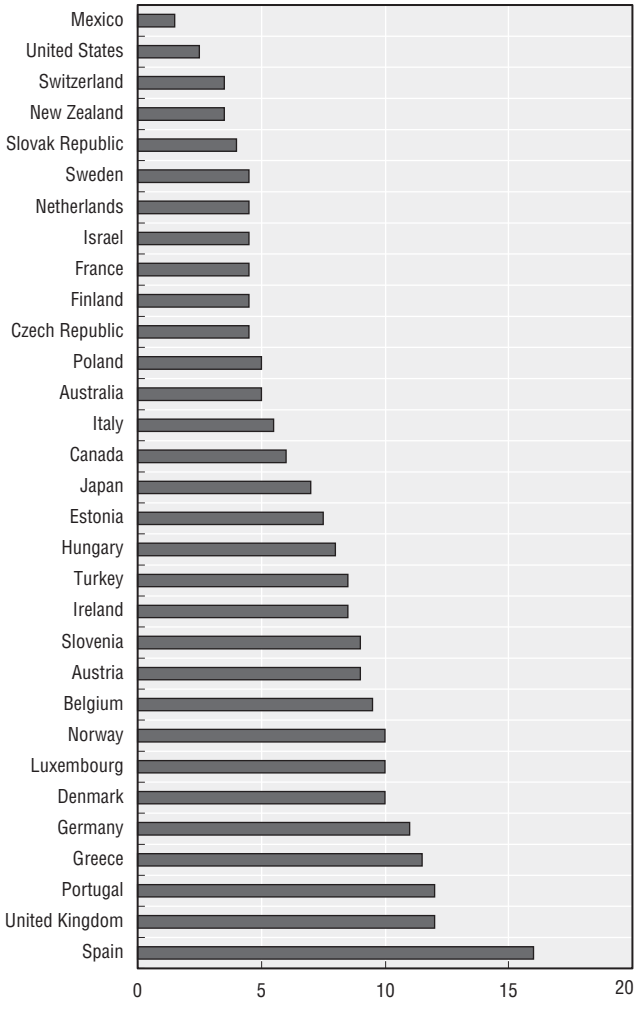


Figure 8.6b. **Number of months after year-end that audited accounts are publicly disclosed (Q60): PEMPAL**

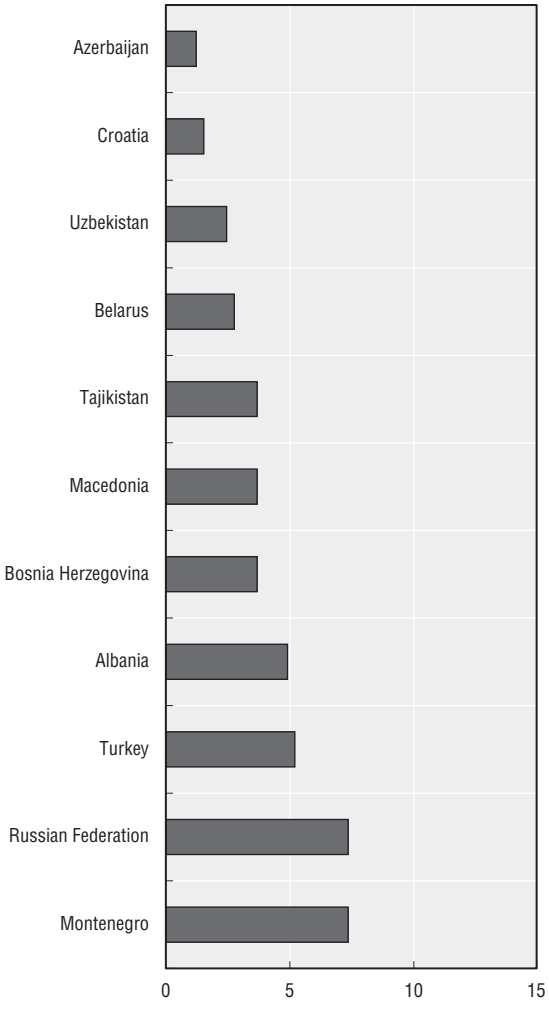
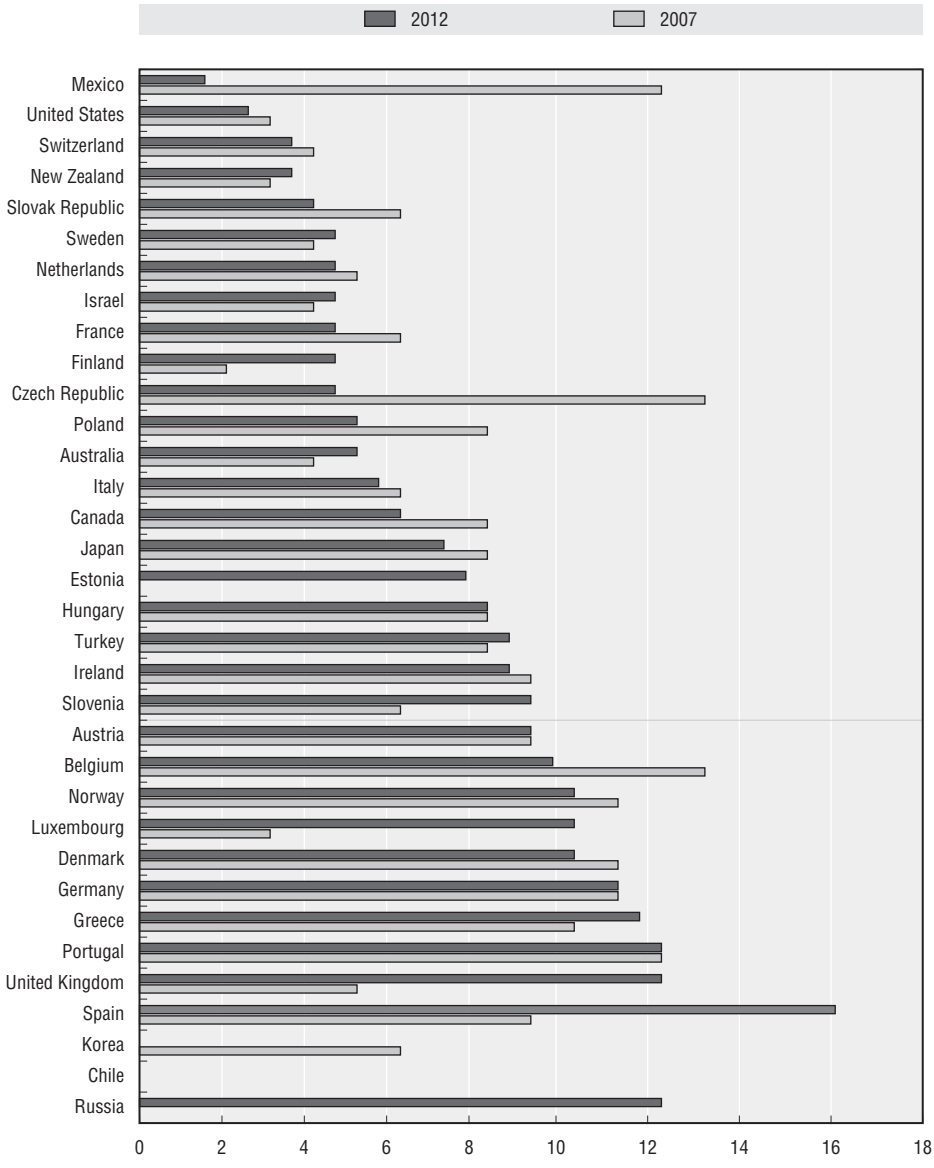


Figure 8.6c. **Number of months after year-end that audited accounts are publicly disclosed (Q60)**



Note: Data is not available for Chile and Korea.

