OECD Journal on Budgeting

Special Issue

The Legal Framework for Budget Systems

AN INTERNATIONAL COMPARISON

OECDPUBLISHING

Volume 4, No. 3

OECD Journal on Budgeting

Volume 4 – No. 3

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Publié en français sous le titre :
Revue de l'OCDE sur la gestion budgétaire
Volume 4 – n° 3

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Foreword

Budget design is a key policy instrument for public management. Budget system laws as an instrument of governance reform play a pivotal role in influencing patterns of public sector behaviour. The relationship between budget design and behavioural incentives is critical to the work of the OECD Working Party of Senior Budget Officials (SBO). Thus the Working Party decided to launch a comparative study of budget system laws in OECD member countries.

This book is composed of four parts. Part I discusses theories of comparative law, constitutions, politics and budget systems. Part II presents a comparison of OECD country legal frameworks for budget systems. Part III examines the question of whether there is an optimum legal framework for the budget system and discusses legal norms for budgeting. Part IV contains case studies for selected OECD countries: Canada, Denmark, Finland, France, Germany, Japan, Korea, New Zealand, Norway, Spain, Sweden, the United Kingdom and the United States.

The study was initiated by the Budgeting and Management Division of the Public Governance and Territorial Development Directorate (GOV). Moo-Kyung Jung began work on the study in early 2003. At the same time, Ian Lienert of the International Monetary Fund (IMF) was embarking on an identical project, and a partnership was thereby formed for completing the study.

Through the SBO network, comments were provided by officials in national administrations; acknowledgement of the individuals concerned is contained in each country case study. Comments on earlier versions of various parts of this book were given by Professors James Chan (University of Illinois at Chicago, United States), Joanne Kelly (University of Sydney, Australia), Allen Schick (University of Maryland, United States), John Wanna (Griffith University, Australia) and Joachim Wehner (London School of Economics and Political Science, United Kingdom), as well as Professor Emeritus Gabriel Montagnier (University of Lyon-3, France). In addition, comments were received from OECD staff, particularly in the Budgeting and Management Division (notably Alex Matheson, Head of Division, Jón Blöndal, Dirk-Jan Kraan, Michael Ruffner and Joaquin Sevilla) and the OECD Economics Department, and Eivind Tandberg of the Fiscal Affairs Department of the IMF. The authors extend their thanks to all these persons. Any errors are the responsibility of the authors.

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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, as well as special contributions from Finance Ministries of member countries and others, 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.*

We are anxious to receive feedback from our readers. Your views on how to improve the Journal are welcome and can be sent to: The Editors, The OECD Journal on Budgeting, *OECD, 2 rue André-Pascal, F-75775 Paris Cedex 16, France. Fax: (33 1) 44 30 63 34; e-mail: sbo.news@oecd.org.*

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Preface

By
Richard Emery
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and Chair of the OECD Working Party of Senior Budget Officials

The Working Party of Senior Budget Officials addresses key policy options for the efficient functioning of the budget system. Reviews of the budget systems of individual OECD member countries have been undertaken since 2001. This comparative analysis of budget system laws will provide further understanding of instruments for the effective governance and management of public resources.

The laws that support annual budget processes lay out a framework for the power struggles between legislatures and executives. Legislatures approve annual budgets and receive ex post reports on budget execution. Executives prepare and submit national budgets to the legislature, implement the budget, and prepare accounts and fiscal reports. To what extent does the legislature dictate the "rules of the game" for each of these budget processes?

Within OECD countries, and especially economies in transition, there is a tendency to over-legislate. Executives sometimes draft budget-related laws before asking whether executive regulations would suffice. Adoption of a law by the legislature does not ensure budget reform. Would this problem be eased with a standard set of budget principles, against which a country could obtain guidance on what type of provisions should be included in law? Should, for example, accountability relationships within the executive be specified in law or in executive decree? What minimum norms should, or could, be included in law? Would the durability and quality of the budget system laws be better with more careful diagnostic analysis of the "right" law for the country in question? To date, public finance specialists and lawyers have not extensively studied, across countries, legally binding norms for the various stages of budget processes. Do such norms even exist? If so, who should issue them and ensure their implementation?

As new countries are formed or experience sharp regime changes that lead to a new constitution, there is a need for a new budget system law. But can a law incorporating a results-oriented budget system and an accrual-based accounting system bring about budget reform in a country with limited capacity for preparing and implementing a budget? Is it better to adopt a less complex law in the first instance? If so, with what features? And what model should be used in a country where the new constitution could be heavily influenced by one model, but where the budget system is influenced by other norms?

This book addresses many of these questions. With a focus on similarities and differences in formal laws, the information in this book will be useful for all budgeting specialists and for any government planning to reform its budget system laws.

ISSN 1608-7143
OECD Journal on Budgeting – Volume 4 – No. 3
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Executive Summary

Sharp differences exist in the legal framework for budget systems

The legal basis for national budget systems varies enormously across OECD member countries. In some countries, the content of laws supporting annual budgeting processes is confined mainly to a brief elaboration of the main budget issues of concern to the legislature. Such laws incorporate well-known budget principles. The details of budget processes are delegated to lower-level regulations. In other countries, laws contain specific provisions for all of the main stages of the budget cycle. The constitutions of many countries specify the general roles of the legislature and executive, including a few essentials for budget processes. In a few countries, constitutions contain an entire chapter devoted to public finance. Some OECD member countries do not have a written constitution.

A few countries give special status to budget system laws. In these cases, constitutions require that an "organic" law be adopted to guide budget processes for the State. Although organic laws provide a coherent framework, the coverage of the budget is limited to what is exclusively under control of the State, and may exclude important central government functions, especially in the area of social security. Laws establishing extrabudgetary funds or governing budget processes for such funds have been adopted to complement budget system laws whose application and coverage is limited to a smaller set of central government budgetary entities. In federal countries, sub-national governments' constitutions or laws* are generally adopted independently from those at the federal level. In contrast, in Germany, a federal law requires nation-wide coherence of budget and accounting systems. The budget principles incorporated in a federal law are also embodied in laws adopted by states (*Länder*). The resulting harmonisation of budget laws throughout the nation facilitates budget reporting for all government entities throughout the nation.

Most countries have just a few main statutes pertaining to the budget system – perhaps one or two principal laws, possibly supplemented by a Parliament Act. The United States is an outlier: its legislature has adopted many budget-related laws, with considerable detail in most. At the other extreme, the parliaments of Denmark and Norway have never adopted a formal statute to

* It is beyond the scope of this book to examine the laws of sub-national governments.

guide annual budget processes. Regulations of the executive or parliament substitute for budget-related statutes in these two countries.

Public finance and legal theories do not explain inter-country differences in budget system laws

Research comparing the legal framework of budget system laws is virtually non-existent. The public finance academic literature provides a limited number of insights. Public choice theorists stress that rules are needed as constraints on the potentially self-interested behaviour of "organisations" such as the legislative and executive branches of government. The main principle to which this theory has been applied is that of budget balance. One Nobel Prize laureate suggested that a balanced budget rule should be incorporated in the constitution. This viewpoint is debateable, given the rigidity that such a rule would impose and the difficulties of enforcing it.

Many studies have examined the relationship between fiscal rules and budgetary outcomes, notably the performance of the budget balance and public debt. The literature does not attempt to rank or weight the 20 or so "rules" chosen to form indices of performance. Nor are views taken as to whether particular rules should be formally embodied in law. Several of the rules are included in law, especially in countries with a strong tradition of embodying rules in law. However, the budget decision-making rules within the executive are generally excluded from statutes. Such rules are either stated in internal regulations (orders, decrees, etc.) of the executive or remain unwritten, notably in countries where convention or informality is widely accepted.

Studies in comparative law include those that categorise law into various "families". The broad classification between "civil law" and "common law" countries is more useful for laws affecting the private sector. For budget system laws, this distinction is less useful, since judges are not called upon to make laws for national budget systems. The origin of budget-related laws in "common law" countries is not precedent. More relevant is a categorisation of countries according to whether they have a comprehensive written constitution.

In the Westminster countries – where constitutions are not (fully) specified in writing – in recent years legislatures have adopted new statutes for the budget system, especially with respect to the budget principles of accountability and transparency. As a consequence, the gap in the density of budget-related statutes between Westminster countries and continental Europe – whose countries all have written constitutions – is not as great as 25 years ago. Nonetheless, there is not yet a convergence in coverage of budget-related laws.

Political variables and legal culture help explain the inter-country differences

Political variables have been postulated to be important for explaining differences in budget systems across countries. This study emphasises the influences of the historical and present form of government. The degree of separation of powers between the executive and the legislature appears to be particularly important for explaining differences in the extent to which law is used to underpin budget processes. Presidential forms of government, where the powers of the legislature and executive are strongly separate, have used law most for controlling the executive in budget matters. Parliamentary monarchies with essentially two-party political systems are at the other extreme. When combined with inherited powers that produce a strong executive, the formal budget powers of parliaments in such countries are particularly weak. The need for statute laws is less, since the executive dominates the legislature. Statutes in such countries tend to strengthen the budgetary powers of the executive. The balance of formal budgetary power in parliamentary republics and semi-presidential forms of government appears to be between these two extremes.

Other political variables also appear to contribute to explaining why budget-related law varies across countries. In countries with proportional representation electoral systems that result in a multiplicity of political parties and coalition governments, the need for the legislature to establish "permanent" budgetary rules by way of statute is lessened if there is also a convention (or possibly a legal requirement) for the governing political parties to present their economic and budgetary programme to parliament. In such countries, budget objectives are often made clear in "coalition agreements", which, although not legally binding, constrain the margin of manoeuvre of the government. These agreements may be compared with quantitative fiscal rules that are embedded in law in other countries. Such agreements also fulfil part of the accountability requirements that law may establish in other countries, as governments' budgetary programmes are publicly available once finalised. However, unlike law, they are valid only for the life of parliament.

Legal culture also helps to explain why a few countries have not adopted budget system laws. Although there are three generic steps in law making – initiation (often by the executive), resolution (by the legislature), and "concluding activities" (including legal reviews) – countries differ on the importance and procedures for all three steps. In continental European countries, the United States and the Asian OECD member countries, high-level courts ensure that budget-related laws are consistent with written constitutions. In Westminster and Nordic countries, the legal formalities are lighter and the options for legal instruments other than formal statute are greater. The Westminster countries

are unconstrained by extensive written constitutions. Nordic countries do not have constitutional courts to contest non-constitutionality. In both groupings of countries, written or unwritten constitutional provisions for budgeting are interpreted liberally. Also, the delegation of budget authority to the executive appears to be higher than in the legally formalistic countries – those whose constitutions either specify key requirements for the annual budget or require that the budget system be governed by law. In summary, there are countries where attitudes towards formal law are not rigorous and countries where there is a culture of subservience to the legal aspects of budgeting.

Norms for budget systems have been issued and many should be in budget system laws

Public finance specialists and legal theorists have shied away from establishing legal norms for budget systems, except for quantitative fiscal rules. In contrast, international organisations have published comprehensive guidelines for desirable features of budgetary transparency. However, these organisations have not specified which features should be incorporated in domestic law. An exception is for external audit, where constitutional standards have been recommended by the International Organization of Supreme Audit Institutions (INTOSAI).

Classical and new budget principles, as well as the separate responsibilities of the legislature and the executive in budgetary processes, should guide policy makers who wish to establish a "good" law for their national budget system. Principles that are important for governing budget preparation, adoption, execution, reporting and auditing are: authoritativeness, comprehensiveness and accountability. Using a total of ten budget principles, suggestions are made as to which aspects of the budget system could be included in the constitution, in primary law and in secondary law.

The principle of aligning budgetary functions and legal instruments is proposed. On this basis, the executive, by regulation, would establish internal rules for budget preparation and budget execution – the areas of the budget process that legislatures could delegate to the executive branch. By contrast, this principle would require statute law, complemented by internal regulations of the legislature ("parliamentary regulations") to provide the formal rules for budget presentation and adoption by the legislature, as well as for *ex post* reporting by the executive to the legislature. A separate law for establishing the independence, responsibilities, and powers of an external audit body serving primarily the legislature appears desirable.

This study does not specify a "model" budget system law or a "model" external audit law that could be used in all countries. This would be inappropriate.

Budget system laws need to be adapted to each country's constitutional, political, institutional, legal and cultural setting. There is no such thing as a "one-size-fits-all" law for the budget system.

OECD member countries do not adopt, or amend, budget-related laws after referring to international standards. Some continental European countries begin with budget principles and then move to law. The traditional emphasis has been on incorporating into law the principles of universality, unity, specificity, and annuality. These principles relate primarily to the early stages of the budget cycle – preparation, presentation and adoption of the budget by the legislature. There has been relatively less emphasis on incorporating into law the budget principles associated with the later stages of the budget cycle – accountability, transparency, stability and performance. In contrast, the budget laws of Westminster countries emphasise accountability and other aspects relating to budget execution. The foundation for such laws in these countries was the United Kingdom's Exchequer and Audit Departments Act, 1866. Many of the provisions of this very old law were valid in the United Kingdom until 2000, when a new government accounting law was adopted. This example illustrates how budget-related laws do not evolve quickly.

Budget reforms are a major reason why budget-related laws have been changed

Although the introduction of budget reforms is a major reason why OECD member countries have replaced existing budget system laws or adopted new ones, there are differences across countries in the extent and areas in which this has occurred. In some countries, where changes have been in response to budget crises, major changes have been introduced by adopting new budget-related laws.

In continental European countries, it is considered important that the legislature first discusses budget principles. At a second stage, the budget system law is amended or a new law is adopted. Implementation may be spread over a period of years. In Westminster countries, these steps tend to be reversed. Budget reforms are first introduced, perhaps on a pilot basis. If the new budget arrangements or procedures are perceived to be working, law may then be changed.

In recent years, fiscal transparency, accountability and macro-fiscal stability principles have increasingly been embodied in law. New Zealand's 1994 Fiscal Responsibility Act has been influential in a number of other countries, both those within the Westminster "model" and those outside it. For example, France's new Organic Budget Law, adopted in 2001, incorporated into law a new principle of budget "sincerity".

Budget-related laws may be adopted in order to better control the macro-fiscal position – especially to reduce deficits that are perceived to threaten fiscal sustainability. In this regard, the experience with embedding quantitative fiscal rules in law has generally been negative. Canada, Japan and the United States all allowed such laws to lapse. In the case of Japan, the law was barely operative for more than 12 months. The experience of some European Union countries in respecting the supranational body's near-laws for budget deficits and debt barely fares better.

A number of OECD member countries have revised external audit laws in recent years. The aim of reforms has been to enhance the independence of the supreme audit institution (SAI), expand the coverage of audited entities, and strengthen the investigatory powers of the SAI.

Not all budget reforms are introduced by law. Nor are all budget processes necessarily provided with a legal basis. For example, some countries' governments may prepare and submit a medium-term macro-fiscal framework to the legislature, even though this is not required by law. Another example is the introduction of an accrual basis for government accounts. Some countries' laws do not specify the financial statements to be prepared, but nonetheless still prepare balance sheets, operating statements and cash flows, all of which are submitted to the legislature. Law may simply require that the government accounting system conforms to "generally accepted accounting principles", without providing details of what this implies – this is left to regulations.

If fundamental changes in the budget system are to be made – such as moving from an input-based to a results-oriented budgeting system – it is usual for a new law to specify the new appropriations structure. Although there has been a widespread movement towards performance- or results-oriented budgeting in OECD member countries, there are cases where the executive, not the legislature, controls the structure and format of annual appropriations acts, *i.e.* a new appropriations structure has not been introduced by law. In countries where executives have strong inherited or delegated powers, convention may allow the introduction of far-reaching budget reforms without changing the law or by making just a few changes in existing budget-related laws.

Budget system laws are adopted to strengthen the powers of the legislature or the executive

Although the "supremacy of parliament" in budgetary matters is a widely accepted principle in all democratic countries, the procedures and timing of parliamentary budget processes differ widely. There are two categories: countries where the authority and powers of the legislature in budget making

are strong and those where the executive has the "upper hand" in budget processes. In both cases, law may be used to strengthen these relative powers. In the first case, law-making initiatives begin in the legislature. In the second case, new laws are drafted by the executive.

The legislature of the United States is the prime example of a country in the first category. Since the 1970s, by adopting new laws, Congress has strengthened its budgetary control over the executive. Since the adoption of new law in 1974, the Budget Committees in both houses formally decide the budget strategy (in contrast, several countries' laws prevent the executive's proposed strategy from being changed easily, if at all). The law severely limits the executive power to make in-year budget adjustments. A heavily funded congressional budget office, which serves the legislature, was established by law. Financial management laws allow the legislature to be involved in internal audit arrangements (*e.g.* the chief financial officers of executive agencies report to Congress).

If the executive is perceived to have too much power, some of which is non-transparent in government-controlled budget accounting practices, the legislature may adopt a law to swing the balance of budgetary power in its own favour. This is one reason which stimulated France to adopt a new Organic Budget Law in 2001.

For countries in the second category, the legislature trusts the executive. In Westminster countries, law(s) may formally delegate authority to budget actors in the executive. Based on delegated authority, the roles and responsibilities of key actors in budget processes may be specified by decree (*e.g.* some Nordic countries) or not by any formal document (*e.g.* the strong budget-related powers of H.M. Treasury in the United Kingdom, which are based in inherited powers). For budget implementation, the executive enjoys considerable powers, without close supervision by the legislature. Internal audit arrangements are seen to be part of good overall management. In contrast to, say, the United States, there are no laws requiring internal audit bodies to report to the legislature.

Countries in the second category are likely to have fewer legal provisions concerning when the annual budget is to be submitted to the legislature and/or approved. Although it is good practice for the budget to be approved before the beginning of the new fiscal year, several Westminster countries approve in law the budget after the beginning of the year, following a perfunctory budget debate in parliament. Such countries also have strict limitations on the legislature's amendment powers. These are important ways in which the executive dominates the legislature.

This study has not attempted to measure the separate powers of the legislature and the executive in budget processes. Additional research could be conducted to test the relative powers of each branch of government.

Country studies reveal a multiplicity of reasons for adopting budget-related laws

This comparative study examines the major differences across countries in the legal provisions for budget preparation, presentation, approval, execution, government accounting and fiscal reporting. It includes in-depth country studies for nine OECD member countries that allow comparability of different aspects of the budget process or of different budget actors. A mini-comparative study for four Nordic countries highlights the considerable differences in the use and attitude towards budget-related laws in these seemingly similar countries.

More generally, this study highlights the wide differences between the legal frameworks for budget systems. Whereas budget systems may be converging in OECD member countries, the laws associated with budget systems do not appear to be converging at the same rate. This is partly because today's conglomerate of budget-related laws in a given country is a result of years, perhaps centuries, of evolution of previous laws. Each country's specific institutional features and political systems result in differences in laws for government budgeting systems.

Conclusions

One conclusion from this study is that budget-related laws are adopted for a variety of reasons. These include: to introduce budget reforms – perhaps as a result of a budget crisis; to change the balance of power between the legislature and the executive; to enhance macro-fiscal stability; to enhance transparency and accountability in the budget system. These different goals, combined with a diversity of constitutional, political and other country-specific arrangements, make it difficult to categorise countries' legal arrangements for budgeting into neat, mutually exclusive groups. Differences in budget-related laws are therefore likely to persist.

At the broadest level, OECD member countries fit into one of two groupings: those whose budget systems are constitutionally constrained and those where there are no constitutional constraints. In the first grouping, the authors would place continental European countries, the United States and the Asian OECD member countries. In these countries, budget systems are constrained either directly by written constitutions or indirectly by the statute laws that have been adopted, consistent with constitutions. Constitutional courts (or the equivalent) play a guardianship role in ensuring the constitutionality of budget-related laws. At times, courts may find legal reasons to reject changes in laws pertaining to the budget system.

The second grouping includes the budget systems of the Westminster and Scandinavian countries, as these are not constrained by constitutions. In some of these countries, the absence of a written constitution necessarily exonerates the budget system from high-level legal constraints. Where written constitutions do exist, their provisions are not onerous. A formal law for the budget system is not a necessity – it is an option. The examples of Denmark and Norway demonstrate that there are other options, notably regulations adopted by the executive or a parliamentary committee. These substitute for formal statutes that have completed all law-making phases. Regulations have the advantage of having an impact similar to statute law, but without the rigidities, including the relatively greater difficulty of making changes in the budget system via amendments to law. Convention and informality are relatively more important in these countries, which also do not have constitutional courts to oversee that budget-related laws meet the letter of constitutional law.

As a final remark – and as a guide for making choices relating to budget system law(s) – a country may wish to consider whether the results produced by the budget system are relatively more important than the laws that produce the results.

ISSN 1608-7143
OECD Journal on Budgeting – Volume 4 – No. 3
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PART I

Comparative Law, Constitutions, Politics and Budget Systems

This part aims to identify reasons for the wide differences in budget system laws in advanced countries. Comparative research on budget system laws is virtually non-existent. The economics and public finance literature provides little explanation as to why budget system laws differ so widely across countries. Comparative law studies are more promising, particularly those relating to the hierarchy of law. The differences in the relative importance of the constitution, statutes and regulations provide some explanation as to why countries' budget-related laws are so different. However, there is no theory to explain why the relative weight of each of these sources of law differs across countries. Political variables are also important, particularly the past and present forms of government. The degree of separation of powers between the executive and the legislature partly explains the extent to which law is used for specifying budget processes and actors.

1. Introduction

In some Western European countries, the origins of national budget systems can be traced to the institutional arrangements prevailing before democracy was introduced. Monarchies had royal treasuries to manage government finances, sourced by obligatory taxes on citizens. In a few countries, the "constitutional" arrangements for budget systems have an inheritance dating back several centuries.[1] Although many changes and reforms in the legal framework for budget systems have been introduced over the centuries, a few ancient features still prevail – especially in the United Kingdom and France. These in turn were inherited by the former colonies of these two countries, whose legal frameworks for budgeting still bear resemblances to those inherited at independence.

Over time, many of the rules pertaining to national budgeting systems were written down but not all were. It is therefore important to distinguish between the rules that were written into law and other norms that are analogous to law, although not legally binding rules. There is no distinct line of demarcation between these two kinds of rules. Over time, legal rules often assimilate norms of the other kind. This is what happened – and is still happening – with the rules pertaining to budget systems. However, the extent and speed with which budget rules have been embodied in statutes varies from country to country.

This part first observes the vastly different ways that countries incorporate into law various provisions relating to budget processes and budget actors. It then conducts a search for explanations as to why the organisation, structure and content of the legal framework for budget systems differ so widely across countries. Contributions from economics, public finance, comparative law and political studies are successively examined. Some explanations for differences can be found in differing legal traditions and, especially, the extent to which the legislature controls the executive (or the reverse).

Differing legal traditions reflect, *inter alia*, varying levels of trust between and powers of legislatures, executives (both political and administrative bodies), and citizens, as well as differing political systems. Such factors are taken into account when the legislature incorporates certain aspects of the budget process into law, whilst leaving others to regulation or informal understandings.

Most of this book is confined to discussing the differences across countries in the budgetary provisions of constitutions and statutes. However, other legal instruments can, and do, govern budgetary processes and different countries assign different weights to the importance of constitutions, statute laws, regulations of various types, and extra-legal instruments. This part examines pertinent issues. Theory does not allow strong conclusions to be drawn. Although self-imposed budget-related norms are one way of limiting capriciousness in budget processes, the choice and combination of the legal and quasi-legal instruments intended to limit the powers and roles of specific actors in the budget processes appear arbitrary.

Budget rules, if embodied in law, are useful only if the rules are both enforceable and enforced in practice. For budget-related law, many provisions are "green lights" – they specify desirable features to be implemented by budget players. A few provisions of budget-related laws are "red lights" – rules that governments must not break. Courts are called on to make judgements for any "red light" infractions. Legal arrangements and laws for the enforcement of such rules differ widely across countries.[2]

Unless mandated constitutionally, the judiciary appears reluctant to enter into struggles that are inherently political in nature. Budget-related laws appear to be better confined to formalising agreements that would otherwise be respected on a voluntary basis – "self-enforcing" laws. The experience with coalition agreements in some countries suggests that voluntary pacts, if adhered to, are as effective as legally binding arrangements. Such voluntary agreements are even superior – in terms of achieving desirable fiscal objectives – to formal laws that are not respected.

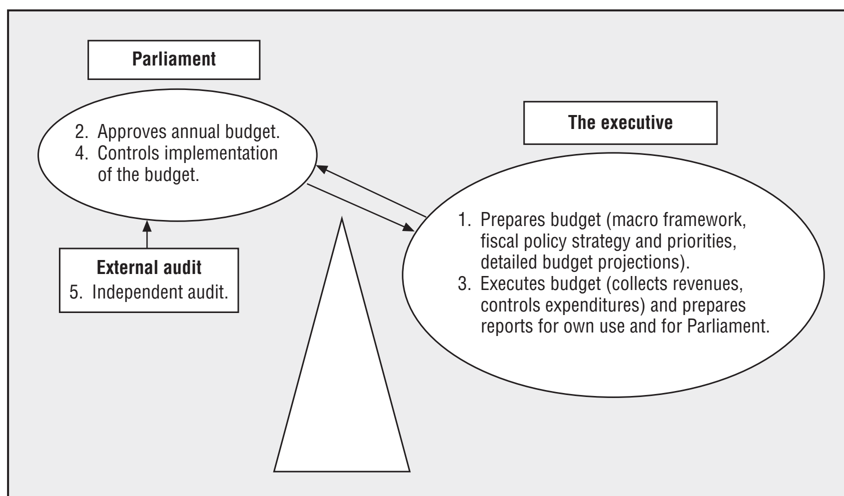
Part II compares the extent to which law is used to specify budget players and processes, with a particular focus on 13 OECD member countries. Part III elaborates on which aspects of the budget system could usefully be incorporated in law, as opposed to voluntary restraints that are not legally binding. The remainder of Part I briefly examines what is meant by "budget processes". Most of the subsequent discussion then addresses the question: "Why is the legal framework for budget systems organised so differently in OECD countries?"

2. Budget processes

2.1. Budgeting: a five-stage process

Five generic stages of annual budget processes can be identified (see Figure I.1). First the executive prepares a draft budget and submits it to the legislature. This is usually a two-step process: a Ministry of Finance (or equivalent) prepares a draft budget that incorporates the government's expressed budget orientation; the draft budget prepared by bureaucrats is then approved by a Cabinet of ministers (or the equivalent for countries with

Figure I.1. **The roles of Parliament and the executive in the budget cycle**



presidential political systems). This budget is submitted to the legislature for possible amendment and approval.

Second, at the Parliamentary stage, the budget is generally discussed in parliamentary committees, which may propose amendments. Once amendments are agreed in plenary session, the legislature approves the budget. Legal authority is provided to the executive for raising revenues if this is not ongoing. Formal adoption of the spending proposals means that legally binding upper limits are established for many expenditure categories.

The third stage is the implementation of the approved budget which is performed by the executive – and/or government agencies. In so doing, a central budget office (usually in the Ministry of Finance or the equivalent) monitors budget implementation and prepares periodic budget execution reports using a well-defined accounting system. The executive may be provided with the power to change the approved budget in the case of unforeseen emergencies, including major deviations in the macroeconomic framework underlying the budget law. A supplementary budget may be needed to confirm any such action by the executive. The executive may also be provided with other powers to modify the approved budget, including powers to change its composition (*e.g.* by virement or by using a reserve fund approved in the annual budget) or to control actual spending to a level below that approved, should economic circumstances dictate.

The fourth stage is parliamentary control of budget implementation. This takes place both during and, especially, after the close of the fiscal year.

Parliamentary control is based on reports provided by the executive. It is Parliament's prerogative to specify the content and timing of such reports, which may contain both financial data (annual accounts) and non-financial data (*e.g.* attainment of performance targets).

The final stage is when an independent external audit office audits the financial accounts. It may also have a mandate to assess the results of the annual budget in terms of efficiency, economy and effectiveness.

2.2. How are the different legal frameworks for budget systems organised?

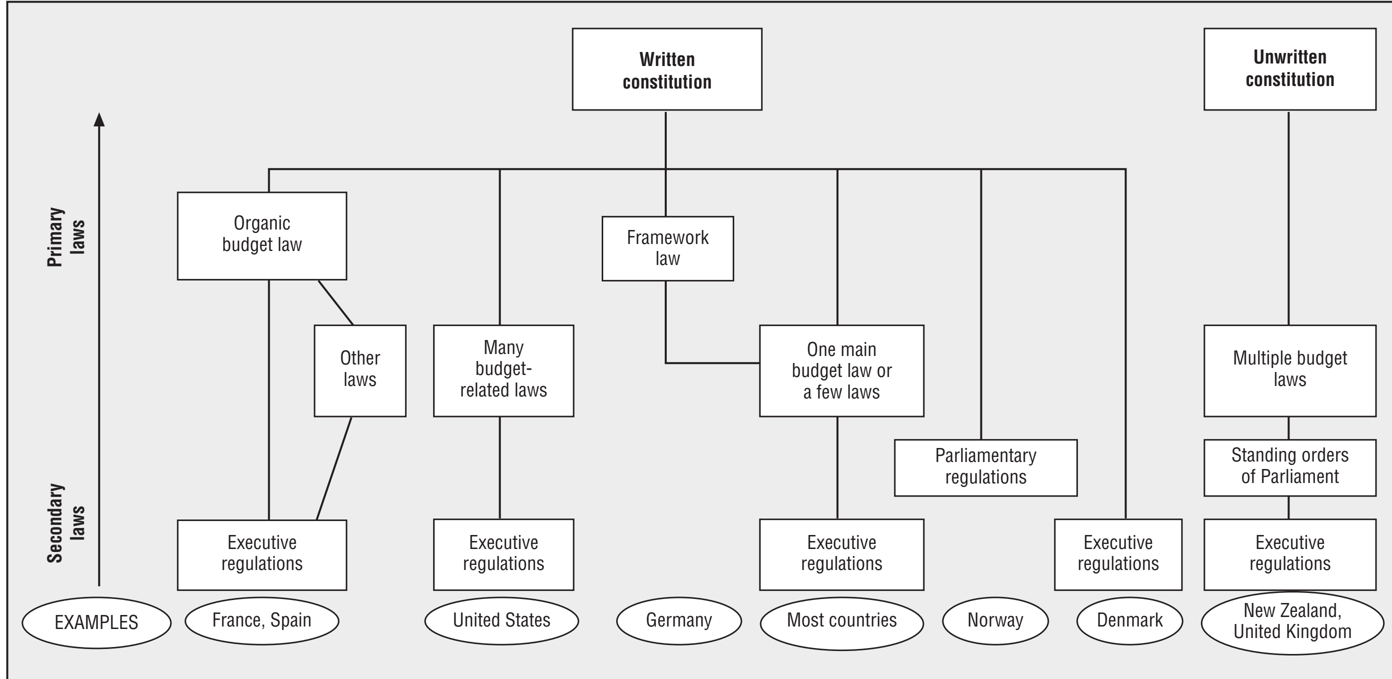
This section describes seven different organisational frameworks for the laws and regulations governing budget systems that can be distinguished in OECD countries. A starting point is to distinguish countries that have written constitutions from those where constitutions are not explicit – two very broad categories (first row of Figure I.2). Within the first category, there are six further categories.

In a few countries, the constitution establishes a hierarchy of law. First, constitutions in some countries require important laws to be "organic" laws, which have a higher status than ordinary statutes. Organic laws are required only rarely, notably in France and Spain. In France, there is an Organic Budget Law that relates only to the State budget. Because of its importance, it is known as the "Financial Constitution". However, transactions of the State in France cover less than 40% of general government transactions (using a national accounts definition). The organic law relating to the annual budget laws of the state is supplemented by another organic law relating to the financing of social security.

In contrast to France, Spain does not have an overarching "organic" budget law that governs budget processes of the state. Instead, these are laid out in a General Budgetary Act and a General Act on Budgetary Stability. However, for constitutional reasons related to the autonomy of self-governing communities, Spain also has an Organic Act Supplementary to the General Act on Budgetary Stability, which requires the self-governing communities to prepare their budgets in accordance with the stability targets required by the two aforementioned ordinary laws. As in France, extensive regulations have been issued to fill out the detail of budget processes and procedures.

A second form of higher law is "framework legislation" in federal countries, where federal law takes precedence over provincial law. In Germany, a Budget Framework Law elaborates on budget principles to be applied at all levels of government and specifies mechanisms for co-ordination of budget policies between the different levels of government. A major purpose of the law is to ensure that budgets at different levels of government are adopted in the context

Figure I.2. **Different models for organising the legal framework of budget systems**



of a coherent national budget framework. On the basis of the Budget Framework Law, the federal government and each *Land* (province) have adopted their own budget laws (called "codes").

Many countries do not have such a hierarchy – all laws are "ordinary" laws. The United States is a federal country whose constitution contains only a few provisions related to the federal budget. A distinguishing feature of the United States – which puts it into a category of its own – is the very large number of laws covering different aspects of the federal budget system (see Box 1 of the United States case study). Budget-related laws have been consolidated in specific chapters of the US Code (especially Titles 2 and 31), which is a consolidation of all federal laws. The many budget-related laws are supplemented by a number of regulations of the legislature, as well as extensive regulations issued by the Office of Management and Budget (OMB). In addition to this dense body of law and regulation at federal level, there are separate constitutions, laws, and regulations in each of the 50 states. Unlike Germany, there is no federal law that requires uniformity in budget and accounting procedures for the nation as a whole.

Most countries' legal systems have no hierarchy in budget-related laws (fourth column of Figure I.2). A few key laws (*e.g.* Australia, Canada, Japan, and Korea) or a single law (*e.g.* Finland) govern budget processes. In several countries (*e.g.* Japan, Korea, Sweden) the major law specifying budget processes is supplemented by a Parliament Act, which contains provisions mainly for parliamentary approval of the budget. Finland's State Budget Act elaborates only on a few issues not covered by the extensive budget-related provisions contained in its written constitution, which has an entire chapter devoted to State finances.[3] In Japan and Korea, the Constitutions have separate sections on fundamental budget principles, which are complemented by key laws governing budget processes including provisions for budget preparation steps within the executive (many countries assign these steps to government decree).

In Denmark and Norway, both of which have written constitutions, no statute law has been adopted to specify principles or details of the budget system (a similar situation prevailed in Sweden until it adopted a budget system law in 1996). In the case of Denmark, budget "guidelines" are issued by the Ministry of Finance. Any changes in the guidelines are always reviewed by the parliamentary Finance Committee – this is a practice, not a legal requirement. The Finance Committee also has other delegated powers conceded by Parliament. These include ones related to adoption of the annual budget and the approval of supplementary spending during the course of the year (see Blöndal and Ruffner, 2004). In Norway, budget regulations are adopted by Parliament. In practice, most amendments to these regulations are initiated by the Ministry of Finance. Thus, in both cases, the Ministry of Finance plays the key role in drafting the budget "regulations" (as in most other countries). The main

difference between Denmark and Norway is the issuing authority for the regulations: the Ministry of Finance as opposed to Parliament. In both cases, Parliament is fully involved in any changes in the regulations. But unlike nearly all OECD countries, formal law for governing budget processes is absent.

Only a few OECD countries do not have a constitution contained in a single document, for example Canada, New Zealand and the United Kingdom. These countries also have several statutes pertaining to the budget system, which have evolved on a piecemeal basis over a long number of years. Beginning in the 1980s, New Zealand strengthened its legal framework for budget processes, including adopting a new law that specifies the responsibility of the government to report to Parliament and the individual responsibilities of the key budget players (including those of chief executives in core government departments, who deliver outputs consistent with the government's budgetary objectives). In these Westminster countries, parliamentary regulations ("Standing Orders") and/or parliamentary resolutions contain provisions which, in countries with strong legal traditions, would be incorporated in formal law. The ministries of finance (sometimes known as "the Treasury") in Westminster countries have strong inherited budget-related powers, several of which are given force by treasury regulations.

3. Can economic theory explain the differences?

This subsection reviews various branches of public finance literature with a view to examining the extent to which different schools of thought provide explanations as to why the laws underlying budget systems differ so widely across countries. This literature review provides some insights into the nature of fiscal "rules" ("institutions" in the literature), especially those which have an impact on budgetary outcomes. However, they do not provide a comprehensive view as to why various budgetary rules have been embodied (or not) in the different types of laws of OECD countries.

3.1. New institutional economics

New institutional economics has defined rules very broadly. One Nobel Prize laureate defines an "institution" as any socially imposed constraint upon human behaviour (North, 1991a, Chapter 1). "Institutions" provide the broad framework of formal and informal rules and constraints that govern the way organisations, as groups of people, function. Formal rules include constitutions and laws. Informal constraints include customs, codes of conduct and sanctions (North, 1991b).

In this literature, "institutions" are distinguished from "organisations". Constitutions, for example, are regarded as institutions, whereas legislatures

and executives are organisations that operate under the constitution. The interaction between institutions and organisations affects the cost of transactions. Appropriate rules can minimise various transaction costs associated with incomplete contracting or asymmetrical information (Williamson, 1996). The insights from new institutional economics are applicable mainly to private sector markets and firms. However, the New Zealand government applied this theory to the public sector, notably its emphasis on the need to minimise transactions costs associated with information asymmetries and agency problems (Scott *et al.*, 1997, p. 360). New contractual relationships, supported by law, have been pursued with vigour in New Zealand (Schick, 1996).

One could model the "institutions" as the set of formal and informal budget rules contained in constitutions, budget system laws and associated regulations. The "organisations" are the executives, legislatures, and independent external audit organisations – the three main players of generic budget processes. "Contracts" govern the roles and powers of various executive branch organisations (*e.g.* cabinets, ministries of finance, spending ministries and agencies) and legislatures (*e.g.* plenary sessions, specialised budget committees of each house of Parliament). The insights of new institutional economics do not appear to have been systematically used for such modelling, in which the role of budget system law is also important. Also, the literature has not analysed why budgetary "institutions" have evolved incrementally over long time periods.

Nonetheless, some recent reforms of budget system laws have aimed at addressing transaction costs, particularly information asymmetries. There has been an emphasis on enhancing transparency and providing more budgetary information to Parliament and the public, as well as strengthening Parliament's "contract" with the executive to be accountable in its preparation and execution of the annual budget approved by the legislature. For example, a budget system law may specify the "contractual terms" for the executive's rights to alter the approved budget during the implementation phase.

3.2. Law, economics and public choice theory

Studies of the interface between law and economics could potentially provide guidance as to why budget system laws differ widely, especially given that the literature emphasises efficiency (Van der Hauwe, 1999, p. 610) – one criterion for assessing budgetary systems. In general, the major focus of the law and economics literature is on the interaction between private sector economic behaviour and law (Werin, 2003). In Anglo-Saxon countries, lawyers recognise that they were slow to appreciate the impact on legal systems of the changing role of "the contracting state" (Taggart, 1997).

In contrast, in continental European countries, law and public finance studies have long been intertwined. Law is generally given primacy over economics – advanced public finance studies are taught in law (not economics) faculties. Within national administrations, large numbers of people with legal training are employed in finance ministries. In Germany, employment and salary incentives in the Federal Ministry of Finance are more favourable for lawyers than for economists (Würzel, 2003, footnote 8). In contrast, theoretical economists in English-speaking countries are reluctant to adopt a legal perspective for budget systems. Brennan and Buchanan (1985) argue that there is constitutional illiteracy amongst economists, who are poorly equipped to assess the rules needed for power struggles. With regard to budget systems, such struggles take place between executives and Parliaments.

Public choice theory and its several "schools" have developed within the economics and law discipline (for a review, see Medema and Mercuro, 1997). The role of the public choice theorist is "to advise citizens on the working of alternative constitutional rules" (Brennan and Buchanan, 1988). One tenet of public choice theory is that legislators and government officials do not act for the common good (McAuslan, 1988). Rules, including changes in actual constitutions, are seen as necessary to tame self-seeking politicians' exploitative ways.

Public choice theorists generally do not examine budget processes comprehensively – at best only particular "rules" are advocated. For example, some public choice theorists (*e.g.* Buchanan, 1997) have proposed that a "balanced budget" rule is so fundamental that it should be inserted into the constitution (this argument has been largely confined to the United States). Under this view, ordinary law or informal agreements are not seen to provide the necessary permanency needed for the conduct of prudent fiscal policy.

3.3. Constitutional political economy: budgetary rules and budgetary outcomes

Constitutional political economy focuses particularly on the analysis of the choice of rules. As a separate discipline (Voigt, 2003), the literature is usually at a general level (*e.g.* Weingast, 1996). One branch of constitutional political economy focuses on the impact that alternative rules have on economic outcomes.

As from the early 1990s, the role of "institutions" (rules) and budgetary performance has been examined extensively. An index of various budgetary rules was first constructed for European Union countries and it was found to be correlated with budget performance (von Hagen, 1992). These studies were refined (von Hagen and Harden, 1994) and provided with a theoretical basis (von Hagen and Harden, 1995). The literature had a considerable influence on the development of formal "fiscal rules" on government deficits and debt,

notably the Maastricht criteria for EU countries. Empirical studies associated with this literature have burgeoned, covering Latin America (Alesina *et al.*, 1996), Eastern Europe (Gleich, 2003; Yläoutinen, 2004), Australia, New Zealand, selected Asian and African countries (Campos and Pradhan, 1996). Studies in this area, including for Switzerland, are reviewed by Kirchgässner (2001).

In a related strain of research, Persson and Tabellini (2001) have examined the effect of electoral rules and political regimes on fiscal policy outcomes. Relative to parliamentary regimes, presidential regimes are associated with smaller governments, as are majoritarian elections relative to systems of proportional representation. The role of budget system law is not examined in this literature. However, it does hypothesise that rules are needed to mitigate conflict over budget disputes within the executive, within the legislature and between the two branches, in order to reduce deficits and government debt. These studies provide a framework for considering which budget processes are important for fiscal stability. However, they do not provide guidance as to which elements of budget processes should be included in formal law and those which should be left informal and non-legally binding (*e.g.* the dominant role of the Minister of Finance in Cabinet).

Views may differ as to whether Parliament should dictate particular rules by adopting primary law(s) or whether the executive should drive budget processes using regulations (executive-controlled "rules"). An executive's decision to issue secondary laws (or not to do so) – from the powers that are delegated to it by primary law or inherited by it from former times – is generally not examined in this literature. Also, the important role of external audit in identifying budgetary mismanagement and suggesting changes in "institutions" is absent from this literature. In contrast, this study and INTOSAI[4] consider that a rules-based external audit organisation is essential for improving budgetary performance.

3.4. Can game theory help?

In game theory, political strategies, social choice and economic outcomes are integrally linked. Strategic actors have the capacity to make binding commitments, with an exogenous enforcement institution that guarantees the promised outcome (Shepsle, 1998). Although this approach has been applied to collective decision making as well as to law (Baird *et al.*, 1994), it has not been systematically applied to budget system law. Game theory has been used to model the supply of public services, provided by the bureaucracy, to meet the demand for public services. Kraan (1996) develops a model for the interactions between politicians and bureaucrats, as opposed to the rules needed for budget processes. The study concludes that the bargaining skills of the actors are the primary determinants of budgetary outcomes.

4. Can comparative law explain the differences?

The focus of comparative law[5] is on identifying inter-country differences in the broad features of legal systems. This section focuses on the various bullet points of Box I.1, except the last, which has been discussed in the introduction above.

Box I.1. **Comparative law: Aspects of relevance for budget system law**

- "Models" or families of legal systems.
- Constitutions, statutes and budget system law.
- Hierarchy within primary law.
- Law-making processes.
- Secondary law, regulations of the legislature, and customary law.
- Rules *versus* law.

4.1. Families of legal systems and the importance of the constitution

A families-of-law approach provides some insights – admittedly incomplete – as to why budget system laws differ so widely across countries.[6] First, the classification of legal systems into "families" is a difficult task, since when the scope of the "family" is defined, all key systemic features need to be incorporated without weakening the notion of homogeneity. Second, comparative law studies do not focus on the content of norms to be embodied in law, but rather on the overall approach. Third, "families" of laws are generally classified by specifically legal features. Findings of comparative law studies are therefore likely to provide, at best, an explanation as to why the organisational structure and density of budget system laws differ across countries.

At the broadest level, two law "families" or legal traditions were identified over a century ago (David, 1900):[7]

- Romano-Germanic (civil law model).[8] Laws and codes are framed abstractly, with judges interpreting laws. Written constitutions are important for all such legal systems.
- English (common law model). Laws are not initially written down, but made by judges' decisions, often based on precedents. The distinction between public law and private law is virtually absent (Allison, 1997).

Civil law countries generally also contain a large body of public administrative law, which specifies the legal relationships between those administering and those administered. However, budget system laws are

absent from comparative studies on administrative law (Schwarze, 1992). One major reason for this absence is administrative law's emphasis on the relations between the State – including its agents (bureaucrats) – and citizens. Administrative law concentrates on the legal framework for the administrators of public laws, such as the legal rights of civil servants, but generally not on their responsibilities in budgetary processes. In contrast, budget system laws focus on the budgetary responsibilities of the executive, the legislature, and the external audit organisation.

In common law countries, budget processes have not been a focus of courts' and judges' decisions. Rather, the legal basis of budget systems and players can be in any of the following: "the prerogative" of the executive (see the case study for the United Kingdom), the constitution, statutes, Standing Orders, and various types of normative acts of the executive. In civil law countries, where written constitutions provide a guiding framework for all law, challenges to budget system laws by constitutional courts have also been few.[9]

The differences between civil law and common law systems are lessening because of greater reciprocal knowledge of the two models and the increasing tendency in English-speaking countries to adopt statutes – lawyers' laws are being reinterpreted and put onto a statutory footing by Parliaments. In the case of the United Kingdom, the influence of European law is also a factor resulting in the convergence of the two main legal families.

Although there is some convergence between civil law and common law, there is one characteristic of the civil law and common law "families" that help explain – at least at the broadest level – why budget system laws are so different. This concerns notably the role of the written constitution. First, a constitution often contains at least a few provisions relating to the budget system, which influence the content of any non-constitutional laws pertaining to the way the budget system should operate. Second, a constitution may specify how laws are organised – both in general and for budget laws in particular. In countries without written constitutions, statutes are drafted and adopted without any formal constitutional constraints and the need for statutes is less pressing when there is no constitution that specifies legal procedures and what subject areas must be regulated by law. Third, written constitutions specify the roles of the key players in budget processes. In civil law countries, constitutions and statutes serve different broad purposes (Box I.2).

The distinction between civil law and common law leads to the following two groups:

Group 1: Countries with written constitutions. The constitution defines the relations and differences in function of the key public bodies involved in budget processes. The distinction between the executive and the legislature is

Box I.2. **Purposes of constitutions and characteristics of statutes**

Constitutions (purposes):

- To establish and specify the organisation, powers and roles of parliament, the executive, and the external audit office, and the relationships between them.
- To specify the role of sub-national legislatures (if any), governments and administrative units.
- To establish, implicitly or explicitly, a hierarchy among the sources of law.*

Statutes (characteristics):

- General in content, although the degree of detail and specificity varies.
- Embody principles and/or outline missions, roles and responsibilities for regulating economic activity and budgetary processes.
- Are adopted by parliament, the supreme institution endowed with law-making powers.

* Delpérée, 1988.

explicit. An external audit body is usually established. In general, written rules are trusted. Constitutions are particularly difficult to change – usually a parliamentary supermajority is needed, perhaps coupled with other restrictions (see Nordic countries case study). Constitutional courts or supreme courts have a mandate to safeguard the constitution, including reviewing statutes for their constitutionality.

Group 2: Countries without written constitutions. The relations and differences in function of the key public bodies involved in budget processes are more blurred than in countries where constitutions spell out roles with some detail. The executive and the legislature are not distinct, in part because constitutional rules specifying their roles have never been written down. For example, in the United Kingdom, the role of the Cabinet of ministers is not written. Combined with a first-past-the-post electoral system, the resulting unwritten powers conferred on the Prime Minister are very strong. Compared with Group 1 countries, unwritten rules supplement written rules. New "constitutional" values are easy to introduce since, in the absence of a special court mandated to review constitutionality, new statutory law can be adopted easily by Parliament at the initiative of the executive.

The observations concerning the distinction between the executive and the legislature are particularly pertinent when it comes to budget system

laws. In Group 1 countries, since constitutions explicitly define the general roles of the executive, the legislature and the judiciary, and the relationships between the executive and the legislature, any draft budget system law will of necessity be reviewed carefully by all players, including possibly the constitutional courts mandated to review statutes for constitutionality. Indeed in Group 1 countries, portions of laws or entire budget-related laws have been rejected (see footnote 9) or criticised[10] by constitutional courts. Such far-reaching reviews or legal challenges are non-existent in Group 2 countries, thereby making it is easier to adopt statutes, perhaps of a lower quality. The relative ease of adopting laws is also accentuated by the non-separation of the executive from the legislature.

4.2. Absence of norms for constitutions partly explains differences in budget system laws

Within Group 1 countries, constitutional provisions vary widely. There are no universal rules for the content of written constitutions. In general, the amount of detail in constitutions varies widely. For example, the number of articles in the Constitutions of France and Portugal are 89 and over 300 respectively.[11] The size of the constitution is not necessarily a guide to the extent to which legal requirements for the budget system are embedded in the constitution.

Constitutions have been distinguished according to whether they are "normative" or "programmatic" (Denniger, 1988, p. 108). The former are constitutions that contain legal rules that can be executed directly. In contrast, programmatic constitutions are those where provisions are not self-executing. To implement non-executable constitutional provisions, a statute law is usually required. It could be postulated that the countries whose constitutions have an entire chapter on public finances (*e.g.* Finland and Germany) are more likely to be "normative", since detail is provided in the constitution to ensure that provisions are executable. However, there does not appear to be a correlation between the extent to which the constitution contains provisions related to the budget system and the density of statutory law pertaining to national budgeting. For example, the constitutions of Norway and the United States have few constitutional provisions relating to the budget system, yet Norway has no statute regulating its national budget system, whereas the United States has adopted a multiplicity of budget-related laws. An avenue of further research would be to examine more systematically the relationship between predominately normative or predominately programmatic constitutions and the density of budget-related statutes.

Even the number of constitutional documents varies. Whereas for most countries, the constitution is a single written document, a few countries (*e.g.* Austria and Sweden) have several formal laws that constitute their written

constitutions. Thus, these two countries are barely distinguishable from two Group 2 countries (Canada and New Zealand) which, while having adopted Constitution Acts, recognise that the full constitution is incomplete without a number of other statutes, as well as conventions.

Moreover, the ease with which a constitution can be changed varies. For example, the United States has amended its Constitution only 27 times in over 200 years, whereas Germany has amended its Constitution nearly 50 times in less than 60 years. Denmark has never changed its 1953 Constitution. Thus, for countries whose constitutions contain a number of budget-related constraints, it may be difficult to introduce budget reform by law since constitutional change may be required.

Comparative international studies in constitutional law usually focus either on the differing constitutional rights of citizens or the differing political arrangements between countries. Although most countries accept the principle of parliamentary supremacy over the "power of the public purse", there is a dearth of international studies on comparative constitutional provisions for budget preparation, adoption, execution and reporting. Part II attempts to fill this gap.

4.3. Hierarchy within primary law also partly explains differences in budget-related laws

In a country with a strong emphasis on a hierarchical system of law, the budget system is primarily "determined" by the country's written constitution and any high-level law(s). The following discussion focuses on legal systems in which "organic" laws are an integral part and those in which "framework" laws are present. These distinctions are made in constitutions. Such constitutional provisions provide some explanation as to why the legal frameworks of the budget systems in some countries are dominated by "higher" primary law.

First, in some countries, constitutions require laws and regulations to be established according to a strict hierarchy (*e.g.* Spain, see Box I.3), under which laws of lower jurisdictions cannot conflict with laws of higher jurisdictions. A specific type of primary law – an "organic" law – is required by the written constitutions of France[12] and Spain. The main characteristics of organic laws are:

- They are more difficult to change than ordinary laws (*e.g.* in France, organic laws have to be adopted by both houses of Parliament on identical terms and require an absolute majority – a supermajority is not needed for their adoption).
- In the case of conflict with ordinary laws, organic laws take precedence, even if the ordinary law is adopted at a point later in time than the organic law.

Box I.3. **Hierarchy of laws: The example of Spain**

The rank, from higher to lower level, is:

- **The Constitution,** which lays out the various types of laws, as follows.
- **Organic laws.** These are a specific type of statute regulated by the Constitution. They differ from ordinary legislation in two ways:
  - ❖ The subject matter which they regulate is either specified in the Constitution (*e.g.* Statutes of Autonomy, the electoral system) or required in specific articles of the Constitution (*e.g.* organic laws are needed to establish the Council of State and the Constitutional Court).
  - ❖ The requirements for their approval, modification or repeal. Organic laws require an **absolute majority** of the Congress of Deputies in a final vote on the **entire** bill.
- **European Union legislation.** Any conflicts between domestic legislation and European legislation must be resolved according to the principle of the supremacy of Community law.
- **Ordinary laws.** These are laws whose subject matter is not reserved to organic laws by the Constitution. They require a **simple majority** of the Congress of Deputies and the Senate, with the Congress adopting the final decision.
- **Decree-Laws.** These are provisional legislative decisions that the government may issue for urgent matters. They rank as laws, but must be ratified by the Congress of Deputies within a period of 30 days.
- **Legislative decrees.** These are dispositions of the government containing delegated legislation. They also rank as laws. The delegation of power under which they are made must be granted by law.
- **Regulations.** These are lower status rules. The Constitution provides the government with regulatory power. However, other constitutional organs of the State, including the Congress of Deputies, the Senate and the Constitutional Court, also have regulatory powers. There are three main types of regulation:
  - ❖ **Decrees** from the Council of Ministers.
  - ❖ **Orders** from ministers or delegated commissions.
  - ❖ **Instructions** and **orders of regulation** from inferior authorities and public administration bodies.

Source: Cabrero (2002).

This does not, however, exclude the possibility of adopting additional "ordinary" laws to elaborate on budget principles and processes. In the case of France, there are no additional laws of importance relating to State budget processes – the emphasis is on ensuring that budget and accounting regulations are in place (for detail, see the France country case study).

Second, there are "framework" laws, which differ from "organic" laws. In a federal country, the constitution may allow laws to be adopted that oblige sub-national governments to adopt legislation in line with general principles specified in a federal law. Germany is a prime example: the 1967-69 constitutional amendments authorised the Federation to adopt legislation that establishes budget principles applicable to both the Federation and the provinces (*Länder*), even though the two levels of government are "autonomous and independent of each other in budget management".[13]

Many countries do not have a hierarchical system of law, and there, all laws apart from the constitution are ordinary laws. Such countries are free to adopt tailor-made laws for specific areas of budget management. Nonetheless, differences exist between countries in the way ordinary laws relating to budget processes are organised and consolidated. The main options are:

- **Codification** which can be defined as a consolidation of pre-existing laws in a logically conceived framework.[14] The United States is an example. For budget management, Title 31 of the US Code – on "Money and Finance" – was adopted as a separate law in 1982. The sections on budget processes and financial management provide a sizeable part of the formal legal framework for United States federal government budget processes.
- **Consolidation of existing ordinary laws.** This may occur if there is a perceived need to clarify, modify, or simplify laws that possibly overlap. For example, in December 2004, New Zealand integrated modified versions of the 1989 Public Finance Act and the 1994 Fiscal Responsibility Act in a single new act.
- **No consolidation.** In some countries' legal traditions are such that there is no perceived need for consolidation of existing public finance laws. For example, in the United Kingdom, although parts of the 1866 Exchequer and Audit Departments Act have been repealed by subsequent laws, some sections are still operative.

4.4. Not all countries complete all steps of formal law-making processes

Differences between countries' budget system laws and regulations can be partly explained by difference in attitudes towards completing the three main phases of making law and regulations (Box I.4).

Box I.4. **Steps in making law**

Initiation. Legal instruments concerning the annual budget are usually initiated by the executive. The formulation of draft budget laws – either those governing generic budget processes or annual budget laws – is an important task of the executive in all countries. Executives, on the basis of law, are also empowered to issue regulations, often on their own authority. The powers and processes relating to the initiation of law and regulations are generally spelled out in constitutions and/or other laws.

Resolution. This is the phase of formally agreeing on the contents of the proposed law or regulation. For primary law, in countries with two chambers in the legislature, constitutions (or other law) specify the approval processes in each chamber and, in the cases of non-agreement between the two chambers, procedures for reconciling differences. For secondary law, the resolution phase is usually decided by the cabinet of ministers or an equivalent high-level body or juridical person (*e.g.* the president in presidential systems).

Concluding activities. Before a law or regulation can be formally adopted, additional steps are required. These include quality control, signatures (*e.g.* the head of State and/or ministers for primary law), promulgation and publication in the official gazette (which is usually obligatory in civil law countries). In particular, in some countries, laws may be reviewed by a constitutional court and regulations may be reviewed by a high-level administrative court – *e.g.* the Council of State (*Conseil d'État*) in France.

Source: Pizzorusso (1988), pp. 44-45.

In Denmark, where budget procedures are governed by regulation, not formal law, not all of the above steps are completed. Although the "initiation" phase is completed by the Ministry of Finance, the "resolution" phase by Parliament is absent. Some "concluding activities" – including review by a constitutional court (which does not exist in Denmark) and the signature of the monarch – are also absent.

4.5. *Greater use is made of secondary law in some countries*

The main distinction between "primary" and "secondary" law is that primary law is adopted by the legislature whereas secondary law is adopted by the executive. Differences across countries exist in each of the three steps shown in Box I.4 – both for primary and secondary law.

Secondary law can be categorised in two broad ways. First, there are regulations, issued by the executive that are explicitly drawn up to elaborate on a primary law. Second, there are executive orders or regulations that have

been drawn up when primary law is silent on a given issue. This may lead to an independent source of administrative law.

As with primary law, there is considerable country variation in both the role and categories of "secondary" law, also known as "delegated legislation" (Caretti and Cheli, 1988). The differences are largely a function of institutional arrangements associated with the separation of powers between the executive and legislation, as illustrated in Table I.1.

Table I.1. **Delegated legislation and separation of powers**

	United Kingdom	France	United States
Does secondary law have the same force as primary legislation?	Yes, secondary legislation can be used to amend existing primary legislation.*	No, secondary law is subservient to primary law.	No, legislation adopted by Congress has greater authority than executive regulations that implement statutes.
Does the legislature exercise control over delegated legislation?	This depends on the original act. Some statutory instruments (SIs) require parliamentary approval. In practice, the vast majority of SIs are not reviewed by Parliament.	No, this is delegated, according to provisions of the Constitution.	No. The President and bodies established within the executive branch may issue orders without review by Congress.
Is there a special juridical body for controlling normative acts of the executive?	No, but parliamentary committees have been set up for this purpose. They examine the consistency with the parent act, not the merit of the SI itself.	Yes, a Council of State *(Conseil d'État)* is established in the Constitution with a major purpose of vetting draft regulations.	No, but all draft regulations are reviewed by the Office of Management and Budget, an agency under the presidency.
Is the separation of the executive from the legislature a principal feature when there are conflicts regarding the role of secondary law?	No, any conflict would centre on the joint executive-legislature position *versus* that of the judiciary (*i.e.* the courts – there is no constitutional court).	Yes, since the Constitution specifies clearly the realm of law by Parliament (Art. 34) *versus* that of regulations by the government (Art. 37).	Yes, a sharp separation of powers is a fundamental tenet of the United States Constitution – the drafting of regulations is entrusted to the executive.

* See House of Commons *Factsheet L7 Legislative Series "Statutory Instruments"* (2002, revised July 2003).

Table I.1 demonstrates that secondary law in the United Kingdom is weakly controlled by Parliament, even though secondary law has the same force as primary law. Parliamentary debates on the role of statutory instruments are usually on technical issues, not on the substance of the secondary law. The executive drafts budget-related laws that lay out general principles and ensures that such laws delegate the formulation of details to itself, via the regulatory authority of Statutory Instruments. These practices provide a strong source of legal authority for the executive.

In contrast, in France, the Council of State provides advice to the government on the legality of normative acts – both draft laws and draft decrees. It intervenes – provides its advice – just prior to the consideration of draft laws or decrees by the Cabinet of ministers. Although the Cabinet is not obliged to accept the advice of the Council of State, its recommendations are influential, resulting in a high standard of regulation and, in principle, full consistency of primary and secondary legislation.

In pure presidential systems, all normative powers of the executive are a direct result of deliberate acts of delegation by the legislature. There is rigorous application of the separation of powers. In the United States, a presidential Executive Order lays out the executive branch's internal procedures to ensure control of all regulations.

4.6. Decisions and regulations of the legislature are particularly important in some countries

If Parliament takes a decision, but not all the "concluding activities" (see Box I.4) are completed, the parliamentary resolution does not become a statute or formal law. Nonetheless, such decisions have the same impact as law. If the formalities associated with law making are not accorded the same importance as they are in countries with strong constitutional and legalistic cultures, parliamentary resolutions can be an important source of "quasi-law" governing budget procedures and processes. Such situations appear to arise particularly in parliamentary monarchies. Two examples are provided.

First, in the United Kingdom, the House of Commons adopts resolutions – based on law – that have a similar impact to formal statute. For example, in 1998, the miscellaneous provisions of the 1998 Finance Act authorised the Treasury to draw up a Code for Fiscal Stability, to be approved by the House of Commons by resolution. The 1998 Act did not require approval of the Code for Fiscal Stability by the upper house of Parliament – the House of Lords. To become statute law, approval of both Houses of Parliament and the Queen's assent is required. This was not the case for the Code for Fiscal Stability, which lays out very important fiscal reporting requirements.

Second, in Norway, according to the 1814 Constitution, every bill is first passed in the *Odelsting*, and then approved in the *Lagting* – these are separate chambers of the Parliament, the *Storting.*[15] If the King assents to a bill, he appends his signature, and the bill becomes law. Many bills – including the budget regulations and annual budgets – are adopted by parliamentary decision, *i.e.* by the full *Storting*, without separate discussions taking place in the two chambers. Technically, resolutions of the Parliament are not formal law. However, their impact is identical to that of a law.

Apart from parliamentary decisions, the regulations that govern the internal operations of legislatures can be particularly important for budget processes, especially where these concern the adoption of annual budgets as laws and the reporting of budget execution to Parliaments. In some countries (*e.g.* France, Spain), normative decisions governing parliamentary procedures are like statutes and require a constitutionality review. In other countries, such decisions do not have the status of law – they are regulations internal to the legislature, approved according either to their own procedures or those laid down in the law. In countries with bicameral legislatures, separate regulations govern the internal procedures of each house.

The degree of separation of executive and legislative powers is crucial as to the content and impact of internal regulations on budget processes. In countries like Italy or the United States whose legislatures have considerable independent powers, internal regulations are drawn up and approved exclusively by parliamentary (congressional) bodies. In Italy, the Constitutional Court has explicitly declared that is not necessary for parliamentary regulations to be reviewed for their constitutionality (Pizzorusso, 1988, p. 85). Since the executive is excluded constitutionally from interfering with the drawing up of internal rules, legislatures in such countries can use them for expanding their budget powers. For example, the United States Senate has established a "filibuster" rule, which requires a supermajority of senators (three-fifths) to approve the closing of a debate on any issue. Unless this rule is waived, budgetary decisions taken by Congress not only require a majority but a large political consensus (Blöndal *et al.*, 2003, p. 21). This rule can lead to long delays in approving annual appropriation bills.

In contrast, in parliamentary countries of the Westminster tradition, parliamentary regulations (Standing Orders) are heavily influenced by the government, either directly (where the Treasury prepares a first draft) or indirectly (by influencing the key parliamentary committee, which is dominated by members of Parliament from the ruling parties of government). Standing Orders – not statute law – limit any important role in the budget process being played by the Parliaments of such countries. Two examples illustrate the extent to which Parliament's powers are restricted by its "own" regulations:

- United Kingdom. Standing Order No. 54 limits debate on the budget estimates in the House of Commons to three days (a separate law excludes the House of Lords entirely from any discussion of the government's proposed tax and expenditure estimates in the budget).
- New Zealand. Any proposal by Parliament to amend the government's draft budget can be overridden by the government if it considers that the amendment would change the government's agreed fiscal aggregates, or the composition of proposed expenditures, in more than a minor way. This so-called "financial veto" is specified in Standing Order No. 312.

4.7. Customary law and coalition agreements are relatively important in some countries

Customs can be defined as practices that emerge outside legal constraints and which individuals or organisations spontaneously follow in the course of their interactions, out of a sense of legal obligation (Parisi, 2004). Whenever customary rules are granted legitimate status in a legal system, they acquire the same effect as other sources of law, though they would be subordinate to formal legislation (Parisi, 2001). Customary law derives its force from:

- The consistent occurrence of a uniform practice.
- A belief that adherence to it is obligatory, without necessarily being formally incorporated into any written body of law.

In some countries' budget systems, notably those of the United Kingdom and its ex-colonies, customary sources of law play a role. Several examples may be cited. First, the establishment of the Cabinet – the all-important body for budget decision making – has no legal basis, *i.e.* there is no legally binding document that specifies Cabinet's roles and responsibilities in budgetary matters. Second, the royal prerogative in the United Kingdom – the powers unique to the executive that the courts recognise it possesses for the purposes of carrying out the business of government – is another source of extra-legal influence. Several of H.M. Treasury's powers – including specifying the structure of appropriations and controlling expenditures – are derived from the royal prerogative (Daintith and Page, 1999). Third, Cabinet minutes or Treasury Concordat are extra-legal documents that also guide budgetary processes in countries with Westminster parliamentary systems.

In several continental European countries with coalition governments (*e.g.* Germany, the Netherlands), prior to the formation of a new government, the political parties about to govern draw up a "coalition agreement". Such pacts specify the political and economic agenda of the government that is valid for the life of the government. Because of their limited duration, such agreements cannot be regarded as customary law. Also, because of their non-binding nature – they are voluntary agreements – they cannot be considered a source of law. Nonetheless, in some cases, they provide detailed rules for aspects of the budget process and, at least for their duration, have the same impact as law.

As an illustration, the government of the Netherlands drew up a detailed set of macro-fiscal stability rules (Blöndal and Kristensen, 2002, Box 1). By voluntarily adhering to the rules, the general government deficit was turned to a surplus in the 1990s. Thus, the impact of the coalition agreement was identical to that which would have been achieved by a law of limited duration prepared by the government and adopted formally by the Dutch Parliament.

4.8. Are laws "green lights" or "red lights"?

Laws differ in how they regulate budgetary action. Some countries may be more prone to adopting permissive budget-related laws, which simply lay out desirable budgetary principles. Voluntary compliance with "green light" provisions of laws is expected. There are few or no penalties for not respecting the "good" budget principles. For example, many countries' legal frameworks permit, but do not require, a supplementary budget to be presented to the legislature during the fiscal year, should the need arise. There are no penalties should a government not present a supplementary budget in a given year. Nor are there penalties for adopting four supplementary budgets in the same year.

In contrast, some countries may require a formal mid-term budget review to be conducted every year. When embodied in law, there is a compelling requirement on executives to submit such a review by a given date. No exceptions are allowed (except perhaps if the government falls at the time of the mid-term review). Some laws may also prohibit certain actions – dictate what the government or legislature cannot do. For example, a quantitative fiscal rule may prohibit the deficit exceeding x% of GDP. These two forms of "red light" laws may be more prevalent in some countries than others. In Section 5.4 below, it is proposed that countries with strong legislatures may use law more often than in countries with weak separation between the executive and the legislature. Strong legislatures adopt both "green light" and "red light" laws to regulate budget processes. In contrast to permissive law, restrictive law requires the detailed specification of sanctions in law. In countries where many laws with "red light" provisions are adopted for budget processes, density of budget-related law is likely to be greater.

5. Forms of government and budget system laws

This section highlights the extent to which past and present forms of government affect the source of laws in general and budget system laws in particular. It highlights the use of the law for strengthening budget powers. In regimes where the separation of powers is strong, legislatures use the law to strengthen their powers in the budget processes. Conversely, in countries where there is a weak separation of powers, the executive also uses the law – but to strengthen its own budgetary powers.

In major OECD countries, three main groupings of governments may be distinguished: 1) constitutional or parliamentary monarchies; 2) presidential and semi-presidential governments; and 3) parliamentary republics.

5.1. Constitutional or parliamentary monarchies

A key characteristic of absolute monarchies was the lack of separation of powers: the monarch was the holder of all State functions. Before democracy,

the monarch convoked assemblies of nobility, clergy and other representatives. In some cases, such assemblies adopted the "budget" of the monarch. The specification of standards in law, which had previously been reserved to the monarch or a non-autonomous judicial body, was increasingly assigned to Parliaments. However, the degree of independence of Parliaments varied. Within Europe, two models evolved.

In France and in German-speaking countries, judicial organs developed under the auspices of the absolute ruler, executive power grew, as did the public administration of the State. Over time, the power of the monarch diminished. Some budget-related organisations, notably courts of accounts, date from an early emphasis on a semi-autonomous judiciary. Additionally, the notion of the State, a written constitution and a system of public and administrative law developed. These influences continue to impact on the primacy given to the law in these countries.

In contrast, in Britain, parliamentary assemblies became increasingly important and the monarch's role gradually diminished until it became, as today, a purely ceremonial one. The form of government evolved into a "limited monarchy", where the Crown fulfilled state functions on the basis of national policies decided according to Parliaments' legislative powers. However, there remained some fields in which the Crown retained the royal prerogative. In 1714, a special bond between the parliamentary assembly and the executive organs developed, notably that of ministerial responsibility before Parliament. These features, especially the prerogative powers of the Crown, which today are exercised by Cabinet and H.M. Treasury, continue to play important roles in the budget framework in countries that have inherited the "Westminster" governance model. In the United Kingdom in particular, the necessity for statute law to govern budget processes is played down. When statute laws on budget-related issues are adopted, the impact of such laws is to maintain the strong inherited prerogative powers enjoyed by the government. This, combined with the first-past-the-post electoral system, allows the executive to dominate the legislature. The Prime Minister and his/her Cabinet not only controls the legislative agenda, but also exercises prerogative powers.[16]

Some European countries (*e.g.* Denmark, Netherlands, Norway, Spain, and Sweden) as well as Japan have also retained a parliamentary monarchy form of government. In all cases except Spain, the role of the monarch has been reduced to one of representation. However, in most of these countries, electoral laws are different, resulting in multi-party political systems and the formation of coalition governments. Also, Cabinet ministers may be chosen from outside political parties, *e.g.* high-level bureaucrats. Thus, parliamentary and executive powers in these countries are generally more balanced than in countries of the Westminster tradition.

5.2. Presidential and semi-presidential governments

The key characteristic of a presidential system is that the head of State is directly elected by the people, in clear contrast to monarchies. Under a "pure" presidential system, the directly elected head of State, by constitutional design, is also the head of the executive. All executive power is vested in one person, not a collective body such as a Cabinet of ministers. However, the president's room to manoeuvre in budget matters is constrained by the extent that the legislature dictates the "rules of game" of budget management by adopting laws or imposing other rules.

A "pure" presidential system operates in the United States and other countries on the American continent. The United States president's powers are "balanced" by those of a House of Representatives, a Senate, and a judiciary. This form of government is characterised by very strong separation of powers.

In a semi-presidential system, the head of State – the president – is also directly elected. However, the executive is divided between the head of State and the head of government, the prime minister (who is usually the leader of the majority political ruling parties at the time of legislative elections). The president may have strong powers, specified in a written constitution. Finland, France,[17] and Korea have adopted a model in which the prime minister is formally appointed by the president after approval or election by Parliament. In contrast to the Westminster system, any elected parliamentarians usually must resign from Parliament to become a Cabinet minister – the two functions are perceived to be incompatible.

5.3. Parliamentary republics

In several respects, parliamentary republics are similar to semi-presidential systems. The major difference is that the president is not directly elected by citizens. The presidents of such countries generally have weaker constitutional powers. Germany and Italy are examples. In these countries, the head of the Cabinet of ministers (*e.g.* the Chancellor in Germany) plays the politically dominate role and speaks for the parliamentary majority. Cabinets are formed mainly from parliamentarians (who must resign from Parliament), although non-elected officials may be appointed.

5.4. Relationship between forms of government and budget system law

The relative strength of executives and legislatures varies considerably according to the form of government. Under a pure presidential system, the separation of the legislature from the executive is specified in the constitution. By adopting laws, the legislature can reinforce its supremacy over the executive in budgetary matters.

In parliamentary systems there is less separation of the executive and the legislature. Provided discipline within the ruling party or parties is maintained, the government can propose laws to Parliament, which adopts them with relative ease. Maintaining party discipline is easier in two-party systems than in multiparty systems, where reaching and maintaining a consensus within the coalition parties that make up the government can be troublesome. In both systems, however, the main effective tool that Parliaments have for "controlling" the executive is to propose a vote of no-confidence in the government and cause its collapse if the vote succeeds. This happens rarely in parliamentary monarchies that have first-past-the-post electoral systems. In such countries, in budgetary matters, the executive holds the "power of the purse", even though, constitutionally, Parliament is said to be supreme in money matters.

A detailed comparison of specific budget powers embodied in primary law is provided in Part III. On the basis of budget-related laws, the legislatures in the countries with a strong separation of the legislative and executive branches have strong powers in relation to budget processes, including powers to:

- Specify the timing of submission of the draft budget to the legislature.
- Decide, for the annual budget and the medium-term budget framework, the levels of the aggregates for revenues, spending, and new borrowing.
- Ensure that plenty of time is allowed for budgetary debate in the legislature.
- Specify the nature, form and duration of the appropriations for annual budgets, as well as the supplementary information required to accompany the draft annual budget law.
- Amend the executive's draft budget, possibly without any legal constraints, for both total expenditure and the composition of spending programmes.
- Prevent the executive from withholding spending, once the annual budget is approved (*i.e.* provide the executive with weak or no powers to cancel or defer spending approved by the legislature).
- Decide on the number, size, and uses of extra-budgetary funds, by adopting specific laws.
- Limit to the maximum the executive's ability to manipulate government funds outside the purview of the legislature.
- Require substantial *ex post* budgetary information, including an audit of the financial accounts and an annual performance review of budget execution relative to the approved budget.
- Define the main roles of a supreme audit institution and require that it serves primarily the needs of the legislature.

- Require officials from the executive to defend budgetary outcomes before committees of the legislature and to report on identified cases of financial mismanagement.

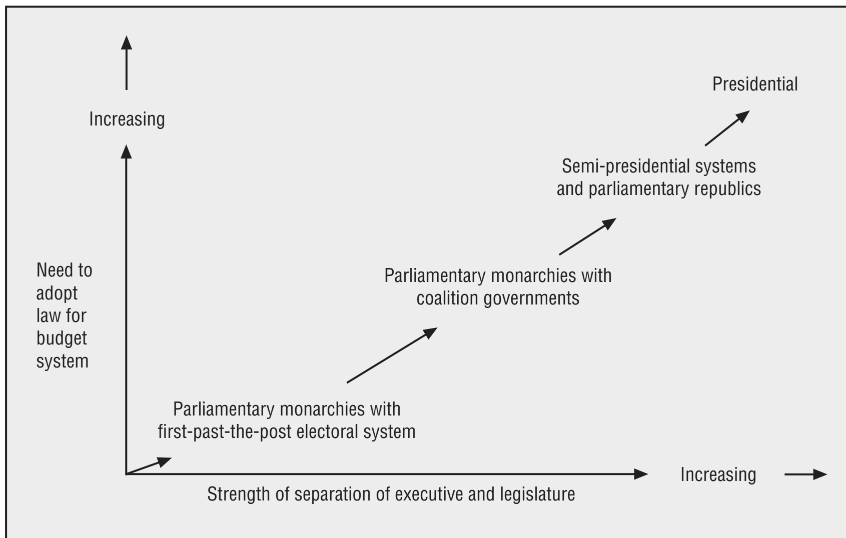
A number of the above differences – between a country with an executive-dominated Parliament (the United Kingdom) and a country with a very strong separation of executive and legislative powers (the United States) – are illustrated in Table I.2.

Table I.2. **Differences in selected budgetary powers of the executive and the legislature**

	United Kingdom	United States
Executive		
An executive office drafts the annual budget.	H.M. Treasury prepares a draft budget for Cabinet approval, subject to government-decided rules on fiscal aggregates, which will not be challenged by Parliament.	The Office of Management and Budget, a presidential agency, prepares a draft detailed budget. The executive may propose a medium-term fiscal strategy, but this is not binding on Congress, which has unlimited power to adopt its own fiscal strategy.
The political executive proposes the budget to Parliament.	The Chancellor of the Exchequer makes a speech, at around the beginning of the fiscal year, outlining the decisions that Cabinet has reached on all important budget matters.	The President submits a draft budget to Congress eight months before the new fiscal year begins. The President's budget provides a baseline for the "real" budget that is made by the legislature.
Legislature		
The legislature considers the budget in committees.	Yes, but only in the House of Commons. Most committees take little interest in the draft budget, mainly because any proposals for substantial changes are unlikely to be adopted. Such proposals are vetted by the House of Commons Liaison Committee and only three days of debate are allowed in plenary session.	Budget committees of both the House of Representatives and the Senate first agree on a "budget resolution" which could propose fiscal aggregates quite different from those proposed by the President. Subsequently, appropriation sub-committees may alter budget programmes substantially.
The legislature approves the budget as law.	Yes, but the adoption of finance acts and appropriation acts are mere formalities – they are not debated at the stage when the budget becomes formal law.	Yes, for discretionary spending, the budget becomes law in the form of 13 separate appropriation bills, which cover about one-third of total federal expenditure. Non-discretionary spending and taxes are also approved but by other laws.

It appears that when the legislative and executive branches are strongly separated, there is a greater tendency for legislatures to specify the content, detail and powers contained over the budget system in primary law (Figure I.3). In countries with political systems with a strong separation of powers, the legislature is reluctant to delegate law-making authority (Epstein and O'Halloran, 1999). Their strong powers are upheld by the courts. In contrast, delegation of law making by Parliaments, or maintenance of existing law-making powers by executives, is strong in countries with a weak separation of the executive from Parliament. In such countries, the representation of the government on parliamentary committees allows the executive to maintain those powers. A strong committee system has been found to derive from the larger constitutional context, with committees established in part to oversee executive agencies and thereby limit the powers of the executive (Epstein and O'Halloran, 2001).

Figure I.3. **Separation of powers and the need to adopt budget-related laws**



Although the strength of the legislature's powers in budget management is particularly strong in countries with strong legislatures relative to executives, the relationship is not necessarily one to one (as drawn in Figure I.2 for illustrative purposes). Other factors influencing the need for a country to regulate the budget system by the adoption of law include:

- The political system, particularly: 1) whether there is a bicameral or a unicameral system. the existence of a bicameral system in a Parliament, in which the second chamber also has strong powers in relation to budgeting, swings the balance of budgeting powers towards the legislature relative to a

unicameral system where fewer players are involved at the parliamentary stages; 2) the degree of proportional representation, which may weaken the powers of a government relative to a first-past-the-post electoral system. Some countries (*e.g.* Germany) have cut-offs that exclude very small parties from Parliament, whereas others (*e.g.* Italy) have had more complete proportional representation that allows more political parties, including the very small, to have seats in Parliament; and 3) the impact of a direct voting system for a president on the effectiveness of the separation of powers (*e.g.* in France in times of cohabitation,[18] the President of the Republic has limited capacity to influence the executive's draft budget).

- The weight and influence of the bureaucracy supporting the executive. The executive's central budget policy-making body – the Cabinet of ministers – is usually supported by a strong central Ministry of Finance (or equivalent) and thousands of highly-trained civil servants who, *inter alia*, prepare and implement annual budget laws. Such a body of staff contrasts vividly with the meagre resources generally available to Parliaments – a few hundred elected parliamentarians assisted by a few non-political staff to assist work on parliamentary committees, including those that examine draft annual budgets.
- The role of the judiciary, notably in limiting the legislature's powers.

Notes

1. In England, for example, the principle that grants to the Crown ("executive") should be made by the Estates of the Realm (forerunner of "Parliament") and the right of inquisition into the application of (royal) funds was established in the 14th century (Bastable, 1892, Chapter VI).
2. This study does not discuss "soft law" *versus* "hard law", which has generated considerable debate in Europe with respect to EU laws/directives and domestic law in EU countries (Abbot and Snidal, 2000).
3. A major reason for the relatively large number of budget-related constitutional provisions in Finland is `because it was decided, when drafting the new constitution (adopted in 1999), to merge the 1928 Parliament Act (with amendments) with the 1919 Constitution Act (with amendments). In contrast, in Sweden the Parliament (*Riksdag*) Act is not part of the four laws composing the Swedish Constitution (see the Nordic countries case study).
4. INTOSAI is the International Organization of Supreme Audit Institutions. Information on the role of INTOSAI role may be found on its Internet site: *www.intosai.org*.
5. Pizzorusso (1988) emphasises the interface between law and political studies; a companion book by Viandier (1988) focuses on the function of statutes – principally in private and public law – as the source of law and the object of interpretation.
6. See Footnote 107 of Pizzorusso (1988), which cites some 20 of the most influential comparative law studies.

7. Marxist law, laws based on religious values (*e.g.* Islamic law) or on strong cultural factors (*e.g.* the Far East, where law is regarded as an instrument to be avoided by a just man) have also been identified. Since the collapse or weakening of communism, marxist law has been, or is being, replaced by "western" law (*e.g.* for China, see Peerenboom, 2002).
8. One could attempt to refine the characteristics and disaggregate "civil law" countries into the Romano, Germanic or Nordic models (see, for example, Zweigert and Kotz, 1998). Other authors (*e.g.* Thuronyi, 2003) have presented alternative "family" classifications for these countries differently (*e.g.* the French, Northern European, Southern European families).
9. Two examples are provided where such challenges have occurred. 1) France. Article 58 of the 2001 Organic Budget Law required the external audit office's workplan to be reviewed by Parliament. The Constitutional Council judged this to be unconstitutional since the Constitution establishes the independence of the Court of Accounts from the legislature. 2) The United States. The line-item veto of the President of the United States, embodied in the 1997 Budget Enforcement Act, was rejected in 1998 by the Supreme Court as unconstitutional, as the Court decided that the act allowed the President to unilaterally amend or repeal parts of duly enacted statutes by using line-item powers.
10. In Germany, the Constitutional Court in 1989 criticised the loose way in which "investment" is defined in Article 115 of the Constitution, which allows borrowing for investment purposes.
11. Approximate numbers, since based on the numbering in constitutions, including repealed articles or additions of new sub-articles.
12. The 1958 Constitution (Article 34) specifies that annual budget laws, which determine the resources and obligations of the State, shall be adopted according to conditions as specified in an organic law (*loi organique*, see *www.assemblee-nat.fr/connaissance/constitution.asp#art55*).
13. See Article 109 of the 1949 Basic Law (*Grundgesetz*). Conditions associated with the adoption of the budget framework law are more specific than those for general framework laws. Framework laws may or may not contain directly applicable provisions. The Basic Law Article 75(2), which states that "framework legislation may contain detailed or directly applicable provisions only in exceptional cases", was adopted in 1969, repealed in 1971 and re-inserted in 1994.
14. Codification in continental European countries is defined more comprehensively, as the systematic assembling of innovative dispositions founded on common principles. It is distinguished from consolidation (see Viandier, 1988, pp. 37-58).
15. Immediately following legislative elections, the *Storting* chooses one-fourth of its members to form the *Lagting* and the remaining three-quarters become members of the *Odelting*.
16. Prerogative powers originally belonged exclusively to the Crown. However, as ministers took responsibility for actions done in the name of the Crown, prerogative powers were delegated to ministers. Parliament was not involved with this transfer of power. Such prerogative powers may be described as "ministers' executive powers" (House of Commons, 2004, p. 8).
17. The 1958 Constitution did not originally include a directly elected president. This was decided by referendum in 1962.
18. Cohabitation is when the elected president is of a political persuasion different from the government.

