

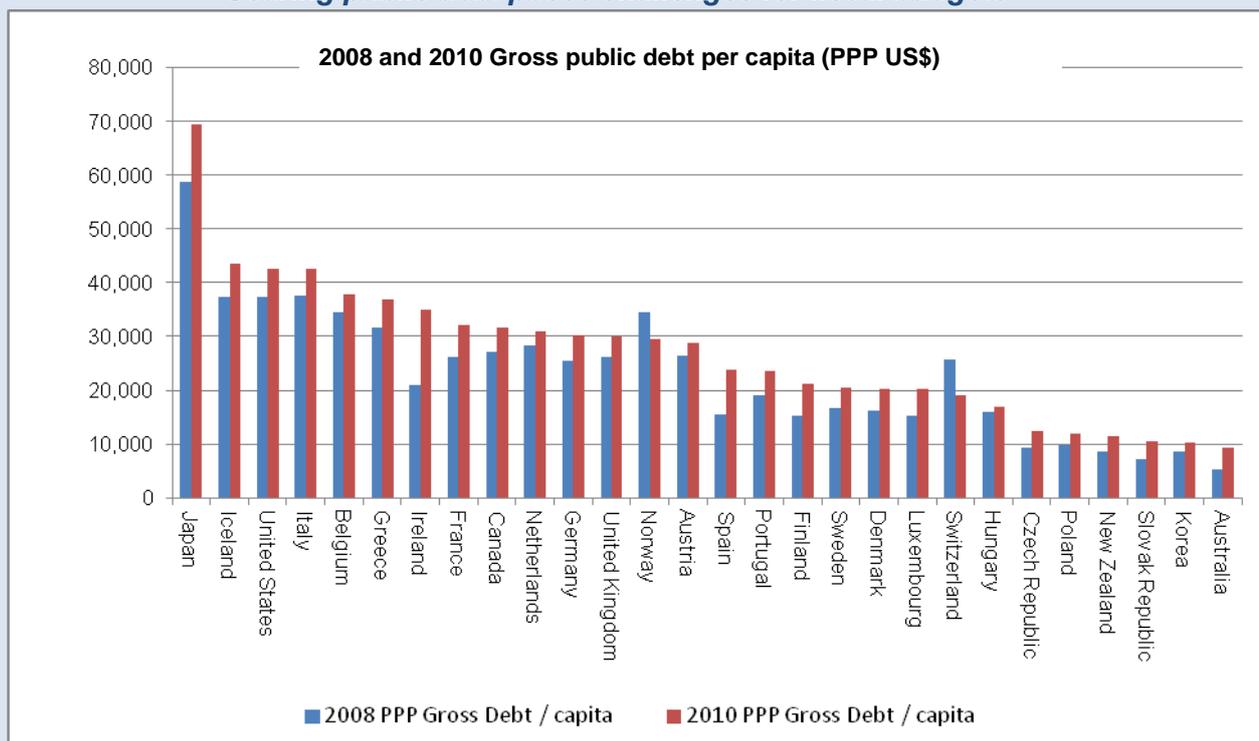
As countries formulate and implement expenditure reduction initiatives, it is important to also reform the institutional framework for budgeting. The several OECD countries that encountered fiscal crises in the mid-1990's recognized that the budget process itself had contributed to the situation and modernized their budget processes significantly. Those are the same OECD countries that have fared the best in fiscal terms during the current crisis. Implementing such institutional reforms should contribute to minimising the extent of any future fiscal crisis.

This note highlights key institutional elements of a reformed budget process. These elements are not listed in any order of importance. In fact, they are very much inter-related and the most effective reforms would incorporate all of them. Implementation, of course, needs to take due account of the specific situation in each country.

Fiscal Rules

- Fiscal rules are numerical targets that constrain budget aggregates over at least a medium-term perspective. They can play an important role in articulating and reinforcing the government's fiscal policy objectives. Political commitment to the fiscal rule is crucial.
- Expenditure rules are important for complementing deficit and debt rules. The test of any fiscal rule occurs during times of good economic growth. Only expenditure rules serve to limit expenditures in those conditions. Further, expenditure rules can be designed to be flexible for some types of expenditures, i.e. the automatic stabilizers, thus enhancing counter-cyclicality.
- Special care needs to be taken to incorporate tax expenditures and public-private partnerships into any expenditure rule, as they could otherwise be used to evade the expenditure rule.
- Fiscal rules should optimally cover all levels of government.

Soaring public debt poses challenges for fiscal budgets



Source: OECD Economic Outlook No.87 (May 2010). Gross debt per capita calculated by dividing PPP-adjusted gross debt by total population. Data unavailable for Chile, Mexico, Slovenia, and Turkey.

Economic Forecasts

- The most significant risk to any fiscal strategy is the use of inaccurate economic forecasts, notably the use of “optimistic” ones which make additional revenue seemingly available and thus reduce overall discipline. The independence of the preparers of economic forecasts needs to be assured.
- It is important for countries to fully disclose all assumptions underlying the economic forecasts. Sensitivity analysis of key variables should be provided and where appropriate comparison with private forecasts should be made
- The use of separate independent bodies to prepare economic forecasts is a notable trend. Such bodies can also play an important role in assuring the observance of any fiscal rule.