9. Ensuring an effective role for the Legislature (Q.6, 60, 64-67)

Although conventional wisdom is that a strong role for Parliament equates an undermining of fiscal discipline, the experience in OECD member countries simply does not show that to be the case. The OECD strongly believes that an effective role for the legislature is a key ingredient in establishing and maintaining fiscal discipline, while providing a necessary link with civil society and fostering accountability by the executive (Blöndal, 2002).

Legislatures are constitutionally mandated to hold governments to account. Nowhere is this more important than the budget process. Indeed the evolution of legislative "power of the purse" dates back to medieval times. Today's legislatures scrutinise and authorise revenues and expenditures and ensure that the national budget is properly implemented.

This is done through a variety of means, including committee review, plenary debates, and parliamentary questions and interpellations. It is worth noting that the general trend in OECD countries in terms of committee structures for reviewing the budget appears to be a dominant Budget/Finance Committee responsible for budget review which co-ordinates varying levels of input from sectoral committees. Ideally a strong Budget/Finance Committee promotes co-ordination and consistency in legislative budget action and facilitates fiscal discipline, while involving sectoral committees allows the legislature to draw on their specific expertise (Posner and Park, 2007; Schick, 2002).

9.1. Amendment powers (64-66)

There is nevertheless great variation in legislative influence over the budget in OECD and PEMPAL countries, as demonstrated by a legislature's amendment powers. At one end of the spectrum, the legislature in the United States has the power to rewrite the government's proposed budget, at the other end are legislatures such as Greece or Ireland that can only approve or reject the budget. In Australia the legislature can only make amendments on new policies.

The legislature's formal amendment powers may be defined as unrestricted, restricted or prohibited.

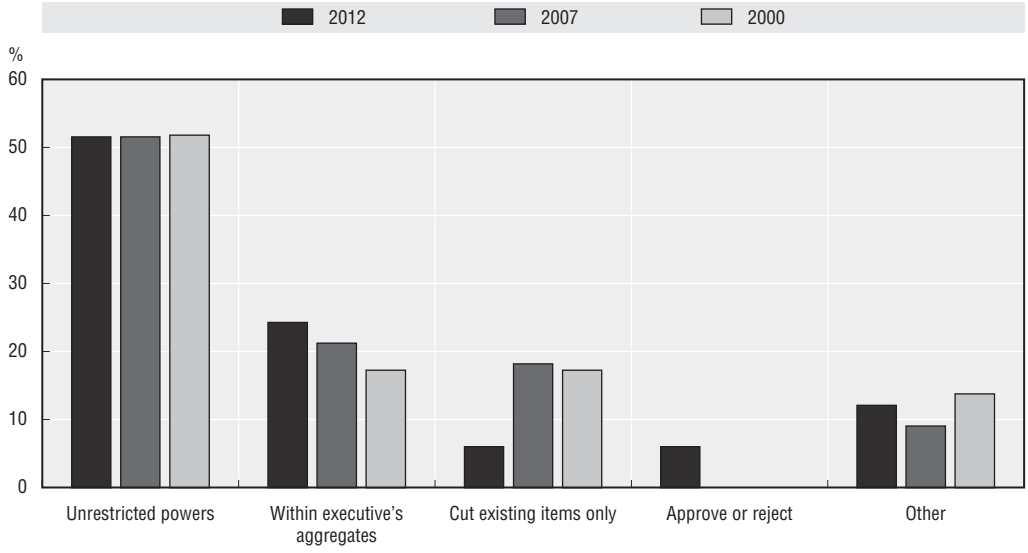
- **Unrestricted:** The legislature may increase or decrease the level of revenues and/or expenditures without the consent of the executive.
- **Restricted:** The legislature is only able to make budget amendments insofar as the budget balance (surplus or deficit) of the executive's budget proposal is unchanged; or, alternatively, the legislature may only amend downwards any aggregates, often requiring overall reductions in expenditure.
- **Prohibited:** The legislature may not make any amendments to the executive's budget proposal, and must either approve or reject the budget in its entirety (Wehner, 2006).

It is important to distinguish between formal powers of amendment, such as those outlined in primary and secondary law, and actual practice, reflecting customs and conventions. While legislatures may have formal legal powers to amend the government's draft budget, their actual use may be curbed for reasons including fiscal rules and mandatory spending. Consultation and bargaining during the budget formulation stage may also reduce the size of the legislature's actual amendments during the approval stage. And some countries, particularly those with Westminster based systems, are effectively restrained from using amendment powers as votes on the budget are considered as a vote of no confidence in the government (Figures 9.1).

The percentage of OECD countries where the legislature holds unrestricted amendment power has stood still at 52% since 2000, slightly below that of PEMPAL countries at 54%. Those PEMPAL countries where the legislature holds such unrestricted amendment powers include Azerbaijan, Belarus, Bosnia and Herzegovina, Kyrgyz Republic, Montenegro, and Uzbekistan. Some of these legislatures made changes in the last budget ranging from under 1% to 3.2% of the total budget. For OECD countries, the percentage of countries that can amend the budget within executive's aggregates has slightly increased to 24% (compared to 38% of PEMPAL countries). The remaining OECD countries are either allowed to cut existing items only (Chile, United Kingdom), approve or reject the budget (Greece and Ireland) or other practices. Examples of practices from PEMPAL countries include Albania, Croatia, Macedonia, Serbia and Tajikistan, where the legislature may make amendments within the budgetary

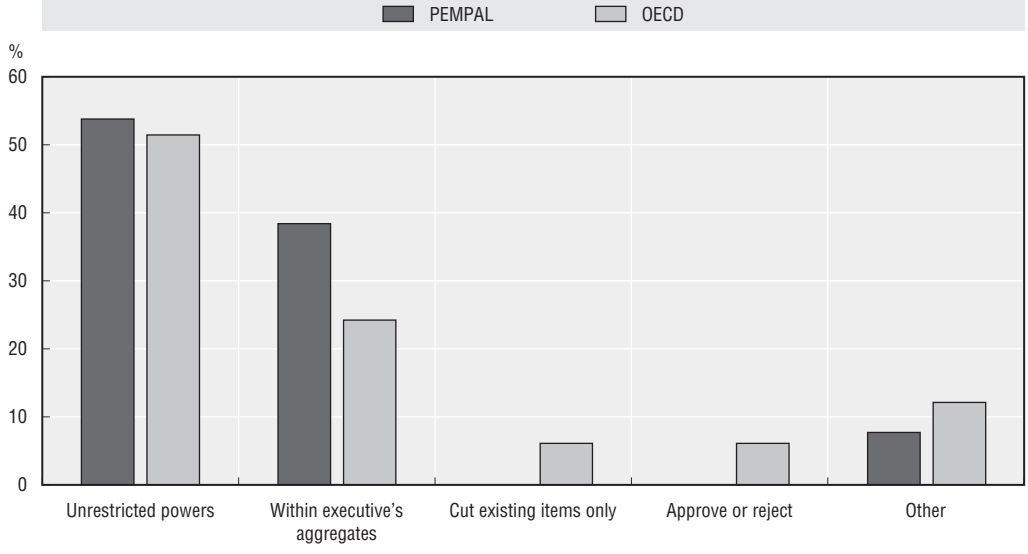
framework i.e. the overall surplus/deficit proposed by the executive cannot be changed. For the Russian Federation, the Legislature may make amendments within the budgetary framework but total expenditures and surplus/deficit can be changed only after Government approval. In Turkey, in the Budget and Planning Committee, any change in the budget is possible but in plenary session, with the Legislature having no right to increase expenditures or decrease revenues. In Australia the legislature has only amendment power on new policies. In Canada and Korea the legislature are allowed to amend the budget provided the executive's approval. In France the legislature can only reallocate within the total budget, the legislature can neither diminish the resources nor aggravate the balance (Figures 9.1).