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ISSN 1608-7143
OECD Journal on Budgeting – Volume 4 – No. 3
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PART II

Comparisons of OECD Country Legal Frameworks for Budget Systems*

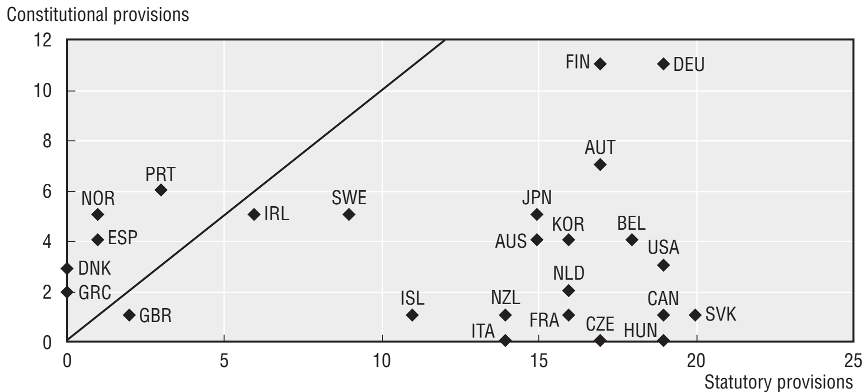
This chapter compares the extent to which law is used to specify budget players and processes, with a particular focus on 13 OECD countries. Although budget system laws serve differing purposes, new budget-related laws are often adopted to introduce budget reforms. Differences in the laws underpinning the main budget players – especially legislatures, the political and non-political executive, and external audit offices – are found to be wide. Important differences are observed in the extent to which law is used for specifying each stage of the budget processes: preparation, presentation, adoption (by the legislature), execution, government accounting and fiscal reporting arrangements. Comparative "models" or tables are provided for various budget-related issues and processes, including: budget timetables (legal requirements); fiscal rules; medium-term budget frameworks; the nature, structure and duration of appropriations; annual and in-year accounts, as well as for specific budget players such as parliamentary budget committees or external audit offices.

* This part incorporates the comments of officials from the Ministries of Finance (or equivalent) of Canada, Germany, Norway, Sweden and the United Kingdom who are acknowledged at the beginning of each of those country case studies, as well as useful comments from Kazuhiro Minamitsu (Ministry of Finance, Japan), and Céline Allard and Etibar Jafarov (European Department of the International Monetary Fund).

1. Introduction

OECD countries differ substantially in the extent to which constitutions and law are used to incorporate budget principles and specify details of the budget system (Figure II.1). This part examines more closely the differences between the OECD countries: 1) in the way their legal frameworks for budgeting are organised; 2) in the purposes for which their budget system laws exist; 3) in their legal provisions establishing the roles of the main actors in the budget processes, including the role of external audit offices; and 4) in the extent to which law, as opposed to regulations or informal practices, is used for specifying the different functional processes of budgeting: preparation; adoption, execution, accounting and reporting. In contrast with Part III, which will examine possible norms for a budget system law, Part II examines actual practice in selected countries. The description is largely based on the 13 country studies presented in more detail in Part IV. This information complements the OECD Survey on Budget Practices (OECD, 2003).

Figure II.1. **Density of legal framework for budget systems in 25 OECD countries**



Note: This figure is based on positive responses to Questions 1.3 and 2.1 of the OECD Survey on Budget Practices (OECD, 2003). Twenty-three questions on the legal provisions for budgeting (including for fiscal rules) are included: *i.e.* the total score could be 23. In each question in the survey, a distinction was made between legal provisions in constitutions (vertical axis) and statutes (horizontal axis).

The observed differences in the density of law in OECD countries is attributable mainly to legal tradition, the powers of the legislature relative to the executive, and the cumulative effect of introducing budget reforms by adopting new laws or amending existing laws. Before these issues are examined, the widely differing ways in which legal frameworks for budgeting are established in OECD countries are discussed.

Most countries have a legal framework comprised of a written constitution, one or a few ordinary statutes for the budget system, and several budget regulations (Table II.1 lists the major laws and regulations in 13 OECD countries). Regulations are mainly issued by the Minister or Ministry of Finance (or equivalent), although legislatures also issue regulations. Of the latter type, first, there are regulations that are applicable only to the chamber(s) of the legislature (*e.g.* the Standing Orders of the House of Commons in Canada and in the United Kingdom). Second, in some countries, parliamentary "regulations" or "resolutions" are applicable to bodies outside the legislature, including those within the executive. Although such regulations are not formal law, they may have a similar impact to law, especially the second type. Regulations supplement (or replace, in the cases of Denmark and Norway) statute laws that govern the budget system.

2. Different purposes of the legal frameworks for budget systems

The different ways budget-related laws are organised in OECD countries partly reflects the differing purposes of the legal frameworks for budget systems. It also reflects differing legal traditions, especially the importance given to a written constitution and the establishment – or non-existence – of bodies to ensure the constitutionality of budget-related laws.

One of the main purposes of budget-related laws is to provide a clear set of rules for the various steps of budget processes – the preparation, adoption, execution, reporting, and audit of the budget, as well as specifying the roles and responsibilities of the various actors in those processes. Although there is a consensus on the need for clear rules, important differences exist as to the extent to which such rules are embodied in a law. These differences reflect, *inter alia*, the presence of any constitutional constraints on the budget system They also result from the perceived need: 1) to embody budget principles in a law rather than in less formal arrangements; 2) to establish "permanent" as opposed to temporary rules;[1] and 3) to use the law to constrain abuse of power by the political authorities of the legislature or of the executive. Law is often used to introduce budget reforms. The legal framework for the budget system serves other purposes too, including providing meaning to the principle of the supremacy of the legislature in national financial matters, improving macroeconomic stability, and enhancing budget transparency by making available to citizens the rules of the national budgeting system (Box II.1).

Table II.1. **Legal frameworks for budget systems: 13 OECD countries**

	Constitution (year adopted)	**Main laws** (year when first adopted; substantial or minor amendments have occurred)	**Regulations/decrees/ standing orders**
Canada Federal government		• Constitution Act 1867 • Financial Administration Act 1985 • Auditor General Act 1977 • Federal-Provincial Fiscal Arrangements Act 1985	• Standing Orders of the House of Commons • Rules of the Senate • Regulations issued by the Treasury Board Secretariat and by the Department of Finance
Denmark	Constitution 1953	• State Accounting Law 1984 • Auditor General's Act 1976 • Local Government Act 1968	• Budget guidelines issued by the Ministry of Finance • Parliamentary Standing Orders
Finland	Constitution 1999	• State Budget Act 1988 • State Audit Office Act 2000 • Local Government Act and other local government statutes	• State Budget Decree 1992 • Parliamentary Rules of Procedure
France	Constitution 1958	• Organic Budget Law 2001 • Organic Law Relating to the Financing of Social Security 1996 • Law on Controlling Expenditure Commitments 1922 • Social Security Code • Financial Jurisdictions (External Audit) Code • Local Government Code	• Decree on Public Accounting 1962 • Regulations of the National Assembly • Regulations of the Senate • Decisions of the Constitutional Council
Germany Federal government	Constitution 1949	• Law to Promote Economic Stability and Growth 1967 • Law on Budgetary Principles 1969; Federal Budget Code 1969; Federal Court of Audit Act 1985 • Laws on Intergovernmental Relationships • Laws establishing the Social Security Funds	• Regulations for Implementing the Federal Budget Codes • Rules of the *Bundestag* • Rules of the *Bundesrat*
Japan	Constitution 1946	• Public Finance Act 1947 • Public Accounts Act 1947 • Diet (Parliament) Act 1947 • Board of Audit Act 1947	• Budget Formulation Guidelines issued by the Ministry of Finance
Korea	Constitution 1948	• Budget and Accounting Act 1961 • Framework Act on Fund Management 1991 • National Assembly Act 1948 • Public Enterprise Budget and Accounting Act 1961 • Board of Audit and Inspection Act 1963 • Public Bond Act 1949; Government Asset Management Act 1950; Treasury Fund Management Act 2002 • Acts on Local Government Finance • Basic Act on Managing Statutory Expenses 2002	• Budget Formulation Guidelines issued by the Ministry of Planning and the Budget
Norway	Constitution 1814	• Auditor General Office Act 2004 • Local Government Act 1992	• Budget Regulations 1959 issued by Parliament[1] • Parliamentary Rules of Procedure • Government Financial Management Regulations 2002

Table II.1. **Legal frameworks for budget systems: 13 OECD countries** *(cont.)*

	Constitution (year adopted)	**Main laws** (year when first adopted; substantial or minor amendments have occurred)	**Regulations/decrees/ standing orders**
New Zealand		• Constitution Act 1986 • Public Finance Act 1989[2] • Fiscal Responsibility Act 1994[2] • State Sector Act 1988 • Public Audit Act 2001	• Standing Orders of the House of Representatives
Spain	Constitution 1978	• General Budgetary Act 47/2003 • General Act on Budgetary Stability 18/2001 • Organic Act supplementary to the General Act on Budgetary Stability 5/2001 • Organic Act on the Court of Accounts 1982 • Court of Accounts (Functioning) Act 1988	• Standing Orders of the Congress of Deputies • Standing Orders of the Senate
Sweden	Constitution 1974 (four acts, including the Instrument of Government Act)	• State Budget Act 1996 • State Borrowing and Debt Management Act 1998 • Parliament (*Riksdag*) Act 1974 • Auditing of State Activities Act 2002 • National Audit Office Act 2002 • Local Government Act 1991	• Executive Regulations pertaining to public financial management, issued by the Ministry of Finance
United Kingdom		• Exchequer and Audit Departments Acts 1866 and 1921 • Parliament Acts 1911 and 1949 • National Loans Act 1968 • National Audit Act 1983; Audit Commission Act 1998 • Local Government Acts • Devolution Acts 1998 (notably for Scotland and Wales) • Government Resources and Accounts Act 2000	• Code for Fiscal Stability adopted by the House of Commons • Standing Orders of the House of Commons • Official documents of the government, *e.g.* economic and fiscal strategy reports • "Government Accounting" issued by H.M. Treasury
United States Federal government	Constitution 1789	• Anti-deficiency Act 1905[3] • Budget and Accounting Act 1921[3] • Congressional Budget and Impoundment Control Act 1974[3] • Balanced Budget and Emergency Deficit Control Act 1985 • Budget Enforcement Acts 1990 and 1997 • Government Performance and Results Act 1993 • Inspector General Act 1978; Federal Manager's Financial Integrity Act 1982; Chief Financial Officers Act 1990 • Federal Credit Reform Act 1990 • GAO Human Capital Reform Act 2004 • Government Management Reform Act 1994 • Federal Financial Management Improvement Act 1996	• Rules of the House of Representatives • Rules of the Senate • "Preparation, Submission and Execution of the Budget", Circular A-11 of the Office of Management and Budget (OMB)

1. Comprehensive technical revisions to the Budget Regulations are planned to be presented to Parliament in 2005.
2. In 2004, these two acts were being merged, along with the Crown Entities Act 2004.
3. These and other acts have been incorporated in the US Code, especially Title 31 (Money and Finance) or Title 2 (Congress). Other sections of the Code are also relevant to the budget system, especially Titles 3 and 5 (the President and Government Organization respectively).

Box II.1. **Purposes of budget system laws**

- Provide clear operational rules for the budget system to all interested players.
- Ensure that budget rules have sufficient authority.
- Incorporate budget principles into legal text.
- Elaborate on constitutional requirements for the budget system.
- Reform the budget system – either radically or on a piecemeal basis.
- Specify the financial powers of the legislature and the executive.
- Contribute to macroeconomic stability.
- Enhance the transparency of the budget system.

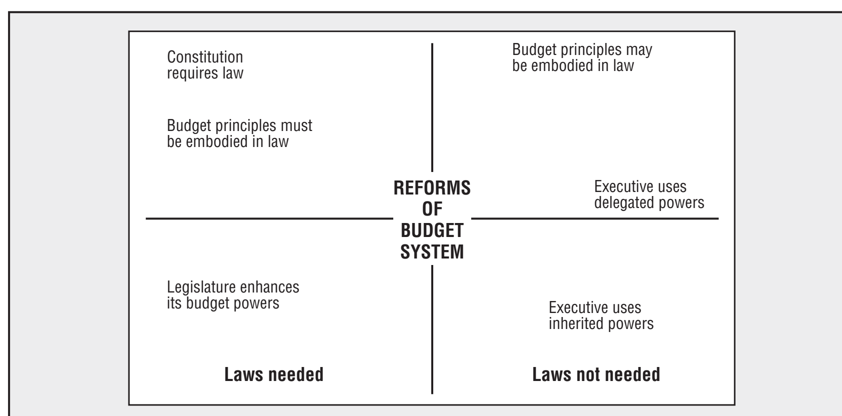
2.1. Legal necessity?

Although all democratic countries embody in law the principle of the supremacy of parliament in budget matters – notably that no taxation or spending can take place unless on the basis of law (*i.e.* with the approval of the legislature) – the degree to which other budget processes are based on law varies across countries The extent to which this is done depends, in part, on the relative importance given to providing a legal basis for budget processes at different stages of approval of the budget.

In continental European countries and the two Asian OECD countries, the role of the written constitution and the need to translate principles into law are given prominence (these countries could be placed in the first quadrant of Figure II.2). In some of these countries, written constitutions require the elaboration of constitutional principles in organic or ordinary law. In such countries, a legal way of thinking is firmly embedded: it is considered essential to begin with general principles, embody them in law, and then operate the budget system. At the outset of any budget reform, amongst the first questions asked is "how does the existing law need to be changed to incorporate the changes into existing principles or to introduce new principles previously not incorporated in the law?" In a legalistic cultural setting, the prevailing sentiment is that the government – or even civil servants – are powerless to act unless the authority of the legislature has been obtained.

This contrasts vividly with the attitude towards law in some Nordic countries and the Westminster countries (which could be placed in the second and fourth quadrants of Figure II.2 respectively). In the Westminster countries, the executive already has inherited considerable powers in budget processes. For example, the types and structure of budget appropriations in the United

Figure II.2. **Budget reforms and changes in budget laws**



Kingdom are specified without direct approval of the legislature. Besides inherited powers, the government may have acquired strong delegated powers. Accordingly, the executive issues orders or other rules relating to the budget system. Because the executive dominates the legislature, it may even cause parliament's own "internal" regulations ("Standing Orders") to be changed to enhance its own powers (*e.g.* by severely limiting parliamentary budget amendment powers or restricting the time period allowed by parliament for the budget debate). In these countries, the starting point for budget reform is not "law is needed to incorporate new budget principles". Rather, if it is considered expedient, then a law may be adopted. But there is no necessity to do so. The executive in such countries usually has nothing to lose by adopting a law, since it provides a weak Parliament with an opportunity to rubber-stamp its budget proposals.[2] For example, the legislation adopted in Westminster countries in the 1990s to provide greater transparency in government budgetary processes was a no-risk way of bringing Parliament "on board" with government propositions for future fiscal policies of the government. These countries all have parliamentary systems in which the Cabinet of ministers (or a powerful sub-committee serving the Cabinet) agrees on budget strategy, sets the budgetary aggregates and allocates resources. The main way for Parliament to object would be to bring down the government through a vote of no-confidence. However, this tool is seldom used, as discipline within the governing party has traditionally been strong.

In Nordic countries, the need to reach consensus without undue confrontation is highly valued. This is also a necessity, given the multiplicity of political parties that are included in coalition governments. In some of these countries, a consensus to reform the budget system has been reached without

having to go through all the formal steps of law making. Since such semi-legal arrangements work, there is no perceived need to change laws or introduce new laws. Unnecessary formalism is avoided. Revision of the law would be perceived as limiting the flexibility to make further changes in a consensual way. In Denmark and Norway, what counts is that essential rules pertaining to budget processes are agreed to and known by all the actors. (It appears to be immaterial that the "regulations" are issued by the legislature in one country and the executive in the other.) Unlike continental European countries, in Nordic countries there is no constitutional court to safeguard the constitutional requirements for budgeting. The public is also well informed due to the long-standing emphasis on openness and availability of information – another cherished value. Finally, government ministers are individually accountable to Parliaments, which have strong powers to receive information and examine the performance of ministers. In the case of Denmark, the Constitution allows Parliament to impeach ministers for maladministration. This contrasts with some European countries where ministers are sheltered from prosecution and court trials for budget mismanagement.[3]

There is a clear divide between those countries that perceive that "law is definitely required" to implement changes in the budget system and those that act on the basis that "law is not needed" or that "law may be required, especially if it enhancing executive budgetary powers". Reforming budget systems is easier in the latter category of countries than in the former – those shown to the right of the solid line in Figure II.2. Westminster and Nordic countries are not bound by an engrained legalistic way of thinking based on the importance of constitutionalism. Law comes as an afterthought, rather than as the necessary prerequisite and leading component for driving the budget reform process.

2.2. Budget reform: when is law required?

Whereas law has been used for introducing budget reforms in some countries, others have introduced budget reforms without the use of law. In general, a law is less likely to be used in the Westminster and Scandinavian countries than in continental Europe, Asian OECD countries, and the United States. Nonetheless, in Westminster countries, law has in fact been used quite extensively in introducing various reforms (Table II.2). This largely reflects the far-reaching nature of budget reforms adopted in these countries, rather than an introduction of a new legalistic way of thinking. It also indicates that these countries' executives are voluntarily proposing new laws, especially in the area of budget transparency, to enhance their own inherited or delegated powers.

Law may be used primarily to allow reforms to be introduced in the future. Alternatively, a law may confirm changes that are underway or have

Table II.2. **Reasons for changes in budget system laws:* Selected countries**

	Finland	France	Germany	Japan	New Zealand	Spain	Sweden	United Kingdom	United States
1. Improve macroeconomic stability in general (reduce fiscal deficit)	Early 1990s		1967-69	Late 1990s	As from 1986		Mid 1990s		As from 1985
1*a*. Qualitative fiscal rules					In 1990s			(Yes, but not by law)	
1*b*. Quantitative fiscal rules			Golden rule	1998					1985-89, 1991-02
2. Enhance fiscal transparency		2001			1994		1996	1998	
3. Introduce a medium-term budget framework		2001	1967-69		1994	2003	1996		
4. Introduce performance-oriented budgeting		2001			Late 1980s	2003		2001	1993
5. Introduce more flexibility in budget appropriations	1992	2001	1997		Late 1980s		1996		
6. Introduce accrual accounting or possibility of accrual accounting	1988	2001			1989	2003		2001	
7. Reduce off-budget activity	1991	2001							
8. Weaken the authority/powers of the executive in budget processes		2001							1974, 1990

* The dates shown refer to when the law(s) was (were) adopted, not when implementation began.

already been implemented. In the "laws are required" countries, modifications to law are made early in the reform process. In contrast, in the "laws may not be necessary" countries, laws may be changed late in the change process, or not at all. Two examples illustrate this contrast. In contemplating budget reform in France towards the end of the 1990s, it was quickly realised that changes in the 1959 Budget Law were needed (France National Assembly, 1999). It took about three years from the time major reform was studied intensively until the adoption of the new Organic Budget Law in August 2001. To ensure the success of the new performance-oriented budgeting system, the law is being implemented progressively over a five-year period (2001-06). In contrast, the United Kingdom government issued a discussion paper on changing the budget and accounting system in 1995.[4] Prior to the adoption of the new law – the Government Resources and Accounts Act in 2000 – government ministries had already begun piloting the new budget and accounting system. Full implementation of the system took place on 1st April 2001 (H.M. Treasury, 2001), only a few months after the adoption of the act.

2.3. Elaborating on the budget powers of the legislature vis-à-vis the executive

A principal purpose of budget system laws is to clarify the powers of the legislature to approve and follow up on the annual budget. This latter power includes the extent to which the legislature can intervene in budget execution, including expenditure control and accounting. In this context, the United States and the United Kingdom contrast strongly. In the United States there is a keen awareness that any budget reforms have to be fully consistent with the Constitution. Any constitutional questions are likely to be framed in terms of the separation of the legislative and executive branches. Legislators in that country know that the Supreme Court is likely to support them if it can be construed that the executive – the presidency – is acting as a law maker. Such considerations are less relevant in the United Kingdom where the equivalent of the United States Supreme Court is lodged in the House of Lords. Although the House of Lords has, in principle, the power to judge budget-related cases like any other administrative cases, in practice the House of Lords does not constrain the strong powers of the executive in proposed budget-related laws. Unlike in most OECD countries, the highest court of the United Kingdom cannot refer to a written constitution.

In the 1960s and early 1970s, when the president of the United States was frequently cancelling or postponing approved expenditures, it was perceived that the executive was encroaching on the legislator's right to specify expenditure policies in annual appropriation acts. This led to the adoption of the Congressional Budget and Impoundment Control Act 1974, which, *inter alia*, created a non-partisan Congressional Budget Office with some

250 staff. The act reduced the executive's capacity to cut expenditures to levels below those approved by Congress, thereby reducing the "excessive" budgetary powers perceived to be held by the executive. Budget reform legislation was used in the United States to enhance the already strong powers of the legislature (the United States could be placed primarily in the third quadrant of Figure II.2). Unlike the United Kingdom, which does not have a single Budget Committee in its Parliament to propose far-reaching amendments to the government's proposed budget, the United States House of Representatives and Senate have some 40 committees involved in the budget process (see United States country case study).

Examples of the differing dominant factors that provoke countries to introduce budget reform by adopting a law are shown in Table II.2, which shows that:

- Piecemeal budget reforms have been implemented in the laws of Germany (medium-term budget framework), and are beginning in Spain (medium-term framework and a performance-based system). Comprehensive budget reforms – based on law – are under way in France, at least for the State sector (which covers only around 40% of general activity).[5]
- Comprehensive budget reforms in New Zealand and the United Kingdom were in part supported by new laws (more so in New Zealand than the United Kingdom), adopted late in the reform cycle. In some budget-related laws, considerable authority has been delegated to the executive (*e.g.* the United Kingdom Treasury decides on the content of a code for fiscal stability which it presents to the House of Commons).
- Some budget reforms in Finland and Sweden do not necessarily need a law, reflecting delegation of authority and/or strong co-operation between the legislature and the government.
- A special Government Performance and Results Act was adopted in the United States to introduce a performance orientation to the federal budget. The budget appropriations structure is firmly controlled by the legislature – congressional committees are free to add projects in the annual appropriations laws (this would be inconceivable in Westminster countries).

In "constitutional" countries, laws have been used to enhance the authority of the legislature. Three examples are provided. In Finland, the new Constitution adopted in 1999 slightly limited the executive's powers concerning delegated legislation (Art. 80). In France, when the new "Financial Constitution" was adopted in 2001, some of the legislature's powers that were removed in 1958, when the Constitution was adopted, were restored. In 2003, Korea amended the National Assembly Act to establish a special standing Budget and Settlement Committee and a National Budget Office to strengthen the National Assembly's capacity to review and approve the draft budget submitted by the government.

3. Differences in the legal framework for the main actors in budget systems

Budget processes are mainly performed by the legislature, the executive and external audit offices, at both central government and sub-national government levels. When extrabudgetary funds provide the revenue for some of the roles of central or local government, governing boards or other decision makers decide on the revenues and expenditures of such off-budget activity. In addition, the judiciary may, at times, be asked to intervene or make decisions on some aspect of budget processes, or to ensure the constitutionality of laws relating to budget actors or budget processes. For this reason, it is also included in the following section on "budget actors".

3.1. Legislatures

Written constitutions establish the type of legislature and specify its main roles in most OECD countries. Constitutions vary considerably in age and the extent to which budget processes are specified. Some countries of the Westminster tradition have constitution acts (Australia, Canada, New Zealand), which are not comprehensive constitutions (*e.g.* there are no provisions for human rights and a constitutional court does not exist). The United Kingdom's Parliament Act contains constitutional provisions. Both Asian OECD countries have also adopted a Parliament Act, as has Sweden. In these three cases, Parliament Acts supplement the constitutional requirements regarding the role of Parliament.

3.1.1. Bicameral versus *unicameral legislatures*

Constitutions and/or a Parliament act specify the structure and powers of the legislature, both of which influences the budget approval process. When there are two chambers in the legislature, budget making becomes more complicated – both for reaching agreements on the budget system law(s) as well as for adoption of the annual budget. The following "models" emerge concerning the role of legislatures in annual budget processes:

- **Bicameral legislatures with each chamber having equal budgeting powers.** This is usually the result of direct and separate elections to each chamber (*e.g.* United States). The obtaining of a consensus for the annual budget in such countries is more complex, especially if the mix of political party representation in the two chambers differs.
- **Bicameral legislatures with considerable powers in both chambers, but with one dominant for the budget.** Two-chamber Parliaments can be the result of direct elections (*e.g.* Japan), indirect elections (*e.g.* Germany) or an appointment process (*e.g.* France, Spain). Each chamber discusses the draft annual budget law (often the elected chamber first). The constitution

provides for reconciliation procedures in cases of conflict between the two chambers – usually a final decision is made by the elected chamber.

- **Bicameral legislatures with few, or no, budgetary powers in the upper chamber.** The second chamber may be the result of an appointment process by the government (*e.g.* Canada's Senate, which is prevented from introducing money bills) or by nobility (*e.g.* the United Kingdom's House of Lords, which is excluded from blocking the annual budget).
- **Unicameral Parliaments, formed by direct elections** (*e.g.* Denmark, Finland, Korea, New Zealand, Sweden). The adoption of the annual budget and budget system laws is simplified by not having a second chamber. In some Scandinavian countries and New Zealand, a second chamber existed in earlier times, but was abolished with constitutional reform.[6]

3.1.2. Committee structure within the legislature

Legislatures usually have some powers to modify the proposed budget – 55% of OECD countries have unlimited powers (OECD, 2003). Draft amendments are usually proposed by a budget committee, or a number of budget-related committees, serving the legislature.

Constitutions or Parliament acts specify that a budget committee, or the equivalent, be set up for co-ordinating the overall budget in Parliament (*e.g.* Finland, Japan, Korea, Sweden). In Finland, the Constitution requires that the draft budget must be considered by the Finance Committee. France's Constitution, unusually, limits the number of parliamentary committees to six for each of the two chambers. This was a reaction to the "excessive" powers of Parliament prior to 1958 when the Constitution was adopted. Japan and Korea specify the creation and role of a budget committee in law, not in the Constitution (notably the Diet Act in Japan and the National Assembly Act in Korea).

Regulations, or "Standing Orders", of the legislature may establish a single budget committee or several budget-related committees (*e.g.* Canada, France, Germany, New Zealand, Spain). Models for the role of a budget committee, irrespective of the form of law establishing it, are:

- **No budget committee for examining the *ex ante* budget.** The United Kingdom provides one of the few examples. The House of Commons Public Accounts Committee only examines budget execution (traditionally, the "appropriation accounts"), not the draft budget prior to its adoption. The United Kingdom Parliament's taxation ("Ways and Means") committee was abolished in 1967. In contrast, Scotland's regional assembly established a finance committee with power to propose budget amendments to the budget for Scotland.

- **A single budget committee that shares power with sectoral committees.** Canada and New Zealand, unlike the United Kingdom, have finance committees for examining the *ex ante* budget. However, their power is very limited because of lack of budget amendment powers. In contrast, Sweden's Finance Committee has wide-ranging competencies, established in the Parliament Act, 1974. As in Norway, this committee is responsible for overseeing the establishment of expenditure ceilings in over 20 areas of expenditure. Once established, sectoral parliamentary committees are responsible for the allocation of expenditures within those ceilings. Japan and Korea also each have a budget committee, established by the Diet Act and the National Assembly Act respectively, with oversight powers of both the *ex ante* draft budget and *ex post* budget execution.
- **Multiple budget-related committees that share power with other committees.** The United States House of Representatives and Senate committee structure is complex and unique. The Budget Act 1974 created the Budget Committees of each house, giving them the responsibility to draft the annual budget plan of Congress (the "budget resolution") and to monitor implementation of the federal government's budget. The Budget Committees have jurisdiction over the annual congressional budget processes and also examine draft budget-related acts such as the Line-Item Veto Act of 1996.
- **A single budget committee with wide-ranging powers.** Each chamber of the French Parliament has established a *Commission des Finances*, which examines both the revenue and expenditure side of draft budgets. This is also the case for Germany's *Bundesrat*, but not the *Bundestag* which has a Budget Committee for examining detailed expenditure estimates and a "Finance" Committee for reviewing draft tax legislation. Spain also has a Budget Committee in both chambers to examine, amend as necessary, and approve the State budget.

3.1.3. Parliamentary regulations: who determines them?

The roles of parliamentary committees and other procedures of the legislature are usually laid down in the rules and regulations of each chamber of Parliament. In countries with a strong separation of powers, the executive plays no role in drawing up parliamentary rules. For example, extensive rules are elaborated by each house of the United States Congress, independently of the executive. In Norway, in the absence of any constitutional or legal constraints, and in line with longstanding practice, special parliamentary regulations relating to budget processes are reviewed – and even prepared – by the executive, notably the Ministry of Finance. "Parliamentary" regulations apply to both Parliament and the executive's ministries and agencies. However, such regulations do not complete all of the requirements to make them formal law (compare France, where parliamentary regulations have the status of law). In the Anglo-Saxon

countries, as in Norway, executives also may draft parliamentary regulations. For example, the "financial veto" in New Zealand – which prevents Parliament from amending the executive's draft budget – was incorporated into Parliament's Standing Orders following an initiative from the Treasury (the equivalent of a Ministry of Finance).

3.1.4. Budget offices in the legislature

Constitutions do not specify the resources available to the legislature to assist in budget analysis. In some continental European countries, civil service laws and/or annual budget laws (*e.g.* Germany) specify the number and salary structure of non-partisan staff to assist parliamentary committees.

In 1974, the United States created a Congressional Budget Office (CBO) by law. The CBO is responsible for producing an annual economic forecast (in addition to that prepared by the executive), reviewing the President's annual budget submission, scoring all spending legislation passed by the Congress, and preparing reports in compliance with the Unfunded Mandates Reform Act 1995. The number of staff exceeds 230. This is well in excess of those in Korea and Mexico, the only other OECD countries which have established such offices, largely using the United States CBO as a model. In Korea, the National Assembly Budget Office Act was adopted in 2003.

3.2. Executives

The executive branch has two particularly important roles to play in budget processes. First, it must prepare the initial draft of the annual budget, which should be set in the context of a coherent medium-term fiscal strategy. Second, the executive is responsible for executing the annual budget and accounting to the legislature for budget implementation and results. The legal framework for the important individual steps in these processes is examined in subsection 4 below. This section is confined to examining the legal basis establishing the main actors in the executive branch. In this context, decision making and accountability in the executive may either be individual or collective. The legal basis for each is examined in turn.

3.2.1. Individual budget powers at political level: presidents and monarchs

There are five main individuals at political level who potentially could play a role in budget processes, namely presidents, monarchs, prime ministers, individual ministers, and political appointees. This section examines the legislative basis for the first four. In some countries, administrative law specifies the extent of political appointees – who are often involved in budget-making

processes – within the executive (*e.g.* Spain's Organic Act on the Organisation and Functioning of the Central State Administration).

In a presidential political system, all executive power is invested in the president. Budget-related responsibilities and powers may include the obligation to formulate the annual budget, submit it to the legislature, sign it into law, veto it (in part or in whole), promulgate it, and prepare reports on budget execution. Similar powers are extended to draft laws pertaining to the budget system and draft supplementary budgets. As head of the executive, the president also signs presidential decrees or orders, including important ones relating to the budget system.

Written constitutions usually only summarise the president's role in the budget area. For example, the United States Constitution states that "executive power shall be vested in a President". The Constitution only elaborates indirectly on presidential duties for the federal government's budget, by requiring that "he shall from time to time give information to Congress on the State of the Union and recommend for their consideration such measures as he shall judge necessary and expedient". The president is individually responsible for formulating and submitting the budget: by law (US Code, Title 3), the president formulates and submits a draft budget to Congress. Individual accountability is safeguarded by strong constitutional powers for presidential impeachment, although it is extremely difficult to break constitutional obligations in the budgeting area.

Not all presidential systems require the president to submit the budget to the legislature. In Korea, for example, the Constitution requires the executive as a collective body, not the President as an individual, to submit the draft budget bill to the National Assembly.[7] This reflects an alternative constitutional provision that "executive power is vested in the executive branch headed by the President". In semi-presidential systems, such as Finland and France, the president's responsibilities in the budget area are exercised largely through the constitutional provision that he/she is the head of the Council of ministers. In Finland, "the President of the Republic makes decisions in Government on the basis of proposals for decisions put forward by the Government" (Constitution Art. 58). His/her powers are weaker than those of France, where the President could, provided the ministers are from the same political grouping, exercise an influential voice in Cabinet on budgetary matters (see country case study for France).

In summary, constitutional provisions for presidents' responsibilities and powers in budget processes vary from country to country. However, even in countries where a president's individual powers are strong, the important budget processes – formulating a detailed budget and reporting on its execution – are delegated to collective bodies within the executive.

The same observation is true for monarchs. In some constitutional monarchies (*e.g.* Denmark, Norway, Spain), constitutions, at first sight appear to grant strong authority to the monarch. In Denmark, "executive authority is invested in the King", "the King shall have supreme authority in the Realm" and the "King shall not be answerable for his actions". However, these provisions are counterbalanced: the King "shall exercise supreme authority through the Ministers" and "the Ministers shall be responsible for the conduct of government; their conduct shall be defined in statute". Norway's Constitution does not contain such counterbalancing provisions. Nonetheless, principles of parliamentarianism have been accepted despite the absence of constitutional provisions. Today, in no OECD country does the monarch play an important role in the budget process – nominal powers are invariably delegated to ministers. In contrast to the example of Denmark above, the delegation is not always formally stated. In Westminster countries, the Queen (or Governors General in Australia, Canada, and New Zealand) traditionally follows the advice of her ministers.

3.2.2. Prime ministers

The prime minister is usually the head of government in countries with parliamentary political systems. Depending on whether the country accords a high importance to the law, his/her responsibilities in budget matters are specified in the legal framework. First, in some countries, written constitutions specify the key responsibilities and powers of the prime minister (or the equivalent, such as the Chancellor in Germany). In France, for example, the 1958 Constitution (Title III) states that the Prime Minister is the head of the government, assures the execution of laws (including the annual budget law), and is (individually) responsible for the government's programme. The Constitution expressly states that the Prime Minister may delegate certain functions. Thus, the Minister of Finance, who is not mentioned in the Constitution, submits the annual draft budget law to the French National Assembly. In view of the Constitution, it is made clear that this is on behalf of the Prime Minister, who has final authority over the Minister of Finance on the draft budget submitted to Parliament.

Second, there are countries where the prime minister's responsibilities have no legal basis. This is the case in the Westminster countries whose prime ministers have very strong powers. In Canada, for example, the Prime Minister appoints not only Cabinet ministers, but also senators. In all Westminster countries, the prime minister determines the government's overall priorities – he/she has veto powers in Cabinet and in the caucuses of his/her political party. These are unwritten powers. Depending on the extent of delegation and trust in his/her Minister of Finance (or equivalent), the prime minister is also influential in deciding the government's budgetary policies and annual budgets.

3.2.3. Ministers of Finance

The Minister of Finance (or equivalent) plays a key role in budget management in countries with a Parliament. His/her role is seldom specified in the constitution. Austria and Germany are exceptions. For example, in Germany, "the Minister of Finance, on behalf of the government, has to submit annually to Parliament (both houses) an account of revenues, expenditures, property and debt in the preceding fiscal year" (Constitution Art. 114). In a further 13 OECD countries, the effective control of the Minister of Finance over budget management is made explicit in a law (OECD, 2003). Government decrees may elaborate on the Minister's responsibilities. For example, in France, a presidential decree (which is also signed by the Prime Minister), specifies the responsibilities of the Minister of Finance.

The Minister of Finance of Westminster countries has unwritten powers to veto Cabinet colleagues on budget decisions. In the United Kingdom, the Chancellor of the Exchequer, although he/she is formally not the head of H.M. Treasury, nor seldom mentioned in legislation, may exercise a particularly powerful role in Cabinet for final decisions on the budget.[8]

3.2.4. Collective and individual responsibility of government ministers

In some countries with parliamentary systems, the responsibilities of the cabinet of ministers are explicit in the constitution. Japan's Constitution specifies that "executive power is vested in the Cabinet" (Art. 65), which, "in exercising executive power, shall be collectively responsible to the Diet" (Art. 66). Cabinet must resign en masse should the House of Representatives pass a no-confidence resolution (Art. 69). Moreover, "Cabinet must prepare the budget and present it to the Diet" (Art. 73). In contrast to the constitutional status of Japan's Cabinet, in Westminster countries, the Cabinet of ministers is an extra-legal organisation – its responsibilities are not specified in the law. Despite its absence of formal powers, Cabinet's decisions are binding and this body exercises strong control over government departments, including the size of their budgets.

If a legislature perceives that Cabinet has too much power, it has two main options: either to remove Cabinet or to limit Cabinet's powers, by adopting a law if necessary. Both options would result in a political crisis. Under the first option, once Parliament obtains the necessary majority, it could bring the government down through a vote of no-confidence. Under the second option, a parliamentary majority to pass an authority-limiting law would be required. When Cabinet ministers are all senior politicians, this would also result in a crisis of confidence in government leaders. This suggests that it does not appear essential that Cabinet's responsibilities are fully specified in law, as the legislature could "control" abuses of Cabinet's budgetary power by engineering a political crisis.

In some countries, a law specifies ministers' individual responsibilities to the legislature for their actions regarding the annual budget. In the Nordic countries, constitutions include strong accountability requirements on ministers. In Denmark, "Ministers shall be responsible for the conduct of government and individual ministers may be impeached for maladministration of office" (Constitution, Arts. 13 and 16). In Finland, the Constitution requires ministers to disclose their assets and outside duties to Parliament. In Sweden, both individual and collective responsibility is stressed. Sweden's parliamentary Committee on the Constitution "shall examine ministers' performance of their official duties. The committee has access to the records of decisions taken in government matters and all documents". The Constitution adds that all members of Parliament, and by extension, any Swedish citizen, may obtain records of ministers' performance. Such constitutional provisions are supplemented by freedom of information acts, which allow citizens to be provided with the release of nearly all official documents.

In France, Parliament adopted a law establishing a special Court of Budgetary and Financial Discipline to follow up on the diversion or misappropriation of funds (Arts. L311-316, *Code des juridictions financières*). However, the law has had a limited impact, mainly because members of Parliament, presidents of regional councils, and mayors are exonerated from having to appear before the court.

3.2.5. Establishment of ministries and subordinate agencies

One of the innovations of "new public management" is to provide increased budgetary and management authority and autonomy to units within ministries. To what extent has law been used to introduce enhanced delegation of authority – from ministers to non-elected officials who are responsible for running branches of executive authority along commercial lines?

The establishment and roles of ministries are set out either in law or by government decree. The United States has exceptionally strong legal provisions for the establishment of executive "agencies" ("ministries" in other countries). The US Code provides that no department or agency can be established without explicit approval of Congress. Thus, the roles of the United States Treasury and the Office of Management and Budget (OMB) were first specified in a 1921 law. Similarly, in Canada, the Financial Administration Act defines the responsibilities of the Treasury Board and the Ministry of Finance. In Japan, the National Organization Act 1948 requires ministries to be established by law. Accordingly, the Ministry of Finance Act 2000 was adopted to rearrange responsibilities and establish a budget bureau and a tax bureau under the Ministry.

In some continental European and Nordic countries, the creation or merger of ministries is an internal matter for the government (see country

case studies). Councils of ministers generally make such decisions. In the United Kingdom, the full extent of the roles and responsibilities of H.M. Treasury has never been specified in law. Its authority is derived from the royal prerogative (*i.e.* the pre-existing powers that the courts recognise as legitimate for the purpose of carrying out government functions). However, some United Kingdom spending ministries have been established by law.

Regarding agencies for executing the budget, Sweden is one of the few examples where autonomous "administrative authorities" are provided with constitutional authority: the Constitution prevents Parliament and the government from determining how an administrative authority decides to exercise public authority in individual cases. In other countries, a law may be used to establish public agencies. In continental Europe, a distinction is made between agencies created under public law and those created under private law,[9] with the latter more entrepreneurial and under less ministerial supervision (OECD, 2002a). Not all agencies are created by individual acts – many are considered administrative units under ministries. This is the case for many of the United Kingdom's executive agencies (which now employ over 75% of United Kingdom civil servants). However, some agencies in the United Kingdom – non-departmental public bodies – are created by individual laws. Few countries have adopted framework legislation to categorise various agencies by function, degree of independence, or governance structure. However, in 2004, New Zealand planned to adopt the Crown Entities Act for this purpose.

3.2.6. Accountability of the non-political executive

Accountability relationships between ministers (who are members of a council of ministers) and the operational heads of ministries ("secretary generals", "chief executives", etc.) traditionally are usually not governed by law. In many countries written constitutions require that administrative arrangements for the civil service be elaborated in a law. Accordingly, civil service laws have been adopted in a number of countries. These typically define the job duties and responsibilities of all civil servants (World Bank, 2001). Such laws specify the overarching role of civil servants (*e.g.* "to serve the State") and set out arrangements for tenure, job security, remuneration and disciplinary arrangements. However, these laws merely provide a framework for specifying particular responsibilities. Most countries' governments (not legislatures) adopt decrees to define more precisely the responsibilities of senior civil servants to ministers.

The accountabilities within the executive for responsible financial management have been specified in law in a few countries (*e.g.* the United States). This reflects the legislature's desire to control budget implementation. In most countries the legislature trusts the executive to issue decrees for designing and monitoring financial control procedures (see section on internal

audit and control below). In New Zealand, prior to adopting a performance-oriented budgeting system, a law was adopted in 1988 to clarify accountabilities between Cabinet ministers and senior civil servants responsible for providing public services. The State Sector Act 1988 fundamentally changed the roles of the heads of government departments, who became managers of the budget allocated to them, the personnel under them and all other departmental resources. No longer did Parliament control inputs such as staffing of ministries and agencies. Inspired by new institutional economics, new contractual arrangements were introduced (Box II.2). Few countries have imitated the strict contractualism embedded in this legislation.

Box II.2. **New Zealand's State Sector Act 1988**

The Act requires or provides:

- Budget authority to heads of government departments, who become "chief executives" responsible for managing **inputs**, including staff and their remuneration. As managers, they must determine the most efficient way of producing the government services for which they are responsible.
- Personal accountability of chief executives for producing high-quality **outputs** – the provision of goods and services for the government and other users.
- Contracts between individual budget managers (suppliers of services) and ministers (purchasers of services) that specify the quality, quantity, timing and price of agreed services. Each chief executive has a personal performance agreement with the appropriate minister, accompanied by a purchase agreement which specifies the **outputs** to be supplied by the department to the minister.

3.3. Judiciary

When the budget system is being reformed and a new law is introduced into the legislature for this purpose, the judiciary may intervene. There are two main possibilities:

- **Review of laws by a special or constitutional court.** In countries of this "model" (*e.g.* Germany, Korea, Spain), the establishment of courts for ensuring constitutionality is laid out in the constitution. In examining draft budget system laws, courts may strike down parts of the laws as adopted by legislatures. Two examples are provided. First, the Line-Item Veto Act of 1996, which would have granted the President of the United States with the ability to eliminate certain line items from the approved appropriations

bills, was declared unconstitutional by the United States Supreme Court in 1998. As a consequence, the entire law was abrogated. Second, as part of its obligatory review for constitutionality of "organic laws", the French Constitutional Council removed two articles from the Organic Budget Law in 2001. The requirement for Parliament to review the annual work plan of the external audit office (the Court of Accounts), an independent constitutional body with some juridical functions, was declared unconstitutional.

- **No review for constitutionality.** In Westminster and most Nordic countries, there is no constitutional court. Should any changes in the budget system be incorporated in a new law, there is no high-level court that questions constitutionality. Nonetheless, the justice department and/or parliamentary law drafters ensure that laws are consistent with other legislation.

Besides reviewing budget system laws at the stage between adoption and promulgation, courts may be called upon to make judgements when the legislature and executive do not respect the law. Such instances are rare. This partly reflects the nature of budget system laws: they provide an overarching framework and are flexible in implementation, so there are few areas where executives or legislatures could be "prosecuted" by interested parties for non-compliance with the law.

Laws may provide safeguards for non-compliance. For example, if the annual budget is not adopted by the legally prescribed date, the budget system law usually makes clear provisions to provide interim budget authority at the beginning of a new fiscal year. A second example concerns quantitative fiscal rules. When these are embedded in law, there are generally also enforcement mechanisms, such as expenditure sequestering requirements (*e.g.* Budget Enforcement Act in the United States) or fines in the form of compulsory deposits (the European Union Maastricht criteria). If enforcement rules are not respected, the courts may be called upon to intervene.[10] In the states of the United States, where 1) budget system laws are quite specific, and 2) resort to litigation is common, the state judiciaries have, on rare occasions, been called upon to make judgements when a state has failed to balance its budget, as required by state constitutions (Briffault, 1996).

3.4. External audit offices

3.4.1. Constitutional or legal "models" for external audit

In most OECD countries, the written constitution establishes an independent external audit office (or equivalent). Even if there is no written constitution, external audit offices are usually established by a dedicated law. Such laws differ according to the degree of auditors' independence (especially from the executive), their governance structures, and whether they have juridical functions. In external audit laws, one can distinguish five "models" of

external audit offices, of which the first is now predominant and the one most closely in line with INTOSAI standards:

- **Independent bodies entirely at the disposition of the legislature.** In Westminster countries, the head of the external audit office is considered an officer of Parliament. These countries have also assigned a "controllership" function to the Auditor General, requiring him/her to countersign all releases of budgeted funds to spending ministries.[11] In the United States, the General Accounting Office (GAO), established by law in 1921 and renamed by law in 2004 as the Government Accountability Office, provides audits exclusively for Congress. The Austrian Court of Accounts, which does not possess the competencies of a court, also best fits this model (IMCL, 2003).
- **Parliamentary auditors, with an external audit body serving them.** This is the case of the Nordic countries, whose constitutions require parliament to appoint or elect a number of parliamentary auditors or, as in Sweden, an advisory board. In all the Nordic countries, parliamentary auditors or the advisory board work in collaboration with, or are serviced, by an external audit office entirely under the control of Parliament.
- **Independent "courts", without juridical functions, partly serving the executive.** The Constitutions of Germany and the Netherlands establish Courts of Accounts that are characterised by collegial management. In Germany, members of the court (who have the same independence as judges) form "colleges" for peer reviews of individual audits. In contrast to the courts in several other continental European countries (see next bullet), these "courts" do not exercise juridical powers.
- **Independent courts with juridical functions, partly serving the executive.** The courts of accounts of countries such as Belgium, France, Italy, and Spain have juridical powers. The members of the courts are magistrates, who judge the accounts of government accountants, and are empowered to take follow-up legal action if necessary. By its Constitution, the French Court of Accounts serves both the executive and legislature, whereas the Italian and Spanish Courts of Account are directly accountable to their Parliaments. In France, the president of the Court is appointed exclusively by the head of State (not Parliament), on the recommendation of ministers (Flizot, 1998), whereas in Spain he/she is appointed by the King upon the recommendation of the full session of the Court. In contrast, in Belgium, the president of the Court is appointed by Parliament.
- **Independent bodies under the executive.** In Japan and Korea, the external audit offices are under the control of the executive. However, they are independent from the Cabinet of ministers and are not part of a government ministry.[12] By contrast, until recently, the external audit offices in Finland and Sweden were under the Ministry of Finance, as was that of Denmark until the

mid-1970s (see Nordic country study). In France, the annual budget of the Court of Accounts (although independent from the executive) has been part of the annual budget of the Ministry of Finance.

3.4.2. Content of audit laws

Audit laws spell out the institutional coverage of audits. In addition to auditing all units comprising general government, several are empowered to audit public enterprises. In federal countries, sub-national audit bodies have been established by sub-national laws. In some unitary countries, regional audit offices have been established by law, although they may only audit the accounts of sub-national governments (*e.g.* regional audit offices in France or the Audit Commission in the United Kingdom).

The types of audit are typically specified in a law. Many countries' laws now require performance (value-for-money) audits, in addition to regularity and compliance audits. Laws also provide external audit offices with powers to investigate financial mismanagement. Follow-up may be by the external audit office or by the parliamentary committee responsible for pursuing recommendations contained in annual or specific reports of the external audit office.

Constitutions or external audit laws specify reporting obligations. Many countries' laws require audit reports to be presented directly to the legislature. In most Nordic countries, the external office submits its report to the parliamentary auditors, who in turn submit the findings to plenary sessions of Parliament. In Sweden, the responsible Auditor General submits financial and performance audit reports to the government with the exception of agencies under Parliament. The audit report on the State's annual accounts is submitted to the government and Parliament. The Advisory Board may submit reports to Parliament. In Korea, a law requires that the reports of the external audit office be submitted simultaneously to the executive and the legislature. In Japan, the Public Finance Act requires the Cabinet (a constitutional body) to submit audited accounts to Parliament, implying that the Board of Audit must first submit its audit report to Cabinet. In summary, there are differences – embodied in the external audit laws – in accountability arrangements. These, along with differences in who appoints the Auditor General (or equivalent), are considerable (Table II.3).

3.5. Sub-national governments

Constitutions usually spell out the relationships between various levels of government and/or Parliaments. Regional governments may or may not have budget independence from central government. An in-depth study of the legal framework for sub-national governments is beyond the scope of this

Table II.3. **External audit legal frameworks: Selected differences**

Head of supreme audit institution is accountable primarily to:	Head of supreme audit institution is appointed by:		
	Parliament	Executive	Both*
Parliament	Denmark, Finland, Norway, Sweden	Canada, New Zealand, United Kingdom	Spain, United States
Executive			Korea
Both		France	Germany, Japan

* Spain: formal appointment by the King upon recommendation of the Court of Accounts. The United States (and Korea): nominated by the President, confirmed by the Senate (Parliament). Germany (and Japan): formal approval by Parliament upon a proposal of the government (Cabinet).

study, which examines three main categories of budget systems characterising sub-national governments:

- **Federal countries, with sub-national legislatures adopting budget (system) laws applicable in sub-national jurisdictions.** Such law-making capacity is governed by written constitutions at each level of government. These define the roles and responsibilities of regional legislatures and executives in budget processes. Budget-related laws adopted by sub-national legislatures need to be fully consistent with the federal constitution. In federal countries, there are differences in the constitutional distribution of roles and responsibilities in budget matters, the extent of interdependence and collaboration across legislatures, and in the role of concurrent and exclusive jurisdiction of federal and sub-national budget laws (Watts, 2003). State/provincial budget laws are adopted by regional representative assemblies in various OECD countries, including the states of Australia and the United States, provinces in Canada, *Länder* in Austria and Germany, and cantons in Switzerland.
- **Unitary countries with regional assemblies that have budget law-making capabilities.** Some unitary countries are "semi-federal" – the constitution provides legislative powers to regional assemblies in specific areas of competency, including for the local budget. In the case of Spain, all autonomou regions are endowed with law-making capabilities, which are guided by a national framework law. Other unitary countries have adopted a national law that provides parts of the country with budget law-making capabilities. The United Kingdom's Devolution Act of Scotland 1998 established a Parliament in Scotland with full budgetary law-making powers. Using its powers, the Scottish Parliament adopted its own budget system law, the Public Finance and Accountability (Scotland) Act 2000. In contrast, in Wales, the regional assembly (established by the Devolution Act of Wales 1998) can only make secondary laws applicable to Wales.

- **Unitary countries with regional assemblies that do not have law-making capabilities.** In such countries, sub-national jurisdictions are subject to national laws that lay out the authority and competencies of central and sub-national governments in taxation, expenditure and borrowing, as well as types of intergovernmental transfers that aim to attenuate horizontal and vertical disparities. In France, the Local Government Code adopted by the National Assembly categorises all laws, including those for budget processes, according to which of the three levels of sub-national government (regions, *départements* and *communes*) they apply to. The code is supplemented by the Organic Law on Financial Autonomy of Local Governments 2004. Japan, Korea, the Netherlands and the Nordic countries are other examples of unitary countries – they too have local government acts that specify budget arrangements for regions and municipalities. Some of these countries (*e.g.* Denmark, Finland and France) possess a few jurisdictions – including offshore islands – that have special autonomy, including for budgeting.

A first important question is whether the laws of a country – whether federal or unitary – require application of nationwide principles for budgeting and government accounting. For federal countries, the example of Germany contrasts sharply with that of the United States. In Germany, the federal Constitution authorises the two chambers of Parliament to adopt a federal law for budget management at all levels of government. Accordingly, the Law on Budgetary Principles was adopted in 1969. It lays out both principles and procedures that apply to every region (*Land*). There is a requirement for each *Land* to adopt the same budget and accounting framework as that of the federal government. An intergovernmental co-ordination body, with advisory (but not legal) powers, is established by the law. This body administers the system of interlocking intergovernmental relations. In the United States, the principle of "states' rights" and budgetary autonomy are interlocked: each of the 50 states is free to determine the way its budget is prepared, adopted, executed and reported. State constitutions and laws contain differing provisions relating to their budgets. There is no requirement to harmonise budget procedures (including establishment of off-budget funds) or require uniformity in accounting.

In unitary countries, laws and/or regulations are adopted to require sub-national governments to report to central governments on budget developments. In some unitary countries, the reporting system is facilitated by a nationally imposed central accounting and treasury system (*e.g.* France). The authority of the central government to establish an accounting system is usually established in law. It is important that the central budget body (*e.g.* the Ministry of Finance) has authority to ensure that local governments provide periodic reports on budget execution, laid out according to standard accounting norms. In some countries, co-ordination with ministries of the interior (or equivalent) is

required, as these ministries have broad responsibilities for co-ordinating relationships with local governments.

A second important question concerns legal arrangements for intergovernmental transfers, since in several countries (*e.g.* Canada, Japan, Korea, the Nordic countries, Spain), transfers or grants from the federal (or central) government to the sub-national government(s) account for a large portion of the revenues of lower level government. In these and other countries, special legislation has been adopted to specify the various arrangements for intergovernmental transfers (to address horizontal and vertical imbalances), earmarked grants, tax-sharing arrangements, etc. It is beyond the scope of this book to examine the detailed differences between countries in the laws governing fiscal decentralisation.

In both federal and unitary countries, separate legislation applies to borrowing by sub-national governments. In federal countries, sub-national legislatures may have constitutional or legal restrictions on the amount of annual borrowing approved by sub-national legislatures. In the case of Germany (unlike, say, the United States), a law authorises the federal government, with the consent of the *Bundesrat*, to limit borrowing by any level of government to levels below those approved by sub-national legislatures, should this be necessary to avert a disturbance of macroeconomic balances. In unitary countries, local government laws (*e.g.* France, Italy, Sweden) may contain a "golden rule" that limits sub-national governments' borrowing to that needed for investment. In a few unitary countries (*e.g.* Finland), sub-national countries have no constraint on borrowing other than that of the market (Ter-Minassian and Craig, 1997, Table 1).

3.6. Supra-national bodies and international organisations

The 25 EU member countries have been provided with fiscal policy guidelines. The first is what is commonly known as the "Maastricht criteria" – principally that the member countries should ensure that public debt does not exceed 60% of GDP and that the general government deficit does not exceed 3% of GDP. The second – the Stability and Growth Pact – requires that EU member countries' fiscal balances be zero or positive over the economic cycle. The main question that arises for this study is whether or not these directives are legally binding on member countries. The short answer is that the EU's quantitative directives do not have the force of law in member countries, since the guidelines are specified in protocols to treaties, and only the treaties themselves are legally binding on member countries (provided countries have revised constitutions or adopted domestic law conferring such powers on the EU, which is the case for most countries). Thus, France and Germany, which have not incorporated the EU Maastricht criteria into any domestic laws, did not consider that they

were breaking the law when their budgets for 2004 exceeded the maximum general budget deficit of 3% of GDP.

Some EU countries, however, have voluntarily adopted domestic laws aligned with the budgetary directives of the EU. Thus, Spain's General Act on Budgetary Stability 18/2001 and other laws were adopted largely to allow easier implementation of the EU guidelines in the context of strong regionalism. A second example is Poland which, prior to its EU membership, even modified its Constitution in 1997 to embed the Maastricht maximum debt criterion of 60% of GDP (Art. 216). Poland's Public Finance Act 1998 elaborates on the constitutional requirement and includes the EU's 3% budget deficit criterion.

International organisations, such as the IMF and World Bank, in dealing with developing countries, impose conditions in their programmes with member countries. However, these conditions do not have the same force as domestic law, as parliaments are not involved – only governments of the country. Non-compliance with the conditions could lead to non-disbursement of the loan, in accordance with the signed contractual arrangements.

In some developing or transition countries, international organisations have required the adoption of new budget-related laws – or at least the presentation of a new law to Parliament – as part of the loan conditions (*e.g.* the IMF programme for Tanzania in 2000 required presentation of a new public finance act as a structural performance criterion; the law was adopted in February 2001).[13] Although it is clear that the adoption of new law cannot guarantee good budgetary practice, the cases of Denmark and Norway illustrate that new law may not even be a prerequisite to it.

4. Differences in the legal framework for budget processes

This section summarises the differences observed across countries in each of the following four main stages of the budget process: budget preparation by the executive, budget approval by the legislature, budget execution, and government accounting and reporting systems. Country-specific details are provided in the country case studies.

4.1. Budget preparation by the executive

4.1.1. Definition of budget terms

In the Westminster countries and the United States, it is common practice to include in the law itself a list of definitions of the terms used in the law. In contrast, in continental European and Asian OECD countries, budget terms are not explained in the law itself. In part, this reflects traditional approaches to law making. It also reflects that in continental European countries, there are special legal bodies – administrative and constitutional courts – whose role includes

interpreting the law in cases of dispute. Jurisprudence – the formal decisions of such bodies – is respected just like statute law.

Legal practice in the Westminster countries allows "schedules" to be attached to the law. These may also be used for elaborating on the definitions or coverage of terms used in the law. For example, schedules to New Zealand's Crown Entities Act 2004 (which defines various categories of semi-autonomous executive agencies), contain a complete listing of every agency in each category, and delineate which are exempt from certain rules (for investment, borrowing, guarantees, use of own revenues etc.) defined in the law. This practice has the advantage of making the law self-contained. In other countries, separate regulations may be issued to provide such details.

4.1.2. Coverage of the budget: extrabudgetary funds

Although all countries accept the principle of universal coverage of revenues and expenditures in the annual budget, it is rare for a country to adopt explicit legal restrictions against the creation of extrabudgetary funds. Finland is an exception. Its Constitution (Art. 87) specifies that an extrabudgetary fund can only be established by law if Parliament adopts a draft bill with a supermajority – at least two-thirds of the votes cast. Moreover, Finland's Constitution requires a strong justification for creating a new extrabudgetary fund: its establishment is only permissible if it is vital for performing the essential permanent duties of the State.

The Westminster countries have adopted in the law, the concept of a consolidated revenue fund. This dates back to the United Kingdom's 1866 Exchequer and Audit Departments Act. In these countries, it is considered a constitutional requirement to pay all revenues into a consolidated fund, out of which all expenditures are to be appropriated. Despite this, as in all OECD countries, certain expenditures are authorised by Parliament outside the consolidated revenue fund. Nonetheless, budgetary coverage is generally greater than in countries whose budget system laws do not specify the use of a consolidated revenue fund.

All OECD countries have established government-owned pension funds, other social security funds and other extrabudgetary funds to perform government functions. Such laws specify the purposes of the fund, its revenue sources, and its governance structures. In most instances a special law has been adopted by Parliament to establish these entities, which, in some OECD countries, are numerous (see fiscal transparency reports found at *www.imf.org/external/np/rosc/rosc.asp*).

Draft budgets of extrabudgetary funds are usually first approved by the fund's governing body. Thereafter, there are different models as to whether Parliament also approves the revenues and expenditures:

- Parliament does not approve the budgets of revenues and expenditures of the fund and Parliament is not required to be informed regularly of its revenues and expenditures. In France, during the 1990s, off-budget funds (*fonds de concours*) – resourced by retained revenues – were used by the executive without parliamentary authority. The 2001 Organic Budget Law explicitly tightened up control of *fonds de concours*.
- Parliament does not approve the budgets of revenues and expenditures of the fund, but Parliament is informed of revenues and expenditures of extrabudgetary funds. This is common in OECD countries. One example: the revenues and expenditures of the United States social security budgets and the postal service, which are formally considered "off-budget", are included in the aggregates for monitoring the federal budget.
- Parliament approves the revenues and expenditures of the funds, but separately from those of the annual budget (*e.g.* France, Korea). This is the case for social security funds in France, which adopted an Organic Law Relating to the Financing of Social Security in 1996. The social security funds' budgets are presented to Parliament by the Minister of Health, not the Minister of Finance. Unlike the State budget, in adopting the social security funds' budgets, Parliament does not place legally binding limits on the different categories of social security expenditures. Transfers from the State for covering deficits of the social security funds are approved in the annual State budget.
- Parliament approves the revenues and expenditures of the funds as an integral part of the annual budget estimates. An example is spending from resources of the United Kingdom's National Insurance Fund (NIF). The expenditure estimates, which are approved by Parliament following budget discussions, include government expenditure funded from non-consolidated revenue fund sources, including notably the various pension and social security schemes funded by the NIF. Although included in tables of aggregate spending approved by Parliament, the NIF-funded spending are non-voted outlays, as they are not included in consolidated fund acts and appropriation acts.

Irrespective of whether extrabudgetary funds' revenues and expenditures are approved by Parliament separately or in conjunction with the annual budget discussion, for macro-fiscal control purposes, it is important that Parliament is informed of aggregate revenues and expenditures. "General government", as defined in the IMF *Government Finance Statistics Manual* (GFS) (IMF, 2001) or the European system of accounts (EUROSTAT, 1996), is used as a

standard. For monitoring compliance with the Maastricht deficit and debt criteria, the EU uses this broad definition of government. In reporting consolidated fiscal developments to Parliament, some countries' laws (*e.g.* France's Organic Budget Law) explicitly require reporting of the government's overall fiscal strategy to be based on "general government" as defined in the National Accounts. In contrast, in Westminster countries, the Treasury is free to define the aggregates. In general, these countries voluntarily formulate fiscal policy in terms of "general government".

For macroeconomic control, it is desirable for extrabudgetary funds to be included in revenue and expenditure control totals. Unfortunately it is rare in OECD countries for a law to prescribe this. In Germany, indeed, the Constitution explicitly allows extrabudgetary funds to be outside the ambit of the control totals needed for implementation of the "golden rule" (Art. 115). This is a grey area, as the same Constitution (Art. 110) requires all revenues and expenditures to be in the budget (Sturm and Müller, 2003, p. 199).[14] In Japan, the law allows the use of special funds for entities that are outside the scope of "general government" as defined in GFS. Some government affiliated agencies' budgets are approved by the Japanese Parliament whilst others are not. In all cases, the quasi-fiscal activities of government-owned finance companies are beyond the scope of expenditure control totals.

4.1.3. Fiscal rules

Ensuring that fiscal policy is used to achieve macroeconomic stability is a concern for all countries. When rules on fiscal aggregates (*e.g.* those on fiscal balances – deficits or surpluses, total expenditures and government debt) have been adopted, the budget must be prepared and executed according to these rules.

The extent to which fiscal rules have been embedded in law varies considerably (for a discussion on fiscal rules, see Table 3 of Joumard *et al.*, 2004; Banca d'Italia, 2001; Kopits and Symansky, 1998; Dában *et al.*, 2003). In summary, four main situations exist:

- **Fiscal rules are not embodied in a law but in government statements** (*e.g.* Norway, Sweden, United Kingdom). The United Kingdom has operated two fiscal rules in recent years. The first requires that, over the cycle, the government borrows only to invest and not to fund current spending (a "golden rule"). The second requires public sector net debt as a percentage of GDP to be held at a stable and prudent level – currently defined as below 40% of GDP over the economic cycle (the substantial investment rule). Fiscal rules of the government are consistent with the fiscal stability code (which is not a formal law).

- **Qualitative fiscal rules are included in a law.** One example is New Zealand, where the Fiscal Responsibility Act, 1994, specifies five important principles to be kept by the government, notably to: 1) reduce total debt to a prudent level; 2) ensure that on average, over a reasonable time period, that total operating expenses do not exceed total operating revenues (this "budget balance" rule allows total debt to be maintained at a prudent level); 3) maintain net worth at a level that provides a buffer against the factors that impact adversely on net worth; 4) manage fiscal risks prudently; and 5) pursue policies consistent with a reasonable degree of predictability about the level and stability of future tax rates. Non-quantitative rules allow flexibility in the setting of annual fiscal targets, especially in the face of any external fiscal shocks that may alter the projected debt or fiscal balance objectives laid out in the medium-term budget strategies.
- **Quantitative fiscal rules are embedded in laws of limited duration** (*e.g.* Canada, the United States). To address high fiscal deficits and rapidly increasing debt, Canada's Spending Control Act, 1992, was relatively successful in limiting the growth of federal debt, by directly controlling spending (Kennedy and Robbins, 2001). The United States adopted two laws for reducing federal budget deficits during the 1980s and 1990s. The Balanced Budget Act 1985 targeted progressive reductions in the deficit during 1986-90 and a balanced budget in 1991. It complemented the Congressional Budget Act 1974, under which Congress is required to establish non-binding ceilings on budget outlays. The 1985 Act did not achieve its objectives and was replaced by the Budget Enforcement Act (BEA) in 1990. Rather than a deficit ceiling, the BEA established legally binding ceilings on discretionary spending and a "pay-as-you-go" requirement for mandatory spending (see United States country chapter). Although more successful than its predecessor in restraining expenditure and reducing deficits, the BEA was allowed to lapse in 2002 following a few years of non-compliance with the spirit of the law. In Japan, the Fiscal Structural Reform Act, 1997, was quickly suspended when it was clear its objectives were too ambitious in the face the Asian economic crisis, which created a need to loosen fiscal policy.
- **Quantitative fiscal rules are included in enduring laws** (*e.g.* Germany, Korea, Spain). Germany's Constitution specifies that revenue from borrowing shall not exceed total investment included in the budget. Korea's Budget and Accounting Act, 1961, also establishes a "golden rule": annual expenditure should be financed by revenue excluding bond proceeds or other borrowings, except in unavoidable circumstances and subject to the prior approval of the National Assembly. Spain's General Act on Budgetary Stability 18/2001 aims to ensure that central and regional governments prepare draft budgets in accordance with budgetary stability objectives, which are set in a rolling

medium-term budget framework. Sanctions are included should entities fail to comply with their budgetary commitments.

4.1.4. Timetable and approval process leading up to budget submission to the legislature

The key date for determining the budget timetable within the executive is the date on which the budget should be submitted to the legislature. On average, OECD countries require budgets to be submitted three months in advance of the beginning of the new fiscal year. There is a wide range around this average – from eight months before the fiscal year begins (United States) to one month after (New Zealand). Although the timing of the submission of the budget is a constitutional requirement in several countries, it is included in the Parliament Acts in Sweden, in the Public Finance Act in Japan, and parliamentary regulations in Norway (Table II.4).

Table II.4. **Legal requirements for the date of submission of the budget to the legislature**

Number of months in advance of fiscal year	Legal requirement			Practice
	Constitution	Law	Regulation of Parliament	
More than 6 months		United States (8 months)		
4-6 months	Denmark (4 months), Finland*	Germany (4 months)	Norway (4 months)	
2-4 months	France, Spain (3 months), Korea (90 days)	Japan (2-3 months), Sweden (3⅓ months)		
0-2 months				Canada
After year begins		New Zealand (no later than one month after year begins)		United Kingdom

* Finland's Constitution requires submission of the budget "well in advance". In line with this requirement, the budget normally is submitted about four months before the new fiscal year begins.

In Canada and the United Kingdom, there is no legally binding submission date – the executive decides. In the United Kingdom, during the period 1993-96, the government presented the budget about five months earlier than previous practice; however, the new government of 1997 reverted to the original practice of presenting the budget to Parliament at around the beginning of the fiscal year.

In only a few countries does the law prescribe how the executive should organise itself for preparing the annual budget in order to meet the prescribed

deadlines for its submission. In many countries, the legislature entrusts the executive with meeting the deadline, and the executive works backwards from the submission date. In some countries, the executive determines all aspects of budget preparation, including the date of the submission of the budget to Parliament. Examples of the three "models" are:

- **Instructions on budget preparation are provided in a law.** In Japan, the Public Finance Act, 1947, provides several instructions for the Minister of Finance (who co-ordinates the initial budget estimates of ministries), Cabinet (which is required by law to issue the budget guidelines, including initial expenditure ceilings) and spending ministries (who are to submit detailed estimates not exceeding the ceilings). Korea has similar budget preparation procedures prescribed by the Budget and Accounting Act 1961.
- **Parliament explicitly entrusts the executive with taking all necessary steps to meet the deadline.** In Finland, the State Budget Act (s. 10a) states that "provisions concerning the stages of and procedures to be followed in the preparation of the budget proposal may be issued by government decree". In many countries, executive decrees, especially those issued by the Ministry of Finance, specify the detailed steps needed to meet legal requirements concerning the types and format of appropriations and, especially, the documents needed by the legislature to accompany the draft budget law. In the United States, the law requires that the head of each agency (the equivalent of a ministry in other countries) prepare and submit to the President each appropriation request, in a form and by a date prescribed by the President. In view of this delegation, much detail is elaborated in OMB's budget circular A-11.[15]
- **Practices have developed over a long period and it would be inconceivable that Parliament would adopt a law specifying the steps for budget preparation.** This is the case in the Westminster countries, where the executive is free from any legal constraint on the annual budget preparation processes.

4.1.5. Presentation of the "budget": a law or a report on the budget?

A major difference between countries exists on the emphasis given to the legal aspects of the budget *versus* the strategic and policy aspects.

- **The budget is primarily a draft law for revenues and expenditures.** The budget system laws of many continental European countries require the executive to submit a draft budget law. The emphasis is on submission of a legal document containing annual revenue estimates and proposed detailed expenditures. In such countries, the annual budget law often incorporates changes in tax legislation necessary to attain the revenue estimates. On the expenditure side, the budget law establishes legally binding ceilings for most

expenditure chapters and items (some expenditure categories may be excluded from the binding ceiling requirements). In the case of Germany, footnotes to some expenditure items are also legally binding.

- **The budget is primarily a statement of the government's budgetary strategy and policies.** In the Westminster countries, the emphasis in the government's budget is to provide a statement of budgetary policies for the year ahead and to show the annual budget estimates in relation to its medium-term fiscal strategy (which may not be formally approved by Parliament). Legal formalities associated with any new tax measures are initiated on "budget night" – when the budget is announced. The possibility for Parliament to amend proposed tax changes is generally very limited. The detailed expenditure estimates are later debated in Parliament. Once approved by Parliament, an annual appropriations act is adopted, generally without parliamentary debate, *i.e.* the legal aspects of the budget are viewed as end-of-process formalities. Since the 1990s, some Westminster countries have formalised in the law the need for the government to present a report on the budget and/or a pre-budget report, in part to remove the importance and degree of surprise that were traditionally associated with the budget speech of the Minister (*e.g.* New Zealand's Fiscal Responsibility Act, 1994).

The Nordic countries are probably closer to the Westminster "model". The law merely requires a "fiscal budget" (Norway) or "proposals" for State revenue and expenditure (Sweden). Unlike continental European countries, the budget's legal aspects are not emphasised. The emphasis is on fiscal strategy and policies, and macro-fiscal control. In Japan and Korea, laws requires a "draft budget" not a draft budget law.

At its early stages, the United States budget process is akin to Westminster countries, in that the president's budget proposes a strategy and Congress adopts a "budget resolution" laying out the budget strategy. However, at the second stage – that of congressional approval – the budget process becomes akin to continental European countries. Congressional committees become preoccupied with ensuring congressional budget control and each action has a strong legal foundation, which eventually leads to the adoption of 13 separate appropriation acts each year. As in Germany, the legislature may add detailed "footnotes" that place legally binding constraints on the executive in executing the detailed budget. In general, strong legislatures are strongly associated with a considerable emphasis on the law in budget matters.

4.1.6. Documents required for submission with the annual budget (law)

The legal requirements for documents to accompany the draft budget vary enormously between OECD countries, reflecting to a considerable extent

the degree of separateness between the legislature and the executive. Documentation requirements are:

- **Established in considerable detail in law.** The documentation requirements for the federal budget in the United States extend for about ten pages. The executive is required to present analytical perspectives, historical tables, and appendices (the last are largely to enable the appropriation sub-committees of the legislature to begin amending, at a detailed level, the proposed draft programmes and appropriation accounts). The legal requirements are the most detailed of OECD countries. Other less extreme examples, where a law specifies requirements in detail, include France (see Box II.3, which shows the type of detail that is included in the law in some countries) and Germany.
- **Briefly elaborated in the budget system law.** Sweden's Parliament Act and its State Budget Act contain a few requirements for budget documents. Similarly, the other Nordic countries do not have legal requirements for detailed budget documentation to be prepared Full information is nonetheless provided, on a voluntary basis, in the light of informal discussions between the Ministries of Finance and parliamentary finance committees.
- **Not required by a law.** Prior to 1990, the Westminster countries' executives decided the content of budget documentation and the form of the estimates. In recent years, fiscal responsibility laws, or near-laws[16] have specified the content of pre-budget and budget reports. Canada has not adopted such a law.

4.2. Parliamentary approval of the budget

4.2.1. Timetable for parliamentary discussion and adoption of the annual budget

The timetable for parliamentary discussion partly depends on the nature of the legal obligations to: 1) submit the draft budget by a certain date; 2) limit budget debate time in parliamentary committees and plenary sessions; and 3) adopt the budget before the beginning of the new fiscal year. This subsection is limited to points 2 and 3; for 1, see Table II.4.

Parliamentary debate time on the draft annual budget may be limited by law, parliamentary regulations, or not at all. In France such restrictions are embodied in the Constitution. The first readings of the draft annual State budget law are required to be completed within 40 days (National Assembly) and 15 days (Senate) of its presentation, with Parliament (both chambers) making a final decision on the budget within 70 days of its presentation. The Constitution, as amended in 1996, also limits the time – to 50 days – for making a decision on draft social security financing laws. It is highly unusual for parliamentary discussion time to be limited in the Constitution. However, France adopted the constitutional change in 1958 in reaction to uncontrolled

Box II.3. **France: Legal requirements for budget information**

France's 2001 Organic Budget Law (OBL) requires the following documentation for the State budget, which the OBL requires to be presented by the first Tuesday in October (the fiscal year begins on 1st January).

- **A report on the economic, social and financial situation,** to be formally attached to the draft budget. This report is an update of the pre-budget report (see below). It is required to contain the main hypotheses and projection methods of the variables underlying the budget projections and the economic and fiscal outlook for at least four years following the budget year, including the revenues, expenditures and fiscal balance of general government.
- **A detailed account of the previous year's budget execution.** As from 2006, when the budget will be adopted on the basis of missions and programmes, outcomes will be assessed on the basis of performance indicators associated with each programme.
- **Explanatory annexes.** A number of annexes are required, including:
  - Detailed evaluation of the impact of all taxes, by category of tax.
  - An analysis of the impact on revenues, expenditure and the fiscal balance of changes in budget presentation from that of the previous year.
  - Details of revenues, current expenditure and capital expenditure.
  - Estimate of revenues foregone by tax exemptions.
  - Annual performance reports of each of the 150 or so programmes.
  - Details on special accounts that are permitted by law.
- **Written responses by the government of questions asked by Parliament.** The OBL specifies the date by which written questions to the government must be submitted, and the date – eight days after the draft budget is submitted to Parliament in early October – by which written responses must be received by parliamentary committees.

A **pre-budget report,** to be presented in advance of the above and during the final quarter of the parliamentary year (i.e. in May-June), is also required by the OBL. This is:

- **A report on the orientation of fiscal policy.** This report provides Parliament with an early view of the government's thinking on the direction of fiscal policy. It contains a description of overall economic, social and financial developments ("in view of France's European commitments" – an indirect reference to EU fiscal rules on government deficits and debt) and the medium-term development of State budget revenues and expenditures, with the latter disaggregated by broad functions.

parliamentary budget discussions (and frequent adoption of the budget after the beginning of the new fiscal year) in the years prior to 1958.

The United States Congressional Budget Act 1974 lays out a detailed timetable for congressional decision-making processes. Despite the specification of eight precise dates (US Code, Title 2, s. 631), a final date for the adoption of all 13 appropriation acts is not included. In practice, the budget is frequently not adopted before the beginning of the new fiscal year. This raises the question as to whether the steps already set out in the law should be replaced or supplemented by a more binding constraint on the date for the adoption of the budget by the legislature.

In some bicameral countries, laws contain specific time limits for reconciliation over budget disputes between the two chambers. Japan's Constitution specifies a 30-day period for reconciliation should the two chambers of the Diet not agree. Beyond the 30-day period, the House of Representative's conclusion prevails over that of the House of Councillors.

Westminster countries' laws generally do not specify the date by which the draft budget should be adopted by Parliament. If there are restrictions, they are in parliamentary regulations – Standing Orders. In the United Kingdom, Standing Orders limit the parliamentary debate on the estimates of expenditure in the House of Commons to three days[17] and specify 5 August (more than three months after the beginning of the fiscal year) as the date by which the House of Commons must complete its discussion of expenditures. On the revenue side, changes in existing taxes are adopted without parliamentary debate on "budget night", on the basis of delegated legislation. All new tax measures are adopted in annual finance acts, which also have to meet the 5 August deadline. In practice, Finance Acts – which formalise tax measures already implemented on the basis of temporary parliamentary resolutions – are adopted by Parliament well before this date, but still one to three months after the beginning of the fiscal year.

In sharp contrast, the constitutions of three of the 13 countries examined in detail in this book require adoption of the annual budget prior to the beginning of the new fiscal year. In the cases of France and Germany, the budget must be approved by Parliament prior to the beginning of the new fiscal year. In the case of Korea, parliamentary approval must be within 30 days before the beginning of the fiscal year.

In addition to specific limitations on parliamentary discussion time or approval dates, in some countries where the budget is viewed essentially as a draft law (as opposed to a policy statement) it is a legal requirement to give priority to the draft annual budget law in parliamentary discussions. When constitutional law establishes an agenda-setting rule for Parliament, non-budget laws are necessarily of lower priority to the draft budget law. A major

example is Germany, where the urgency of adopting the draft budget law is signalled by the constitutional requirement to introduce the draft budget into both chambers of Parliament simultaneously. Non-budget laws are introduced first to the elected chamber (*Bundestag*) before being considered in the second chamber (*Bundesrat*).

4.2.2. Provisional budgets

Many OECD countries have legal provisions for provisional budget authority in a new budget year should the legal or conventional deadlines for budget adoption not be respected. This authority is often, but not always, specified clearly in the Constitution (*e.g.* Denmark, Finland, France, Germany, Korea, Spain, Sweden) or ordinary law (*e.g.* Japan). In some countries, the law provides the authority for the executive to continue to operate government on the basis of the previous year's budget authority. For example, the Spanish Constitution specifies that the previous year's budget will automatically be considered extended until a new one is approved. The French Constitution allows the government to adopt a decree to keep the government running. The French Organic Budget Law elaborates that this is on the basis of the minimum that is indispensable for the provision of public services, under the same conditions as those approved in the previous year's budget. Germany's Constitution contains detailed provisions: payments may be made to maintain statutory institutions, carry out measures authorised by existing law, meet the Federation's legal obligations, and continue projects or make transfers already approved in the previous year's budget. To the extent that revenues are insufficient to cover these revenues, the executive is authorised to borrow (up to a maximum) to conduct current operations. Korea's Constitution also specifies the scope of the provisional budget, notably for the maintenance and operation of agencies and facilities established by law, the execution of the obligatory expenditures as prescribed by law, and the continuation of projects previously approved in the budget.

In some countries, the law may allow interim approval on the basis of the government's proposed budget. For example, the Constitution of Finland allows the budget proposal of the government to be applied on a provisional basis. In other countries (*e.g.* Denmark, Sweden, Japan), constitutions or other law allow for interim draft budget laws, but are not precise as to their basis. In Sweden, for example, a law provides that "Parliament may approve appropriations as required". Under that power, the Swedish Parliament has delegated its decision-making powers to the parliamentary budget committee. In Japan, the Public Finance Act is also vague: the Cabinet may submit a provisional budget to the Diet for a certain period of time, but the law does not state whether this is on the basis of the previous or new fiscal year's budgets.

In the Westminster countries, given that the budget is always presented to Parliament very late in the budget cycle (and, in the United Kingdom, always adopted a few months after the start of the fiscal year), interim legal authority for budgetary transactions in the early months of a new fiscal year is always required. In the United Kingdom, legal authority is provided by a parliamentary "Vote on Account", 4-5 months before the beginning of the fiscal year, at the time of the presentation of the winter supplementary estimates. This authority is granted without parliamentary discussion.

Whereas nearly all OECD countries have legal provisions or engrained practices that would never allow the government to shutdown, the United States does not have such provisions. Should the Congress not adopt the appropriation acts by the beginning of the new fiscal year, "continuing resolutions" are adopted by Congress. A continuing resolution specifies the rate at which obligations may be incurred, based either on the rate of the previous year or that contained in the President's budget request. If Congress decides not to adopt a continuing resolution, or allows one to lapse, the federal government is forced to shutdown. This happens infrequently, usually in situations where the executive and the legislature have a different political party composition.

4.2.3. Legal constraints on the legislature's power to amend the budget

About 45% of OECD countries have some type of restriction on the legislature's authority to amend the budget (OECD, 2003). In some countries, these are written into the constitution (*e.g.* France, Germany, Korea, Spain). In others, the restriction is contained in parliamentary regulations (*e.g.* New Zealand, United Kingdom). The extent of the restrictions on the legislature varies. In Australia, Canada and New Zealand, Parliament must adopt the proposed budget as a whole unless changes are very minor or total expenditures are reduced. In France and Germany, total expenditures may only be raised (or total revenues reduced) if there are offsetting measures which leave the budget deficit unchanged. Spain's Constitution requires prior consent of the executive when Parliament's amendments would result in an increase of appropriations or a decrease in revenues. In Korea, there are also severe constitutional restrictions (a reflection of a tradition of prudence in budgeting) – the National Assembly is neither allowed to increase the amount of any expenditure item nor create any new expenditure item without having the prior consent of the executive. The National Assembly is, however, free to increase or decrease revenues.

The Nordic countries are amongst those that have no legal constraints on parliamentary amendment powers. In the case of Finland, the Constitution specifies that the Parliament has the authority to make amendments – implicitly providing Parliament with a constitutional right to amend the draft budget without any constraint. However for the EU members (Denmark, Finland, and

Sweden) the EU's limits on general government deficits and debt potentially play a role in limiting parliamentary amendments. More important, however, are the self-imposed limits implicit in fiscal strategies adopted by governments in the context of coalition agreements. Although no single political party has a majority in Parliament, the political parties forming the formal or informal coalition may not wish to propose amendments that would result in a budget different from that proposed by the government. In the case of Sweden, Parliament's amendment powers at the budget approval stage are limited by the aggregate expenditure ceilings that Parliament may have adopted earlier. In Norway, Parliament also adopts, in November, aggregate ceilings as the first part of its budget approval process prior to adopting the detailed budget by end-December. This first step of budget approval limits Parliament's effective amendment powers at the second stage – in this case only re-allocations of expenditure items between and within the expenditure sub-limits can be made by Parliament.

The Nordic countries illustrate that the absence of legal constraints on parliamentary amendment powers in constitutions or other law does mean there is no such constraint in practice on the parliamentary budget approval processes. Japan provides another example, as the Diet usually adopts the Cabinet's proposed budget unless changes are very minor or total expenditures are reduced. However, this practice has no legal basis.

4.2.4. Approval of medium-term fiscal strategy by the legislature

In OECD countries, the documents accompanying the draft budget generally present an analysis of past and projected budgetary developments. The presentation of a medium-term fiscal strategy – with aggregates for total revenue, total expenditures, and the fiscal budget – is now virtually standard in OECD countries. Whereas such presentation is a legal requirement in some OECD countries (*e.g.* France, Germany, New Zealand, Spain), other countries (including Canada, Denmark, Japan, Korea, Norway) do not require it by law (OECD, 2003).

Although presentation by the executive of a unified budget, with budgetary aggregates shown over the medium term, is now standard, OECD countries' budget laws differ as to whether there is a legal requirement for the legislature to approve total revenues, total expenditures and the balance between them, for the budget year and years beyond the budget year.

- **A quantified multi-year medium-term fiscal strategy is approved by the legislature.** A country's legislature may adopt by law a quantitative fiscal rule, thereby dictating the course of medium-term fiscal aggregates. If such a law is adopted, the executive must, each year, present a budget consistent with it. Only modification or abrogation of such a law would release the

executive from this obligation. If such a law relates only to the projected deficit, another law may be required to ensure that the legislature also approves, separately, total revenues and expenditures. The United States Balanced Budget Act 1985 and its successor the Budget Enforcement Act 1990 are examples (see fiscal rules above). In the EU countries, the Maastricht deficit and debt criteria and the Stability and Growth Pact's requirement for "at least a balanced budget over the economic cycle" provide strong deficit guidelines for each country. However, the quantitative deficit/debt limit rules are not strictly legally binding and have been broken with impunity in several cases.