Medium-Term Expenditure Frameworks

- Medium-term expenditure frameworks reconcile a fiscal rule with baseline projections of revenues and expenditures, i.e. it operationalises the fiscal rule in concrete terms. It identifies the necessary fiscal consolidation efforts required in order to observe the fiscal rule (or the fiscal space that is available).
- They lengthen the time frame of budgeting, typically to three-five years beyond the upcoming budget on a rolling-basis. It thus becomes the foundation for the annual budget process. The first year beyond (t+1) becomes the foundation for next year’s budget and a new last year is added. This longer time frame also fosters reforms that require a multi-year time horizon, which may not otherwise have been implemented.
- It is paramount that the medium-term expenditure frameworks be well integrated into the annual budget process. They need to be kept up to date and their observance with the fiscal rule assessed on a regular basis.

Top-Down Budgeting

- Top-down budgeting involves each ministry being allocated a lump-sum of money at the beginning of the annual budget formulation process to cover its expenditures. For each ministry, these lump-sum allocations are typically ring-fenced into four categories of expenditures: salaries, other operating expenditure, transfers and capital.
- Top-down budgeting recognizes the budget as the pre-eminent policy declaration of governments, where policy objectives are reconciled and implemented in concrete terms. In order to achieve this objective effectively, it is important that high-level budgetary allocations be made at the centre of government reflecting political priorities. This exercise is informed by medium-term expenditure frameworks.
- Following the decision of lump-sum allocations, each minister should be given maximum freedom in achieving this total among his various agencies and programs. This also fosters internal reallocations within each ministry as new initiatives can be funded by decreasing funding for lower priority initiatives. As such, it acts as a check on incremental budgeting.
- Top-down budgeting reduces the game-playing associated with the traditional budget process, reflects information asymmetry between the centre and each ministry and enhances the ownership of actions by each ministry.

Greater Managerial Flexibility

- Based on the same philosophy as top-down for formulating budgeting, this seeks to give greater flexibility to managers in the implementation of the budget. It recognizes that the heads of ministries and agencies are in the best position to manage resources effectively and efficiently.
- Typical elements include reducing the number of line-items in the budget (thus promoting reallocation during budget implementation), end-of-year flexibility (carry forwards), and reforming central management controls (especially in the area of human resource management).
- A robust system of internal controls needs to be in place to prevent abuse.

Performance and Results

- A focus on performance and results (outcomes, outputs) is the quid pro quo for greater managerial flexibility. It is the new form of accountability – replacing a reliance on input controls only. For performance and results to achieve its greatest potential, it must be accompanied by greater managerial flexibility. Otherwise it risks being viewed as simply an additional layer of controls.
- Performance and results information also serves to inform the budget formulation process and thus promoting value-for-money. It is important for the agency, its ministry, the budget office, the centre of government and parliament to establish their respective requirements for performance and results information in order to ensure its maximum use. Appropriate performance and results information should be included in the annual budget documentation.

Long-Term Budget Projections

- Long-term budget projections (20, 40, 60 years i.e. 1, 2, 3 generations) provide a means to assess fiscal sustainability based on assumptions of current policies, stable taxes, and other key demographic and micro- and macroeconomic parameters. Fiscal projections should include all public revenues and expenditures to support fiscal stability and efficient allocation of resources.
- They help to ensure that medium-term expenditure frameworks are in line with long-term fiscal needs. They also offer invaluable signposts to help current governments to respond to known fiscal pressures and risks in a gradual manner, earlier rather than later, and help future governments avoid being forced to adopt sudden policy changes. In doing so, they can also help future governments to position themselves better to manage unforeseen or less predictable fiscal pressures.

Senior Budget Official networks (SBO)

Since 1980, budget directors from OECD member countries have been meeting regularly in the Working Party of Senior Budget Officials, colloquially known as the SBO.

The SBO has launched five regional networks and five associated networks.

Regional SBO networks draw upon the successful format for the SBO and annually bring together budget directors and other senior officials from each region to address key budgeting concerns and relevant policy options. In some regions, reviews of budgeting systems have been conducted (peer review).

Africa: Collaborative Africa Budget Reform Initiative (CABRI)

Asia: OECD-Asian SBO network

Eastern Europe: Senior Budget Officials from Central, Eastern and South-Eastern European Countries (CESEE)

Latin America: Regional SBO network for Latin America

MiddleEast/North Africa (MENA): Regional SBO network for MENA

The **associated SBO networks** are each composed of the relevant senior officials from member countries. They convene regularly and operate in the same manner as the SBO.

The SBO Network on Financial Management is responsible for government accounting frameworks and focuses on the issues associated with the adoption of accruals.

The SBO Network on Performance and Results focuses on the use of performance information and measures in the budget process. In particular, the Network assists member countries to design and implement performance-based (results-based) budgeting and management reforms.

The SBO Network of Parliamentary Budget Officials focuses on the legislature's scrutiny of the budget and the relationship between the legislature and the budget office in the budget process.

The SBO Network on Public-Private Partnerships focuses on these contractual arrangements between a government and a private partner.

The SBO has also created the **SBO Experts Group on Accountability and Control (SBO-A&C)** and related topics.

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