Figure 9.1a. **Legislative amendment power (Q64)**



Note: Percentage of participating OECD countries (33 in 2012, 33 in 2007 and 29 in 2000).

Figure 9.1b. **Legislative amendment power (Q64)**



Note: Percentage of participating 13 PEMPAL and 33 OECD countries

Figure 9.2a. **Is a vote on the budget a vote of confidence in the Government? (Q66)**

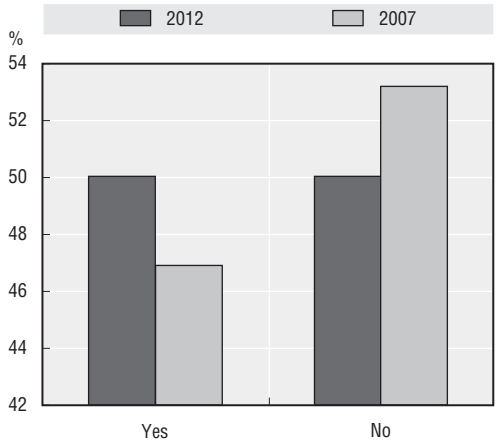
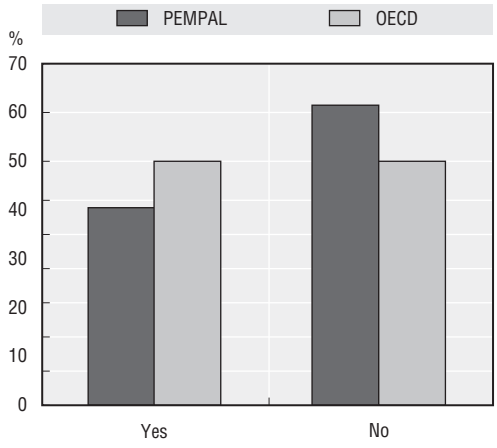


Figure 9.2b. **Is a vote on the budget a vote of confidence in the Government? (Q66)**



Notes: Percentage of responding OECD countries (32 in 2012 and 32 in 2007). Israel did not answer the question in 2012; Percentage of participating 13 PEMPAL and 33 OECD countries.

9.2. Time available for legislative debate (Q.6h+i)

The effectiveness of a given legislature in the budget process is also influenced by the time available for legislative debate and the level of resources that the legislature has at its disposal. It should be emphasised that the presentation of the budget and related documentation in the legislature is normally the first opportunity for public scrutiny of the government's spending priorities and legislative debate in both the plenary and committees facilitates public participation in the budget process.

Legislatures and their committees require an adequate amount of time to reflect upon and debate budget documentation prior to approval. This is particularly important in order to ensure that legislative committees (which exist in all OECD and PEMPAL legislatures and which provide the most in-depth scrutiny of the budget) have sufficient time to review, debate, and propose amendments. The OECD (2002) Best Practices on Budget Transparency recommend that the executive's draft budget should be submitted far enough in advance to allow for its proper review by the legislature. This should be no less than three months prior to the start of the fiscal year and the budget should be approved by the legislature prior to the start of the fiscal year.

In 61% of the OECD countries and only 38% of PEMPAL countries, the budget is presented to the legislature at least three months before the start of the fiscal year, and the vast majority of OECD countries also approve the budget prior to the start of the fiscal year. For OECD countries, legislative debate on the budget ranges from one month in Greece, Portugal and United Kingdom to four months in Canada, Denmark, Germany and Poland and eight months in the United States. The range is not so wide for PEMPAL countries with the Russian Federation and Montenegro allowing only 1 month, Bosnia and Herzegovina 2 months, Azerbaijan, Belarus, Turkey and Uzbekistan, 2.5 months, Kyrgyz Republic 3 months and Tajikistan allowing the maximum of all the countries at 3.5 months. In comparison, in a little less than half of OECD countries the legislature has at least three months to debate the budget, in 14 countries it has two months and in three it has only one month (Figures 9.3 and 9.4).

Figure 9.3a. **Time table for presentation of budget and legislative debate, percentage of OECD countries (Q6h+i)**

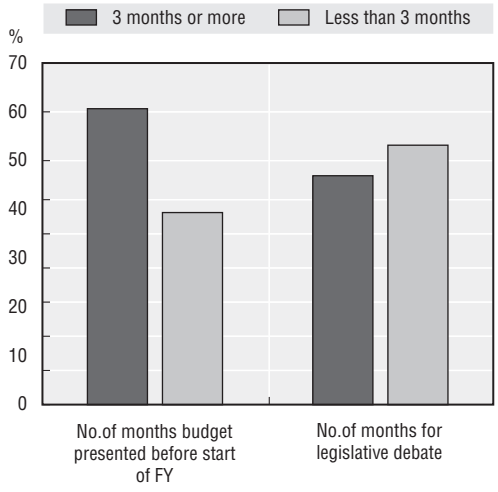
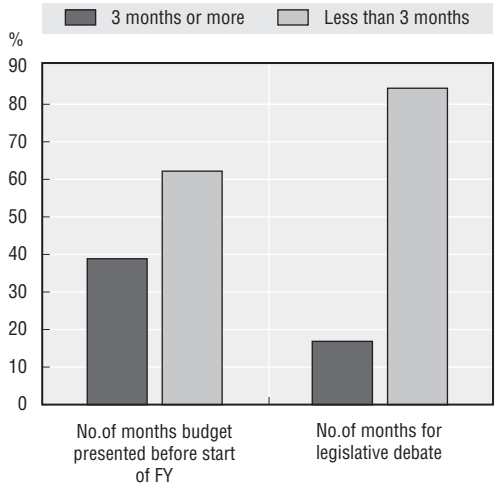


Figure 9.3b. **Time table for presentation of budget and legislative debate, percentage of PEMPAL countries (Q6h+i)**



9.3. Reversionary budgets (Q.67)

There is always a risk of a budget not being approved in advance of the start of the new fiscal year. For this reason rules regarding a reversionary budget are established in many countries. However, the details of the reversionary budget reflect more than just actions taken to safeguard the execution of public services. The provisional measures and the cost of non-approval and compromise provide insight into the balance of budget powers between the executive and legislature.

Provisional measures may be considered favourable to the executive if they validate its current budget proposal. Validation may be in the form of the executive's draft budget taking effect either in full or in part. Conversely, they may be considered favourable to the legislature if contingency measures require the executive to negotiate provisional measures with the legislature or prohibit unauthorised spending altogether. Provisional measures may be said to be impartial if the approved budget from the previous year is adopted for a specified period of time to enable negotiations between the executive and legislature to continue.

Despite the diversity among methods, all OECD and PEMPAL countries have mechanisms in place to deal with the possibility of delays to the approval of the budget with last year's budget taking effect on an interim basis as the most common in both country groupings. In 12% of the OECD countries, the provisional budget rules are described by the CBA as favouring the executive and encouraging restraint of the legislature budget amendment powers. For example, in Chile, Finland and Poland, the executive's budget proposal takes effect in full if the legislature does not approve the budget before the start of the fiscal year. In New Zealand, the executive's proposal comes into effect only on an interim basis, positioning the legislature to compromise on an outcome in accordance with the executive's preferences. Similarly in the Kyrgyz Republic the executive's proposal takes effect in the interim period.