- **Medium-term fiscal strategy is presented annually and approved by the legislature.** Countries generally do not include in law a requirement that the legislature approves the medium-term fiscal strategy each year, as part of regular budget process. In Sweden, the State Budget Act 1996 allows the government to propose expenditure ceilings (limits) to Parliament that become binding for the years beyond the budget year. In practice, each November, prior to approving the detailed annual budget, the Swedish Parliament approves an aggregate multi-year expenditure ceiling. In particular, it makes a decision on the level of spending in year (+3), *i.e.* Parliament adds a new year to its rolling three-year expenditure ceilings. Spain's General Budgetary Act 47/2003 also requires the establishment of legally binding ceilings on total expenditures.
- **Medium-term fiscal strategy is presented annually, but not approved formally by the legislature.** In most countries, there is no legal obligation for the medium-term fiscal strategy to be formally approved by Parliament. Despite this, nearly 75% of all OECD countries' executives prepare a medium-term budget framework and present it to the legislature (OECD, 2003). However, except in a few cases, these are for the legislature's information only – the aggregates are not formally approved. For example, Germany's 1967 Law to Promote Economic Stability and Growth – an early law requiring medium-term budget projections – specifies that a five-year medium-term plan is to be adopted by the government, but this is only to be submitted to the two chambers of Parliament (s. 9).

A few OECD countries specify in law the number of years to be included in the medium-term budget projections. When this is specified in law, it is generally three to five years (*e.g.* France, Germany, Spain). However, New Zealand's Fiscal Responsibility Act 1994 required the government to present to Parliament each year a fiscal strategy report which describes the government's long-term objectives and a set of projections of budget aggregates covering a ten-year period. The United Kingdom's code of fiscal stability – which is not a formal law – followed New Zealand's example and adopted the requirement for ten-year projections in 1998. In the United States, law requires five-year

projections,[18] but fiscal policy projections are habitually framed for a ten-year period, on the basis of a rule adopted in the Senate in the early 1990s.

4.2.5. Approval of resources

The legal requirements for the legislature's approval of the revenue estimates of the annual budget should not be underestimated. Five aspects are considered.

First, the reporting of all revenues to Parliament on a gross basis is incorporated in several countries' budget system laws (*e.g.* Germany, Finland, Sweden). However, all countries have legal dispositions for making exceptions to the principle of universality (see Part III). A major exception is when revenues are deducted from expenditures that are appropriated (see net budgeting below). In Germany, the Law on Budgetary Principles also allows an exception for receipts in the case of sales or acquisitions. However, computations are to be shown in an annex or an explanatory note.

Concerning geographical coverage, in federal countries where there are revenue-sharing arrangements, federal laws (or the constitution, for example in Germany) specify the shares of specific taxes that will be retained by each level of government and shown as revenues in the federal and sub-national budgets (expenditures in central governments). In unitary countries, transfers to local governments are usually shown as expenditures. In others, however, transfers to local authorities from shared taxes are shown as negative revenues. In France, for example, consistent with the principle of showing all revenues on a gross basis, the annual budget law shows all taxes inclusive of any reimbursements, tax deductions, and transfers. The annual State budget also shows, as negative taxes, the transfers of shared taxes to local governments and those to be transferred to the EU's budget (based on a fixed percentage of VAT revenues).

Second, in many countries, tax laws provide permanent authority for the executive to levy and collect taxes each year. At the other extreme, in some countries (*e.g.* France), Parliaments must renew taxation authority every year in the context of adoption of the annual budget law. The United Kingdom is between these two extremes: whereas for most taxes, the government's authority to levy and collect revenues is permanent, for income taxes, the authority has to be renewed each year, in the context of adopting the annual finance acts.

Third, in some countries, budget system laws provide a summary of revenue nomenclature. In Germany, for example, the Constitution's assigning of revenues between the Federation and the *Länder* provides an implicit categorisation of revenues. This is complemented by the Law on Budgetary Principles and the Federal Budget Code (also a law) which specify the main few

revenue categories and requires all revenues to be arranged according to economic and functional categories. Details are left to regulations of the Ministry of Finance. In other countries (*e.g.* United Kingdom), the executive has the complete discretion on how to present the annual revenue estimates – there is no constraint imposed by statute law.

Fourth, by embedding a consolidated revenue fund in legislation, some countries' laws highlight the principle of equality of all revenues. All public revenues are deemed to serve the public interest, irrespective of whether they are taxes or non-tax revenues. This principle of equality of all revenues has been affirmed by the Constitutional Council in France (Bouvier *et al.*, 2002, p. 234), where such jurisprudence adds to formal statutes. Despite this, France's 2001 Organic Budget Law allows earmarking to take place within the State budget, by using budget annexes, special accounts and specific accounting arrangements. Also, a percentage of excise taxes on tobacco are earmarked for financing part of the deficits of social security organisations and, as from 2004, the newly-devolved responsibilities of local governments.

Fifth, revenue estimates approved by the legislature are evaluations of likely taxes and non-tax revenues to be levied and collected by the executive. When revenue projections are exceeded, a constitutional requirement in many countries (even if not a written one) is that such revenues may not be spent except as authorised by a law. Hence, the law requires that a supplementary budget be adopted to spend such revenues. To avoid optimism in revenue projections – and hence budget expenditures that cannot be financed – a law could theoretically require conservatism in revenue projections. Although legislatures in OECD countries have not, in general, used budget system laws for this purpose, some countries' governments have adopted rules requiring conservatism in revenue projections. In Canada, the federal government projects revenues using private sector forecasts of economic activity that have been deliberately adjusted down. Such rules have been adopted by the Netherlands government since 1994 (Dában *et al.*, 2003, p. 30).

4.2.6. Nature of budget appropriations

There are at least three questions relating to the nature of appropriations dealt with in budget-related law. First, does the law specify the basis of appropriations? Second, are appropriations always gross, as required by the principle of universality? Or are exceptions made, with some appropriations approved on a net basis? Third, what appropriations are approved outside annual appropriation acts?

First, OECD countries' budget laws differ as to the meaning of "expenditure", as approved by the legislature. The possibilities are: commitment; accrual; payment order issuance; or payment. Countries' budget system laws traditionally

contained provisions relating to the authority for the executive to make cash payments in a 12-month period. However, for some spending – especially investment – there are relatively long lag times during the project planning and ordering phases, prior to cash spending. For this reason, some countries' budget system laws (*e.g.* Germany) require or allow expenditure in the annual budget to be on both a cash basis and a commitment basis. In the case of France, the Organic Budget Law allows expenditure commitments covering a three-year period to be approved annually, as well annual limits on payment order issuance or cash payments. The United States federal budget is based on the notion of "budget authority", which is the legal authority to incur financial obligations that result in outlays (*i.e.* cash spending). Forms of budget authority include appropriations, borrowing authority, contract authority, and spending authority from offsetting collections.[19] Appropriation is the provision of law authorising the expenditure of funds for specific purposes. Appropriations acts are one form of appropriation: they authorise federal agencies to incur legally binding "obligations", as well as allow the Treasury Department to make payments for designated purposes. When accrual-based budgeting (not only accounting) was adopted in New Zealand, appropriations were for expenses and for capital contributions – largely depreciation of fixed capital.

Second, a major exception to the gross budgeting principle is fees for a specific service, where the "user pays" principle is applied. Budget system laws as diverse as France's Organic Budget Law, 2001, and the United Kingdom's 1891 Public Accounts and Fees Act allow for net budgeting under certain circumstances. Even though net budgeting is authorised, it is usual for the fees collected and retained by spending ministries or agencies to be approved in the annual budget law. In France, the Organic Budget Law requires such revenues to follow usual gross accounting procedures, where collections are shown under "revenues" of the State budget (either in the main budget, a budget annex, or a special account). In contrast, in the United Kingdom, government departments' retained revenues ("appropriations-in-aid") are netted from gross expenditures and the expenditure estimates are adopted on a net basis. The annual appropriations acts authorise only the net amount needed by the department from the Consolidated Fund. However, Parliament also approves retained revenues as negative expenditures. If departments or agencies collect more revenues than projected, additional parliamentary approval is needed before ministries or agencies can spend their "own" excess revenue.

Net budgeting without the corresponding approval of revenues by Parliament in the annual budget law may be incorporated in separate laws. This is the case for autonomous entities with their own legal identity and which are largely dependent on their "own" revenues. Such entities may have a governing board that approves their "independent" budgets. Typically, the central

government's budget will only show net transfers to these entities, to supplement their own revenues. The legal basis for net budgeting by these entities is usually established in either a budget system law or the law establishing the entity. Such laws may require these entities to report total revenues and expenditures to Parliament with their annual budgets. In the absence of such reporting obligations, Parliament would not be able to exercise its oversight role. The law may also specify the powers and limitations on borrowing by the entities.

Third, budget authority – or appropriations – may be provided for on the basis of laws other than the annual appropriation act(s).[20] This is often the case for social transfers to households, where social welfare and/or benefit legislation establishes mandatory payments to households. Debt servicing and salaries of officials of constitutional bodies are other examples. Several countries' laws require uniform reporting even if expenditure authority is required by acts other than the annual appropriation act. For example, the New Zealand Public Finance Act requires that each expense or capital expenditure incurred or each payment made other than by an appropriation act must be managed and accounted for in the same manner as those made by appropriation acts.

4.2.7. Structure of budget appropriations

With regard to the structure of appropriations to be specified in budget system laws, OECD countries have typically chosen an input-based structure. For example, in Germany, the 1969 Law on Budgetary Principles requires expenditures of each department to be classified by object, including for personnel costs, other current expenditures, transfers to sub-national governments, subsidies to enterprises, debt service payments, and investment (with various sub-categories). In addition, the law requires a budget annex to classify expenditures functionally, and to provide a matrix of expenditures classified functionally and by object (economic classification). The United States federal budget is also input-based: budget system law focuses on objects or purposes of expenditure for the appropriation "accounts" approved annually by Congress. The US Code authorises budget appropriation titles to be changed by appropriation laws, *i.e.* Congress controls the detailed appropriation structure. The OMB has a detailed accounting system in which object and functional classification (amongst others) is also maintained.

Since the advent of "new public management", some countries have abandoned the traditional input-based appropriations structure. Beginning with New Zealand's Public Finance Act in 1989, some countries' budget-related laws now require appropriations to be output- or outcome-based. Although New Zealand's change was fundamental, the appropriation structures are not exclusively based on output classes – it also includes various categories of

benefits (mandatory transfers to households), borrowing expenses, "other" expenses, and capital expenditures.[21] France's 2001 Organic Budget Law focuses on missions – the ultimate objective of government policy – and programmes, the basis for broad-based appropriations to be adopted by the French Parliament as from 2006. For implementing the annual budget, the Organic Budget Law requires the executive to provide seven categories of expenditures (salaries, operating expenses, investment, etc.) within each programme. These input estimates will be purely notional, with the exception of salaries. For each programme, salary projections will be binding upper limits – *i.e.* in executing each budget programme, managers will not be allowed to transfer non-salary expenditure authorisations into salaries. Thus, in contrast to the absence of such a constraint in New Zealand, the French Parliament will retain control over the public service salary bill. The Organic Budget Law also requires employment levels in each ministry to be approved by Parliament each year.

4.2.8. Duration of budget appropriations and carryover provisions

Budget laws may specify exceptions to the principle of annuality (see Part III), which limits appropriations to a 12-month period. There are three aspects relating to duration, notably whether: 1) certain appropriations are provided for a period longer than 12 months; 2) unused 12-month budget authority can be carried over for use in the following fiscal year; and 3) the 12-month budget authority expected in the next fiscal year can be anticipated in the current fiscal year (*i.e.* borrowing against future budget appropriations).

Traditionally, budget authority for cash spending was limited to a 12-month period. Unused appropriations at end-year were cancelled. However, some countries (*e.g.* France, Germany, Japan, Korea, United States) have, for some time, provided a legal basis for multi-year budget authority for certain expenditures, notably those that require long planning and ordering periods. In other countries, such flexibility is more recent (Westminster and Nordic countries). Multi-year budget authority is, in practice, generally confined to investment spending, although budget system laws in some countries are worded generally, so that multi-year budget authority for current expenses is also permissible. For example, in Finland's State Budget Act, "transferable" appropriations relate to appropriations that may be transferred either across time (*i.e.* multi-annual appropriations, up to two years) or across government agencies. Regarding "flexible" appropriations in Sweden, the State Budget Act simply states that unused funds may be carried over and used during a subsequent fiscal year.

Nearly all OECD countries allow carryover of budget authority for current and capital expenditure that is unused at end-year, under certain conditions. Greece, Ireland, Spain, and the United States (current expenditure only) are amongst the few exceptions (OECD, 2003, Q.3.2.1). Budget system laws usually

provide this authority. However, some expenditures, notably transfers, are usually excluded from carryover provisions. Countries' budget system laws or regulations provide the executive with a variety of powers:

- Unlimited carryover authority for both current and capital expenditures (notably for Australia, Denmark and Germany).
- Unlimited carryover authority for particular expenditures (*e.g.* Germany, Sweden – for "flexible" appropriations, but not for "fixed" appropriations).
- Unlimited carryover for investment spending delegated to the Minister/ Ministry of Finance (*e.g.* Austria, Belgium, the Netherlands).
- Carryover authority up to a given percentage (*e.g.* Norway's Budget Regulations – for current expenditure appropriation items, up to 5%).
- Carryover authority for certain types of expenditure (*e.g.* Japan's Public Finance Act – for expenses that did not take place for unavoidable reasons, usually project-related).
- No carryover without approval of the legislature (*e.g.* New Zealand).

In most OECD countries, budget-related laws prohibit borrowing against appropriations for future years, as this could pose a risk for expenditure control. However, seven countries allow such borrowing for both operating costs and investment expenditure. The authority for such borrowing is included in the budget system law in most cases. Only Iceland allows unlimited borrowing. For the other six OECD countries, four European countries (Belgium, Denmark, France, and Sweden) allow such borrowing up to certain percentage (after which parliamentary approval must be sought); in Australia and Canada, such borrowing must be approved in a supplementary budget.

4.2.9. Approval of borrowing, government guarantees and public debt

The authority of the legislature to approve government borrowing is often contained in constitutions (*e.g.* Denmark, Germany, Finland, Japan, Korea, Norway, Spain, Sweden, United States), reflecting the importance attached to the legislature's right to control borrowing on behalf of the taxpayer. In other OECD countries, the obligation for borrowing to be approved by the legislature is usually laid down in the budget system law (*e.g.* Canada, France, New Zealand). Some countries have separate public debt laws (*e.g.* Denmark, Sweden) to supplement constitutional or other budget-related laws. In the United Kingdom, the National Loans Act 1968 established a national loans fund, separate from the consolidated revenue fund, which is used for financing central government operations by borrowing.

The main provisions in these laws relate to gross or net borrowing – changes in the stock of debt – rather than the level of debt. Generally, the law requires the annual budget law to approve new borrowings – creating a binding

limit – for a 12-month period. Laws often delegate the management of borrowing to the Minister of Finance (or equivalent), whose responsibilities in borrowing and debt-related matters are elaborated in the law. A supplementary budget is generally needed should the borrowing limit be exceeded.

Only a few countries have a binding limit on the outstanding stock of government debt – in terms of national currency. The United States is one example: the US Code (Title 31) specifies the maximum debt in terms of dollars. This limit has to be revised upwards periodically. With large federal deficits re-emerging after 2000, Congress had to adopt legislation to revise the debt limit upwards.[22] Poland's embedding of the EU debt criterion (maximum general government debt not to exceed 60% of GDP) in its Constitution is exceptional. In most countries, the stock of public debt is controlled indirectly by the legislature, by: 1) placing legally binding limits on new borrowing in the context of the annual budget law; and 2) reviewing the government's proposal for the medium-term macroeconomic projections – including for the stock of debt. In most EU countries, the Maastricht debt criterion provides moral suasion for governments to maintain debt at a "sustainable" level. Various EU countries (*e.g.* Italy) have adopted domestic laws prohibiting central bank financing of the State deficit by buying government securities on the primary market. In Westminster countries, it is the government that defines what is meant by a "sustainable" or "prudent" level of debt. Legally binding debt levels are not formally approved by Parliament in these countries. However, governments are required to explain to the legislature any departures from previously announced debt strategies.

In Sweden, the 1998 State Borrowing and Debt Management Act establishes the objectives for debt management, namely to minimise long-term costs while taking into account risks. As in many countries, the Swedish government (not Parliament) decides annual guidelines for debt management in line with the 1998 Act. However, that act requires the government to submit an annual debt management report to the legislature, which enables Parliament to evaluate the government's management of public debt. The preparation of debt reports is also a legal obligation in several Westminster countries (for details of the legislative framework for debt management in these and other countries, see IMF, 2003).

The rules for the issuance of government guarantees are also usually laid down in law. Whereas in Finland and Germany, the written constitution requires parliamentary approval of government debt guarantees, in most countries ordinary laws (either budget system laws or specific debt/borrowing laws) contain such a provision. For example, Sweden's State Budget Act allows the government to issue guarantees for purposes and amounts that are approved by Parliament. In many countries, because of cash-based accounting, the budgetary cost of loan guarantees is only shown when the loan guarantee is

called up. In contrast, since the adoption of the Federal Credit Reform Act in 1990 in the United States, the cost of a loan guarantee – defined as the net present value of cash flows to cover claims by the lender for defaults and other costs – is included in the federal budget. No other OECD country has adopted such a specialised law to cover this important budgetary issue.

4.2.10. Supplementary budgets

General provisions relating to supplementary budgets are laid out in the Constitutions of several countries (*e.g.* Denmark, Finland, Korea, Spain, Sweden) or in a budget system law (*e.g.* France, Germany, Japan, New Zealand, United States). The reasons for supplementary budgets are stated in some countries' laws. For example, in Japan, the Public Finance Act permits Cabinet to submit a draft supplementary budget to the Diet for: 1) supplementing funds necessary to meet statutory contractual government obligations unforeseen in the initial budget; and 2) modifying the budget to meet additional spending needs arising after the budget is approved by the Diet. Supplementary expenditure needs generally include natural disasters, *ad hoc* emergencies, new policy initiatives, or transfers of budget authority.

The law seldom restricts the number or timing of supplementary budgets. In Germany, for example, the federal budget code allows supplementary budget requests to be submitted to the legislature at any time provided they are before the end of the fiscal year. In no OECD country does the law restrict the size of budget revisions. This is generally upward (although not always) for most expenditure items, but by less than 10% on average when it does occur. In many countries, two to three supplementary budgets are adopted by the legislature at regular times during the annual budget cycle. In some countries, the executive is required by law to present a mid-year review of budgetary developments, which may be used to present a supplementary budget request to the legislature.

4.3. Budget execution

Many countries do delegate authority to the executive to issue decrees or regulations for the budget execution processes. This is a sign that the legislature trusts the central budget authority to implement the approved budget and the audit body to provide reports to the legislature on budget execution. In Finland, for example, the State Budget Act contains a specific article to this effect. There are, however, some areas, where Parliament may be involved during the course of budget implementation. These include the extent to which the executive has authority to cancel or transfer budget appropriations which have been approved by the legislature and, in special circumstances (*e.g.* emergencies, from contingency funds), to make expenditures prior to *ex post* approval by the legislature. The United States is an example of a country that has adopted

detailed laws in these and other areas of budget execution so that the legislature can closely monitor and control in-year budget developments. This section examines country practice in selected areas of budget execution.

4.3.1. Apportionment of expenditure authority

After the legislature has approved budget authorisations for a 12-month period, many countries trust the executive with all in-year allocations – or apportionments – of budget authority. In such countries (*e.g.* Canada, France, Germany, New Zealand, Spain, United Kingdom), a law may provide general authority for apportionment, but not elaborate on details. For example, in Germany, the Law on Budgetary Principles merely requires that "appropriated funds be administered in such a way that they suffice to cover all expenditures falling due under the various purposes indicated". In France, in-year appropriations are made available to ministries by government decree. In Westminster countries, the Crown authorises the Treasury to issue funds to departments for meeting expenditures; procedures for allocating authority for particular time periods are contained in regulations, not law.

In contrast, in the United States the law sets out the apportionment process in considerable detail. Title 31 (ss. 1501 to 1558) of the US Code requires appropriations to be apportioned by the Office of Management and Budget for periods within the fiscal year or among functions, activities, projects and objects. The code specifies precise dates by which apportionments should be notified in writing to departments and agencies (*e.g.* 15 days after enactment of the appropriation acts), the legislature and the judiciary. The apportioned amounts cannot be exceeded, without administrative sanction, by those executing the budget. The law also allows apportionments to be subdivided administratively within the limits of the total apportionment. The relevant laws in Japan and Korea also have elaborated apportionment procedures, with perhaps a little less detail than in the US Code.

4.3.2. Cancellation or postponement of budget authority

In implementing the legislature's approved budget, OECD the executive may cancel or postpone approved appropriations, under conditions stated in the law in about half of OECD countries (OECD, 2003, Q.3.1.c). For example, in Germany, the law authorises the Minister of Finance to make commitments or cash expenditures subject to his approval should developments in revenues or expenditures so require. In other countries, quantitative and other restrictions may be imposed. For example, the Organic Budget Law authorises the executive in France to cancel appropriations by government decree, up to a maximum of 1.5%. The law requires that parliamentary committees be informed, prior to the issuance of the decree. Extensive legally binding restrictions on the executive were incorporated in the United States Impoundment Control Act 1974, which

distinguishes cancellations ("rescissions") from postponements ("deferrals"); the former require congressional approval in all instances (see the United States country case study for details).

For spending that is mandatory – because it is required by a law separate from the annual budget law spending – the executive in nearly all OECD countries is not authorised to cancel or limit such spending. For discretionary expenditure, two-thirds of OECD countries do not allow the executive to withhold funds for approved spending (OECD, 2003, Q.3.1.d). In such countries, executives are generally free to propose cancellations via a supplementary budget.

4.3.3. Emergency spending and contingency funds

The constitutions of four OECD countries (Austria, Finland, Germany and Japan) and the budget system laws of most other countries contain provisions relating to the authority of the executive to spend public money in excess of the approved budget, when there are specified contingencies. In order to avoid undermining the legislature's budgetary authority, restrictions necessarily apply.

In Germany, the Constitution authorises the Minister of Finance to consent to excess spending only in the case of an unforeseen and compelling necessity. For the federal budget, the Federal Budget Code elaborates: the need shall not be deemed compelling if a supplementary budget can be adopted in time or if the expenditure can be postponed until the following year. In France, in particularly urgent situations, where the national interest is at stake, the Organic Budget Law allows the executive to increase Parliament's appropriations by decree even if it means that the budget deficit target would deteriorate. However, should the Council of Ministers issue such a decree, it must be ratified by Parliament as soon as possible. Besides emergency situations, the executive in France may increase budget appropriations in the event of excess tax revenues, up to a limit of 1%, provided the budget balance is unaffected and after notifying parliamentary budget committees.

In some continental European and Nordic countries, certain appropriations are labelled as "estimated". Budget system laws may allow "estimated" expenditures to be exceeded without parliamentary approval. There are two types of expenditures that may be categorised as "estimated". First, expenditures required to be made by law or legally binding contractual arrangements. A major example is debt servicing payments, which must be made in a timely way irrespective of the approved amount in the budget. Second, some expenditure items, by their very nature, are difficult to estimate. When identified as such in the annual budget, spending on them, in excess of budgeted amounts, is allowed. *Ex post* reporting to Parliament on "estimated" expenditure is generally a legal requirement.

In Japan, the Constitution allows a contingency fund to be authorised by the Diet and to be spent on unforeseen omissions from the initial budget, with Cabinet taking responsibility for such expenditure. The purposes and procedures for which contingency funds may be used are spelt out in the law in many countries. In Japan, the Public Finance Act focuses mainly on the procedures for using the contingency fund, which is managed by the Ministry of Finance. In requesting use of the funds' resources, line ministries must specify the reasons for its use, the amount, and the basis for calculating that amount. The request must then be submitted to the Ministry of Finance which may adjust the request before Cabinet approval. After using the contingency fund, the Public Finance Act requires line ministries to prepare and submit a report to the Ministry of Finance on how the money was used; the Ministry prepares a comprehensive report for the Diet's approval.

Whereas in Japan (and some other countries) the amount in the contingency fund is not specified in the law (the executive determines its size), in other countries the size of contingency funds or reserves is so specified. For example, the United Kingdom's Contingency Fund Act 1974, which authorises the making of urgent expenditures not yet voted by Parliament, is capped at 2% of the previous year's expenditures.

Budget flexibility by the executive is strongly restricted in the United States and a few other countries. Any reserves operated by departments or agencies are limited. On the other hand, the United States legislature reserves flexibility for itself. For example, when the federal government budget turned into a surplus towards the end of the 1990s, Congress knowingly loosely interpreted "emergency" spending allowable under the Budget Enforcement Act, 1990, the aim of which was to provide a framework for budget discipline and control of expenditures.

4.3.4. Transfers and virement of appropriations within the year

Irrespective of whether a country has adopted an output-based appropriation structure – or maintained an input-based appropriation structure – the rules for transfers between appropriations need to be established in a law. The need for complex rules – including regulations within the executive to supplement any laws – increases in line with the extent of the detail of the appropriations structure and the extent to which the legislature chooses to retain transfer authority rather than delegate it to the executive. The main choices made in the law concern the extent of delegated transfer authority between broad categories, such as salaries, other operating expenses, transfers, and investment spending. A variety of legal arrangements exists in OECD countries.

For countries that have adopted a broad-based appropriations structure, the executive is restricted from making transfers of appropriations between

programmes – the executive already has considerable discretion to decide between inputs. Transfers between capital and operating expenditures are prohibited in many countries (*e.g.* Australia, Denmark, Finland, Norway). Legislative authority is usually needed for transfers between programmes (for example, Sweden, United Kingdom).[23] However, a law may provide the executive with interim authority to transfer between appropriations. For example, in New Zealand, output expenses may be transferred by government order, up to a maximum of 5%.

In countries that have maintained a detailed line-item appropriation structure, a law restricts transfer authority. In Germany, virement rules for administrative expenditures were eased somewhat when a new law was adopted in 1997. However, this affected less than 10% of total federal expenditures – major spending programmes were unaffected by the new legislation. In the United States, the executive has very little discretion to make changes in the 1 000 or so accounts that require congressional approval. Exceptions for the Department of Defense have been granted by Congress. Transfers within programmes – known as "re-programming" – is not governed by a general law. However, Congress generally writes reprogramming restrictions into individual appropriation acts. Japan and Korea also have quite strong restrictions on the ability of spending ministries to make virements without either central ministry or parliamentary approval.

4.3.5. Government banking arrangements and cash planning

Budget system laws may establish the concept of a unified revenue account into which all public money is paid and out of which specific expenditures are made. The precise banking arrangements associated with this concept are often not specified in law – certainly not in detail. In France, the Organic Budget Law simply states that there is to be a single account for total revenues and expenditures of the general budget. In the law relating to the Bank of France, the central bank is to provide banking or other services that the State may ask of it, provided that these are specified in protocols and that the services are remunerated to cover costs. This example illustrates that the legal basis for government banking arrangements may be established in a central bank law, with details left to protocols between the Treasury and the central and/or commercial banks.

Surprisingly, the Westminster countries' budget-related laws contain some details on government banking arrangements. Part of this is due to the inheritance of the 1866 Exchequer and Audit Act in the United Kingdom, which specifies that the Treasury issues public funds to departments out of a consolidated Exchequer account held at the Bank of England. The New Zealand legislation goes further in specifying the authority of the Minister of Finance over government banking arrangements. In particular, in accordance with the

provisions of the Public Finance Act, the Treasury ("Ministry of Finance") may open, maintain, and operate the Crown Bank Account at a bank or banks that the Minister of Finance may direct. Departmental bank accounts may be opened, maintained, and operated by a department at bank(s) as the Minister of Finance may direct. The Minister of Finance may give directions as to any terms and conditions under which any departmental bank account may operate and at any time close and suspend the operation of an account (for further details, see the New Zealand country case study).

The short-term forward planning of cash inflows, outflows and financing needs, and arrangements for managing short-term developments in the government's balance sheet (if there is one) is a matter of concern to the executive – not the legislature. Accordingly, in many countries, government regulations provide guidelines for these aspects of budget execution. Nonetheless, in some countries, a law contains a few principles relating to cash management, such as "revenues shall be collected punctually and in full" and "money may only be spent as and when necessary" (Germany, 1969 Law on Budgetary Principles). The principle that gross revenues be paid into a single treasury account is important; such a provision is captured in the United Kingdom's 1866 Exchequer and Audit Departments Act ("public moneys must be paid into the 'Exchequer account'"), which the law specifies be held at the central bank. Although OECD countries have not adopted treasury laws, Lithuania is one country that has adopted such a dedicated law.

4.3.6. Internal control and audit

A mixture of law and regulation is usually used for specifying internal audit arrangements. However, in a few countries (including Denmark, New Zealand, and the United Kingdom) neither law nor regulations define coherent principles, systems and functioning of internal controls and audit (OECD, 2003, Q.4.1.a). In these countries, internal control and audit within spending ministries is seen as one of the management functions performed by those responsible for "efficient, effective and economic management of the activities of the department" (see the New Zealand State Sector Act 1988).

In countries with decentralised internal control and audit, budget system laws only provide a few general guidelines for internal control and audit. For example, the State Budget Acts of Sweden and Finland merely specify a need to "follow up" budget execution. Regulations on internal control and audit in such countries are issued usually by the central Finance Ministry or a dedicated agency. The Nordic countries are unique in that organisationally, internal audit entities usually exist at the programme level, not at the level of a ministry (although this is possible). In most countries, since internal control and audit is at the ministry level, internal audit procedures and the preparation of reports for managers (including ministers) are specified in regulations.

Internal audit is centralised in some countries. In Japan, the Public Finance Act requires line ministries to implement budgets in accordance with guidelines approved by Cabinet and issued by the Ministry of Finance. Decrees elaborate on these general provisions, which include a strong role for the Ministry of Finance. Spain's General Budgetary Act 47/2003 establishes a General Controller of State Administration for internal oversight of financial management of the State sector as a whole. This powerful body is somewhat paralleled in France, which has a high-level inspectorate (established by decree in France's case), under the Minister of Finance.

The adoption of dedicated laws for centralised financial control is not common in OECD countries. However, France and the United States are exceptions. In France, a 1922 law established centralised *ex ante* control over expenditure at the commitment stage. The need to adopt a law, rather than a decree, derives from the fact that government ministers authorise expenditure commitments. Prior to the adoption of this law, ministers were not respecting approved budget limits (see Bouvier *et al.*, p. 410).

The legislature of the United States is particularly active in seeking to assure that the federal budget is implemented as adopted by Congress. In sharp contrast with other OECD countries, it has adopted at least six separate laws relating to financial management in executive agencies (see the United States country case study). The Inspector General Act of 1978 established the Office of Inspector General in the Department of the Treasury. The Inspector General is required to keep both the Secretary and Congress fully informed about the problems and deficiencies relating to the administration of department programmes and operations. The Chief Financial Officers Act 1990 established an Office of Federal Financial Management in the Office of Management and Budget. To support the OMB's leadership role in improving financial management in agencies, the law requires chief financial officers to be established in all major agencies. The advice and consent of the Senate is needed when the President appoints the Inspector General in the Treasury, the Deputy Director for Management in the OMB and all chief financial officers in agencies. Whereas in most countries, heads of internal audit units report only to agency heads, in the United States, chief financial officers and the Inspector General are required to report to Congress as well as to their agencies.

4.4. *Government accounting and fiscal reporting systems*

In many OECD countries, the law only provides a few general statements concerning the basis of the accounting system. Nonetheless, a few countries (*e.g.* Denmark, Japan) have specific public accounting laws. Budget system laws – or special fiscal transparency laws – often elaborate on the timing and content of periodic budget execution reports and annual accounts, which are

major accountability documents by which the legislature can reach conclusions concerning budget execution.

4.4.1. The accounting framework

The traditional cash basis for government accounting is usually not explicit in law. However, the Law on Budgetary Principles in Germany requires that "collections and disbursements shall be recorded in accounts. The Minister of Finance may order accounts to be kept on commitments entered into and monies accruing". Collections and disbursements are both cash concepts.

Although there has been a move towards accrual accounting in a number of OECD countries (Blöndal, 2003), major changes in law to accommodate the new accounting systems have not always been adopted. Some reforming European countries have inserted an article in the budget system law such as "the State accounts shall be kept according to generally accepted accounting principles (GAAP)" (*e.g.* Finland, Sweden) or "the government accounting norms will not differ from company accounting except to the extent that the State has specific characteristics" (France). In these countries, brief statements in law are accompanied by detailed regulations.

In contrast, the laws in Westminster countries provide some details of accounting arrangements. In the United Kingdom, the Government Resources and Accounts Act 2000 (GRA Act) formally changed the cash basis of government accounting to an accrual basis, with "resource accounts" replacing the "appropriation accounts" that had been in place for 150 years. The act specifies that accounts will be prepared in accordance with directions issued by H.M. Treasury, which shall ensure that resource accounts present a true and fair view and conform to GAAP, subject to such adaptations as are necessary for departmental accounts. For these purposes, the Treasury is guided by an independent Accounting Standards Board.[24] The GRA Act also specifies the content of resource accounts: they must include a statement of financial performance, a statement of financial position, and a cash flow statement. A resource accounting manual provides a guide on accounting and management control procedures.

4.4.2. Annual accounts and reports

The necessity to submit annual accounts and/or reports to the legislature is a constitutional requirement in several countries (*e.g.* Denmark, Germany, Finland, Japan, Norway). In Germany, it is considered important that the legislature, after approval of the audited annual accounts, formally discharges the government from its duty to execute the budget. The Law on Budgetary Principles lays out procedures leading to discharge. The granting of discharge of ministers is also included in the Netherlands Government Accounts Act, 2001.

Countries with constitutional requirements for submission of annual accounts generally elaborate in law the content of both the annual accounts and the annual reports on budget execution. The example of Finland is provided (Box II.4). The content of reports and accounts reflects Finland's adoption of a performance-oriented budget system and an accrual accounting system. Not all countries' laws require such comprehensive reporting. The legal requirements for

Box II.4. **Finland: Legal requirements for annual report and annual accounts**

Report on the State annual accounts

The report shall include:

- The State annual accounts, all necessary other information on the management of central government finances and compliance with the State budget, together with information on the most important factors determining effectiveness and operational performance of the State's operations.
- The report shall also incorporate income statements and balance sheets on State public enterprises and extrabudgetary funds.
- Further provisions concerning compilation of the report on the State annual accounts may be issued by government decree.

State annual accounts

The State annual accounts comprise:

- A statement on budget implementation, specified by section or main division, by chapter and by item. This statement includes the surplus or deficit for the financial year shown in the State annual accounts as well as the cumulative surplus or deficit from previous financial years.
- An income and expenditure statement on revenues and expenditure.
- A balance sheet illustrating the financial position on the final date of the financial year.
- A cash flow statement illustrating cash flows.
- Notes to the accounts needed to provide true and fair information.

True and fair information

The State annual accounts and information on the central government finances and the State's financial management and operational performance included in the report on the State annual accounts shall provide true and fair information on compliance with the budget, on State revenues and expenditure, on the State's financial position, and on performance.

Source: Finland, State Budget Act 1988, as amended in 2003, ss. 17-18.

annual reports in several countries relate only to the institutional units included in the annual budget law, *i.e.* exclusive of the activities of extrabudgetary funds and public enterprises. In contrast, the Australian Charter of Budget Honesty Act, 1998, requires the final budget outcome report to contain both the budget sector and the general government sector of the federal ("Commonwealth") government.[25]

Only a few OECD countries' budget system laws require a comparison between revenues and expenditures approved by Parliament and actual outcomes, with an explanation of why deviations occurred. There are no obvious patterns as to why some countries do or do not include such a requirement in the law.[26] For countries that have not adopted a performance-oriented approach to budgeting, comparisons are usually made at the consolidated level – not at the level of individual government ministries and/or programmes. For example, the 1959 Organic Budget Law in France required the draft budget execution law to present, in an annex, explanatory notes for why budget appropriations were exceeded and the nature of the profits and losses (of certain budget entities included in the State budget). The emphasis was on presenting an aggregate accounting statement to accompany the required legal contents. These included ratification of in-year modifications to appropriations made by the government within its legal powers; approval of budget appropriations that were overspent for justifiable reasons; and cancellation of unspent budget appropriations that are not being carried over. Although laws in some Westminster countries' laws (*e.g.* New Zealand) also require statements of unappropriated (excess) expenditures, emergency expenditure and trust money, emphasis is on the requirement for departments to provide an analysis of financial outcomes.

The production of departmental annual accounts has been a long-standing legal requirement in Westminster countries, in part because responsible ministers and heads of departments are required to defend the annual financial outcomes of "their" budget before Parliament. In these countries, a law requires the availability of both departmental and whole-of-government reports, to assist parliamentary oversight. In contrast, some European countries and Japan have stressed only consolidated accounts of the reporting entity (*e.g.* the federal or central government, the State). Accordingly, if the law mentions departmental accounts, the emphasis is on ensuring that they are available to the Ministry of Finance for consolidation (see country case studies for Germany and Japan). In France, prior to the adoption of the new Organic Budget Law in 2001, there was no legal obligation for ministries to prepare annual accounts and reports.

The obligation to present non-financial information, especially related to departmental performance, is not elaborated on by the law in some countries (*e.g.* Denmark, Sweden). In such countries, performance-related information is largely "volunteered" to the legislature with the government determining

the "rules" (*e.g.* for preparing public sector and service delivery agreements in the United Kingdom). At the other extreme, the Government Performance and Results Act 1993 in the United States elaborates extensively on the contents of annual performance reports, required for each government programme in each federal agency. France and New Zealand are perhaps in an intermediate position – their respective laws specify some details on the content of the annual department performance reports, including an assessment of why actual performance was higher/lower than that anticipated one year earlier in statements of intention and projections of performance.

Although constitutions in several countries require the submission of annual accounts and/or reports to the legislature, they seldom specify the time delay. Two exceptions are Denmark and Norway (the two countries without a budget system law), whose Constitutions require unaudited annual accounts to be submitted to parliamentary auditors within six months after the end of the fiscal year. Most countries specify the reporting lag in statute law. Lags vary, from just over three months in New Zealand to 10 months in Japan and the United Kingdom (Table II.5). In practice, annual accounts and reports are submitted within the statutory time delays, or even faster (*e.g.* in Sweden, the 1996 State Budget Act requires the annual report to be submitted within nine months, whereas in practice it is submitted within four to five months after the end of the fiscal year).

Table II.5. **Legal requirements for submission of annual report to the legislature: Selected countries**

Number of months after the end of the fiscal year	Legal requirements	
	Submission of accounts to auditors	Submission of audited accounts and report to legislature
0-3 months	New Zealand (2 months)	New Zealand (3 months and 10 days)
4-5 months	Netherlands (4⅔ months)	France (5 months), Netherlands (5⅔ months)
6-8 months	Denmark, Korea, Norway (6 months), Japan, United Kingdom[1] (8 months)	United States (6 months)
9-12 months		Canada, Korea, Sweden (9 months), Japan,[2] United Kingdom (10 months)
Dates not in law		Finland, Germany

1. In the United Kingdom, the requirement is not for whole-of-government accounts, but for accounts of individual government departments, which are submitted directly to the Auditor General.
2. In Japan, the law requires their submission during the "ordinary parliamentary session in the subsequent fiscal year" which must be convoked in January of each year. This means that the legal delay is a minimum of 10 months.

With increased computerisation of accounting and computer-assisted auditing techniques, statutory lags for the submission of audited annual accounts and reports to Parliaments could be shortened. Partly reflecting this, when France revised its Organic Budget Law in 2001, it advanced the legal date of submission by seven months (the 1959 law allowed a 12-month delay). There was also a strong desire by Parliament in France to receive the draft budget execution law and annual performance reports prior to (instead of after) the submission of the budget for the upcoming budget year.

4.4.3. In-year reporting to the legislature on budget execution

Only a few countries' laws require monthly financial statements on budget execution. Reporting delays (*e.g.* four to six weeks after the end of the month) are generally not written into the law. New Zealand's Public Finance Act is one exception; this law contains relatively extensive legal provisions relating to the timing, accounting basis, and coverage of monthly financial statements. France's 1922 Law on Controlling Expenditure Commitments requires expenditure commitments to be reported each month, but not complete monthly financial statements. Many countries (including Germany, Japan, the Nordic countries and the United Kingdom) publish monthly budget execution data as a matter of course, although this is not a legal requirement. The reporting delay of such data in most OECD countries is one month or less (OECD, 2003, Q.5.2.f).

Some OECD countries' laws require a formal mid-year (or "mid-term") report to be prepared by the Ministry of Finance (or equivalent) and submitted to Parliament. In the 1990s, this was written into the laws of several Westminster countries (fiscal responsibility acts or similar). It provides an opportunity to review budget execution and, if necessary, adopt a supplementary budget. The 1989 New Zealand Public Finance Act required submission of a report and financial statements to both the Parliament and the Audit Office, "as soon as practicable" after the end of the six-monthly period. The US Code contains dense legal provisions for the mid-term review (see the country case study), for which the president must submit a detailed report to Congress by 16 July, *i.e.* mid-way through the ninth month of the fiscal year. Besides the report of the Office of Management and Budget, the Congressional Budget Office is also required to submit a mid-term update report to congressional committees. France's 2001 Organic Budget Law (and laws in several other countries) requires a report analysing recent economic and budgetary developments to coincide with the timing of the budget proposal for the next fiscal year (see Box II.3). Laws in some countries (*e.g.* France, New Zealand) require pre-budget reports. Following New Zealand's example of adopting legislation to improve fiscal responsibility – requiring not only pre-budget, mid-year, annual, long-term

and pre-election reports –, Australia's 1998 Charter of Budget Honesty commits the government to processes for costing election campaign promises made by the major political parties (Australia Government, 2003).

Notes

1. Laws are permanent until amended. The ease with which laws may be changed differs across countries.
2. Wehner (2005) constructs an index of legislative budget capacity, in which Westminster countries have low scores.
3. In France, a special court for budget discipline exists for *ordonnateurs* – those that order spending. However, this court has been largely ineffective because the 1948 law setting it up excluded government ministers – the main ordonnateurs (Bouvier *et al.*, 2002, p. 390).
4. See White Paper, *Better Accounting for the Taxpayer's Money*, H.M. Treasury, 1995.
5. A debate is under way on how to integrate elements of the Organic Budget Law – applying to the State – to the social security organisations and local governments.
6. Denmark, by the Constitution, 1953; Sweden, by constitutional reform, 1969. In New Zealand, "constitutional reform" means adopting a statute of constitutional significance; the act abolishing the Legislative Council was adopted in 1951.
7. In practice, the Ministry of Planning and Budget prepares the budget on behalf of the executive.
8. The Prime Minister is formally the nominal head of H.M. Treasury, reflected in the title "First Lord of the Treasury". In practice, the Chancellor of the Exchequer is the head and exercises day-to-day authority. The office of the Chancellor is very rarely referred to in the law (for example, the Government Resources and Accounts Act 2000 does not mention the post, whereas the Treasury is mentioned nearly 90 times). The phrase "the Treasury" in fact refers to the Lords Commissioner of the Treasury, who consist of the Prime Minister, the Chancellor and six government Whips. It is these individuals, *i.e.* politicians (not civil servants working for H.M. Treasury), who constitute "the Treasury" when it is mentioned in the law. See the Interpretation Act 1978 for details.
9. More generally, continental European countries' legal systems distinguish the body of law that governs the State (public law) from that which governs non-State activities (private law).
10. When the deficit criterion was breached by France and Germany, the EU's Council of Finance Ministers did not follow the EU Commission's November 2003 recommendation to speed up the excessive deficit procedure, the last step of which is the imposition of fines (IMF, 2004, Box 1). The Commission challenged the legal basis under which the Council acted and took the case to the EU Court of Justice for a ruling.
11. In the United Kingdom, a strong comptrollership function was specified in the 1866 Exchequer and Audit Departments Act: to this day, the head of the supreme audit institution is known as the Comptroller and Auditor General. Whereas some countries of the Westminster tradition have retained (*e.g.* India, Ireland) or reinstated (*e.g.* New Zealand) the controller function, in Canada, the Auditor General has not had a comptroller function since it was abolished in 1931.

12. The Board of Audit in Japan, under the law establishing it, is independent of the Cabinet of Ministers, and is neither under the control of the legislature nor the judiciary. This is illustrated in the Organisation Chart of the Government of Japan – see Japan (2004). The Korean Board of Audit and Inspection is a constitutionally independent agency under the President of the Republic – see *www.bai.go.kr/english/p_e_about01.html*.
13. See Table 2 of *www.imf.org/external/NP/LOI/2001/tza/01/INDEX.HTM*.
14. Extrabudgetary funds at federal level are of diminishing quantitative importance. In 1999, the debt servicing of some large funds (*e.g.* the Inherited Liabilities Fund, the Federal Railways Fund) were integrated into the budget.
15. The 2003 version of the budget circular contained 738 pages. This is much longer than that of other OECD countries.
16. By law in Australia (1998) and New Zealand (1994); by near-laws in the United Kingdom (Resolution of the House of Commons on the code for fiscal stability).
17. New Zealand's Standing Orders also limit parliamentary debate on the main estimates to three days. The Standing Orders also limit the financial review debate (prior to the beginning of the fiscal year) to six days, and the debate on select committees' reports on departmental annual reports and financial statements to four days. In Canada, 20 "opposition days" for debate on the government's expenditure proposals are specified in the Standing Orders of the House of Commons; however, because of the extremely limited budget amendment powers, many of these days are devoted to non-budget discussions.
18. The 1921 Budget and Accounting Act required OMB to prepare four-year projections; the Congressional Budget Act 1974 requires the CBO to prepare five-year projections.
19. Offsetting collections are collections that, by law, are credited directly to expenditure accounts and deducted from gross budget authority and outlays of the expenditure account, rather than added to receipts. They result from business-type activities, for which spending for specific purposes is authorised by Congress.
20. Most OECD countries only have one annual budget law, consolidating both revenues and expenditures. However, the Westminster countries typically adopt a consolidated revenue fund act (or finance act) and an appropriation act. The United States Congress passes 13 appropriation acts each year. The Parliaments of the Netherlands and Sweden pass more than 20 individual appropriation acts.
21. The notion of "capital contribution" was repealed in 2004 and replaced by "capital expenditure", meaning the costs of assets acquired or developed, inclusive of tangible, intangible and financial assets.
22. This can be done either by regular legislative procedures or, more likely, as part of the congressional budget processes. See Heniff (1998).
23. "Programme" is used for simplicity; "programmes" are known as "requests for resources".
24. English-speaking countries rely on outside bodies for advice on accounting standards (exclusively in the cases of Australia and New Zealand), and follow the accounting norms used in the private sector. In other countries, Ministries of Finance (in collaboration with external audit offices) are responsible for establishing government accounting norms. However, in France, the 2001 Organic Budget Law requires review by a committee composed of public and private sector

representatives. For different models of government accounting, see OECD (2002b) for a full discussion.

25. The act also refers to GFS Australia, which is a statistical publication of the Bureau of Statistics containing concepts, sources and methods for preparing government finance statistics (GFS) in Australia.

26. For example, New Zealand requires it by law, whereas Australia and Canada – other Westminster countries – do not require it by law. Austria and Finland – which incorporate many budget-related provisions in law – do not require an *ex post* comparison between projections and actual expenditure. See Q.5.2.n of OECD (2003).

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ISSN 1608-7143
OECD Journal on Budgeting – Volume 4 – No. 3
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PART III

Is There an Optimum Legal Framework for the Budget System?

Public finance specialists and constitutional theorists are very reluctant to establish legal norms for budget systems. International organisations have published guidelines for desirable features of budgetary transparency. Except for external audit standards, international bodies have not specified which features should be incorporated in domestic law. As a result, there are no international standards that specify legal requirements for desirable features of national budgeting systems. Classical and new budget principles, as well as the distinct functional responsibilities of the legislature and the executive in budgetary processes, should guide policy makers who wish to establish a "good" law for their national budget system. For budget preparation, adoption, execution, reporting and auditing, this section identifies desirable features that should be included in the law. Suggestions are also made as to which budget principles should be included in constitutions, primary law and secondary law.

1. Have standards for the legal framework of budget systems been drawn up?

1.1. Normative and positive approaches to budget law

Part I identified reasons for the wide differences in budget system laws in advanced countries. A variety of influences, including the role of constitutions, legal traditions, and forms of government have influenced present-day legal frameworks for budget systems. So far the analysis has followed a positive approach – explained what is. This section focuses on a normative approach to budget system laws – establishing what should be.

Norms are useful for two main purposes. First, they can be used for the evaluation of existing budget system laws. If a stable set of norms exists, legal frameworks for national budget systems could be "scored" according to the set of agreed criteria (this study does not attempt such an evaluation of actual budget system laws). Second, the norms could be used for prescriptive purposes: recommendations for improving the existing legal framework for budgeting could be made relative to the internationally agreed legal framework. Key questions in this context are:

- Can a set of norms, or standards, be drawn up to guide the formulators of the legal framework for budget systems?
- If yes, who should formulate standards for national budget system laws and regulations, what should be their content, and who should have the responsibility for ensuring that they are followed?

1.2. Limited guidance from normative constitutional economics

In "conventional" economics, legal frameworks are assumed to be given exogenously and to be unchanging over time. By contrast, constitutional political economy analyses the choice of rules using standard methods of economics, especially rational choice. The academic literature is one potential source of guidance for the "right" choice of rules for budget systems.

Economists and lawyers have, however, been reluctant to enter the realm of normative analysis. The positive strain of thinking has been particularly prevalent in the Anglo-Saxon economics tradition, where it is considered important that all propositions are empirically verifiable. Nonetheless, economists offer prescriptive policy advice, including suggesting that some public policy choices be embodied in law. On occasions, economic theorists

have proposed constitutional amendments for budgetary rules to impose a balanced budget or restrict debt levels. Such prescriptive advice necessarily involves making value judgements. It is therefore important to establish criteria for establishing specific standards for a "budget system".

In public choice economics, judgements of existing rules are usually based on the criterion of "efficiency" or possibly, "fairness". In this literature, the principle of normative individualism – the value judgement that nobody's goals and values should *a priori* be more important than those of anybody else's – is upheld (Buchanan, 1987). Every individual is assumed to be pursuing his or her own ends within the framework of the "is". However, in these studies, norms established by society as a whole do not exist and therefore a societal "is" cannot be compared with a societal "ought". Instead, the unanimity principle is stressed, namely that rules that have consequences for every member of society can only be looked upon as "good" if every member has voluntarily agreed to them. Under such an approach, it is difficult to change rules on the basis that one proposed alternative set of rules is "better" relative to the initial set.

Public choice economists have entered debates on "appropriate" constitutional rules. The literature often remains at an abstract level and cannot be applied easily, if at all, to real-world constitutional law. "Constitutions" are defined broadly, being perceived as "a set of rules which constrain the activities of persons and agents in the pursuits of their own ends and objectives" (Buchanan, 1977, p. 292). Scholars have acknowledged that preconceptions about government behaviour are important when judgements are made on real-world constitutions (Boadway, 2003, p. 64). However, public choice theorists have not provided a clear conceptual framework for the following questions (Voigt, 1999, p. 530):

- What should be the content of rules constraining actual constitutions?
- Which issues should be dealt with in the written constitution and which should be left to sub-constitutional choices (*i.e.* ordinary laws or regulations)?
- What characteristics should constitutional rules have?

These are highly relevant questions for this study.

2. Who should set and monitor legally binding standards?

The standards for budget system laws are intricately linked with the standards for budget systems as a whole. Three questions arise: "What are the key ingredients of a 'good' budget system?", "Which features of budget systems are so important that the rules governing them should be embodied in formal law?", and "Who should establish the 'good' or 'best practice' standards, both for the budget system as a whole and for the specific features to be incorporated in law, and who should monitor such standards?". This

subsection is mainly confined to the "who" questions, examining the roles of politicians, bureaucrats and international organisations.

2.1. Role of politicians and bureaucrats

Legally binding budget standards are first and foremost set by politicians – legislatures and executives. But who influences politicians? Bureaucrats advise the political authorities. In some countries, bureaucrats may be the initiators of changes in budget system laws. In particular, the professionals who work in Ministries of Finance (or the equivalent) as well as other central ministries or agencies propose ideas for budget reform. The drafting of new or revised budget laws is often initiated by bureaucrats for consideration by their political superiors.

2.2. International transmission of budget system laws

A second source of "standards" is countries' budget system laws, which are often used as models or starting points for budget reforms. Importing the desirable features of other countries' budget systems (laws) into their own laws is common within OECD countries. When embracing the budget-related aspects of "New Public Management", the Anglo-Saxon and northern European countries adapted budget laws or introduced new ones (Lienert, 2005). In so doing, some countries looked to the leaders of the reform movements. France's 2001 Organic Budget Law was partly influenced by performance-oriented budget reforms adopted in the previous decade in other OECD countries.[1] New Zealand's budget reform "model" was imitated in several countries – in particular, the 1994 New Zealand Fiscal Responsibility Act that supplemented the State Sector Act 1988 and the Public Finance Act 1989. For example, the legal frameworks in Australia and the United Kingdom in 1997-98, relating to budget transparency and medium-term macro-fiscal stability, incorporated many of the features of the New Zealand reforms. The Nordic countries, which compare budget problems and solutions in frequent regional discussions, have adapted their budget systems (including laws in two cases), being fully aware of similar reforms in neighbouring countries.

Using OECD countries' budget laws as standards is prevalent in transition and developing countries. For example, a number of Latin American countries (Oliva, 2001) and India (India, 2003; Hausmann and Purfield, 2004) have adopted fiscal responsibility acts, modelled on those adopted in other countries, particularly the New Zealand Act of 1994 and the EU Maastricht criteria.[2] In Francophone Africa, in 1997, the West African Economic and Monetary Union (UEMOA, 1997) directed its eight member countries to adopt an organic budget law, modelled largely on the Organic Budget Law 1959 used (until recently) by France for its State budget. In Anglophone Africa, some countries have revised

their public finance acts, although remnants of the long-standing British legislation is still evident.[3]

2.3. International organisations as standard setters

International organisations that include public financial management as part of their mandates provide a third source of standard setters for budget systems and laws associated with them. Such organisations include the International Monetary Fund (IMF), the OECD and the World Bank. Any standards issued by such organisations are clearly not legally binding. The normative impact of standards of international organisations does not depend on their legal status, but on their substance and the authoritativeness of the organisation issuing the standards.

Well-known non-binding multilateral instruments, such as the 1948 Universal Declaration of Human Rights (Brownlie, 2003, p. 534), have had a strong indirect influence on United Nations member countries, in part because of their constitutional status and in part because of the extensive debates that took place before issuing them. Although budget-related standards do not have the same influence as high-level United Nations declarations, to the extent that an international organisation's published standards are known and the organisation is respected for its integrity, such norms can provide firm guidance to national authorities formulating budget system law.

In this context, the IMF and the OECD have issued standards for "good" and "best" standards respectively (IMF, 2001b and 2001c; OECD, 2002a). These standards cover many aspects of budget systems and budget actors. They recommend guidelines, to be adopted voluntarily by member countries. The norms were influenced by the perceived need for greater budgetary transparency and good governance, which were themes cherished in the 1990s in Anglo-Saxon countries,[4] perhaps in part because the executives of these countries were perceived to have too much discretionary power.

The codes of the international economic organisations do not recommend which standards should be embodied in law. The IMF Code of Good Practices on Fiscal Transparency (IMF, 2001b) states that there should be a clear legal and administrative framework for fiscal management. It does not elaborate on the criteria for ensuring that primary laws are clear, although it does refer to the clarity of secondary law.[5] There are only three areas where the IMF code provides guidance for incorporating budgetary transparency in law, notably:

- Any commitment or expenditure of public funds should be governed by comprehensive budget laws and openly available administrative rules.
- Taxes, duties, fees and charges should have an explicit legal basis, with tax laws and regulations being easily accessible and understandable.

- The publication of fiscal information should be a legal obligation of government.

The OECD Best Practices for Budget Transparency (OECD, 2002a) is more narrowly focused on budgetary standards (see Box III.1). The OECD does not take a view as to whether these standards should be embodied in law.

Box III.1. **The OECD Best Practices for Budget Transparency**

Budget reports

- Budget report.
- Pre-budget report.
- Monthly (quarterly) reports.
- Mid-year report.
- Year-end report.
- Pre-election report.
- Long-term report.

Specific disclosures

- Economic assumptions.
- Tax expenditures.
- Financial liabilities and financial assets.
- Non-financial assets.
- Employee pension obligations.
- Contingent liabilities.
- Accounting policies.

Source: OECD, 2002a.

The International Organization of Supreme Audit Institutions (INTOSAI) and the Public Sector Committee of the International Federation of Accountants (IFAC) have issued standards for public sector external audit and government accounting respectively (see INTOSAI, 1977, and IFAC, 2004). INTOSAI has also issued an international code of ethics for auditors of the public sector and formed working groups for establishing international standards for internal audit and government accounting. The INTOSAI standards are relevant mainly for its members, *i.e.* for national supreme audit institutions (SAIs). However, SAIs do not directly implement the standards – they can only exert a degree of influence on the government(s) and parliament(s) of its country. Only a country's parliament can adopt the laws necessary to make the INTOSAI standards (or those of any international body) legally binding.

In its 1977 "Lima Declaration", INTOSAI issued four constitutional standards relating to public sector external auditing (Box III.2).

Box III.2. **Constitutional norms for external audit: Extracts from the INTOSAI "Lima Declaration"**

- **Independence.** The establishment of SAIs and the necessary degree of independence shall be laid down in the **constitution**. Details may be set out in legislation.
- **Appointment and removal.** The independence of members shall be guaranteed by the **constitution**. The procedures for removal (of members) from office shall be embodied in the **constitution** and may not impair their independence.
- **Relationship with parliament.** The relationship between the SAI and parliament shall be laid down in the **constitution** according to the conditions and requirements of each country.
- **Annual reports.** The SAI shall be empowered and required by the **constitution** to report its findings annually and independently to parliament or any other responsible public body; this report shall be published.

Source: INTOSAI, 1977.

Cultural and functional differences may partly explain why INTOSAI has taken a strong position on desirable features to include in law. Codes of international organisations for budget systems have generally been developed by economists without legal training. In contrast, the standards for external audit have been formulated by external auditors, who may well have received some legal training and are involved in questions of legality in their work on traditional compliance audits. This would be particularly the case if continental European representatives on INTOSAI – magistrates from courts of accounts – influenced the formulation of the INTOSAI guidelines for external audit. Also, external auditors are aware that SAIs are bodies typically established in constitutions and that their effective independence is enhanced if certain desirable features are embodied in constitutional or ordinary law.

2.4. Monitoring standards

If international standards for budget system laws were to be set, an independent body of standard keepers would need to be established to ensure, with objectivity, that the standards are adopted and maintained. This is unlikely to happen – national governments are unlikely to set up an external "rating agency of budget system laws". Apart from the specialised nature of such a hypothetical body, it is unlikely that countries would provide an independent standard keeper with the necessary juridical powers to enforce

compliance with "desirable" norms promulgated by an international body. Individual countries are best placed to ensure compliance with standards most fitting with their own circumstances.

At best, international organisations require members to comply voluntarily. This is the case for the attainment of the standards set by the IMF – some 50 country reports on fiscal transparency have been published (*see www.imf.org/external/np/rosc/rosc.asp*). The OECD has not systematically monitored member countries' compliance with its best standards. From the outset the OECD stressed that the best practices did not constitute a formal "standard" for budget transparency (OECD, 2002a, p. 7). Similarly, INTOSAI acknowledges that the word "standard" is used synonymously with "guideline" which "keeps the authority for compliance within the domain of each supreme audit institution" (INTOSAI, 1992, p. 23).

3. Principles to support the legal framework of budget systems

From the preceding sections, it can be concluded that, for most aspects of budget processes, there are no universally accepted standards as to which features of budget systems should be included in the law. This section discusses 10 principles (Box III.3) on which budget laws and regulations may be based.

In continental European countries, for a long period of time, several "classical" principles have guided budget processes and the laws associated with them. These are mainly principles associated with *ex ante* budget processes – budget preparation and adoption. More recently, several Anglo-Saxon countries have embodied in law principles associated particularly (but not exclusively) with *ex post* budget processes. Stressing the principles of accountability, transparency, stability and performance, there has been a focus on budget reporting requirements, especially the executive's obligations to report to the legislature on budget results. The 10 principles were derived from these considerations.

All 10 principles are important, but not equally. As discussed below, some are considered to be of constitutional significance and should be included in a country's constitution. Some are more suitable for statutes relating to budget processes. It is tentatively proposed that three budget-related principles – those of authoritativeness, universality, and accountability – are of sufficient importance that specific provisions should be incorporated in a country's constitution, which establishes the legislature, the executive, the judiciary, and other constitutional bodies, at both central and sub-national level, and specifies their roles.

3.1. Authoritativeness

The most important of the 10 principles is that of authoritativeness. This asserts that in the budget process, decision-making authority should be

Box III.3. **Ten principles for a budget law**

1. **Authoritativeness:** Where decision-making authority lies is specified at each of the stages of the budget process shown in Figure I.1. The supremacy of the legislature in budget matters is an integral part of this principle.

Classical principles

2. **Annual basis:** Budget authority is provided for a 12-month period. The annual budget is enacted prior to the year to which it refers. All transactions are estimated for their one-year effect.
3. **Universality:** All revenues and expenditures are included in the budget on a gross basis. Revenues are not earmarked. Expenditures are not offset by revenues.
4. **Unity:** The budget presents, and may seek approval for, all receipts and payments at the same time, usually in the same document.
5. **Specificity:** Revenues and expenditures are shown with some detail in the budget estimates. Spending authorisations (appropriations) show legally binding maximum expenditures for particular purposes.
6. **Balance:** Budget expenditures are balanced by budget revenues and financing. "Balance" is well defined.

Modern principles

7. **Accountability:** The executive gives an account of how it meets its responsibilities to the legislature. Within the executive, the accountability of budget managers is clearly defined. An independent external audit body reports at least annually to the legislature on budget execution.
8. **Transparency:** The roles of various State bodies are clear. Timely financial and non-financial information on the budget is publicly available. The terms used in the budget law are clearly defined.
9. **Stability:** Budget and public debt objectives are framed in the context of a regularly updated medium-term budget framework. The rates and bases of taxes and other charges are relatively stable.
10. **Performance:** The expected and recent past results of budget programmes are reported in the budget. The principles of efficiency, economy and effectiveness are associated with "performance".

assigned to the appropriate body of the legislature and the executive. On the basis of its authority, each body may in turn delegate its authority to lower-level entities.

3.1.1. The legislature's authority to approve the budget and receive reports on budget execution

In all democratic countries and in non-democratic countries with legislatures (*e.g.* China), the national legislature is supreme in matters concerning public money. However, the meaning of the "supremacy of the legislature" in budget matters needs to be qualified. Generally it is confined to meaning that the elected representatives of the people have the authority – exercised through the legislature's law-making function – to:

- Approve the annual budget. The budget system law should specify that the budget must be approved before the new fiscal year begins.
- Oblige the executive to prepare reports on budget execution. This enables parliamentary "control" to take place.

The legislature, as the organ of supreme authority, should specify in law the periodic reports on budget execution that the executive must provide during the budget year. In a principal-agent model, with the legislature as the principal and the executive as agent, the executive is delegated with the task of implementation and preparation of periodic reports. The legislature should set out a requirement in law that its "agent" prepare annual report(s) on budget execution after the fiscal year is completed. The law should require these reports/accounts to be audited by an external office serving the interests of the legislature, the (elected) body representing citizens.

3.1.2. Which aspects of budget authority could be included in the constitution?

It is difficult to establish legally binding norms as to the extent of the legislature's "supremacy". This depends on a number of factors affecting the power struggles between the executive and the legislature, including the form of government, the electoral system, and legal culture. However, at a minimum, it is proposed that it is desirable for a constitution to specify that:

- **All taxation should be based on law,** which implies that tax revenues cannot be collected and spent without the authority of the legislature. The principle of universality implies that the constitution should also specify that all non-tax revenues should also be based on law. The annual budget is often used as an occasion for parliaments to approve changes in tax and other revenue laws, in order to achieve the budget's revenue estimates. If tax laws do not provide permanent authority for the government to levy and collect the projected budgetary revenues, the annual budget law should renew such authority for another 12-month period.
- **All government expenditure is based on law.** A universally accepted democratic value is that the executive has no authority to commit public money for expenditure without the knowledge of the elected representatives

of the people. Hence the law should require the approval of total annual expenditure by the legislature in the annual budget, consistent with the agreed fiscal policy strategy, as well as its approval of some of the details of the expenditure in appropriations acts (see principle of "specificity" below).

The balance of budgetary powers between the executive and the legislature is also a constitutional question. There are at least two areas where this balance could be specified in a constitution. First, the extent to which the legislature can modify the executive's proposed draft budget. Second, the extent to which the executive can modify and/or reduce the legislature's approved budget. There are no internationally agreed legal standards in these areas. If not included in the constitution, primary law should govern the following important areas:

- **The legislature's amendment powers.** One extreme is to provide unlimited power to the legislature to amend the budget. However, the principle of stability requires that fiscal policy be framed in the context of a medium-term strategy, designed to assure monetary policy formulators and markets that there will be no radical changes in short-term fiscal policy. If it had unlimited amendment powers, an irresponsible legislature could derail a well-justified medium-term fiscal strategy. At the other extreme, law could deprive the legislature of all amendment rights. However, this would not be in accordance with the democratic principle of allowing the people's elected representatives decision-making powers on expenditure. If all budget-making power is concentrated in a few members of the political executive, citizens may object to a power that is exercised by such a small number of people (usually the cabinet of ministers). Thus, should a constitutional choice be made that very limited or no amendment powers will be afforded to parliament, the principle of democracy would require an accompanying constitutional provision that the government must have the confidence of parliament. With such a provision, parliament and/or citizens could show their discontent with budget decisions by bringing down the government.
- **Delegation of authority for flexible implemention of the budget.** Parliament may choose to delegate authority to the executive to make "minor" changes in the approved budget expenditures, should the need arise. Should the legislature decide that such flexibility is desirable it may, for example, provide the executive with a small unallocated budgetary reserve that may be spent under the authority of the Minister of Finance (or equivalent). As the reserve is used, the minister may transfer budget authority from the reserve to a specific budget line, without returning to the legislature – at least for small amounts. There are no international norms is this area. In general, the more sizeable the change, the higher the level of authority that is needed for approval. The law should require that large changes be approved by the legislature and that the executive reports regularly and in

full on all changes in budget appropriations that it makes under delegated authority from parliament. At year end, a full reconciliation between the opening authorisation, final authorisation and actual spending should be required by law.

- **Cancellation of expenditure authority.** To ensure that "its" budget is adopted, the legislature may limit the executive's power to cancel or postpone specific budget appropriations. The principle of "supreme legislative authority", if taken literally, would force the executive to spend every dollar budgeted, *i.e.* each line item in the appropriations law would be a lower limit as well as an upper limit. If this principle dominates, all reductions or postponement of budget authority would require approval of the legislature. Such legal restrictions would introduce rigidity into the budget process. This principle also does not recognise that, in executing the budget, unexpected surprises such as revenues being lower than projected, are normal.[6] A possible norm is this area would be for the law to allow the executive to cut budget authority by a certain percentage before returning to parliament. Only larger cuts or postponements of budgetary authority over a certain threshold would need approval of the legislature. Alternatively, the law could provide the executive with unlimited power to impose spending ceilings below appropriations should economic circumstances dictate such action. Whatever option is chosen, accountability requires regular reporting to parliament. Such reporting requirements should be embodied in law.

Individual countries may choose to incorporate in constitutions more or fewer budget-related provisions than those discussed above. The borderline between "constitutional rules" for budget systems and "statutory provisions" is not distinct. Even if the borderline was distinct, it is unlikely that a given country would modify its constitution solely to meet internationally agreed standards for budget law. Only issues of extremely high political importance are placed on the agenda of constitutional change.

3.1.3. Authoritativeness, legal instruments and functional responsibilities

If only a few of the budget principles should be included in the constitution, which budget principles should feature heavily in primary law? Which should be primarily confined to regulations – of the executive or of the legislature? These questions are examined by considering the major concerns of the legislature with regard to budget processes, which are first, the rules governing the legislature's budget approval processes and second, its need for budget execution reports from the executive. The legislature should ensure that primary law specifies the necessary principles and procedures.

The requirements to be embodied in law vary according to whether there are unicameral or bicameral legislatures, and on the extent to which the legislature is separate from the executive. Using law, the legislature may choose to delegate to the executive the authority to perform many of the steps in budget preparation and execution, as many of the detailed steps are too complex for legislatures. Unless there is strong technical support, legislatures are ill-equipped relative to the large bureaucracies that sustain the executive branch of government in preparing and executing the annual budget. By adopting primary laws, the legislature may choose to delegate many of these detailed processes to secondary law: ordinances, orders or decrees (Table III.1). On the basis of authority delegated to them by the legislature, high-level executive personalities or organs (presidents, prime ministers, cabinets of ministers, the minister of finance) could delegate authority further, to the central budget authority (often the ministry of finance) or other budget managers (*e.g.* in spending ministries), by way of guidelines and instructions. By contrast, external audit is a constitutional issue whose details are best formulated in a primary law, supplemented with secondary legislation if necessary. An appropriate use of primary and secondary law associated with the allocation of budget responsibilities could be as described in Table III.1.

Table III.1. **Stages of the budget cycle and legal instruments**

Task	Primary law (constitution, statutes)	Secondary law (orders, decrees, etc.)
Budget preparation		The executive issues orders or guidelines.
Budget approval	Parliament adopts a budget system law that specifies content, timing and approval procedures for annual budget.	
Budget execution		The executive issues decrees for financial control, internal audit, accounting, etc.
Budget reporting	Parliament adopts a budget system law that specifies content, periodicity and timing of *ex post* reports on budget execution.	
Budget audit	Parliament adopts an external audit law that specifies the powers of the independent audit authority and its reporting obligations.	

Table III.1 is simply a guideline for indicating areas of budget processes that should primarily be governed by primary or secondary law. Watertight compartmentalisation is not suggested. Clearly primary law could (and should)

be used for some aspects of budget preparation, and especially, budget execution. For example, the legislature may specifically wish to control, in primary law, the extent to which the executive may modify the adopted annual budget (law) without returning to the legislature to obtain additional approval (*e.g.* for transfers or cancellations of annual appropriations) and propose a supplementary budget.

3.2. Annual basis

This principle requires the budget and medium-term projections to be provided annually. A law should specify the fiscal year. It should also specify that the budget document, as presented to parliament, should provide estimates for budget outcomes of previous years, the estimated outcome for the year on which the projections are based. The law could specify that the legislature approves first the annual aggregates for revenues and expenditures (and possibly also the medium-term aggregates proposed by the government[7]) before approving the detailed appropriations of expenditure.

Although law should specify that budget authority is provided for a 12-month period, the nature of that authority, and any exceptions, should also be specified. In particular, the law should specify:

- Whether taxation and other revenue levying authority is permanent or for 12 months only.
- Whether some expenditure authority is provided permanently (*e.g.* entitlement programmes are approved by specific laws). A budget system law could define various categories of appropriations, according to whether the annual limits are legally binding or whether they can be surpassed because contractual or other legally binding arrangements require payment irrespective of budget estimates (*e.g.* for debt servicing).
- End-year carryover of budgetary authority.
- Borrowing from the following year's (anticipated) budgetary authority.

3.3. Universality

This principle states that all revenues and expenditures are to be included in the budget on a gross basis. The principle of comprehensiveness is of sufficient importance that some elements of it should be included in the constitution.

It is desirable for the constitution to specify (at least) the principles associated with local government's independent revenue levying powers and expenditure authority. This will depend importantly on whether a federal or unitary government is also specified in the constitution. In federal countries, the degree of budgetary autonomy provided to sub-national governments should be specified. Primary law should elaborate on constitutional provisions for

central-local government budgetary relations, including any revenue-sharing arrangements and systems of intergovernmental transfers. Intergovernmental co-ordination mechanisms or bodies should be established in law, to co-ordinate nationwide budgetary objectives, policies and procedures.

Either the constitution or a budget law should incorporate the principle of revenue pooling by specifying the establishment of a consolidated revenue fund into which all budget revenues are paid and out of which all budget expenditures are made. Such a concept is given effect by a single treasury account, usually held at the central bank. Details of the operation of the single treasury account (which may have sub-accounts for specific expenditures) could be placed in regulations. In federal countries, where each level of government is provided with budgetary autonomy, each level would have a self-contained consolidated revenue fund, out of which sub-national expenditures would be paid.

Law is needed to ensure that nationwide fiscal strategies are publicly available. When sub-national governments are significant, their combined fiscal position should be consolidated with central government and resulting accounts and strategies be published. This is needed so that the central budget authority is fully informed of past and future nationwide fiscal developments, including fiscal risks at all levels of government (including any implicit guarantees that the central government would bail out a sub-national government that defaults on its borrowing obligations). An intergovernmental financial relations law would, *inter alia*, specify the co-ordination body responsible for consolidating all budgets and for formulating nationwide budgetary policies. A law should specify that the main aggregates of the consolidated government budgets (revenues, expenditures, balances and financing) are clearly identified and split between the central and various sub-national governments (even though each level of government – inclusive of their various extrabudgetary funds – may have budget-making autonomy). Arrangements for consolidating "general government"[8] budget data – both *ex ante* and *ex post* – should be specified in law.

Exceptions to the universality principle need to be included in a budget system law or separate laws, especially for:

- **Extrabudgetary funds.** In order to safeguard the principle of universality, it is important for governments and legislatures to limit severely the creation of extrabudgetary funds.[9] If needed, each such fund should be established by a separate law that specifies the fund's governance structure(s) and its obligatory reporting requirements (both *ex ante* and *ex post*) to the legislature. The law could provide legal authority to collect earmarked revenues and allow the special fund to use them for specific purposes (*e.g.* social security payments).

- **Exceptions to gross recording.** On the revenue side, budgetary projections should only be allowed to be shown on a net basis (*e.g.* budgeted VAT revenues may be shown net of reimbursements of VAT paid on inputs) if this is provided for in the law. On the expenditure side, any offsetting with revenues should have a legal basis – and only if there is a clear justification. Some argue that a government agency should be authorised to retain revenues it raises itself and use them for its own purposes, as this is the most effective way of maximising revenues from such a source. In particular, with revenue retention, the agency is provided with strong incentives to project expected revenues realistically in the annual budget and to ensure that all projected revenues are collected as projected. Instead of parliament approving gross expenditure in the annual budget (with fees detailed in the budget's non-tax revenue estimates), net expenditure would be approved by the legislature in the budget (with revenues retained by the agency approved as negative expenditures). Any spending of revenues collected in excess of the budget's projections should require parliamentary approval.

3.4. *Unity*

This principle requires the budget to present all receipts and payments at the same time. However, revenues and expenditures approved in the annual budget law by parliament may only be a subset of total revenues and expenditures in the fiscal strategy underlying the annual budget. This is mainly because of the exceptions to the principle of universality such as autonomous sub-national governments, net appropriations or extrabudgetary funds. A law should therefore require the executive to prepare, as part of the annual budget documentation for parliament, a table showing how the revenue and expenditure aggregates (preferably on a national accounts basis) in the macro-fiscal strategy relate to the revenues and expenditures to be approved in the annual budget.

3.5. *Specificity*

This principle states that revenues and expenditures are approved in some detail in the budget. On the revenue side, the law should define the broad categories of revenues. The IMF *Government Finance Statistics Manual* (IMF, 2001a) could be used as a guide for this. It categorises various kinds of tax revenues, other revenues (fees, property income, etc.), social contributions, and grants.

On the expenditure side, a law should specify the categories, basis, nature and duration of appropriations. A budget system law should:

- Distinguish between fixed appropriations – legally binding maximum expenditures for a 12-month period – and unlimited appropriations, which

may be exceeded because of other laws or contractual arrangements (*e.g.* laws requiring social benefits to be paid to households, debt contracts that specify that the government must service its debt) irrespective of budget estimates. The law should require that periodic reports to the legislature justify why unlimited appropriations exceed indicative amounts.

- Specify the basis for appropriations: cash, accrual, or commitment (or obligation). The law may allow (or require) both cash-based and accrual (or commitment) expenditure estimates to be approved in the annual budget law.
- Distinguish between net *versus* gross appropriations (see exceptions to gross recording above) – and identify earmarking of revenues for particular purposes.
- Identify multi-year and/or appropriations of unlimited duration. Certain expenditures – such as investment projects that require long-term planning horizons – are better approved on a multi-year basis, at least for expenditure commitments (annual cash limits could also be imposed in the budget law).

3.6. Balance

3.6.1. The balanced budget principle

This principle states that budget payments should equal budget receipts. In order for this principle not to be merely a cash-based accounting statement, it is important to distinguish: 1) cash receipts from revenues, and 2) cash payments from budget authority to spend. In economic terms, the principle states that expenditures[10] are balanced by budget revenues and financing. The law should define revenues, expenditures and balance, with the legislature approving the limits on the first two.

3.6.2. Fiscal rules

A considerable literature on fiscal rules has developed (see, for example, Kopits and Symansky, 1998; Banca d'Italia, 2001; Schick, 2003). Such rules are perceived to be needed for macroeconomic stability – a stable price level, stable economic growth and minimisation of exchange rate fluctuations. Commitment to firm fiscal targets is needed so that fiscal policy is consistent with monetary policy objectives. In particular, the level of government debt needs to be contained and monetary financing of fiscal deficits avoided. Some commentators propose that fiscal rules should be embodied in law, or even in constitutions.[11] The proponents of this view argue that the authority of constitutional law is necessary to ensure that the legislature adopts a disciplined

budget every year.[12] Those opposed to embedding quantitative rules in law argue that:

- If fiscal balance and government debt targets are permanently set, policy makers would be deprived from using discretionary fiscal policy. In particular, counter-cyclical fiscal policy – temporary deviation(s) from planned medium-term quantitative targets for deficits and public debt – can be justified when there are adverse fiscal shocks.
- Credible commitment to medium-term fiscal policy targets requires political agreement. Since the life of a legislature is limited to only a few years, a more effective way (relative to a permanent rule fixed in law) is to reach a non-binding political agreement for medium-term fiscal policy and renew it periodically in the light of evolving economic, social and political circumstances.
- Loopholes can be found in legally binding rules. Financial transactions can be conducted outside the scope of the rules that apply to particular concepts, budget years, and budgetary entities. "Creative accounting" has been used to move transactions for one year to a different year in order to "respect" the rule for that year, or to move budgetary transactions off-budget to circumvent the rule (see Milesi-Ferretti, 2000). Alternatively, allowable exceptions to the rules are abused (*e.g.*"emergency" spending takes place much more frequently than the law intended).
- Quantitative targets, if embedded in law, need to be enforced by judges. However, it is considered undemocratic that non-elected judges should dictate fiscal policy when economic circumstances demand that the rule be broken. In practice, judges are seldom called upon to enforce the rules in cases of non-respect,[13] raising questions about their enforceability through legal channels.
- "Permanent" statutory restrictions can be easily changed by temporary laws.[14]
- Sanctions exist only on paper. For political reasons, it is often too difficult to apply them in practice.[15]

Stock-related balances – assets and liabilities – may be covered by a separate law or in the budget system law. Until the advent of accrual accounting in government, the norm for budget system law was that only cash-based revenues and expenditures should be covered by the law. Asset and liability transactions received little, if any, attention in legislation. If there was no separate public debt law, accounting regulations may have contained provisions for government asset and liability transactions.

3.7. Accountability

A fiscal responsibility act could distinguish between *ex ante* and *ex post* accountability to the legislature. The first concerns what the executive is

obliged to provide in the draft budget for parliamentary consideration. The second relates to the information the executive should provide once the budget has been executed. Besides these areas, there are at least two other aspects associated with accountability – notably accountability within the executive and the role of the external audit body. The following responsibilities should be provided for in laws or regulations and, for the external audit agency, in the constitution.

3.7.1. Responsibilities of the political executive to the legislature

The accountability for budget management of the political executive to the legislature should be specified in the law. Whether the responsibility to the legislature is by an individual (*e.g.* the Minister of Finance) or by the cabinet of ministers depends on whether the constitution specifies, explicitly or implicitly, individual or collective responsibility. Budget-related accountability law(s) need to supplement any constitutional norms, including specifying the requirements that:

- The government, or the Minister of Finance (or equivalent), submits a draft budget to the legislature by a specified date, at least three months before the beginning of the new fiscal year. It may be desirable to specify that the executive has exclusive authority to prepare the initial draft budget.
- The budget must be submitted to the legislature by a date, which could even be specified in the constitution. This date should be sufficiently in advance of the new fiscal year (*e.g.* at least three months) so that it allows adequate time for the legislature to consider the draft budget. The requirement that the budget is adopted before the beginning of the new fiscal year – and legal provisions providing for the situation should this not be done – is considered particularly important for responsible fiscal management. The constitution could therefore make at least general provisions for the timing of adoption of the annual budget law, with primary law providing the detail.
- Reports to accompany the draft *ex ante* budget (see below).
- The government, or the Minister of Finance, presents the audited outcome of budget execution to the legislature by a specified date, which should be no later than the presentation of the budget for the following year.
- The legislature may call any government member, political appointee or civil servant to defend, orally or in writing, budget projections and/or outcomes.

3.7.2. Reporting by the executive to the legislature

A budget system law should also specify the scope and contents of *ex post* budget execution reports and financial accounts, which accompanied by the external auditor's annual report, by a certain date after the end of the fiscal

year. The final date should be prescribed: 12 months is a lenient standard (IMF, 2001b); six months is "best" practice (OECD, 2002a).

Possible minimum legal norms for all budget reporting, derived from the OECD Best Practices for Budget Transparency (OECD, 2002a) and the IMF Code of Good Practices on Fiscal Transparency (IMF, 2001b), are shown in Box III.4.

Other budget information and periodic reports outlined in the OECD best practices could be made a legal requirement. Although included in law, the authorities may choose not to meet the standards immediately. This is the case especially in developing or transition countries, where the capacity of the executive to produce the required reports is limited or parliament does not perceive the need to be provided with detailed information. Even in OECD countries, with performance-oriented budgeting, there is a risk that legislatures can receive too much information, since performance-related information supplements traditional financial information. Judicious choices need to be made before imposing legal requirements such as a requirement for ministries to prepare annual performance reports. A distinction should be made between what parliament needs and the information needs for internal management purposes, with the latter being governed by regulation, not law.

3.7.3. Accountability of budget managers to the political executive

Within the executive, the accountability of budget managers to higher-level political managers needs to be clearly defined. Embodying this in the law is not necessarily required.

Whether the accountability of civil servants within the executive should be governed by law depends on the degree to which the legislature wants to intervene in budget preparation and execution by the executive branch of government. If, after the basic accountability requirements of the executive are specified in the law, the legislature fully trusts the executive to prepare and implement the adopted budget, it could leave all organisational matters to the executive. In this case, the executive would issue internal regulations to organise itself, including specifying the roles, responsibilities and rights of the civil servants and political appointees serving the political executive.

Any contractual employment agreements between the government as employer and civil servants as employees would be governed by general employment legislation that applies equally to private sector employees. If, however, a political choice is made to provide a special status to civil servants (*e.g.* provide lifetime employment and benefits in exchange for the loyalty and professionalism needed for government jobs), a civil service law may be required.

Administrative law imposes a constraint on the freedom of the executive to formulate its internal accountability arrangements. Reflecting long-standing

Box III.4. **Possible minimum legal norms for budget reporting**

Budget report(s) (to accompany annual budget)

- A medium-term fiscal strategy, fiscal policy objectives, the budget framework showing expected revenue, expenditure, budget balance and public debt during at least the two years beyond the next fiscal year.
- Clear identification of new policies being introduced in the annual budget.
- Comparative information on actual revenue and expenditure during the previous two years and an updated forecast for the current year, with a commentary on each revenue and expenditure programme.
- Reconciliation with forecasts contained in earlier budget reports for the same period, accompanied by explanations of all significant deviations.
- Identification of revenues and expenditures authorised in permanent legislation. These should be included in the budget aggregates contained in the medium-term fiscal strategy.
- Identification and discussion of the economic assumptions and fiscal risks underlying the projections. Tax expenditures, contingent liabilities and quasi-fiscal activities should be discussed if quantitatively important.

Quarterly (or monthly) reports

- Monthly and year-to-date budget execution reports, to be released within four weeks of the end of each period. A brief commentary on revenues, expenditures and balance should accompany the data.

Mid-year report

- A comprehensive update on budget implementation, released within six weeks of the end of the mid-year period. The report should include an updated budget forecast for the current fiscal year and the following two fiscal years.
- Discussion of the impact of changes in economic assumptions underlying the budget, the impact of any recent political decisions or other circumstances that may have a material effect on the budget.

Year-end accounts and annual report

- Annual accounts should show compliance with the budgeted levels of revenues and expenditures authorised by parliament. The format of the accounts should be identical to the budget presentation. Any in-year adjustments to the original budget should be shown. Comparative information on revenues and expenditures of the preceding year should also be provided.
- The annual accounts should be audited by the external audit body and submitted to parliament within no more than nine months after the fiscal year ends.