At the other end of the spectrum, the reversionary budget arrangements in 21% of the OECD countries[35] may be considered to favour the legislature, compared to only 8% of

PEMPAL countries. In Ireland, Mexico and Switzerland, spending is prohibited altogether until the budget is passed. In Canada, Japan, Norway and the United States the legislature will vote other interim measures. Four countries are grouped under "Other": In Australia, 75-80% of the Budget has ongoing legislative approval and will continue; the remainder that does not have approval will cease. Also in Italy (and Croatia) the government shuts down and an emergency budget applies until (interim) agreement is reached. In Hungary, if the Parliament has not adopted the budget before the start of the fiscal year, the government is authorised to collect the revenues determined in the relevant legislation and, within the framework of the appropriations set out in the approved budget for the previous year, make the expenditures as commensurate. In Sweden, if the Legislature hasn't decided about an appropriation on interim basis, then the last budget remains in force (Figure 8.11).

Figure 9.4b. **Time available for legislative debate of the government's budget proposal (Q6h+i): OECD**

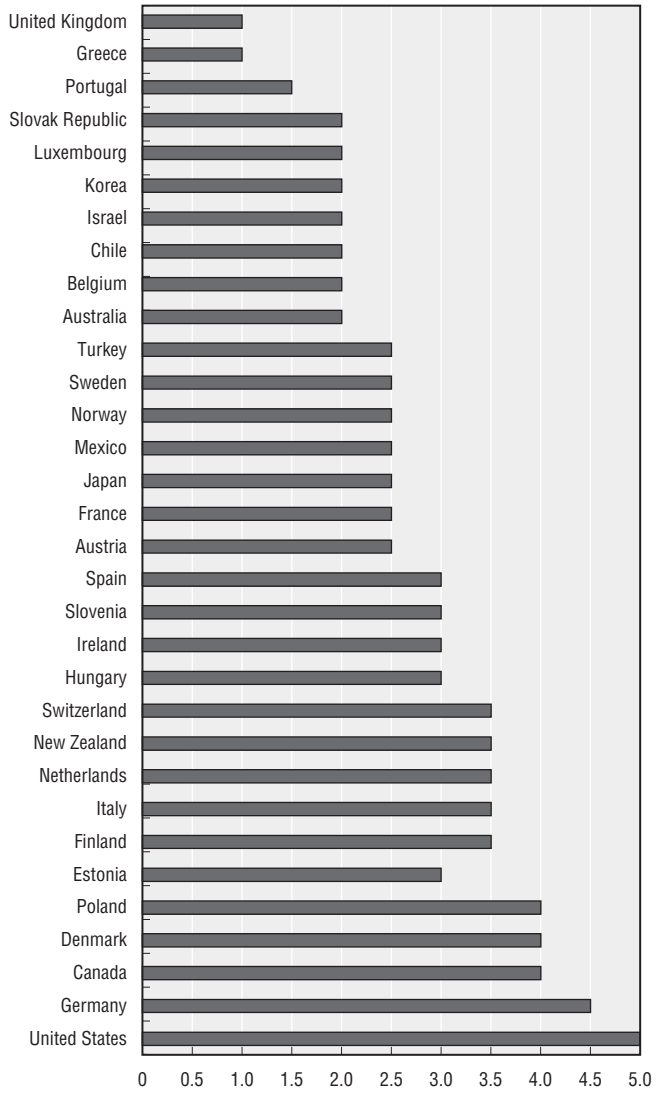


Figure 9.4c. **Time available for legislative debate of the government's budget proposal (Q6h+i): PEMPAL**

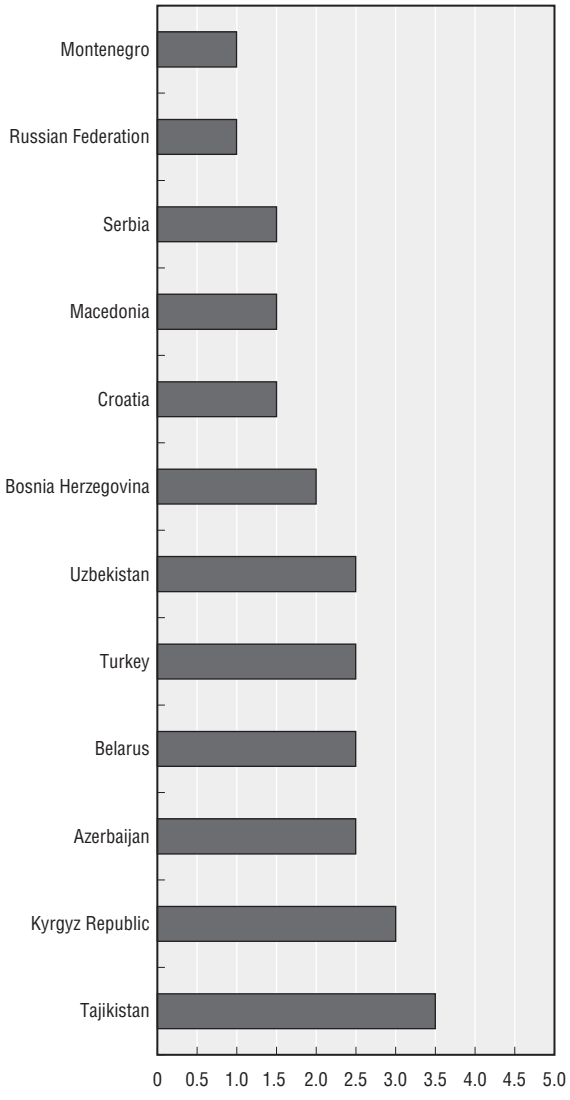
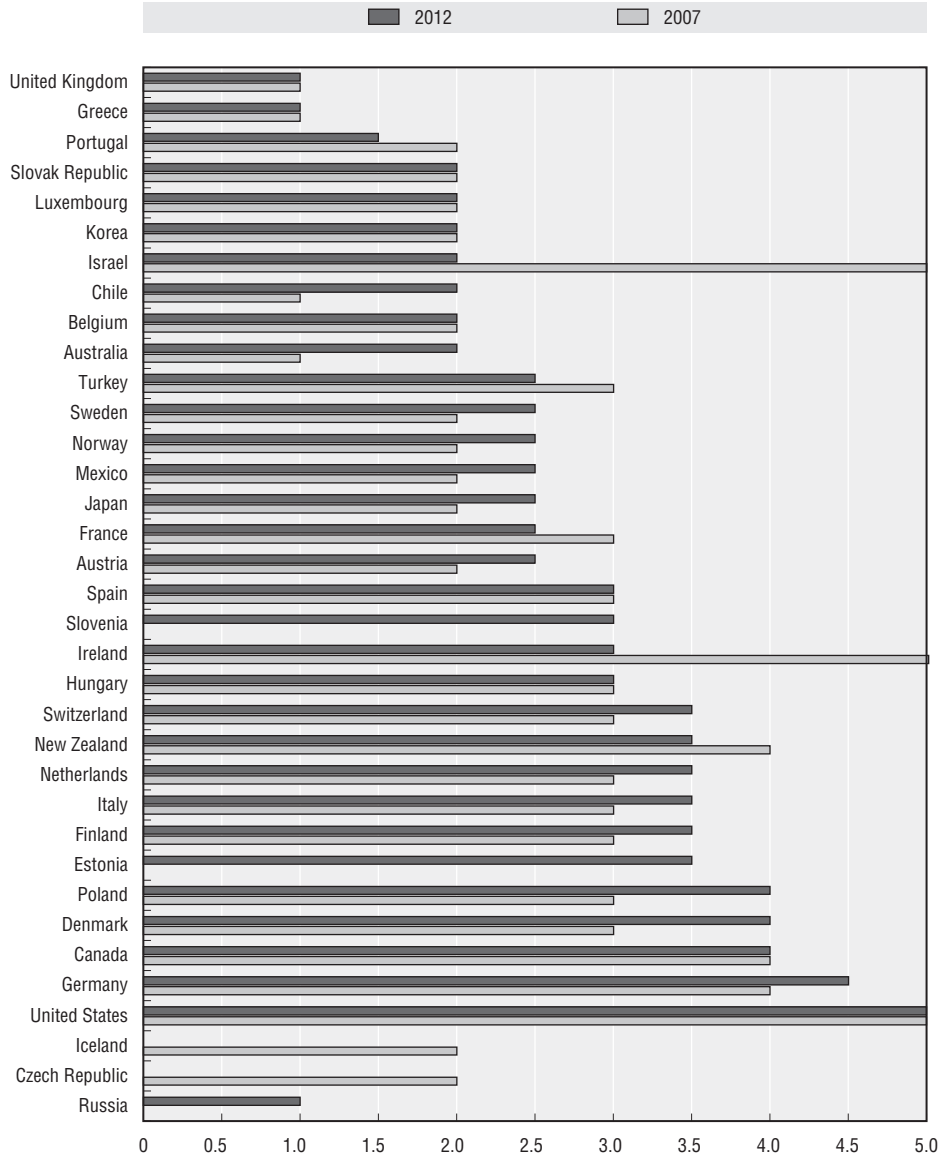


Figure 9.4a. **Time available for legislative debate of the government's budget proposal (Q6h+i)**



Notes:

1. Czech Republic does not have a law based date for when the Legislature must approve the budget. Iceland did not provide a response to the survey in 2012.
2. USA allows eight months for legislative debate before the start of the fiscal year.

9.4. Analytical capacity (Q.60)

To meaningfully engage in the budget process rather than simply serving as a rubber stamp, legislatures require reliable, unbiased information as well as strong analytical capacity. Strengthening research capacity, hiring adequate committee staff, and allowing committees to consult or employ experts all serve to enhance legislative effectiveness and redress the capacity imbalance between the legislature and the executive. Most parliaments in OECD countries have access to several sources of technical capacity for budget analysis. Committee staff is perhaps the most commonly available resource; however, the number of

Figure 9.5a. **Consequences if the budget is not adopted before the start of the fiscal year (Q67)**

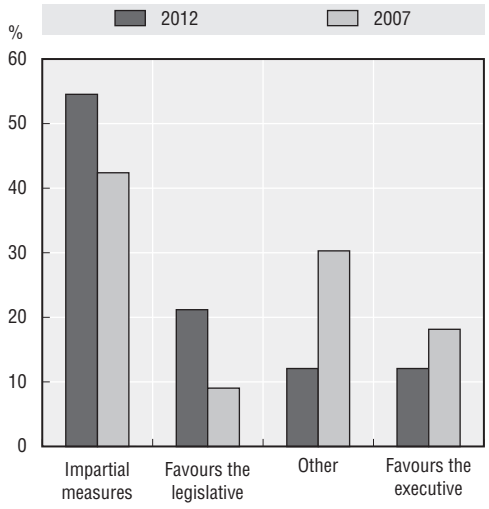
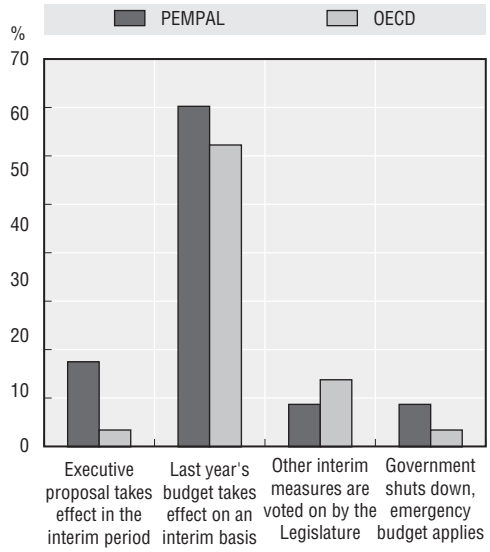


Figure 9.5b. **Consequences if the budget is not adopted before the start of the fiscal year (Q67)**



staff available to assist the Budget/Finance Committee in undertaking specialised analysis of the budget and related matters varies widely.

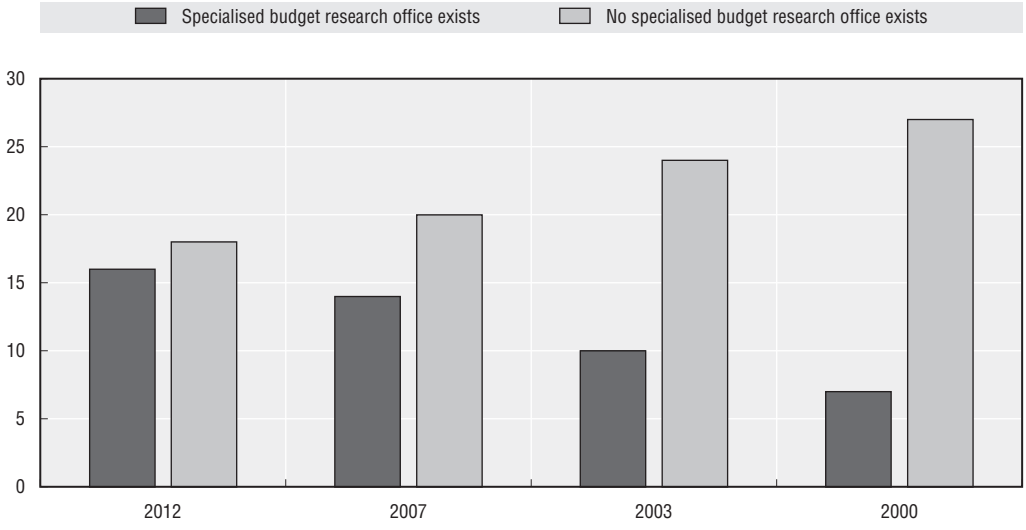
There is a trend in OECD countries to establish specialised units that assist legislatures with budget-related research and analysis. In some cases, these units are located within parliament, often as part of parliament's research services. In others, they are independent. Examples of the former include the Scrutiny Unit in the United Kingdom Parliament, the Budgetary Control Department in the Research and Information Center in the Israeli Knesset, and the Department of Social and Economic Research in the Bureau of Research in the Chancellery of the Polish Sejm. Some larger legislatures, such as the French Parliament, maintain a large unit to assist the finance committee on work on the public finances. Examples of independent bodies are the United States Congressional Budget Office (CBO), the Korean National Assembly Budget Office (NABO), and the Netherlands Bureau for Economic Policy Analysis (CPB). The status of the Canadian Parliamentary Budget Officer (PBO) lies somewhere in-between; although legislation established the PBO with an independent mandate, it is affiliated with the Library of Parliament.