Box III.4. **Possible minimum legal norms for budget reporting** *(cont.)*

- The year-end budget report should contain a comprehensive discussion of the overall budget outcome (compared with targets for key aggregates), as well as for broad categories of revenues and expenditures. In addition to the overall report prepared by the central budget authority (Ministry of Finance), spending ministries' reports on budget outcomes may be included. If appropriate, the law should require that annual reports include non-financial performance information, including a comparison of performance targets and actual results achieved.

tradition, constitutions in some countries require administrative law to specify the obligations and roles of those who are assigned to administer (including the budget system). This is especially the case in countries that distinguish sharply between public and private law. Accordingly, their constitutions require that public law specifies the rights, status, service, and loyalty of members of the public service (*e.g.* German Constitution 1949), possibly distinguishing between the civil service and the military (*e.g.* 1958 Constitution of France). If these constitutional requirements lead to civil service laws that impose rigidities (*e.g.* a uniform remuneration scale), the political or administrative executive may be prevented from exercising the necessary salary flexibility needed for effective budget management. Countries without constitutional or legal norms for civil servant remuneration and other employment conditions are provided with the flexibility to make non-legally binding contracts that specify the accountabilities (responsibilities) of senior bureaucrats to the political executive (generally government ministers).

The legislature may consider that it has a right to control, through law, civil service staff levels and remuneration. If the legislature is more concerned about the outcome of government policies for which it has provided the necessary finance in the context of the annual budget, it will be indifferent as to whether the executive achieves those outcomes by using personnel or non-personnel inputs. What counts are the results themselves, not the means employed to achieve the results. In contrast, if the legislature considers that the civil service salary bill is "too high" or there are "too many" or "too few" civil servants, then the legislature may choose to approve, in the context of the annual budget, the levels of the number of civil servants and unit salaries. By adopting a civil service law, or requiring attachments to the annual budget on civil service staff levels, the legislature is able to satisfy its politically determined objectives (an economic rationale for such control is more difficult to find).

3.7.4. The powers, roles and responsibilities of the supreme audit institution

Since the supreme audit body should be established in the constitution (see Box III.2), it would be desirable to follow INTOSAI guidelines, including a constitutional requirement for the deposit of the audit report to the legislature, possibly by a specified date. An external audit law should elaborate on the powers, roles and responsibilities of the external audit body. External audit law(s) should mainly elaborate on INTOSAI constitutional norms. The INTOSAI auditing standards consist of four parts: basic postulates, general standards, field standards, and reporting standards (see summary in IMF, 2001c, Box 24). Possible minimum norms for an external audit law are shown in Box III.5.

3.8. Transparency

Besides accountability, which is linked to transparency, there may be other aspects of fiscal transparency that should be incorporated into law, especially those related to the clarity of the role of the State.

3.8.1. Clarity of roles in the public sector

The IMF Code of Good Practices on Fiscal Transparency (IMF, 2001b) requires that the government sector should be distinguished from the rest of the public sector and the rest of the economy. In making this distinction clear in law, both budget laws and specific laws relating to the organisation of government, quasi-government and non-government entities are required, including for:

- State involvement in commercial activity. New law(s), or amendments to existing law, are needed should the State nationalise enterprises or withdraw from activities better performed by the private sector. Government-owned enterprises are outside the scope of "general government" as defined in national accounts. It is beyond the scope of this study to elaborate on norms for the establishment of public enterprises or the desirable contents of privatisation laws.
- Clarity in the status of government agencies. There are different types of semi-autonomous entities within "general government". Some such entities may be established by law, whereas others may not be required to have their own legal identities. Either way, a framework law is desirable for defining various classes of government entities (Box III.6).
- Explicit and hidden subsidies. A law should require government functions that are performed off-budget by public enterprises in a non-transparent way to be reported comprehensively to the legislature, preferably in the context of the annual budget discussions. Similarly, the reporting of tax expenditures[16] and quasi-fiscal activities[17] to the legislature should be a legal requirement.

Box III.5. **Ingredients of legal norms for external audit**

- Independence: institutional, financial, managerial and operational. A law should ensure that the external audit office is independent of the audited entity. Independence from the executive should be as complete as possible.
- Appointment and removal of the head, deputy head(s) and staff of the external audit body. The legislature should be the main body involved in appointing the head of the office and his/her deputy(ies), who in turn should be provided with the freedom to recruit, promote and dismiss staff without outside interference.
- Tasks: types of audit. At a minimum, legality and regularity audits of financial management and accounting should be conducted. A certification of the financial accounts is desirable. The effectiveness of internal audits should be examined. A higher standard would require audits of performance (efficiency, economy and effectiveness). These would cover non-financial performance and management.
- Relationships of the external audit body with, and responsibilities towards, the legislature and the executive should be established. The law may specify that the annual work programme of the external audit body is largely self-determined or perhaps approved by the legislature.
- Reporting obligations. An annual report should be prepared and submitted primarily to the legislature, within no more than nine months after the fiscal year ends. It, and other *ad hoc* reports requested by the legislature, should be published. Exceptions should be specified, for example, for national defence.
- Investigatory powers. The law should provide the external audit office with the power to access all documents and information needed to perform its functions.
- Ensuring follow-up to recommendations made in audit reports. Law or regulation should elaborate on the obligations of members of the executive to respond to issues raised by audit reports. Written responses of actions taken (or to be taken), addressed to a parliamentary committee, is a common procedure.

Source: INTOSAI "Lima Declaration" (INTOSAI, 1977) and IMF Manual on Fiscal Transparency (IMF, 2001c).

- Contingent liabilities. A law should require the reporting of explicit contingent liabilities to parliament (Polackova, 1998, distinguishes implicit and explicit contingent liabilities – the former are not legally binding). The law should also require quantification for contingent liabilities known to be

important (*e.g.* government guarantees on loans). Under a cash-based accounting system, the immediate cost to the government's budget of a possible loan default is not recorded in the budget. Techniques are available for quantifying in the annual budget the cost of providing guarantees. Key elements could be embodied in the law, especially if a country decides to adopt accrual accounting principles selectively.

Box III.6. **Ingredients of legal norms for government agencies**

The legal framework for classes of "arm's length" government agencies depends in part on whether public law is distinguished from private law (OECD, 2002c). Possible classes of semi-autonomous agencies are:

- Entities directly controlled by ministries, without governing boards. This class of agency would not have its own legal personality. The director of the agency would report to the minister, via the parent ministry. The agency would, however, have its own accounts and be funded entirely, or mostly, by the government budget.
- Entities directly controlled by ministries, with governing boards. Unlike the above, this class of agency would have its own legal personality. The director of the agency would report to its governing board, which in turn would report to the minister, via the parent ministry.
- Entities indirectly controlled by ministries. These agencies have less importance in terms of government policies. This class of agency would be provided with more autonomy, in terms of reporting requirements and ability to retain revenues. They would have their own legal personalities and governing boards.

Within the above broad framework for non-enterprise government agencies, further variants could be adopted. For example, entities could be categorised by nature of activity (administrative, regulatory, research, etc.) or sector of activity (health; education – primary, secondary, tertiary; defence; etc.).

Company law would be used to establish publicly owned enterprises.

3.8.2. Public availability of budget information

The publication of comprehensive fiscal information should be a legal obligation. As discussed above, legal norms for more advanced countries should be aligned with OECD best standards. The timing and periodicity of special reports (*e.g.* pre-election, pre-budget, long-term) should, like the annual budget report, be embodied in law.

3.9. Stability or predictability

A law should require the budget and public debt objectives to be framed in the context of a regularly updated medium-term budget framework. Commitment of a government to such a framework requires that the rates and bases of taxes and other charges are relatively stable. Thus, when the annual budget estimates are presented to the legislature, a law should require that projections for the years after the budget year should also be presented. Such a medium-term fiscal framework allows the legislature to consider the 12-month budget projections in the light of the longer-term strategy for fiscal policy – the overall balance, total revenues and total expenditures. The law could require the medium-term projections to be formally adopted by the legislature. In particular, the legislature can signal a strong commitment to responsible fiscal management, if it adopts each year updates of its own legally binding medium-term limits on aggregate spending.

A law could also require parliamentary approval of the budget aggregates and the detailed estimates, possibly in two quite distinct stages. First, the balance, total revenues and total expenditures could be adopted. At a second stage (which could be several months later),[18] law could require the detailed appropriations of expenditure to be approved. The adoption of separate laws for different expenditures (multiple appropriation laws), or separate budgets for current and capital expenditures (a dual budget system), runs counter to the principle of budgetary unity.

3.10. Performance (or efficiency, economy, and effectiveness)

Budgetary performance has been increasingly stressed in many countries. In general, efficiency is viewed as the paramount criterion for the evaluation of human interaction (Brion, 1999, p. 1043). However, efficiency has been criticised by legal scholars, who argue against its usage as a legal principle.[19]

If a country has the willingness and capacity to implement a performance-oriented budget system, it should aim for the higher norms embodied in the OECD Best Practices for Budget Transparency. In particular, a law would require the executive to present past and projected performance-related information to the legislature in the context of the presentation of the annual budget and also require budget managers to report on performance to the legislature after the budget is executed. Such a budget system may require changes in the external audit law, or in administrative or employment laws.

Notes

1. Although the reform of the State's "Financial Constitution" had a domestic origin, the French authorities were keenly aware of reforms – and accompanying laws – that had taken place in Anglo-Saxon countries.

2. The Brazilian Ministry of Planning, Budget and Management acknowledges the influence on its own law from the EU Maastricht criteria and the fiscal stability-responsibility acts in New Zealand and the United States. *See http://federativo.bndes.gov.br/Destaques/docs_Pagina_LRF/Ingl0599.ppt.*

3. For example, Tanzania adopted a new Public Finance Act in 2000 to replace a 1962 Ordinance, heavily influenced by the Exchequer and Audit Departments Acts of the United Kingdom, which, as in Tanzania today, contained both budget execution and external audit in a single act. By contrast, the United Kingdom, in an effort to separate to the Auditor General more fully from the executive, adopted a new National Audit Act in 1983.

4. Chevauchez (1999) notes that the IMF Code of Good Practices on Fiscal Transparency (IMF, 2001b) was initiated by the United Kingdom Chancellor of the Exchequer during the 1996 annual meeting of the IMF. In 1998, the IMF published its code of good practices, which also included minimum standards – abandoned in later versions of the manual accompanying the code (IMF, 2001a). The OECD developed its best practices in 2000 (OECD, 2002a). These are somewhat more demanding standards applicable to more advanced countries' budgetary systems.

5. Box 4 of the manual to the code (IMF, 2001c) summarises OECD guidelines on the characteristics of transparent regulations. However, as indicated in OECD country surveys of regulatory reform (see OECD, 2002b), the transparency of secondary law, *i.e.* regulations, is highly dependent on the clarity of primary law.

6. To limit this risk, the law could require deliberately conservative revenue projections.

7. Law could specify that the legislature approves medium-term expenditure ceilings. A few months after such approval, the approved ceiling for year (+2) would automatically become the starting point for the budget projections for year (+1) of a new budget preparation cycle.

8. As defined in the IMF *Government Finance Statistics Manual* (IMF, 2001a) or in national accounts.

9. The restricting of extrabudgetary funds could be incorporated in law. For example, the Constitution of Finland requires a supermajority of Parliament for the creation of any new extrabudgetary fund.

10. Under accrual accounting, a distinction is made between expenses and expenditures. The terms used in budget system laws would have to be consistent with the accounting system adopted.

11. For example, in the United States, Buchanan (1997) argued that a constitutional requirement for a balanced budget was necessary to control the burgeoning federal government budget deficit.

12. Proponents in the United States also argue that the federal government should follow the precedent of 49 of the 50 states, whose constitutions contain some kind of "balanced budget" rule. They cite evidence that a state's general fund surplus is higher in states that have constitutional rules applying to *ex post* budget balances (Bohn and Inman, 1996). A closer examination of this assertion reveals that in only 36 states are there constitutional references to balanced budget rules (Briffault, 1996, p. 8) and that some states apply the rule only to the budget presented to the legislature. Detractors note that the only state without any constitutional budget rule (Vermont) has a very good record regarding budget balances.

13. Kopits and Symansky (1998) report that, in Germany, the constitutional rules are often not realised and rarely attract a judicial challenge. Similarly, although most

of the 50 states of the United States have some form of a "balanced budget" requirement in their constitutions, these are frequently broken by using off-budget funds or other "creative accounting" techniques. Briffault (1996) reports that there were no legal challenges during 1978-96. For the only two cases in the 1970s, the challenge was not to the non-compliance with the balanced budget rule *per se*, but ancillary aspects.

14. Several countries use the annual budget as an occasion for changing previous budget-related laws. In Japan, although the Public Finance Act 1947 requires a balanced budget except for construction expenditure (which may be financed by special bonds), during 1975-96 the government overrode this restriction when adopting the annual budget law, by allowing bond issues for general budget financing. In 1997, a Fiscal Structural Reform Act was adopted. This restored the 1946 legal provision and fixed a quantitative target for the fiscal deficit in 2003 equal to 3% of GDP. However, the 1997 law was abrogated in 1998 when it was clear that the quantitative rules could not be respected.
15. The non-compliance with the Maastricht criteria by France and Germany in their 2004 budgets is an example. When the general government deficits of these two countries exceeded the 3% limit, financial sanctions, in the form of non-interest bearing deposits and their eventual confiscation, should have been applied.
16. Tax expenditures are tax privileges to non-government legal entities that reduce government revenues and which have a similar impact to that of providing a direct subsidy to the beneficiary entity.
17. Quasi-fiscal activities are government financial policies that are carried out by non-government entities (*e.g.* public goods or services provided by public enterprises at prices below market; subsidised credit by State-owned banks).
18. One legal norm would be to require parliamentary approval of the government's proposed fiscal strategy at an early stage of the budget preparation, *e.g.* seven to eight months before the fiscal year begins. Only at a later stage, *e.g.* one to two months before the fiscal year begins, would parliament approve the detailed estimates.
19. Kirstein, 1999, cites a number of studies in which legal scholars argue against the usage of efficiency as a legal principle in Germany.

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ISSN 1608-7143
OECD Journal on Budgeting – Volume 4 – No. 3
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PART IV

Case Studies of Selected OECD Countries

ISSN 1608-7143
OECD Journal on Budgeting – Volume 4 – No. 3
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Canada*

Structure of the Case Study

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* This chapter has benefited from comments from: Yvon Besner, Laura Danagher, Catherine Foskett, Mike Joyce, Bob Mellon and John Morgan (Treasury Board); Peter Devries (Department of Finance); Basil Zafiriou (Office of the Auditor General); John Mayne (consultant to the OECD and former OAG staff member); and OECD colleagues including Deborah Roseveare of the Economics Department.

1. Overview

1.1. The legal framework governing budget processes

Canada has a Westminster model of government and therefore does not highlight the legal basis for annual budget processes. A combination of laws, regulations and conventions govern budget preparation, adoption and budget reporting to Parliament. Although the principle of the supremacy of Parliament is enshrined in the Constitution, in practice, the executive – in particular the Cabinet of Ministers – has strong powers regarding the policies and amounts provided in annual budgets. The government has exclusive power to introduce the budget, and the legislature's power to amend the budget proposed by the executive is extremely limited. Legislation does not provide a deadline for the executive to submit the budget to Parliament. In practice the budget is submitted to Parliament about one month before the fiscal year and adopted about three months after the fiscal year begins. The Constitution Act 1867, the Financial Administration Act 1985 (FAA) and the Auditor General Act 1977 (AGA) are the fundamental statutes governing budgetary processes (Box 1).[1] The FAA has played a particularly important role in establishing the budget and financial management system. The Parliament of Canada Act 1875 does not contain any provisions on the parliamentary budget review process.

Box 1. **Canada: Main budget system laws**

- The Constitution Act 1867.
- The Financial Administration Act 1985 as amended (FAA).
- The Auditor General Act 1977 as amended (AGA).
- The Federal-Provincial Fiscal Arrangements Act 1985 as amended.

Source: All laws are available on the Internet site of the Ministry of Justice: *http://laws.justice.gc.ca*.

The Constitution Act (Chapters VI and VIII) stipulates the principal provisions for Parliament's budgetary powers, including for the adoption of appropriation and tax bills, and for approving public debt. Expenditures are required to be financed from a consolidated revenue fund. The act also

establishes constitutional principles for fiscal relationships between the federal and provincial governments. The FAA as amended specifies both general principles and specific procedures on public financial administration. One of the most important provisions is that the government cannot raise revenues or incur spending without the approval of Parliament. It also establishes the Treasury Board and the Ministry of Finance, and specifies principles for the use of public money, public debt, and public accounts. The AGA confirms the long-standing existence of the Office of the Auditor General (OAG) (over 125 years), and states the types of audit and criteria for undertaking them, the power of the Auditor General, and measures to secure the independence of the audit including the appointment and tenure of the Auditor General.

Intergovernmental fiscal relations are based on the Constitution Act 1867 and the Federal-Provincial Fiscal Arrangements Act 1985. The latter act states the major types of federal transfers to the provinces to support specific provincial and territorial programmes (health and social transfer), to provide general funding to less prosperous provinces (fiscal equalisation payments), or to help a region with special needs (fiscal stabilisation payments).

1.2. Reforms of budget system laws

Over the past 20 years, there have not been any path-breaking changes in the laws relating to the budget system, although some amendments have been made to the FAA and AGA. In general, new budgeting procedures have been introduced by Cabinet decision, rather than by new statutes or major modifications to existing statutes. This reflects the strong unwritten powers enjoyed by Cabinets and Cabinet committees in Westminster countries. Also, unlike several other Westminster countries, Canada has not adopted a law to enhance fiscal responsibility and accountability.

After study, it was concluded that the federal government did not need to adopt a new law or amend the FAA to introduce accrual accounting (compare the adoption of a statute in 2000 to introduce an accrual-based accounting system in the United Kingdom). The adoption of full accrual accounting for the budget and Government of Canada audited financial statements was a policy decision taken by the government in 2003. The FAA provides broad powers to the Minister of Finance and the President of the Treasury Board relating to the form and content of the public accounts. In 2004, partly to address mismanagement of public funds, the government announced that it would review the FAA for the purpose of strengthening oversight and accountability. Changes in the FAA may be required to align the accounting basis of the budget, Government of Canada financial statements, the estimates, and the spending authority.

To address high fiscal deficits and rapidly increasing public debt, Parliament enacted the Spending Control Act in June 1992 (Box 2). This statute was designed to directly control spending and indirectly limit the growth of the federal debt.[2] In 1994, the government chose not to extend the act beyond its original five-year period.

Box 2. **Canada: Main provisions of the Spending Control Act 1992**

- Expenditure ceilings, expressed in Canadian dollar terms, were established. The ceilings applied only to programme spending, which was defined as expenditures that were funded directly by an independent source of revenue.
- The spending limits covered five fiscal years: 1991/92 to 1995/96.
- Exceptions to the ceilings were made. In aggregate over the five-year period, adjustments to the limits amounted to only CAD 315 million.
- Overspending in any fiscal year was permitted provided that the government accounted for the excess spending in the following two fiscal years. Excess spending could be justified if the proposed increase would result in government revenues equal to or greater than the proposed excess spending.

In 1994/95, significant reforms in the budget planning process were made by the government, without resort to legislation. The key reform was to establish and maintain successive rolling two-year fiscal objectives. Two institutional features in budget formulation were included, namely prudent economic assumptions and a contingency reserve fund to be used only for compensating forecasting errors and unpredictable events (Blöndal, 2001, Box 2). Furthermore, a programme review was conducted to review all aspects of non-statutory departmental spending based on six tests.[3] The key objective was to reduce or eliminate low priority programmes, and require government resources to be directed to high priority activities where the federal government is best placed to deliver its service. Statutory programmes were subject to review as well, with major structural changes made to the employment insurance programmes and transfers to other levels of government. In addition, a pre-budget consultation process was introduced, again without legislation, to encourage wider participation in budget formulation at the earlier stages.

The budget programme reviews led to major cuts in expenditures, including a substantial reduction of government personnel (Sturm and Müller, 1999).

Reforms made in the system of transfers to the provinces resulted in making them more cost effective and flexible, requiring amendments to the Federal-Provincial Fiscal Arrangements Act. The new Canada Health and Social Transfer, made in the form of a block grant to the provinces, replaced transfers under the Canada Assistance Plan, with funding of provincial social welfare programmes based on a shared-cost basis and on the Established Programmes Financing System, which provided block grants to finance provincial post-secondary education and health.

The more flexible programme review arrangements contributed to a sounder fiscal position. Large and growing deficits were replaced by sustained surpluses, as from 1997, through expenditure reduction and prudent budget planning. After rising for more than 20 years, total government debt has been diminishing since 1996.

2. Principles underlying budget system laws

Like other countries with Westminster governments, Canada does not systematically embody budget principles in law. At federal level, however, some principles are embodied in budget system law. The principle of parliamentary authority, relating to the authorisation of taxation and public expenditures, is incorporated in the Constitution Act 1867. The FAA also requires the government to obtain the approval of Parliament to raise revenues or spend public expenditures (Arts. 17 and 26). The FAA specifies the principle of an annual budget (Art. 2) operating within the rolling two-year budget framework. The fiscal year begins on 1st April and ends on 31 March of the following year. The government is required to formulate the draft budget for each fiscal year, which is then approved by Parliament. The principle of accountability is embodied in the AGA. The Auditor General is required to see if the government spent public money for the specific purposes intended by Parliament (principle of specificity). The principle of universality of all revenues and expenditures is embodied in the concept of a Consolidated Revenue Fund (FAA, Art. 17). However, the principle of universality is not applied nationwide, and consolidated outcome data for federal and provincial budgets are not systematically produced. The principle of unity – that all revenues and expenditure are included in a single budget – is not fully practised. Whereas the budget presents both revenues and expenditures, tax bills and appropriation bills are presented separately.

The principle of stability is not embodied in law since the Spending Control Act 1992 lapsed in 1996. However, the government aims to achieve "a balanced budget or better". The principle of transparency is not embodied in law either. However, the International Monetary Fund evaluated that "fiscal management in Canada meets the requirements of the fiscal transparency code and in a number of instances represents best practice" (IMF, 2002).

3. Legal basis for the establishment and the powers of the actors in the budget system

3.1. The executive and the legislature

3.1.1. Overview

Canada is a constitutional monarchy, a federation and a democracy. The responsibility for governing at the federal level is shared by the legislative, executive and judicial branches. Constitutional conventions and Constitution Acts provide the principles for the relationship between the executive and the legislative branches at federal level.

- The executive branch comprises the Prime Minister, the Cabinet and the public service. It is responsible for proposing the budget and for the use of the public funds approved by the legislature. Some funds are approved on an ongoing basis by statute while others are voted annually in appropriation bills.
- The legislative branch consists of two houses of Parliament: the House of Commons and the Senate. Members of the House of Commons are elected at least every five years. Senators are appointed by the government and selected from across Canada. Constitutionally, the House of Commons enjoys pre-eminence in budgetary matters. The legislature exercises oversight of the budget process via parliamentary committees and the Auditor General, an officer of Parliament.
- The judicial branch, consisting of various federal courts culminating with the Supreme Court, is independent of the executive, and adjudicates cases dealing with financial laws.

3.1.2. Roles and responsibilities of the Cabinet and individual ministers

The roles and responsibilities of the Cabinet and ministers are governed by long established conventions. The Prime Minister is the head of government. The law does not specify his/her roles in detail. The major roles of the Prime Minister are to: *i)* appoint senators, members of Cabinet and other senior positions; *ii)* organise government and determine overall government priorities. The Prime Minister appoints the Cabinet from among members of his or her party. The Cabinet in 2004 was made up of 28 ministers (elected officials, with a few exceptions) whose work is assisted by 11 secretaries of State. Previous governments have had as many as 40 ministers in Cabinet, making decisions highly complex. The Privy Council Office supports the Prime Minister and, accordingly, acts both as advisor on major issues of interest to departments and as a secretariat to support decision making by Cabinet and Cabinet committees.

Cabinet ministers are selected by the Prime Minister on the basis of their experience but also with a view to ensuring diversity. Each Cabinet minister is given responsibility for a department (ministry in other countries) and may hold additional responsibilities for regional or provincial interests, or for Crown corporations. The Prime Minister and ministers in Cabinet make all major policy decisions.

Cabinet committees, whose number and type depends on the government in power, are established at the discretion of the Prime Minister, with the exception of the Treasury Board, which is established in the FAA. Cabinet committees review proposals from individual ministers and send written recommendations to Cabinet for ratification (Kelly, 2001). If proposals have expenditure implications that go beyond the approved budget allocations for the department, the proposal must also receive the approval of the Treasury Board.

3.1.3. Establishment of ministries and executive branch agencies

The central budget office function is divided between the Department of Finance and the Treasury Board. Both are established under the legal authority of the FAA.[4] The Finance Minister is responsible for general economic affairs and for the fiscal policy framework including the preparation of the federal budget, tax and tariff legislation, and the management of federal borrowing on financial markets. In addition, the Finance Minister is directly responsible for the administration of several transfer programmes. The Finance Minister presents the budget to Parliament.

The Treasury Board manages the government's financial, personnel, and administrative responsibilities. As expenditure manager, it is responsible for preparing the government's expenditure budget (the main estimates) and monitoring programme spending in departments. It also provides the policy framework in areas such as accounting, audit and evaluation, contracting and financial management.

Other federal departments are generally created by separate acts of Parliament (for example, Department of Health Act, Department of Industry Act – see *http://laws.justice.gc.ca*), which specify the powers, duties and functions of individual ministers. Departments and agencies are listed as Schedule I.1 and II of the FAA. Departments are responsible for designing policies, delivering programmes to the public, and managing federal government regulations. In total, there are about 20 operating departments and more than 100 other organisational entities.

3.1.4. Responsibilities of senior civil servants

There are no specific legislative provisions concerning senior civil servants. The Public Service Modernisation Act 2003 (PSM) modernised conditions for

public service employment. Part 1 enacted the Public Service Labour Relations Act, which provides for a labour relations regime in the public service. Part 2 amended the FAA to put direct responsibility for certain aspects of human resources management in the hands of deputy heads, subject to policies and directives of the Treasury Board. New deputy head responsibilities include providing awards and setting standards of discipline. The FAA was also amended to provide for annual reporting to Parliament by the President of the Treasury Board on the application of the human resources management provisions of the PSM Act. A new Public Service Employment Act was enacted,[5] modernising staffing in the public service and retaining core values such as merit, excellence, and non-partisanship. The Act gives a new meaning to merit and provides the Public Service Commission (PSC) with the legal responsibility for protecting and promoting merit-based staffing. Whereas the PSC is responsible for overseeing many public service values, individual departments are responsible for the values of flexibility and efficiency. The head of each organisation is accountable for achieving the results in relation to delegated responsibilities. The Act requires, in addition to the annual reporting by the PSC, that the President of the Treasury Board report annually to Parliament on the Treasury Board's responsibilities under the Act.

3.1.5. Establishment and roles of parliamentary committees

The Parliament of Canada Act does not contain any specific provisions on the composition of parliamentary committees. These are laid down in Standing Orders of the House of Commons and in Rules of the Senate. Each house has four types of committee: standing committees, special committees, legislative committees, and committees of the whole. The number and type of committee depend on the government in power. The standing committees mainly focus on a substantive sphere of government policy, each being responsible for one or more government departments. In 2004, the House of Commons had 19 standing committees including the Finance Committee which deals with the budget and economic and financial issues. The Senate had 16 standing committees including the National Finance Committee which deals with government finance issues. Most committees are controlled by the government, as the chair and majority of members are from the governing parties.

3.2. Roles and responsibilities of sub-national governments

Canada is divided into ten provinces and three territories, with considerable variation in size. The Constitution Act 1867 lays out the areas of provincial and federal jurisdiction (ss. 91 and 92). Most powers are assigned exclusively to one of these two levels of government, although a few are designated as concurrent powers. Federal responsibilities include monetary policy, defence, foreign relations, trade and criminal law. Provinces are generally responsible

for health, education, property and civil rights, social security and municipal institutions. Residual powers, that is, any power not set out in the Constitution Act, lie with the federal government (for details, see OECD, 2000).

Canada stands out as a decentralised fiscal system since provinces have extensive taxing and spending powers, and federal regulatory interventions at territorial level are few (OECD, 2002). Financial relations are governed by the Federal-Provincial Fiscal Arrangements Act. Transfers to provinces take a number of different forms, including those for tackling the disparities between provinces. Three major programmes account for most of the transfers: the equalisation programme under the Constitution Act (Art. 36.2) and the Federal-Provincial Fiscal Arrangements Act (Part 1); the territorial formula financing under the Federal-Provincial Fiscal Arrangements Act; and the Canada Health and Social Transfer (CHST) under the Federal-Provincial Fiscal Arrangements Act (Part V). The Constitution Act 1867 states the objectives of the equalisation programme, one of the main transfer payments: "Parliament and the Government of Canada are committed to the principle of making equalisation payments to ensure that provincial governments have sufficient revenues to provide reasonably comparable levels of public services at reasonably comparable levels of taxation."

Box 3. **Canada: Major transfers from the federal to the provincial governments**

- Equalisation transfers: These are vertical transfers from the federal government to provinces with low fiscal capacity, which are calculated by comparing the per capita revenues that could be generated by each province if the average of five provinces were applied (British Columbia, Manitoba, Ontario, Quebec and Saskatchewan).
- The Canada Health and Social Transfer system (CHST) provides provinces with both cash payments and tax transfers in support of health care, post-secondary education and social services, including childhood development. CHST payments are partially conditional: provinces and territories have flexibility to allocate payments among social programmes according to their priorities provided they respect the principles of the Canada Health Act and do not impose a condition of a minimum residency period with respect to social assistance. The CHST was replaced by the Canada Health Transfer and the Canada Social Transfer with effect from 1st April 2004.
- Territorial formula financing (TFF): This is an annual unconditional transfer from the federal government to the three northern territorial governments. It enables these territories to provide a range of public services comparable to those offered by provincial governments.

4. Legal provisions for each stage of the budget cycle

4.1. Budget preparation and presentation by the executive

4.1.1. Institutional coverage of the budget

By a convention inherited from the United Kingdom, a distinction is made between the budget and the main estimates. The budget is the document tabled in the House of Commons by the Department of Finance giving the government's overall fiscal plan for revenues and expenditures, including new initiatives. The main estimates are the detailed plans for government expenditures, by department and agency, tabled several days after the budget by the Treasury Board. The budget and main estimates are limited to fiscal activities of the federal government. The coverage of the budget is not defined in law. By convention, the executive departments can propose changes in the institutional units comprising "federal government".

The provincial governments have their own budgets which have similar structure and characteristics of federal government. Provincial laws relating to provincial budget processes are beyond the scope of this study. At the federal level, there is no legal requirement for provinces and territories to report on their fiscal developments to the federal government.

4.1.2. Extrabudgetary funds and earmarking of revenues

A central feature of financial management is the Consolidated Revenue Fund (CRF), established under the Constitution Act 1867. This fund pools all federal government income, such as revenues from taxes, tariffs and fees, and profits from Crown corporations. The FAA requires all revenues of the government to be paid into the CRF, and money must not be paid out of the CRF, without the authority of an appropriation by Parliament (Art. 17). The main exceptions to the concept of CRF are certain social insurance programmes, whose sources of funds are payroll taxes paid jointly by employers and employees. The Employment Insurance Act 1996 stipulates the setting of premiums and eligibility requirements for the payment of unemployment benefits. However, although contributions are earmarked, the programme is consolidated with the government's financial statements (there is no separate account). In contrast, for the pension funds, although contributions are deposited in the CRF, transactions are not consolidated in the financial statements of either the federal government or the provincial governments. The Canada Pension Plan Act 1966, as amended, governs the activities of the main programme, which is a jointly managed programme between the federal government and the provinces, with the exception of Quebec which has its own programme.

Transfers of taxpayers' money to foundations and other delegated arrangements set up to achieve public objectives have been a source of concern.

Although the funds provided to such foundations are shown in the budget, the use of these funds is beyond the scope of government accounting and audit arrangements. The statutory authority for some of these delegated arrangements is in the Canada Corporations Act, the federal non-profit framework law. Only a few of these arrangements were established by direct legislation, which has the advantage of facilitating good governance and accountability to Parliament.

4.1.3. Definition of budget aggregates

The major budget aggregates are not defined in law. In the process of preparing the annual budget, the budget aggregates for major sectors and each ministry or agency are proposed for two years.

4.1.4. Fiscal rules

Canada currently has no statutory fiscal rules to control spending, deficits or debt. As mentioned, the Spending Control Act 1992 lapsed in 1996. However, clear fiscal targets are set by the government in the budget formulation process. The federal fiscal policy presently aims to achieve "a balanced budget or better" to ensure that the public debt-to-GDP ratio remains on a clear downward track. In the 2004 budget, the government announced an objective of reducing federal debt to 25% by 2010. Although the *ex ante* target aims at balancing the budget, the prudence allowance and contingency reserve have led to *de facto* budget surpluses.

4.1.5. The timetable for budget preparation and presentation to Parliament

The fiscal year for the federal government begins on 1st April (FAA, Art. 2). The timetable for budget preparation and presentation to Parliament is not governed by law. Traditionally, the budget planning process begins about 12 months before the beginning of the fiscal year, with the Department of Finance submitting macroeconomic forecasts to Cabinet, and the Treasury Board calculating reference levels for expenditure of each department and government programme (Box 4). Each department then enters into negotiation with the Treasury Board on the spending levels for the upcoming year. Departments must submit a business plan to the Treasury Board in June. These plans include proposed expenditure for the upcoming year, the department's strategy, goals and targets, and measures for programme and management changes over the next three years. Cabinet reviews the budget priorities and strategy and makes a final decision on the budget in January or February. The Minister of Finance typically submits the budget and the Treasury Board typically submits the main estimates (appropriation bills) to the House of Commons around February-March.

Box 4. Canada: Key steps in the annual budgeting process

- March-June: Preparation and review of departmental business plans.
- June: Cabinet review of priorities.
- September-October: Cabinet review of budget consultation targets and conduct of consultations.
- December-January: Cabinet review of budget strategy.
- January-February: Final Cabinet decision on the budget between the Prime Minister and the Finance Minister, and the President of the Treasury Board.
- February-March: Budget speech and tabling of estimates.

4.1.6. Approval process within the executive

The approval process by Cabinet is not specified in law. New policy initiatives are presented directly by ministers to the applicable policy Cabinet committees. These committees meet weekly during the autumn to discuss the merits of new policy proposals presented by ministers. During this process, the Privy Council Office, the Department of Finance and the Treasury Board also review ministers' proposals. After negotiations, Cabinet approves the draft budget. However, final decisions on the budget are made by the Prime Minister and the Minister of Finance.

4.1.7. Documents to accompany the budget law

The content of the budget proposal agreed by Cabinet is governed by convention. The main estimates present information on operating and capital expenditures, the cost of servicing the public debt, transfer payments to other levels of government, organisations or individuals, and payments to Crown corporations (Box 5).

Medium-term macroeconomic framework and fiscal strategy. Since 1995, a system of rolling two-year fiscal objectives was introduced by a Cabinet decision, not law. Before 1995, a five-year fiscal framework was used. The reason for the change was that the government wanted to enhance its credibility and be held accountable for meeting its targets (Blöndal, 2001). A distinctive feature is the systematically prudent economic assumptions for the macroeconomic framework. Optimistic assumptions for the budget had significantly downgraded the credibility of government-generated economic forecasts. Rather than relying on internally-generated economic forecasts for the budget, the government now uses the average of forecasts made by four private sector forecasting firms which are contracted to derive the fiscal

Box 5. **Canada: Major contents of the main estimates**

- **Part I: The Government Expenditure Plan.** This provides an overview of federal spending and summarises the relationship of the key elements of the main estimates to the current expenditure plan.
- **Part II: The Main Estimates.** These directly support the Appropriation Act. The main estimates identify the spending authorities (Votes) and amounts to be included in appropriation bills. Parliament will be asked to approve these Votes to enable the government to proceed with its spending plans.
- **Part III: Departmental Expenditure Plans.** These are divided into two components: Reports on Plans and Priorities (RPPs) and Departmental Performance Reports (DPRs). RPPs, which are tabled in the spring (the March-May period), are individual expenditure plans for each department and agency (excluding Crown corporations). These reports provide detailed information on objectives, initiatives and planned results, including links to related resource requirements over a three-year period. DPRs are individual department and agency accounts of results achieved against planned performance expectations, as set out in respective RPPs. DPRs cover the most recently completed fiscal year and are normally tabled in the autumn (September-November period).

projections using the average of the private sector economic forecasts. Prudent projections and a contingency reserve act as a buffer to maintain the government's fiscal objectives. In addition, the Minister of Finance presents an Economic and Fiscal Update to the House of Commons Finance Committee early in the autumn. This provides an update of macro-fiscal developments since the last budget and launches the pre-budget consultation process. Since 1999, the economic and fiscal projections are for a five-year period. The committee holds public consultations and presents recommendations to the government based on its hearings in early December.

New measures *versus* existing expenditure policies. The law does not require new policies to be distinguished from existing expenditure policies or ongoing projects. New budgetary initiatives are proposed by Cabinet, with parliamentary approval granted either through the appropriation bills or the Budget Implementation Act.

Performance-related information. Although there is no legal obligation, the federal government presents two main reports with performance-related information to Parliament: Reports on Plans and Priorities (RPPs) and Departmental Performance Reports (DPRs) midway through the financial year (see Box 5). In the context of the provision of information about what each

department plans to achieve with the resources entrusted to it and how it performed against those plans, the Treasury Board has provided the following six reporting principles:[6]

- Provide a coherent and balanced picture of performance that is brief and to the point.
- Focus on outcomes, not outputs.
- Associate performance with earlier commitments, and explain any changes.
- Set performance in context.
- Link resources to outcomes.
- Explain why the public can have confidence in the methodology and data used to substantiate performance.

Tax expenditures, contingent liabilities and fiscal risks. There are no statutory provisions requiring the reporting of tax expenditures and fiscal risks. However, the budget presents information on new tax expenditures, general tax relief initiatives and their fiscal impact. Also, potential fiscal risks are included in the Economic and Fiscal Update. The Department of Finance releases information and assessments on tax expenditures on an annual basis.

The Financial Administration Act (FAA) requires reports on contingent liabilities in the public accounts. Contingent liabilities are listed in the audited financial statements, and appropriate provisions are included in the statement of assets and liabilities.

4.1.8. Budgets of Parliament and other constitutional bodies

Statutory provisions allow Parliament to prepare its own budget independently of the Department of Finance or the Treasury Board. The Parliament of Canada Act provides that the Clerk of the Senate shall, by an order signed by the Clerk, apply for such credits as the Clerk deems necessary for the expenditures of the Senate not otherwise provided for under the Act (s. 3). The same Act also provides that, prior to each fiscal year, the Board of Internal Economy of the House of Commons shall cause to be prepared an estimate of the sums required to be provided by Parliament for the payment of charges and expenses of the House of Commons during the fiscal year (s. 52.4). The estimate shall be transmitted by the Speaker to the President of the Treasury Board who shall lay it before the House of Commons with the estimates of the government for the fiscal year. Also the Auditor General Act (AGA) has statutory provisions for the budget preparation of the audit office (Chapter IV.5).

4.2. Budget process in Parliament

The parliamentary budget process can be divided into two distinct stages: the pre-budget consultation process and the approval process. The pre-budget consultations were started during the fiscal crisis of the 1990s as a vehicle for promoting the government's budget policy.[7] Consultations begin in September or October when the government announces its budget policy themes and releases its Economic and Fiscal Update. The process ends in early December when the House of Commons Finance Committee presents its report on the pre-budget consultations.

4.2.1. The timetable for budget adoption and constraints on the budget debate in Parliament

There are no legal requirements regarding the timing of the submission of the budget by the government, nor on the adoption of the annual Appropriation Act. In practice, however, the budget is presented to Parliament about one month before the beginning of the fiscal year, several days prior to the introduction of the estimates. Following the tabling of the budget, there is a required four days of debate on the budget. After this debate, there is a confidence vote in the House of Commons on the government's overall management of the economy.

Following the presentation by the Minister of Finance and the President of the Treasury Board, the House of Commons begins its deliberations, following procedures laid down in Standing Orders. The estimates are automatically referred to the standing committees of the House. Each standing committee examines those parts of the estimates that fall within its mandate. There is, however, no committee that co-ordinates the examination of the estimates or examines them on an aggregated level. The standing committees can call ministers, senior officials and other interested parties to appear. The committees report back to the House on the estimates before 31 May. If they have not reported, they are deemed to have reported (this was designed so that committees could not delay the parliamentary budget process).

The Standing Orders specify that 20 days be reserved for debate of the government's expenditure proposals in full House session. Nineteen of these days are reserved for the Opposition. Although these days are fully used by the opposition, they are used not only for debate on the estimates, but also as an opportunity for general policy debate.

4.2.2. Provisional budgets

The fiscal year starts on 1st April but the main estimates are not traditionally approved until just before Parliament's summer recess in late June. Parliament traditionally grants the government interim supply from the beginning of the

Box 6. Canada: The budget approval process in Parliament

- Late September: House of Commons Finance Committee begins public hearings on budget policy. The pre-budget consultation process begins.
- Mid October: Minister of Finance announces the government's broad budget policy themes to the Finance Committee and releases the government's Economic and Fiscal Update.
- Early December: Finance Committee presents its report on pre-budget consultations.
- Late February: Minister of Finance introduces the budget and the President of the Treasury Board introduces the estimates. Standing committees begin their examination of the estimates.
- Late March: The President of the Treasury Board introduces a report on plans and priorities (RPP) for each department and agency. Parliament grants interim supply to end June.
- 1st April: Start of fiscal year.
- Late May: Standing committees report on the estimates.
- Late June: Approval of the estimates.

fiscal year until the end of June. Interim supply allows the government to spend the funds necessary for its ongoing operations during this period. This procedure is inherited from the United Kingdom and has no legal basis.

4.2.3. *Powers of amendment*

Amendment powers, which are not specified in law, are very limited. By convention, the government has exclusive power to initiate expenditure proposals. Parliament can only approve the government's proposals, either in full or at a reduced level of funding, or reject them altogether. Parliament is prohibited from proposing new expenditure programmes or increasing the proposed level of funding.[8] The role of Parliament is further limited by the "confidence" convention: a vote on any "money bill" is considered a vote of confidence in the government. This is not enshrined in any legislation but is rather a tradition enforced through party discipline. The confidence convention is interpreted strictly, meaning that any vote on a "money bill" is a vote of confidence in the government.[9]

4.2.4. *Approval of resources*

The Constitution Act 1867 clearly states that Parliament has an exclusive legislative power on matters relating to the raising of money by any mode or system of taxation. It is therefore illegal for the executive to raise a tax or levy

without having legislative authority from Parliament. At the federal level, all tax liabilities, credits, deductions, and exemptions are embodied in statutes (for instance, the Income Tax Act, the Customs Act, and the Excise Act). All revenues including taxes, tariffs and other money received by the federal government must be credited to the Consolidated Revenue Fund and be properly accounted for.

4.2.5. The nature, structure and duration of appropriations

The estimates aim at presenting to Parliament information in support of budgetary and non-budgetary spending authorities that will be sought through appropriation bills. These authorities are divided into two categories: voted and statutory. Voted authorities are those for which the government must seek Parliament's approval annually through an Appropriation Act. The authority attributable to each vote appears in a schedule attached to the Appropriation Act. Once approved, the vote wording and approved amounts become the governing conditions under which specific expenditures may be made. When approved by Parliament, the relevant estimates form the basis for the annual Appropriation Act for that year, which is adopted like any other piece of legislation.

There is no statutory provision for the appropriations structure and detailed budget classification. Traditionally the main estimates are first classified according to section, which represents around 20 broad functional categories of public expenditures. For instance, sections include agriculture and agri-food, environment, finance, health, industry, national defence, transport, Canadian heritage and foreign affairs and international trade. Within sections, the estimates are further classified according to department or agency, within which various votes are included. To determine and report more accurately the impact of government revenues and expenditures on the economy, the main estimates are also classified according to 12 standard objects of expenditure, including personnel, transportation and communications, information, professional and special services, rentals, purchased repair and maintenance, acquisition of land, buildings and works, transfer payments, and public debt charges.

4.2.6. Carryover of appropriations and borrowing of future appropriations

In principle, the balance of unexpended appropriations lapses at the end of a fiscal year (FAA, Art. 37). However, the government permits the carryover of unused appropriations up to 5% for operating costs. There is also a system for carryover of unspent capital appropriations – these are approved on a case-by-case basis. The Department of Finance and the Treasury Board Secretariat add amounts equal to the carryovers to the requested funding levels from

Parliament in the subsequent year. Annual appropriations for the Canada Customs and Revenue Agency and the Canada Parks Agency do not lapse until two years following the start of the fiscal year in which the appropriation was granted.

4.2.7. Public debt approval

Confronted with high indebtedness in the 1990s, Canada has very strict legal control over debt issuance. Part IV of the FAA is devoted exclusively to public debt. Article 43 states that no money shall be borrowed by the government except as provided by or under the FAA or any other Act of Parliament that expressly authorises the borrowing of money. In addition, no securities shall be issued by the government without the authority of Parliament. Once Parliament has provided legal authority, the FAA provides for the Governor in Council to authorise the Minister of Finance to borrow money by any means that the Minister considers appropriate (Art. 44). The Minister is thereby authorised, for example, to make portfolio shifts between different debt instruments.

4.2.8. Promulgation, veto and publication of the adopted budget

There is a legal requirement to publish all statutes, including the Appropriations Act, under the Revised Publication of Statutes Act 1985. The documents for the budget and updates are available on the Internet site of the Department of Finance.

4.2.9. Supplementary budgets (rectifying laws)

The main estimates provide funding only for programmes and activities for which there is existing parliamentary authority. Parliament may be asked in supplementary estimates, tabled later in the year, for funding for new initiatives. The supplementary estimates may contain funding for unforeseen contingencies if the budget's reserve for funding new initiatives and contingencies is completely exhausted.

4.2.10. Budgetary implications of other bills

There is no legal provision which requires any bill having budgetary implications to be reviewed by the Cabinet or a parliamentary committee before it is approved by Parliament. It should be noted that statutory authority which Parliament has approved through other legislation does not have to be approved annually as long as the enabling legislation is effective. The enabling laws set out both the purpose of the expenditure and the terms and conditions under which it may be made. Statutory spending is included in the estimates for information only, and accounts for around 70% of the total estimates.

4.3. Budget execution

4.3.1. Apportionment of expenditure authority

At the beginning of each fiscal year, following a directive issued by the Treasury Board, the deputy head of each department prepares a division of the appropriation into allotments and submits the division to the Treasury Board (FAA, Art. 31). Where a division is approved by the Treasury Board, the allotments shall not be varied or amended without the approval of the Board.

4.3.2. Cancellation of budget authority and other in-year expenditure controls

There is no statutory provision to grant power to the executive, notably the Treasury Board, to cancel appropriations approved by Parliament. However, the FAA provides the Treasury Board with the authority to freeze appropriations approved by Parliament. When the government considers it prudent to reduce or cancel part of any appropriation, supplementary Appropriation Acts also may be used.

4.3.3. Emergency spending, excess spending and contingency funds

The law does not regulate the use of the contingency reserve fund established by the government in each year's budget as a result of prudent economic assumptions. According to a Cabinet decision, the fund can only be used to compensate for forecasting errors and unpredictable events. It may not be used for new policy initiatives. If recourse is not made to the contingency reserve funds, they are automatically applied to deficit reduction in their entirety.

When a payment is urgently required while Parliament is not in session and there is no available appropriation for payment, the Governor General in Council, on the report of the President of the Treasury Board, may, by Order, direct the preparation of a special warrant authorising payment to be made out of the Consolidated Revenue Fund (FAA, Art. 30). A special warrant is deemed to be an appropriation for the fiscal year in which the warrant is issued. Every such warrant shall be published in the Canada Gazette within 30 days, and a statement showing all warrants issued and the amounts of those warrants shall be laid by the President of the Treasury Board before the House of Commons within 15 days after the commencement of the next session of Parliament (Art. 30). Where a special warrant has been issued, the amounts appropriated shall be deemed to be included in the Appropriation Acts (Art. 30).

4.3.4. Transfer and virement of appropriations within the year

Where a division of appropriation into allotments is approved by the Treasury Board, the allotment is not permitted to be varied or amended

without the approval of the Treasury Board (FAA, Art. 31). In practice, the operation of transfers between appropriation lines depends on the nature of appropriations. Transfers between operating expenditures are permitted provided Parliament is notified, whereas transfers between operating expenditures, investment and programme funds are possible only with parliamentary approval. Appropriations can be reallocated from one programme to another with the approval of the Treasury Board.

4.3.5. *Cash planning and management of government assets and debt*

The FAA requires the Department of Finance to publish annually a debt management report and a debt management strategy. The debt management report provides a comprehensive record of the federal government's debt operations in the previous fiscal year. It must be tabled in Parliament within 45 sitting days of the tabling of the public accounts (Art. 49). The debt management strategy provides information on the federal government's planned management of debt for the coming fiscal year. It must be tabled before the end of the current fiscal year (Art. 49). Departments are required to keep accounts to show clearly the status of their assets as well as direct and contingent liabilities of the government (Art. 63). Data on financial assets, including international reserves, are included in the public accounts and the debt management reports.

4.3.6. *Internal audit*

Following directives issued by the Treasury Board, the deputy head is required to ensure, by an adequate system of internal control and audit, that the allotments provided are not exceeded (FAA, Art. 31). The deputy head shall establish and maintain records respecting the control of financial commitments chargeable to each appropriation (FAA, Art. 32). Ministries and agencies are required to audit and evaluate their programmes and operations so as to assess whether the management framework is well designed and working as intended. Internal audit policy and standards provide departments with a basis for carrying out cost self-assessment and improving quality.

4.4. *Government accounting and fiscal reporting*

4.4.1. *The accounting framework*

The FAA and regulations of the Treasury Board govern the accounting framework. The FAA states that, subject to regulations of the Treasury Board, departments are required to keep accounts so as to show expenditures made under each appropriation, revenues, and other financial transactions into and out of the Consolidated Revenue Fund (Art. 63). Without changing legislation,

the government has presented its financial statements on a full accrual accounting basis since 2003.

4.4.2. Government banking arrangements

The law requires that all public money be deposited to the credit of the Receiver General, the chief financial officer of the federal government, who receives all revenues from the government and deposits them in the CRF (FAA, Art. 17). The FAA empowers the Receiver General to establish accounts for the deposit of public money and the Treasury Board to make regulations prescribing the manner in which public money shall be paid to the credit of the Receiver General.

4.4.3. In-year reporting

There are no legal provisions requiring the government to publish in-year reports on budget execution. However, throughout the year, monthly financial statements are published in the Fiscal Monitor. Results for each month and the year to date are compared with the same amounts during the same time period of the previous fiscal year.

4.4.4. Annual accounts and reports

Annual public accounts are required to be prepared by the Receiver General for each fiscal year and to be laid before the House of Commons by the President of the Treasury Board on or before 31 December following the end of that fiscal year (FAA, Art. 64). The public accounts need to be in such form as the President of the Treasury Board and the Minister of Finance direct. By law, the accounts are required to include:

- A statement of the financial transactions of the fiscal year, the expenditures and revenues for the fiscal year, and such assets and liabilities that, in the opinion of the President of the Treasury Board and the Minister of Finance, are required to show the financial position of the government at the end of the fiscal year.
- Other documents and information relating to the fiscal year as are deemed necessary by the President of the Treasury Board and the Minister of Finance to present fairly the financial transactions and the financial position of the government or as required by the FAA or any other Act (FAA, Art. 64.2).
- Contingent liabilities of the government.
- The opinion of the Auditor General on the accounts (AGA, s. 6).

In practice, the public accounts are in two volumes and provide a comprehensive report of budget execution. The accounts show the sources and uses of funds for each appropriation. The sources are broken down by

several groupings – the main estimates, the supplementary estimates, adjustment and transfers, and transactions of previous years. The uses of funds are split between those used in the current year, lapsed or over-expended, available for use in subsequent years and used in the previous year. Volume I contains the summary report and financial statements. It provides a comparison of revenues and expenses in the budget. Volume II contains details of revenue and expenditure. It reports on the use of spending authorities (estimates) and reconciles expenditures (spending) to expenses (accrual).

The Minister of Finance voluntarily (*i.e.* there is no legal requirement) provides an Annual Financial Report to Parliament, which provides an *ex post* report on budget implementation. This is a short statement and is supplemented by condensed financial statements of government transactions. These financial statements are also audited.

4.4.5. Reporting of fiscal intentions

There are no statutory provisions requiring the government to report long- and medium-term fiscal strategies and objectives to Parliament and the public. Unlike other Westminster countries, Canada has not adopted a legal approach to comprehensive disclosures (compare the Fiscal Responsibility Act of New Zealand). However, the budget and the Economic and Fiscal Update provide Parliament with the short- or long-term fiscal intentions of the government.

4.5. External audit

4.5.1. Managerial, financial and operational independence

The Auditor General Act 1977 (AGA) governs the general principles and procedures for external audits by the Office of the Auditor General. The AGA does not specify any parliamentary involvement in the appointment of the Auditor General. This position is appointed by the Governor General in Council (*i.e.* the head of the executive) for a non-renewable ten-year period and the holder may be removed by the Governor General in Council on address of the Senate and House of Commons (AGA, Art. 3). Each year, the Auditor General prepares an estimate of the sums that will be required to fulfil the responsibilities of the office. The provisions of the FAA with respect to the division of appropriations into allotments do not apply in respect of appropriations for the office of the Auditor General (FAA, Art. 20). The office has the freedom to recruit its own staff and set the terms and conditions of employment for staff in accordance with Article 15 of the Public Service Employment Act.

4.5.2. Institutional coverage of audits

The Auditor General is required to examine several financial statements, as specified in the FAA (Art. 64) and any other statements that the Treasury Board or the Minister of Finance may present for audit (Art. 6). These include a statement of the financial transactions of the fiscal year, expenditures and revenues for the fiscal year, and the assets and the contingent liabilities of the government (FAA, Art. 64).

The Office of the Auditor General audits most areas of government activities, including:

- Federal government departments and agencies ranging from small boards to large, complex organisations whose activities extend across Canada and overseas.
- Crown corporations (for example, the Canadian Broadcasting Corporation, the Royal Canadian Mint). Under the FAA, most Crown corporations must undergo a value-for-money audit every five years (in addition to an annual audit of their financial statements).
- Departmental corporations.
- Areas of responsibility shared by more than one department, such as immigration.
- Issues that affect the entire government, for example, personnel matters or the use of computers.

4.5.3. Types of audit

Pursuant to the AGA (Arts. 17 and 7.2.f) and the FAA (Part X), the Auditor General conducts several types of legislatively-authorised audits:

- Performance audits of departments and agencies. These examine whether programmes are run economically, efficiently and with due regard for their environmental effects, and also whether the government has the means to measure their effectiveness.
- Attestation audits of the summary financial statements, to verify that they represent fairly the government's overall financial situation. Only the Government of Canada financial statements contained in section 2 of volume 1 of the annual accounts is audited. The other financial information is not explicitly audited although the Office of the Auditor General may look at aspects of it during the course of its work.
- Financial audits of Crown corporations, territorial governments and other organisations to determine whether their financial information is presented fairly and whether they comply with legislative authorities.

- Special examinations of Crown corporations to determine whether their systems and practices provide reasonable assurance that assets are safeguarded, resources are managed economically and efficiently, and operations are carried out effectively.

In addition, the Auditor General reports annually on the extent to which departments are meeting the objectives and implementing the plans set out in their sustainable development strategies, which they have been required to prepare under amendments to the AGA in 1995.

4.5.4. *Powers of investigation*

The AGA contains provisions and powers for investigation (Art. 13). The Auditor General is entitled to free access, at all convenient times, to information that relates to the fulfilment of his/her responsibilities, and to require and receive such information, reports and explanations as he/she deems necessary. He/she may station persons employed in the Office of the Auditor General in any department, and that department shall provide the necessary office accommodation. Furthermore, the Auditor General may examine any person on oath for matters pertaining to any account. For the purpose of any such examination the Auditor General may exercise the powers of a commissioner specified under Part I of the Inquiries Act.

4.5.5. *Reporting obligations and publication*

Since 1879, the principal instrument for reporting has been the Auditor General's Annual Report to the House of Commons (AGA, Art. 7). The observations of the Auditor General on the government's financial statements are also included in the public accounts and complement the Auditor General's annual audit report. The Auditor General may also make special reports, including:

- where the Auditor General considers that the matter is so important and urgent that he/she should not delay in reporting it until the presentation of the next annual report (Art. 8);
- where he/she considers that amounts provided for the office in the estimates submitted to Parliament are inadequate to enable him/her to fulfil the responsibilities (Art. 19).

Since the amendment of the AGA in 1994, the Auditor General may produce up to three reports per year in addition to the annual and special reports (Art. 7). In any given year, these reports contain the results of:

- Comprehensive audits of federal departments and agencies, and of issues that cross department lines.
- Government-wide audits.

- Follow-up reports, which review the actions taken by departments in response to previous audits.
- Audit observations, which are significant matters that are not included in the above audit reports.

Each annual report is required to be submitted to the House of Commons on or before 31 December in the year to which the report relates. Where the Auditor General proposes to make an additional report, he/she is required to send written notice to the House of Commons, and each additional report is required to be submitted to the House of Commons on the expiration of 30 days after the notice is sent (Art. 7).

4.5.6. Enforcement of findings

The Office of the Auditor General has no enforcement powers of its own. It provides information and advice to Parliament, and relies on the power of Parliament and the force of public opinion to have its recommendations adopted. In 2004, the Auditor General's annual report identified a number of issues involving non-respect of financial controls and actions by public officials who knowingly mismanaged public funds. In response, the government announced it will review and strengthen the FAA, with a view to increasing oversight and accountability.

Notes

1. In addition to these laws, there are various tax acts as well as legislation for other statutory programmes and appropriations acts, which authorise the government to spend money or collect taxes. In 1992, the Spending Control Act was adopted to control government expenditures; it ceased to be in force in 1996. Similarly, the Debt Servicing and Reduction Act 1992 was formally repealed in 2003.
2. Although the act contributed to reduced spending, the purposes of the act may have been better achieved if the law had also focused on the revenue side of the budget (Geist, 1997; Philipps, 1997).
3. These are: 1) Does the programme serve a public interest?; 2) Is this an appropriate role for the government?; 3) Could this be done better by another level of government (provincial or municipal)?; 4) Could this be left to the private sector or volunteer sector?; 5) Could the programme be delivered more efficiently?; 6) Is it affordable?
4. The FAA provides the legal authority for establishing the Treasury Board as a Committee of the Privy Council. Article 7 defines the responsibilities of the Treasury Board for general administrative policy in the public service, public service organisation and control, financial management, including estimates, expenditures, financial commitments, accounts, procedures by which departments manage, record and account for revenues received or receivable, the review of annual and longer term expenditure plans and programmes of department, and determination of priorities with respect thereto, and personnel management in the public service including the determination of the terms and conditions of employment. In addition, the FAA provides the legal basis for the establishment of

the Ministry of Finance, responsible for the management of the Consolidated Revenue Fund and the supervision, control and direction of all matters relating to financial affairs not by law assigned to the Treasury Board or to any minister (Arts. 14-16).

5. The new Public Service Employment Act replaces the 1967 Act, amended in 1992, of the same name. It is to be implemented in stages, through 2005. See *www.parl.gc.ca/37/2/parlbus/chambus/house/bills/government/C-25/C-25_4/C-25_cover-E.html*.
6. See Treasury Board of Canada Secretariat (2002).
7. The stated purpose of the pre-budget consultations is to provide a mechanism by which citizens could make suggestions to include in the upcoming budget. The pre-budget consultations would, however, appear to have been launched primarily to educate the public about the fiscal situation and create an environment more conducive to accepting difficult budget decisions. By using Parliament as the vehicle for this, it also served the purpose of involving the opposition in discussions of fiscal policy changes.
8. This constitutional convention is common to most of Westminster countries and derives from 18th century budget practices in Great Britain where the monarch "billed" Parliament for his expenses. Parliament did not "volunteer" funds to the monarch.
9. For example, the Clark Government resigned in 1979 due to Parliament's refusal to adopt its budget proposals. Since then, governments usually ensure that its proposals enjoy the support of Parliament before introducing them. If parliamentary support is not ensured, specific aspects of the budget may be withdrawn.

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ISSN 1608-7143
OECD Journal on Budgeting – Volume 4 – No. 3
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France*

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1. Overview

1.1. The legal framework governing budget processes

France has a comprehensive legal framework for the State budget, with a constitution that provides the executive with strong powers in budgeting. The 1958 Constitution limits the role of Parliament in budgetary matters to changing the composition of expenditures. Parliament cannot raise total expenditures, nor can it lower revenues of the State budget. The Constitution also contains some fundamental principles for the State budget and, since 1996, for the social security organisations as well.

The main law governing budget processes is the 2001 Organic Budget Law (*Loi organique relative aux lois de finances,* LOLF), to be fully implemented in 2006. This law lays out principles relating to the content, preparation, adoption and reporting of annual budget laws of the State. However, annual State expenditures cover only 37% of total general government expenditures. Various extrabudgetary funds account for 45% of general government expenditures (OECD, 2003, p. 117). The principal funds relate to healthcare, pensions, unemployment insurance and family support. Since 1996, the financing of the social security funds is examined by Parliament, the conditions for which are laid out in a separate organic law (see Box 1). The remaining 19% of general government expenditure is executed through local governments' budgets, governed by a comprehensive legal framework, the Local Government Code. External audit laws have also been codified,[1] as have the laws relating to general taxation, public procurement and social security. A separate Public Finance Code has not been adopted, although the idea has been raised.[2]

The Constitution and the two organic laws are accompanied by a hierarchical system of laws and regulations that elaborate on budget processes and procedures.[3] The 1962 Public Accounting Decree lays out the responsibilities of key players in budget and accounting processes. A 1922 law put the financial controllers under the authority of the Ministry of Economy, Finance and Industry (MINEFI). These controllers are responsible for a priori checks on expenditure commitments. The accounting and expenditure controls reflect the traditional highly centralised approach to budget management.

France is a member of the European Union, for which budgetary rules for achieving macroeconomic stability have been issued. In particular, the Maastricht criteria limit the general government fiscal deficit to a maximum of 3% of GDP

Box 1. **France: Main budget system laws**

- 1958 Constitution.
- 2001 Organic Budget Law (*Loi organique relative aux lois de finances*, LOLF), August.
- 1996 Organic Law relating to the Financing of Social Security (*Loi organique relative aux lois de financement de la sécurité sociale*, LOLFSS), July.
- Social Security Code.
- 1994-95 Financial Jurisdictions Code (external audit law).
- Local Government Code.
- 1962 Public Accounting Decree.
- 1922 Law on Controlling Expenditure Commitments.

Source: All laws and decrees are available (in French) at *www.legifrance.gouv.fr*.

and general government debt to 60% of GDP. However, these quantitative limits have not been specifically incorporated into any French laws and, strictly speaking, they are not legally binding on France.[4]

1.2. Reforms of budget system laws

The adoption of the Constitution in 1958 was a major reform at that time, as it reduced Parliament's powers in budget making. Prior to 1958, the Minister of Finance was obliged to present to Parliament a draft budget that had already been amended by parliamentary budget committees (*Commissions des finances*). The Constitution removed this parliamentary privilege, set a limit on the number of parliamentary committees (previously many committees influenced the shape of the budget), and provided the executive with strong powers in budget preparation and execution. Parliament's powers of amendment became more limited.[5] The adoption of the 1959 *Ordonnance* on the budget system drastically reduced the number of budget lines from the 4 000 prevailing in 1956 (Bouvier *et al.*, 2002, p. 239). Despite this, for more than 40 years, Parliament only had a single vote for existing policies (*services votés)*. This resulted in budget inertia and contributed to a ratcheting-up in the level of total expenditure. Also, since most expenditure was carried over from year to year, there was little debate in Parliament on the objectives of budgetary policies. The legal framework allowed the executive powers to manipulate funds without parliamentary knowledge.[6] Finally, the information provided by the executive on budget execution was neither complete nor timely.

To address these and other deficiencies, and at the initiative of Parliament, a new LOLF was adopted in August 2001 (for explanations and background, see for example Camby, 2002, and Hochedez, 2004). This revised "financial constitution" introduced a new philosophical approach to budget management (Bouvier, 2004) and the law was adopted with a wide consensus, following 35 previous attempts to change the 1959 law.[7] The main objectives of the 2001 LOLF are:

- To modernise the State by presenting a budget by missions (at a first level of parliamentary vote) and programmes (at a second level – the main management framework to which objectives and indicators of results are linked). The aim is to replace input-oriented, incremental budgeting by zero-based, results-oriented budgeting. About 850 line items of expenditure will be replaced by 158 programmes.[8] Accrual accounting is to accompany the budget reform.
- To increase parliamentary powers in budgeting and enhance accountability, in line with the 1789 Declaration of Human Rights that "society has the right to ask public agents to account for their administration". The reduction of the executive's powers in the budget process is to be achieved by increasing the coverage of the State budget to include off-budget activity previously controlled by the MINEFI, enhancing the clarity and transparency (*sincérité*) of the annual budget, and increasing the role of Parliament in scrutinising and modifying the composition of proposed budget expenditures. To these ends, budget information available to Parliament and the public is being enhanced – both for the *ex ante* budget projections and for the *ex post* results of the budget. In particular, annual reports will be prepared so that Parliament can appreciate whether outcomes and programme objectives are being attained.

The LOLF is to be fully implemented by 2006. Some of the easier provisions were already implemented during 2002-03 (Arthuis, 2003). Several important issues were resolved or addressed in 2004, including the definition of missions and programmes (MINEFI, 2004a, Annex 6) and the structure of a new accounting framework. A guide for development of strategies, objectives and performance indicators, along with the responsibilities of budget programme managers (*gestionnaires de crédits*), was published conjointly by the executive, the Parliament and the Court of Accounts (MINEFI, 2004b). Full implementation of the LOLF requires changes in mentality. Past attitudes have been formed in the context of a control-based budget system rather than one where performance is highlighted and individual responsibility is rewarded. The LOLF may induce changes in other laws, notably the 1922 Law on Controlling Expenditure Commitments, the 1962 Public Accounting Decree, and the 1983/84 laws relating to public servants' duties and rights.

With a planned continuation of decentralisation of central government competencies to local governments, and the recurrent financing problems of

the social security funds, a global approach to public finances is required, possibly via law. Multi-year budgetary projections prepared for the EU and for Parliament are discussed in terms of all government bodies (*administrations publiques*) (Mer and Lambert, 2003). The 2001 LOLF may have to be supplemented by legal dispositions that integrate fully the revenues, expenditures and balances of the budgets of the State, the social security organisations and local governments.[9]

2. Principles underlying budget system laws

High-level laws are seen as a channel for specifying important principles.[10] Textbooks on the French budgeting system, often written by law faculty professors (*e.g.* Bouvier *et al*, 2002; Mekhantar, 2003; Querol, 2002; Saidj, 2003; Trotabas and Cotteret, 1995), inevitably highlight traditional budget principles, notably: annual basis, universality, unity, specificity, balance, and the separation of the person responsible for giving orders to collect revenues or pay expenditures (*ordonnateur*) from the public accountant (*comptable public*). Public sector lawyers, rather than economists, have taken the lead in embodying these principles in law.

Traditional principles have been incorporated in successive organic budget laws. However, the annual-basis principle, which relates to annual appropriations, was often not respected.[11] Also, the 1959 *Ordonnance* on the budget system did not require the annual budget projections to be placed in a medium-term context (even though medium-term projections were prepared prior to 2000). This was changed in the 2001 LOLF (Art. 50), which requires four-year projections of revenues and expenditures. The LOLF states that there is to be a single "account" (meaning a document) for total revenues and expenditures of the general budget (Art. 6), an embodiment in law of the principles of budgetary universality and unity. Although the principle of universality has traditionally been stressed, the State budget is presented by the Minister of Finance, whereas the social security financing law is presented by the Minister of Health – clear exceptions to the principles of universality and unity, resulting in a dual budget process. The two separate budget processes are regulated by two separate organic laws (see Box 1). The State budget itself is not unified, as earmarked funds, budget annexes, and special treasury accounts supplement the "general" budget. The 2001 LOLF, like its 1959 predecessor, provides the legal basis for segregation of the State budget. However, the concept and application of a single treasury account is an important principle of public finance in France.

The principle of specifying the budget balance is incorporated in the 2001 LOLF (Art. 1). The notion of "balance" is not clearly defined in the LOLF, which requires the budget to present tables showing the main data associated

with the fiscal balance and how the fiscal balance will be financed (Art. 34). The LOLF also requires the government to present a report on future orientations of economic and budget policies, taking account of its European commitments (Art. 48). However, there is no legal requirement to specify the links between the revenues, expenditures and balance of general government (as reported to the European Union) and the aggregates of the annual State budget, the social security funds and local governments' budgets.

The principle of the separation of the person responsible for giving orders to collect revenues or pay expenditures (the *ordonnateur*) and the public accountants who manage cash revenues and expenditures, was established in Napoleonic times. It was believed that a separation of these functions would allow public accountants, who are financially and personally liable for irregular expenditures or uncollected revenues, to provide an independent check on the authenticity of *ordonnateurs'* acts, thereby preventing irregularity and fraud. This principle has largely broken down on the revenue side, since many taxes are self-assessed – the valuation of the amount to be paid and actual tax payment take place nearly simultaneously. Although academics have questioned the need to retain the principle on the expenditure side (*e.g.* Saidj, 1993), for central ministries this principle is still considered sacrosanct. The LOLF requires responsible management in spending ministries, especially by managers of the 132 budget programmes of the general budget who were nominated in 2004.[12] With the accounting function to be decentralised to spending ministries (annual accounts for each ministry will be prepared), the principle of separation of *ordonnateurs* and *comptables* will become less important, since programme managers' responsibilities for "ordering" expenditures and ensuring their payment will increase. Also, computerisation reduces the need for such a distinction.[13]

The way in which the principle of specificity will apply as from 2006 will completely change. Most State budget titles will be voted by 158 programmes, within the framework of 47 missions (objectives). This replaces the previous 848 chapters for expenditures previously classified by administrative unit and economic type of expenditure. The new performance orientation is accompanied by the newer principles of transparency, accountability and responsibility. Budget transparency (*sincérité)* is a new principle that was introduced into the 2001 LOLF (Art. 32 and 33). The major reasons are that Parliament wished to increase the scope of the universality principle and transparency – a strong desire for clearer information, including on performance, in the draft budget law and accompanying budget documents. Henceforth, budget programme managers will be responsible for preparing *ex ante* and *ex post* performance indicators for their programmes and contributing to annual reports. In this way, the legal basis for the principles of accountability and responsibility of managers of budget programmes for attaining missions has been reinforced.[14]

3. Legal basis for the establishment and the powers of the actors in the budget system

3.1. *The executive and the legislature*

3.1.1. Overview

The 1958 Constitution establishes a two-house Parliament composed of a directly elected National Assembly and an indirectly elected Senate. The functioning of both houses is governed by an organic law. Since a 1962 referendum, the head of State, the President of the Republic, has been elected by universal suffrage. The President nominates the Prime Minister as well as other ministers (on the recommendation of the Prime Minister), chairs meetings of the Council of Ministers, and promulgates laws adopted by Parliament (or asks Parliament to reconsider laws). The government is headed by the Prime Minister, who may delegate certain powers to individual ministers (Constitution, Art. 22) who cannot retain their seats in Parliament if they are elected parliamentarians (Art. 23). The government determines the nation's policies and is collectively responsible before Parliament (Art. 20) – namely the National Assembly (Art. 49 and 50).

France is a unitary State and the central government has traditionally been very strong. Certain central government functions and powers are progressively being transferred to local governments. The top tier of local government – a region – was created by law in 1982. In contrast, departments (*départements)* and municipalities (*communes)* are long-standing forms of local government.

3.1.2. Roles and responsibilities of the Council of Ministers and individual ministers

There are no constitutional constraints on the number of ministers. As a consequence, the number of ministers has varied greatly over the past 50 years. The Prime Minister directs the work programme and action of the government. After consultation with the Council of Ministers, he/she is responsible for defending the government's programme before Parliament.

The Minister of Finance is not mentioned in the Constitution. His/her roles are specified by a presidential decree, signed also by the Prime Minister. In 2004, the Minister headed a "super-ministry" covering economy, public finance and industry.[15] The Minister's attributions include preparing and executing the budget, pensions, public accounting, and tax/customs policies. Several of these responsibilities have been delegated to the Secretary of State for the Budget and Budgetary Reform. Based on Decree No. 2002-952, the Secretary of State for the Budget and Budgetary Reform is specifically charged with implementing the 2001 LOLF.

3.1.3. Establishment of ministries and executive branch agencies

Spending ministries do not need a law for their establishment. Government decisions create, merge, or abolish ministries. The number of ministries has varied enormously, as different Councils of Ministers have attempted to reform government administration via ministerial fragmentation or consolidation.[16] Their internal organisation – particularly the number of internal departments (*directions générales*) – is established by Prime Ministerial decrees, after draft decrees are examined by the Council of State (*Conseil d'État* – see section 3.1.6).

The Constitution specifies that categories of public establishments are to be established by law. However, no overall framework law has been adopted, even though public establishments play a very important role in implementing the annual budget. In broad terms, there are two main categories of public establishment (see Box 2). In 2003, there were about 1000 EPAs (excluding thousands of schools and hospitals) and about 100 EPICs at national level.[17] Within the "administrative" public establishments (EPAs), there are several sub-categories, the most important of which are the social security organisations. Individual public establishments are created either by law or by decree. Apart from the social security public establishments, there is no common framework for essential matters such as governance structures or the preparation and submission of mission statements to supervising ministries. Although regular reporting to Parliament of the activities of public establishments is not required by law (except for the social security EPAs), a dedicated unit in the MINEFI closely monitors State-owned companies and reports to Parliament annually.[18]

Box 2. **France: Characteristics and types of public establishments (*établissements publics*)**

- Public establishments are legal entities, separate from the State, with financial management flexibility of varying degrees.
- Public establishments are distinguished by function – notably those that perform commercial functions (EPICs), administrative functions (EPAs), or scientific, cultural, or educational functions (specialized public establishments). The major social security funds are national EPAs.
- EPICs are public enterprises, usually governed by corporate law; EPAs are governed by public law.[1] Personnel of EPAs are treated as civil servants and all accounting is performed by public accountants under the MINEFI.

1. In the absence of clear distinguishing features of EPICs and EPAs, the distinction between them is being deprived of meaning (Rochet, 2003, p. 152). Some non-commercial EPAs have the status of an EPIC, mainly so that they can escape certain public law requirements.

Source: Rochet, 2002.

Public establishments generally have a management board (*conseil d'administration*). The State generally has a representative from the responsible ministry, as well as a representative of MINEFI, on the management board. In many cases, the board's president is nominated by government decree. For some public establishments, a director, selected by the government, coexists with a board president. Local governments, users, and other interested parties are also represented on the board, depending on the functions of the public establishment. For the social security funds (for which governance structures are clearly laid out in the Social Security Code), employer and employee representatives dominate boards.

3.1.4. Responsibilities of senior civil servants

Under the Constitution, the Council of Ministers appoints senior civil servants – directors of central administrations (Art. 13). In practice, the President of the Republic, the Prime Minister and the minister concerned jointly sign off on high-level appointments. All civil servants' general responsibilities and rights are specified in Law No. 83-634 of 1983 (itself a revision of a law passed in the 1940s). Civil servants' roles are further elaborated in law (*dispositions statutaires*), notably Law No. 84-16 of 1984, or by decree (*dispositions réglementaires*), with advice provided by the Council of State (*Conseil d'État* – see section 3.1.6). These laws concern recruitment, career structure, discipline, etc. However, the laws do not lay out principles for any special relationships between senior civil servants and higher authorities. Implementing decrees accord privileges to particular categories of civil servants. Overall, the legal framework induces rigidity in employment structures, which may inhibit the decentralised management responsibilities required for implementing the LOLF. It is recognised that written performance agreements may be required to clarify the responsibilities of budget programme managers, staff in ministerial private offices (including political appointees), ministry heads and ministers. However, the nature of contractual arrangements has not been made explicit in law (Arthuis, 2003, p. 83).

3.1.5. Establishment and roles of parliamentary committees

The Constitution limits the number of permanent parliamentary committees in each house to six (Art. 43). Special parliamentary committees may be created for examining specific laws. The detailed internal regulations of each house (which have the status of law) fix the composition and appointment methods of each permanent or special committee. The law that governs the functioning of parliamentary assemblies empowers these committees to summon to hearing any person judged necessary (1958 *Ordonnance* No. 58-1100, Art. 5bis). The same *ordonnance* allows the creation of parliamentary temporary commissions of enquiry. Three parliamentary evaluation offices that serve

both houses were created by law.[19] Each house has a permanent budget committee (*Commission des finances*) that scrutinises the annual draft budget law. The LOLF has strengthened the role and powers of these committees, especially their access to documents and powers to request and conduct hearings (Art. 57). The regulations of each house lay out the co-ordination mechanisms between various parliamentary committees, as well as the co-ordination arrangements between the National Assembly and the Senate.

3.1.6. Establishment and roles of other constitutional bodies[20]

The Constitution affirms an independent judiciary and creates a Constitutional Council. Organic laws and parliamentary regulations must be examined by the Constitutional Council before promulgation, to ensure their consistency with the Constitution. Concerning the 2001 LOLF, parts of two articles were declared unconstitutional by the Constitutional Council and, on the basis of Article 62 of the Constitution, were deleted. The Constitutional Council may also ensure that annual budget laws are consistent with the Constitution and the LOLF. For example, the Constitutional Council draws attention to any non-respect of constitutional provisions for the number of days for parliamentary discussion of the annual budget.

The Constitution also refers to a high-level administrative court – the Council of State (*Conseil d'État)* – which plays an important role in the creation of laws and decrees. Under the Constitution (Art. 39), the Council of State is required to comment on all draft laws, including draft budget laws, before they are examined by the Council of Ministers. The Constitution also creates an Economic and Social Council (*Conseil économique et social*, CES), whose functions are governed by Organic Law No. 58-1360. The Council provides opinions on draft laws. However, mainly owing to the exclusion of budget laws from its advisory functions (Article 2 of the 1958 organic law relating to the CES), the CES does not have an influence on annual budgets.

3.2. Role and responsibilities of sub-national governments

Local governments, like the State, are legal entities governed by public law. A detailed legal framework defines and governs all three tiers of local governments which consist of 26 regions, 100 departments[21] and 36 763 municipalities (*communes*). The constitutional provisions for local governments were substantially revised in 2003[22] with extensive elaboration of provisions pertaining to territorial administrations outside metropolitan France. Local governments' councils may pass their own decrees; but only central government can adopt laws. In territorial units of the Republic, a representative of the State ensures that national interests, administrative control, and the rule of law are respected (Constitution, Art. 72).

Unlike federal States such as Germany, for example, the Constitution does not specify revenue and expenditure competencies of local governments. The Constitution nonetheless contains a number of general provisions that point to specific areas to be governed by separate laws. In particular, Article 72-2 of the Constitution provides that:

- Local governments may use revenues within conditions laid down by law. Revenues may come from any tax, whose base and rate are established by law.
- Local governments' self-raised revenues are to provide the major portion of their resources. An organic law is to govern this rule.[23]
- Transfers of expenditure competencies from the State to local governments must be accompanied by a corresponding increase in resources, to be determined by law.[24]
- Equalisation mechanisms that promote regional equality across local governments are to be determined by law.

The Local Government Code (*Code général des collectivités territoriales*), which regroups, under specific themes, the various laws and decrees relating to local governments, is divided into four main parts. The first part (general dispositions) includes the establishment of a high-level committee on local government finances. This committee is composed of representatives from: both houses of Parliament, the central government, regions, departments, municipalities, inter-municipal public entities[25] and mayors. The committee prepares an annual report on local government finances and studies of medium-term developments of local government spending. Parts II to IV of the Code contain provisions relating to municipalities, departments, and regions respectively. For each of these three levels of local government, the Code specifies revenue and expenditure assignments, budgeting and accounting arrangements (see Box 3), and special arrangements for large cities or specific local governments.

4. Legal provisions for each stage of the budget cycle

4.1. Budget preparation and presentation by the executive

4.1.1. Institutional coverage of the budget

The LOLF relates only to annual budget laws covering "the State". It does not define the institutional units covered by the budget. In practice, the State budget covers only a portion of central government institutional units, namely central administrative directorates, administrations under national competence, and local services of central government (*services déconcentrés*) (OECD, 2003, Table 15). Public establishments and local authorities are excluded from the State budget, although transfers to them are included.

Box 3. **France: Key features of the Local Government Code**

- Establishes co-ordination arrangements – a local government finance committee.
- Details revenue assignments and shared revenues.
- Specifies in detail the compulsory expenditure assignments for each level of government (L2321, L3321, and L4321).
- Allows an unallocated reserve of up to 7.5% of total budgeted expenditure that permits local governments to meet unforeseen expenditures.
- Requires regional and departmental budgets to be voted by councils.
- Requires municipal budgets to be voted by 31 March by municipal councils.
- Specifies that separate budgets be prepared for current and capital expenditures. Budget nomenclature is to be established by the Ministers of Local Government and of Finance.
- Establishes a "golden rule": current spending must be fully covered by revenue.
- Specifies that borrowing for investment is not restricted by central government.
- Allows public services at local level to be contracted out.
- Applies for all local governments the principle of the separation of *ordonnateurs* (mayors and presidents of regional councils) and *comptables*.
- Designates that all accountants of local governments are central government employees appointed by the MINEFI. They collect local taxes and make payments.
- Specifies that regional Chambers of Accounts perform external audit functions.

4.1.2. Extrabudgetary funds and earmarking of revenues

The 2001 LOLF retained a number of the articles of the 1959 *Ordonnance* devoted to the earmarking of revenues, budget annexes and special accounts. However, compared with the 1959 law, expenditures from the cost-sharing contributions (*fonds de concours*) are to be appropriated by Parliament and included in total expenditure aggregates (Art. 17) rather than escaping parliamentary control. Moreover, missions and programmes have to be developed (a framework was established for them in 2004) for the budget annexes and the special accounts. The LOLF allows the executive to spend excess revenues in earmarked accounts (*comptes d'affectation spéciale*) – those higher than foreseen in budgetary projections – subject to informing Parliament (Art. 21).

The health and social security funds are not governed by the LOLF and are not part of the State budget. The Organic Law No. 96-646 of July 1996 relating to the Financing of Social Security (LOLFSS) provides a framework for parliamentary approval of the expected revenues (mostly payroll taxes[26]), the objectives for spending, and the financing of the social security funds. Discussion in Parliament of the annual law for financing social security must take place in conjunction with the discussion of the annual budget law (*loi de finances*) of the State. The LOLFSS does, however, define the compulsory schemes and associated organisations. Binding expenditure limits are not established for each sector and Parliament votes on only seven categories of social security revenues. This inhibits, for example, establishing health spending priorities. In 2001, to address some of the shortcomings of the 1996 LOLFSS, the Senate presented a revised organic law (*www.senat.fr/leg/pp100-268.html*). However, it was not adopted.

4.1.3. Definition of budget aggregates

The 2001 LOLF and the 1996 LOLFSS do not begin with a comprehensive list of definitions, although some terms are defined in individual articles of the text. For example, the LOLF specifies that total inflows (*ressources*) include budget revenues and financing inflows, and total outflows (*charges*) include budget expenditures and financing outflows (Art. 2-6). The LOLF also defines the financial inflows and outflows (Art. 25) and requires the financing of the budget balance to be shown in a table of the annual budget (Art. 34.I.8).

The Constitution requires the financial balances of the social security funds to be shown in the annual law for financing social security. The concept of financial balance is not clearly defined in the LOLFSS. More importantly, the overall balance of general government is not defined by law, even though fiscal policies and the budgetary strategy are formulated on the basis of this balance.

4.1.4. Fiscal rules

Under a constitutional amendment (Art. 88-2), France consents to transfer competencies necessary for the establishment of the European Economic and Monetary Union. However, domestic laws were not changed to include quantitative fiscal rules proposed by the European Union. Nonetheless, the LOLF (Art. 50) requires that budgetary projections are to be drawn up “taking into consideration its European obligations” – an indirect reference to EU directives such as the Maastricht criteria on deficits and debt and the Stability and Growth Pact’s obligation for “at least a balanced budget over the cycle”. A “golden rule” is not established for the State budget. However, the Local Government Code imposes such a rule on local governments’ budgets.[27]

4.1.5. *The timetable for budget preparation and presentation to Parliament*

The LOLF establishes the first Tuesday of October as the latest day that the draft annual State budget is to be submitted to Parliament (Art. 39). The fiscal year begins on 1st January (LOLF, Art. 1). To meet the October deadline, the budget preparation process begins in the previous December, with an update of the multi-year medium-term budget framework. There are internal non-legally-binding deadlines for the key steps in budget preparation (OECD, 2003, Table 16).