In the past decade, the number of specialised budgetary research units has more than doubled, and in some cases their size has increased. In 2000, only seven OECD legislatures had specialised budget research offices. This number increased to ten in 2003 and 14 in 2007. In 2010-12, several new bodies have been established in countries such as Australia, Austria, and Greece. Furthermore, the parliamentary institutions of some countries are in the process of establishing or developing a specialised budgetary research unit, such as Ireland and Spain. It should be noted that typically the work programme of both internally and externally based units is decided with the input of the Budget/Finance Committee. Moreover, while such units may serve other committees and individual Members, as well as undertake analyses on their own initiative, the Budget/Finance Committee's requests typically take priority. Across the OECD, these bodies differ in terms of size, constituents and core functions, but all help to simplify the complexity of the budget, eliminate the executive's monopoly of information in the budget process, and improve the budget's credibility and

accountability. Key tasks, for example, may include analysis of the executive's budget proposal or the estimates, costing of legislation, and economic forecasting.

In contrast, such specialised budget research offices are not common in PEMPAL countries, with only three countries having them (Azerbaijan, Kyrgyz Republic, and the Russian Federation) (Figures 9.6).

Figure 9.6a. **Existence of a specialised budget research office attached to the legislature (Q60)**

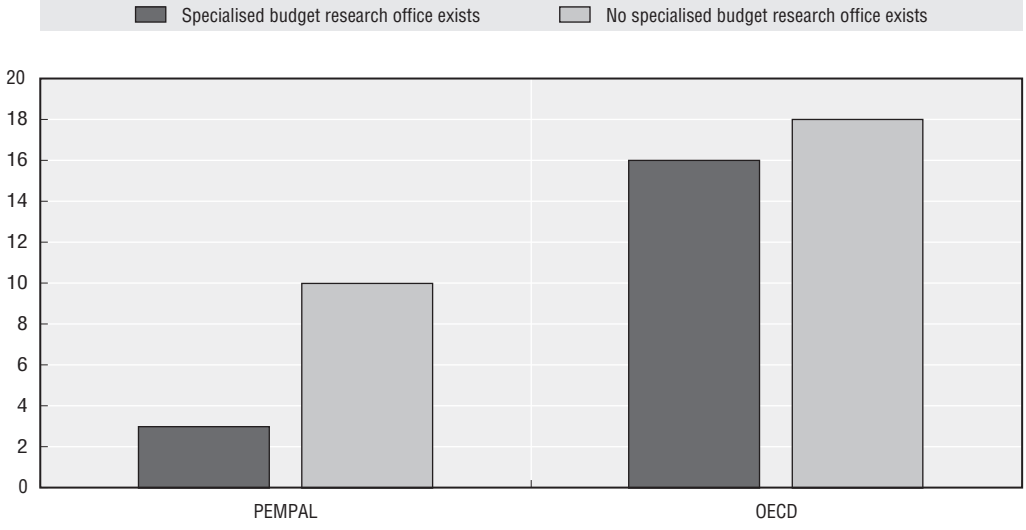


Notes:

1. Since 2007, Australia, Austria, France and Greece have established a legislative budget research office. On the other hand, Chile and UK previously reported such offices but responded no such office in the 2012 OECD Budget Survey.
2. All OECD members (34 countries) are included for all the years displayed. Data for Iceland are from 2007. Estonia and Slovenia are registered in 2000-2007 as not having such office, like in 2012.

Source: OECD (2000, 2003, 2007, 2012), *OECD International Budget Practices and Procedures Database* and other research, *www.oecd.org/gove/budget/database*.

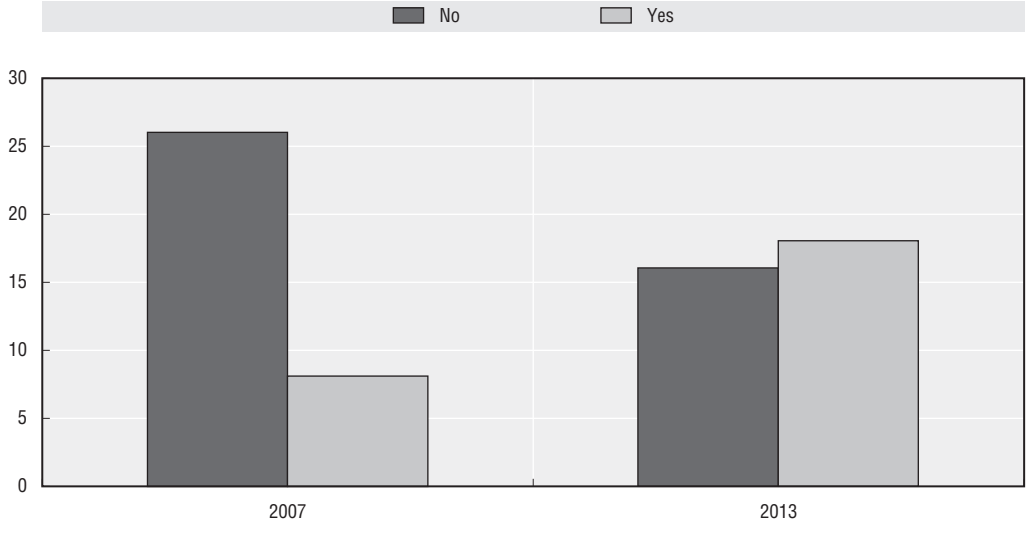
Figure 9.6b. **Existence of a specialised budget research office attached to the legislature (Q60)**



9.5. *Independent Fiscal Institutions (IFIs)*[36]

There is a clear trend within OECD countries to establish independent fiscal institutions (typically referred to as fiscal councils or parliamentary budget offices), as one means of enhancing independent oversight and accountability in regard to the fiscal performance of the executive, and/or to improve the credibility of budgetary forecasts. In the mid-1990s academic economists floated the idea that countries could adapt some of the good experiences of independent central banking to the fiscal sphere. But it was the surge of government deficits and debts following the recent crisis that gave impetus to many of the new fiscal councils, with governments seeking to reinforce fiscal rules that had proved inadequate on their own to ensure prudent management of the public finances, and to signal their commitment to act virtuously after the crisis. This is particularly true in the euro area where new regulations require member states to base their draft budgets on independent macroeconomic forecasts and to have independent bodies monitor compliance with national fiscal rules. Other recent examples, (Canada, Australia) were established to increase fiscal transparency and enhance the role of the legislature in the budget process. In addition to this "new generation" are a handful of much older institutions, such as the Congressional Budget Office (CBO) in the United States, the Belgian High Council of Finance, and the Netherlands Bureau for Economic Policy Analysis (CPB). As of 2013, most OECD countries (18) have established or are establishing an independent fiscal institution, up from eight in 2007 and 16 in 2012 (Figure 9.7). According to the IMF database,[37] out of the 21 PEMPAL member countries, the following have IFIs: Croatia, Romania, Serbia, and Georgia. Bosnia and Herzegovina also has a fiscal council. Azerbaijan, Kyrgyz Republic and Russia indicated they have a specialised budget research office or unit attached to the legislature which conducts analyses of the budget.

Figure 9.7. **Countries with independent fiscal institutions**



The role and structure of these bodies varies considerably across countries. Some are under the statutory authority of the executive, while a smaller number are under the legislature. The CBO has the largest budget at USD 45 million and a staff of around 250, while the Irish Fiscal Advisory Council operates for under a million euros with three secretariat

staff (Figures 9.7-9.8). Three institutions have budgets with multi-annual funding commitments, a practice which can enhance independence and help insulate the institution from political pressure (Australia, Netherlands, and United Kingdom). As described earlier in this paper, some (the Netherlands CPB, United Kingdom's Office for Budget Responsibility) have been tasked with producing the official forecasts. Others produce alternative forecasts (United States and Canada); while others provide an opinion on the government's forecasts (France) and still others (Australia) have no forecasting role at all. Apart from a role forecasting, typical tasks include analysis of the executive's budget proposals; monitoring compliance with fiscal rules or official targets; costing of legislative proposals; and analytical studies on selected issues. Both the Netherlands CPB and the Australian Parliamentary Budget Officer (PBO) are also tasked with costing election platforms.

Figure 9.8a. **Independent fiscal institutions – number of staff**

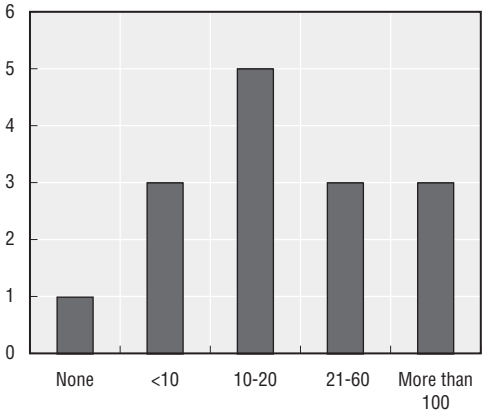
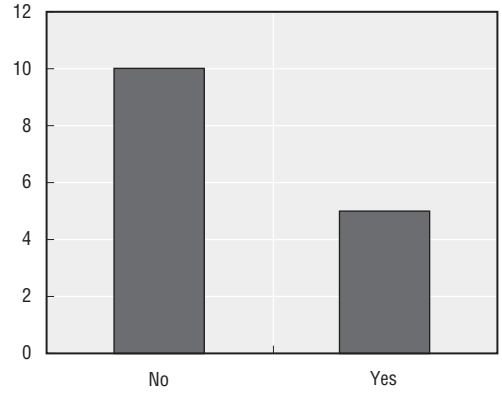


Figure 9.8b. **Independent fiscal institution has staff that are seconded from another institution**



A fiscal council's independence – real and perceived – is critical to its success. Independence is underpinned by a clear legal framework.[38] The OECD's "Principles for Independent Fiscal Institutions" identify several factors that can enhance independence, such as:

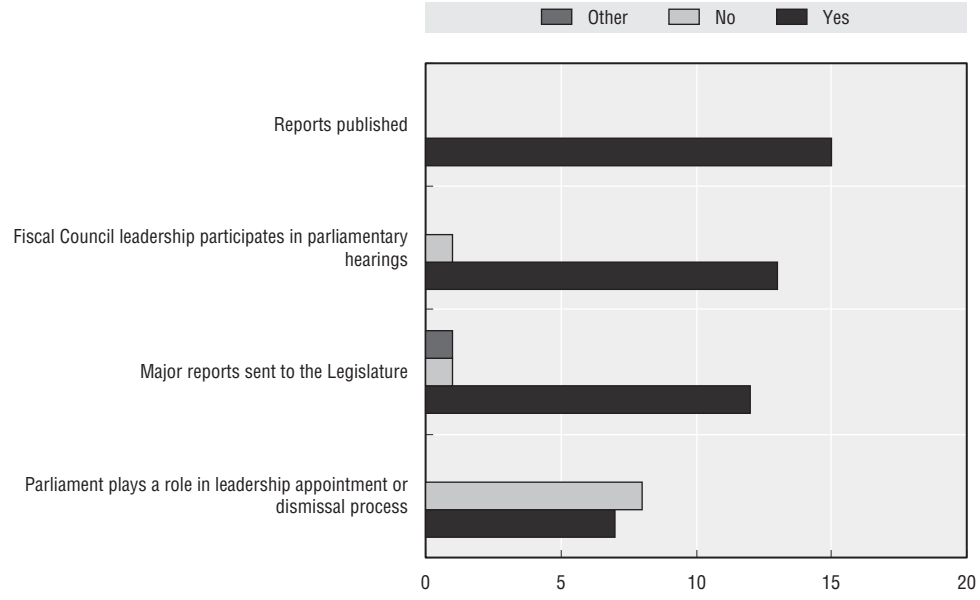
- leadership appointments made on the basis of merit and technical competence, clearly defined term lengths (preferably independent of the electoral cycle), clearly defined criteria and process for dismissal, and control over the hiring process for staff;
- ability to set their own work programme within their mandate with the scope to produce reports and analysis at their own initiative;
- a separate budget line and multiannual funding commitments;
- guarantee of access to information in legislation (if necessary reaffirmed through protocols or memoranda of understanding); and
- full transparency in their work and operations.

This last relates to the intrinsic goal of fiscal councils to bring transparency to fiscal policy and allows them to build credibility with the public. Fiscal councils' influence in fiscal policy making is persuasive – rather than coercive by means of legal sanctions or other punitive measures. Their influence is largely exercised through contributions to the public debate – thus fostering informed constituencies that may then exercise timely

pressure on the government to behave transparently and responsibly in fiscal matters. This underlines both the importance of fiscal councils' maintaining a transparent publishing model and the importance of their relationship with the legislature and the media as concrete avenues of influence. All of the fiscal councils in OECD countries publish their reports making them available to the legislature, media, other stakeholders and the general public.[39] Typically they also hold press conferences or send press releases around the release of major reports. Larger institutions typically have a designated press or communications officer who can help manage relationships with journalists, channel media questions, and ensure accuracy in reporting. Some monitor media coverage (US, Korea) and the Office of the Canadian Parliamentary Budget Officer has offered trainings for members of the media on how to understand and use the PBO's reports and databases.

Legislatures are constitutionally mandated with approving the budget and holding governments to account. Legislative discussions on the budget (which should include fiscal policy objectives, the macroeconomic framework and the policy basis for the budget, and major fiscal risks) provide a unique opportunity to consider fiscal councils' analysis – discussions which may in turn be reported on in the media. The vast majority of fiscal councils send reports to parliament and/or testify before relevant parliamentary committees, even when there is no formal requirement to do so (Figure 9.9). While those fiscal councils that are under the statutory of the legislature naturally have the most frequent contact with legislative committees, other examples of fiscal councils making a targeted effort to contribute to the legislative debate abound. The UK's Office for Budget Responsibility provides evidence to Parliament through committee hearings and answers parliamentary questions, which are also published on the OBR website. As part of a PEMPAL study visit to UK in 2013, several member countries met with the Office for Budget Responsibility and the presentation is available at *www.pempal.org/data/upload/files/2013/05/jon-riley_office-for-budget-responsibility.pdf* The Irish Fiscal Advisory Council appears before the Joint Oireachtas Committee for Finance, Public Expenditure and Reform and

Figure 9.9. **Independent fiscal institutions – relationship with the legislature**



publishes transcripts of these appearances on the Council's website. The Swedish Fiscal Policy Council participates in a public hearing held by the Riksdag's Finance Committee, which uses the FPC's report as a basis for its evaluation of the Government's policy.