4.1.6. *Approval process within the executive*

The Constitution states that the Prime Minister is responsible before Parliament for the government's programme (Art. 39). The LOLF (Art. 38) specifies that the Minister of Finance prepares the draft budget law, under the authority of the Prime Minister. The timing and most procedures for preparing and approving the draft budget law within the executive are determined internally. The President of the Republic can also play a role in shaping the draft annual budget law. In particular, the LOLF states that the draft budget law is discussed in the Council of Ministers, which is headed by the President (Constitution, Art. 9). In practice, the roles of the President, the Prime Minister and the Minister of Finance are dependent on the political situation. In normal times, the President of the Republic makes final decisions when budget clashes occur in the Council of Ministers (which happens rarely). In contrast, in times of cohabitation – when the President of the Republic and the Prime Minister are from different political groupings – final budget decisions are taken by the Prime Minister in meetings with Council ministers not attended by the President of the Republic.

4.1.7. *Documents to accompany the budget law*

Medium-term macroeconomic framework and fiscal strategy. In submitting the draft annual budget law to the two houses of Parliament, the LOLF (Art. 48 and 50) requires the government to present a report on the national economic situation, including:

- Macroeconomic projections, based on national accounts. These are to include the hypotheses on which they are based and projection methods.
- Medium-term developments, covering at least four years following the year in which the draft budget is submitted – of consolidated revenues, expenditures and balance for general government, with disaggregation by sub-sectors. Medium-term projections of revenues (*ressources*) and expenditures (*charges*) of the State budget, with the latter disaggregated by main functions,

are required by the LOLF. The LOLFSS also requires medium-term projections of revenues and expenditures.

- The main orientations of economic and budgetary policies, considering France's European commitments.

New measures *versus* existing expenditure policies. The 1959 *Ordonnance* on annual budget laws distinguished expenditures based on existing policies and those based on new policies. The budget was adopted on this basis – with a single vote on existing expenditures. This distinction was abolished by the 2001 LOLF: new measures are henceforth to be introduced in the context of specific programmes, which will be re-examined each year in the context of justifying every euro. For enhancements in general measures regarding civil servants, a provision is foreseen; only the global amount is proposed in the budget. Once Parliament adopts the budget, the executive allocates the salary increases by programme.

Performance-related information. The fiscal strategy report annexed to the draft budget must contain a list of missions and programmes, as well as programme performance indicators relating to the next year's budget (Art. 48). Draft performance plans for each programme are to be annexed to the budget, including objectives, costs, and past and expected results as measured by performance indicators (Art. 51).

Tax expenditures, contingent liabilities and fiscal risks. An explanatory annex on projected tax expenditures is required to be presented with the budget (Art. 51). The LOLF requires parliamentary approval of new debt guarantees as well as the take-over by the State of debts issued by public or private bodies (Art. 34). All existing government guarantees are required to be established by law by end-2004; the budget execution report for 2004 is to contain an annex with all guarantees granted by the government but unknown by Parliament (Art. 61). The LOLF does not require that any other explicit, and any implicit, contingent liabilities be annexed to the draft annual budget. Nor is there a legal obligation to provide a statement of fiscal risks.

Other information required by law. The LOLF (Art. 51) details other information to be annexed to the draft annual budget. This includes the earmarking of taxes benefiting public entities outside "the State", an analysis of the impact of changes in budget presentation, and the schedule of expected annual payments associated with multi-year authorisations for expenditure commitments. Details of projected State employment, by category or by type of contract, inclusive of justifications for variations, must also be annexed.

4.1.8. Budgets of Parliament and other constitutional bodies

Each house of Parliament is financially independent (see *Ordonnance* of November 1958 relating to the functioning of the two houses, Art. 7). The same law specifies that the budget of each house is prepared by a joint commission presided by a chair of a chamber of the Court of Accounts.

The LOLF does not address explicitly the budget procedures for non-executive State entities. However, a specific mission is envisaged for the "public powers" (Art. 7), each of which may receive one or more allocations (*dotations*). *Dotations* may allow single-line budget appropriations for the National Assembly, the Senate, the Court of Justice and the Presidency, without the need for them to present mission statements and performance indicators. The Court of Accounts is not shown separately – its budget will not be a separate mission, unlike the Economic and Social Council (also a constitutional body). The latter will have a single-programme mission under the new budget nomenclature, *i.e.* the objectives of the Economic and Social Council are among the 48 missions of the State, whereas the arguably more important body, the Court of Accounts, does not have its own mission.

4.2. Budget process in Parliament

Parliament has progressively been receiving more information on the draft budget from the government. In particular, before the draft budget law is submitted to Parliament, the National Assembly and the Senate have a chance to debate a pre-budget report provided by the government. The LOLF formalised this procedure, known as the *débat d'orientation budgétaire*.

4.2.1. The timetable for budget adoption and constraints on the budget debate in Parliament

The draft budget law must be submitted to in Parliament by the first Tuesday of October (LOLF, Art. 39). Annual budget laws – for the State and for social security financing – must be initiated by the government, not Parliament (Gicquel, 1998). The Constitution (Art. 39) specifies that the annual draft budget laws must first be debated in the National Assembly, *i.e.* the government may not first submit the draft budget law to the Senate. This article shows symbolically the political pre-eminence of the National Assembly.

The Constitution specifies strict time limits for debate in the two houses on the annual budget. The aim of these provisions is to accelerate parliamentary debate and to adopt the budget law and the law for financing social security before 1st January. Following the reception of the draft budget law in early October, the number of days allowed for completing the first readings are specified by law: the National Assembly has 40 days (Constitution, Art. 47) and the Senate 20 days (LOLF, Art. 40). A 70-day limit from the reception of the draft

in early October is imposed on Parliament to make a final decision on the budget. This limit is inclusive of committee examinations in the two houses. In the case of disagreement of the committees of the two houses, the Prime Minister may establish a joint committee to resolve the impasse (Constitution, Art. 45).[28] If the 70-day limit is not respected, the government adopts the budget by special *ordonnance*.[29] Similarly, a 50-day limit for parliamentary decision on the draft law for financing social security is included in Article 47-1 of the Constitution.

4.2.2. Provisional budgets

Should the budgets not be adopted by 31st December, the executive is authorised by the Constitution (Art. 47 and 47-1) to adopt a provisional State budget and a provisional law for financing social security. For the State budget, expenditures ("*services votés*") are based on policies of the previous year (LOLF, Art. 45); this is the only reason why the concept of *services votés* has been retained.

4.2.3. Powers of amendment

The Constitution does not allow Parliament to propose any amendments (to any law) that would create new expenditures, raise total State expenditure (*charges*) or lower revenues (*ressources*) (Art. 40). Parliament may only alter the composition of proposed State budget spending, by changing the amount allocated to programmes within missions (LOLF, Art. 47).

Even if Parliament proposes amendments, another constitutional provision allows the government to force through its own version of the budget. Article 49 authorises the Prime Minister, after agreement within the Council of Ministers, to commit the responsibility of the government on a draft law. If he/she does so, the text is considered to be passed into law unless the National Assembly proposes a motion of censure (which would result in the fall of the government) within 24 hours. This provision was used by a minority government in the early 1990s to adopt the annual budget (Hubert, 1996). Use of this provision was made possible by prior understandings with political parties supportive of the government's budgetary policies.

4.2.4. Approval of resources

The authority for the government to collect taxes and other revenues is re-issued for a 12-month period in each budget, by a single vote of Parliament on the first part of the State budget (LOLF, Art. 34). Revenues are projected on a gross basis, although in execution, withholding of revenues destined to local governments and the EU is allowed (Art. 6). The draft budget law is voted in two parts, with Parliament first approving revenues, total expenditure ceilings

(for the general budget, budget annexes and special accounts) and balance, before beginning a discussion on the second part of the budget law (Art. 42), namely detailed appropriations – a vote for each mission (Art. 43). If this procedure is not followed, the Constitutional Council may annul the entire budget law by declaring it to be unconstitutional (this happened in 1979[30]). In order to renew the annual authority to collect taxes as from 1st January, the Constitution (Art. 47) includes an emergency procedure on which the LOLF (Art. 45) elaborates: a special temporary law to authorise tax collection must be passed prior to the adoption of the annual budget law.

4.2.5. The nature, structure and duration of appropriations

Prior to 2006, budget appropriations are by ministry and by economic type of expenditure (salaries, other current expenditures, investment, etc.), with the latter broken down between existing and new policies. The 2001 LOLF replaced this appropriation structure by one based on missions and programmes. Parliament particularly wished to see results from government programmes and an avoidance of overlap in government functions that had been perpetuated by a budget adopted on the basis of administrative units (see Arthuis, 2003).

Although the annual budget, as from 2006, is to be voted by mission and by programme, the programmes are to be broken down by seven different types of expenditures (salaries, running expenses, investment, etc.) (LOLF, Art. 5). With one exception, these are purely indicative; budget programme managers may reallocate between them. For example, investment and running expenses for a programme may be swapped by the budget manager without the authority of Parliament (not the case under the 1959 *Ordonnance*). The exception is for personnel expenditure: the upper limit for each programme is binding (LOLF, Art. 7). Moreover, the budget law must contain, for each ministry, binding ceilings for the number of personnel (Art. 7-III).

Under the LOLF, Parliament authorises a maximum amount for expenditure for each programme of the general State budget, each budget annex and each special account. Authority to spend is provided for both commitments and cash payments (LOLF, Art. 34). For commitments, Parliament grants authority and approves an upper limit for the State to enter into contractual arrangements that involve future payment. There is no time limit on commitment budget authority (LOLF, Art. 8). In contrast, the authorisations of cash payment are the upper limits for payment order issuance or actual payment within a 12-month period (LOLF, Art. 8). For personnel spending, the law states that commitments and payments are equal.

For most expenditures, budgeted amounts are binding maximum limits (*crédits limitatifs*). For certain expenditures (debt servicing, call-up of government guarantees, and others enumerated in Art. 10 of the LOLF), the limits

are non-binding (*crédits évaluatifs*). These are items that must be paid irrespective of possible projection errors. If any excess spending relative to approved budgetary projections occurs on these items, the Minister of Finance must inform the parliamentary budget committee of each house of the reasons why overspending occurred. The Minister must also propose rectification in a supplementary budget before the end of the fiscal year (LOLF, Art. 10).

4.2.6. Carryover of appropriations and borrowing of future appropriations

Carryover of previous-year commitment authorisations must be stated in a government order (LOLF, Art. 15). For cash spending authorisations, carryover of expenditures within a given programme is allowed up to 3%. For non-personnel expenditures beyond this limit, any carryover has to be re-appropriated in a new budget law (Art. 15). Borrowing from next year's appropriations is permitted for expenditure commitments, under conditions established in budget laws (Art. 9).

4.2.7. Public debt approval

Net increases in negotiable State debt are approved annually in the context of approval of the total resources – the first part of the budget (Art. 34-9). Lending by the State is subject to binding limits (except for foreign currency lending to countries where France has a monetary union). The LOLF also establishes mechanisms for following up on loan defaults by beneficiaries (Art. 24).

The law does not fix quantitative limits on the projected stock of public sector debt, nor does the LOLF refer to the need to establish prudent debt levels. This is in line with the constitutional limitation that the LOLF only deals with revenues and expenditures (Art. 34), not debt, other liabilities or assets. France, like other EU member countries, reports general government debt levels to the EU at least once a year. The MINEFI updates France's three-year Stability Programme, which is approved by the Council of Ministers (but not Parliament). After assessment by the EU Commission, the EU Council adopts a formal opinion of the programme, in particular in relation to the Maastricht criteria.

4.2.8. Promulgation, veto and publication of the adopted budget

All laws, including annual budget laws, must be promulgated by the President of the Republic within 15 days of their adoption (Constitution, Art. 10). The President may, within the 15-day limit, require Parliament to reconsider the budget. Promulgated laws are published in the Official Gazette.

4.2.9. Supplementary budgets (rectifying laws)

A supplementary budget has the force of law – a "rectifying" law (LOLF, Art. 1). Rectifying laws are the only way in which budget revenue estimates, spending appropriations and fiscal balance of the initial budget can be changed in a major way. They must show how the budget balance is being modified; the rectifying law authorises supplementary net borrowing by loans or other treasury operations. Rectifying laws are also prepared to ratify major modifications introduced by the executive using the advance appropriation (*décret d'avance*) instrument (LOLF, Art. 13 and 35). The LOLF does not limit the number of annual rectifying laws. Normally, at least one rectifying law is adopted each year and at times several more are enacted, especially when there is a change in the governing majority.[31]

4.2.10. Budgetary implications of other bills

When new laws or regulations are susceptible to alter revenues or expenditures, the consequences on the fiscal balance must be evaluated, with the changes authorised by Parliament in the next supplementary budget (LOLF, Art. 33).

4.3. Budget execution

4.3.1. Apportionment of expenditure authority

Appropriations are to be made available to ministries (LOLF, Art. 7-IV). The LOLF does not contain explicit clauses relating to how this budget authority will be apportioned during the course of the year. This is done by decree.

4.3.2. Cancellation of budget authority and other in-year expenditure controls

To prevent deterioration in the budget balance, especially if revenue shortfalls occur, the executive is authorised to cancel budget appropriations by decree, following a report by the Minister of Finance, up to a limit of 1.5% (LOLF, Art. 14). However, before the decree is published, relevant parliamentary committees must be informed. The law is unclear whether the 1.5% applies to total appropriations inclusive of those in budget annexes and special funds, or whether it applies only to the general budget (for discussion, see Arthuis, 2003, pp. 38-40).

In the LOLF, three stages of expenditure are distinguished: commitment (*engagement*), payment order issuance (*ordonnancement*) and payment (*paiement*). A law establishing centralised control of expenditure commitments was adopted in 1922.[32] This 1922 law created a body of financial controllers under the exclusive authority of the Minister of Finance (Art. 2 of the 1922 law). A major task of financial controllers, who are placed in each spending ministry, is to

exercise a priori control on most non-personnel expenditure commitments and *ordonnancements,* and on every appropriation that is delegated to non-central budget managers.[33] Financial controllers are required to prepare an annual report on expenditure and revenue operations verified by them (Art. 7 of the 1922 law). This text is being modified, to refocus financial control on the control of budget execution and to limit a priori control to particular cases.

Most State expenditure programmes are legally-binding maximum amounts authorised for spending. In contrast, for social security spending, the LOLFSS does not establish binding limits or require rectifying social security financing laws to change policies to prevent overspending. Only indicative limits on spending of the social security organisations are required in annual laws for financing social security. For health spending under ONDAM (*Objectif national des dépenses d'assurance maladie*) a global amount is established. However, the government is not required by law to prepare a detailed report outlining choices and priorities to ensure that this objective is met. The Senate proposed amendments to the LOLFSS in 2001 to address some of the expenditure control weaknesses of the 1996 LOLFSS, but there was not enough political support to adopt into law the recommended changes (see *www.senat.fr/leg/pp100-268.html*).

4.3.3. Emergency spending, excess spending and contingency funds

For "ordinary" emergencies, the executive may increase certain budget appropriations by decree (*décret d'avance*), provided the budget balance is unaffected and after notifying the two parliamentary budget committees (who can object within a seven-day limit) (Art. 13). In such situations, excess tax revenues may be used or other budget appropriations are cancelled. The cumulative amount of new appropriations is limited to 1% of total appropriations approved in the annual budget. Prior to the issuance of any such decree, the Council of Ministers must first receive the opinion of the Council of State and must be ratified by Parliament in the next rectifying budget law.

In particularly urgent situations and where the national interest is at stake, the executive may increase Parliament's appropriations by decree (*décret d'avance*) even if it means that the budget deficit target will deteriorate (Art. 13). In such situations, the government decree is issued after the receiving the opinion of the Council of State; parliamentary ratification must be asked for immediately.

Annual budget laws contain an unallocated amount for natural disasters or other unforeseeable expenditures, including for salary-related measures whose details are not known when the budget is adopted (LOLF, Art. 7). These authorisations are later implemented by decree, following a report by the Minister of Finance and allocation by programme (Art. 11).

4.3.4. Transfer and virement of appropriations within the year

The LOLF (Art. 12) distinguishes virement (swapping of budget authority for programmes within a ministry) from transfers (swapping of budget authority for programmes between ministries). Virement within a ministry is allowed, up to a limit of 2% of the amount authorised for a programme. Transfers of programmes serving the same purpose are allowed. Virement and transfers are authorised by decree, but only after the report of the Minister of Finance has been viewed by parliamentary committees.

4.3.5. Cash planning and management of government assets and debt

The LOLF does not specify principles or procedures for in-year management of government assets and liabilities. The focus in the law is on the resources available to the Treasury (a department of MINEFI) for cash management (Art. 25). These resources include the compulsory deposits of funds raised by local governments, various public establishments, and certain funds of government-owned financial institutions (including the *Caisse des dépôts et consignations*, which manages a huge portfolio of public assets). These provisions reflect the centralised cash management of State funds.

4.3.6. Internal audit

The LOLF does not mention internal audit or internal control. For expenditure control, the MINEFI – through a body of financial controllers – exercises a priori control on expenditure commitments. An internal audit unit also exists in the Public Accounting Directorate of the MINEFI. In spending ministries, internal inspection units do not carry out all the functions of an internal audit body. Several audit activities are carried out by the Inspectorate of Finances (*Inspection générale des finances,* IGF), a specialised body within the MINEFI, which is attached to the minister. The IGF fulfils an internal audit role within the executive branch as a whole. Decrees, not a law, specify: the IGF's inspection powers with respect to public accountants and authorising officers (*ordonnateurs*); and the special rules for inspectors. IGF reports are sometimes released to the public, following ministerial decision.

4.4. Government accounting and fiscal reporting

4.4.1. The accounting framework

A distinction is made between budget accounting (for revenues and expenditures) and general accounting for all financial transactions (LOLF, Art. 27). All accounts must be "regular and accurate, giving a faithful account of the State's balances and financial situation". Budget accounting includes a complementary period of 20 days for receiving revenues or making payment after the end of the year (Art. 28). One new feature of the LOLF is that an

accrual basis of accounting of the State's transactions is introduced (Art. 30). Accrual accounting is not required to be introduced for activities governed by the LOLFSS. In particular, there is no legal obligation to record future liabilities of the public pension schemes.

The new accounting basis is to be indistinguishable from private sector accounting except for specificities of the State. Accounting norms are required to be formulated by a committee composed of both public and private sector accounting experts, and after review by parliamentary committees (Art. 30). This requirement was fulfilled in 2004 with the issuance of new accounting standards based on 13 principles used in the private sector (MINEFI, 2004c). Although the Court of Accounts is not required by the LOLF to play a role in developing new accounting norms, in practice it participates in working groups set up for this purpose. Also, since any changes in accounting conventions must be annexed to the annual Budget Execution Law (see section 4.4.4) (Art. 54-7), the Court of Accounts can comment on any changes made to the accounting system.

The 1962 Public Accounting Decree is considered to be a fundamental legal document.[34] The decree specifies that ministers are the principal authorising officers (*ordonnateurs*) responsible for executing revenues and expenditures (in pre-payment stages). The decree establishes general principles for public accounting, both for the State and for national public establishments. The principle of the incompatibility of the functions of *ordonnateurs* and *comptables* is specified. Public accountants must use double-entry accounting, based on a chart of accounts elaborated by the MINEFI. This decree does not (yet) refer to accrual accounting, nor to the alignment, to the fullest extent possible, of public sector accounting principles with those used by the private sector. The LOLF states that arrangements for government accounting and the personal responsibility of public accountants may be included in annual budget laws (Art. 34-II.7f).

4.4.2. Government banking arrangements

The Bank of France (the central bank) is required by the Monetary and Financial Code to provide banking or other services that the State may ask of it, provided these are specified in protocols and that services are remunerated to cover costs. The Treasury department of the MINEFI is specifically mentioned as being able to hold bank accounts at the Bank of France (Monetary and Financial Code, Art. L 141-8). The LOLF does not specify explicitly that a single treasury account is established at the central bank. However, since 1857, a single treasury bank account has been established at the Bank of France. All government transactions pass through this account, including those relating to budget annexes, special treasury accounts, and transactions with public entities obliged to deposit funds at the Treasury. The LOLF is also silent on whether

spending ministries can open bank accounts. In practice, banking and accounting services for spending ministries are provided exclusively by the Treasury: it would be inconceivable for ministries to retain funds in their own accounts.

4.4.3. In-year reporting to Parliament

The LOLF and the LOLFSS are devoted to the financial and non-financial reporting obligations that are used for the parliamentary debates on, the State budget and the social security financing law respectively. Extensive and comprehensive reporting is required (this is one of the innovations of the LOLF relative to the 1959 *Ordonnance*).

Second quarter[35] – reports for the pre-budget debate. The government presents a report on the evolution of the national economy and on the outlook for public finances, including the major orientations of its economic and budgetary policy, taking into account France's European commitments (LOLF, Art. 48). This report can lead to a debate in the National Assembly and the Senate. The government must also present annual performance reports (see next section) before 1st June (LOLF, Art. 46). The Court of Accounts is also required to present a preliminary report on budget execution.

October – submission of the budget to Parliament. The draft budget law for the following year, accompanied by several documents that are required by Articles 50-51 of the LOLF – such as the report on the economic, social and budgetary situation and forecasts (for at least the next four years) – are submitted at the latest by the first Tuesday of October (Art. 39). Some annexes can be presented after this deadline, but must be distributed at least five days before the examination by the National Assembly of the revenues or the authorisations.

Other months. The LOLF does not require regular (*e.g.* monthly) in-year budget execution reports and/or financial accounts to be transmitted to Parliament and the public. Nonetheless, the MINEFI issues monthly – both in the *Journal Officiel* and on its Internet site – a detailed summary of budget execution and of treasury and debt operations.

The LOLF specifies that an economic and budget report is needed to accompany every supplementary budget law proposal (Art. 53). Budget execution information is required by the 1922 Law on Controlling Expenditure Commitments, as modified in 2002, but this is confined to monthly reports on expenditure commitments (not cash spending). These reports are submitted to the two houses of Parliament. The same law requires expenditure commitments of the previous year to be provided to Parliament by 30 April.

4.4.4. *Annual accounts and reports*

The Budget Execution Law (*Loi de Règlement*). The annual report on budget execution – for revenues and expenditures – is adopted as a law (LOLF, Art. 37). Traditionally, the draft Budget Execution Law was accompanied by the Court of Account's "declaration of conformity" (see below). As a legal document, the Budget Execution Law:

- ratifies in-year modifications to appropriations made by the government within its legal powers, notably those of advance appropriation (Art. 13);
- increases budget appropriations that were overspent for justifiable reasons beyond the control of government; and
- cancels unspent budget appropriations that are not being carried over.

An annex must specify, for each programme, the reasons for divergences between budget allocations and final outcomes (Art. 54). This includes the special funds, which had previously been a source of abuse (see footnote 8). The Budget Execution Law also formally acknowledges the final outcomes for revenues, expenditures, and financing transactions.

Annual performance reports. The requirement for the government to prepare a set of performance reports is a major innovation of the LOLF. The draft annual budget law must be accompanied by the projected annual performance of each programme (Art. 51). After 12 months, actual budget expenditure outcomes for each programme need to be explained in terms of actual performance, based on reports of *ex ante* and *ex post* performance indicators for each programme. Also, since salaries and employment are still centrally controlled, an explanation of why authorised employment levels and costs may be different from those planned is obligatory (Art. 54). Guidelines on performance strategy, objectives and indicators have been issued (MINEFI, 2004b).

4.5. *External audit*

The external audit body is the Court of Accounts (*Cour des comptes*), established by law since 1807 and enshrined in the 1958 Constitution. In addition, a Court of Budgetary and Financial Discipline was created by law in 1948, with competencies in areas not covered by the Court of Accounts. In France and some other continental countries, such courts are considered part of a three-part overall control system: administrative controls (those exercised by bodies internal to the executive); political or parliamentary control (exercised by the legislature); and jurisdictional control (those exercised by a judicial body). The laws specifying the competencies of the Court of Accounts, its regional chambers, and the Court of Budgetary and Financial Discipline have been codified in the Financial Jurisdictions Code.

4.5.1. Managerial, financial and operational independence

The Court of Accounts is a public authority whose existence pre-dates Parliament.[36] The Constitution only refers to the Court assisting both branches of government in their control of the execution of State budget laws and the implementation of social security financing laws (the latter role not being specified until the 1996 constitutional amendment) (Art. 47 and 47-1). Neither the Constitution nor the laws pertaining to the Court of Accounts refer explicitly to its independence. Nonetheless, the independence of the Court is asserted by the fact that its members have a legal position of magistrates and as such are fully independent from both the executive and legislative branches. This position has been upheld by the Constitutional Council on various occasions.

For day-to-day operations, including the extent of delegation of work to the 22 regional audit chambers,[37] the Court of Accounts is independent. The law establishes that the Court has full rights to fulfil its duties (Financial Jurisdictions Code, L111-9). Consequently, the Court of Accounts approves its rolling three-year work plan on the basis of propositions from its seven chambers.[38] In view of its independence as a judicial body, the Constitutional Council declared as unconstitutional the proposed obligation that the Court of Accounts present its draft annual work programme to Parliament.[39] In the absence of formal processes for co-ordinating its work programme with Parliament, difficulties in incorporating investigations requested by parliamentary committees have been experienced (Poncelet, 1997, p. 128). However, the LOLF (Art. 58) obliges the Court of Accounts to respond to requests for assistance coming from parliamentary budget committees.

The Court of Accounts is not independent of the executive for personnel appointments and promotions. First, the president and the chairs of the seven chambers of the Court are appointed for life by decree of the Council of Ministers. Parliament does not participate in such decisions. This is in sharp contrast to all other European Courts of Accounts (including those of Austria, Belgium, Germany, Italy, Netherlands, Portugal, and Spain). Also, the law does not contain any provisions for the removal of presidents or chairs of the Court of Accounts (*e.g.* for gross negligence). Second, the legal frame workplaces strict limitations on the ability of the president of the Court to recruit and promote staff. In particular, there are rigid quotas that require that most staff be recruited from the National School of Public Administration. Promotions must be based largely on seniority and age (Financial Jurisdictions Code, L121-122 and R121). With these restrictions, it would be difficult to recruit, for example, auditors with private sector audit experience for mid-career positions. But such new entrants may be needed for implementing the new certification requirements contained in the LOLF.

Financial independence is not explicitly assured by law. The annual budget of the Court of Accounts has never been a separate budgetary title. Traditionally, it has been obscured within the annual budget of the MINEFI. The Court's negotiations with the MINEFI on the "appropriate" level of financing for its own annual budget are not made public. A logical consequence of the 2001 LOLF is the separation of the mission and programmes of the Court of Accounts from those of the MINEFI. However, in implementing the LOLF, it is planned to place the Court under the mission "Management and Control of Public Finances". The programme manager of "Financial Jurisdictions" will be the president of the Court of Accounts, who will be only one voice in determining the overall mission of managing and controlling public finances.

4.5.2. Institutional coverage of audits

The Court of Accounts has very broad audit responsibilities, covering not just the State but the entire public sector. Audit coverage is obligatory for the State budget, national public establishments, public enterprises (since 1976) and social security organisations (since 1950) (Financial Jurisdictions Code, L111-1 to 6). In addition, it may audit some entities established under private law, notably those that receive financial assistance from the State or from the European Union (L111-7). Some of these entities are named specifically in law (L111-8). The Court of Accounts only has jurisdiction over public accountants. Ever since the 1807 Law was adopted, the Court does not have jurisdiction over government ministers as *ordonnateurs* (L131-2) – they escape control of any court (they are exempt from the jurisdiction of the Court of Budgetary and Financial Discipline). In contrast, activities of senior civil servants that lead to gross mismanagement or acts of financial malfeasance come under the jurisdiction of the latter Court (L321-1, 2) in cases not protected by an order from a minister.

4.5.3. Types of audit

The law emphasises traditional financial compliance audits. As a judicial body, the Court of Accounts judges the accounts of public accountants (L111-1), whose submission delays are established by decree (L131-1). The Court is obliged to verify, on the basis of documents and field visits, the regularity of accounts of revenues and expenditures and the good use of public funds (L111-3). Since each principal public accountant's accounts must be aggregated, the Court also audits the general accounts of the State and issues a "declaration of conformity", which is annexed to the draft Budget Execution Law (LO132-1). This declaration signifies that the financial accounts are internally consistent.

The 2001 LOLF, which requires the Court of Accounts to certify accrual-based accounts, will induce major changes in the Court's methods (Joxe, 2001; Cieutat, 2001). To date, the Financial Jurisdictions Code has not been changed

to reflect the new performance orientation of budgeting, accounting, and auditing. This may not even be necessary as, in practice, considerable portions of the audit activity of the Court and of its regional chambers are directed towards performance audit. This is one important component of the legal requirement for "good use of public funds" (which is made even more explicit in some other OECD countries, by specifying the three Es – economy, efficiency, and effectiveness).

For public enterprises, the Court of Accounts is required to conduct financial and management audits (L111-4). For the social security organisations, annual verifications are required (L111-5). The Law does not explicitly require a performance audit, such as whether the social security organisations achieved their stated objectives for the year under examination. However, in practice, such audits are completed.

4.5.4. Powers of investigation

The Court of Accounts is authorised to procure all necessary information for its enquiries (L140-1). Professional secrecy cannot be used by audited bodies as a reason for not providing information (L140-4). Failure to provide information is subject to fines, established in nominal currency terms in law (L140-1). For technical investigations, the Court may use outside experts (L140-3), although in practice this does not happen often.

4.5.5. Reporting obligations and publication

The Financial Jurisdictions Code requires three important annual reports. First, the annual report on the activities of the Court of Accounts is addressed to the President of the Republic and submitted to Parliament (L136-1). This report, which contains the responses of ministers and other State agents to the Court's recommendations made in unpublished detailed reports, is required by law to be published (L136-5). Second, an annual report on the draft Budget Execution Law is submitted to Parliament as soon as it is finalised by the Court of Accounts (LO132-1). The LOLF (Art. 58) requires this report to accompany the pre-budget debate (*débat d'orientation budgétaire*). Third, an annual report on the execution of the social security financing laws, together with an analysis of the accounts of the social security organisations and responses to the Court's observations, is also submitted to Parliament as soon as it is prepared (LO132-3).

These public reports represent the "cream" of the Court's reports. Over one thousand communications are prepared annually (Magnet, 1997), mainly directed at specific financial management activities of ministries, local governments, and other government bodies. The law does not require publication of these reports, although in recent years, some major reports have been

published, largely at the discretion of the Court of Accounts. Reports of the regional Chambers of Accounts concerning the statutory audit of local authorities are accessible, upon request, to citizens.

4.5.6. Enforcement of findings

The preparation and publication of the responses of ministers and other senior managers to the observations of the Court of Accounts establishes the intentions of audited bodies to follow up. Since 1996, other communications of the Court to ministers have to be submitted to parliamentary committees or commissions of enquiry after a delay for response of three months (Financial Jurisdictions Code, L135-5). In recent years, Parliament has been expressing greater interest in Court-related issues and has been receiving more information than in the past. Finally, although the Court of Accounts is a judicial body, this aspect of its work does not have a major impact on follow-up to its audit recommendations which are normally contained in its reports (as with non-judicial external audit offices), not in its rulings.

Notes

1. Codification allows new laws, or amendments of existing laws, to be incorporated in a logical and clear legal framework for a specific subject matter. Nearly 60 different codes have been adopted in France.
2. See Bouvier and Montagnier, 2001, p. 49.
3. The hierarchy is as follows: the Constitution, organic laws, ordinary laws (separately or grouped in codes), ordinances (*ordonnances*), and then presidential, prime ministerial, and ministerial decrees.
4. The legal provisions of the European Union refer to an excessive deficit procedure. However, the reference values of 3% for the deficit and 60% for debt are contained in a protocol which is not legally binding on member countries, who "shall ensure that national procedures in the budgetary area enable them to meet their obligation" (European Union, 1992).
5. Prior to 1946, parliamentarians could introduce new spending without limits (Bigaut, 1995, p. 82). Both the 1946 and 1958 Constitutions prevented Parliament from raising total expenditure. The 1958 Constitution removed Parliament's power to lower total revenues.
6. During the 1980s and 1990s, the MINEFI used a number of techniques to change budget appropriations without parliamentary authority. These included: introducing by decree "urgent" spending that could easily have been foreseen in advance; carrying over large amounts of budget authority and spending them the next year; and cancelling certain appropriations with little justification. There were also off-budget activities, financed by parafiscal taxes, which were not subject to the same accounting and reporting requirements as the State budget. Such non-transparencies helped trigger the reform of the budget process in the late 1990s (for discussion, see National Assembly, 1999, Part II).

7. The Senate already approved changes in the 1959 *Ordonnance* in 1960. However, these were not carried into law. During 1960-2000, the 1959 *Ordonnance* was modified in only minor ways (notably in 1971 and 1995).
8. In the LOLF, special funds have been maintained as separate “programmes”. A distinction is made between the 132 programmes of the general budget and the 26 additional programmes covering earmarked funds (10), budget annexes (7) and special treasury accounts (9).
9. Even prior to adoption of the LOLF in 2001, several commentators noted the need for a more global approach. See, for example, Auberger, 2001; Bouvier and Montagnier, 2001; and Philip, 2001.
10. Caudal (2004) traces the history of how budget principles became embodied in all constitutions since 1789.
11. Exceptions include: paying appropriations for year n in year n + 1; carrying over appropriations at end-year; and committing certain expenditures in year n – 1, before Parliament approves the budget for year n. In view of these exceptions, the principle applies more to annual reporting than to annual appropriations.
12. Programme managers are listed. See *www.lolf.minefi.gouv.fr/architecture/index_responsables.html*.
13. New software to assist *ordonnateurs,* programme managers, financial controllers, and public accountants in recording and controlling expenditures was expected to be operational by end 2004 (see *www.lolf.minefi.gouv.fr/essentiel/index_chan.html*). However, due to various difficulties, the ACCORD 2 project was cancelled in May 2004, and the date of 2006 was set for the modification of existing tools.
14. The accountability of *ordonnateurs* was already specified in the 1948 Law creating the Court of Budgetary and Financial Discipline. The responsibilities of public accountants were specified in the 1963 annual budget law (*Loi de finances)* (Art. 60).
15. The Minister’s responsibilities have traditionally been wide-ranging. However, there have been times when responsibilities have been narrow. For example, during 1993-95 there was a Minister/Ministry of Economy and a Minister/Ministry of the Budget, as well as a separate minister responsible for industry. See *www.finances.gouv.fr/minefi/ministere/index.htm*.
16. In 1991 there were 46 ministries or State secretariats compared with 28 in 1967 and an average of 15-20 during 1946-58 (see Rouban, 1995, p. 43).
17. EPIC (*établissement public à caractère industriel et commercial)* is a commercial or industrial public establishment; EPA (*établissement public à caractère administratif)* is an administrative public establishment.
18. The unit – the Agency for State Shareholding (*Agence des participations de l’État)* – was created in 2003. See *www.finances.gouv.fr/TRESOR/agence_part_etat.htm*.
19. The 1958 *Ordonnance* No. 58-1110 concerning the functioning of Parliament mentions three evaluation offices, covering: scientific and technological choices; legislation; and health policies.
20. For the Court of Accounts, see section 4.5 on external audit.
21. Including four *départements* outside metropolitan France (Guadaloupe, Guyane, Martinique, Réunion).
22. See Constitutional Law No. 2003-276 of 26 March.

23. Although Organic Law No. 2004-758 was adopted by Parliament in July 2004, the law could not be promulgated since the Constitutional Council declared that certain provisions – those relating to the adequacy of local revenues to guarantee "free administration" – were obscure and imprecise (Constitutional Council Decision 2004-500 DC, 29 July 2004).

24. Several mechanisms exist at national level, including direct grants from the State budget, tax-sharing arrangements, and solidarity and equalisation funds. Regional and local levels have similar arrangements (Saidj, 2003, p. 452-454).

25. During the 1990s, municipalities began co-operating with a view to rationalising existing structures.

26. *Charges sociales* are payroll taxes from an economic viewpoint; from a legal viewpoint, they are social fees.

27. The golden rule (*équilibre budgétaire réel*) is rigorously enforced by the regional Chambers of Accounts.

28. The Prime Minister may establish a joint committee after one reading in each house. The text agreed by this joint committee is then submitted to both houses, whose proposed amendments have to be acceptable to the government, which has the right to refuse them. These procedures are based on decisions of the Constitutional Council.

29. *Ordonnances*, which have the force of law, normally need ratification by Parliament. However, for budget laws, the government can adopt them by an *ordonnance* that does not require parliamentary ratification (Art. 47). This constitutional provision has never been used.

30. See Constitutional Council Decision 79-110 DC at *www.conseil-constitutionnel.fr/decision/1979/79110dc.htm*, 24 December 1979.

31. In 1981, following presidential and legislative elections and major changes in the direction of macrofiscal policy, there were four rectifying laws.

32. In the 19th century, ministers (acting as *ordonnateurs)* were committing expenditures in excess to approved limits. To control commitments, in 1890 the annual budget law required each ministry to record expenditure commitments, with "expenditure commitment controllers" designated by individual ministers. Since these controllers were not independent from the minister, the 1922 law placed all controllers under the central authority of the Ministry of Finance (Bouvier *et al*., 2002, p. 410).

33. Since many State expenditures are executed outside Paris, the authority to enter spending commitments is delegated to secondary *ordonnateurs* (*e.g.* prefects in *départements*), a process known as *délégation de crédit.*

34. Legifrance, which is the service that diffuses French laws, considers the Public Accounting Decree as a fundamental text (*www.legifrance.gouv.fr/html/aide/lois_reglements1.htm*), the only decree having this status. The 1962 decree is to be updated to make it consistent with the new accounting provisions of the LOLF (Art. 27-30).

35. The LOLF specifies "the last quarter of the ordinary session". According to the Constitution (Art. 28), the ordinary session begins on the first working day of October and ends on the last working day of June. Normally the budget orientation debates take place during the month of May or June.

36. The Chamber of Accounts, which verified the accounts of the kings of France, was formally constituted in the 14th century. Three centuries later, the first French Parliament was formally established in the 1791 Constitution (Magnet, 1997).
37. One for each of the 22 administrative regions of France. The Financial Jurisdictions Code establishes special audit arrangements for French overseas *départements* and other dependencies.
38. See *www.ccomptes.fr/FramePrinc/frame01.htm* for the internal structure of the Court of Accounts.
39. The first sub-article of Article 58 of the LOLF adopted by Parliament in 2001 required the Court of Accounts to submit its draft annual work plan to Parliament for comment, with both houses being given 15 days to express opinions. Since the Court of Accounts is a judicial body, and the judiciary is constitutionally independent from both the executive and the legislature, the Constitutional Council declared that the Court's independence would be compromised if it were obliged to present its draft work plan to Parliament for comment. See Constitutional Council Decision 2001-448 DC of 25 July 2001.

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ISSN 1608-7143
OECD Journal on Budgeting – Volume 4 – No. 3
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Germany*

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* This study has benefited from comments from officials of the Budget Department of the Federal Ministry of Finance and from OECD colleagues including Eckhard Wurzel of the Economics Department.

1. Overview

1.1. The legal framework governing budget processes

Germany has a very comprehensive and detailed legal framework for budget processes at different levels of government. The Basic Law (*Grundgesetz* – hereafter GG) or Constitution, defines the roles of the key actors in budget processes. The GG lays out in some detail the respective fiscal responsibilities of the Federation and the *Länder* (states). It establishes that the Federation and the *Länder* independently prepare, adopt and execute their own budgets. The GG also contains an entire chapter devoted to budget management.

The Constitution is supplemented by a very solid body of laws (Box 1) and regulations. The most important budget laws date from the late 1960s. These lay out budget principles consistent with macroeconomic stability. A distinguishing feature of Germany's legal framework is the Law on Budgetary Principles (*Haushaltsgrundsätzgesetz* – hereafter HGrG), which is applicable not only to the federal government, but also to the independent *Länder* governments and all local governments (*Gemeinden* – municipalities). Part 1 of the HGrG lays out obligations concerning budget preparation, budget execution, government accounting, and independent external audit. The legal

Box 1. **Germany: Main budget system laws**

- The Basic Law (the "Constitution"), 1949 – *Grundgesetz*, GG.
- Law to Promote Economic Stability and Growth, 1967 – *Stabilitäts- und Wachstumsgesetz, StWG*.
- Law on Budgetary Principles, 1969 – *Haushaltsgrundsätzgesetz*, HGrG.
- The Federal Budget Code, 1969 – *Bundeshaushaltordnung*, BHO – and the 16 *Länder* budget codes.
- Federal Court of Audit (*Bundesrechnungshof*) Act, 1985.
- The laws on intergovernmental relationships – especially the solidarity pacts and the Law on Equalisation Grants from federal to *Länder* governments.
- The laws establishing social security funds.

Sources: Tschentscher (2002); Federal Ministry of Finance (1995 and 2000); *www.bundesrechnungshof.de/en/veroeffentlichung/800.html*.

requirements of the HGrG are elaborated further in individual budget codes – one for the federal government (the *Bundeshaushaltordnung* – hereafter BHO) and a separate code for each of the 16 *Land*. Each code has the status of law. The *Länder* budget codes contain broadly similar provisions to those in the federal code – since all are based on the common framework of the HGrG. *Länder* budget codes – including those for the former East Germany – are not reviewed in this study.[1] In 1985, the Federal Court of Audit Act was adopted to clarify governance structures and procedures for the external audit.

In contrast to some federal countries that do not have formal arrangements for fiscal policy co-ordination between different levels of government, there is a constitutional requirement that budget management of the Federation and the *Länder* take account of the need for macroeconomic equilibrium (GG, Art. 109). The Constitution also envisages the adoption of a federal law, applicable to both the Federation and the *Länder*, to govern budgetary management and to ensure multi-annual financial planning. Accordingly, the Law to Promote Economic Stability and Growth (*Stabilitäts- und Wachstumsgesetz* – StWG) requires the formulation of five-year plans. The law also promotes responsible fiscal management: both the federal and *Länder* governments are obliged to consider nationwide objectives when formulating their economic and fiscal policies. The StWG incorporates strict Keynesian economic theory that was widely accepted when the law was adopted in 1967. Some of this law's provisions, including the establishment and use of a counter-cyclical reserve fund to prevent overheating of the economy, are of little relevance when high unemployment and below-potential growth characterise the economy.[2] Also, the maintenance of counter-cyclical reserve funds that do not earn interest, as required by the GG [Art. 109(4)], is a questionable cash management practice.[3]

To ensure intergovernmental co-ordination, the StWG (s. 18) and the HGrG (Part 2) establish a co-ordinating body, the Financial Planning Council (*Finanzplanungsrat*). This body comprises the federal Ministers of Finance and of Economics, the *Länder* Ministers of Finance, and four representatives of municipalities designated by the *Bundesrat* (the second parliamentary chamber, representing *Länder* interests, see section 3.1.1) at the suggestion of local government associations. A principal aim of the Financial Planning Council, as a co-ordinating body, is to prepare coherent medium-term financial plans and to set priorities for nationwide fiscal policies. Under the HGrG, all levels of government are obliged to supply the Financial Planning Council with all information necessary for carrying out its functions. *Länder* must provide all relevant information on behalf of municipalities. All public law entities and all social insurance institutions – at both federal and *Länder* level – are also included in the reporting requirement. Thus, the Financial Planning Council is able to obtain all the information necessary for monitoring

budgetary developments for the nation as a whole.[4] Decisions of the Financial Planning Council are politically binding, but not legally binding.

The concept of *Rechtsstaat* – or rule of law – is very well-developed, with the law and legalistic approaches to public administration being very important. The Constitution requires the government to obtain the consent of the *Bundesrat* before issuing general administrative rules (GG, Art. 84), as well as stating that "federal supervision covers the lawfulness and appropriateness in execution of the administrative rules" [GG, Art. 85(4)]. The civil service, which is established by separate laws, takes pride in serving political authorities in a professional manner. Entry to the civil service is easier if one has legal training.

Despite the rule of law and the accompanying strong emphasis on ensuring that proper legal structures are in place, some budget decision making takes place outside the formal constitutional framework. This is largely a consequence of party politics and the need for coalition governments. Coalition agreements between the governing parties lay out a framework for budgetary policies. Since the 1990s, such agreements have become increasingly detailed and may even incorporate fiscal rules in addition to the Constitution's "golden rule" (see section 1.2). Although these agreements are not legally binding and may not be respected,[5] they nonetheless constitute an important informal framework to supplement the formal legal framework for budget processes. Pre-Cabinet decision making is a second area where less formal arrangements, dictated by the needs of party politics, supplement the legalistic framework. Negotiations between ministers outside formal Cabinet meetings may bring a consensus on controversial budget issues prior to formal decision making in Cabinet. Key decision makers are party heavyweights, who may or may not be members of the *Bundestag* (see section 3.1.1) or even the government (Sturm and Müller, 2003, p. 194).

Finally, Germany is a member of the EU, for which budgetary rules for macroeconomic stability have been issued. In particular, the "Maastricht criteria" limit the general government fiscal deficit to a maximum of 3% of GDP and general government debt to 60% of GDP. These quantitative limits are not incorporated into domestic legislation. However, actual budgetary decisions reflect the interplay of power between political parties, especially those comprising the coalition government. Although the parliamentary budget (or finance) committees exert some influence, Parliament's main role is largely limited to legitimising decisions already taken by the government coalition. Any non-respect of EU criteria reflects the difficulty of reaching a political agreement on legally-binding expenditure targets for the Federation and for each *Land*. Such targets are required for achieving overall targets for general government revenues, expenditures and deficit.[6]

1.2. Reforms of budget system laws

Following World War II, the fiscal deficit was strictly controlled, as the Constitution allowed a deficit only in exceptional circumstances. However, in 1965/66, it was believed that balancing the budget during a recession was inappropriate. A window of political opportunity opened up to change the Constitution and adopt new budget laws that formally embodied the Keynesian economic thinking that was in vogue in the 1960s (for details, see Sturm and Müller, 1999, p. 70-71). The principle innovations were:

- In budget management, the federal and *Länder* governments were required to take into account the four macroeconomic variables, namely steady economic growth, stable prices, high employment levels, and external balance.
- Borrowing was allowed to finance investment spending (a "golden rule").
- Annual budgets were to be formulated in the context of a medium-term plan covering five years.[7]
- The high-level Financial Planning Council was formed to co-ordinate budgetary planning nationwide and enable budget management at all levels to be assessed.
- A detailed budgetary classification and a uniform cash-based accounting – to be used at all levels of government – were introduced.
- A parallel budget – financed from carried-over cash reserves – was eliminated. Carryover of unused funds was curtailed.

Since these reforms were adopted, Germany has maintained a detailed line-item budget system, although in late 1997, the Law Adapting Budget Legislation of the Federation and *Länder* was adopted. This law (which amended the HGrG and the BHO) provides for:

- an extension of the eligibility for transfers of budget authority to allow greater flexibility in budget management by spending ministries;
- an easing of end-year carryover rules;
- greater incentives to budgetary bodies to raise additional revenues;
- cost-benefit accounting for central government budgetary activity;
- an obligation to conduct an efficiency analysis for all measures having a budgetary impact.

Unlike other countries, there has not been a nationwide movement towards performance-oriented budgeting, with an accompanying reform in the cash-based accounting system. Nonetheless, in 2000 pilot "product budgets" were launched, with six federal agencies being included in 2004 (Federal Ministry of Finance, 2004). The aim is to add an output orientation to the input-oriented budget. The product budget, which is annexed to the main

budget, shows the performance of an authority in product areas and groups, and assigns to these both quantities and costs derived from cost-result accounting. The introduction of performance-oriented reforms would, however, require a major simplification of the present detailed appropriations structure.

Concerning modifications to the accounting system, there has been some experimentation with accrual accounting at the local government level (Lüder, 2002). First, some municipal budget acts were changed to allow experimentation. In 1999, the City of Weisloch became the first German city to introduce an output- and accrual-based budgeting and accounting system. Second, some *Länder* (notably Hessen, whose government decided, in 1998, to adopt accrual accounting over a ten-year period) have also begun changing. However, these efforts are in addition to the requirements of the HGrG, which does not allow the *Länder* to abandon the traditional "cameralistic" accounting system.[8] The 1969 laws appear to be proving a constraint for innovation.

Major changes in the law – perhaps even the Constitution itself – would be required to introduce major budget and accounting reforms. However, in a reunited Germany it is more difficult than, say, 30 years ago, to reach the necessary two-thirds majority in both chambers of Parliament needed to change the Constitution. Another constraint to reform is the traditional sharp distinction between politics and administration. The notions of professionalism and loyalty in the civil service induce a strong desire to implement whatever policies are proposed by the government of the day.[9] Thus, although civil servants would react positively once the necessary political consensus for budget reform is obtained, professional loyalty may induce them to be less willing (compared to other countries) to actively promote reform initiatives themselves. Finally, a legalistic culture also acts as a constraint. Judging from the number of issues which are referred to the Constitutional Court by politicians, one might ask whether the legalist mode of thinking is more pervasive among politicians than among civil servants. Whatever the response, the weight of the law appears to have been a constraint on reforming the budget system.

2. Principles underlying budget system laws

It is considered very important to embody budget principles in law. The equalisation of living conditions across the country is a fundamental constitutional principle, which has strong implications for budget expenditure policies and the size of the deficit. Also, unlike some continental European countries, Germany has incorporated several budgetary principles in its Constitution, notably:

- An annual budget.
- Timeliness – the budget must be adopted before the year begins.

- Universality of all revenues and expenditures.
- Unity – all revenues and expenditures to be included in a single budget law.
- Overall economic equilibrium.
- The budget must be balanced.
- Restriction of content of budget.
- Budgetary autonomy for each level of government.

The current year principle states that cash expenditures are limited to a twelve-month period and generally lapse at end-year. This does not mean that budgetary authorisations are limited to 12 months (see below for a fuller discussion) or that only one financial year is shown for detailed estimates. The principle of universality is embedded in the Constitution: "all revenues and expenditures of the Federation are included in the budget" (Art. 110). This principle implies the recording of revenues and expenditures on a gross basis, without offsetting. The principle of equilibrium reflects the perceived need to draw up the federal and *Länder* budgets taking into account the main objectives for macroeconomic stability. The requirement for "a balanced budget" is in respect of revenues and expenditures in an accounting sense, not an economic sense. It means that the budget must show revenue (inclusive of revenues raised by borrowing) to cover all expenditures, inclusive of debt servicing spending. The budget's content is restricted: the annual "budget statute may contain only such provisions as apply to revenues and expenditures of the Federation and to the period for which the budget statute is being enacted" [GG, Art. 110(4)]. This means, for example, that any legal provisions relating to the level of debt would have to be adopted in the context of a law other than the annual budget law.

Besides the Constitution, the budget-related laws elaborate on these principles, or introduce others, including:

- Specificity: revenues categorised according to origin and expenditures for specific purposes (HGrG, BHO).
- Efficiency and economy (HGrG).
- Separate budgeting for cash expenditures and future commitments (BHO).

The principle of specificity, or the "single estimates" principle, results in a very detailed budget. By adhering to this principle, Parliament exercises influence over budget details. Partly as a consequence, Parliament is relatively less actively involved in approving the overall fiscal strategy.

The principles of "clarity and reliability" are considered to be implicit by the Federal Ministry of Finance. The principle of clarity derives from the constitutional requirement of a "balanced" budget, as well as the extensive detailed classification system. The Ministry also notes that the principle of

reliability requires that revenues and expenditures are estimated as precisely as possible, which can be verified provided a detailed uniform budget classification system is in place (see Federal Ministry of Finance, 2000).

3. Legal basis for the establishment and the powers of the actors in the budget system

3.1. The executive and the legislature

3.1.1. Overview

The 1949 Constitution (The Basic Law, *Grundgesetz*, GG) establishes a two-chamber Parliament for the federal government, composed of a *Bundestag* with 603 members elected by universal suffrage and a *Bundesrat*, which represents the interests of the 16 *Länder* at federal level. The *Bundestag* makes and changes the Constitution, federal laws, and the annual budget. The Federal Chancellor is the head of government and the political leader. The President, who is head of State, has limited powers. He/she is elected by the Federal Convention, composed of both chambers of Parliament.

Germany is a federal State, divided into three tiers: federal, *Land* and municipal (*Gemeinden*). *Länder* have their own governments (elected by *Länder* parliaments), administrative authorities and independent judiciaries, laid out in *Länder* constitutions. Each *Land* and municipality is a public entity with its own authority. The 16 *Länder* possess considerable law-making powers and are responsible for the administration and implementation of many federal laws.

3.1.2. Roles and responsibilities of the Cabinet and individual ministers

Three principles are embodied in the federal Constitution establishing the federal executive: the chancellor principle, the departmental principle (*Ressortprinzip*), and the cabinet principle (Derlien, 1995, p. 78). The government consists of the Federal Chancellor and ministers (GG, Art. 62). The Federal Chancellor is elected, without debate, by the *Bundestag* (GG, Art. 63) and is formally appointed by the President. The Federal Chancellor selects his/her ministers, who are formally appointed and dismissed by the President (GG, Art. 64). The Federal Chancellor sets government policy guidelines within which the federal ministers run their departments on their own responsibility (GG, Art. 65). An important facet of the departmental principle is that, as part of their responsibility, individual ministers report to, or appear before, Parliament, answering questions and taking the blame for any failures. This is seen as a legitimate expression of political supremacy over administrative affairs (Döhler and Jann, 2003, p. 99). The Constitution does not explicitly refer to a "Cabinet" (of ministers). It states that "the government decides on differences of opinion between ministers", implying the existence of a collegial body for deciding government business – the collegial principle.

The number of ministers is not limited by law. Rather the number of ministers depends primarily on the political exigencies to accommodate party interests and to co-opt forces within the parties of the government coalition. Besides the Federal Chancellor's Office, in 2004 there were 13 ministries. Traditionally, there has been a Minister of Finance and a Minister of the Economy, although the role of the latter in budgetary matters has diminished over time.

3.1.3. Establishment of ministries and executive branch agencies

Spending ministries. Ministries do not need a law for their establishment. Cabinet decisions create, merge, or abolish ministries. For example, in 2002, the Ministry of the Economy was merged with the Ministry of Labour by executive decree. Since the federal government has tasks at a national level, it has a greater number of ministries than *Länder* governments. However, since the Constitution assigns administration mainly to the *Länder*, the size of federal ministries is relatively small and, apart from a few exceptions (for example, Customs), there are no regional offices of federal ministries.

The internal structure of ministries is determined by ministerial order. Each spending ministry has its own budget department. The finance officer – responsible for preparing the budget – plays a powerful role in budget negotiations (Sturm and Müller, 2003, footnote 2).

Executive agencies (federal level). The Constitution allows for "independent federal authorities under public law to be established under public law. Where new functions arise for the Federation in matters on which it has the power to legislate, federal authorities may be established with the consent of the *Bundesrat* and a majority of members of the *Bundestag*" [Art. 87(3)]. There is no framework law establishing various types of federal agencies. The Administrative Procedure Act 1976 provides a somewhat circular definition of these semi-autonomous bodies, namely that each unit that carries out functions of public administration is a public authority (Döhler and Jann, 2003). The main distinguishing feature of "public authorities" is the type of law under which they are constituted (Box 2). Public law "independent authorities" are distinguished according to whether they are directly or indirectly governed by supervising ministries. At federal level, there were about 114 direct agencies and 330 indirect ones in 2001 (British Council, 2001).

Unless there are specific provisions in the enabling law establishing a public law agency, all such agencies are under the oversight of a ministry. This hierarchical structure is derived from the constitutional principle of ministerial responsibility. In principle, ministers are provided with unlimited rights, including over the agencies' budgets, staffing, and policies. However, in practice, the degree of supervision varies. For example, the *Bundesbank* is an

Box 2. **Germany: Public agencies**

Characteristics and types

- Agencies are under either public law or private law.
- Agencies under public law are either direct or indirect (federal) agencies.
- Direct agencies generally cover core government functions.
- Indirect agencies, including many social security and employment administrations, have their own legal identity.
- Agency types are not distinguished by function (for example, by classifying them according to whether they are policy-making, service delivery, or regulatory authorities).
- Private law entities are mainly entrepreneurial and have less ministerial oversight.

Governance structures

A collegial governing board is rare for direct public law agencies, less rare for indirect public law agencies, and frequent for private law bodies.

The federal or *Länder* government ministers generally appoint directors (who are responsible for representing the agency) and deputy directors (who are often responsible for internal management).

Source: Döhler and Jann, 2003.

indirect public agency and in principle the Ministers of Finance and the Economy could be board members or sit at its meetings. This does not happen, in part because the *Bundesbank* Act 1992 stresses it "is not subject to instructions from the federal government" (Art. 12).

As a general rule, public law agencies are part of the budget of their overseeing department – their budget is allocated top-down from the department, which reviews the legal use of money allocated. A few agencies raise substantial revenues. The law requires these to be included as revenues in the federal budget. The federal government budget only approves transfers to bodies such as the Labour Market Administration (for paying unemployment benefits) and the Social Security Administration (for paying pensions).

The Joint Procedural Code [s. 4(6)] was amended in 2000 to require ministerial departments, inclusive of agencies under them, to prepare mission statements, goal agreements, and new financial, personnel and quality controls on an experimental basis. In general, federal agencies have a distant relationship with Parliament. Agency officials may be called upon to give

testimony to parliamentary committees. However, in practice, officials from the supervising ministry provide evidence to Parliament.

Public authorities established under private law have company status. Many are State enterprises, including utility companies and publicly owned banks. Some are research institutes or cultural bodies. There are two types of private law entities (for details, see Döhler and Jann, 2003, p. 102 and Annex). "Charged administration" agencies are generally the most free from ministerial oversight.

3.1.4. Responsibilities of senior civil servants

There are no special laws specifying the roles and responsibilities of senior civil servants in budget formulation and execution. However, all public servants' responsibilities and rights are fully specified in law. The main distinction is between civil servants and public employees. The former are governed by civil service public laws, whereas the latter are governed by contractual arrangements under private law. All senior civil servants are in the first category.

The Constitution authorises the Federation to enact framework legislation for *Länder* laws concerning the legal status of persons in the public service of the *Länder*, *Gemeinden* and other corporate bodies established under public law (GG, Art. 75). A framework law has been adopted, notably the Act Defining the Scope of Civil Servants' Rights and Duties (*Beamtenrechtsrahmengesetz*). The Act on Federal Civil Servants (*Bundesbeamtengesetz*) elaborates on the rights and responsibilities of federal civil servants. The law provides civil servants at all levels of government with life-time employment and benefits, in exchange for loyalty and professionalism. Tenure requires meeting certain criteria, of which training in law is one. Government employees who do not have civil service status – who represent over 60% of all government employees (Lüder 2002, p. 226) – generally do not have these privileges in their employment contracts.

The Constitution requires that "civil servants employed in the highest federal authorities are drawn from all *Länder* in appropriate proportions" (GG, Art. 36). This requirement is not strictly binding, although the administration pays attention to it.

The Federal President appoints and dismisses all federal civil servants, although he/she can delegate this function (GG, Art. 60). In practice, the minister of the concerned ministry appoints high-level appointments. German ministries traditionally have had no political staff (Derlien, 1995, p. 79). However, the State secretaries and the heads of ministerial departments can be appointed or dismissed for political reasons. This provision does not apply to the heads of semi-autonomous agencies under ministries, who, in most cases, are career civil servants appointed by the relevant minister. For some indirect

agencies, the laws establishing them specify the non-application of civil service laws to their employees.

3.1.5. Establishment and roles of parliamentary committees

The Constitution establishes three permanent parliamentary committees – for EU matters, for foreign affairs and defence, and for petitions (Art. 45). A permanent committee relating to public finances is not mentioned in the GG. However, under its Rules of Procedure, the *Bundestag* has the authority to create permanent committees. In 2003, there were 21 permanent committees, including a Budget Committee, a Finance Committee, and an Economic Affairs Committee (see *Bundestag*, 2003). Other specialist parliamentary committees are established in the *Bundestag*, broadly in accordance with the departmental jurisdictions of the executive.

The Budget Committee of the *Bundestag* plays an important role in approving the draft annual budget. By convention – not stated in the Rules of Procedure of the *Bundestag* – the chair of the Budget Committee is filled by a member from the opposition (Wehner, 2001). At the beginning of each parliamentary term, rapporteurs are appointed for each departmental budget. Given the four-year parliamentary cycles, these rapporteurs develop in-depth knowledge of the aims and financial plans of the corresponding ministry. The rapporteurs, along with the chair, share the responsibility for drawing up the results of deliberations and proposing amendments to the *Bundestag*.

Besides the role of proposing amendments for the plenary session's second reading of the draft budget law, there are two other important functions of the Budget Committee. First, its sub-committee, the Auditing Committee, ensures that the recommendations made in the annual report of the Federal Court of Audit are introduced into the budgetary processes. This sub-committee can request the Federal Court of Audit to examine particular aspects of budget execution, accounts, or procedures. Second, under rule no. 96 of the Rules of Procedure, the Budget Committee is asked, after the first reading of any bill that entails higher public expenditure, to investigate whether the proposed bill is compatible with the budget situation. Unlike comments from other committees, the Budget Committee's report is addressed directly to the plenary for the second reading, not to the chair of the responsible specialist committee, that is, the committee responsible is not free to accept or reject the Budget Committee's views. Under the constitutional provision that budget revenues and expenditures must be balanced (GG, Art. 110), the plenary must ensure that cover is provided for new expenditures. The Budget Committee submits a recommendation for cover; failure to find budgetary cover would result in the bill not being adopted.

The Constitution states that the *Bundesrat* draws up its own Rules of Procedure (GG, Art. 52). Like the *Bundestag*, it has established a permanent Finance Committee for examining the draft budget. The work of this committee is assisted by a sub-committee comprising financial specialists of the *Länder* governments. Any joint committees of the two chambers are established by the procedural rule of the *Bundestag* (GG, Art. 53a). A Mediation Committee has been established, which, inter alia, resolves budget disputes between the two chambers.

3.1.6. Establishment and roles of other constitutional bodies

The Constitution creates a Constitutional Court (GG, Art. 93) and other high-level courts. Of relevance for budget system laws is the Federal Administrative Court (for adjudicating disputes on decisions and actions by the administration), a Federal Finance Court (for tax disputes) and a Federal Social Court (for social security disputes) (GG, Art. 95). The GG also authorises the Federation to establish federal courts for disciplinary proceedings, or the pursuance of complaints, against federal public servants (GG, Art. 96).

3.2. Role and responsibilities of sub-national governments

The Constitution establishes separate and autonomous governments at three levels. Although federal law takes precedence over *Länder* law (GG, Art. 31), the Constitution was designed to provide the *Länder* with strong legislative powers. In particular, the exercise of governmental powers and the discharge of governmental functions are incumbent on the *Länder* unless otherwise provided or permitted in the Constitution (GG, Arts. 30 and 70). The Constitution specifies areas where the Federation has exclusive legislative powers (for example, the foreign service, federal waterways and shipping, border guards, central police, communications), as well as those where the Federation and the *Länder* have concurrent legislative powers (Arts. 70-74a). Social insurance institutions, whose competence extends beyond that of one *Land*, are administered as direct corporate bodies – either at federal or *Länder* level.

The Constitution elaborates on all important issues concerning intergovernmental financial relations. Legislative powers concerning revenues, revenue assignments and revenue administration are elaborated in detail (GG, Arts. 105-108). While some taxes are assigned to one level of government exclusively, revenues from all major taxes are shared among the Federation, the *Länder*, and the municipalities (*Gemeinden*). Revenue from shared taxes is redistributed horizontally among the *Länder* by equalisation transfers (*Finanzausgleich*), and vertically by general or special add-on transfers from the Federation to the financially weaker *Länder*. Both types of transfer are governed by specific laws. The Constitution also authorises the Federation to

make transfers according to specific purposes – for example, public transportation (GG, Art. 106a). It can also compensate *Länder* or *Gemeinden* for special burdens imposed on them [GG, Art. 106(8)].

The Constitution stipulates that, in principle, each level of government should independently finance the tasks it is obliged to perform, in order to ensure efficient and effective performance. Expenditure assignments for the Federation and the *Länder* are specified in the Constitution. Major competences of the *Länder* comprise education, university systems, and health. However, in these and other areas such as social security, expenditure competencies of the Federation and sub-federal governments overlap. Also, the Constitution provides that the Federation pays the *Länder* for tasks executed by the *Länder* either on behalf of the Federation, or for which the Federation has a legal co-financing responsibility (GG, Arts. 91a, 91b and 104a). Importantly, many investment projects are jointly financed by the Federation, the *Länder*, and/or the *Gemeinden*. Finally, about one-third of total government spending (excluding transfers) is conducted by sub-federal governments, considerably lower than in some federal OECD member countries (for example, Canada, Switzerland) but higher than Austria (OECD, 2003, Figure 1).[10]

Länder constitutions, the HGrG and individual *Land* budget codes lay out the legal obligations for budget preparation, execution, accounting and audit. Although the system of intergovernmental budgetary relations is complex,[11] it is understood by the various actors, in part because of the crucial role of the Financial Planning Council as a co-ordination body between the Federation and the *Länder*.

4. Legal provisions for each stage of the budget cycle

The HGrG provides not only principles, but also some detailed legal obligations applicable to both federal and *Länder* budgets. All stages of the budget process are covered by the HGrG, except for the parliamentary approval stage. The same stages are elaborated in the 17 budget codes, which have the status of law. Only extracts from the code applicable for the Federation (BHO) are reported below.

4.1. Budget preparation and presentation by the executive

Laws specify procedures for preparing and approving the draft budget law within the executive. This contrasts with most other countries, where executive decrees and/or conventions guide the budget approval process within the executive.

4.1.1. Institutional coverage of the budget

Budgets at each level are prepared and adopted independently. The institutional units comprising "government" at each level are not enumerated in law. The official statistical definition (*finanzstatistische Abgrenzung*) is the primary standard used for establishing the coverage of institutional units at each level of government. Coverage and reporting standards are laid out in administrative regulations.[12] The consolidated budgets of all governments include all institutions that follow cash-based government accounting principles, but exclude institutions and enterprises that are legally independent and use commercial accounting.[13]

4.1.2. Extrabudgetary funds and earmarking of revenues

The principle of general coverage that "all revenue shall serve all expenditure" is included in the GG and the BHO. However, the Constitution allows the establishment of federal special funds, where "only allocations to and revenue from them need be included" in the budget (GG, Art. 110). Also, "revenue may be earmarked for use for specific purposes if this is stipulated by law or if exceptions have been provided for in the budget" (HGrG, s. 7). For such funds, only outflows from, or contributions to, the Treasury are to be taken up in the budget (HGrG, s. 18).

On the basis of these laws, separate laws have established the major social security funds, for which there are approximately 720 institutions (IMF, 2003, paragraph 4). There is usually a legal requirement for these funds to be balanced. To achieve the zero deficit target, for some funds (for example, pension funds), the law specifies the formula for transfers needed from the federal government to cover annual operating deficits. The transfers to such funds are appropriated in the federal budget. However, the revenues and expenditures of the funds are approved by a governing board. These are not shown in the annual federal government budget.

Extrabudgetary funds, whose number and size has varied over time, are also used extensively for off-budget activities. After reunification in 1991, there was an initial boost in the number and size of such funds, which contributed to the growth of the general government deficit (Sturm and Müller, 2003, table 4.4). The deficits of extrabudgetary funds are not subject to the deficit-limitation requirements of Article 115 of the GG (Burmeister, 1997, p. 227). In 2003, there were about 42 extrabudgetary funds: 16 at federal level and 26 at *Länder* level.[14]

4.1.3. Definition of budget aggregates

The Constitution specifies which revenues accrue to which level of government and which are shared. All tax and non-tax revenues are specified

(GG, Arts. 106-107). The Constitution also states that “budget revenue and expenditure shall be balanced” [Art. 110(1)], although it does not elaborate on what “balance” means.

The HGrG defines what is meant by *ex ante* “financial balance” – the difference between revenues and expenditure (with both excluding clearly specified financing transactions) [HGrG, s. 10(4)]. The counterpart – the “borrowing plan” – is defined as the revenue from loans minus debt repayments. Revenues of departmental budgets include taxes, administrative receipts, proceeds from asset sales and revenues from non-liquid loans. Expenditures are defined by economic object: personnel, current goods and services, debt servicing, grants and subsidies, and investment, with further details provided in the HGrG [s. 10(3)].

The BHO defines not only *ex ante* financial balances (as in the HGrG, see above), but also an *ex post* “surplus or deficit, which is the difference between actual revenue and actual expenditure” (Art. 25). Any surpluses arising from past budget execution “shall be used, in particular, to reduce the borrowing requirement, repay debts, or allocated to the reserve for counterbalancing economic trends”. Any deficits are to be covered principally by borrowing (compare HGrG, s. 17).

4.1.4. Fiscal rules

The “golden rule” embedded in the Constitution states that “revenue from borrowing shall not exceed the total expenditure for investment provided for in the budget estimates” (GG, Art. 115). Similar “golden rules” are written into *Länder* constitutions. The federal Constitution allows two exceptions to the golden rule: 1) to avert a disturbance of macroeconomic equilibrium; and 2) for special funds that may be authorised by federal legislation. The second exception was used in the early 1990s, when off-budget funds were used to meet the acute financial needs of the eastern *Länder*.

There has been a debate on the definition of investment – what it covers and whether it should be on a gross or net basis.[15] In 1989, the Constitutional Court, in commenting on the constitutionality of the 1981 deficit, requested Parliament to develop a more precise definition of investment. To date, this has not been done in new legislation (although the HGrG was changed in 1990 to require explanatory notes to be attached to the budget in the case of “unavoidable” deficits). Investment is based on a gross concept: it includes not only gross purchases of fixed assets but also transfers and subsidies in support of investment (IMF, 2003, Box 2). Using a gross rather than a net concept is consistent with Germany’s cash-based accounting system, in which depreciation and other capital charges are excluded from current expenses.

Until 2002, law did not specify that budgetary projections should be drawn up taking into consideration its European obligations. However, since 2002, the HGrG (s. 51) requires the "maintenance of budgetary discipline within the framework of European Economic and Monetary Union". The Financial Planning Council, whose secretariat is based in the Federal Ministry of Finance, shall take into consideration economic and fiscal factors and then make recommendations regarding budgetary discipline. It examines budget proposals – in particular it will recommend a common expenditure course – in the light of EU requirements on deficits and debt for general government, *i.e.* federal plus *Länder* plus *Gemeinden*, inclusive of all extrabudgetary funds. In transmitting general government budget plans to the EU, the Federal Ministry of Finance converts national budget accounting data to the international norms specified in the European System of Accounts.

4.1.5. The timetable for budget preparation and presentation to Parliament

For the federal budget, the BHO requires that "the draft budget law be submitted to the *Bundestag* and *Bundesrat*, together with the draft budget, before the beginning of the fiscal year. As a rule, this should be not later than the first week of the *Bundestag's* session following September 1" (Art. 30). To reach this deadline, the BHO also requires that estimates shall be submitted to the Federal Ministry of Finance by the agency responsible for the departmental budget on the date that shall be determined by the Ministry (Art. 27). This date is typically in early March. However, the budget preparation process begins about three months earlier, when the Federal Ministry of Finance sends the annual budget circular to departments. This includes an updated five-year financial plan and guidelines for preparing draft annual budgets.

4.1.6. Approval process within the executive

The Federal Ministry of Finance is required by law to scrutinise the estimates received from departments, amend them (in consultation with the departments) and prepare a draft budget [BHO, s. 28(1)]. Once prepared, the Federal Ministry of Finance transmits the draft budget to the Federal Chancellery, for approval in Cabinet. A federal minister may obtain a decision by the federal government on matters with considerable financial implications. If such decisions go against the opinion of the Federal Minister of Finance, he/she may challenge the government decision. Procedures are detailed in Rules of Procedure of the federal government [BHO, s. 28(2)]. These legal provisions reflect the possibility that not all budget conflicts are resolved at a technical level and may need resolution at ministerial level. Following these steps, the draft budget law and budget are adopted by the federal government [BHO, s. 29(1)]. This is typically in early July.

Unusually, the law requires the external audit office to receive the draft budget estimates from ministerial departments. The Federal Court of Audit may comment on them [BHO, s. 27(2)]. Typically, representatives of the Federal Court of Audit attend budget negotiations in an advisory capacity at divisional level, but they do not take part in negotiations at higher levels, where decisions are increasingly motivated by policy considerations.

The law also specifies internal administrative arrangements: "Every agency that administers revenue and expenditure shall appoint a finance officer unless this task is assumed by the head of the agency. The finance officer shall be directly subordinate to the head of the agency. The finance officer shall be responsible for the preparation of documents required for financial planning and for the draft budget estimates. The finance officer is also responsible for executing the budget, a task that may be delegated" (BHO, s. 9).

4.1.7. Documents to accompany the budget law

Medium-term macroeconomic framework and fiscal strategy. To accompany the budget debates in Parliament, the law requires that a five-year financial plan (quantitative estimates of the fiscal policy strategy) be submitted to the legislative bodies, at the latest upon submission of the draft budget (HGrG, s. 50). The financial plan is adopted only by the government (StWG, s. 9). Its presentation to Parliament is for information only. The first year of the financial plan is specified to be the current financial year. The second year is the budget year, leaving a further three years beyond the budget year. The law assigns responsibility to the Federal Minister of Finance for drawing up the financial plan and updating it annually in line with economic developments (StWG, s. 9). Federal ministers are to draw up investment programmes in their areas of responsibility. These are to show, for each year, direct spending on projects, as well as federal financial aid for third-party investment (StWG, s. 10).

For the federal government, the Federal Ministry of Finance is required to present, with the draft of the federal budget law and the draft budget, a report on the current state of public finances and their likely impact on the economy as a whole (BHO, s. 31). This Finance Report is a key budget document, as it provides extensive information for an assessment of the budget proposal. The law does not specify its contents. It typically contains summary tables and explanations of the budget; the medium-term federal finance plan; a description of the macroeconomic context and tax policy; a description of the financial interrelationships of the Federation, *Länder*, and *Gemeinden*; financial relations with the EU; debt, commitments, and obligations of the Federation; information on federal special purpose funds; and an overview of government assets and privatisation activities.

Concerning the medium-term financial plan, by convention (not law), the Federal Ministry of Finance:

- prepares macro variables based on likely developments in the first two years and cyclically-neutral economic growth developments in the three later years;
- distinguishes between expenditures for which a definite provision must be made and expenditures where a global provision is made (for example, for salaries);
- for both revenues and expenditure, may incorporate planned policy changes – but not explicitly – into the projections;
- does not strongly link annual budgets with medium-term financial plans.

The published financial plan contains about 40 functional categories of expenditure. However, detailed estimates for the 7 000-8 000 expenditure titles and 1 100 revenue items are prepared within the administrations of the Federation, each *Land* and all *Gemeinden*, since all are obliged to participate in the medium-term planning exerucise.

New measures *versus* existing expenditure policies. For investment spending, the law requires detail on both new projects and ongoing projects (StWG, s. 9). Such a distinction is not made in the law for current expenditures of the proposed budget.

Performance-related information. Budgets for each department are drawn up using detailed economic and functional classifications. Appropriations are not on an explicit programme and activity/project basis. Hence, the law does not require (programme) performance indicators to accompany budget submissions.

Tax expenditures, contingent liabilities and fiscal risks. Every two years, the federal government is required to submit to the *Bundestag* and the *Bundesrat*, along with the budget estimates, a survey of financial aid to agencies outside the federal administration, listing separately the financial support to enterprises or sectors of the economy. A survey of tax concessions to industries, including an estimate of revenue foregone, is required (StWG, s. 12). This law requires an assessment of when it would be desirable to remove tax concessions and subsidies to industry, with government making legislative proposals.

Concerning contingent liabilities, the Constitution requires federal legislative authorisation for the assumption of guarantees or other commitments necessitating expenditure in future fiscal years (GG, Art. 115). Because of this constitutional requirement, full information is made available on contingent liabilities, including budgetary subsidies needed when loan guarantees are called up.

There is no legal requirement to present a risk assessment in the budget and the budget does not include a detailed risk analysis. Any published budget estimates on fiscal risks tend to be rather general (IMF, 2003). Also, there is no legal requirement to prepare periodic long-term projections of revenues and expenditures which would enable the risk of uncertain demographics on the costs of present social transfer programmes to be identified.

Other information required by law. By law, three budget annexes are required at all levels of government (HGrG, s. 11; BHO, s. 14). First, an annex must contain descriptions of revenues, expenditures, and future commitments classified by object (economic classification) and by function, with a matrix showing cross-classification of these two classification systems. This applies to revenues, expenditures and authorisations of future commitments. Second, a summary of self-balancing items is required. Third, a summary of posts of established civil servants, unestablished salaried staff and wage earners must be shown.

For indirect agencies (see Box 2) and special funds, net flows only are shown in the budget law. The law requires – as budget annexes or explanatory notes – summary information on the funds' revenues, expenditures and authorisations of future commitments (HGrG, s. 18; BHO). For such agencies, the established positions of civil servants must be stated in the budget. The BHO requires similar summaries of revenues and expenditures for: 1) public law entities that are fully or partly supported by the federal government, and 2) agencies not belonging to the federal administration, but which receive allocations from the federal government. The Federal Ministry of Finance is authorised to permit exceptions to the reporting requirements for agencies of the second category.

4.1.8. Budgets of Parliament and other constitutional bodies

Constitutional bodies are financially independent. The law makes provision for possible budgetary disputes between the Federal Ministry of Finance and the draft budget estimates of the Federal President and the presidents of the *Bundestag*, the *Bundesrat*, the federal Constitutional Court, and the Federal Court of Audit. In particular, "the Federal Minister of Finance shall notify the federal government of any deviations" [BHO, s. 28(3)] and if the draft budget deviates from the estimates of these five constitutional bodies, and if differences have not been resolved, then the sections on which no agreement has been reached shall be attached to the draft budget [BHO, s. 29(3)].

4.2. Budget process in Parliament

The law, beginning with the Constitution, has specified the steps required to be followed in approving and adopting the budget law in Parliament.

4.2.1. The timetable for budget adoption and constraints on the budget debate in Parliament

The fiscal year for all levels of government is the calendar year (HGrG, s. 4). A budget is prepared for every financial year, covering revenue expected during the year, money likely to be spent in the financial year, and all authorisations of future commitments likely in the financial year (HGrG, s. 8). A budget may be prepared for two years, each year being dealt with separately (HGrG, s. 9). The Constitution specifies that the budget should be adopted by Parliament before the beginning of the financial year (Box 3). In contrast to non-budget laws, which are submitted first to the *Bundesrat* (GG, Art. 76), the Constitution requires that the annual draft budget be submitted simultaneously to the *Bundestag* and the *Bundesrat*. The BHO requires that, as a rule, the draft federal

Box 3. **Germany: Budget processes in Parliament**

- Simultaneous introduction of draft budget to both chambers [GG, Art. 110(3)].
- First stage in the *Bundesrat*. It must state its position within six weeks [GG, Art. 110(3)].
- First reading in the *Bundestag* – usually in September, when the Federal Minister of Finance gives his/her budget speech and outlines the government's fiscal policy strategy.
- Budget Committee of the *Bundestag* examines budget proposals, prepares a report, and proposes amendments if necessary.
- Second reading in the *Bundestag*. Budget Committee's findings presented, plenary session debate on departmental budgets, with separate decisions on each.
- Third reading in the *Bundestag*. Vote on the budget as a whole.
- *Bundestag* resolution transmitted to *Bundesrat* [GG, Art. 77(1)].
- If necessary, vote on any amendments proposed by the Mediation Committee.
- Second stage in the *Bundesrat*. *Bundesrat* may enter objection [GG, Art. 77(3)]. This can be rejected by the *Bundestag* with the required majority [GG, Art. 77(4)].
- Budget statute signed into law by the Federal President (countersigned by the Federal Chancellor and the Federal Minister of Finance).
- Publication in the Federal Law Gazette.

budget law, together with the draft budget, be submitted to the *Bundestag* and *Bundesrat* no later than the first week of the *Bundestag's* session following 1st September (s. 30). This timing allows nearly four months for budget discussions in Parliament.

The *Bundesrat's* comments are provided by its president to the Federal Chancellor, who passes them on to the Federal Ministry of Finance. If necessary the Ministry drafts a response on the *Bundesrat's* comments, submitting them to the Federal Chancellor for submission to, and adoption by, the government. These are submitted without delay to the president of the *Bundestag* by the Federal Chancellor.

The *Bundestag's* Rules of Procedure specify that all bills, including the draft budget law, pass through three readings. After the first reading, the Budget Committee's rapporteurs of each departmental budget scrutinise the detailed estimates in their area of competency. The role of the chair of the Budget Committee is to synthesise their findings and prepare a report suggesting amendments to the government's draft budget law. Since the Constitution requires that any statutes increasing budget expenditures require the consent of the government, nearly all of the work of the Budget Committee on the expenditure side is directed at changing the composition of expenditures, rather than attempting to change total expenditures. Also, since the budget contains details on proposed changes in the number of civil servants and salary levels, the *Bundestag's* discussion on resources relative to staffing is often the most contentious part of the budget debate (*Bundestag*, 2003).

4.2.2. Provisional budgets

Should the budgets not be adopted by the end of a fiscal year, the federal government is authorised by the Constitution to make payments that are necessary to maintain statutory institutions, carry out measures authorised by existing law, meet the Federation's legal obligations, and continue projects or make transfers already approved in the previous year's budget (GG, Art. 111). To the extent that revenues are insufficient to cover these expenditures, the executive is authorised to borrow to conduct current operations, up to a maximum of one-quarter of the total amount of the previous year budget (GG, Art. 111).

4.2.3. Powers of amendment

The Constitution severely restricts Parliament's amendment powers. Statutes increasing budget expenditures proposed by the government, or involving or likely in the future to cause new expenditures, require the consent of the government. A similar provision applies to statutes involving decreases in revenues (GG, Art. 113). Also the government may demand that

the *Bundestag* postpones its vote on such bills. The Constitution includes a six-week time limit for government withholding its consent to statutes (GG, Art. 113).

4.2.4. Approval of resources

An independent Working Group on Tax Revenue Estimates, which includes federal and *Länder* representatives, reviews tax revenues in the spring (the March-May period) and updates them at the parliamentary approval stage. The latter are used by the Budget Committee at a "settlement" session that finalises the estimates to be included in the annual budget law. Revenues are projected on a gross basis and on the basis of existing laws (which do not have to be renewed annually with each budget law). The Budget Committee scrutinises all estimates in detail, expenditures as well as revenue. The *Bundestag* takes a separate decision on each departmental budget, prior to *Bundesrat* consideration of each departmental budget.

4.2.5. The nature, structure and duration of appropriations

The "budget" (excluding annexes) consists of three main elements: the budget law (BHO, s. 1); an aggregate budget; and departmental budgets [HGrG, s. 10(1)]. The budget law defines expenditure totals. The aggregate budget is a summary of the revenues, expenditures, and authorisations for future commitments contained in departmental budgets, a summary of how the fiscal balance will be financed, as well as new loans and repayment of old loans [HGrG, s. 11(4)]. Departmental budgets are very detailed, being required to contain revenues, expenditures, and authorisations for future commitments of a single agency, sub-divided into chapters and titles. The economic classification of revenues and expenditures is detailed in the HGrG [s. 10(3)]. The authorisations for future commitments are budgeted separately from expenditure items [HGrG, s. 12(2)]. For each department, the budget is subdivided into chapters and titles. Titles, which are the smallest units in the budget, identify the purposes of expenditure or special items. There are 7 000-8 000 titles (Sturm and Müller, 2003, p. 198).

Revenue and expenditure are budgeted in full and independently of each other. Exceptions, particularly for receipts in the case of asset sales or incidental expenses, may be allowed, provided the computations are shown in a budget annex or an explanatory note [HGrG, s. 12(1)]. Funds to independent self-administration agencies may be allocated on a net basis if this is in the interests of efficiency and economy [HGrG, s. 12(3)]. The statutory items are the estimates for revenues according to origin, cash expenditures for the year, authorisations for future commitments according to purpose, and budget notes. Explanatory notes are not legally binding unless declared to be so [HGrG, s. 12(4)]. For expenditures, titles may be grouped into a heading

designating a common purpose. Flexible budget management applies (see below).

The Constitution specifies that the budget shall be laid down in a bill covering one or several financial years separately. Provision may be made for parts of the budget to apply for different durations or different financial years [GG, Art. 100(2)]. Normally, both expenditures and authorisations for future expenditures may be used only up to the end of the financial year. However, it may be provided in the law that unused authorisations for future commitments shall be valid until the promulgation of the budget law of the next fiscal year [HGrG, s. 27(1)].

4.2.6. Carryover of appropriations and borrowing of future appropriations

Investment expenditure and expenditure from specifically earmarked revenues may be carried over. Other expenditure may be carried over if it is earmarked for a specific purpose covering several years and if this is in the interests of efficiency and economy [HGrG, s. 15(1)]. For carried-over expenditures, unexpended balances may be accumulated which remain available for the particular purpose beyond the financial year up to the end of the second financial year. The Minister of Finance may permit expenditure to be carried over in specially justified cases, provided that funds are still to be spent in the next fiscal year on measures that have already been authorised [HGrG, s. 27(1)]. The 1997 Law Adapting Budget Legislation of the Federation and the *Länder* widened the scope of these provisions by extending eligibility for carryover to all expenditures coming under flexible management arrangements (see below). It also abolished the requirement to effect savings in departmental budgets when use was made of unexpended funds.

4.2.7. Public debt approval

The Constitution requires that the borrowing of funds and the assumption of pledges, guarantees or other commitments, as a result of which expenditure may be incurred in future fiscal years, necessitate federal legislative authorisation indicating, or permitting computation of the maximum amounts involved (GG, Art. 115). The annual budget law must determine the level up to which the Minister of Finance may borrow funds for deficit financing and for ensuring effective cash management [HGrG, s. 13(1)]. This authorisation is valid for the fiscal year, or until the annual budget law of the following year is promulgated [HGrG, s. 13(2)]. It may be provided by law that revenue from borrowing is designated to specific expenditures [HGrG, s. 13(3)].

"The granting of guarantees or any other warranties that may result in expenditure in future financial years shall require legal authorisation in terms of definite amounts. Promises of loan guarantees shall require the consent of the Minister of Finance. He shall be involved in the negotiations" (HGrG, s. 23).

The protocol attached to the EU Treaty of Maastricht requires the general government deficit to be no higher than 3% and gross debt to be no higher than 60%. Member countries report debt and general government balance levels to the EC twice a year. For Germany, the Federal Ministry of Finance reports a scenario for public debt that has been approved by Cabinet. Parliament has never established maximum limits on the total amount of general government debt.

The law authorises the federal government, with the consent of the *Bundesrat*, to adopt ordinances (having the force of law) that limit the borrowing of funds by any level of government. Such limits apply to special funds and administrative entities. Governments may limit borrowing to below that approved by Parliament in the framework of the annual budget should it be necessary to avert a disturbance of general economic equilibrium (StWG, s. 19). The *Bundestag* has the right to overturn such ordinances. The transferring of unutilised maximum borrowing rights between public entities (for example, municipalities or associations of municipalities) is permitted (StWG, s. 21).

4.2.8. Promulgation, veto and publication of the adopted budget

Following the *Bundestag's* third reading of a bill and the receiving of the consent of the *Bundesrat*, the annual budget law is signed by the Minister of Finance, the Federal Chancellor and the Federal President. Neither the Federal President nor the Federal Chancellor has the right to veto the budget approved by the two chambers of Parliament. The budget, once published in the Federal Law Gazette, becomes law.

4.2.9. Supplementary budgets (rectifying laws)

Provisions relating to supplementary budgets are contained in budget codes. For the federal government, it is stated that Parts I and II of the code (respectively, general provisions and budget preparation provisions respectively) apply to: 1) amendments to the draft budget law and draft budget and 2) supplements to the (adopted) budget law and budget (BHO, ss. 32-33). The law does not limit the number of supplementary budgets in a given year. The only limitation is that drafts for supplementary budgets must be submitted before the end of the fiscal year (BHO, s. 33).

4.2.10. Budgetary implications of other bills

The Constitution states that "bills which increase the budget expenditure proposed by the federal government or involve or will give rise to new expenditure shall require the consent of the federal government. This shall also apply to bills which involve or will give rise to cuts in revenue" (GG, Art. 113). Also, measures which may oblige the Federation or the *Länder* to spend in future financial years shall only be permissible if the budget provides authorisation for them to do so (HGrG, s. 19).

4.3. Budget execution

Budget execution is governed by the HGrG and budget codes. For the federal government, the law authorises the Federal Ministry of Finance to issue administrative regulations concerning financial and budgetary administration (BHO, s. 5). Detailed regulations have been issued, which have binding force over federal ministries and dependent entities. Similar regulations have been issued by the 16 *Länder.*

4.3.1. Apportionment of expenditure authority

Appropriated funds shall be administered in such a way that they suffice to cover all expenditure for the various purposes indicated (HGrG, s. 19). Disbursements (and collections) may be made only on the basis of written warrants by the Minister of Finance or by agencies so authorised (HGrG, s. 32). The law adds that the minister may approve exceptions.

4.3.2. Cancellation of budget authority and other in-year expenditure controls

The Minister of Finance can block expenditures: "if developments in the revenue or expenditure situation so require, the Minister of Finance may make commitments or expenditure subject to his approval" (HGrG, s. 25). The instrument of freezing expenditures has been used in recent years. When spending exceeded the cash limits established by the Ministry of Finance, spending ministers were required to seek the permission of the Minister of Finance prior to spending authorised amounts (Sturm and Müller, 1999, p. 198). For investment spending financed by loans, prior approval of the Minister of Finance is needed for both commitments and payments (HGrG, s. 21). The regulations to the budget codes contain details on how these provisions are implemented.

4.3.3. Emergency spending, excess spending and contingency funds

The Constitution authorises expenditure in excess of budgetary appropriations, with the consent of the Minister of Finance, but only in the

case of an unforeseen and compelling necessity. Details may be provided by federal legislation (GG, Art. 112). For the federal budget, "the need shall not be deemed compelling if in the specific case a supplementary budget can be adopted in time or if expenditure can be postponed until the next budget law has been passed. A supplementary budget shall not be required if the excess expenditure does not in any one case exceed a specific amount to be stipulated in the budget law" (BHO, s. 37).

The law provides the authority for the federal government's budget to contain an unspecified expenditure item for use when economic activity declines and a disturbance in general economic equilibrium needs to be averted. Approval by the *Bundestag*, with comments by the *Bundesrat*, is needed for expenditure under this item (StWG, s. 8).

Concerning wage expenditures at all levels of government, "the granting of salary payments in excess of the collectively agreed scale requires the consent of the relevant Minister of Finance if this results in additional expenditure in the current or following fiscal year" (HGrG, s. 24). Similarly, the minister's consent is required should administrative fees be lowered, resulting in a loss of revenue (HGrG, s. 24). Statutory expenditures (for example, for regular payments to civil servants, pensions) have to be paid irrespective of the amount provided for in the budget.

4.3.4. Transfer and virement of appropriations within the year

Transfers of budget authority between ministries is generally possible. Virement – the swapping of budget authority within titles and chapters for a particular ministry – has traditionally been very restrictive. Prior to the 1998 budget, virement was allowed between expenditure titles "only if there was an administrative or substantive connection. Expenditure budgeted without any detailed indication of its purpose could not be declared eligible for virement" [HGrG, s. 15(2)]. Following the adoption of the Law Adapting Budget Legislation of the Federation and the *Länder* in late 1997, virement rules for administrative expenditures were eased. The new rules allow virement within section 4 (salaries, except title 411), within section 5 (non-personnel administration expenditures), within title 711 (construction projects) and section 8 (other capital expenditure). Additionally, 20% of the budgets for each of these sections may be swapped with other sections. The impact of this more flexible management has been rather limited since only about 6% of total federal expenditures has been affected (even though the rules relate to 104 chapters, comprising about 3 000 budget titles). The main reason for this is that major federal government expenditures, including those on social security, transportation, subsidies and interest payments, were unaffected by the new legislation.

4.3.5. *Cash planning and management of government assets and debt*

Principles for efficient cash management are incorporated in law, notably that "revenues shall be collected punctually and in full" and that "money may only be spent as and when necessary" (HGrG, s. 19). Also, for the federal government, the Federal Budget Code specifies "that a liquid reserve should be accumulated with the *Bundesbank*… In order to ensure proper cash management without recourse to borrowing authorisations" (BHO, s. 62).

The BHO also contains provisions for asset acquisitions ("only if required for the performance of the federal government's tasks in the future") and for asset sales ("sold only if not required for the performance of the federal government" and "sold at full value, with exceptions permitted in the budget") (BHO, s. 63). There is also an article relating to real estate property (BHO, s. 64).

The executive is authorised to exercise in-year control over government borrowing for macro-stability reasons. The StWG provides details on operating procedures. In particular, the law requires a special committee of the Financial Planning Council to prepare a quarterly schedule of the priority of proposed borrowings, the amounts involved, and borrowing terms and conditions. This schedule may be declared binding by the Federal Minister of Finance. In consultation with the *Bundesbank*, the minister may suspend the schedule should capital markets deteriorate (StWG, s. 22). Each *Land* is required to ensure by appropriate measures that borrowing by a *Land*, its municipalities and other subordinated entities do not exceed the level decided at federal level (StWG, s. 23). *Land* and special funds are required to report, if requested by the Federal Minister of Finance, on their borrowing requirements (StWG, s. 24).

4.3.6. *Internal audit*

Until 1997, the law required government authorities to carry out internal financial control in the form of *ex ante* control, including for receipts, payments, commitments to incur expenditure, assets, and liabilities (BHO, s. 100). The BHO required a finance officer to be established in every agency (BHO, s. 9). Each internal audit office (called a pre-audit office) was integrated with the authority in which it was established, being directly subordinate to the head of such authority. The Federal Court of Audit was required to give its agreement to the appointment and recall of heads of internal audit offices, and each internal audit office was required to submit its audit results to the Federal Court of Audit. Since 1997, this legal requirement was removed from the HGrG. The pre-audit offices were replaced by internal auditing within the departments, where specific transactions can be checked at any time. Internal auditing is carried out on a decentralised basis in all departments in the form of a self-check.

4.4. Government accounting and fiscal reporting

4.4.1. The accounting framework

The Constitution requires annual accounts to cover not only revenues and expenditures, but also assets ("property") and debt liabilities (GG, Art. 114). When this clause was inserted in the Constitution in 1969, it was understood that the governments' accounting systems would be on a modified cash basis. "All collections and disbursements shall be entered separately for each financial year, in the year in which they were made" (HGrG, s. 34). "Collections and disbursements shall be recorded in accounts chronologically and in accordance with the procedure laid down in the budget or otherwise provided. The Minister of Finance may order accounts to be kept on commitments entered into and monies accruing. All entries in accounts shall be supported by documents" (HGrG, s. 33). A few exceptions are specified in the law, including transactions made during the unspecified complementary accounting period when books are being closed.

4.4.2. Government banking arrangements

The concept of a consolidated revenue fund for all revenues is explicit in the law: "all revenue shall serve as cover for all expenditure. Exceptions must be stipulated by law" (HGrG, ss. 7-8). However, the law does not require a single treasury account, opened in the name of the Minister of Finance. Nor does the law specify government banking arrangements associated with federal cash offices. The *Bundesbank* Act, 1992, entitles the central bank to conduct any financial transaction (with the exception of granting loans) for the Federation, special funds, *Länder*, and other public bodies. However, the law does not oblige the *Bundesbank* to be the federal government's banker. In practice, however, nearly all federal government financial transactions are carried out via accounts managed by the *Bundesbank* on behalf of the Ministry of Finance.

4.4.3. In-year reporting to Parliament

For the annual budget debate (usually September). The legal requirements and actual information provided are discussed in above. Coverage of the Finance Report is extensive. Law does not explicitly state that Parliament must be provided with the fiscal strategy needed to meet its European commitments.

January. The federal and *Länder* governments are required to submit an annual economic report to the *Bundestag* and the *Bundesrat* in January of each year (StWG, s. 2). This report must contain:

- comments on the Annual Report of the Council of Experts;[16]

- the federal government's economic and fiscal aims (annual projections) for the current year. This projection shall employ the same methods as the national accounts unless alternative accounts are necessary;
- a survey of planned economic and fiscal policy measures for that current year.

Other months. Law does not require regular (for example, quarterly) budget execution reports to be transmitted to Parliament and the public. However, in practice, the Federal Ministry of Finance publishes a monthly report (including a 15-page summary in English) on federal fiscal developments – revenues, expenditures, balance, federal borrowing, guaranteed debt. It includes an advance calendar of publication dates. The Federal Ministry of Finance also regularly provides data on fiscal developments for general government, especially to the EU and other international bodies.

4.4.4. Annual accounts and reports

The Constitution requires "the Minister of Finance, on behalf of the federal government, to submit annual accounts to the *Bundestag* and the *Bundesrat* in order to obtain discharge; the accounts cover revenues, expenditures, property (assets) and debt" (GG, Art. 114). The law requires the Minister of Finance to set the date for closing the accounts (HGrG, s. 36). An explanatory report on the closed accounts is required (HGrG, s. 41).

To reach these legal requirements, the steps in preparing consolidated and nationwide accounts are embodied in law. "The responsible agencies shall render their closed accounts for each financial year. On the basis of the closed accounts, the Minister of Finance shall draw the consolidated budgetary account for federal government for each financial year" (HGrG, s. 37; BHO, s. 80). The HGrG specifies in detail the requirements for revenues, expenditures and financing (HGrG, ss. 38-40; BHO, ss. 81-83). Once the cash accounts and the budget have been closed, an explanatory report is required by law (HGrG, s. 41; BHO, s. 84). At federal level, additional summary information is required, including for excess and extrabudgetary expenditure, special funds and reserves, indirect federal agencies, revenue from asset sales not envisaged in the budget, and a "property" account (a balance sheet with certain assets and debt liabilities). The law does not include the date by which the minister must provide the consolidated annual accounts to the Federal Court of Audit for audit.

Federal entities whose accounts follow the rules of the Commercial Code (that is, who prepare annual accounts and reports using commercial double-entry accounting standards), may be excused the Federal Ministry of Finance's

reporting requirement. They have to prepare accounts as close as possible to those of federal ministries (BHO, s. 87).

4.5. *External audit*[17]

The Federal Court of Audit (*Bundesrechnungshof*), including its nine regional audit offices, performs the external audit functions at federal level. The legal basis for the Federal Court of Audit and its working procedures are mainly contained in the Constitution, the BHO and the 1985 *Bundesrechnungshof* Act. Independent courts of audit also exist at *Länder* level – they perform at *Länder* level a role similar to that of the Federal Court of Audit at federal level. Their legal basis is established in *Länder* constitutions and laws; these are not covered in this sub-section.

4.5.1. Managerial, financial and operational independence

The Federal Court of Audit is not part of the legislative, judicial or executive branches of government. It has an independent status and is subject only to the law. This special feature distinguishes the external audit body from internal audit bodies that are integrated into ministries and various agencies. Functionally, the Federal Court of Audit provides assistance to the federal Parliament and the federal government (*Bundesrechnungshof* Act, s. 1).

Upon a proposal of the federal government, Parliament elects the president and vice-president of the Federal Court of Audit, for a non-renewable period of 12 years (*Bundesrechnungshof* Act, s. 5). The staff of the Federal Court of Audit – about 700 established posts – is made up of members (president, vice-president, senior audit directors and audit directors), audit managers, auditors and support staff. The Constitution specifies that the members of the Federal Court of Audit enjoy the same independence as judges (GG, Art. 114). In respect to their duties, they are governed by the same regulations as those applied to the judges of federal supreme courts (*Bundesrechnungshof* Act, s. 3). Internally, decisions are made collegially, including by "colleges" and a "senate", whose composition and functions are outlined in the *Bundesrechnungshof* Act.

In the budget preparation procedure, the budget of the Federal Court of Audit enjoys the same protection as the budgets of other constitutional bodies. If a draft budget adopted by the federal government diverges from the estimates of the Federal Court of Audit without the latter having agreed to the changes, the estimates of the Federal Court of Audit must be presented to the Parliament unchanged (BHO, s. 29.3). Parliament is thereby informed of the differences of opinion between the Federal Court of Audit and the federal government. The accounts pertaining to the annual budget of the Federal Court of Audit are examined each year by the two chambers of Parliament, who grant discharge (BHO, Art. 101).

The president of the Federal Court of Audit is responsible for general management (*Bundesrechnungshof* Act, s. 6), including recruitment of staff. However, members must be qualified for a career in audit and at least one-third of members must be qualified to hold judicial office (s. 3).

4.5.2. Institutional coverage of audits

The Federal Court of Audit has very broad audit responsibilities, covering "the entire financial management of the Federation, including its separate property funds" (BHO, s. 88). This authority covers nearly all public law corporations and social security institutions established under federal law,[18] and enterprises established under private law in which the Federation is a stakeholder (HGrG, ss. 53 and 55; BHO, ss. 104 and 111). In addition, the Federal Court of Audit may audit bodies outside the federal administration if they implement parts of the federal budget or have been reimbursed by the Federation, or receive federal grants (BHO, s. 91). The Federal Court of Audit may restrict its audit coverage at its own discretion. Joint audits with *Länder* audit courts take place when responsibilities overlap (BHO, s. 93).

4.5.3. Types of audit

The Constitution requires the Federal Court of Audit to audit the accounts and determine whether public finances have been properly and efficiently administered (GG, Art. 114). Audits examine whether the regulations and principles of correct financial management have been observed (BHO, s. 90). The BHO specifies:

- financial audits ("whether the budget act has been adhered to");
- compliance audits ("receipts and payments have been properly substantiated by vouchers");
- value-for-money audits ("funds are administered efficiently and economically" and "functions might be performed with fewer human or material resources, or more effectively by other means").

Besides audit, the Federal Court of Audit is charged with advisory responsibilities. First, it has to be consulted prior to the issuance of administrative regulations for implementing the Federal Budget Code (BHO, s. 103). This affects particularly regulations concerning financial transactions and accounting systems. For their part, the federal authorities are required to inform the Federal Court of Audit, without delay, whenever there are new federal regulations relating to the management of federal budget funds or affecting federal receipts and payments (BHO, s. 102). Second, the Federal Court of Audit participates in budget negotiations between the Federal Ministry of Finance and departments [BHO, s. 27(2)]. Third, the Federal Court of Audit provides testimony to Parliament in the course of preparatory talks with

the chairs of the parliamentary Appropriations Committee and during that committee's deliberations. There is no legislation requiring this involvement of the Federal Court of Audit in the parliamentary deliberations on the budget, which represents a special case of advising the Parliament. The Federal Court of Audit serves as a valuable source of information for the Appropriations Committee, as it informs and advises the rapporteurs of all the parliamentary political parties in a professional and politically neutral manner.

4.5.4. *Powers of investigation*

The Federal Court of Audit is authorised to obtain all the necessary information for carrying out its functions: all documents must be provided within the prescribed time periods (BHO, s. 95).

4.5.5. *Reporting obligations and publication*

The Constitution requires the Federal Court of Audit to submit an annual report directly to the federal government as well as to the *Bundestag* and the *Bundesrat* (GG, Art. 114). The BHO elaborates: "the Federal Court of Audit shall compile annual observations for the two chambers of Parliament, including the results necessary for the discharge of the federal government in respect to the budget and capital accounts." Any confidential observations shall be transmitted to a more limited audience (BHO, s. 97). Besides an annual report, the Federal Court of Audit may at any time inform both chambers of Parliament of matters of particular importance, provided it informs the federal government at the same time (BHO, s. 99). The law does not require publication, although as a rule, these reports are disclosed to the public. In addition to reports to Parliament, the Federal Court of Audit carries out about 600 audit missions each year, providing relevant report findings to the audited bodies.

4.5.6. *Enforcement of findings*

The *Bundestag* shall, with due regard to the comments of the *Bundesrat*, ascertain the substantial matters raised in the annual report of the Federal Court of Audit and shall decide on the action to be taken (BHO, s. 114). The Federal Court of Audit has no independent powers to enforce its findings – it must convince parliamentary committees by the force of its arguments. Parliament must ensure follow-up: the *Bundestag* sets a date by which the federal government must report back to Parliament on the action taken. When such action has failed to achieve the desired result, either chamber may take up the matter again (BHO, s. 114). As a practice (not a legal requirement), the Federal Court of Audit issues an audit impact report stating whether and how the audit recommendations have been supported by Parliament and what remedial action has been taken.

Duration of budget system law. The budget system laws are permanent laws, unless they are repealed or amended. Whereas the HGrG needs the consent of the both the *Bundestag* and the *Bundesrat* to enact amendments, the federal Constitution and the Federal Budget Code require the consent only of the *Bundestag*, although the *Bundesrat* may lodge objections.

Notes

1. The 1969 laws originally applied to West Germany. Following the Unification Treaty of 1990, the HGrG was amended to apply to East Germany, after which each eastern *Land* adopted an individual budget code.
2. Another of the aims of the StWG was to take the burden of policy adjustment off monetary policy and to make fiscal policy more fast-acting. To this end, new short-term fiscal policy instruments (counter-cyclical funds, limitations on borrowing, and rapid tax increases or decreases) could be implemented by ordinance, thereby avoiding the need for parliamentary approval of new laws. See Hunter (1978) for a fuller discussion.
3. It is not good use of government money to borrow on the capital markets and, at the same time, build up unremunerated government deposits at the central bank. Such a policy provides a hidden subsidy to the central bank.
4. Coverage of entities performing general government functions is incomplete to the extent that private law institutions using commercial accounting are excluded from reporting requirements (see IMF, 2003, paragraph 4).
5. For example, the 1994 coalition agreement stated that the new government aimed to reduce public expenditure to below the pre-unification level of 46% of GDP. However, after 1994, public expenditure continued to grow (see Wurzel, 2003, Figure 21).
6. Agreements reached in the Financial Planning Council, including specific targets for total expenditures of the Federation, each *Land*, and each social security organisation, could be made legally binding. Nonetheless, expenditure targets do not guarantee the achievement of the aggregate deficit target (IMF, 2003, paragraph 80).
7. Although medium-term financial planning was institutionalised in the late 1960s, annual budget plans were not derived from medium-term plans. According to Derlien (1995, p. 82), it has been the contrary: medium-term plans were updated on the basis of the annual budget.
8. Cameralistic cash accounting for public sector use was invented in Austria some 250 years ago and is primarily used in Austria, Belgium, Finland, Germany, and the Netherlands (Lüder, 2002, footnote 3).
9. See Derlien, 1995, for results of a survey of willingness to serve whatever government is in power.
10. See Table 1 of Wurzel, 2003, for the distribution of functional spending by level of government.
11. The intergovernmental fiscal system is described in several publications, including the Finance Report (*Finanzbericht*) and a brochure available on the

Internet site of the Federal Ministry of Finance, *www.bundesfinanzministerium.de/Anlage20651/Finanzbeziehungen-Bund-und-Laender.pdf*.

12. A description of the definition is contained in the administrative regulations on the budget classification of the Federation (*Verwaltungsvorschriften zur Haushaltssystematik des Bundes, Allgemeine Hinweise zum Gruppierungsplan und zum Funktionenplan*, paragraph 3.8.1).

13. Services are reported as a government activity if they are carried out by a government agency, but are not reported if they are carried out by a publicly owned company established under private law. Since the latter are included in the definitions in the national accounts, further coverage adjustments are necessary to convert the official statistical definition of "consolidated government" to that of "general government" as defined in the government finance statistics of the IMF or the system of national accounts (SNA). Wurzel (2003, paragraph 31) discusses some of the differences between official German and European classification norms.

14. Those at federal level are listed in the 2003 Finance Report (*Finanzbericht*) and in footnote 29 of IMF, 2003.

15. See p. 14 of Creel, 2003, for additional references on this debate.

16. The Council of Experts ("three wise men") and their reporting responsibilities are specified in the 1963 Law concerning the Appointment of a Council of Experts.

17. This section is largely based on "Mandates of Supreme Audit Institutions – Germany", *www.bundesrechnungshof.de/en/veroeffentlichung/brh_frame_veroeffentlichung.html*.

18. Exceptions are made in agreement with the Federal Ministry of Finance and the Federal Court of Audit, on condition that: 1) the public law body does not have a substantial impact on federal government finances; and 2) where the institution is responsible for health, long-term care, accident or pension insurance, if it does not receive any federal grants or if a guarantee obligation by the federal government is not in principle justified (BHO, ss. 111-112).

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ISSN 1608-7143
OECD Journal on Budgeting – Volume 4 – No. 3
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Japan*

Structure of the Case Study

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* This study has benefited from helpful comments from Yutaka Sunayama of the Budget Bureau of the Ministry of Finance, Hideaki Tanaka of the Australian National University, and OECD colleagues.

1. Overview

1.1. *The legal framework governing budget processes*

Japan has a comprehensive legal framework for the budget system. The underpinnings of the legal framework governing budget processes are the Constitution 1946, the Public Finance Act 1947 (PFA) and the Diet (Parliament) Act 1947 (Box 1). The Constitution stipulates general principles for public finances. It requires taxes and government spending to be established by law. It also requires the Cabinet, a constitutional body, to submit a draft budget to the Diet. The House of Representatives (the lower chamber) has priority over the House of Councillors (the upper chamber) for final decisions on the budget. Finally, the Constitution establishes the Board of Audit (BOA), which audits annual final accounts of government in order to secure accountability of the government's financial management.

Budget rules not provided for in the Constitution are mainly governed by the PFA. Unlike many countries, this law prescribes the budget process within the executive. Cabinet is given a strong role in budget formulation. The PFA

Box 1. **Japan: Main budget system laws**

- The Constitution 1946, as amended *(www.kantei.go.jp/foreign/constitution_and_government/frame_01.html)*.
- The Public Finance Act 1947, as amended *(www.mof.go.jp/english/budget/brief/2002/2002-35.htm)*.
- The Diet Act 1947, as amended *(www.sangiin.go.jp/eng/law/diet/index.htm)*.
- The Public Accounts Act 1947, as amended.
- The Board of Audit Act 1947, as amended *(www.jbaudit.go.jp/engl/law/index.htm)*.
- The Local Autonomy Act 1947, as amended; the Local Finance Act 1948, as amended; the Local Tax Act 1950, as amended; the Local Allocation Transfer Act 1950, as amended; and various Transfer Tax Acts (including the Local Road Transfer Tax Act 1955, as amended).

Source: Laws are available on the Internet sites maintained by the Cabinet Office, the Ministry of Finance, the Diet, and the Board of Audit respectively. See also *http://homepage2.nifty.com/paper/lawcollection.htm* for part of the laws in English.

contains the general principles of the budgeting and accounting system, including budget preparation and execution procedures in the Ministry of Finance and line ministries. The PFA is complemented by guidelines for budget formulation issued by the Cabinet. These guidelines set out: 1) basic principles, 2) ceilings of expenditure requests for the whole budget including public investment, discretionary expenditures and non-discretionary expenditures for the coming fiscal year, and 3) detailed procedures for budget preparation. The Public Accounts Act 1947 specifies the principles consolidating national treasury funds and the technical procedures for keeping accounts in line ministries. Line ministries are required by law to pay their revenues into the national treasury funds and are prohibited from using their revenues for other purposes.

The Diet Act prescribes parliamentary budget processes: the composition of the Budget Committee which is solely responsible for the review of the Cabinet's draft budget and the reconciliation process between the Diet's two chambers in cases of budgetary disputes. The Board of Audit Act 1947 (BOAA) governs the competence and organisation of the BOA, the coverage of audits, and the audit processes for enhancing accountability and control over the national budget. Finally, various local government acts (notably the Local Autonomy Act 1947, the Local Finance Act 1948, the Local Allocation Transfer Act 1950 and various laws for earmarking revenues) provide local governments with the power to prepare their own budgets. These and other laws specify fiscal relations across levels of government.

All budget-related laws are closely interrelated, with a view to ensuring that the national budget is formulated and implemented to achieve national objectives and policies. However, budgetary arrangements are fragmented and government accounting is complex. The law does not require the government to provide timely information on the overall stance of fiscal policy, such as a mid-year budget report. Also, extensive use has been made of supplementary budgets, in part because the budget system laws do not require fiscal policy to be formulated in a medium-term budget framework. Another distinctive feature of the legal framework is the splitting of the national budget into a general account and special accounts. In addition the budgets of some government affiliated agencies (public corporations) are included in the budget. Borrowing is included in revenues in some of the special accounts. The law does not require consolidated general government reporting on a national accounts basis and such accounts are not prepared by the government.

1.2. Reforms of budget system laws

The budget system laws have operated since the late 1940s with only a few minor amendments. Detailed input-oriented annual appropriations are maintained.

The PFA prohibits the issuance of any government bonds, with the exception of bonds for financing public works and similar expenditures (Art. 4). If the government cannot finance current expenditure with current revenue, a special law is needed to override Article 4 of the PFA. During 1975-2004, new laws were adopted to address macro-fiscal stability issues (Ministry of Finance, 2004, pp. 26-32). First, in 1975, the Diet enacted a special law to enable the government to issue deficit-financing bonds to stimulate the stagnant economy caused by the 1973 oil crisis. The Special Law was in effect initially for only the fiscal year concerned. However, it was renewed annually (with the exception of a few years) to override the golden rule in the PFA. This resulted in the rapid increase in government debt, which rose to 155% of GDP in 2003 (OECD, 2003).

Second, a Fiscal Structural Reform Act (FSRA) was enacted in 1997 (Box 2) to strengthen fiscal sustainability and reduce the issuance of public bonds. In early 1998, the government amended the FSRA to allow the government to issue additional bonds and to extend the fiscal consolidation target from 2003 to 2005 due to the domestic consequences of the Asian economic crisis. As the economy worsened further during 1998, the FSRA was suspended in December of that year.

The experience of FSRA suggests lessons for any future legislation aimed at fiscal consolidation (Tanaka, 2003). First a new act would need to be more flexible in expenditure control at the time of an economic downturn. Second, the cap for each category's expenditure should target not only the initial

Box 2. **Japan: Main contents of the 1997 Fiscal Structural Reform Act**

The Act:

- Restored the "golden rule", whereby the net bond issuance is limited to the level of public investment by FY 2003.
- Aimed to reduce the general government deficit (excluding social security), to below 3% by FY 2003 and to ensure that the sum of taxes, social security contributions and the fiscal deficit does not exceed 50% of GDP.
- Imposed ceilings on most major individual expenditure lines such as social security transfers, spending on public works and education spending.

budget but also the final budget (the cap focused only on the initial budget, whereas expenditure increased significantly through the adoption of supplementary budgets). Unless the act puts strict constraints on expenditure, credibility is undermined.

In recent years, the government has introduced some broad government reforms, which have had significant effects on public finance management. In 2001, the leadership of the Prime Minister and Cabinet was enhanced, with the creation of the Cabinet Office and the Council on Economic and Fiscal Policy. The primary aim of the council is to research and deliberate on important matters of economic and fiscal policy, such as overall economic management, fiscal policy management and budget formulation, including the drafting of the outline of the national budget, formerly the exclusive job of the Ministry of Finance (see section 3.1.3 below). Important steps have been taken to improve the transparency and accountability of government policies. In May 1999, the Diet enacted the law concerning access to information held by administrative organisations, which enables individuals to request the ministries and agencies concerned to disclose their information on public finance management. The Government Policy Evaluation Act 2001 was introduced to evaluate the policies of each ministry and agency, which moves Japan towards the early stages of performance management.

2. Principles underlying budget system laws

Japan has incorporated some traditional budget principles into its legal framework for the budget. However, the modern principles of transparency and performance have not been formally embodied in the budget system laws in a formal manner, apart from general statements in the Constitution and PFA. In particular, the Constitution requires the Diet's prior authorisation of taxation and expenditure of public funds by the executive. The Constitution also specifies the principle of accountability (Art. 90), by requiring final accounts of expenditure and revenues of the government to be audited annually by the BOA, which determines whether public funds were spent in accordance with the laws and regulations concerned. The executive is also accountable for their fiscal activities to the Diet. The Diet reviews whether the budget was executed in line with their intentions, and approves the final fiscal accounts audited by the BOA (Art. 90).

The Constitution, complemented by the PFA, states the principle of the annual budget. The Constitution requires that the draft budget be prepared for each fiscal year (Art. 86), which begins on 1st April and ends on 31 March of the next year (Art. 11, PFA). Budget estimates are provided for a 12-month period. The annual budget is approved prior to the year to which it refers. All transactions are estimated for their one-year effect. An exception to the

principle arises when the government needs to make payment for projects. In this case, the Diet can approve multi-annual amounts for projects (Art. 14bis, PFA).

The principles of unity and universality play an important role in the budget process. The PFA requires all revenues and expenditures to be incorporated into the annual budget (the principle of universality, Art. 14). However, the principle of unity is not fully respected in that three separate budgets (general account, special accounts, and government affiliated agencies), not in the same document, are submitted to the Diet for its approval. Although revenues and expenditures are consolidated, the overall budget balance on a national accounts basis is not shown.

The principle of specificity, which requires revenues and expenditures to be shown in some detail in the budget documents, is embodied in the PFA (Art. 23). The revenue and expenditure budgets are required to be classified according to ministries or agencies concerned. Within that, revenue is categorised by the nature of the revenue whereas expenditure is classified by its purpose.

The principle of a balanced budget, embodied in the PFA, requires that budget expenditures are balanced by budget revenues and financing: "expenditures of each fiscal year should be met by the revenue of the same fiscal year" (Art. 12). The PFA defines the revenue as received funds that serve as the source of payment to meet the demand arising from various levels of the government. Expenditure is defined as disbursed funds to meet the demand arising at various levels of the government in a given fiscal year (Art. 2). Although the PFA requires expenditures to be appropriated within the current year's revenues inclusive of borrowing for public works expenditures (Art. 4), as noted above, special laws overriding this principle have been enacted.

Finally, while there are many respects in which fiscal transparency meets international standards (IMF, 2001a), including the rich amount of information that is presented to the Diet and the public, there is still room for progress in key areas. For instance, the government does not provide the Diet with consolidated data for the general account, the special accounts and the budgets of government affiliated agencies. Nor does it provide consolidated budget information for the central government, local government and the social security system in the draft budget.

3. Legal basis for the establishment and the powers of the actors in the budget system

3.1. The executive and the legislature

3.1.1. Overview

Japan is a unitary and parliamentary State with three layers of government (central government, regional government – mainly prefectures, and municipalities). Executive power is vested in the Cabinet under the Constitution. Only the Cabinet has the authority to prepare the draft budget and submit it to the Diet around early January. The Diet has two Houses: the House of Representatives (HR) and the House of Councillors (HC). The imposition of taxes and the appropriation of expenditures require the authorisation of the Diet. The deliberation in the Diet on the draft budget begins in the HR, and after approval at the plenary session of the HR, it is sent to the HC around early March, even though this is not a legal rule.

3.1.2. Roles and responsibilities of the Cabinet and individual ministers

The Constitution states that the Cabinet, being composed of the Prime Minister and other ministers defined by law, has executive power (Arts. 65 and 66). The Prime Minister, the head of the Cabinet, is designated from among the members of the Diet by a resolution of the Diet (Art. 67). The Constitution provides the Cabinet with various powers, including: *i)* to administer the law faithfully, *ii)* to administer the civil service, and *iii)* to prepare the budget and present it to the Diet. The Cabinet Office was newly established by law in January 2001, by consolidating several ministries including the former Prime Minister's Office and the Economic Planning Agency. The Cabinet Office is in charge of overall policy planning and co-ordination to support the Cabinet's strategic function.[1] The Cabinet Law 1947 as amended specifies the operational procedures of the Cabinet and limits the number of Cabinet members to not more than 17.[2] The Constitution requires Cabinet ministers to take collective responsibility for the exercise of executive power (Art. 66).

3.1.3. Establishment of ministries and executive branch agencies

General principles for establishing ministries, commissions, and agencies are stated in the National Organisation Act 1948 (NOA), as amended.[3] The NOA provides only general rules, and the list of ministries, commissions and agencies are contained in an appendix. Each ministry must have its own establishment law, specifying its functions (Art. 4). Accordingly, the Establishment of the Ministry of Finance Act 2000 was adopted as a result of the central government organisation reforms. The Ministry of Finance, having a budget bureau and a tax bureau respectively, is responsible for fiscal

management of the central government. The Ministry of Finance prepares the national budget, submits it to Cabinet for approval, and oversees the execution of the budget by line ministries.

The Council on Economic and Fiscal Policy (CEFP)[4] created in 2001 under the Cabinet Office shares responsibility with the Ministry of Finance for fiscal policy and budgeting (the Cabinet Office Establishment Act 1999). Even though it is an advisory board to the Cabinet, it deliberates on some key issues including policies on economic and fiscal management and guidelines for budget formulation. One of the most striking events in the budget process is that the first draft on guidelines for formulation of the budget is prepared by the CEFP. The Finance Minister is one of the members of the CEFP and contributes to policy making for economic and fiscal management. By contrast, the Minister for Public Management, Home Affairs, Posts and Telecommunications is responsible for local government finance and administration.

The objectives and scope of the activities of each public corporation are specified in its establishment law. Most government funds in the form of capital subscriptions, loans, and transfers, are reported in the national budget. In particular, profit and loss statements, and balance sheets of the 62 largest public corporations are provided to the Diet. Public corporations, and some privatised companies in which the government retains an equity interest, have public policy obligations related to the provision of universal services and other non-commercial objectives.

3.1.4. Responsibilities of senior civil servants

There are no special legal provisions for senior civil servants for budget management. All civil servants are bound by a code of conduct, which is derived from the National Public Service Ethics Law 2000, as amended. According to the code of conduct, civil servants are required not to give unfair, discriminatory treatment to the public with respect to information gathered in the performance of their duties, recognising that they are servants of the whole nation and not of any special group.

3.1.5. Establishment and roles of parliamentary committees

The Constitution states that the Diet is the highest organ of State power and is the sole law-making organ of the State (Art. 41). The Diet Act requires that the budget must first be submitted to the HR, and the Committee on the Budget be established as a Standing Committee to consider the draft budget submitted by the Cabinet in the HR and the HC respectively (Art. 41). Upon consideration of the budget, when the HC makes a decision different to that of the HR, the Constitution (Art. 60) complemented by Chapter X of the Diet Act

(Relations between the Two Houses) requires a special procedure – a reconciliation process by means of a Conference Committee of both Houses to reach an agreement on the budget. A Conference Committee is comprised of selected members from both Houses. If the Conference Committee cannot come to an agreement, or if the HC does not make a final resolution within 30 days after the receipt of the budget by the HR, the conclusion made by the HR prevails over that of the HC. This procedure facilitates budget deliberations by both Houses and does not unduly delay the passage of the draft budget in the Diet.

3.2. Role and responsibilities of sub-national governments

The Constitution as amended provides the basic principles for the operation of local government. First, the organisation and operations of local governments should be enacted in accordance with the principle of local autonomy (Art. 92). Second, members of the legislature and the head of the executive should be elected by direct public elections (Art. 93). Third, local authorities have the right to manage their property, affairs and administration and to enact their own regulations within the law (Art. 94), which delegates much of its power to a number of laws concerning local government.

One of the main laws is the Local Autonomy Act 1947 (LAA), as amended, which establishes a two-tier structure of prefectures and municipalities (47 prefectures including the metropolis of Tokyo and 3 100 municipalities, as of April 2004), and specifies the structure, composition and powers of elected councils and their executive bodies. The LAA also defines the status of local authorities, including their relationship with central government as well as other local authorities, and has legal provisions for their financial affairs and other important administrative matters.

Despite the fact that local authorities are authorised to levy and collect taxes (the Local Tax Law 1950, as amended), the basic pattern of managing service delivery remains centralised, and most local governments' revenues depend on the central government's assistance. Locally-raised revenues account for 35-40% of total local revenues. The Local Finance Act 1948 (LFA) as amended also authorises local authorities to issue bonds to finance capital expenditures and the expenses of public enterprises (Art. 5). Prefectures, however, must obtain approval from the Ministry of Public Management, Home Affairs, Posts and Telecommunications, and municipalities require approval from the prefecture prior to issuing bonds.[5] Besides these, local authorities also receive direct grants from central government, as well as revenues from various shared taxes (Box 3). National Treasury disbursements are grants whose use is predetermined by central government under the LFA. The legal basis of tax-sharing arrangements is provided by various transfer tax acts including the Local Road Transfer Tax Act 1955, as amended.

Box 3. **Japan: Grants from central government to local governments**

- **Earmarked grants.** National Treasury disbursements is the name for funds disbursed from the central government to local governments for specified uses. There are three types of national treasury disbursements: 1) National Treasury obligatory shares, which are payable for undertakings that are carried out under the joint responsibility of the central and local government, 2) National Treasury grants in aid, which are distributed as subsidies for local undertakings, 3) National Treasury payments for tasks that are the responsibility of the central government, but are entrusted to local authorities for convenience and efficiency.
- **Shared taxes, largely for equalisation**. On the basis of the Local Allocation Transfer Act, certain taxes are shared, aimed at adjusting imbalances in local government's revenue raising capacities, ensuring that local governments can provide a standard level of administrative services and making basic public investments for people. The total amount is linked to certain percentages of national tax revenues: 32% of income tax, corporate tax, and liquor tax; 24% of consumption taxes; and 25% of tobacco excise taxes.
- **Shared taxes, for specific purposes.** The local transfer taxes are the basis for the transfer of the proceeds of part of certain national taxes to local governments for specific purposes. A major example is the local road tax on fuels such as petrol, which is collected by the central government and subsequently transferred to prefectures and municipalities as the local road transfer tax.

The Local Allocation Transfer Act 1950, as amended, requires local authorities' budget estimates of income and expenditure to be approved by Cabinet, submitted to the Diet for information and published (Council of Local Authorities for International Relations, 2002). The programme shows whether the local authority revenues will be sufficient to provide a given level of service as well as meet legal obligations. The process involves totalling all local authority income and expenditure; if revenue is insufficient, the central government is required to support local governments, by amending the local tax system, increasing the local allocation transfer, issuing bonds, or other assistance.

4. Legal provisions for each stage of the budget cycle

4.1. Budget preparation and presentation by the executive

4.1.1. Institutional coverage of the budget

The PFA applies to the national budget (Art. 1), which is divided into a general account and special accounts (Art. 13), and the budgets of government affiliated agencies. The national budget covers all ministries, commissions, agencies, and some public corporations. The national budget is submitted to the Diet in the form of the general account, 31 special accounts (as of April 2004) and the budgets of nine government affiliated agencies.[6] All ministries are included in the general account, but only some ministries are authorised to establish special accounts and government affiliated agencies. Local governments' budgets are excluded from the application of the PFA – they are governed by the LFA as amended.

4.1.2. Extrabudgetary funds and earmarking of revenues

The budget is fragmented because of the multiplicity of special accounts and government affiliated agencies (Ministry of Finance, 2004, p. 3). Special accounts can be established only by legislation (Art. 13, PFA). The government has initiated the creation of special accounts to carry out specific projects, to administer and manage specific funds, or to administer revenues and expenditures separately from the general account. All special accounts are submitted to the Diet for parliamentary review and expenditures can not be appropriated without the Diet's authorisation. Each special account generally has its own distinct source of revenues; some accounts can finance imbalances by borrowing or receiving funds from the general account. The government's loan programme is managed through one of the special accounts – the Fiscal Loan Fund Special Account, which is a main part of Fiscal Investment and Loan Programme (FILP). National pension and health care services have operated as special accounts (for example, National Pension Special Account, Labour Insurance Special Account).

A number of government affiliated agencies have been established under special laws. Whereas the central government provides subsidies to these agencies, which are fully capitalised, the budgets for most of them are not subject to the Diet's approval. However, nine agencies (seven public financial corporations and two banks), [7] which are closely linked to overall government policies, have their budgets approved by the Diet. Since most of these agencies are not institutional units within "general government" – as defined by the GFS manual of the International Monetary Fund (IMF, 2001b) – they cannot be regarded as extrabudgetary funds. Rather they are quasi-fiscal activities, where the government uses enterprises – either financial or non-financial – for fiscal policy purposes. These enterprises are under the surveillance of line

ministries. By law, the budget and financial plan of each government corporation is required to be approved by the Finance Minister as well as by the responsible minister.

4.1.3. Definition of budget aggregates

The law does not provide a definition of the various budget aggregates. For the general account, the guidelines for budget requests clearly define, and establish ceilings for, the bulk of the total expenditure for the next year. The difficulty in defining "government" revolves around the extensive use of special accounts, some of which are outside the general government sector.

4.1.4. Fiscal rules

Up until 1975, a version of the golden rule, which limited borrowing to construction bonds issued to finance investment spending, had worked strictly. Thereafter, this was replaced by renewable laws that allowed the government to issue special deficit-financing bonds in addition to construction bonds. The FSRA set a medium-term fiscal target for reducing the government deficit, but this law was suspended in 1998. In 2003, the government's revised reform and perspective programme aimed at maintaining general government expenditures at no more than the level in FY2002 (about 39% of GDP) and achieving a primary budget surplus by the early 2010s. Although this rule is not legally binding, it has substantial force in the Cabinet, which makes the important decisions for the annual budget.

4.1.5. The timetable for budget preparation and presentation to Parliament

The Constitution only requires Cabinet to prepare and submit a draft budget to the Diet. The PFA specifies that the draft budget is to be submitted to the Diet by the Cabinet during January of the current fiscal year (Art. 27). Most of the provisions for the timetable for the budget process (Box 4) are set out in the PFA, guidelines or regulations.

The Prime Minister and other ministers submit the initial estimates of revenues and expenditures (so-called "budget requests") to the Minister of Finance. The government Ordinance for Budget, Settlement and Accounting requires budget requests to be submitted by the end of August (seven months before the next fiscal year beginning on 1st April) (Art. 8). Prior to this, ceilings are proposed by the Finance Ministry in consultation with the Prime Minister and the Cabinet Office. The CEFP discusses the content of the guidelines in detail and sends them to line ministries after the Cabinet authorises them.[8] The PFA requires the Minister of Finance to co-ordinate budget requests by line ministries, and to prepare the budget proposal to be approved by the

Box 4. **Japan: The timetable for the budget process**

- 1st April: a new fiscal year starts.
- April to August: preparation of budget requests by line ministries.
- July to August: examination of the guidelines for budget requests by the CEPF and issuance of them by Cabinet.
- End of August: submission of budget requests by line ministries to the Ministry of Finance.
- September to December: scrutiny of line ministries' budget requests and bilateral discussions with the Ministry of Finance, in order to prepare the draft budget proposal for Cabinet approval.
- Beginning of December: issuance of the guidelines for budget formulation prepared by the Ministry of Finance and approved by the Cabinet.
- Mid-December: presentation of the budget proposal by the Ministry of Finance to the Cabinet. Final negotiations between Finance Minister and each line minister to settle remaining disputes, usually on politically important matters.
- Late December: approval of the budget proposal by the Cabinet.
- Early January: submission of the budget proposal to the Diet.
- March: approval of the budget by the Diet.

Source: Ministry of Finance, 2004.

Cabinet (Art. 18) usually in December. Thereafter, budget documents are prepared by the Minister of Finance and submitted to the Diet by the Cabinet in January based on a Cabinet decision (Arts. 21 and 27).

4.1.6. Approval process within the executive

Unlike in most countries, where budget approval within the executive is determined by internal rules, the law (the PFA) contains a few key provisions relating to Cabinet approval of the budget. Around the beginning of December, Cabinet issues the "General Principles of Budget Formulation" and the Ministry of Finance completes the draft budget in accordance with the PFA requirements. Negotiations take place between the Ministry of Finance and relevant line ministries. After reconciliation, the draft budget is officially approved by the Cabinet at the end of December. The PFA requires the Cabinet to submit the draft budget and additional documents to the Diet during January of the current fiscal year (Art. 27).

4.1.7. Documents to accompany the budget law

The PFA specifies five areas which must be covered in the budget to be submitted to the Diet (Art. 16). Other articles of the PFA elaborate on these five areas, notably:

- **General provisions.** There is an emphasis on comprehensiveness, including the provision of ceilings on public bonds as well as on Treasury bills, temporary borrowings, and other liabilities to be borne by the Treasury; the range of expenses for public works; and other matters necessary for budget implementation (Art. 22).
- **The revenue and expenditure budget.** Estimates are drawn up in the executive according to the binding procedures of the PFA. Detailed revenue and expenditure estimates must be annexed to the budget.
- **Continuing expenditures.** The expenditures for which there is an exception to the single-year budget principle are stated to include construction and manufacturing (Art. 14bis). The same article limits continuing budget authority to a maximum of five years. Both the scope and duration of such expenditures is subject to the Diet resolution.
- **An approved expenditure to be carried over to the following fiscal year.** This arises where the appropriation is not likely to be spent within the fiscal year concerned due to its nature or any reasons after the budget is approved, subject to the Diet resolution (Art. 14ter).
- **Future liabilities that could be borne by Treasury (contract authorisation).** This system allows the government to make contracts for projects in which it is necessary to incur a liability within a given fiscal year and make all or part of the outlays in subsequent years. The draft budget must contain an amount for such contracts (Art. 15). The government is required to get advance approval from the Diet for possible future disbursements.

Medium-term macroeconomic framework and fiscal strategy. Although the budget is formulated under the single-year budget principle stipulated by the PFA (Art. 14) and no law requires the presentation of a medium-term budget framework, the government has developed medium-term fiscal planning for providing the basis for economic and fiscal policy decisions in the government. The Ministry of Finance usually releases a "Medium-Term Fiscal Projection" at the end of January when the session in the Diet begins. The Cabinet Office also prepares medium-term scenarios, based on a macroeconomic model. Such projections provide the Diet with information on the medium-term fiscal implications of current budget policies, although it does not place firm ceilings on total or specific categories of main expenditures for the following years.

New measures *versus* existing expenditure policies. The PFA does not require a distinction to be made between new measures and existing expenditure programmes of the draft budget. However, in practice, the above-mentioned medium-term projections of the Ministry of Finance are on the basis of unchanged policies,[9] whereas those of the Cabinet Office include some policy changes such as structural reforms.

Performance-related information. The Government Policy Evaluations Act 2001 requires line ministries to provide some information on evaluation when they submit their budget request to the Ministry of Finance. Although a lot of information on evaluation is released by each ministry through the year and the overall evaluation report by the Ministry of Public Management is tabled in the Diet, such information is not included in the budget documentation. Nonetheless, the Diet may use performance-related information for making budget decisions.

Tax expenditures, contingent liabilities and fiscal risks. No law requires the government to include a statement of tax expenditures and major fiscal risks in the budget. Nonetheless, the Ministry of Finance usually provides a report on tax expenditures to the Budget Committee of the Diet. The report states how much revenue is reduced by each specific tax expenditure for several years, including the budget year.

Government guarantees are required to be approved by the Diet. Accordingly, detailed information of each contract for government guarantees and indemnities are included in the budget documents. Furthermore, the amounts of obligations and dissolutions (flows) and carryover to the following years (stocks) of each guarantee are reported in the "Statement of Liabilities of the State" and submitted to the Diet with the final annual accounts.

Other information required by law. The PFA requires a considerable amount of supplementary information to accompany the budget (Art. 28), including for corporations under government control (Box 5). In practice, the profit and loss accounts and balance sheets of the 62 largest public enterprises are submitted to the Diet for information.

4.1.8. Budgets of Parliament and other constitutional bodies

Constitutional organisations, notably the two chambers of the Diet, the Supreme Court (and the Board of Audit) prepare their budget estimates differently from line ministries. The PFA provides a special process for these constitutional organisations, giving them the authority to prepare their budget estimates and submit them directly to Cabinet with the Cabinet co-ordinating all budget proposals (Art. 17).[10] The PFA requires the Minister of Finance to make the necessary adjustment on the estimated amount proposed by constitutional organisations subject to the Cabinet decision

Box 5. **Japan: Additional documents attached to the draft budget**

- Specification of the revenue budget.
- Request of the planned expenditure of each ministry or agency.
- Statement of the total and net amount of the final fiscal reporting of the previous three years including the current fiscal year.
- Report on the state of national treasury funds in the previous three years including the current fiscal year.
- Report on the state of national bonds and borrowings, the estimated balance as well as the list of the year of redemption of public bonds and borrowing.
- Report on the balance of national property in the three previous years.
- Report on assets and liabilities, and profits and losses of major corporations in which the government has invested in the three previous years.
- Report on any measures incurring liabilities with National Treasury funds including the plan of the repayment.
- Report on continuing expenditure.

(Art. 18). When the Cabinet intends to make decisions on these estimates, the PFA requires Cabinet to ask in advance the heads of those organisations for their opinions (Art. 18). Furthermore, in cases where the Cabinet reduces the estimates proposed by those organisations, the PFA requires the Cabinet to clarify this in the budget (Art. 19).

4.2. Budget process in Parliament

4.2.1. The timetable for budget adoption and constraints on the budget debate in Parliament

According to the Constitution and the Diet Act, the parliamentary review process starts in the HR first. Major stipulations in the Diet Act concerning parliamentary budget review are as follows:

- A Committee on the Budget may be established as a Standing Committee in each House to consider the budget proposal (Art. 41).
- The Committee on the Budget is required to hold open hearings on the overall budget and to hear views from the interested parties (Art. 51).
- Motions of budget amendment are allowed (see section 4.2.3 below).

After the approval of the budget by the HR Budget Committee, the amendment of which is not always the case, it is put to a vote at a plenary session of the HR. Following its approval, the budget is then sent to the HC,

whose Budget Committee deliberates in the same way as that of the HR. Likewise, the Budget Committee sends the budget to the plenary session of the HC for its approval. Provided approval is received before 1st April, the budget becomes effective as from that date, the beginning of the fiscal year. The Constitution and the Diet Act stipulate special reconciliation procedures in a situation where the two Houses have different opinions on the budget (see section 3.1.5 above).

4.2.2. Provisional budgets

The PFA (Art. 30) allows the Cabinet to prepare a provisional budget to cover a specified portion of the fiscal year in order to avoid the shutdown of the government, when the Cabinet expects that the regular budget cannot be approved by 1st April, for reasons such as an upcoming general election. The provisional budget becomes invalid once the regular budget is approved by the Diet. Expenditures or contracts based on the provisional budget are regarded as based on the regular annual budget. The law does not mention the scope of the provisional budget in detail, but in practice the expenditures in the provisional budget are strictly limited to those that are indispensable to be appropriated for the proper functioning of the government until the adoption of the regular budget by the Diet.

4.2.3. Powers of amendment

The Diet Act provides the Diet with the power to amend the draft budget. The Act requires a motion of budgetary amendment to be supported by at least 50 members in the HR or at least 20 in the HC (Art. 57bis), but the act does not place quantitative limits on amending the draft budget. However, the Constitution also stipulates that only the Cabinet makes budget proposals. Moreover, the Diet Act requires a House or a Budget Committee to afford the Cabinet an opportunity to give its opinion on a proposed amendment that increases the total amount in the budget (Art. 57ter).[11] Although the Cabinet does not have the right to veto the budget amendment made by the Diet, the general understanding is that the Diet cannot amend the government's budget proposal significantly. By virtue of the nature of parliamentary government, the executive directly depends on majority support in the Diet, and the composition of the Diet and the executive are intertwined, so the executive's draft budget is conventionally accepted without any serious amendments or modifications.[12] Like other parliamentary governments, attempts by the Diet to refuse the draft budget of the executive, if successful, would be considered tantamount to a vote of no confidence in the government.

4.2.4. Approval of resources

The Constitution states that no new taxes are imposed or existing ones modified except by law or under such conditions as the law may prescribe (Art. 84). The PFA states that any surcharge as well as any monopolistic price or charge for a service which legitimately or practically belongs to the government, is determined in accordance with the law or by a Diet resolution (Art. 3).[13] In addition, the Diet approves the draft annual revenue budget prepared by the Cabinet and set out according to the source of the revenues.

4.2.5. The nature, structure and duration of appropriations

The budget appropriations specify the maximum limit of government expenditures although this is not specified by law. Concerning the structure of appropriations, the PFA requires the budget including the special accounts, to be classified administratively (according to department and division) and into paragraphs *(kwan)* according to the purpose of the disbursement (Art. 23). Within ministries, the PFA requires expenditure paragraphs *(kwan)* to be subdivided into articles *(kou)*. Articles *(kou)* are the unit of appropriation by the Diet and the budget documents include detailed figures which break down articles *(kou)*. The budget is adopted mainly on an economic classification of expenditure, supplemented by a mixed programme and functional classification at a more detailed level. In line with this classification, line ministries are required to implement expenditures.

4.2.6. Carryover of appropriations and borrowing of future appropriations

The period of the appropriation is usually one year except for continuing expenditure. For projects such as construction and manufacturing which require a few years for completion, the government may continue to disburse over several fiscal years, subject to the Diet resolution in advance (Art. 14bis, PFA). The continuing expenditure does not exceed five consecutive years unless the Diet authorises it. There are no permanent appropriations.

Expenditure that is not likely to be spent within the fiscal year is allowed to be carried over to the following fiscal year under exceptional circumstances. The PFA permits carryover to the following fiscal year with the approval of the Ministry of Finance if this is caused by the nature of expenditure or any reasons after the approval of the budget, subject to the Diet resolution in advance (Art. 14). For the purpose of obtaining approval of the Ministry of Finance, the PFA (Art. 43) requires line ministries to prepare a statement of carryover, in which reasons for and the amount of expenditure to be carried over is specified by item. If approval is obtained, the expenditure may be carried over and used in the following years within the approved amount. Line

ministries are also required to report the use of the carried over expenditure to the Ministry of Finance and the Board of Audit.

4.2.7. Public debt approval

The Constitution requires that all obligations entered into by the government be authorised by the Diet (Art. 85). Obligations include both debt and potential liabilities such as guarantees. The PFA stipulates that public bonds or borrowings are only permissible for limited purposes such as the finance of public works expenses not exceeding the amount approved by the Diet resolution with repayment plans submitted to the Diet (Art. 4). All matters with some exceptions concerning the issue of public bonds are prohibited to be undertaken by the Bank of Japan (Art. 5). The limit of the amount of public bonds or borrowings must be included in the general provisions of the annual budget and approved by the Diet (Art. 22). Furthermore, in cases where a surplus is generated in current transactions in each fiscal year, an amount equivalent to more than half of the surplus, in addition to what is otherwise required by other laws, is used for the redemption of public bonds and repayment of borrowing, within two years from the fiscal year in which the surplus was generated (Art. 6).

4.2.8. Promulgation, veto and publication of the adopted budget

There is no legal requirement for promulgation because the budget is not perceived as law which requires promulgation to take effect. The Constitution and the PFA require the government to make the adopted budget available to the public. The Constitution stipulates that the Cabinet should report regularly to the Diet on the fiscal information (Art. 91). The PFA provides that the content of the national budget, and supporting information, should be made available to the public as soon as it passes the Diet (Art. 46).

4.2.9. Supplementary budgets (rectifying laws)

The PFA provides the legal basis of supplementary budgets. The Cabinet is permitted to prepare and submit a draft supplementary budget to the Diet to amend the initial budget (Art. 29). There is no legal constraint on the number of supplementary budgets. The Cabinet can compile a supplementary budget and submit it to the Diet in the following cases: 1) to supplement a shortage of funds necessary to meet statutory contractual government obligations, or to supplement the budget so as to meet additional expenditure or contract requirements needed after the budget is made; and 2) to modify the budget for other reasons arising after the budget is made.

Supplementary budgets are adopted for a variety of reasons such as the necessity of stimulating the economy or recovering from a natural disaster.

The final budget is often different from the initial budget, which may be formulated in a contractionary stance compared with the previous year. Frequent use of supplementary budgets has a risk of undermining confidence in the value of the initial budget.

4.2.10. Budgetary implications of other bills

In cases where a motion of amendment on bills brings about an increase of the budget or requires budgetary action, the Diet Act requires a House or Budget Committee to afford the Cabinet an opportunity to give its opinion on an amendment to increase the total amount of the budget (Art. 57ter).

4.3. Budget execution

4.3.1. Apportionment of expenditure authority

The PFA governs budget implementation. The PFA requires the Cabinet to allocate appropriations to line ministries by article and by item (Art. 31). The Ministry of Finance is required to report this to the Board of Audit (Art. 31). Overall responsibility for executing the budget is given to the head of each ministry and agency, following detailed allocation (Art. 32). To spend, the PFA requires line ministries to prepare a draft disbursement plan and submit it to the Ministry of Finance for approval (Art. 34). The Ministry of Finance also is required to prepare implementation guidelines to be decided by the Cabinet, taking into account the state of National Treasury funds, revenues, finances and expenditures. When the Minister of Finance approves the draft disbursement plan, he/she is required to report it to the line ministries and the Bank of Japan.

4.3.2. Cancellation of budget authority and other in-year expenditure controls

There is no legal provision which allows the cancellation of a spending authority by the executive. In practice, when the executive needs to cancel appropriations, a supplementary budget is proposed.

4.3.3. Emergency spending, excess spending and contingency funds

The Constitution requires a contingency fund to be authorised by the Diet and to be expended for unforeseen deficiencies in the initial budget upon the responsibility of the Cabinet (Art. 87). On this basis, the Cabinet prepares a certain amount of unallocated expenditure in the annual budget not specifying any particular purpose, and the Diet reviews whether the proposed amount is appropriate. Once the draft budget is approved by the Diet, the Cabinet may spend the money as it deems appropriate for unexpected circumstances such as natural disasters or a weaker-than-projected economy. The PFA provides procedures on how to use the contingency fund. The

Ministry of Finance is granted the power to manage and use it (Art. 35). For the use of the contingency fund, the PFA requires line ministries to prepare documents specifying the reasons for its use, the amount of the expenditure to be used and the grounds of the calculation of the expenditure to be used, and submit it to the Ministry of Finance (Art. 35). Then, the Ministry of Finance reviews and adjusts the request and seeks the Cabinet decision. When Cabinet approves the proposal of the Ministry of Finance, spending may take place. After using the contingency fund, line ministries are required to prepare and submit the report on how it used the money. The Ministry of Finance then prepares a comprehensive report for the Diet's approval, after the opening of the subsequent ordinary session of the Diet.

4.3.4. *Transfer and virement of appropriations within the year*

The PFA strictly limits the use of budget spending authority by line ministries. The PFA prohibits line ministries from using expenditures for any purpose other than those appropriated in the approved budget (Art. 32). The PFA also prohibits line ministries from transferring budget authority for paragraphs *(kwan)* among ministries and divisions (Art. 33). Only in cases where such a transfer was approved in advance by the Diet, taking into account the necessity of implementing the budget, can the appropriated budget be transferred upon obtaining the approval of the Ministry of Finance. Spending ministries that wish to transfer budget spending authority at the item level (*i.e.* within articles, *kou*) can only do so upon obtaining the approval of the Ministry of Finance (Art. 33.2). If the ministry would like to transfer money between articles *(kou)*, approval of the Diet is required.

4.3.5. *Cash planning and management of government assets and debts*

The Ministry of Finance is responsible for cash planning and management of government assets and debt. Based on the implementation plan approved by the Ministry of Finance, money is allocated to line ministries from the National Treasury funds established in the Bank of Japan (Art. 2 of the Public Accounts Act 1947, as amended). The Bank of Japan, in cases where a cheque issued by line ministries is presented, is required to pay the amount of money required (Art. 28). The Public Accounts Act also requires the separation of the duty of disbursement and account keeping in order to prevent any possible corruption (Art. 26). The PFA provides the legal basis for the management of national public property. National property, unless otherwise authorised by law, is not to be exchanged as a payment or transferred without the receipt of a proper price. It needs to be managed in the most efficient manner (Art. 9).

4.3.6. Internal audit

Line ministries' financial activities are under the control of the Ministry of Finance. The PFA requires line ministries to implement their budgets in accordance with guidelines issued by the Ministry of Finance, which need to be approved by the Cabinet. In addition, under the Public Accounts Act 1947, as amended, line ministries are required by the Ministry of Finance to report revenues and expenditures, to conduct field examinations of the state of budget implementation and, subject to Cabinet decision, to give the necessary instructions for implementation of budget (Art. 46). Even though the Ministry of Finance has authority to require field examinations of budget implementation, in practice this authority has not been exercised for a long time. Instead, the Ministry of Finance has carried out a budget execution survey on selected projects since fiscal year 2002 to review whether the budget execution of each line ministry is efficient and effective. Internal audit procedures are set out in the administrative guidelines of line ministries, and internal audits are subject to review by the Board of Audit.

4.4. Government accounting and fiscal reporting

4.4.1. The accounting framework

The PFA states that the government accounts consist of the general account and special accounts (Art. 13). Expenditure authority is cash based, as the PFA states that "expenditure shall mean disbursed funds" (Art. 2). The term "income" as used in the law, shall mean received funds that serve as the source of payment to meet demands, while "expenditure" shall mean disbursed funds to meet various demands (Art. 2). Non-cash transactions are excluded.

4.4.2. Government banking arrangements

The National Treasury funds account is at the Bank of Japan, into which revenues from the general account and the special accounts are paid and out of which the expenditures from both accounts are met (the Public Accounts Act 1947, as amended). All national funds are accounted for as government deposits at the Bank of Japan. They are classified into a checking account, a separate account, or a designated account, and receipts into and payments from the accounts are made only from the Bank of Japan (Ministry of Finance, 2004, p. 16).

4.4.3. In-year reporting

The Constitution provides that at regular intervals and at least annually, the Cabinet is required to report to the Diet and the public on the state of the national finances (Art. 91). Accordingly, there is quarterly reporting to the Diet and the public on the execution of the budget, with a one quarter lag. There is

also monthly reporting of the receipts and outlays of national treasury accounts, with a two month lag (IMF, 2001a).

4.4.4. Annual accounts and reports

The Constitution requires the BOA to audit the government's annual accounts and for the Cabinet to submit the accounts to the Diet, together with the audit report of the BOA (Art. 90 of the Constitution and Art. 40 of the PFA). For the Ministry of Finance to prepare the annual accounts, after the close of the fiscal year, the PFA requires line ministries to submit their accounts to the Ministry of Finance. Based on these, the Ministry prepares consolidated accounts for total revenues and expenditures, as well as a statement of liabilities (Art. 37). After approval by the Cabinet, the annual accounts are required to be sent to the BOA by 30 November (Art. 39), *i.e.* within eight months after the end of the fiscal year.

There is no legal provision requiring the government to make special reports such as long-term projections, statements of fiscal policy intentions or of the major fiscal risks in budget projections.

4.5. External audit

4.5.1. Managerial, financial and operational independence

The Board of Audit (BOA) is established in the Constitution, which requires an annual audit and statement of audit by the BOA (Art. 90). The Constitution leaves the details of the organisation and competency of the BOA to be set out in legislation. In view of this, the Board of Audit Act (BOAA) was adopted in 1947. Unlike many countries, the BOA is not directly under the Diet, but under the Cabinet. The BOAA, however, states that the BOA is independent from the Cabinet in terms of operation, appointment and finance (Art. 1).

The BOA is composed of Audit Commission consisting of three commissioners and a General Executive Bureau in order to secure the independence of the BOA in terms of its management and decision making (Art. 2). Commissioners are appointed by Cabinet with the consent of both Houses of the Diet (Art. 4). The president of the BOA is appointed by the Cabinet in accordance with the decision of the commissioners (Art. 3). Their term of office is seven years and they may be reappointed only for one additional term (Art. 5). A commissioner can only be removed from office on the decision of both Houses where he/she is unable to perform their duties due to mental or physical impediment or he/she is in violation of their duties in office (Art. 6). A commissioner is also not required to resign unless he/she is condemned to a serious penalty by a criminal court (Art. 7). The PFA provides a special budget process for the BOA in order to strengthen its financial

independence, giving the BOA the authority to prepare its budget estimates and submit them to Cabinet.

4.5.2. Institutional coverage of audits

The BOAA requires the BOA to audit all financial and non-financial matters/activities of the central government, as well as of public corporations (Arts. 22 and 23). Public corporations include entities partially owned or invested in by the government. Audits cover:

- Revenues and expenditures of the government.
- Acceptance and distribution of cash and goods owned by the government.
- The accounts of legal entities if more than half of the capital is invested by the government.
- Securities which are owned or taken custody of by the government, and cash and goods taken custody of by the government.
- Acceptance and distribution of cash, goods and securities by entities other than on behalf of the government.
- The accounts of bodies that receive subsidies, incentive grants, or other financial assistance such as loans or indemnity of losses, directly or indirectly by the government.

4.5.3. Types of audit

The BOAA requires the BOA to audit annual accounts to secure their adequacy and rectify their mistakes from the viewpoints of accuracy, regularity, economy, efficiency and effectiveness (Art. 20): 1) whether expenditures (settlement of accounts) fairly reflect implementation of the budget and its financial position (accuracy); 2) whether accounting is in conformity with the budget requirements, laws and regulations (regularity); 3) whether projects are implemented in economical and efficient ways (economy and efficiency); and 4) whether project goals are achieved (effectiveness). Traditionally, the first two objectives used to be dominant, but since the late 1990s, economy, efficiency and effectiveness audits have become increasingly important (OECD, 2000).

4.5.4. Powers of investigation

Those bodies subject to audit by the BOA are required to submit to the BOA statements together with supporting documents in accordance with the regulations (Art. 24). The BOA may dispatch its staff to conduct field audits on a regular or irregular basis (Art. 25). The BOA, if necessary for its audit, may demand submission of books, documents or reports from those bodies subject

to audit by the BOA, or may ask questions or demand appearance before it of a person concerned (Art. 26).

4.5.5. *Enforcement of findings*

In cases where the BOA deems, as a result of an audit, that an official in charge of government financial transactions has caused a grave loss to the government intentionally or through gross negligence, it may make a demand for disciplinary action against the official, to the head of the line ministry concerned or to other persons responsible for supervising him/her (Art. 31). In cases where the BOA adjudicates that a cash-handling official or a goods-handling official is liable to pay an indemnity, the head of the line ministry concerned is required to order him/her to pay the indemnity in accordance with the adjudication made (Art. 32). Furthermore, in cases where the BOA deems that an official in charge of government financial transactions has committed a crime while discharging his/her duties, the BOA is required to notify the Public Prosecutors Office of the matter (Art. 33).

Notes

1. The new Cabinet Office is part of three interrelated organisations: the new Prime Minister's Office (secretary and advisors), the Cabinet Secretariat (a small number of officers, about 50 to 100, dealing with strategic issues of the government), and the Cabinet Office (dealing with a wide range of issues; like a ministry in size).
2. The major members of the Cabinet, currently 17, include the Prime Minister, the Minister for Public Management, Home Affairs, Posts and Telecommunications, the Minister of Justice, the Minister of Foreign Affairs, the Minister of Finance, the Minister of Education, Culture, Sports, Science and Technology, the Minister of Health, Labour and Welfare, the Minister of Agriculture, Forestry and Fisheries, the Minister of the Economy, Trade and Industry, the Minister of Land, Infrastructure and Transport, and the Minister of the Environment. See the Internet site for more details: *www.kantei.go.jp/foreign/constitution_and_government/the_cabinet_law.html*.
3. For more details, see the Internet site *www.kantei.go.jp*.
4. The CEFP is a representative council within the Cabinet Office set up at the time of the Administration Reform 2001. The purpose of the CEFP is to allow the Prime Minster to show full leadership on economic and fiscal policies, fully reflecting the opinions of knowledgeable persons. Members consist of the Prime Minister (Chairman), the Cabinet Secretary, the Minister of Economic and Fiscal Management, the Minister of Finance, the Minister of the Economy, the Minister of Public Management and Home Affairs, the Governor of the Bank of Japan, and four people from outside the government.
5. The Law of Decentralisation 2000 amended this. As from fiscal year 2006, prefectures and municipalities must consult with the Ministry and prefectures respectively. If the Ministry and prefectures do not agree on the bond issuance,

prefectures and municipalities may still issue public bonds, provided they report in advance to the parliaments of the prefectures and the municipalities.

6. These budgets are submitted to and approved by the Diet at the same time although they are compiled separately. The general account budget, commonly referred to as "the budget", consists of the government's major programmes, such as public works, social security, education, science, national defence, and economic co-operation. All national taxes, even if shared with local governments, are treated as revenue of the general account except for several earmarked taxes, including road taxes.
7. Examples include the National Life Finance Corporation, the Government Housing Loan Corporation, the Agriculture, Forestry and Fisheries Finance Corporation, the Japan Finance Corporation for Municipal Enterprises, the Japan Bank for International Co-operation, and the Development Bank of Japan.
8. The guidelines set out the ceilings of expenditure requests for the whole budget, including public works and social security, for the next fiscal year. These ceilings are usually expressed in terms of absolute or percentage increase (decrease) compared to the previous fiscal year's amount. Also, the guidelines specify the government's fiscal target, the policies proposed, and the procedures for the preparation of the sectoral budget.
9. The assumptions underlying the Ministry of Finance's plan are available on the Ministry's Internet site, notably *www.mof.go.jp/english/budget/brief/2004/2004f_04.htm*.
10. Ministries within the executive branch submit budget estimates to the Ministry of Finance (*i.e.* from one ministry to another ministry), while the Diet, the Court and the BOA submit them to the Cabinet (*i.e.* from one constitutional organisation to another constitutional organisation).
11. This article is ambiguous, as the term "budget" includes both revenues and expenditures. Interpreted literally, it means that proposals to either increase spending or revenues need Cabinet consideration. On the other hand, since the law does not discuss possible decreases of the "budget", the question arises as to whether the Diet is empowered to reduce taxes without Cabinet consideration.
12. There have been only four times since the end of World War II that amendments have been made (Tanaka, 2003).
13. Article 3 of the PFA has been suspended by special legislation (the Act Concerning the Exception to Article 3 of the Public Finance Act 1948). It says that "the Government can decide or revise the prices stipulated by the Art. 3 of the PFA without legislation or Diet approval as long as the current situation of economic emergency remains."

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ISSN 1608-7143
OECD Journal on Budgeting – Volume 4 – No. 3
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Korea*

Structure of the Case Study

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* This study has benefited from comments from: Hong Sang Jung, Director in the Ministry of Planning and Budget; several officials from the Ministry of Finance and the Economy and from the Board of Audit and Inspection; and OECD colleagues including Sang-In Kim (from the Ministry of Government Affairs and Home Administration).

1. Overview

1.1. The legal framework governing budget processes

Korea has a comprehensive set of laws for budget processes. The Constitution, as the cornerstone of the legal framework, specifies fundamental budget rules and the major actors in the budget process. The executive prepares the draft national budget and Parliament (the National Assembly) reviews and approves it. The Board of Audit and Inspection (BAI) plays a pivotal role in securing the accountability of the budget system. The local governments are provided with budgetary autonomy from the central government. The Constitution also governs other fundamental budget rules, such as for provisional and supplementary budgets. Despite its relatively detailed provisions, the Constitution delegates a lot of budgetary powers to various lower laws, especially the Budget and Accounting Act (BAA), the Framework Act on Fund Management (FAFM), the National Assembly Act (NAA), and the Board of Audit and Inspection Act (BAIA) (Box 1).

Box 1. **Korea: Main budget system laws**

- The Constitution 1948, as amended.
- The National Assembly Act 1948, as amended.
- The Budget and Accounting Act 1961, as amended.
- The Framework Act on Fund Management 1991, as amended.
- The Board of Audit and Inspection Act 1963, as amended.
- The Public Enterprise Budget and Accounting Act 1961, as amended.
- The Basic Act on Managing Statutory Expenses 2002.
- The Treasury Fund Management Act (cash management) 2002; the Government Asset Management Act (public assets) 1950, as amended; and the Public Bond Act (debts) 1949, as amended.
- The Local Autonomy Act 1949, as amended; the Local Finance Act 1963, as amended; The Local Share Tax Act 1961, as amended; and the Local Transfer Fund Act 1990 as amended.

Sources: Ministry of Planning and Budget (MPB) English Internet site *www.mpb.go.kr*; National Assembly English Internet site *www.assembly.go.kr/index.jsp*; Board of Audit and Inspection English Internet site *www.bai.go.kr*.

The national budget comprises the general account budget, the special account budgets and public funds (OECD, 2003). The general account budget is commonly referred to as "the budget" representing the central government's major fiscal activities. The special account budgets, established by various acts (currently 22), have specific objectives or their own revenues earmarked exclusively for those objectives. The public funds (currently 57) are also established by acts when a certain fund is required for a specified purpose. While the BAA specifies the rules for the general account and special accounts, the FAFM applies to the public funds.[1] The BAA is a basic and general law that comprehensively governs central government budget processes. It specifies detailed procedural rules between the Ministry of Planning and Budget (MPB), which is the central budget authority, and line ministries within the executive. Its major provisions include: what the national budget consists of; what documents should be presented to the National Assembly; what procedures should be followed for preparation of the national budget; how the national budget should be executed and reported; and what accounting system should be used. The Public Enterprise Budget and Accounting Act (PEBAA), however, allows more flexible budget and accounting procedures for the railways,[2] postal services, telecommunications, public procurement and grain management, the nature of whose business is commercial. In contrast, the FAFM provides particular rules for the management of public funds. It specifies the requirements to establish a public fund, the documents for the National Assembly's approval, and the management of public funds according to the principles of efficiency, transparency, and accountability. It requires a draft fund management plan to be submitted to and approved by the National Assembly annually, in a way analogous to procedures for the national budget.

The National Assembly has its own law (the NAA) governing budget processes in Parliament. It establishes the Special Budget and Settlement Committee (Budget Committee) whose exclusive role is to examine and approve draft annual budgets and draft annual fund management plans. It also specifies the composition of, and procedures of the Budget Committee. The BAIA establishes the BAI and provides procedural rules to secure the accountability of the government and other public sector entities.

The management of cash funds, public assets and debts are governed by the Treasury Fund Management Act (cash management), and the Government Asset Management Act (public assets) and the Public Bond Act (public bonds). Finally, various local finance acts (the Local Autonomy Act, the Local Finance Act, the Local Share Tax Act, and the Local Transfer Fund Act) provide detailed budget procedures and fiscal management.

1.2. Reforms of budget system laws

Until the late 1990s, there had been no substantial reforms of the major budget system laws that were adopted in the 1960s.[3] Since budgetary performance over several decades had been sound, it was perceived that there was less need to reform budget system laws compared with other OECD member countries. Even after passing through the Asian crisis that began in 1997, gross public debt was only around 22% of GDP in 2001, well below the average of 74% in the OECD area (OECD, 2003).[4] Under these circumstances Korea has maintained an annual budgeting system with an input-orientation, strong control over budget execution by the central budget authority, and lack of formal fiscal rules for controlling public expenditures.

The way the budget system operates came to the fore during the 1997 financial crisis, which required a radical change in fiscal policy from the previous conservative fiscal management.[5] In particular, the government started to issue public bonds to stimulate the economy, which increased public debt. There was also recognition of the upward potential pressures on public expenditure over the medium term, including those caused by the financial sector restructuring programme (mostly financed by government-guaranteed bonds); an expansion of spending on pensions, health care, and unemployment benefits; and the uncertain cost of co-operation with North Korea (OECD, 2003). Finally, over the years, there had been a steady increase in the number of public funds, which complicated overall fiscal management, especially due to the fact that public funds and the national budget were not reviewed together (MPB, 2002).

To meet these challenges, the government initiated some reforms in budget system laws (MPB, 2004a). First, for the purpose of enhancing transparency and the surveillance of the National Assembly over the public funds, the FAFM was substantially amended in 2001 and 2003. All public funds are now subject to approval by the National Assembly. Before the amendment, public funds had not been subject to supervision and approval by the National Assembly, even though they are financed by levies or transfers from the budget. These amendments have reduced fragmentation in the operation of the national budget.

Second, the Basic Law on Managing Statutory Expenses was enacted in 2002 to enhance transparency in the collection and implementation of quasi taxes.[6] In order to prevent ministries from creating new quasi taxes and to strengthen the transparency of the quasi taxes, the act requires ministries to obtain prior approval from the MPB before creating a new quasi tax and to report how these revenues will be collected and used to the National Assembly annually. The act provided the National Assembly with stronger control over public financial management.

Box 2. **Korea: Major provisions of the National Budget Bill 2004**

- The Bill would repeal the BAA and the FAFM.
- The government would be required to submit to the National Assembly a medium-term fiscal plan (including targets for a consolidated budget balance and public debt) and a national debt management plan.
- A "top-down" budget system would replace the present detailed incremental budgeting.
- Supplementary budgets would be restricted to emergency situations.
- Any bills generating higher public spending or lower revenue would require a plan on how to finance the costs. Consultation with either the MPB or the Ministry of Finance and the Economy (MOFE) would be required before the National Assembly debate.

Third, during 2004, a "Big Bang" reform of the budget system laws was under discussion both at State Council (see section 3.2.1 below) level and in the National Assembly. The MPB proposed the National Budget Bill in July 2004 (MPB, 2004b). The draft new law, which aims to strengthen the fiscal sustainability, transparency and performance of the national budget, if passed, would be far-reaching. The proposed comprehensive budget reforms, shown in Box 2, would help control fiscal risk and facilitate effective allocation of resources in a medium-term framework (Park, 2004). The draft new law is a follow up to the Fiscal Responsibility Bill that was submitted to the National Assembly in 2001, but was not passed due to the lack of political consensus.[7]

Irrespective of whether the proposed National Budget Bill is adopted, in 2004 the State Council decided to introduce a "top-down" budget system, under which spending ministries are provided with firm ceilings for budget preparation (MPB, 2004c; MPB, 2004d).[8] Based on these, spending ministries prepare their budget request by the end of May, the legal deadline for submitting budget requests. Although not in a law (at the time of writing this study), this change will be a turning point in the public expenditure management system, since it seeks to set up a strategic framework for budget decision making which, through a top-down approach, is likely to eventually alter managerial behaviour and organisational culture in the government.

2. Principles underlying budget system laws

The legal framework for the budget includes the principles of annuality, universality, balance, accountability, and specificity. However, the modern

principles of transparency, stability and performance have not been sufficiently embodied into budget system law.

The principle of statutory authorisation by the National Assembly is included in the 1948 Constitution (Arts. 54, 58 and 59) and other laws. New taxation (including quasi taxes) or changes in existing levels of taxation should be authorised by the National Assembly before the executive levies or spends it. The principle of accountability is also embodied in the Constitution and the BAIA. The BAI, as the supreme audit institution, audits the annual accounts of government and submits its audit report to the President of the Republic and the National Assembly.

The Constitution, complemented by the BAA, specifies the principle of an annual budget. The fiscal year begins on 1st January and ends on 31 December (BAA, Art. 2). The executive is required to prepare the draft budget for the fiscal year (Constitution, Art. 54). The budget estimates are for a 12-month period. The budget document contains data for the fiscal year, and appropriations, in principle, are required to be implemented within the fiscal year (see exceptional circumstances in section 4 below).

The principle of unity, which requires all revenues and expenditures to be included in the same budget document, is not well respected. The budget documents for general account, special accounts, and the public funds are separately submitted to the National Assembly. However, the total revenues and expenditures approved by the National Assembly cover all central government financial activities (the principle of universality). The principle of specificity is included in the BAA. Budget appropriations are for a specific purpose (Art. 20). Budgets for each department are drawn up according to detailed economic and functional classifications.

The BAA also specifies the principle of balance. The law requires an accounting balance between budget expenditures and budget revenues and financing (Arts. 3 and 18). Annual expenditure should be financed by revenue other than bonds or borrowings (Art. 5). The BAA permits the issuance of public bonds or borrowing only in unavoidable circumstances, and subject to the prior approval of the National Assembly (principle of stability).

Various commentators have pointed to the lack of transparency in the budget system (for example, see IMF, 2001; OECD, 2003). Transparency has been hampered by the highly fragmented and compartmentalised budget structure – general account, special accounts and public funds. The budget document does not contain a statement of the major fiscal risks, nor is the performance principle respected. In an effort to enhance performance in public finance management, some pilot projects were launched in 1999. Under this system, 26 participating agencies prepared and submitted performance plans to

the MPB specifying objectives, strategies, and indicators. However, these were implemented on the basis of a State Council decision, not law.

3. Legal basis for the establishment and the powers of the actors in the budget system

3.1. The executive and the legislature

3.1.1. Overview

Korea is a unitary State with a central government and two tiers of local government. It has a presidential system, in which the President is the head of State. The Constitution states that executive power is vested in the executive branch headed by the President (Art. 66). The legislature (the National Assembly) has one chamber and its main functions are to oversee executive power and enact laws, including approving the annual budget. The National Assembly, however, has a limited role in amending the draft budget since the Constitution bars the National Assembly from creating a new expenditure item or increasing the budget estimates without the consent of the executive.