Notes

1. PEMPAL is a regional initiative to help countries strengthen their capacities to implement public financial management (PFM) reforms. The initiative was launched in 2006, and is being supported by the World Bank, the Russian Federation and State Secretariat for Economic Affairs of the Swiss Government (SECO). PEMPAL creates networks of high level PFM practitioners who meet regularly in workshops, study visits and meetings to discuss common reform issues. There are 22 county members in IACOP and 21 in TCOP and BCOP. Refer to *www.pempal.org* for more information.
2. Each political/administrative tier in Bosnia and Herzegovina is responsible for the adoption and implementation of its own budget. Based on OECD advice, this survey response from BiH covers only the central state level only (BiH Institutions). Entity budgets of the Federation and the Republic of Srpska; the budget of Brcko District; budgets of cantons; and budgets of local governments are not included. The BiH Institutions account for approximately 1/12 of public revenues of all government levels, while the majority of fiscal operations (including administration of all direct taxes and extra-budgetary funds) are at the Entity level. Thus the results of the Survey would differ if different Government levels were included for Bosnia and Herzegovina.
3. Except Bosnia and Herzegovina, who has the Directorate of Economic Planning, an independent body of the BiH Council and also the Department for Macroeconomic Analysis which is under the Indirect Taxation Authority, and Albania where it is undertaken by the Prime Minister's office.
4. Although the State level in BiH (which is the only level covered by this Survey, as explained above) does not have fiscal rules, the Entity levels do (debt rule in Republika Srpska and budget balance rule in Federation of Bosnia and Herzegovina).
5. Noting Turkey has been included in both analyses as a member of both PEMPAL and OECD.
6. The statistical data for Israel are supplied by and under the responsibility of the relevant Israeli authorities. The use of such data by the OECD is without prejudice to the status of the Golan Heights, East Jerusalem and Israeli settlements in the West Bank under the terms of international law.
7. In Bosnia and Herzegovina, Presidency of BiH has a role in budget adoption only for the State-level budget, while in the Entities, allocation disputes are resolved by the Cabinets.
8. Refer to *www.pempal.org/event/view/treasury/1/*.
9. In the Entities of Bosnia and Herzegovina, time span varies, with only one month being allows for legislative debate in Republika Srpska, for example.
10. Source: IMF, 2013, the Functions and Impact of Fiscal Councils, July 2013 *www.imf.org/external/np/pp/eng/2013/071613.pdf*.
11. This World Bank classification of countries includes 30 in total, of which 21 are members of PEMPAL BCOP.
12. At Entity level, Finance Ministries prepare separate projections for the Entity-level revenues.
13. For example Azerbaijan does sensitivity analysis in regards to possible different levels of natural resource revenues; or different levels of wages and salary; and their impact on the economy when analyzing different policy scenarios.
14. A variation of a balance rule is the "Golden Rule" in which the government is only allowed to borrow to finance investments. The rationale underlying the golden rule is that investments represent future, and not current, consumption and have the potential to generate future growth. Critics of the golden rule hold that it is a private sector concept not immediately applicable to the public sector.
15. The database can be accessed at *www.imf.org/external/datamapper/FiscalRules/map/map.htm*.
16. Although the State level in BiH (which is the only level covered by this Survey, as explained above) does not have fiscal rules, the Entity levels do (debt rule in Republika Srpska and budget balance rule in Federation of Bosnia and Herzegovina).
17. Noting Turkey has been included in both analyses as a member of both PEMPAL and OECD.

18. Kyrgyz Republic entered into a three year Extended Credit Facility on June 20, 2011 with IMF for USD 102.3 million. *Source: www.imf.org/external/np/country/notes/kyrgyzrep.htm*. KR advises that the budget deficit is capped at 5 per cent of GDP in the short term.
19. In Bosnia and Herzegovina, Presidency of BiH has a role in budget adoption only for the State-level budget, while in the Entities, allocation disputes are resolved by the Cabinets.
20. Capital expenditures refer to the purchases of fixed assets; operating expenditures refer to the day-to-day expenses incurred in running an activity or a project.
21. Source: Ivor Beazley, World Bank, "Performance budgeting – concepts and terminology" presentation delivered PEMPAL BCOP meeting March 2012. Robinson (Footnote 14) notes that programme budgeting is one from of performance budgeting and warns against distinguishing between the two (page 15).
22. Source: Brian Olden, IMF, "Program and Performance Budgeting Experiences from South East Europe: Their Role in the Fiscal Consolidation Process", presentation delivered PEMPAL BCOP meeting, March 2012.
23. Source: Lewis Hawke, World Bank, "Public Sector Performance Management in Australia – is it successful?", presentation delivered PEMPAL BCOP meeting March 2012.
24. Source: Nick Manning, World Bank, "Improving the Contribution of Senior Staff to Program Performance", presentation delivered PEMPAL BCOP meeting March 2012.
25. Source: Ivor Beazley, World Bank, "Performance budgeting – concepts and terminology", presentation delivered PEMPAL BCOP meeting March 2012 citing OECD classifications from Curristine, T. (2005), Performance Information in the Budget Process: Results of the OECD 2005 Questionnaire' OECD Journal on Budgeting, 5(2), pp.88-131, Paris available at *www.oecd.org/dataoecd/4/53/43480959.pdf*.
26. The responses to these surveys are not quality checked and the survey instrument is only intended to provide an illustrative guide to status of reforms to facilitate benchmarking and networking between countries during PEMPAL meetings. The results are presented to the countries at the beginning of major meetings.
27. Source: Deanna Aubrey, World Bank, "Status of Reforms: Results of pre-meeting survey of PEMPAL countries", presentation delivered PEMPAL BCOP meeting, March 2012.
28. For full materials for these meetings see *www.pempal.org/event/read/58, www.pempal.org/event/read/78*, and *www.pempal.org/event/read/99*. Also see IMF blog articles *http://blog-pfm.imf.org/pfmblog/2012/05/program-budgeting-is-on-the-reform-agenda-across-europe-and-central-asia.html* and *http://blog-pfm.imf.org/pfmblog/2013/05/twenty-one-countries-meet-in-albania-to-discuss-program-budgeting-reforms.html*.
29. OECD, Draft Principles of Budgetary Governance, Public Governance and Territorial Development Directorate OECD Senior Budget Officials (SBO) Initial Consultation Draft, November 2013.
30. Macedonia from the Budget for 2014 started to send the medium term fiscal policy goals to the Legislature. (Question: No. 61[a]).
31. Refer to *www.pempal.org/event/view/treasury/1/*.
32. OECD Glossary of Statistical Terms, extracted from the web *http://stats.oecd.org/glossary/detail.asp?ID=7292* on August 13, 2009. OECD's definition based on interpretation of glossary definition of IMF, 2007, Manual on Fiscal Transparency, IMF, Washington, DC and the IMF's Government Financial Statements (GFS) manual.
33. Allen and Radev, 2006, *IMF Working Paper* available at *www.imf.org/external/pubs/ft/wp/2006/wp06286.pdf*.
34. Potter and Diamond 1999, Section 3 of the IMF Guidelines for Public Expenditure Management, Washington, DC extracted from web 20th August 2009 *www.imf.org/external/pubs/ft/expend/*.
35. This includes the sub-categories "interim measures voted on by the legislature" and "expenditure without legislative approval are not allowed".
36. The data, collected via a set of questions for in-depth country notes on independent fiscal institutions beginning in 2011, focuses on institutions in 15 OECD member countries (see data annex for more information). In preparing the country notes, the OECD Secretariat consulted extensively with officials in the selected independent fiscal institutions, as well as with parliamentary officials, government officials, academics, and other stakeholders as appropriate. Updates were made for several countries in 2013 and new data is being collected for France, Finland and Italy, and will be collected for any new institutions, but was not complete at the time this publication was being prepared.

37. Source: IMF,2013, the Functions and Impact of Fiscal Councils, July 2013 *www.imf.org/external/np/pp/eng/2013/071613.pdf*.

38. The Netherlands CPB's independence within the executive is de facto, not de jure: – independence is not mentioned in its establishing legislation. However, a new decree in 2012 clarifies some aspects of the CPB and other bureaus' independence related to research and methodology.

39. Typically these institutions publish all of their work. Some exceptions exist, for example for the Australian Parliamentary Budget Office and the Korean National Assembly Budget office around publishing certain costings.

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