3.1.2. Roles and responsibilities of the State Council and individual ministers

The Constitution establishes the State Council[9] as the highest decision-making organ in the executive (Constitution, Art. 88). The State Council, whose head is the President, comprises the Prime Minister, the Minister of Finance and the Economy (MOFE), the MPB and other ministers (no more than 30 and no less than 15), and deliberates on important fiscal policies that fall within the power of the executive including draft budgets, settlement of accounts, basic plans for disposal of State properties, and contracts incurring financial obligations on the State (Constitution, Art. 89; Government Organisation Act, Art. 12). Ministers are individually responsible – they are not legally required to take collective responsibility for decisions of the State Council.

3.1.3. Establishment of ministries and executive branch agencies

Central government organisations, including ministries, are established and their roles are defined according to the provisions of the Government Organisation Act 1948 (GOA), as amended. Reorganisation of existing central government organisation is also governed by the GOA. Therefore, the National Assembly has strong authority over the establishment or reorganisation of government ministries. Within the executive, the responsibility for fiscal management and control is shared between three ministries: the MPB, the MOFE, and the Ministry of Government Affairs and Home Administration (MOGAHA). MPB is primarily responsible for budget formulation, management

and execution. MPB also oversees and co-ordinates the privatisation and restructuring programme for State-owned enterprises (GOA, Art. 23). MOFE is responsible for preparing the macroeconomic outlook and revenue projections (GOA, Art. 27). The execution of the central government budget during the course of the year is controlled by the budget apportionment plan set by MPB and the monthly financial plan by the MOFE, while the Treasury Bureau of MOFE is in charge of releasing the necessary funds. The MOGAHA is responsible for local government finance and administration (GOA, Art. 33).

Line ministries are responsible for preparing their own budget proposals, submitting them to the MPB and executing the budget approved by the National Assembly and apportioned by the MPB, under the provisions of the GOA and the BAA. During the preparation of budget proposals, they are required to co-ordinate their policy priorities within the guidelines for budget preparation provided by the MPB. Line ministries have very limited managerial discretion to shift budgetary outlays from one budget category to another.

The Act Related to the Establishment and Operation of Executive Agencies 1999, as amended provides special rules for executive agencies, whose objectives are to enhance administrative efficiency and the quality of administrative services. In 2004, 26 executive agencies had been created under this Act.[10] Agency chiefs are recruited by open competition, and autonomy is provided to them for personnel, organisation and budget operation. They are guaranteed independence in running the organisation while obliged to bear responsibility for their performance. An agency chief is provided with a considerable degree of latitude in appointing and transferring employees, hiring contracted employees and making decisions on bonus payments. To secure budget autonomy, the executive agencies are run under the Executive Agency Special Account, which features corporate budget accounting methods and a more flexible budget execution than those for other general administrative organisations. An agency chief is required to report its operation plan to the parent ministry, but is not obliged to submit its performance report to the National Parliament.

3.1.4. Responsibilities of senior civil servants

The responsibilities and roles of all civil servants are governed by the National Civil Servant Act 1949 as amended. There is no special law pertaining to responsibilities and roles of senior civil servants. The civil service system is based on the merit principle (Art. 26). Appointments of civil servants are made in accordance with their knowledge, skill and ability, through examinations, performance records and professional qualifications. Any civil servant is required to carry out his/her duties in the interest of the public and exert his/her utmost effort in the performance of his/her duties. They are not allowed to hold positions in private companies or other profit-oriented organisations or

be involved in political activities. They must keep in strictest confidence any sensitive information received when performing their duties. Civil servants are also bound by a code of conduct, outlined in the Ethics in Public Service Act 1981, as amended and the Code of Ethics for Civil Services. The act and code specify an obligation of loyalty to the State, honesty and service to the people, and professional and personal integrity.

3.1.5. Establishment and roles of parliamentary committees

In order to review and approve the draft budget and the draft fund management plan, the NAA requires the Special Budget and Settlement Committee (Budget Committee) to be established (Art. 45). Legal provisions include:

- The number of members of the Budget Committee is 50, selection of which is made by the Speaker at the request of members representing each negotiating party.
- The term of the members of the Budget Committee is one year.
- The Chairman of the Budget Committee is elected at the plenary session in May in a procedure similar to that for the election of the Speaker.

In addition to the Budget Committee, there is a Finance and Economy Committee, which has jurisdiction on taxation bills, revenue projections and matters pertaining to the MOFE. The Finance and Economy Committee submits its report on the revenue projections to the Budget Committee, which approves it.

To strengthen the National Assembly's oversight of the national budget, the National Assembly Budget Office (NABO) with about 100 staff members was established in 2004, following the enactment of the National Assembly Budget Office Act in 2003 and amendments to the NAA. The main role of the NABO is to assist the members of the National Assembly in relation to their parliamentary activities relating to the budget (NABO, 2004). In particular, the NABO analyses and evaluates the government's fiscal policy, draft national budget and draft fund management plan.

3.2. Role and responsibilities of sub-national governments

The principles for the autonomy and the structure of local governments and local councils are stated in the Constitution, which grants to local governments the power to enact provisions relating to local autonomy, within the limit of laws and regulations (Art. 117). The Constitution empowers local governments to decide on the structure of local governments and the organisation and powers of local councils (Art. 118). Based on the authority given by the Constitution, the Local Autonomy Act 1949, as amended defines the structure and functions of local governments, which have two tiers:

16 upper-level local governments (7 metropolitan cities and 9 provinces) and 232 lower-level local governments for cities (*Shi*), counties (*Gun*) and districts (*Gu*) (as of 2004). The act also requires local governments to perform local autonomous and centrally mandated affairs (for example, national highway maintenance, for which central and local governments share the costs). The Local Finance Act 1963, as amended provides local governments with autonomous budget procedures and the power to levy taxes within the limit of the law, independently of the central government. Both acts require local governments to prepare balanced budgets. All local government borrowing must be approved by the central government, thus ensuring conservative financial practices by local government (Kim, 2003a).

Various intergovernmental transfers are provided to minimise a large degree of variation between local governments' fiscal capacity (Hur, 2003; Kim, 2003b).[11] For example, while the ratio of local government revenues to total local government spending is more than 94% for the Seoul Metropolitan Government, the ratio is below 50% for more than 80% (194 out of 248) of the local governments (OECD, 2003). A large portion of this fiscal gap is covered by central government transfers including tax sharing and grants. Three laws govern these intergovernmental fiscal relationships: the Local Share Tax Act, the National Treasury Subsidies Act, and the Local Transfer Fund Act (Box 3). Unlike other OECD member countries, there is an Educational Local Share Tax Act 1971. This law establishes a local educational share tax to be used exclusively for expenditures of local education. In addition, the Special Act on Regional Balanced Development 2003 (which replaces the Local Transfer Fund Act and is to be implemented in 2005), establishes a special fund for regional development.

4. Legal provisions for each stage of the budget cycle

4.1. Budget preparation and presentation by the executive

4.1.1. Institutional coverage of the budget

The purpose of the BAA is "to provide for the fundamental legal framework for the national budget and accounting" (Art. 1). The institutions covered by the national budget include the presidential office, the National Assembly, the judiciary, all central ministries, agencies and commissions (Art. 14). Local governments' budgets are excluded from the scope of the national budget; they are governed primarily by the Local Finance Act. Public corporations are also excluded from the national budget.

4.1.2. Extrabudgetary funds and earmarking of revenues

The special account budgets (currently 22) have their own revenues earmarked exclusively for specific purposes by their establishing acts.

Box 3. **Korea: Major acts governing the fiscal relationship across government levels**

- **The Local Share Tax Act 1961 as amended:** This provides a vertical tax-sharing system designed to equalise vertical and horizontal disparities with respect to tax-raising capacities and needs. The Act sets a fixed percentage (15%, but to rise to 18.3% by 2005) of the total national tax to be allocated to local governments. While 10/11 of the total amount is a general transfer, based on pre-defined criteria, a small fraction (1/11) of the Special Local Share Tax is earmarked, *i.e.* it functions as a conditional grant.
- **The Educational Local Share Tax Act 1971, as amended:** The Act sets a fixed percentage (currently 13%) of the total national tax to be allocated exclusively for use for investments in education facilities by local government.
- **The National Treasury Subsidies Act 1963 as amended:** National Treasury Subsidies are matching grants (conditional grants) provided to local governments for specific projects. They are allocated in line with national policy priorities for each economic sector based on annual evaluations of local needs by the central government. They also reflect nationwide objectives that would otherwise not be taken into account in local government decision making.
- **The Local Transfer Fund Act, 1990 as amended** (abolished at the end of 2004): The Local Transfer Fund is somewhere between tax-sharing and conditional grants and is often called a "block" grant because of its relatively broad objectives. It was introduced to stimulate local capital investment in infrastructure such as road maintenance, farming and fishing development, water purification, and regional development. It is financed by specific shares of national taxes.
- **The Special Act on the Regional Balanced Development 2003:** The regional development fund, replacing the local transfer fund, will begin to be implemented in 2005 for the purpose of helping develop underdeveloped regions.

Subcategories of special accounts are: 1) government-operated special enterprises (currently five, including the national railroad, the communication service, the government supply and agency operation), 2) government-held and operated special funds (currently one, the fiscal financing special account), 3) earmarked revenues used for specified expenditures (currently 16, including national property management, agricultural and fisheries structural adjustment, military pensions, postal insurance service). The public funds

(currently 57), which are generally governed by the FAFM,[12] also have their own resources, which are to be spent exclusively for specific purposes stated in the individual establishing acts.[13] Since the application of the amended FAFM in 2001 and 2003, which requires the National Assembly's approval of the management plan of all public funds,[14] there is less distinction between the special account budget and the public funds because both are now subject to the approval of the National Assembly (Cho, 2004; Koh, 2004). However, public funds still have more autonomy and flexibility in financial management and less scrutiny in the parliamentary approval process than the special account budgets. Therefore, line ministries prefer to establish their own public funds.

The National Health Insurance Fund, established by the National Health Insurance Act, is the only extrabudgetary fund whose budget is not subject to parliamentary approval. All other social security funds, including the National Pension Fund, the Employment Insurance Fund and the Industrial Workers' Accident Compensation Insurance Fund, are subject to parliamentary approval.

4.1.3. Definition of budget aggregates

The legal framework for the budget does not include definitions for budget aggregates. Until 2003, budget aggregates were calculated *ex post*, as the sum of ministries' expenditure. However, a new aggregates system for ministries or sectors was introduced by a State Council decision in early 2004. Spending ministries are now required to prepare their draft budget within the budget aggregates decided by the State Council around April. Spending ministries use the budget aggregate as a binding guideline to prepare their budget request by the end of May, the BAA's deadline for submitting budget requests to the MPB.

4.1.4. Fiscal rules

The Constitution requires the government to obtain prior approval of the National Assembly for public bond issuances (Art. 58). The government can issue public bonds only up to the limits approved annually by the National Assembly and must return to the National Assembly to get approval for additional borrowing. Apart from this constraint, the government is not bound by any other legally binding fiscal rules such as a cap on the amount of spending or a target for budget deficit reduction.

4.1.5. The timetable for budget preparation and presentation to Parliament

The budget year starts on 1st January and ends on 31 December (BAA, Art. 2). The Constitution and the BAA state the timetable for each major stage of the budget process to be followed by the MPB and line ministries (Box 4). In

Box 4. Korea: Legal requirements for the timetable for budget preparation and deliberation

- End of February: submission of plans for new and major ongoing projects to the MPB by line ministries (BAA, Art. 25).
- 31 March: issue of the budget preparation guidelines, which are approved by the State Council and signed by the President, for the budget preparation for the next fiscal year by the MPB to line ministries (BAA, Art. 25).
- 31 May: preparation of the written budget request for revenues and expenditures in accordance with the guidelines and submission of these to the MPB by line ministries (BAA, Art. 30).
- 2 October: submission of the budget proposal to the National Assembly (Constitution, Art. 54, requires submission 90 days before the next fiscal year).
- 2 December: approval by the National Assembly (Constitution, Art. 54, requires approval 30 days before the next fiscal year).

addition, in order to strengthen the *ex ante* evaluation process of major new public investment projects since 1999, the implementing decree of the BAA requires ministries to conduct preliminary feasibility studies for roads, railways, airports, seaports and cultural facilities prior to making a budget request to the MPB (Arts. 9-2).

4.1.6. Approval process within the executive

The BAA stipulates several key dates for the approval process within the executive (Box 4). The draft budgets of line ministries are screened for approximately three months from June to August by the MPB. The MPB formulates an aggregate budget proposal on the basis of each written budget request of line ministries. During this process, the MPB reviews the details of individual budget items requested by the line ministries, taking into account past performance, the accuracy of the information, and the potential spending pressures of the projects being reviewed.[15] After negotiations and final reconciliation, the draft budget is finalised in late July. For the remaining unsettled projects, the MPB has a series of consultations with spending Ministers to reconcile the conflicts between the MPB and line ministries. Then, the MPB reports the results of consultations to the President and finalises the content of the draft budget. After being officially approved by the State Council and signed by the President, the government submits the draft budget to the National Assembly 90 days before the fiscal year begins.

4.1.7. Documents to accompany the budget law

The draft budget has five main contents (BAA, Art. 19) as follows:

- **General provisions:** This provides general guidelines for the national budget, including the maximum amount of national bonds or borrowing, the maximum amount of temporary borrowing, and other matters necessary for budget execution (BAA, Art. 26).
- **Revenue and expenditure budget:** It is a key component of the budget proposal, which shows the detailed estimates of revenues and expenditures.
- **Continuing expenditures:** The BAA stipulates the operational procedures for continuing expenditures (Art. 22) when the government needs to make payment over several years, but not more than five years.
- **Expenditure to be carried over to the following fiscal year:** This is applied where an apportionment of any expenditure is not expected to be completed within the fiscal year due to the nature of the project. The BAA requires such expenditure to be specified in the budget and to be carried over to the following fiscal year with the prior approval of the National Assembly (Art. 23).
- **Future liabilities that could be borne by treasury (contract authorisation):** The government is allowed to make contracts for projects in which it is necessary to incur a liability within a given fiscal year. The draft budget must include an estimate for such contracts, which is then approved by the National Assembly (Art. 24).

Medium-term macroeconomic framework and fiscal strategy. The BAA does not require the budget document to include any information on medium-term budget aggregates since the current budget process is essentially geared to a single fiscal year. However, the BAA states that the MPB can make a medium-term fiscal plan to strengthen the efficiency and sustainability of fiscal management (Art. 16). In accordance with this provision, medium-term fiscal plans have been announced since the 1970s. The medium-term fiscal plan, the main contents of which are the overall deficit of the consolidated central government and the fiscal strategy for a five-year period, constitutes informal guidelines, not legally binding limits. Details are not provided on the macroeconomic framework underlying the forecast and on the fiscal aggregates other than the overall deficit.

The BAA does not specify which organisation is responsible for the macroeconomic projections underlying the budget preparations. However, the GOA assigns the MOFE to make projections of the macroeconomic outlook in the process of formulating annual economic policies, with the MPB to provide inputs into that process.[16] The budget document contains macroeconomic forecasts only for the budget year. The public does not have access to the

macroeconomic model underlying those forecasts, nor the key parameters that influence the projections of the fiscal aggregates.

New measures *versus* existing expenditure policies. The BAA requires line ministries to submit the major new and existing expenditure programmes to the MPB by the end of February (Art. 25). The MPB uses this information as a reference to evaluate the intensity of expenditure pressures for the next fiscal year. However, the budget appropriations do not formally distinguish new measures and existing expenditure programmes even though the MPB includes the list of new expenditure programmes as a reference for parliamentary review.

Performance-related information. The BAA does not require the budget documents to include performance-related information. However, in 1999, some experimentation with performance-oriented budgeting began. In 2004, the MPB issued guidelines for performance-oriented budget information to 26 line ministries or agencies. The selected pilot projects are narrow in focus and are not yet formally integrated with the budget preparation processes. Comprehensive performance reports are not presented to the National Assembly for review.

Tax expenditures, contingent liabilities and fiscal risks. On the basis of a procedure prescribed by the Special Tax Treatment Control Act 1965, as from 1999 the MOFE began to report tax expenditures to the National Assembly. The ratio of tax expenditures, including exemptions and deductions to total tax revenues has been around 13% over the past few years despite the government's effort to reduce tax expenditures (OECD, 2004). Tax expenditures are mainly made to provide incentives to investment, to small- or medium-sized enterprises, for research and development, and to stimulate the economy.

Information on the total size of government guarantees is required to be reported separately to the National Assembly on an annual basis (BAA). There is no quantification of the likely liability resulting from government guarantees. Other implicit liabilities of the government, for example in the National Pension Service are not disclosed. Nor does law require a statement of major fiscal risks in the budget document.

Other information required by law. The BAA requires the draft budget to include the information set out in Box 5.

4.1.8. Budgets of Parliament and other constitutional bodies

The BAA provides special budget preparation procedures for the National Assembly, the Supreme Court, the Court of the Constitution, and the National Election Commission, which are constitutionally independent organisations. If the requested amount is to be reduced, the MPB is required to hear the

Box 5. Korea: Other documents annexed to the draft budget

- Guidelines for budget preparation (Art. 25).
- Gross and net amounts of the revenue and expenditure budgets, and item by item explanations.
- Explanation of measures resulting in liabilities being borne by the Treasury. A statement of the actual redemptions of national bonds and borrowing funds at the end of year before the preceding year, the presumed present amount thereof at the end of the preceding year and current years, and the annual redemption schedules.
- For measures for which liabilities are borne by the Treasury, a statement of the estimated amount of expenditure by the end of the preceding year and the amount after the current year.
- For continuing expenditures, a statement of the estimated amount of expenditure until the end of the preceding year, the pre-determined amount of the expenditure after the current year, the overall project plans and the situation of progress thereof.
- The number of personnel in budget entities and the salary assumptions for the budget proposals.
- A statement of the value of State property at the end of the year before the preceding year, and the estimated value at the end of each of the preceding and current years.
- If the budgetary amount requested by an independent institution is reduced, reasons for such reduction and the opinions of the head of the independent institution concerned.
- Other documents needed to clarify the financial situation and contents of the budget proposal.

opinion of the constitutionally independent institution affected in the State Council (Art. 29), and attach any reason for the reduction in the draft budget submitted to the National Assembly.

4.2. Budget process in Parliament

4.2.1. The timetable for budget adoption and constraints on the budget debate in Parliament

The budget review by the National Assembly begins in early October, consistent with the requirement for the National Assembly to approve the draft budget within 30 days before the beginning of the fiscal year (Constitution, Art. 54). There is no legal restriction on the time spent on

discussion and debate in the Budget Committee and in Parliament's plenary session. However, the NAA provides general procedures for reviewing the draft budget (Art. 84).

- After the draft budget is submitted to the National Assembly, the President (sometimes the Prime Minister on behalf of the President) will make a speech at the plenary session on the next fiscal year's economic and fiscal policy, and the basic direction for, and the major contents of, the draft budget.
- The draft budget is first required to be referred to the competent standing committees including the Finance and Economy Committee, the Education Committee, the Agriculture, Forestry, Maritime Affairs and Fisheries Committee, the Health and Welfare Committee, and the Environment and Labour Committee. The standing committees will review the draft budget within their areas of jurisdiction and submit their reports to the Speaker.
- The Speaker is required to refer the draft budget to the Budget Committee with the reports made by the competent standing committee.
- The Budget Committee commences the examination of the draft budget by hearing an explanation of the draft budget by the MPB and by examining a report of an expert adviser in the Budget Committee. Following general and ministerial hearings, the Budget Committee will reduce or increase the budget estimates item by item.
- The Budget Committee is required to respect the contents of the pre-examination report of the competent standing committees. In cases where any budget estimate is recommended to be reduced by the competent standing committee, the Budget Committee is required to seek the approval of the competent standing committee before it makes the final decision on the draft budget.
- After the Budget Committee's examination, the Speaker calls the plenary session. The amended budget is approved by a majority vote.

The NAA (Arts. 84-2), as amended in 2001, stipulates general procedures for reviewing the Draft Fund Management Plan submitted pursuant to Article 7 of the FAFM. It requires the National Assembly to approve the draft fund management plan up until 30 days before the beginning of the fiscal year. The parliamentary review process for the public fund management plan follows the same procedures and timetable defined in the BAA.

4.2.2. Provisional budgets

The Constitution (Art. 54) provides for provisional budgets. If the draft budget is not passed by the beginning of the fiscal year, the government may, in conformity with the budget of the previous fiscal year, apportion funds for

the following purposes until the draft budget is approved by the National Assembly: 1) the maintenance and operation of agencies and facilities established by the Constitution or law; 2) the execution of the obligatory expenditures as prescribed by law; and 3) the continuation of projects previously approved in the budget. The BAA specifies that expenditures or contracts based on the provisional budget are regarded as being based on the regular annual budget when the latter is approved by the National Assembly (Art. 34).

4.2.3. Powers of amendment

The Constitution states that the National Assembly shall, without the consent of the executive, neither increase the estimates of any expenditure item nor create any new expenditure items in the budget submitted by the executive (Art. 57). The National Assembly is only free to reduce estimates of expenditure in the draft budget. However, the National Assembly, in practice, has exercised a substantial power to amend the draft budget. In contrast, the National Assembly has unlimited powers to amend draft taxation bills, which can result in increases or decreases of the budget deficit proposed by the government.

4.2.4. Approval of resources

The Constitution states that the type and rate of taxes is determined by law (Art. 59). Therefore, new taxes are imposed or levels of existing taxes can be amended only when authorised by the National Assembly. Furthermore, the Basic Law on Managing Statutory Expenses (Quasi Taxes) 2002 requires that any new surcharges be levied only by an act. A revenue budget, prepared by the MOFE, is submitted to the National Assembly along with the expenditure budget. It shows projections of total national revenues including taxes, debt or borrowings, and other non-tax revenues. The National Assembly reviews and approves a draft revenue budget. Revenue is required to be classified by the nature of source (*e.g.* tax, public bond or borrowings, and other non-tax revenues). Within each category, revenue is further divided into chapter ("*Jang*") and section ("*Kwan*"). These are required by the BAA to be on a gross basis.

Public funds have their own surcharges as one of their revenue sources. These revenues are included in the draft fund management plan and approved by the National Assembly.

4.2.5. The nature, structure and duration of appropriations

The nature and structure of appropriations are largely characterised by detailed line items. The BAA requires the draft budget (expenditure and

revenue) to be classified by item (Art. 20). Expenditure is classified by function (*e.g.* economic, social welfare, defence), nature of expenditure (*e.g.* salary, capital investment), or institution (*e.g.* ministries, agencies). Within that category, expenditures are further divided into: chapter ("*Jang*"), section ("*Kwan*"), item ("*Hang*"), sub-item ("*Se-hang*"), sub-sub-item ("*Se-se-hang*"). The current classification shows 2 200 "*Hang*" and 6 000 "*Se-hang*". The National Assembly approves expenditure by item ("*Hang*").

The duration for the appropriation is usually for one year except for continuing expenditure which needs multi-year appropriations. There are no permanent appropriations. The continuing expenditure system, authorised by the Constitution (Art. 55) and the BAA (Art. 22), enables the government to make payment over a period of several years. The Constitution requires the executive to obtain the approval, in advance, for the total amount and periods of a continuing expenditure by the National Assembly when it is necessary. The BAA further specifies that a continuing expenditure should not be for more than five years from the fiscal year concerned and the extension of a continuing expenditure can be made only after approval of the National Assembly.

4.2.6. Carryover of appropriations and borrowing of future appropriations

The BAA allows end-year carryover of unspent appropriations under certain circumstances (Art. 38). First, carryover is allowed provided that approval is sought in advance from the National Assembly. Second, carryover is authorised where a contract is made in the fiscal year, but the actual payment is not possible in the same year due to unavoidable reasons. Third, line ministries may carry over up to 5% of certain operational expenditures defined by the MPB without having prior authorisation from the MPB.

4.2.7. Public debt approval

The Constitution provides that when the executive plans to issue public bonds or to make contracts which may incur financial obligations on the government, it needs the prior approval of the National Assembly (Art. 58). The Public Bond Act 1949 as amended governs the operation of the public bonds and the public debt. The act requires the MOFE to obtain prior approval from the National Assembly on the amount of public bonds to be issued. The government has a legal obligation to prepare a comprehensive report on the national debt and present it to the National Assembly. The BAA also requires the government to seek prior approval from the National Assembly when the government decides to guarantee bond issues by public corporations.[17] The government is required to submit report to the National Assembly. The law does not restrict the amount of debt guarantees that the government may issue.

4.2.8. Promulgation, veto and publication of the adopted budget

Once the draft budget is approved by the National Assembly, the adopted budget automatically takes effect on the commencement of the new fiscal year after the President signs the budget. The budget is available on the internet sites of the MPB and the National Assembly.

4.2.9. Supplementary budgets (rectifying laws)

Under the Constitution, the executive can prepare a draft supplementary budget and submit it to the National Assembly when it is necessary to amend the initial budget (Art. 56). The BAA elaborates: a draft supplementary budget may be submitted only when it is necessary to amend the budget approved by the National Assembly due to any causes that have occurred after the budget has entered into force (Art. 33). While the general procedures for approving supplementary budgets are the same as that of the initial budget, in practice, they are usually not reviewed in the context of their expected overall impact on fiscal outcomes. There are no legal restrictions on the number of supplementary budgets. Recently, two to three supplementary budgets have been adopted each year.

4.2.10. Budgetary implications of other bills

The law does not specify any special procedures on how bills having budgetary implications are dealt with. However, the MPB requests line ministries to attach estimates of the budgetary implications of draft new legislation when it is presented to the State Council.

4.3. Budget execution

The BAA requires line ministries to execute their budget in accordance with guidelines issued by the MPB, after approval by the State Council. Line ministries are required to consult with, or to obtain a prior approval of the MPB, when it is necessary for them to deviate from the approved budget apportionment plan. The MPB is required to inform the MOFE and the BAI of any changes in budget implementation plans.

4.3.1. Apportionment of expenditure authority

The BAA governs the general procedures for apportionment of appropriations. When the budget enters into force, line ministries are required to submit a draft budget apportionment plan to the MPB (Art. 35). Considering those plans, the BAA requires the MPB to prepare the annual budget apportionment plan which is subsequently deliberated on by the State Council and signed by the President with the finance plan by the MOFE. Line ministries are required to implement their budget in line with these plans.

4.3.2. Cancellation of budget authority and other in-year expenditure controls

There is no special law governing cancellation of appropriations. When it is considered necessary to reduce or cancel part of the appropriations, supplementary budgets may be used.

4.3.3. Emergency spending, excess spending and contingency funds

In order to meet unforeseeable circumstances after budget adoption, the BAA requires that unallocated contingency funds be included in the annual budget and approved by the National Assembly (Art. 21). The BAA specifies that the contingency fund, whose use is not initially specified, is controlled by the MPB (Art. 39). When it is necessary to use the contingency fund, line ministries are required to prepare a statement specifying the reason for its use, the required amount and the basis of the estimate, and to submit these to the MPB. For large-scale natural disasters, line ministries can make a demand on the contingency fund by making rough estimates of amounts. After examining the request(s) by line ministries, the MPB prepares a statement of use of the contingency fund, which is then approved by the State Council and signed by the President. The BAA further requires line ministries to prepare a statement of the amount used from the contingency fund and to submit it to the MOFE, which then is sent to the BAI after being deliberated on by the State Council and signed by the President (Art. 40). The government is also required to submit it to the National Assembly to obtain its approval, within 120 days before the end of following fiscal year.

4.3.4. Transfer and virement of appropriations within the year

The BAA places strict limitations on the use of appropriations. First, line ministries are prohibited from using the appropriations for any purpose other than those approved by the National Assembly (Art. 36). Nor do they have the authority to make transfers among the following budget categories: ministries or agencies, chapters, sections or items, as specified in the budget. If approved by the National Assembly in advance as a part of the annual budget, for the purpose of flexible budget execution, the BAA allows line ministries to transfer and use the appropriations for purposes other than those approved by the National Assembly. In this case, the approval of the MPB is needed at the time of implementation. Line ministries can transfer appropriations for sub-items ("*Se-hang*") and sub-sub-items ("*Se-se-hang*") the lowest levels of budget classification, but only with the approval of the MPB pursuant to the provisions of the BAA (Art. 37).

4.3.5. Cash planning and management of government assets and debt

The Treasury Fund Management Act 2002 specifies the general procedure for cash management. The Act requires line ministries to prepare their monthly finance plan after the approval of the draft budget. Then, the MOFE, which is responsible for cash planning and management of government assets and debt, prepares the draft monthly finance plan. This is mainly based on line ministries' proposals, and the prospects for revenues and expenditures. The plan is submitted to the MPB, approved by the State Council and signed by the President.

The Government Asset Management Act and the Government Bond Act provide basic procedures for the management of government assets and debt respectively. Line ministries are required to consult with the MOFE when there are prospective sales or purchases of assets. The BAA requires the government to regularly prepare a comprehensive report on the status of government assets and debt.

4.3.6. Internal audit

Line ministries have their own internal audit units for budget implementation within their ministry, including any agencies and funds (BAA, Art. 118). The MPB has the authority to investigate whether line ministries implement their budget correctly and to make an order on budget implementation to line ministries after this has been deliberated on by the State Council and approved by the President (Art. 117).

4.4. Government accounting and fiscal reporting

4.4.1. The accounting framework

The government's accounts are cash based, although this is not specified explicitly in law. The possibility of adopting accrual accounting standards for the national budget is under investigation. In the meantime, the PEBAA requires some special accounts (including the national railroad special account, the communication service special accounts, the government supply special account, the grain management special account, the agency special account) to be recorded on an accrual accounting basis. Also, the FAFM requires the public funds to be recorded on an accrual accounting basis.

4.4.2. Government banking arrangements

There is no single consolidated account into which all revenues are deposited and out of which all expenditures are made. There are two main separate government bank accounts. First, the Treasury Fund Management Act requires a general bank account for the general and special accounts to be established at the Bank of Korea (the central bank). All revenues for the

general and special accounts should be paid into, and all expenditures for the same account should be paid out of, this bank account only with the approval of the MOFE. Second, the public funds that have their own earmarked sources of revenue have their own accounts at the Bank of Korea. Such accounts are permitted by the individual laws establishing each public fund. Each bank account is managed by the individual ministry responsible for the management of each public fund.

4.4.3. In-year reporting to Parliament

The law does not specify the government's in-year reporting obligations to the National Assembly on budget implementation. However, the NAA (Art. 53) requires the government to report any budget-related issue to Parliament's Budget Committee if necessary.

4.4.4. Annual accounts and reports

The BAA requires the MOFE to prepare final accounts for central government transactions and have them audited by the BAI. For this, line ministries are required to prepare their own accounts for revenues, expenditures and public debt for the fiscal year concerned and to submit them to the MOFE no later than the end of February of the next fiscal year (Art. 42). The BAA further requires the MOFE to prepare consolidated accounts according to the same classification of the budget, which will then be deliberated on by the State Council and approved by the President (Art. 43). After that, the MOFE is required to submit them to the MPB and BAI no later than 10 June of the next fiscal year. The BAI must examine the accounts and send the result of its examination back to the MOFE no later than 20 August (Art. 44). Finally, the government is required to submit the annual accounts to the National Assembly no later than 120 days before the end of the following fiscal year. Therefore, the law allows a lag of nearly 9 months between the implementation of the budget and the submission of the annual accounts to Parliament.

Apart from the above report, the law does not require the government to submit special reports such as long-term projections or pre-election fiscal reports to the National Assembly. Like in-year reporting, if necessary, the Budget Committee may request the government to report any budget-related issue to the Committee (NAA, Art. 53).

4.5. External audit

4.5.1. Managerial, financial and operational independence

The Constitution establishes the BAI under the direct jurisdiction of the President, and prescribes its main role and its organisational structure (Arts. 97-100). The BAIA confirms that the BAI is established under the

President. It also establishes that the BAI retains an independent status with regard to its duties, the appointment and dismissal of its officials, its organisation, and the formulation of its budget (Art. 2). The BAI is composed of seven commissioners, including the chairman, whose term is four years (Art. 3). The chairman is appointed by the President with the consent of the National Assembly (Art. 4). The other commissioners are appointed by the President on the recommendation of the chairman (Art. 5). A commissioner may only be dismissed against his/her will when an impeachment is declared, a punishment heavier than imprisonment is imposed or when a commissioner is unable to perform his/her duties due to mental or physical weakness for long periods (Art. 8).

In addition, the BAA provides special procedures for the financial independence of the BAI (Art. 29). If the requested amount of the budget is to be reduced, the MPB is required to hear the opinion of the BAI in the State Council and attach the reason for it to the draft budget to be submitted to the National Assembly.

4.5.2. Institutional coverage of audits

The BAI has the authority to audit all central and local governments, as well as direct or indirect public corporations. These include:

- The accounts of the central government.
- The accounts of local governments.
- The accounts of the Bank of Korea and the accounts of organisations where the central government or a local government holds more than a 50% share.
- The accounts of agencies established by laws that prescribe mandatory audit by the BAI.
- Organisations of the central government established under the GOA or other laws, and duties of the public officials assigned thereto.
- Organisations of local governments and the duties of the public officials assigned thereto.

4.5.3. Types of audit

The BAIA requires the BAI to examine the final accounts of revenues and expenditures in order to ensure that they are prepared in line with the laws and regulations concerned, and to inspect how the duties of administrative agencies and public officials have been undertaken in order to improve and promote the operation of public administration (Art. 20). In fulfilling these requirements, the BAI has traditionally focused on financial audits: whether the money is spent in compliance with legal and procedural rules. Recently the BAI has been broadening its scope and conducting some performance

audits. There is no legal restriction preventing the BAI from completing performance audits. In 2004, the BAI conducted 70-80 performance audits, compared with 200-250 general financial audits (OECD, 2003).

4.5.4. *Powers of investigation*

The BAIA provides the BAI commissioners with various audit and inspection powers. The board of commissioners, when necessary for audit and inspection, is permitted to request the person concerned or witness to appear before it to answer questions, or to request a person of knowledge and experience to give an expert opinion or appraisal (Arts. 14 and 28). The BAIA requires persons subject to audit and inspection to submit such accounting statements, evidence, and other documents to the BAI as the BAI deems necessary (Art. 25). The BAIA also allows the BAI to seal warehouses, safes, documents and articles, if necessary, when conducting audits and inspections (Art. 27).

4.5.5. *Reporting obligations and publication*

The Constitution requires the BAI to report annually the results of the audit and inspection to the President and the National Assembly (Art. 99). The BAIA states the contents (Art. 41), which include:

- The annual accounts of the revenues and expenditures of the government.
- Any violations of laws or regulations found during the audit.
- Whether the National Assembly's approval was obtained for spending from the contingency fund.
- Disciplinary action or reprimands requested and the results thereof.

4.5.6. *Enforcement of findings*

The BAIA stipulates the procedures for enforcing the findings of the BAI. The major enforcement tools include:

- Reparation for liability (Art. 31): after reviewing the results of an audit, the BAI adjudicates on whether an accounting official or any other person is liable for reparation in accordance with law.
- Request for disciplinary action (Art. 32): the BAI also can request the responsible minister to take disciplinary action against public officials.
- Request for correction (Art. 33): if the BAI has found a transaction that seems illegal or improper as a result of audit and inspection, it may request the responsible minister to correct it. The responsible minister is required to comply with such a request within the period set by the BAI.

Notes

1. For more discussion see, for example, Koh (2000) and MPB (2001).
2. The PEBAA will not apply to the railways as from 2005, due to their planned privatisation.
3. Reforms implemented during past decades include the preliminary feasibility study for new large-scale infrastructure projects, tighter management of total investment estimates for large-scale projects, introduction of a medium-term fiscal plan (not legally binding), pilot projects for performance-oriented budgeting, and a budget incentive system to induce lower public expenditures. These led to minor changes in the BAA. See MPB (2002) for more information.
4. This low public debt is explained largely by the culture of fiscal conservation that prevails both within the administration and the public. In addition the concentration of powers for both the drafting and execution of the budget in the hands of a single powerful ministry, the MPB (the former Economic Planning Board), has helped impose a hard budget constraint on line ministries. Moreover, budgets are prepared on the basis of deliberately conservative revenue forecasting, leading to a tendency for overshooting projected revenues. On the appropriations side, spending overruns are rare.
5. For more discussion on the budget's role in overcoming the 1997 financial crisis, see Mun *et al.*, 2002.
6. Quasi taxes are generally defined as "all pecuniary expenses that a corporation is obliged to pay other than taxes" (MPB, 2002). This definition takes the broadest possible interpretation of quasi taxes, and includes legally mandated statutory expenses (*e.g.* social insurance contributions) and other non-voluntary expenses.
7. Major provisions of a fiscal responsibility bill are: 1) The bill would require the government to submit to the National Assembly a three-year fiscal plan, including targets for a consolidated budget balance and public debt; 2) It would restrict supplementary budgets to emergency situations, and establish public debt reduction as the priority in the allocation of any budget surpluses; 3) It would require that any proposals generating higher public spending or lower revenue include a plan on how to offset the negative financial impact; (4) It would create a National Debt Management Committee that reports to the MPB.
8. In September 2004, the "National Fiscal Management Plan (2004-2008)" was approved by the State Council. This plan shows the economic assumptions, the budget aggregates by major sector or ministry, major public expenditure priorities, and national debt for the next five years. The MPB, on behalf of the government, also submitted the draft budget with this plan to the National Assembly. Spending ministries are required to prepare their draft budgets within budget aggregates given by this plan. For more information on the medium-term fiscal framework and top-down budget system, see Kim (2004) and Hur (2004).
9. In some of the other countries reviewed in this book, the State Council is known as "the Cabinet" or "the Council of Ministers".
10. Included are the Government Information Agency, the Public Procurement Service, the Korea National Statistical Office, the Central Supply Office, and the National Medical Center. See MPB (2002).
11. For more information on local government finance, see OECD (2001); Kim (2003a); Yoo (2003).

12. FAFM functions as the parent law. Only public funds, which are listed in the FAFM, can be established by individual establishing acts. The FAFM also regulates the operation of public funds' assets in order to secure the stability and efficiency of the fund.
13. Examples include the Agricultural Management Fund, the Employment Insurance Fund, the National Pension Fund, the Employment Promotion Fund for the Disabled, the Tourism Promotion Fund, the Information Promotion Fund, the Industrial Workers' Accident Compensation Insurance Fund, the Fund for National Heath Promotion, the Livestock Development Fund, and the Broadcasting Development Fund.
14. There were 11 extrabudgetary public funds that were not subject to parliamentary approval under the FAFM, even though they have a substantial impact on the status of public finances. They include the Credit Guarantee Fund, the Housing Finance Credit Guarantee Fund, and the Non-performing Asset Management Fund. However, the amended FAFM in 2003 requires all these funds to be subject to parliamentary oversight.
15. From the early 1980s, the budget authority adopted a new means of budget review, a *de facto* "Council for Budget Deliberation". This Council, which consists of the Assistant Minister for the Budget, three director generals and some major directors, deliberates on budget drafts prepared by each budget division of the MPB. Although having no written statute for its foundation, this council has significantly contributed to improving budget formulation, in line with national priorities.
16. Several government reorganisations have occurred over the last decade, especially concerning the institutions responsible for macroeconomic forecasting, budgeting, and co-ordination. In 1994, the Economic Planning Board, which was responsible for economic forecasting and budgeting, was merged with the Ministry of Finance to form the Ministry of Finance and Economy (MOFE). This was soon broken up leading to the establishment of the Planning and Budget Commission (PBC) and the Office of National Budget (ONB) as separate bodies from the MOFE. Shortly thereafter, the PBC and ONB themselves were merged to create the MPB, leaving the MOFE (economic forecasting function) and the MPB (budget function) as two independent ministries.
17. After 1997, the government issued guaranteed bonds equivalent to 27% of GDP for financial sector restructuring. There is no legal obligation to show the current value of the full cost of this debt, nor the risks involved. Presently, only the interest on the bonds is incorporated into the national budget. There is a risk that any defaults on the bonds would have a high budgetary cost (OECD, 2003).

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ISSN 1608-7143
OECD Journal on Budgeting – Volume 4 – No. 3
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New Zealand*

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* This study has benefited from comments from: Roger Beckett and Ken Warren of the New Zealand Treasury; Wendy Ventner of the Office of the Auditor General; and OECD colleagues including David Rae of the Economics Department.

1. Overview

1.1. The legal framework governing budget processes

Since the mid-1980s the legal framework for the budget has been modernised, reflecting ambitious and unprecedented reforms (Scott, 2001). A series of laws to give effect to fundamental changes in budget and financial management practices were enacted in the decade until 1994 (Box 1). Since then, there have been some amendments and modifications. The Constitution Act 1986, the Public Finance Act (PFA) 1989 as amended, and the Fiscal Responsibility Act (FRA) 1994 as amended, are the underlying legal framework governing budget processes. The State Sector Act (SSA) 1988 governs key budget actors.

The Constitution Act 1986 recognises that Parliament is the supreme law-making authority and controls public finances. This act includes principles for the budget system: it specifies that the Crown may not levy taxes, raise loans, or spend public money except by an act of Parliament. These aspects are set out in formal legal documents, decisions of the courts and conventions (see State Services Commission, 1995; Governor General's Office, 2004).

The PFA governs the use of public financial resources, notably to: 1) provide a framework for parliamentary scrutiny of the government's management of the Crown's assets and liabilities, including expenditure

Box 1. **New Zealand: Main budget system laws***

- The Constitution Act 1986.
- The Public Finance Act 1989, as amended.
- The Fiscal Responsibility Act 1994.
- The State Sector Act 1988, as amended; the State-Owned Enterprises Act 1986, as amended.
- The Public Audit Act 2001, as amended.
- The Crown Entities Act 2004.

* In 2004, the 1989 PFA and the 1994 FRA were being merged in the Public Finance (State Sector Management) Act.

Source: All laws are available at *www.legislation.govt.nz*, maintained by the Parliamentary Counsel Office.

proposals; 2) establish lines of responsibility for the use of public financial resources; 3) specify the minimum financial reporting obligations of the Crown, departments, and Crown agencies; and 4) safeguard public assets by providing statutory authority and control for the raising of loans, issuing of securities, giving of guarantees, operation of bank accounts, and investment of funds.

The FRA lays out transparency and accountability principles for public financial management. The law requires the government to publish regularly its short-term and long-term fiscal intentions, via a budget policy statement, fiscal strategy reports and economic and fiscal updates. Minimum disclosure requirements for these reports are set out. While the 1989 PFA altered arrangements for management and decision making in public sector organisations at a micro level, with the intention of achieving a greater efficiency and more accountable provision of government services, the 1994 FRA focussed on macro-fiscal policy requirements, notably the reduction of public debt and the achievement of operating surpluses (Janssen, 2001). In 2004, the 1994 FRA was being incorporated into a "Fiscal Responsibility" part of a revised PFA (for a guide to the new legislation, see Treasury, 2004). Although the 2004 amendment did not significantly amend the budget system, the new PFA allows greater flexibility for output appropriations. Several commentators had previously drawn attention to the overemphasis on outputs, at the expense of outcomes (for example, Audit Office, 1999; Petrie and Webber, 2001; Rae, 2002).

The State-Owned Enterprises Act (SOEA) 1986 and the SSA 1988 are two other important acts governing public sector financial management. The SOEA allows the government to provide commercial services through an organisational form similar to private sector enterprises. The Act's aim was to increase the efficiency and profitability of publicly owned enterprises.

The SSA focuses on administrative arrangements for core government public services. This law established new accountability relationships between departments' chief executives and ministers. Heads of government departments – who are career civil servants (there are no political appointees) – lost their permanent tenure, being appointed for a fixed term to fulfil contractual obligations to the minister, who became the "purchaser" of government services. Under the act, chief executives became fully responsible for employing their own staff on conditions similar to those applying in the private sector. In exchange for increased budget management flexibility – most input controls were relaxed – chief executives were made accountable for delivering outputs to ministers.

The Public Audit Act 2001 recast the legislation covering the statutory Office of Controller and Auditor General (OCAG). As an officer of Parliament,

the Controller and Auditor General (CAG) provides independent assurance to Parliament and the public that public sector organisations are operating and accounting for their performance in accordance with Parliament's intentions. The act also governs the responsibilities, duties and powers of the CAG, the scope and procedure of audits of public entities, and the duty to report to the House of Representatives.

The Crown Entities Act was expected to be adopted in 2004. This law provides a framework for categorising the various types of "arm's length agencies" that were created in the 1990s (especially) to implement the government's policy of decentralised, but responsible, management of public sector resources.

1.2. Reforms of budget system laws

The far-reaching reforms in the budget system have been categorised into three stages: the marketisation (1985-91), the strategic (1992-96) and the adaptive capacity phases (1997 to the present) (Pallot, 2002). Prior to 1985 – during the traditional and managerialist phases – the government financial management system had come under heavy criticism, because it lacked clear objectives and accountability for results (Treasury, 1989). Relationships between the aims of these programmes and the overall aims of the government were frequently unclear. Accounting systems did not measure total resource use, since the full cost of capital was excluded. The systems administered by central agencies curtailed freedom to manage effectively and resulted in poor central decision making. The system was designed for control of inputs rather than performance in the production of public services. These perceived failures, together with the poor macro-fiscal performance of the 1980s, led to the enactment of new legislation to enhance efficiency and accountability of public financial management (Janssen, 2001). Ministers were provided with new tools for examining spending priorities and for reviewing departmental efficiency.

Besides large fiscal deficits and increasing public debt, theory spurred this reform (Schick, 1996; Scott, 1996). Managerial theory provided a framework to allow more discretion to public sector managers, who were not to be held responsible for results unless they had freedom to act. Hence managers were authorised to: *i)* spend and hire within agreed budgets as they saw fit; *ii)* make their own choices regarding operating expenses and other purchases; and *iii)* run their organisation free of *ex ante* control. Although managerial doctrine explains some of the public sector innovations, it does not account for the government's recourse to contract-type arrangements or the emphasis on outputs. New institutional economics, agency theory, and transaction cost economics provided the intellectual underpinnings to these innovations. Institutional economics suggests the manager's interest might

diverge from the owner's interest resulting in poor and insufficient outcomes. To facilitate appropriate behaviour, *ex ante* performance criteria for managers were specified with the delivery of performance being subject to reporting and scrutiny. A well-run government department should: *i)* have clear objectives that inform managers of what is expected and enables their performance to be monitored; *ii)* be transparent in explaining these objectives and the means by which they are to be pursued; *iii)* give managers and others incentives to achieve agreed goals; and *iv)* have incentives and information that enhance accountability of agents to principals. With the passage of the SSA in 1988, all permanent department heads became chief executives contracted for fixed terms.

Within about eighteen months after enactment of the PFA in 1989, all departments had shifted from cash accounting and budgeting to an accrual basis. The 1994 FRA required the government to establish and disclose medium- and long-term economic and budgetary objectives, and the specification of strategic and key results. Principles of fiscal responsibility were defined in the FRA to assist in ensuring stable macro-fiscal strategy in the face of a changed electoral system – from the first-past-the-post-system inherited from the United Kingdom to a mixed member proportional representation system.

In 2001, a government advisory committee reviewed the operation of the new financial management system during the 1990s. Four priority areas for change were identified: better integrated service delivery; addressing fragmentation and improving alignment in the State sector; enhancing people and culture; and improving central agency leadership. In response, the government introduced the Public Finance (State Sector Management) Bill in 2003 (see Minister of Finance and the Minister of State Services, 2003). The bill encompasses:

- Integration of, and amendments to, the PFA and the FRA, including: broadening appropriations to allow ministers more flexibility while retaining levels of reporting and accountability to Parliament; enhancing departmental disclosures to ensure a broader range of information about intended and actual performance; strengthening the Auditor General's controller function by providing the Auditor General with the power to direct a minister to report to Parliament in a case where the Auditor General has reason to believe that any expenditure that has been incurred is unlawful or inconsistent with an appropriation.
- Amendments to the SSA including: extending the State Services Commissioner's mandate to provide leadership and guidance to the wider State sector, especially on ethics, values and standards, and to promote senior leadership development in the State sector.

- Adoption of a new Crown Entity Act including: building a basis for strategic engagement between ministers and Crown entity boards so as to establish performance expectations and report performance; clarify the relationship between ministers and individual Crown entities with clear and consistent roles and relationships; strengthen integration of Crown entities with the State sector; and provide for whole-of-government information.

Finally, in an effort to strengthen the role of Parliament – in particular the Financial and Economic Committee (FEC) – the Standing Orders of the House of Representatives were amended in December 2003. Although the FEC's oversight of Crown entities and State-owned enterprises was enhanced, Parliament's role in the budget process will continue to be weak so long as the "financial veto" is retained – this is the government's power to reject any proposals by Parliament to amend the government's draft budget (apart from in very minor ways).

2. Principles underlying budget system laws

The budget system laws include all the main classical principles (authoritativeness, annual basis, universality, unity, and specificity) as well as the modern principles (accountability, transparency, stability, and performance).

One of the fundamental principles for the budget system law, the principle of authoritativeness is embodied in the Constitution Act 1986 and the PFA. The Constitution Act clearly states that no expenditure of public money is to be made other than in accordance with appropriation by an act of Parliament (s. 22). The PFA provides that expenditure may only be made to settle appropriated expenses or the costs incurred in acquiring or developing assets or in the repayment of Crown liabilities. Parliamentary appropriations are therefore on an accrual basis giving the legislature authority not only over the disbursement of public money, but also over the incurrence of obligations relating to expenses and capital items.

Other classical principles are also specified in the PFA. The budget estimates are provided for a 12-month period from 1st July to 30 June (annual basis, s. 2, PFA). The principles of universality and unity require the budget to include all revenues and expenditures on a gross basis and in the same document. However, there are some exceptions, as net appropriations are also allowed. The budget estimates are prepared in accordance with types of appropriations under the departments or agencies (principle of specificity, s. 4, PFA).

The PFA and FRA were adopted to include modern budget principles including fiscal sustainability, efficiency and the effectiveness of public expenditure. The FRA requires the government to keep to sound public financial

management by reducing total Crown debt to prudent levels and by pursuing the principles of responsible fiscal management (the principle of stability, s. 4, FRA). The Public Audit Act 2001 assures the accountability to Parliament for the government's use of public resources and powers conferred by Parliament, by conferring on the Auditor General the authority to carry out financial report audits and performance audits.

The 1988 SSA establishes accountability relationships between departmental chief executives and their ministers. All government department chief executives have performance agreements with their responsible minister. Performance agreements include annual milestones to demonstrate the specific results required to achieve each key result area (Treasury, 1996). Budget system laws also focus on maintaining a performance-oriented public finance management.

Finally, the principle of transparency in the budget is assured through the financial reporting requirements of the FRA and the PFA. Departments, State-owned enterprises, Crown entities and the government as a whole, prepare financial forecasts and reports in accordance with generally accepted accounting practice. Details of reporting requirements are discussed later in this case study.

3. Legal basis for the establishment and the powers of the actors in the budget system

3.1. The executive and the legislature

3.1.1. Overview

New Zealand has a centralised, unitary form of government. Local government's powers, although reformed, remain limited (OECD, 1997). The executive consists of the Governor General, the Prime Minister, a Cabinet of ministers, ministries, Crown entities, and State-owned enterprises. The legislature has one chamber – the House of Representative (HR). Members of Parliament are elected every three years. The party which has the highest number of representatives elected is invited by the Governor General to form the government. The leader of the government is the Prime Minister, who selects ministers, who in turn, form the Cabinet.

3.1.2. Roles and responsibilities of the Cabinet and individual ministers

Cabinet is comprised of ministers and chaired by the Prime Minister. It plays a powerful role in government policy decisions and initiating legislation. Ministers as a whole must have the support of the House of Representatives and take collective and individual responsibility for their decisions. The Cabinet in 2004 consisted of 20 members; in addition, there were five

ministers outside Cabinet. Cabinet ministers are usually allocated a number of votes[1] to manage, known as their portfolio.

Cabinet decisions are implemented by ministers through departments or other agencies for which they are responsible. The Cabinet Expenditure Control Committee undertakes the detailed scrutiny of departmental budgets and expenditure proposals. This committee is a sub-committee of Cabinet and comprises most of the senior ministers, including the Minister of Finance. It is chaired by an Associate Minister of Finance. The Committee is supported by a committee of officials from the three central agencies: the Department of the Prime Minister, the State Services Commission, and the Treasury. Within the Cabinet, the Minister of Finance has the principal responsibility for the budget. The budget speech is normally delivered by the Minister of Finance on behalf of the government. The Minister of Finance is the responsible minister for the Treasury department.

3.1.3. Establishment of ministries and executive branch agencies

The Treasury is the principal economic and financial adviser to the government. It reports on most expenditure proposals before the government. The Treasury is also responsible for the development and broad implementation of financial management policy in the public sector and for the preparation of the financial statements of the government. A significant part of the department's work involves advising on the content of the government's annual budget, as well as assisting with the preparation of budget documents and associated legislation. As part of the budget preparation process, the Treasury co-ordinates the review of expenditure programmes, undertakes fiscal analysis, prepares revenue and expenditure forecasts and monitors revenue and expenditure flows. The above roles of the Treasury are not specified in the law, reflecting the inheritance from the United Kingdom, although the detailed appropriations regime acts to specify the services the New Zealand Treasury can deliver.

Crown entities – bodies that are legally separate from the Crown but are not State-owned enterprises (SOEs) – have important roles in providing various public services. Crown entities are established by law and the government has a controlling interest in them through ownership mechanisms (Treasury, 1996). The fourth schedule to the PFA lists most Crown entities or groups of Crown entities. Crown entities can be added to this schedule by Order in Council, *i.e.* the government can create new agencies. However, Crown entities can be removed only by amending the PFA. Crown entities are diverse, ranging from research institutes, school boards of trustees, Crown health enterprises, business development boards, etc. Parliament makes appropriations to the Crown, not to the Crown entities themselves. Because they are not legally part of the Crown, Crown entities

have the freedom to incur any expenses, but each Crown entity must bear any loss it incurs. Appropriations are however required for the Crown to purchase outputs provided by Crown entities and to invest additional capital in them. The Crown Entities Act 2004 set up a consistent governance framework for Crown entities and requires reporting to Parliament on their performance.

The SOEA established SOEs under the jurisdiction of the Companies Act 1955. Their aim is to improve efficiency in trading operations such as postal services, broadcasting, and electricity generation and transmission. Under the Act, a SOE has a responsibility to operate as a successful business. Their Boards of Directors are accountable to the Minister of Finance and the Minister of State-Owned Enterprises, who are prohibited from involving themselves in the day-to-day decision making of SOEs. SOEs have the same powers as private sector companies to borrow, including without government guarantees. As in the case of departments, any investment in the capital of an SOE requires an appropriation by Parliament.

3.1.4. Responsibilities of senior civil servants

The SSA and the PFA provide the legislative basis for the financial management system of the core central government (ministers, departments and Crown entities). Departmental chief executives are hired on fixed term contracts. Each chief executive is responsible to the appropriate minister for carrying out the functions and duties of the department; providing advice to ministers; the good conduct of the department; and the efficient, effective and economical management of the activities of the department.

The core values of the public service are described in the New Zealand Public Service Code of Conduct, which is issued by the State Services Commissioner under the 1988 SSA (s. 57). The code provides guidance to public servants on standards of behaviour. Three principles of conduct for all public servants are included in the code, notably that public servants should: fulfil their lawful obligations to government with professionalism and integrity; perform their official duties honestly, faithfully and efficiently; and not bring the public service into disrepute through their private activities.

3.1.5. Establishment and roles of parliamentary committees

New Zealand has inherited a Westminster parliamentary system, in which Parliament is, in principle, supreme in budget matters. Parliament grants "supply" (authority over resources) to individual ministers by passing appropriation bills, which "vote" money for specific purposes. Parliament's Standing Orders (SOs) establish a Finance and Expenditure Committee (FEC) as one of the House of Representative's 14 subject select committees (s. 187, SO, see Parliament, 2004). After the government introduces the budget, the FEC

may examine any vote itself or refer it to another select committee for examination. Each select committee may recommend a change in the vote. All committees must report back to the House on their examinations of votes within two months of the delivery of the budget. A vote can not be passed until it has been examined by a select committee. FEC also allocates to subject select committees each year the task of conducting a financial review of the performance in the previous financial year and the current operations of each individual department, office of Parliament, Crown entity, public organisation or SOE.

3.2. Role and responsibilities of sub-national governments

Local governments, whose structure is governed by the Local Government Act (LGA) 2002, include regional councils, and district and city councils (OECD, 1997). The last two are collectively termed "territorial authorities". With a few minor exceptions, a group of territorial authorities is defined within the boundary of a regional council. In some cases, a territorial authority may have the statutory functions of a regional council. These bodies are known as "unitary authorities". The number of bodies in each category in 2004 was 12 regional councils and 74 territorial authorities.

The powers and functions of local government are provided in the LGA and in other legislation where central government chooses to devolve responsibility. For example, in the field of territorial planning and environmental management, the Resource Management Act 1991 devolves responsibilities and powers to regional councils and territorial authorities for local policy development and approval. Specific aspects of public health are also devolved through the Health Act 1956 (Part III) to local authorities.

Sources of revenue vary across sub-national administrations. The principal source of local revenue is property taxation. The right to tax property is determined through the Local Government (Rating) Act 2002 (LGA). Under this Act, a local authority can levy a charge on the legal owner of land holdings. The levy may be applied differently across properties – local councils have considerable discretion to determine the most appropriate spread of the rating burden in the community. Local authorities are also authorised to borrow money in accordance with their liability management policy, included in their long-term council community plan (LGA). The LGA specifies reasonably stringent provisions for consultation on a council's plans, policies and decision making, and provides that the Crown is not liable to contribute to the payment of any debts or liabilities of any local authority. Grants from the central government, even though not a large part of local authorities' revenues, are also a source of revenue. They are limited to direct programme grants (for example, for land transport programmes) and payments in lieu of property taxation where land is owned by central government. There is a

mixture of both tied and general grants by central government. Other sources of revenues for territorial authorities are fines and receipts from operations.

4. Legal provisions for each stage of the budget cycle

4.1. Budget preparation and presentation by the executive

4.1.1. Institutional coverage of the budget

The budget estimates are defined as "a statement of the proposed expenses and liabilities to be incurred by the Crown" (s. 2, PFA). The PFA defines the Crown to mean Her Majesty, inclusive of all ministers of the Crown and all departments. Offices of Parliament, Crown entities and SOEs are excluded from the Crown, as are local authorities governed by the LGA. The budget presented to the Parliament includes forecasts covering all departments and agencies in the central government and requests for appropriations by the Crown, departments and offices of Parliament.

4.1.2. Extrabudgetary funds and earmarking of revenues

The scope of the annual appropriations act is limited to the Crown. There are various funds and legal entities whose budgets are approved by bodies other than Parliament. This is the case notably for Crown entities and other public organisations. The Crown Entities Act 2004 classifies Crown entities into various categories. Separate legislation has established most of these, including the New Zealand Superannuation Fund, the Earthquake Commission, and the Accident Compensation Corporation. While the Crown's purchases of services from Crown entities and capital injections into them are included in the Appropriation Act, their own revenues and expenditures are not included in appropriations. However, all Crown entities, other public bodies (including the central bank), and SOEs are included in the government's forecasts of total operating revenues and expense, shown in its fiscal and budget strategy documents.

Some revenues – for example income taxes – are not earmarked for specific expenditures. However, net budgeting – the retention of own revenues by departments and the entities under them – is authorised by the PFA (see below). For example, the levies collected by the Accident Compensation Corporation are retained for its use.

4.1.3. Definition of budget aggregates

In its list of definitions, the PFA does not define fiscal aggregates such as "total operating revenues" and "total operating expenses" which are required for fiscal strategy reports and other documents. However, the definition and coverage are made clear in accounting requirements. In particular, the PFA, as amended in 2004, specifies that annual consolidated financial statements of

"the Government" include, in addition to government departments, all Crown entities, all organisations listed in another schedule to the act, all offices of Parliament (this includes the Auditor General's Office), all SOEs (named in the schedule to the SOEA), and the Central (Reserve) Bank of New Zealand.[2]

4.1.4. Fiscal rules

Qualitative fiscal rules are embedded in the FRA. These rules focus on the levels of debt and net worth, as well as fiscal risk and medium-term macro-fiscal stability (Box 2). The size of the operating balance (the most important budget balance under accrual accounting) is the main fiscal policy aggregate used for achieving public debt targets.

The law permits the government to depart from these principles and objectives, but only if a departure is temporary and provided that the Minister of Finance specifies: *i)* the reasons for departure; *ii)* the approach the government intends to take to return to those principles; and *iii)* the period of time that the government expects to take to return to those principles.

4.1.5. The timetable for budget preparation and presentation to Parliament

The FRA requires a budget policy statement (BPS) to be presented to the HR not later than 31 March. The BPS sets out the overarching policy goals that will guide the government's forthcoming budget decisions, the policy areas it will focus on and how the budget will accord with the most recent FSR. The PFA specifies that the date for presenting the budget to the HR – in the form of a first appropriation act – is before the end of the first month after the start of the financial year. A resolution by the HR could require a different date. In practice, the government typically presents the budget to the HR a month before the start of the fiscal year (which begins on 1st July). The entire budget timetable (Box 3) is decided by the government – the PFA's deadline is barely relevant to actual practice.

4.1.6. Approval process within the executive

Since the adoption of the FRA in 1994, the above budget preparation calendar is conditioned by the requirement for the minister to present to the BPS no later than 31 March (*i.e.* three months before the beginning the fiscal year). The amendments to the PFA in 2004 resulted in the BPS becoming more focused on budget priorities, consistent with the government's fiscal strategy report (see below). Following the BPS – which is a pre-budget statement – Cabinet makes final budget decisions.

Box 2. **New Zealand: Fiscal responsibility (legal provisions)**

- Reducing total debt to prudent levels,* so as to provide a buffer against factors that may impact adversely on the total level of debt. When the FRA was first passed in 1994, New Zealand's public debt level was judged to be too high. The act required the achievement of operating surpluses on government transactions until prudent levels of debt were achieved. Since debt reduction was to be attained by running operating surpluses, the government was prevented from achieving prudent debt levels simply by selling assets.
- Once prudent levels of total debt have been achieved, maintaining total debt at prudent levels by ensuring that, on average, over a reasonable period of time, total operating expenses do not exceed total operating revenues. The principle implies that once prudent levels of debt have been achieved, the government should not borrow to cover operating expenses. This principle is applied over the medium to long term. In the short term, cyclical factors may result in temporary operating surpluses or deficits.
- Achieving levels of net worth that provide a buffer against factors that impact adversely on net worth, that is, to ensure that if the economy is subject to adverse events, the government is able to borrow without undue risk of moving into an unsustainable net worth position. This objective acknowledges that the government's financial strength depends on its overall balance sheet position, not just debt.
- Managing prudently the risks facing the government, that is, to recognise risk and where possible to take steps to manage it. The objective requires that governments should actively reduce risks inherent in their assets, liabilities, and off-balance sheet items such as guarantees. Governments should also look to reduce the risks around their operating flows, by actively protecting the tax base and managing expenditure risks.
- Pursuing policies that are consistent with a reasonable degree of predictability about the level and stability of tax rates for future years, that is, to avoid surprises about future tax rates. The objective reflects the importance of stability in tax rates for private sector planning and hence growth.

* The definition of a "prudent" level of debt is not specified in legislation. It is left to the government to specify this in its budget policy statement and fiscal strategy report, and to justify interpretations to Parliament and the public. This allows the government to change its definition of "prudent" in line with determining factors, including the structure of the economy, vulnerability to shocks, demographic pressures, the cost of debt servicing, and the structure of the Crown's balance sheet.

Box 3. **New Zealand: Key steps and dates for budget preparation by the government**

August-November: Strategic phase. Ministers determine the budget strategy objectives for the coming three years. The Cabinet considers the relative importance of the outcomes the government wants to achieve for the coming budget. Ministers identify priorities for departmental chief executives to guide preparation of budget submissions. Decisions taken during the strategic phase are the basis for the budget policy statement.

December-February: Preparation of vote budgets and development of budget initiatives. Ministers and chief executives prepare draft budgets and "purchase agreements" for the coming year and make budget plans for the following two years.

February-April: Review of budget baselines. Departments refine budget proposals. The mix of inputs may be changed so long as total expenses do not exceed approved baselines. Cabinet considers ministers' requests and proposed budget documents. Ministers are expected to keep total expenses for each vote within approved levels. Ministers may request Cabinet to change to baseline projections.

Budget day (no later than 31 July): Presentation of budget documents to the House of Representatives (HR). In practice, the budget is often presented in May or June.

July-September: Finance and Expenditure Committee of the HR reviews budget documents and reports to the House by 30 September.

September-October: House debates Finance and Expenditure Committee's report. HR must pass the appropriation bill within three months of the delivery of the budget by the government.

4.1.7. Documents to accompany the budget law

On budget day, to accompany the first appropriation (estimates) bill for the new fiscal year, the Minister of Finance must present to the HR the following documents (s. 2, FRA):

- Information that supports the first appropriation bill, including some detail on each vote, each appropriation for expenses, and each appropriation for capital expenditure (see Box 4).
- A fiscal strategy report.
- An economic and fiscal update.
- The future operating intentions of each department, with more detailed information required for the first future financial year.

Box 4. **New Zealand: Information required to support the first appropriation act**

Based on the draft 2004 Public Finance (State Sector Management) Act approved by HR.

For each vote:

- A summary of the financial activity relating to that vote for the financial year covered by the Appropriation Bill.
- Comparative budgeted and estimated actual figures for the previous financial year.

For each appropriation sought:

- The scope, type and time period of the appropriation, including the vote to which the appropriation relates.
- The maximum level of expense or capital expenditure permitted by the appropriation.
- A concise explanation, including the intended impacts, outcomes, or objectives.
- The minister responsible for the appropriation and the department that will administer it.
- Comparative voted and estimated actual expenses and capital expenditure for each appropriation for the previous financial year; comparative actual expenses and capital expenditure for each of the four financial years that precede the previous financial year.

For each output class appropriation:

- The performance measures and forecast standards to be achieved for each class of outputs.
- The forecast expenses to be incurred for each class of outputs within a multi-class output expense appropriation.

For each department:

- The responsible minister for the department.
- The projected balance of net assets for the department at the end of the financial year.

For permanent legislative authorities:

- Equivalent information about each category of expense or capital expenditure.

The Minister of Finance must submit to the Speaker of the House any proposals for significant changes to the format or content of the above documentation or other supporting information and the Speaker must present those proposals to the HR. The Minister must consider any comments of the Speaker or any committee of the HR that considered those proposals before putting the proposals into effect.

Medium-term macroeconomic framework and fiscal strategy. The fiscal strategy report (FSR) must be presented with the annual budget. It describes the government's long-term objectives and its short-term fiscal intentions. The FSR is required to include projections for key fiscal aggregates for a period of ten or more years and an explanation of how these projections accord with the principles of responsible fiscal management. The FSR must also assess the consistency of the long-term objectives with the long-term objectives announced in the BPS. Justification of changes in the government's long-term fiscal objectives is required by law.

Concerning "short-term" objectives, the FSR must indicate, for the financial year to which the report relates and at least the next two fiscal years, the government's intentions for total operating expenses, total operating revenues, the operating balance, total debt, and total net worth. The FSR must also justify any departures from the short term intentions expressed in the budget policy statement. If the short-term intentions are not consistent with the principles of responsible fiscal management or with the long-term intentions, the FSR must state the reasons for departure and the approach the government intends to take to ensure consistency, as well as the time period this is expected to take.

The economic and fiscal update must contain economic and fiscal forecasts relating to the financial year to which the appropriation bill relates and to each of the next two financial years and a statement on the impact of tax policy changes, including changes in tax legislation since the last update and proposed changes in tax legislation. The law requires that the economic forecasts include GDP, consumer prices, unemployment and employment, and the current account of the external balance of payments, together with a statement of all significant assumptions underlying them. The law is also specific on the content of fiscal forecasts, which must include the forecast financial statements including a statement of borrowing and "any other statements necessary to fairly reflect forecast financial operations and financial positions at the end of each of the forecast financial years".

New measures *versus* existing expenditure policies. Since the FRA requires the government to justify any changes in previously-announced medium-term fiscal policy, there is implicitly a legal requirement for the

government to assess the impact of new fiscal policy measures from scenarios previously based on "existing policies".

Performance-related information. To support the Appropriations Bill estimates presented to Parliament, the Minister of Finance must provide information for each appropriation for expenses. This information must contain, *inter alia*, the performance measures expected to be achieved in relation to any classes of outputs or services with the scope of the appropriations, as well as the intended impacts, outcomes, or objectives of the appropriation.

Chief executives of departments are responsible for the financial performance of their departments. They must ensure that each department provides information on the department's future operating intentions to the responsible minister. Annual departmental statements of intent (looking forward a period of at least three years) must include a statement signed by the responsible minister that the information contained therein is consistent with the performance expectations of the government. These statements must set out and explain the nature and scope of the department's functions and intended operations, the specific impacts, outcomes, or objectives that the department seeks to achieve and how the department intends to manage those functions. Extra information for the first of the three financial years includes a set of forecast financial statements including a statement of forecast service performance that describes each class of outputs the department intends to supply.

Tax expenditures, contingent liabilities and fiscal risks. The FRA requires contingent liabilities and fiscal risks to be incorporated into the budget-related documents. Both the BPS and FSR focus on the medium- to long-term implications of a government's policies and various alternative policy sets. The economic and fiscal update is also required to incorporate to the fullest extent possible all government decisions and other circumstances that have an impact on the fiscal and economic outlook (s. 11). The quantified fiscal impact is to be included in forecast financial statements. Decisions that are not quantifiable must be disclosed in the statement of fiscal risks. If disclosure results in prejudice, compromise or material loss of value, the government may withhold the fiscal impact of the decision. For example, the government may decide to sell an asset, but may not wish to disclose the sum it expects to receive for that asset as this could compromise negotiations over the sale.

4.1.8. Budgets of Parliament and other constitutional bodies

The PFA contains provisions for the preparation of the budgets of the offices of Parliament (s. 17). Prior to the commencement of a financial year, the chief executive of each office of Parliament prepares and submits to the HR

a projection of the revenues and expenses of the office, a statement of the estimated financial position at the beginning and end of the year, a description of the classes of outputs to be produced by the office, and an estimate of cash flows for the upcoming year. The HR, after considering the information provided, communicates to the Governor General, an estimate of costs to be incurred in respect of classes of outputs, an estimate of the other expenses to be incurred, and an estimate of the capital contribution to be made, and requests that these estimates be included as a vote in an appropriation bill for that year.

4.2. Budget process in Parliament

Failure by Parliament to enact the budget would represent a lack of confidence in the government and would be likely to precipitate a general election. Since the introduction of mixed member proportional government, most governing parties control only a minority of the HR. Therefore, to ensure that the introduced budget will be enacted, the governing parties consult each other to maintain sufficient political support for the budget to be presented.

Once the budget is submitted, Parliament has very few powers to affect the size and composition of the budget, which is determined almost exclusively by the government, as it has a financial veto over any amendment proposals. Even the timing of the brief parliamentary debate on the budget is determined by the government. As in other Westminster countries, procedures governing parliamentary budget process are not included in the law. Rather they are regulated mainly by the Standing Orders (SOs) of the House of Representatives (see Parliament, 2004).

4.2.1. The timetable for budget adoption and constraints on the budget debate in Parliament

The key steps governing the Parliament's involvement in the pre-budget and budget debates are:

- The FEC must report to the House on its review of the budget policy statement within six weeks of the publication of that statement (SO 318).
- Debate on the budget policy statement and the FEC report take place shortly after the FEC report is tabled (SO 318). The debate provides the opportunity for all parties represented in Parliament to express their views on the parameters for the upcoming budget, prior to the government taking final detailed budget decisions.
- Following delivery of the budget, the estimates are referred to the FEC, which may examine a vote itself or refer it to any subject select committee for examination (SO 322).

- Each select committee determines whether to recommend that the appropriations for a vote be accepted. All committees must report to the House on their examinations of the estimates within two months of the delivery of the budget (SO 323).
- The FEC must report to the House on the fiscal strategy report and the budget economic and fiscal update within two months of the delivery of the budget (SO 321).
- The debate on the third reading of the main Appropriation Bill must be completed within three months of the delivery of the budget (SO 325). The debate on the third reading may include reference to the content of the fiscal strategy report, the budget economic and fiscal update and the FEC report on these documents.
- When the bill has been read a third time, it is passed by the House and becomes law (the annual appropriation act) once it receives the assent of the Governor General.

Parliament's Standing Orders also allow the government to select the day for the estimates debate. The Government determines which votes are available for debate on a particular day and how long in total is to be spent on the debate that day. In countries where the executive and legislature are separate, it would be inconceivable for the government to have such a strong agenda-setting role.

4.2.2. Provisional budgets

"Imprest supply" is the provision by Parliament of interim spending authority. Imprest supply authorises the Government to spend money or incur expenses or liabilities for any purpose up to a specified limit, so long as this is subsequently sanctioned by an appropriation act. An imprest supply act is passed just before the start of the financial year which applies (usually) for the first two months of the year prior to the passing of the main appropriation act. A second imprest supply act is passed with the appropriation act which can be invoked by Cabinet when increased appropriations are required for particular outputs. Cabinet approves the proposed amounts under the imprest supply act and agrees to submit these to Parliament in a supplementary estimates bill prior to the end of the financial year. In the case of a fiscally neutral transfer within a vote, Cabinet has delegated this requirement to the joint approval by the Minister of Finance and the vote minister. Every imprest supply act contains a provision requiring all public money spent and all expenses and liabilities incurred under its authority to be charged in the manner specified in an appropriation act for the same year.

Imprest supply acts are self-contained pieces of legislation. The PFA does not provide any guiding principles governing their use. Usually, the first

imprest supply is for two months, since the budget is usually not adopted as law until after the beginning of the fiscal year (it must be passed by end September). Imprest supply can be extended if the budget is late or if there is likely to be an election.

4.2.3. Powers of amendment

Since February 1996 the HR Standing Orders allow committees to propose changes that would affect the size and allocation of votes. However the same regulations allow the government to exercise a financial veto over proposed changes. In particular, the House is prevented from passing a bill, amendment or motion which the government certifies would have more than a minor impact on: 1) the government's fiscal aggregates and/or 2) the composition of the vote (SO 312). This is an extremely strong constraint, as Parliament is unable to change the totals or the composition of operating expenses, operating revenues, the operating balance, public debt and net worth. Once a financial veto has been exercised and the certificate issued, the veto cannot be overturned by the House. The proposal that is the subject of the veto cannot proceed to a vote in the House. However, the reasons for exercising the veto may be debated when the House debates the bill, amendment, or motion (SO 313).

4.2.4. Approval of resources

The Constitution Act 1986 states that "the HR shall not pass any Bill for the appropriation of the public money and for the imposition of any charge upon the public revenue unless the making of that appropriation or the imposition of that charge has been recommended to the HR by the Crown" (s. 21). Furthermore, the same act specifies that "it shall not be lawful for the Crown, except by or under an Act of Parliament, to levy a tax; or to raise a loan or to receive any money as a loan from any person; or to spend any public money" (s. 22). Therefore, bills relating to the public money must be submitted to the HR and be approved before the government uses public money. The revenues of Crown entities are outside the scope of the definition of public money and these may be retained and used under certain conditions (see below).

4.2.5. The nature, structure and duration of appropriations

The PFA requires that, for the Crown and offices of Parliament, all expenses and capital expenditures in any financial year be made under an appropriation act. Expenses and capital appropriations may be incurred only within the scope of the appropriation and for no other purpose. Separate appropriations are made for:

- Output expenses for each class of outputs or groupings of outputs to be supplied by departments, offices of Parliament, or on behalf of the Crown. Some classes of outputs may be grouped so that one appropriation applies to the group as a whole, rather than to each class of outputs in the group. Appropriation by output class is the usual mode of appropriation for departments.
- Each category of benefits and other non-recoverable expenses. These are payments by a minister on behalf of the Crown, generally to individuals. Examples include superannuation, unemployment benefits and domestic purposes benefits.
- Each category of borrowing expenses. Examples include interest expenses, premiums, borrowing, and other finance costs.
- Each category of capital expenditure.

Each of these appropriations is on an accrual basis and therefore the executive is constrained from incurring obligations relating to expenses or capital expenditure, in addition to the subsequent constitutional constraint on the disbursement of public monies to settle these obligations.

Permanent legislative authority, representing expenses or payments authorised other than by an appropriation act, is used in certain circumstances, such as where a measure of constitutional independence from government control is desirable (for example, judges' salaries), the continuity of supply for essential services or transactions such as debt servicing, or to provide a commitment to the settlement of liabilities, such as repayment of debt and payment of tax refunds.

4.2.6. Carryover of appropriations and borrowing of future appropriations

Although the authority to incur expenses or capital expenditure under the appropriation act usually lapses at the end of the financial year, multi-year appropriations are possible. An appropriation act may provide authority to incur expenses or capital expenditure for more than one financial year, up to a maximum of five financial years.

4.2.7. Public debt approval

The PFA specifies that, unless expressly authorised by an act, it is not lawful for the Crown to borrow or any person to lend money to the Crown. The law authorises the Minister of Finance, on behalf of the Crown, to borrow money if it is expedient in the public interest to do so. This power cannot be delegated. The PFA contains a number of other provisions relating to borrowing, including the Crown not being liable for debts of Crown entities, the appointment of borrowing agents, the terms and conditions of borrowing

and securities. It also prohibits the Crown from lending money except by statute.

No guarantee or indemnity may be given by the Crown except by statute. However, the Minister of Finance may, if it appears to be necessary or expedient in the public interest to do so, give in writing a guarantee or indemnity to a person, organisation, or government. The minister decides on the terms and conditions. However, if the contingent liability of the Crown exceeds NZD 10 million, the PFA requires the Minister of Finance to lay before the HR a statement on the guarantee or indemnity that has been given, with the minister providing details as he/she considers appropriate.

Although borrowing is formally authorised by laws adopted by Parliament, the total level of public debt – direct and guaranteed – is not subject to a formal limit in NZ dollars. However, Parliament reviews and reports on the FSR each year, which includes projections of financial statements, including future levels of total debt. Debt levels are controlled indirectly by Parliament, by approving new borrowings and/or operating surpluses in the context of the annual budget.

4.2.8. Promulgation, veto and publication of the adopted budget

The Constitution Act 1986 requires that an appropriation bill passed by the HR becomes law when the Sovereign or the Governor General assents to it and signs it (s. 16). As with all laws, the adopted appropriations act is published on the legislative Internet site.

4.2.9. Supplementary budgets (rectifying laws)

The PFA lays out provisions for supplementary appropriations bills, which are used to change any information provided for the first appropriation act or to provide information that was not contained in the first appropriation act. Supplementary budgets are used for altering the mix of outputs being delivered, raising their levels, injecting new capital into departments, etc. They may be needed to reflect increases in the amount of appropriation required for non-discretionary payments such as welfare benefits or to provide appropriations for new policy initiatives. However, because of the need for responsible fiscal management, supplementary appropriations are generally limited to switching resources within the overall budgetary level set in the main estimates. With the adoption of the amendments to the PFA in 2004, there is greater flexibility to group output classes and less recourse to supplementary budgets for reallocations between outputs can be expected. There are no limits in the number of supplementary budgets that can be adopted, although typically there are two each fiscal year.

4.2.10. Budgetary implications of other bills

There is no legal provision which requires any bills having budgetary implications to be reviewed by the FEC or any other committee.

4.3. Budget execution

4.3.1. Apportionment of expenditure authority

Once an appropriation act or an imprest supply act has been passed, the departments will agree with Treasury on the timing of the passing of the required funding to Crown and departmental bank accounts that are operated by individual departments. Thereafter, the management of public expenditure is a two-stage process consisting of the incurrence of an appropriation by Parliament and the issue of money from the Crown or departmental bank to settle amounts owing. While these transactions can occur simultaneously, they may be years apart (as is the case for employee superannuation).

Departments incur expenses against appropriation, and must provide the Treasury with information each month on the status of each appropriation. This information is forwarded to the Auditor General within ten working days of the end of each month. The Auditor General may direct a responsible Minister to report on any breaches of appropriation if it is considered that any expenses or capital expenditure has been incurred in excess of or outside the scope of an appropriation.

In addition, if the Auditor General has reason to believe that any money to be paid out of a Crown or department bank account may be applied for a purpose that is not lawful or is outside the scope, financial limit or period of any appropriation or other authority from Parliament, he or she may direct the ministry or the Treasury to stop payments out of the relevant Crown or departmental bank account.

4.3.2. Cancellation of budget authority and other in-year expenditure controls

Appropriations are a permissive authority – there is no requirement imposed on the government to utilise the appropriations approved by Parliament. This means that the government does not require parliamentary authority to cancel appropriations. When it is considered prudent to reduce or cancel part of the appropriations, supplementary appropriation acts or imprest supply acts may be used.

4.3.3. Emergency spending, excess spending and contingency funds

Although spending above appropriations is stated to be illegal, the PFA also authorises the Minister of Finance to approve spending above

appropriation. In particular, the Minister of Finance may approve the incurring of expenses or capital expenditures in the last three months of any financial year which are in excess, but within the scope, of an existing appropriation approved by Parliament. The limit on such excess expenditure is the greater of NZD 10 000 or 2% of the specific appropriation. Any such authorisation must be included in a new appropriation bill. A similar parliamentary approval is needed to validate any unlawful expenditure which the Minister of Finance does not approve. For any such expenses, explanatory statements are required in annual accounts of the government and those of the relevant department.

When there is a national disaster, a civil emergency or a public health or security situation requiring the government to declare an emergency, the PFA allows the government to incur emergency expenses or capital expenditures. No limit applies, but the amounts must be included in the annual financial statements of the Crown and be approved by Parliament in an appropriation bill. Typically, the costs of disasters are first accommodated through the use of an imprest supply act.

4.3.4. *Transfer and virement of appropriations within the year*

Appropriation is made for specific purposes such as purchasing or providing specific classes of outputs, making specific benefit payments or investing in specific entities or assets. Even if the authorised appropriation limit is not reached, the remaining amount of an appropriation cannot be used for another purpose. However, the PFA permits the Governor General, by Order in Council, to direct that an output expense appropriation in a vote be transferred to output expense in that vote if:

- The amount transferred does not increase an appropriation for a financial year by more than 5%.
- No other transfer to that appropriation has occurred during that financial year.
- The total amount appropriated for that financial year for all output expense appropriations in that vote is unaltered.

Such transfers authorised by the executive have to be approved by an appropriation act.

4.3.5. *Cash planning and management of government assets and debt*

All public money must be held in either a Crown or a departmental bank account (see below). This permits centralised Treasury management of the Crown's cash position. The Treasury, under the authority given by the PFA, may invest any money held in a Crown bank account or any departmental bank account for such periods on such terms and conditions as it thinks fit. In order to maximise the long-term economic return on the Crown's financial

assets and debt portfolio, and to manage the risks to the taxpayer involved in the government debt, the New Zealand Debt Management Office (NZDMO) was established in 1988 by the PFA.[3]

4.3.6. Internal audit

Chief executives of departments are responsible to the responsible minister for the financial management of the department. Amongst their principal responsibilities, the SSA states that a chief executive of a department shall be responsible to the appropriate minister for the efficient, effective, and economical management of the activities of the department (s. 36). In fulfilling these duties, it is expected that a chief executive will put in place appropriate internal audit arrangements. Large government departments usually have internal audit groups reporting to the chief executive.

The Secretary to the Treasury is required to sign a statement of responsibility with each set of Crown financial statements that the system of internal control (that provides reasonable assurance that the transactions recorded are within statutory authority and properly record the use of all public financial resources of the Crown) has operated adequately throughout the reporting period. To provide assurance of this, the Treasury requires the audit service providers of government departments to undertake and report on the results of an annual departmental internal control evaluation.

4.4. Government accounting and fiscal reporting

4.4.1. The accounting framework

Both the PFA (s. 8) and the FRA (s. 5) require the government to produce actual and forecast financial statements in accordance with generally accepted accounting principles (GAAP), which describes the rules applied when preparing and presenting financial statements. GAAP requires the presentation of financial statements to be on an accrual basis, but also prescribes a cash flow statement. The government began the process of producing its financial statements in compliance with GAAP in 1989. Government departments were the first to move to accrual appropriations and accounting under GAAP. The first set of financial statements reporting on the Crown as a whole was prepared in 1991. The introduction of the FRA in 1994 changed the basis of the fiscal forecasts to accruals.

4.4.2. Government banking arrangements

The PFA specifies that all taxes and government receipts must be paid into a Crown bank account or departmental bank account. The Treasury may open, maintain, and operate the Crown bank account at a bank or banks that

the Minister of Finance may direct. Accordingly, the Treasury has contracted a private bank to act as banker for most departmental and Crown activities. The amount held in the government bank accounts are "swept" into the Crown bank account with the Reserve Bank of New Zealand each night.

The PFA allows a departmental bank account or accounts to be opened, maintained, and operated by a department at such bank or banks as the Minister of Finance may direct. The Minister of Finance may give directions as to any terms and conditions under which any departmental bank account may operate and at any time close and suspend the operation of a Crown or departmental bank account. The following money is required to be paid into a departmental bank account:

- Such money as may be disbursed to the department by the Treasury.
- All receipts relating to departmental revenue.
- All receipts resulting from the sale or disposal of capital assets of the department.

4.4.3. In-year reporting to Parliament

The PFA requires the Treasury to prepare, as soon as practicable after the end of each month (except the first two and the last months) in each financial year, consolidated financial statements for the Crown for the period of the financial year to the end of the month concerned (s. 31A). These must be prepared according to GAAP. The PFA elaborates on content – financial statements required by GAAP, a statement of borrowings, and additional information and explanations. The law also establishes a six week publication lag (with a few exceptions).

Departments are required by Treasury instructions to provide monthly reports to their ministers and Treasury. These consist of actual against projected comparisons for: appropriations by type; an operating statement, cash flows and balance sheet; and net fiscal impact. Every quarter, departments are required to report the actual outputs produced, and the quality, quantity and cost of each, against projected output for that quarter.

4.4.4. Annual accounts and reports

The PFA requires the Treasury to prepare consolidated annual financial statements for the Crown for that financial year, in accordance with GAAP, as soon as practicable after the end of each financial year (s. 27). The major contents include: a statement of the financial position of the Crown (balance sheet); an operating statement; a statement of cash flows; a statement of borrowings, including a comparison between budgeted and actual borrowings; a statement of unappropriated expenses and capital expenditure; a statement of emergency expenses; a statement of trust money held by departments and

Offices of Parliament; and any additional information and explanations needed to fairly reflect the financial operations of government. The annual financial statements must include the government reporting entity's interest in all Crown entities, organisations, and SOEs (as named in schedules to the PFA or the SOEA), all offices of Parliament and the Reserve Bank of New Zealand.

The Treasury is required to forward the annual financial statement to the Auditor General no later than 31 August following the end of the financial year (s. 30). The PFA places a responsibility on the Treasurer and Minister of Finance to ensure that the financial statements fairly reflect the performance and position of the government (s. 28). The PFA further requires the Minister of Finance to table the annual financial statements, together with the audit report and the statement of responsibility before the HR not later than 10 working after the statements are returned by the Audit Office to the Treasury (s. 31).

The PFA also requires each department to prepare annual financial statements, which are required to be forwarded to the Audit Office no later than 31 August following the end of each financial year (s. 35).

The FRA (s. 13) requires the Minister of Finance to publish a half-yearly economic and fiscal update in December. The report includes economic and fiscal forecasts for the current and following three years, updated with new information received since the main budget forecasts were prepared.

The FRA (s. 14) requires the Minister of Finance to publish a pre-election economic and fiscal update not earlier than 42 days, nor later than 28 days, before the polling day of any general parliamentary elections.

4.5. *External audit*

The OCAG is a statutory office created by the Public Audit Act 2001 (PAA). The office exists as a constitutional safeguard to maintain the financial integrity of New Zealand's parliamentary system of government. The CAG provides independent assurance to Parliament that public sector organisations are operating and accounting for their performance in accordance with Parliament's intentions.

4.5.1. *Managerial, financial and operational independence*

The PAA clearly states that the CAG must act independently in the exercise and performance of his functions, duties, and powers. To be credible, the OCAG must be independent of the public entities being audited. To secure independence, the CAG:

- Is an officer of Parliament (ss. 7 and 10). The CAG's draft annual plan is provided to the Speaker of the HR for consideration. After considering

comments, the CAG may amend the plan but indicates in the plan the nature of the changes to work programme priorities requested by the Speaker or any committee of the HR, but not made.[4]

- Is appointed by the Governor General on the recommendation of the HR (s. 7), for a once-only term of not more than seven years (s. 1, schedule 3).
- Has a Deputy who is also an officer of Parliament and can exercise all the functions and powers of the OCAG (ss. 11 and 12).
- Can report directly to Parliament and anyone else.
- Is remunerated by standing authority from Parliament; the amount is determined independently by the Higher Salaries Commission (s. 5, schedule 3).
- Makes requests for funding directly to the HR, after which the House recommends the sum required to the Governor General for inclusion in an appropriation bill (s. 17, PFA).

Auditors appointed by the CAG to carry out audits on his behalf must also be independent. There are strict constraints on auditors, including on: personal involvement with an audited entity (such as between family members); financial involvement with the entity; provision of other services to the entity (such as undertaking valuations); and dependency on fees from one source.

4.5.2. Institutional coverage of audits

The CAG has wide audit responsibilities for public entities (ss. 5, 11 and 19), including for:

- The Crown's financial statements that show the financial state of the government and all its entities.
- A total of 41 departments and ministries.
- About 3 000 Crown entities, including over 2 600 school boards of trustees.
- A total of 15 State-owned enterprises including those in transportation, utilities and television.
- All local authorities and their subsidiaries including cities, district, and regional councils.
- About 200 statutory boards and other public bodies, including trust boards and airport authorities.

4.5.3. Types of audit

Under the PAA, the CAG can carry out:

- Financial audits involving the audit of financial statements, accounts, and other information that a public entity is required to have audited (s. 15).

- Performance audits examining one or more aspects of performance: the extent to which a public entity is carrying out its activities effectively and efficiently; compliance with statutory obligations; whether waste has resulted or may result; and whether there is a lack of probity or financial prudence by a public entity (s. 16).
- Enquiries, either on request or on the CAG's own initiative, into any matter concerning a public entity's use of resources (s. 18). The CAG can also perform other auditing or assurance services at the request of a public entity (s. 17).

The 2004 amendments to the PFA strengthened the pre-audit, or controller, function of the CAG. The PFA set outs the authority that the government must have in order to spend money: the purpose of the expenditure must be lawful; there must be an appropriation voted by Parliament; and there must be a warrant from the Governor General. The act also states that, before any money can be issued from the Crown bank account, the CAG must be satisfied that the money will be applied for purposes which are lawful and are within the appropriations voted by Parliament. In checking whether the government has complied, the controller function preserves the important constitutional principle that the government cannot spend or borrow without the authority of Parliament.

4.5.4. Powers of investigation

The PAA requires the chief executive and the governing body of a public entity to ensure that the CAG has access at all times to the documents of the entity relating to the performance and exercise of the CAG's functions, duties, and powers (s. 24). The CAG also may:

- Require the entity audited to produce to the CAG a document in the entity's or person's custody, care, or control and to provide the CAG with information or an explanation about any information (s. 25).
- Require a person to give evidence either orally or in writing, and for the purpose of examining a person, the CAG may administer an oath in accordance with s. 108, Crimes Act 1961 (which relates to perjury) (s. 26).
- Examine or audit the account of any person in any bank (s. 27).

For the purpose of obtaining documents, information, or other evidence relevant to any matter arising in the exercise or performance of the his/her duties, the CAG may, at all reasonable times enter into and remain on a public entity's premises; or carry out a search for a document, examine a document, and make copies of a document or parts of a document (s. 29).

4.5.5. *Reporting obligations and publication*

A major activity of the CAG every year is the audit of the annual financial statements of the government. According to the PFA (s. 30), the CAG must provide an audit report on those statements to the Treasury within 30 days of receiving them. This enables the Treasury to forward them to the Minister of Finance, who presents the audit report to the HR within 10 working days after receiving them from the Treasury. In total, the PFA requires that the audit report is transmitted to Parliament within a period of three months and 10 working days after the end of the financial year.

The PAA (s. 37) requires the CAG to prepare and present an annual report to the HR, which must include: the audited financial statements prepared in accordance with section 35 of the PFA and audited in accordance with section 39 of that act; an account of the implementation of the annual plan; and a list of the entities audited by the CAG. In addition to the annual report, the PAA requires the CAG to report at least once every calendar year to the HR on matters arising out of the performance and exercise of the CAG's functions, duties, and powers (s. 20). Furthermore, the CAG may report to a minister, a committee of the HR, a public entity, or any person on any matter arising out of the performance and exercise of the CAG's functions, duties, and powers that the CAG considers it desirable to report on (s. 21). For local government entities, the CAG may direct the public entity to table the report during a meeting of the public entity that is open to the public (s. 22).

The PAA also requires the CAG to publish, by way of a report to the HR, the auditing standards that the CAG applies, or intends to apply, to the conduct of audits and inquiries and the provision of other auditing services (s. 23). All reports presented to Parliament or otherwise published are publicly available on the AG's Internet site (*www.oag.govt.nz*). Printed copies of most reports may also be available.

4.5.6. *Enforcement of findings*

The PAA does not provide any special provisions for the enforcement of findings. However, the audit reports presented to the HR by the CAG play key roles in overseeing the government's financial activities by giving the Parliament an independent opinion on whether public entities are operating and accounting for their performance in accordance with Parliament's intentions.

Notes

1. Draft estimates of expenditures are grouped into "Votes" with one or more "Vote" for each minister. Normally, there is one vote for each ministerial portfolio except where the portfolio relates to more than one department. While it is common for

a department to administer just one vote, there are a number of multi-vote departments providing outputs to more than one minister.

2. The 2004 Act clarified the Crown entities to be included and, for the first time, required the central bank to be included in government financial statements.

3. The NZDMO's main responsibilities include: developing and maintaining a portfolio management framework that promotes the Crown's debt management objectives; determining a portfolio structure for currency, maturity and credit exposures; managing risk and undertaking transactions in a manner consistent with government policy and the NZDMO's portfolio management policy and procedural manuals (see *www.treasury.govt.nz/orgstructure/alm/nzdmo.asp*)

4. At least 60 days before the beginning of each fiscal year, the PAA requires the CAG to prepare and submit to the Speaker of the HR a draft annual plan that describes the CAG's proposed work programme for that year. After considering any comments from any committee of the HR, the CAG must present a completed annual plan to the Speaker before the beginning of each fiscal year (s. 36).

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ISSN 1608-7143
OECD Journal on Budgeting – Volume 4 – No. 3
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Four Nordic Countries*

Structure of the Case Study

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* This study has benefited from comments from national authorities, including Hans Christian Holdt (Ministry of Finance, Denmark), Yvan Pederson (National Audit Office, Denmark), Pia Lahti and Timo Lehtinen (National Audit Office, Finland), Tuomas Pöysti (Ministry of Finance, Finland), Alpo Rivinoja (Finance Committee of Parliament, Finland), Espen Aasen and Anniken Hoelsaeter (Ministry of Finance, Norway), Tora Jarlsby (National Audit Office, Norway), Martin Engman (National Audit Office, Sweden), Ake Hjalmarsson (Ministry of Finance, Sweden) and Richard Murray (*Statskontoret*, Sweden), as well as OECD colleagues including Alexandra Bibbee, Jón Blöndal, Per Mathis Kongsrud and Martin Jorgensen.

1. Overview

This study covers Denmark, Finland, Norway and Sweden.[1]

1.1. The legal framework governing budget processes

The common legal framework in each of the four countries is a written constitution and at least one external audit act. These contain several of the main elements of the national budget systems. Denmark and Norway do not have formal specific statutes to govern budget processes. The absence of a budget system law is exceptional among OECD countries. Budget regulations, issued by the Ministry of Finance (Denmark) or by Parliament (Norway), substitute for formal law. Finland and Sweden both have State budget acts, although in Sweden one was only adopted in 1996. Finland has systematically embodied budget principles into law – its Constitution contains a particularly high number of provisions relating to the budget. In the other three countries, there appears to be an arbitrariness in the choice between formal statutes or less formal means of laying out rules for governing budget processes. The need for binding rules appears less pressing in these countries, where achieving consensus is highly valued and entirely necessary, given the multi-party political make-up in each country.

The constitutions generally specify the roles of the main players – Parliament, the executive and distinctive arrangements for parliamentary auditors, where the constitutions provide for external auditors to be elected by Parliaments. Auditors' mandates and responsibilities are elaborated in laws, several of which have been revised recently (Finland in 2000; Norway in 2004; Sweden in 2002), mainly to clarify the relationship between parliamentary auditors (who are often Members of Parliament – MPs) and the Auditors General who manage the independent State Audit Offices now under Parliament, as well as to enhance their formal independence from the executive branch of government.

Parliamentary rules of procedure (except Sweden, which has a formal law) specify the roles of some important budget actors, notably parliamentary committees. In all countries, local governments play a very important role in implementing budget policies. Accordingly, all countries have adopted various local government laws (Box 1).[2]

Box 1. **Nordic Countries: The main budget system laws or near-laws**[1]

All four countries:

- Constitutions.
- External Audit Acts.
- Local Government Acts.

Denmark:

- Budget "Guidelines" (issued by the Ministry of Finance).
- Parliamentary (*Folketing*) Standing Orders.

Finland:

- State Budget Act 1988, with amendments.
- Parliamentary (*Eduskunta*) Rules of Procedure.

Norway:

- Budget Regulations 1959, with amendments (issued by Parliament).
- Parliamentary (*Stortinget*) Rules of Procedure.
- Financial Management Regulations 2002 (issued by the King/Cabinet).

Sweden:

- Parliament (*Riksdag*) Act 1974.
- State Budget Act 1996.
- State Borrowing and Debt Management Act 1998.

1. In addition, borrowing and debt laws have been adopted in Denmark and Sweden.

Source: Mainly Internet sites of ministries of finance, Parliaments and external auditor offices. See, for example, Sweden Parliament (2003). In some cases, the budget laws or regulations are available only in national languages (for example, Denmark Ministry of Finance, 2001).

1.2. Reforms of budget system laws

Budget reforms in Denmark or Norway over the past 20 or so years have been introduced without adopting new laws. Only modifications to the budget regulations of the Ministry of Finance (Denmark) or of Parliament (Norway) have taken place. In contrast, in Finland and Sweden, Constitutions and Parliament Acts (Sweden only) have been modified and State budget acts have been introduced. The main purpose was to provide a legal framework for practices that were already in place, as opposed to being the legal prerequisite needed to usher in, over time, reforms of the budget system. Despite the extensiveness of laws governing the budget processes in these two countries, a number of budget reforms have taken place without changing the formal laws. The government has often introduced reforms by ordinance or decree,

on the basis of explicit delegated authority. Even when the new budget system laws were adopted, they were designed to provide flexibility in application.

In 1999, Finland adopted a new Constitution after three decades of constitutional debate (Nousiainen, 2004). A major aim of the constitutional reform was to clarify the roles of the president and of Parliament – quite unrelated to the budget. Another aim – the codification and modernisation of constitutional laws – resulted in a number of budget-related provisions being transferred to the Constitution.[3] Some provisions, including the requirement of a super-majority of Parliament for the creation of an extrabudgetary fund, are unique in OECD countries.

Changes in budget system laws coincided with a marked improvement in the macro-fiscal positions in Denmark, Finland, and Sweden although there is not a simple causal relationship. Following a sharp deterioration in the early 1990s, Finland and Sweden cut spending strongly, and there was an economic upturn in Denmark, resulting in the elimination of previously high budget deficits and a reversal of growing public debt. In 2003, all three countries were running surpluses on general government transactions – the only EC countries to be doing so (Denmark Ministry of Finance, 2003, Figure 1). In the case of Denmark, since there is no formal budget system law, the improvement did not stem from there. In Finland, the modifications to the State Budget Act, 1988, during the 1990s were relatively minor – even to this day, the law does not require legally binding medium-term expenditure targets. Rather, the fiscal rule adopted was one endorsed by Cabinet, not by Parliament (IMF, 2003, p. 29).

Sweden's first-ever State Budget Act was adopted in 1996. One objective of the act was to clarify the authority of Parliament and of the government in budget matters (Sweden Government Commission, 1996). Another objective was to strengthen fiscal discipline, which was weak. Prior to adoption of the law, in 1994-95, a fiscal consolidation programme began, laying the foundation for a marked turnaround in the fiscal position. The main innovation was a new two-stage budget process, in which "top-down" expenditure ceilings are first approved by Parliament prior to the adoption of the detailed budget estimates (Sweden Ministry of Finance, 2003). Parliament also approved an overall rolling expenditure ceiling that is politically binding for the government. Although the new law contributed to the improvement in fiscal discipline, non legally-binding coalition agreements between the Cabinet and one to two political parties regarding medium-term fiscal projections and the measures needed to achieve them, have been decisive for the marked improvement in fiscal performance.

Norway's situation is quite different, given the petroleum sector. The main macro-fiscal management challenge is knowing how to best manage the

government's oil resources.[4] In this context, a 1990 law established the Government Petroleum Fund for managing oil wealth. Long-term scenarios have been prepared by the government, but not because it is legally bound to do so. The use of resources in the future is decided on practical grounds, including the fact that the resources are non-renewable and that Norway's aging population will place increasing pressure on the national budget (Norway Government, 2001). Government rules, rather than law, have been established to manage the budget inclusive of transfers from the Government Petroleum Fund (see below, as well as OECD, 2004; Norway Ministry of Finance, 2004).

Law has contributed very little to strengthening the performance orientation of budget systems. Some Nordic countries have had a long history of decentralisation of responsibility in budget management. This is especially the case in Sweden where semi-autonomous agencies under ministries are based on long-standing constitutional provisions. The strengthening of the performance orientation of the budget, with decentralised managers responsible for achieving results, has therefore been less of a cultural shock than in countries that have traditionally had a very centralised and hierarchical system of budget management. Finland differs from the other three countries, as it traditionally had a centralised system of budget management before a "cultural revolution" began in the late 1980s (Blöndal *et al.*, 2002, p. 144).

By law (in Finland and Sweden) or regulation (in Denmark and Norway), Parliament has enhanced the flexibility of budget management by ministries and agencies by introducing change in the legal nature of different types of appropriations. In particular, the law allows more use to be made of "flexible" appropriations: time periods for the use of budget authority have been lengthened (multi-annual appropriations) and the usual rigidity of annual appropriations has been loosened by providing more generous end-year carryover of budget spending authority and, under certain circumstances, borrowing from next year's budget authority.

Concerning transparency and accountability, unlike some Anglo-Saxon countries, the Nordic countries have not adopted fiscal responsibility acts that impose on governments clear and enhanced legal requirements for fiscal reporting to Parliaments. This is partly because these countries have had a long history of openness. To elaborate on constitutional rights of public access to government documents, freedom of information acts have been adopted in all four countries, in several cases for a long time.[5] Sweden also has a Freedom of the Press Act, 1978, under which "every Swedish citizen is entitled to have free access to official documents, in order to encourage the free exchange of opinion and the availability of comprehensive information" (Chapter 2, Art. 1). Although Anglo-Saxon countries also have adopted such acts, their adoption is relatively recent (for example, 2000 in the United Kingdom). A more

influential reason stems from the different political arrangements compared with the traditional two-party system in Westminster countries. With multi-party coalition governments often in power in Nordic countries,[6] the reaching of a coalition agreement is particularly important. In Finland, for example, the 1999 Constitution requires the groups represented in Parliament to negotiate a political and economic programme prior to the nomination of the prime minister and the formation of a government. Thus, coalition agreements between the governing parties – which are public documents – provide the basis for fiscal policy during the life of a Parliament. Concerning the requirements for other disclosures, governments voluntarily provide certain fiscal information, including long-term projections, whereas these are mandated by laws such as fiscal responsibility acts in other countries.

Most Nordic countries have modernised their government accounting systems. Denmark has an accountancy act, adopted in 1984, which refers to the need to account for assets and liabilities, as well as revenues and expenditures. Finland and Sweden also have some generally worded accounting requirements in their State budget acts. In Sweden, all government agencies used full accrual accounting before the State Budget Act was adopted. However, accrual budgeting required the approval of a new law by Parliament. In general, the introduction of accrual accounting was regarded as an administrative matter, being introduced without any modification in existing laws.

In summary, several important budget reforms have been introduced without recourse to law. The tough budgetary decisions that resulted in substantial fiscal stabilisation in the 1990s in Denmark, Finland and Sweden were largely achieved without changing the laws pertaining to budget processes. Strong political commitment to fiscal sustainability, non-legally binding coalition or other forms of political agreements, as well as the suasion effect of the EU's Maastricht deficit and debt criteria, appear to have been instrumental in attaining macro-fiscal stability objectives. Improvements in allocation and technical efficiency are taking place largely without changes in law. Nonetheless, greater flexibility of budgetary appropriations was introduced by law in Finland and Sweden (but by regulation in Denmark and Norway). In Sweden, the 27 functional expenditure areas, which are important for decision making about allocations, are laid down in law. Thus, although there are a few exceptions, law is perceived to regulate form, not substance. This contrasts with some continental countries, where the reverse is true. Finally, when laws are adopted, they are written in a language that allows for flexibility in implementation.

2. Principles underlying budget system laws

The supreme authority of Parliament in budgetary and other matters is a fundamental constitutional principle in all four countries. For example, Sweden's Constitution (Art. 1) states a fundamental principle: "all public power proceeds from the people." Parliaments are citizens' representatives elected to exercise power, including approving annual budgets.

The principle of annuality for the budget is usually incorporated into law, although changes in the duration and flexibility of appropriations allow exceptions to this principle. The principle of universality is espoused. However, exceptions to gross recording and reporting are made. For example, in Sweden for fully self-financing government agencies, the State Budget Act states that both revenues and expenditures are excluded from the annual budget and delegates the government to decide on the use of revenues. However, in the annual budget, Parliament is informed of the scope of estimated revenue and expenditure and the kind of self-financed operations carried out. In Denmark, the net principle has resulted in an expansion of the activities of government agencies (see Beck Jørgensen and Mouritzen, 1997).

Concerning budget unity, all countries adopt an annual budget that approves revenues and expenditures at the same time. The budget unity principle is incorporated in the Constitution of Finland, which requires that estimates of revenues, expenditures and appropriations be included in the annual State budget (s. 84). The State Budget Act in Sweden states that all revenue, expenditure and payments that affect the State net borrowing requirement shall be included in the draft budget submitted to Parliament. The principle of budget unity does not figure in law in Denmark and Norway.

The principle of specificity of expenditure is included in law. However, legal provisions in this area are not detailed. In recent years, the number of budget lines has been reduced considerably in all the countries, with a movement away from detailed inputs and towards outputs and outcomes. In general, legal constraints do not prevent the introduction of a new appropriation structure, although changes in the appropriation structure usually must be approved by law.

The principles of transparency, accountability, and performance are not new in Nordic countries, being espoused by society for some time. Constitutions place strong requirements on the political executive to be accountable to Parliament. By law, citizens are provided with substantial information on government activity. Accountability relationships are often worked out informally, rather than set out in law, a consequence of the importance attached to attaining consensus. The Nordic countries have not introduced strict contractual relationships between the political executive and budget managers to enhance budgetary performance. It is mainly the

regulations of the executive (not covered in this study) that spell out the requirements of executive agencies to report to ministries. In summary, pragmatism outweighs rigid adherence to doctrinaire principles.

3. Legal basis for the establishment and powers of the actors in the budget system

This section examines the legal basis of the main actors in budget processes. The focus is on constitutional provisions for the role of the executive and Parliament.

3.1. The constitutions of the four countries

The constitutions of the four countries differ considerably in age, number of constitutional laws and content. First, the age of the constitutions varies from that of Norway, which was adopted in 1814, to that of Finland, adopted in 1999. Second, the constitutions of Denmark, Finland and Norway are a single document, as in many countries. In contrast, Sweden has four fundamental laws that make up its Constitution: the Instrument of Government Act, the Act of Succession, the Freedom of the Press Act, and the Fundamental Law on Freedom of Expression. In the case of Finland, the 1999 Constitution consolidated four previous laws: the Constitution Act of Finland, 1919, the Parliament Act, 1928, and two acts on ministerial liability. The Constitution was adopted after more than 30 years of consideration.[7] Third, the content of the constitutions differs considerably. The four fundamental laws of Sweden are by far the longest in terms of number of articles (Table 1).

Table 1. **Nordic countries: Age and size of constitutions**

	Denmark	Finland	Norway	Sweden
Year of constitution	1953[1]	1999	1814	1974
Year of last amendment	None	None	1995	2002
Number of amendments	0	0	38[2]	3
Number of articles[3]	89	131	112	367[4]

1. The new Constitution of 1953 was essentially based on the 1849 Constitution.
2. Most of these amendments, which include the repeal of ten articles, have been minor. There have been no constitutional innovations directly concerning the budget system since 1814.
3. The table shows the total of numbered articles, even if repealed. Articles of are unequal length.
4. There are 169 articles in the Instrument of Government Act. The other three acts of the Constitution contain a further 198 articles.

Constitutions are even more difficult to change in Nordic countries than elsewhere. In all four countries a proposal must be submitted and approved during the life of a first Parliament, and then be reconsidered and adopted by

a second Parliament after legislative elections. A super-majority is also usually needed (for example, a two-thirds majority in Finland and Norway). In Norway, although there have been a number of constitutional changes since 1814, the stringent requirements for constitutional changes and a conservative attitude largely explain why the Constitution contains a number of outdated provisions. In particular, the Norwegian Constitution has not been updated to include the principles of parliamentarianism. Due to parliamentarianism, the King does not have any real power, but the language of the Constitution has not been changed (Norway Parliament, 2001). In Denmark, after a second Parliament approves a draft constitutional change, the bill is submitted to citizens. If a majority of the persons taking part in the voting, and at least 40% of the electorate, have voted in favour of the bill as passed by Parliament, the Constitution Act shall be changed (s. 88). The stringency of the referendum voter turn-out requirement is a major reason why the 1953 Constitution has never been changed.[8]

Constitutional provisions for the budget system are not proportional to the size of the constitution. Although Sweden's constitutional laws are by far the longest of any of the four countries, much of the Constitution is devoted to freedoms and rights. The number of articles devoted to the budget system in Sweden is about the same as that in the much shorter constitutions of Denmark and Norway.[9] In contrast, Finland's Constitution has an entire chapter devoted exclusively to State finances. As a result, Finland's Constitution has around twice the number of articles relating directly to the budget system compared with the other three countries.

3.2. Legislatures

When the Constitution in Denmark was adopted in 1953 and legal change took place in Sweden in 1969[10] the previous bicameral Parliaments were abandoned (Table 2). Norway, however, has maintained a two-chamber Parliament, which, unlike usual practice for bicameral legislatures, is formed following a single nationwide election. The 1814 Constitution (the second oldest in the world) divides the full Parliament (the *Storting*) into two chambers, the *Lagting* and the *Odelsting* (Art. 49). The *Storting* nominates from among its members one-fourth to the *Lagting* and the remaining three-fourths to the *Odelsting* (Art. 73). Every bill must first be proposed in the *Odelsting* (Art. 76). To become formal law, after the *Odelsting* discussion, either the *Lagting* or the *Storting* in plenary session must approve the draft, after which the King assents to the bill (Arts. 77-78). The annual budget and the budget regulations are voted by the *Storting* in a plenary sitting, which is not formal law. However, the impact of Parliament's decisions is similar to that of formal law. The Norwegian Constitution is the only one of the four countries that does not refer to parliamentary committees. However, the *Storting*'s Rules of

Table 2. **Nordic countries: Constitutional provisions for the legislatures**

Phrasing in written constitution[1]	Denmark	Finland	Norway	Sweden[2]
Parliament consists of one chamber.	Yes	Yes	No (two)	Yes
Bills become law when signed by the monarch, president or prime minister.	Yes, the monarch, no later than 30 days after bills are passed.	Yes, the president; a decision is made within three months.	Yes. The King has a veto right.	Yes, when signed by the prime minister.
Parliament shall establish its own internal procedural rules.	Yes	Yes	Yes	Yes
Parliament shall establish committees.	Yes	Yes		Yes
A budget/finance committee shall be established.		Yes		Yes
Members of Parliament may ask ministers questions on any matter of public interest.	Yes	Yes		
Parliament has the right to receive information and Cabinet and/or appropriate ministers must provide the information.		Yes	Yes	Yes
Ministers who are not MPs have the right to attend and participate in parliamentary debates.		Yes	Yes	
The plenary sittings of Parliament shall be public (with some exceptions).	Yes	Yes	Yes	

1. In this section and subsequent sections, the phrasing of the written provisions in the constitutions is shown in all the comparative tables. Absence of a "Yes" in the relevant column does not necessarily mean that this provision does not exist, or is not practised, in a given country. It simply means that such phrasing is not included in the written constitution, although it may be included in other laws or practised.
2. In addition to the four constitutional acts, Sweden has a near-constitutional law, the Parliament Act. However, its provisions are not recorded in the final column.

Procedure (Norway Parliament, 2004) elaborate extensively on the 12 specified committees. The regulations require every member of the *Storting* to be assigned to a parliamentary committee.

In sharp contrast to Norway, Finland's Constitution has extensive provisions relating to parliamentary committees. A number of committees are specified, including a Finance Committee.[11] In Denmark, such provisions are not specified in the law, but in the Standing Orders of the *Folketing* (Denmark Parliament, 2001). Twenty-four separate committees are specified, but it is left up to the Standing Orders Committee of Parliament to lay down the rules on the spheres of competence of each of the other 23 committees. Sweden's Parliament Act lists 16 parliamentary committees. The Committee on Finance is assigned the key role in budget matters, including for State revenues and the setting of limits for 27 expenditure areas (but not the expenditures themselves, as these are assigned by law to the 16 specialised committees). Whereas in Denmark there is a Municipal Affairs Committee, in Sweden, the

Committee on Finance also prepares matters of general significance for local government finance (s. 4.6.2).

The authority of Parliament to receive information from Cabinet and/or ministers is specified in the constitutions of all four countries. In the case of Finland, "the appropriate minister must ensure that the committees receive without delay the necessary documents" (Art. 47). Individual Members of Parliament have the right to request information as well, although an exception is made for "the State budget proposal under preparation" (Art. 47). Even stronger provisions on ministerial accountability to Parliament are provided in Sweden's Constitution: "The Committee on the Constitution shall examine ministers' performance of their official duties. The committee is entitled for this purpose to have access to the records of decisions and all documents taken in government matters. Any other *Riksdag* member shall be entitled to raise with the Committee on the Constitution any issue relating to a minister's performance of his official duties or the handling of government business" (Instrument of Government Act, s. 12.1).

In line with the strong attachment to the value of openness and providing the public with information, plenary sessions of Parliament are generally open to the public. In contrast, committee meetings are generally not open. In the case of Finland, although parliamentary committee discussions are not open to the public, the Constitution specifies that the minutes of parliamentary committees are to be made public. In Sweden, committees have open hearings on issues of a more general interest.

3.3. The political executive

Three of the four Nordic countries are constitutional monarchies, whereas Finland has a mixed presidential-parliamentary form of government (Table 3). Although the head of the executive – the monarch or the president – appoints the prime minister (the head of government), the Parliaments of each country usually propose the prime minister. In Sweden, the prime minister is usually the leader of a leading political party, although this is not necessarily the case. In Finland, the prime minister does not even have to be a politician.[12] In three of the four countries, a cabinet/council of ministers – the key body for the approval of the draft budget – is specified in the constitution. In Sweden, the Constitution merely states that "government business shall be settled at government meetings". In contrast, Finland's Constitution not only specifies that "matters within the authority of government are decided at plenary meetings of the government or at the ministry" but that the "government may have Committees of Ministers" for the preparation of matters. Consistent with the principle of parliamentary supremacy, the Constitution of Finland specifies that the decision-making powers of the government are laid down in an act. In this context, the Cabinet Finance Committee, composed of

Table 3. **Nordic countries: Constitutional provisions for the political executive**

Phrasing in written constitution	Denmark	Finland	Norway	Sweden
The monarch is the head of State (usually without constitutional authority).	Yes		Yes	Yes
A president heads the executive.		Yes		
Ministers shall form a Council/Cabinet, presided over by the prime minister or the monarch.	Yes	Yes	Yes	
Committees of ministers may be established by the government.		Yes		
All bills and important government measures shall be discussed in Cabinet.	Yes			
Ministers shall be responsible before Parliament for their actions and/or the conduct of the government.	Yes	Yes		Yes
Ministers may be impeached by Parliament for maladministration of office.	Yes			
The government or prime minister shall submit its programme to Parliament.	Yes (prime minister)	Yes		
The government may issue secondary law.	Yes	Yes	Yes	Yes
The government and/or ministers shall have the confidence of Parliament.	Yes	Yes		Yes

the prime minister, the minister of finance and one minister representing each party in the coalition, has been established (Blöndal *et al.*, 2002, Box 8). The committee has a wide remit and must approve nearly all expenditure proposals in excess of € 5 million.

Strong accountability requirements for ministers to Parliament are embedded in the constitutions of three of the four countries. Ministers are generally individually responsible to Parliament for their actions. In Denmark, "Ministers shall be responsible for the conduct of government; their responsibility shall be defined by statute" (Constitution of Denmark, s. 13). Although collective responsibility is stressed in Sweden, the Constitution also includes strong provisions for reviewing ministers' individual performance. In particular, "a *Riksdag* committee or any Member of Parliament is entitled to raise in writing with the Committee on the Constitution any issue relating to a minister's performance of his official duties or the handling of government business" (Sweden Instrument of Government Act, Chapter 12, Art. 1). In Finland, there is a constitutional requirement for ministers to disclose their assets and outside duties to Parliament.

The constitutions in each country specify that the government may issue secondary laws. Finland is the only country whose Constitution specifies the various issuing authorities of secondary law: "the president, the government and a ministry may issue decrees on the basis of the authorisation given to

them in the Constitution or in another act" (s. 80). In Sweden, the government may, with the authority of the law, adopt statutory instruments in many areas (taxation is excluded). Statutory instruments are submitted to Parliament for examination and approval, should Parliament so decide. The government in turn may delegate the task of adopting regulations to a subsidiary body (Instrument of Government Act, Chapter 8). Unlike Denmark and Norway, the monarch in Sweden is not required to sign government decisions. In Norway, ordinances, which remain in force provisionally, are issued by the King provided they do not conflict with the laws (Constitution, Art. 17). In Denmark, the Constitution states that the King "has supreme authority in all affairs of the Realm, exercised through the Ministers, signs resolutions relating to government, which are valid provided that the signature of the King is accompanied by the signature or signatures of one or more Ministers" (ss. 12, 14). In practice, the King signs government resolutions without raising objections. Although the decree (guidelines) issued by Denmark's Ministry of Finance are important parts of the legal framework for the budget system, the authority to issue them is not mentioned explicitly in the Constitution.

Finally, three of the four countries' constitutions explicitly state that the government must have the confidence of Parliament. In Sweden, if Parliament "declares that the Prime Minister or any other minister no longer enjoys the confidence of Parliament, the Speaker shall discharge the minister concerned" [Instrument of Government Act, s. 6(5)]. If the prime minister is discharged, the entire government is discharged. In Norway, parliamentarianism has not been incorporated into the Constitution; however, in practice, the government also must have the confidence of Parliament.

3.4. Ministries and executive agencies

A unique feature in Nordic countries is that ministries are quite small – their role is confined to policy making. In contrast, most executive functions are performed by hundreds of semi-autonomous agencies, established on the constitutional provision that neither a public authority nor the Parliament may determine how an administrative authority shall decide to exercise public authority or apply laws.[13] Finland's Constitution is the only one that specifies in law the principles for the establishment of ministries and the maximum number of ministries, with their internal organisation to be laid down either in a law or in a decree.

Although ministries of finance are not established constitutionally or even by law – in Denmark, Norway and Sweden – they exercise a powerful influence on budget processes in all four countries. In Denmark the ministry's powers evolve according to the relative strength of the Minister of Finance in Cabinet and the negotiating skills of the permanent secretary (see Jensen, 2003, for details). The Danish Ministry of Finance, uniquely, issues budget

guidelines, in co-ordination with the Finance Committee of Parliament. The counterparts of small ministries in Nordic countries are autonomous agencies. In Sweden, autonomous administrative authorities are established in the Constitution.

3.5. *Civil service*

Civil servants play an important role in preparing and executing the State budgets. The constitutions of Denmark and Sweden require civil service rules to be established by law. Accordingly, civil service laws have been adopted in these two countries. In the other two countries, although it is not a constitutional requirement, civil service laws have also been adopted (World Bank, 2001, Appendix). In recent years, these laws have been changed to allow most civil servants to be recruited on a similar basis to that of the private sector. Legal provisions are often supplemented by rules in collective agreements between employers and the trade unions, where there is a tendency to abandon the former centralised approach for civil service salary agreements. In three of the four countries, the constitution indicates that the executive alone appoints civil servants. In contrast, the Constitution of Finland allows a parliamentary committee to be involved in civil service appointments. In Sweden, the Constitution states that, in making appointments to State administration, attention shall be directed to objective factors such as merit or competence. This contrasts with some non-Nordic countries, where regulations for appointment include factors such as seniority or educational establishment.

3.6. *Sub-national governments*

All four countries provide substantial budget authority to lower levels of governments, which comprise counties at the first sub-national level and municipalities at the lowest level (except in Sweden, where there is no regional government but rather two kinds of municipalities). Health, education and social assistance are generally decentralised to sub-national levels of government. Although all four countries are unitary – with county governors appointed by central government in three countries[14] – they are more decentralised than some federal countries including the United States (see OECD, 2003). To support this high degree of decentralisation, local governments have considerable taxation power, with discretion to set local taxes, except in Norway (Daugaard, 2002, Table 1). Nonetheless, most local government revenue is either from taxes shared with central government or from targeted and untargeted grants provided by the central government (see country notes in OECD, 1997).

The constitutions of Sweden and Finland specify that local governments have their own revenue-raising powers and that "the State may impose

responsibilities" (Finland) or "delegate administrative functions" (Sweden) to local governments. Local government acts, whose provisions are beyond the scope of this study, supplement the relatively few constitutional provisions.

4. Constitutional and other legal requirements for budgeting

4.1. *Authority of Parliament*

The supremacy of Parliament in budget decision making is stated explicitly in the constitutions of all four countries. For Finland and Sweden there is a general statement concerning the budget, whereas for Denmark and Norway, there are separate constitutional provisions specifying that taxation is to be by law and that expenditure is only made on the basis of law (Table 4). In Finland and indirectly Norway, constitutions also state that non-tax revenues must be on the basis of law. Sweden's constitutional laws authorise delegation of "matters other than taxes" (provided the authority is based on law). Norway is the only country whose Constitution specifies particular expenditures to be

Table 4. **Nordic countries: Constitutional provisions for the authority of Parliament**

Phrasing in written constitution	Denmark	Finland	Norway	Sweden
Parliament shall decide on State finances.		Yes		Yes
No taxes shall be imposed, altered, or repealed except by statute.	Yes		Yes	Yes
Revenues are imposed for 12 months only; authority must be renewed annually.			Yes	
Non-tax revenues are established by law.		Yes	Yes	
The monarch shall provide for the collection of taxes and duties imposed by Parliament.			Yes	
No tax shall be levied before the budget act has been passed by Parliament.	Yes			
No expenditure shall be defrayed unless provided for in a budget act.	Yes			
Parliament appropriates moneys necessary to meet government expenditure.			Yes	
State funds may not be used other than as determined by Parliament.				Yes
The budget must be balanced.		Yes		
No public loan shall be raised except by parliamentary authority (statute).	Yes	Yes	Yes	Yes
Parliament specifies maximum State debt levels.		Yes		
The monarch shall ensure that properties of the State are utilised in the manner determined by Parliament and in the best interests of the public.			Yes	
Parliament may approve supplementary appropriations.	Yes	Yes		Yes

authorised by law (for example, the amount to paid annually to the royal household; travelling allowances and remuneration for Members of Parliament).

Only in Finland's Constitution is there a generally-worded balanced budget rule, which requires that the revenue forecasts in the budget cover the appropriations included in it. A more important constitutional requirement in Finland is that, following elections, the government shall without delay submit its programme to the Parliament in the form of a statement. Although the government's "statement" is non-binding, sections of it provide the basis for guiding fiscal policy during the life of the government or until the composition of the government is essentially changed. For example, the new government of April 2003 aimed at maintaining balanced central government finances through to the end of the electoral period, at which point the general government surplus would reach around 3% of GDP and the central government debt ratio would decline (Finland Ministry of Finance, 2003).

All four countries' constitutions require parliamentary approval of public loans. Finland's Constitution elaborates that parliamentary authority concerns both debt levels and government-guaranteed debt. Finland's Constitution also specifies that the management of government assets and debts must be decided by Parliament. Sweden's Instrument of Government Act (s. 9:10) requires parliamentary consent for the government to issue guarantees.

In Denmark and Sweden, constitutions are supplemented by separate debt-related laws. Denmark's Act on the Authority to Raise Government Loans, 1993, empowers the Minister of Finance to raise loans on behalf of the central government, up to a maximum (Denmark National Bank, 2004). Sweden's State Borrowing and Debt Management Act does not specify upper limits for borrowing (Sweden National Debt Office, 2002). Parliament authorises the Danish government to borrow specific amounts in the context of the budget. In Sweden Parliament annually authorises the government to borrow what is needed in order to implement Parliament's decisions. Sweden's State Budget Act allows the government to issue guarantees for purposes and amounts that are approved by Parliament. In Norway, with large oil reserves, debt and asset management necessarily have to be viewed together. The Government Petroleum Fund Act, 1990, provides a legal basis for oil revenue to be used for acquiring financial assets from outside Norway and to fully finance non-oil budget deficits.

Related to the principle of budget universality, Finland's Constitution is the only one that specifies that Parliament elects its trustees of the social insurance institution in order to monitor its administration and operations. Finland also has a strong constitutional restriction on the creation of extrabudgetary funds, which "may be created by law, adopted by a

supermajority of votes cast, and only if the performance of a permanent duty of the State requires this in an essential manner" (Constitution, s. 82). Finally, Finland also requires the objectives of State enterprises to be presented with the annual State budget.

4.2. Timing of submission of the annual budget

Only in two of the four countries does the constitution state the timing of the submission of the draft annual budget to the legislature. For Denmark, this is quite specific: four months before the beginning of the next fiscal year. In contrast, Finland's Constitution merely requires submission to be "well in advance of" the next fiscal year. Finland's State Budget Act, 1988, does not contain a more precise date. It delegates "provisions concerning the stages of and procedures to be followed in the preparation of the budget proposals to government decree" (s. 10a). In practice, the annual budget is normally submitted to Parliament in early September (Blöndal *et al*, 2002, Box 3), *i.e.* about four months before the fiscal year begins.

In Sweden, the near-constitutional Parliament Act states that the budget year begins on 1st January and that the government shall submit a bill setting out proposals for State revenue and expenditure for the budget year (the Budget Bill) no later than 20 September. Since general elections are usually held in the middle of September, the same law also makes provision for submission of the budget to Parliament if the 20 September deadline cannot be met on account of a change of government. In this case, the annual budget must be presented within 10 days from the date a new government takes office, but no later than 15 November (Art. 3.2.1).

In Norway, the timing of submission is not laid out in statute law, but in Parliament's Rules of Procedure: "a Royal Proposal concerning the Fiscal Budget for the fiscal year shall be submitted to Parliament within six days after its opening" (s. 19); Parliament opens on the first weekday of October. "A report to Parliament concerning the National Budget is submitted at the same time" (s. 19). In practice, the Ministry of Finance prepares a report on the objectives and new policies in each budget.

Given these legal deadlines for budget submission to the legislatures, the timetable for budget preparation within the executive is regarded as an internal matter. The State Budget Act, 1988, of Finland expressly states that provisions concerning the stages of and procedures to be followed in the preparation of the budget proposal may be issued by government decree. The ministries of finance of all four countries issue budget circulars that provide guidelines for budget preparation within ministries, for presentation and approval by councils of ministers. The circulars are usually decided by the ministries of finance, after consultations with other ministries.

In Sweden, the two-stage budget approval process introduced in the mid-1990s was changed as from the spring (March-May period) of 2002. The government is now obliged to present proposals for guidelines for economic and budgetary policy in April (this was optional previously). No overall expenditure ceiling or specific ceilings for the 27 expenditure areas are presented or voted on. These issues are instead included in the budget bill in September. The reason for the change (relative to the system introduced in the mid-1990s) was that Parliament did not wish to carry out two budget procedures every year.

4.3. Non-adoption of the annual budget before the year begins

With an emphasis on reaching consensus, it is rare for the budget not to be adopted by the Parliaments of the four countries before the new fiscal year begins. Nonetheless, the possible non-adoption of the budget before the beginning of the year is accorded constitutional status in three of the four countries, as follows.

In Denmark, "where it is expected that the reading of the Finance Bill for the next fiscal year will not be completed before the beginning of that fiscal year, a provisional Appropriation Bill shall be laid before the *Folketing*" [s. 45(2)]. In Finland, if "the budget is delayed beyond the new budgetary year, the budget proposal of the government shall be applied as a provisional budget in a manner decided by the Parliament" (s. 83). Similarly, Sweden's Constitution provides that when time does not permit final adoption of the national budget before the start of the budgetary period, the *Riksdag* shall approve appropriations as required to cover the period until the budget is adopted. Delegation of parliamentary authority may be involved: "the *Riksdag* may authorise the Committee on Finance to take such a decision on the *Riksdag*'s behalf" (Instrument of Government Act, Art. 9.4).

4.4. Content of the budget and types of appropriations

The principles of budget unity and annuality are incorporated in the Constitution of Finland, but not in those of the other countries. Finland's Constitution provides budget authority – for both revenues and expenditures – for one year at a time. In Sweden, although the principle of annuality is upheld, the Constitution mentions an exception – Parliament may decide on appropriations for a period other than the budget period. Denmark and Norway have not included these principles in their constitutions.

Both the Constitution and the State Budget Act in Finland and the State Budget Act in Sweden specify various types of appropriations. These are:

- **Fixed appropriations.** These are appropriations that may never be exceeded – the annual budget provides legally binding upper limits for

spending. Moreover, any unused budget authority for fixed appropriations may not be used in subsequent fiscal years.

- **Multi-annual appropriations.** These are also appropriations that may never be exceeded. However any unused budget authority may be used in subsequent fiscal years, up to a maximum of two years (Finland State Budget Act, s. 7) or three years (Sweden State Budget Act, s. 3) beyond the budget year in which the appropriation was presented in the budget bill. In Finland, multi-annual appropriations are called "transferable" appropriations, as budget authority may be transferred between years.
- **Flexible appropriations (Sweden).** These are appropriations that may be temporarily exceeded without any additional authority from Parliament, by use of an appropriation credit (anticipated from the next year's budget), up to a maximum of 10%. This authority may be exceeded for meeting spending unexpected at the time of appropriation approval, or to ensure the fulfilment of a purpose decided by Parliament. The government annually requests such an authority of Parliament, mainly for appropriations for social welfare benefits. Unused funds from flexible appropriations may be carried over and spent during a subsequent fiscal year.

In Finland, the Constitution allows net appropriations, transfers, carryover, and borrowing of future appropriations. Also, the State Budget Act defines estimated appropriations, which may not be transferred to later financial years. However, the law permits estimated appropriations to be exceeded, provided any excess is based on need. Permission to exceed an estimated appropriation may also be granted in the case of a chargeable activity, up to an amount equalling the accumulated revenue. The latter provision allows any government agency that collects fees for service delivery to spend any excess fees, provided this is done on the basis of law.

In Sweden, the State Budget Act prescribes gross appropriations as a general principle. However, exceptions can be made. If revenues cover partially the expenditure of a specific area, net appropriations are included in the State budget. If revenues totally cover expenditure in a specific area, neither the revenues nor the expenditures are included in the budget. Power is also delegated to the government to decide on the use of revenues deriving from goods and services provided by the State if the demand is voluntary.

In Denmark and Norway, various types of appropriations are also defined, but not in law. In Denmark, the budget regulations provide considerable details on the different types of fixed and flexible appropriations, including for multi-year and contingent appropriations, as well as appropriations for different expenditures (personnel, operations, construction) and for the treatment of appropriations for transfers to State enterprises.

In Norway, Parliament's Budgetary Regulations (s. 7) allow, by a system of catchwords associated with each appropriation: 1) transfers from one budgetary period to the next for current expenses, up to 5%; 2) exceeding "estimated appropriations" when provisional projections need to be exceeded; 3) the carry forward of expenditures, for up to two years, for building, construction and materials, and other expenditure which Parliament decides to be necessary; and 4) transfers of underspent amounts for spending under other budget chapters. Also, gross budgeting is allowed although all government agencies can be budgeted on a net basis (in practice, higher education institutions are the main bodies budgeted on a net basis).

4.5. *Documents to accompany the draft budget law*

In Denmark, Finland and Norway, laws do not lay out budget documentation requirements. In general, government regulations or ordinances spell out the main budget documentation requirements for ministries. Discretion is provided to the ministries of finance, who collaborate with parliamentary budget committees when deciding the precise documentation requirements for the annual budget. Given the many executing agencies under ministries, the ministries themselves generally instruct agencies on how to present budget materials, subject to central guidance by the Ministry of Finance. In Sweden, the Parliament Act prescribes that the "budget bill shall contain a finance plan and an allocation of appropriations according to expenditure areas" (Art. 3.2). Additional legal requirements are described below.

4.5.1. Medium-term macroeconomic framework and fiscal strategy

Two of the four countries (Finland and Sweden) prescribe by law the establishment of a medium-term budget framework. In practice, all four countries prepare such frameworks and provide them to Parliament (this only began in 2005 in Norway). For Sweden, the State Budget Act allows the government to introduce ceilings on government expenditure for a period longer than one fiscal year. If the government does not present such a proposal, it must present a long-term estimate of how government revenue expenditure and borrowing will develop on the basis of unchanged policies.

4.5.2. New measures versus *existing expenditure programmes*

Although not an explicit legal requirement in the four countries, major new budget policy changes are necessarily presented to Parliament.

4.5.3. *Performance-related information*

Although all countries have moved to a performance-oriented budget system to at least some extent,[15] law does not specify the need to present performance-related information. In Sweden, the State Budget Act simply requires that the government reports to Parliament on the objectives for, and the results achieved, in various areas of operations. This generally worded article, adopted in 1996, merely confirmed results-oriented budget practices that were becoming increasingly widespread as from the late 1980s.

4.5.4. *Other information required by law*

In general, there are very few legal requirements, apart from in the debt area. In Sweden, under the Instrument of Government Act (s. 9:10) the government is not allowed to borrow or to assume other financial obligations without prior consent of Parliament. The State Budget Act includes more detailed rules for the making of commitments and the issuance of guarantees. The State Borrowing and Debt Management Act requires the government to prepare annual guidelines for debt management, consistent with debt objectives established by Parliament (Sweden National Debt Office, 2002).

No country imposes a legal requirement to report tax expenditures to Parliament as part of the annual budget. This is an important omission if expenditure ceilings are used for expenditure control purposes, as those limits may be breached indirectly should tax expenditures increase (for Sweden, see Roseveare, 2002, p. 10).

Similarly, the reporting of major risks in the budget is not obligatory in law. In practice, only two of the four countries – Finland and Norway – report identifiable risks when presenting the budget (OECD, 2003, Q.2.7.a). In Norway, the risks discussed are mainly macroeconomic risks – the risks associated with particular budget items (for example, entitlement benefits) are normally not identified.

4.6. *Parliamentary committees and budget procedures in Parliament*

Parliamentary committees play a critical role in the budget approval processes in all four countries, but the degree to which these processes are specified in law or parliamentary regulations varies considerably. Draft budgets are first considered by committees and then approved by the full legislatures. These steps are not embodied in law, except in Finland and Sweden. Specifically, the Finnish Constitution requires that the draft budget be considered by Parliament's Finance Committee, which is one of four standing committees named in the Constitution (s. 35). Sweden's Parliament Act provides the Committee on Finance with wide-ranging competencies in money, credit, debt and public finance, including examination of the

estimates of State revenue, budget co-ordination, government accounting, audit and administrative efficiency (s. 4.6.2).[16] In both Denmark and Finland, the constitution specifies that appropriation acts cannot be delayed between readings. In Norway, there is a lack of any constitutional provisions for parliamentary budget approval procedures.

In all countries, parliamentary regulations or law (Sweden only) supplement, or fill the void of, constitutional provisions regarding parliamentary committees. In Norway, parliamentary Rules of Procedure (Norway Parliament, 2004) provide the basis for specifying the budget responsibilities of parliamentary committees. In particular, the responsibilities of the Standing Committee on Finance and Economic Affairs and procedures for adopting the budget are extensively laid out. Its competencies include examination of matters relating to economic, monetary and fiscal policies, inclusive of taxes and duties, national insurance revenues, State guarantees, the fiscal budget and the national budget (s. 12.2). The fiscal budget is received by Parliament in early October. Reflecting the top-down budgeting process introduced in 1997, "no later than November 20, the Standing Committee on Finance and Economic Affairs shall recommend budget limits for each ministry's spending programmes, as well as propose recommendations on taxes, duties and block grants to municipalities" (s. 19). Parliament shall, within one week (*i.e.* by 27 November), make a resolution on binding budget limits for the various aggregates. Thereafter, the other standing committees examine spending programmes and may propose amendments. The Standing Orders are clear: recommendations for changes of chapters or items in each separate spending programme are allowed, provided they do not deviate from the limits decided by Parliament (limits are established for 21 spending areas). This second stage – beginning in late November – must be completed by 15 December (s. 19). Budget resolutions made by Parliament at this stage are final. Comparable rules are laid down in Sweden's Parliament Act. In contrast, in Denmark the role of the Finance Committee is not specified in the Standing Orders of Parliament (Denmark Parliament, 2001). These Orders formally delegate this task to the Standing Orders Committee.

Each Nordic country has a tradition of close collaboration and working relationships between parliamentary committees and the offices of the executive branch. Ministries of finance generally provide the necessary advice to parliamentary committees in a professional manner. In Norway, Parliament has revitalised its own control functions, including by introducing public hearings to parliamentary committees, extending question time in plenary sessions, and expanding the audit function (Christensen *et al.*, 2002). In Sweden, Parliament's general investigating staff, which amounts to 35, supports the parties and Members of Parliament in budgetary matters.

4.7. Parliamentary amendment powers, coalition agreements, two-stage budgeting and fiscal rules

Finland's Constitution is the only one of the four constitutions that states explicitly that Parliament has authority to propose amendments to the draft budget. In contrast to, say, the constitutions of France and Spain, in none of the four Nordic countries does the law limit the extent of parliamentary amendments to the draft budget. In practice, Parliaments take advantage of these powers and regularly modify the budget proposed by the executive. However, in Denmark and Finland, agreements between the political parties establish non-legally binding guidelines on the direction of change of major fiscal aggregates (for Denmark, see Blöndal *et al.*, 2004; for Finland, see Blöndal *et al.*, 2002). In Finland, not only may the Finance Committee propose amendments to the draft budget, but also, during the plenary session, members may propose amendments. When this happens, the budget bill is returned to the Finance Committee, which may concur or propose further amendments (Rules of Parliament, s. 59).

In Sweden, although in principle Parliament has unlimited powers to amend the government's proposal, in practice there are strong restrictions. Decision making in Parliament follows a typical top-down procedure. When Parliament prepares the budget in the autumn (September-November period) there is already an overall restriction – the State expenditure ceiling decided earlier in the spring. After preparation and discussion in the Committee on Finance, Parliament first decides on the expenditure ceiling for the year t+3. Next, it fixes the amount of money to be allocated to each of the 27 expenditure areas for the upcoming fiscal year. Parliament also makes an estimate of the State revenues. These issues are settled in one vote in the chamber. After this decision, which is usually made about 20 November, the specialised committees discuss the detailed allocation of funds between the appropriations within each expenditure area. At this stage they are not allowed to exceed the limits decided by Parliament, but they may reallocate funds between appropriations within the respective expenditure area. When each committee has reached an agreement a proposal is submitted to the chamber where the detailed allocation of funds to all the appropriations within one expenditure area is settled in one vote. The final decisions are usually taken in mid-December. This top-down procedure and the voting procedure may increase the possibilities of a strong minority government getting the draft budget approved with few changes. Furthermore, since 1994 the minority government has co-operated with one or two political parties and negotiated the content of the draft budget before it has been submitted to Parliament in order to ensure a reliable majority. Consequently in recent years Parliament has approved few changes to the submitted draft budget.

Norway also usually has coalition governments. However, fiscal management objectives are quite different from the other three countries, given the important place of oil revenues in the economy. The government's main challenge is to ensure that fiscal policy is sustainable in the long run, given a starting position of very large overall government surpluses (15% of GDP in 2000) and the long-term need to finance future obligations in relation to old age and disability pensions (Norway Government, 2001). The main issue is the speed and time profile of spending oil revenues. In this context, the government has established a fiscal policy rule of allowing the non-oil budget deficit to equal, over time, the projected long-run real return on the Government Petroleum Fund. During 2002-04, the use of oil money exceeded the expected real return to the Fund (OECD, 2004). However, the guidelines allow year to year deviations to smooth market-based swings.

In summary, the government's supporting parties in Parliament have an incentive to vote in favour of the government's proposed budget – it would be politically too costly to leave the coalition or the co-operation between parties. In the case of Finland, the president could veto the adopted budget. However, should Parliament re-adopt the budget law without material alteration, it enters into force without presidential confirmation (Constitution, s. 77).

4.8. Supplementary budgets

The constitutions of three of the four countries authorise the government to propose a supplementary budget. In Finland, a supplementary budget requires justification. The Constitution also allows any Member of Parliament "to submit budgetary motions for budget amendment immediately linked to the supplementary budget" (Art. 86). In Sweden, "the *Riksdag* may revise its revenue estimates for the current budget year, alter appropriations already approved and determine new appropriations in a supplementary budget" (Instrument of Government Act, Art. 9.6). The Swedish government regularly submits supplementary budgets for the current fiscal year in the spring fiscal policy bill in April and in the budget bill in September. Neither the budget bill nor the spring bill are adopted as laws – they are simply decisions.

In Denmark, a practice has developed whereby the Finance Committee of Parliament approves government requests to modify budgetary appropriations during the course of the year. At the end of the year, all approved requests are cumulated into a supplementary appropriation bill. On a strictly legal basis, it is questionable whether this practice is constitutional, since the Constitution specifies that "no expenditure shall be defrayed unless provided for by a finance act passed by the *Folketing* or by a supplementary appropriation act" [s. 46(2)]. In Norway, Parliament's power to adopt supplementary budgets is implicit, not explicit – the Constitution simply specifies that "it devolves

upon the *Storting* to appropriate moneys necessary to meet government expenditures" (Art. 75).

4.9. Budget execution – delegation of authority

Most issues associated with budget execution, such as apportionment of expenditure authority, details of in-year expenditure control, cash planning and internal audit, are not dealt with in law – certainly not in detail. Accordingly, there is a density of regulation in each country.[17] This is the counterpart to the high degree of trust in executing agencies and the focus of Parliament on results rather than controlling budget lines and day-to-day operations of executing agencies. Finland's State Budget Act explicitly mentions that provisions necessary for budget implementation and for the organisation of financial and accounting administration may be issued by government decree (s. 10b). Although such a provision is not written in law in the other countries, there is also a high degree of delegation of authority. In Sweden, it follows from the Constitution that the government has the authority to issue decrees in this area.

Nonetheless, the State budget acts of Finland and Sweden elaborate on a few specific budget execution issues. For example, in Finland the law specifies that government agencies must provide appropriate arrangements for internal control of their own activities and that the arrangements for internal control are run by each agency's management. Even in these areas, the law specifies that government decrees may elaborate. Indeed, the central budget authority issues decrees. These are necessary given the decentralised budget management system – execution is performed by hundreds of agencies in each country. Civil service management is also decentralised. Thus central guidelines are also needed for conditions of employment and remuneration conditions.

4.10. Cancellation of appropriations and contingency funds

In most countries, the government may decide not to spend portions of the moneys approved for programmes in the annual budget. The law does not regulate this tightly. In Sweden, the State Budget Act explicitly allows the government to restrict – without limit – the use of appropriations by subordinate agencies. The government is also authorised to not appropriate funds if circumstances justify this. In contrast, in Norway, an appropriation is regarded not only as permission to spend, but also as an instruction to spend on the activity for which funds have been allocated. This is not regulated by a formal law, but by interpretation of the budgetary guidelines.

Although all four countries have contingency funds in their budget (OECD, 2003, Q.3.2.c.1), the use of this spending flexibility by government (and

government agencies) is generally not regulated by law. However, in some countries, government regulations (for example the *Budgetvejledning* in Denmark) control the use of contingency reserves. In Sweden, there is unlimited discretion up to € 1 million.

4.11. Government accounting

The requirement to submit annual accounts to higher authorities is a constitutional requirement in Denmark, Finland and Norway. In Denmark and Norway, unaudited annual accounts must be submitted to the elected parliamentary auditors no later than six months after the close of the fiscal year (a generous deadline in today's world of computerised accounts). In Finland, the Constitution does not provide a deadline to submit annual reports on State finances and adherence to the budget to Parliament (s. 46). In Sweden, the State Budget Act provides a four-month time limit for the government to submit a preliminary report on the outcome of State budget revenues and appropriations and a nine-month time limit for submission of the final annual report to Parliament. In practice, the final annual report, which must contain full accounting information, is submitted to Parliament by about 15 April.

Additional government accounting provisions are contained in law in Denmark, Finland, and Sweden, although these laws do not elaborate extensively on the accounting framework. Finland's State Budget Act specifies that "the State accounts shall be kept according to generally accepted accounting practice" (s. 14). Sweden's State Budget Act is more specific: it states that the annual report shall contain an operational statement, a balance sheet, and a cash flow statement. Denmark's State Accountancy Law, 1984, is cursory (six articles only). It requires accounts to follow the same presentation as in annual budgets and to cover all State revenues, expenditures, assets, and liabilities. The law also requires ministers to issue accounting instructions to all budget-dependent agencies under them.

Although not a strong legal requirement, Finland and Sweden maintain whole-of-government accounts on an accruals basis. Finland's budget appropriations, except for depreciation of assets, are also on an accruals basis. Sweden's budget is on a modified cash basis and accounting on an accruals basis (Lundqvist, 2003). Denmark has introduced accrual accounting for some transactions. Norway maintains a cash-based accounting and budgeting system.

The content of annual accounts is detailed mainly in regulations in each country. An exception is Finland, where the law specifies that "the accounts shall be arranged so that it is possible to follow up the outcome of the budget at least at the level of detail of budgetary items. The accounts will include all

revenue, expenditure, and financial transactions on a gross basis. Government agencies shall arrange to monitor the profitability of chargeable activities so that their annual results can be presented with their annual accounts" (State Budget Act, s. 15). Government agencies must "account for performance and management, and monitor operating costs, performance and effectiveness" (s. 16).

4.12. Other fiscal reporting and special reports

Apart from the above provisions, there are very few legal requirements for supplementary fiscal information. For Sweden, the State Budget Act elaborates that when submitting the outcome of State budget revenue, spending and debt to Parliament, the government must explain significant discrepancies between budgeted amounts and the estimated outcome. In practice, government programmes are submitted to Parliament at periodic intervals. These are not necessarily linked with the budget cycle. For example, in Finland, the government presents to Parliament its programme, including a medium-term fiscal strategy, in March, whereas the annual budget is submitted to Parliament in September.

4.13. External audit – constitutional and other legal requirements

Given the importance of openness and accountability, all four countries' constitutions contain several provisions for the appointment of auditors to examine the financial activities of the State (Table 5). The constitutional provisions are supplemented by separate external audit laws. In three of the four cases, new audit laws are been adopted quite recently (Finland in 2000; Norway in 2004; Sweden in 2002). In Sweden, the Constitution itself was altered to bring about the changes. The main reasons in all three countries for

Table 5. **Nordic countries: Constitutional requirements for external audit**

Phrasing in written constitution	Denmark	Finland	Norway	Sweden
Parliament supervises the financial management of the State and compliance with the budget.		Yes		
An independent external audit organisation is established.		Yes		Yes
A number of auditors are elected/appointed by Parliament.	Yes	Yes	Yes	
A board of governors and managers of the external audit body are appointed by Parliament.				Yes
Audit rules shall be laid down in statute.	Yes	Yes		Yes
The main purposes of the external audit auditors or the external audit body are specified.	Yes	Yes	Yes	
Auditors shall have full access to all required documents.	Yes	Yes		
Audit reports shall be submitted to Parliament for decision.	Yes			

the modifications were to strengthen the powers of Parliament to exercise control, to reinforce the independence of auditors from the executive branch, to clarify governance structures, and to emphasise even more the three Es of economy, efficiency and effectiveness. In Denmark, the Auditor General's Act 1976 was amended in 1991 and 1996 to strengthen the independence of the National Audit Office and to provide legal authority to access accounting information from independent administrative units.

Control over government finances by parliamentary auditors has a long tradition in the Nordic countries. A common feature is the election or appointment of several auditors by Parliament who are often sitting Members of Parliament. The executive branch is excluded entirely from the appointment of external auditors (compare to France, where the President of the Republic plays a major role). In Denmark, Finland and Sweden (until 2002), constitutions required an unspecified number of auditors to be elected or appointed; in Norway, the Constitution requires five auditors to be appointed by Parliament.

The purpose of external audit is stated in the constitution of each country, usually briefly. For example, in Denmark, the auditors' roles are to "examine the annual public accounts, ensure that all the revenues of the State have been duly entered therein, and that no expenditure has been defrayed unless provided for in a finance act or in some other appropriation act" (s. 47). In Norway, the Constitution confines auditors' roles "to examining the State accounts and publishing the same" (Art. 75 k). In Sweden, the Constitution simply states that the function of the National Audit Office is to "audit the activities carried out by the State. More detailed rules are laid out in the Parliament Act and other legislation" (Instrument of Government Act, Art. 12.7).

External auditors' tasks are spelt out more fully in separate external audit laws, as well as in regulations issued by Parliament (in the case of Norway there are several). There is a strong legal mandate for the auditing of performance, as well as for continuing to conduct traditional compliance audits. Unlike some OECD countries, there has been an emphasis on performance audits for a number of years. This division of labour is reflected in organisational structures. For example, in Finland, there is one financial audit unit, but two performance audit units.

The institutional coverage of audits is established in the individual external audit laws. Coverage includes the State accounts, all central government ministries and agencies, most independent administrative agencies and public enterprises that are owned by government and/or receiving budget subsidies, and in some cases (for example Sweden, but not Finland), the accounts of Parliament. National audit offices do not audit the accounts of regional and local governments, except to follow up in their

accounts the spending at sub-national level that has been funded by the central government. In Finland, a special audit law was adopted in 1995 to specify the competency of the national audit office to audit financial transfers between Finland and the European Union. In the case of Norway and Sweden, the National Audit Office is legally required to audit the accounts of the central bank. The opposite is true in Denmark and Finland.

In all four countries, a collegial approach to management and decision making is taken. Recent changes have been made to clarify governance and management structures, which are similar but not identical in the four countries. In Finland, the 1999 Constitution establishes two independent external audit and control bodies. First, there are parliamentary auditors who are elected from Members of Parliament. Parliament's Rules of Procedure (Art. 12) specify that five State auditors are elected (and five deputy auditors) who are required to submit an annual report to Parliament. Second, the Constitution establishes an independent State Audit Office whose duties are elaborated in law (State Audit Office Act, 2000). To avoid unnecessary overlap, the parliamentary State auditors organise their activities in collaboration with the State Audit Office (Finland Parliament, 2000).

A similar dual parliamentary structure exists in Denmark. The Law on the Auditors of the Public Accounts, 1975, establishes six parliamentary auditors and defines their role and tasks. They are supported by a secretariat – the Office of the Auditors of Public Accounts. As in Finland, this office is distinct from the Office of the Auditor General, established by the Auditor General's Act, 1976.[18] This Act specifies that a single Auditor General will be appointed by the Speaker of Parliament, with the approval of the Standing Orders Committee of Parliament.

Since the constitutional change in Sweden, three Auditors General manage the *Riksrevisionen* (in contrast with Denmark's single Auditor General), which is stated to be an agency under Parliament. The agency has a board whose members are appointed by Parliament and whose tasks are to monitor audit activities, prepare for Parliament proposals that result from the audit reports of the Auditors General, and determine draft national budget appropriations for the office of the Auditor General (Instrument of Government Act, Art. 12.7). The Parliament Act (Art. 8.13) requires the board of the National Audit Office to have no fewer than 11 members.

In Norway, a new law on the external audit office (the *Riksrevisjonen*) came into force in mid-2004. Under the Act, previous organisational structures were maintained. The five Auditors General constitute the board of the *Riksrevisjonen* and are not distinct from it, that is, there is a single legal entity. The board has overall authority in policy matters. Responsibility for the day-to-day management of the *Riksrevisjonen* rests with the chairman of the board.

There is a legal requirement to publish and send to the *Storting* a yearly report on the previous year's financial audit of the State accounts. The law includes specific provisions related to the submission of accounts, notably that accounts with remarks should be forwarded to the *Riksrevisjonen* as soon as possible after the end of the fiscal year and, at the latest, by the deadline determined by the Ministry of Finance.

In the past, not all four countries had a single external audit office directly under Parliament. In Sweden, until the reforms in 2002, the Auditor General and his/her deputy and assistants were appointed by the government. The old *Riksrevisionsverket* was subordinate to the government through the Ministry of Finance, with a State ordinance, rather than a law, specifying the activities of the old office. A similar situation prevailed in Finland – the State Audit Office was under the Ministry of Finance until 2001. In Denmark, prior to 1976, there were four audit agencies under the Ministry of Finance and one under Parliament. Unification and the establishment of an independent Auditor General's Office took place in 1976. This law was amended in 1991 so that the Auditor General was no longer to be appointed by the King upon recommendation of the Minister of Finance, but by the Speaker of Parliament (see United Kingdom National Audit Office, 2001, pp. 61-72).

The State audit office laws include the wide powers of investigation and access to documents needed to conduct its work. Reference to such powers is made in the constitutions of half of the countries. Audit laws also contain strong provisions for the enforcement of the findings of Auditors General. In Denmark, for example, law requires that replies to the Auditor General's comments contained in audit reviews be provided within a six-week time limit (Auditor General's Act, s. 16.1). The Auditor General is authorised to follow up on unsatisfactory responses. He/she may communicate directly with the relevant minister if necessary, requesting comments within six weeks. When requested, ministers must present a statement to parliamentary auditors of the measures and considerations that the report induced (s. 18.1). Ministers' statements and the Auditor General's comments form part of the parliamentary auditors' final recommendation to Parliament. It is a constitutional requirement for the parliamentary auditors' report to be submitted to the *Folketing* for decision (s. 47). The 1976 audit law also requires the Auditor General's annual report to be presented to Parliament's auditors, with the latter determining the time delay.

Finally, although INTOSAI guidelines recommend that publication of an annual audit report be embodied in a country's constitution, publication is only mentioned in Norway's Constitution. In Sweden, the law requires audit reports concerning each of the 250 government agencies to be presented by the government 30 days after the agencies have presented their annual reports. The audit report on the State annual report is submitted to the

government and Parliament on 15 May and immediately made public. In the other countries, publication takes place following the release of the annual report of the parliamentary auditors to Parliament in plenary session.

Notes

1. For reasons of space, Iceland, also a Nordic country, is excluded. Iceland has introduced a number of reforms in recent years, including the adoption of a new Government Financial Reporting Act in 1997 that introduced modified accrual accounting and budgeting to different categories of government entities of the public sector (see *http://brunnur.stjr.is/interpro/fjr/fjr.nsf/pages/gfradoc#Act*).
2. The contents of local government acts, especially the articles devoted to sub-national governments' budgeting and debt management provisions, are not reviewed in this study.
3. Centuries of Swedish-Finnish tradition had seen the constitution divided between two main instruments: the Constitution Act, originally governing the monarchy and the administration, and the Parliament Act, governing the legislature. This broad split is maintained in Sweden to this day.
4. Petroleum-based revenues are deposited in the Government Petroleum Fund and used to acquire financial assets from countries outside Norway. The Ministry of Finance is responsible for policy aspects of the Petroleum Fund, which is managed by the central bank (Norges Bank, 2004).
5. Sweden's Freedom of Information Law was first adopted in 1766 – the oldest such law in the world. Finland's 1919 Act is the second oldest. See *http://home.online.no/~wkeim/foil.htm*.
6. In Denmark, no party has held a majority in Parliament since 1909. Sweden had coalition governments during 1976-82 and 1991-94. From 1994, the social democrat party negotiated support from one or two political parties, without forming a coalition government.
7. A constitutional commission was set up in the 1960s. However, when the commission suggested a drastic reduction in the powers of the president, the commission was abandoned in the 1970s. In the 1980s, a new president reconstituted the commission. In the 1990s, Parliament obliged the government to carry on constitutional reform, focusing on "parliamentarisation of the powers of the President of the Republic" (Nousiainen, 2004).
8. See the Ministry of Foreign Affairs, *www.um.dk/english/danmark/danmarksbog/kap1/1-9.asp#1-9-7*.
9. This statement needs to be qualified. In Sweden, in addition to its four fundamental laws (the "Constitution"), there is the Parliament Act, a near-constitutional law, that has a large number of provisions relating to budget processes.
10. Various constitutional commissions were set up in the 1960s to discuss changes in the cameral and electoral systems. Partial reform of the Constitution was achieved in 1969, leading to the new single chamber for which elections were held in 1970 (see Sweden Parliament, 2003, Introduction).

11. Reflecting the importance of the Finance Committee, Finland's parliamentary Rules of Procedure specify that the Finance Committee must have 21 members (s. 8), whereas all other committees have 17 members.
12. In 1979, a prime minister not representing a party was selected to lead the government.
13. See Sweden Agency for Administrative Development (1999).
14. The county administrative boards in Sweden cannot be regarded as a separate level of government.
15. See, for example, Blöndal *et al.* (2004) for Denmark; Blöndal *et al.* (2002) for Finland; Christensen *et al.* (2002) for Norway; and Blöndal (2001), *Ekonomistyrningsverket* (2003) and Gustafsson and Svensson (1999) for Sweden.
16. The number of staff of the Finance Committee amounts to 11, the largest of all committees.
17. In Sweden, for example, to support the 1994 government decision to decentralise salary negotiation powers to agencies, the Ordinance on the Executive Management of Government Agencies and the Ordinance of the Agency for Government Employment were changed. For accountability and transparency of government activities, the Ordinance on the Annual Reports and Budget Documentation, 2000, specifies the compulsory documents to be submitted to government by government institutions, when they are due, and their contents (annual reports, performance reports, etc.). This ordinance, together with the Book-keeping Ordinance, 2000, the Appropriation Ordinance, 2000, and the Ordinance on Fees and Charges, 1998, prescribes accounting arrangements. Some agencies are authorised to issue supplementary regulations to provide more details.
18. The use of the term "Public Accounts Committee" in the English translation of the Auditor General's Act 1976 is misleading. The *Folketing's* Standing Orders do not include the Auditors of the Public Accounts as one of the 24 committees of Parliament. Rather, the Office of Parliamentary Auditors is a separate legal entity, created by law No. 322 in 1975.

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ISSN 1608-7143
OECD Journal on Budgeting – Volume 4 – No. 3
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Spain*

Structure of the Case Study

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* This study has benefited from comments from Eduardo Zapico Goni of the Ministry of the Economy and Finance, and from OECD colleagues including Joaquin Sevilla (from the Ministry of the Economy and Finance).

1. Overview

1.1. The legal framework governing budget processes

Spain has a comprehensive hierarchical legal framework for its budget system,[1] comprised of the Constitution, organic laws,[2] general laws, and regulations (Cabrero, 2002). The 1978 Constitution provides the fundamental principles governing budget processes and specifies the roles of the key budget actors (the executive, the legislature, the Self-Governing Communities, and the Court of Accounts). The government drafts and submits the State budget while Parliament examines, amends and adopts it. The Constitution recognises and guarantees the rights of the Self-Governing Communities (SGCs), provinces, and municipalities. The Constitution establishes the Court of Accounts (COA) as the superior audit organ of the accounts and financial transactions of the State and the public sector. In order to elaborate on constitutional principles and procedures, various key budget system laws have been legislated, including the General Budgetary Act (GBA) 47/2003, the General Act on Budgetary Stability (GABS) 18/2001, and the Organic Act on the Court of Accounts (OACA) 1982 (Box 1).

The GBA (effective as from 2005) is the most important pillar of the legal framework regulating the financial operations of the State sector. The law is comprehensive. Title I provides a complete listing of the bodies comprising

Box 1. **Spain: Main budget system laws**

- The Constitution 1978, as amended.
- The General Budgetary Act 47/2003.
- The General Act on Budgetary Stability 18/2001.
- The Organic Act Supplementary to the General Act on Budgetary Stability 5/2001.
- The Organic Act on the Court of Accounts 1982 and the Court of Accounts (Functioning) Act 1988.
- Standing Orders of the Congress of Deputies and of the Senate.

Sources: The Congress of Deputies (*www.congreso.es/ingles/index.html*); the Senate (*www.senado.es/info_g/index_i.html*); the Court of Accounts (*www.cagindia.org/mandates/index.htm*), English versions of laws from the Ministry of the Economy and Finance.

the State sector in accordance with the definition of the Organic Act on the Organisation and Functioning of the Central State Administration (OAOFCSA) 1997. Title II is devoted to the general State budget, which is referred to as "a series of economic rights and obligations that must be executed by the general State administration and its autonomous bodies in a budget year" (Art. 5). This section confirms budget stability as a fundamental principle for the annual budget process. It also provides for the procedures for elaborating and approving the contents of the budget within the government. The GBA is structured and oriented towards achieving budgetary stability. The law defines the medium-term budget programme (MTBP) and the details of its content (objectives, means, activities, investment processes and monitoring indicators). Title III covers financial transactions with other administrations including the EU and Spain's autonomous regions. Title IV contains provisions for the management of State debt and guarantees. Title V provides general principles for State sector accounting. Finally, Title VI governs the oversight of financial management by the General Controller of State Administration (GCSA).

The GABS provides guiding principles for budgetary policy in the public sector including the general State administration as well as for local councils. It sets out the necessary procedures for the effective application of the budgetary stability principle incorporated in the EU Stability and Growth Pact. Title I sets out the budgetary stability principles: budgetary balance or surplus, medium-term budget scenarios, transparency and efficiency in the allocation and use of public resources. Title II includes provisions to achieve the objective of medium-term budgetary stability, which is applicable to all public administrations and the State public sector. Common provisions set out basic guidelines on budgetary policy for achieving stability objectives at each level of government.

Following the enactment of GABS, the Organic Act Supplementary to the GABS (OAGABS) 5/2001 was enacted. It amended the Organic Act on the Financing System for the SGCs 8/1980 and established co-ordinating mechanisms between the State and the SGCs in budgetary matters. Despite similarities to the GABS in terms of the content, it is a constitutional requirement for laws related to the autonomy of SGCs (for example, the GABS) to be legislated as an Organic Act (Art. 81). As the title of the OAGABS implies, the interpretation and enforcement of the OAGABS must be made in line with the GABS because both acts are instruments which serve identical economic policy purposes. The OAGABS confirms that the budgetary principles stated in the GABS (budgetary stability, medium-term budget scenarios, transparency and efficiency) are applicable to the SGCs. It also sets out the measures needed to be taken by SGCs in order to comply with the budgetary stability principle, and the principles of joint responsibility of the SGCs with other public

administrations in the event of a breach of the obligations assumed by the Stability and Growth Pact.

The Constitution formally establishes the COA as the organ responsible for auditing the State's accounts and financial management. The Constitution sets out the governing principles for the COA and makes provision for further legislation. Accordingly, the OACA was passed in 1982 to regulate the COA's composition, organisation and duties. This law elaborates on the powers reserved to the COA by the Constitution. It also ratifies the status of the COA as completely independent in the performance of its functions and subject only to the law. Furthermore, the COA (Functioning) Act 1988 contains provisions on the managerial, financial and operational independence of the COA, the institutional coverage of audits, the types of audits, the Court's powers of investigation, and the enforcement of its findings.

Finally, the Constitution allows Parliament to have its own rules – Standing Orders – to govern parliamentary budgetary processes, notably budget review and adoption (Art. 72). The Standing Orders establish a standing Budget Committee in both houses and define their roles in budget processes. The Standing Orders bind the government as well as Parliament.

1.2. Reforms of budget system laws

The main reforms of budget system laws were initiated following Spain's joining of the European Union, which requires prudent fiscal policy under the constraints imposed by the Maastricht Treaty and the Stability and Growth Pact. The Maastricht Treaty specifies that countries must keep general government deficits under 3% of GDP, except for exceptional and temporary reasons, and that gross general government debt must be below 60% of GDP. Subsequent council resolutions require members to attain a fiscal position "close to balance or in surplus" in the medium term. Fiscal challenges facing Spain over the medium term have also contributed to reforms. Like some other EU member countries, Spain also needs to manage high levels of outstanding public debt, the consequences of a rapidly aging population for future social spending, and the need to ensure adequate scope for reduction of a high tax burden, while maintaining an adequate level of public sector capital spending (Daban, *et al.*, 2003; OECD, 2003a).

The adoption of the GABS was the first important measure incorporating the principles of stability of the Stability and Growth Pact into domestic law. Taking into account EU requirements as well as the strong degree of regional autonomy, the central authorities needed new laws to govern public administration and achieve budgetary stability at all levels of government (OECD, 2003a).[3] Pursuant to the provisions of the Constitution (Art. 149.1.13 and Art. 149.1.18),[4] the GABS established the budgetary stability framework,

which is applicable to all public administrations regardless of their legal status. It had the effect of strengthening fiscal discipline at a time when such discipline was not as firmly entrenched as in some OECD member countries. The act provides for an appropriate improvement in the information concerning budget outcomes and increased transparency requirements at all levels of government (OECD, 2001). The GABS included marked changes in the budgetary procedures of the State, including: 1) central government expenditure is to be limited by setting a spending ceiling consistent with the medium-term budget scenarios, and 2) fiscal discipline will be mostly underpinned by monitoring and peer pressure: sanctions will be enforced should these entities fail to comply with their budgetary commitments. The OAGABS extended this reform to local governments at each level.

Having established a general framework for budgetary stability, further reform was made in order to apply the guiding principles of the GABS. The General Budgetary Act 11/1977 and its accompanying Royal Decree 1091/1988, which had provided a framework for budgets, accounting and expenditure control in the public sector for 25 years, were abrogated and replaced by the amended GBA, adopted in 2003. The new GBA aims to introduce (by 2005) a performance-based budget management system. All these measures are an integral part of the process of modernising public finance. Although the 1977 GBA and its subsequent amendments represented some improvement, there was the need to go further in revising the legal framework.[5]

The OAOFCSA brought new forms of institutional organisation and control that were inconsistent with the forms of organisation and control envisaged in the 1977 GBA. Autonomous bodies and semi-commercial public entities, which were newly established by the OAOFCSA, needed to be incorporated into financial management legislation (Zapico Goni and Garces, 2002). Also, substantial regional decentralisation took place after 1980 (OECD, 2003a), which changed the main role of central government and led to the need to establish a new legal framework between levels of government. For instance, in the health sector, the central government's role was changed from being a direct supplier of health services to one where it co-ordinates the different regional health systems so as to guarantee equality of access to basic medical care throughout the country and to stimulate the regions to improve efficiency of public spending.

2. Principles underlying budget system laws

All important budget principles are included in the various laws relating to the budget system. The Constitution requires the State budget to be drafted annually and to include the entire expenditure and income of the State sector (Art. 134, the principles of annuality, universality and unity). The budget year

is the calendar year (Art. 34, GBA). The principle of annuality is complemented by the medium-term budget principle embodied in the GABS and the GBA. The GABS requires the budgets for the State sector to be prepared within the framework of an MTBP compatible with the annual principle which governs the approval and the execution of the budget (Art. 4). The GBA specifies that management of the State sector is subject to the annual budget as approved by Parliament within the spending limits of the MTBP (Art. 27.1).

The GABS, along with the OAGABS and the GBA, incorporates the principles of budget stability, transparency, and efficiency or performance (Art. 3, GABS and OAGABS; Art. 26, GBA). Those acts require the preparation, approval and execution of budgets to be carried out within the framework of budgetary stability arising from the Stability and Growth Pact.[6] The public authorities are required to include in the budgetary regulations the instruments and necessary procedures to ensure that the budgetary stability objective is complied with. Notwithstanding the powers vested in the SGCs, the government must ensure that budgetary stability objectives are observed at all times in the public sector (Art. 7, GABS). Exceptional situations of budgetary deficit must be justified by explaining the reasons which have led to it and identifying the revenues and expenditure related to it; a medium-term economic financial plan is required to be prepared in order to correct this situation.

The transparency principle requires the budget documents to include sufficient and adequate information to allow for verification of compliance with the budgetary stability principle (Art. 5, GABS). A performance-oriented budget is also an integral part of the budget system: budgets are required to be executed to secure their effectiveness, efficiency and quality (Art. 6, GABS). The principle of specificity is embodied in the GBA (Art. 42). It requires line ministries to use their budget exclusively for the specific purpose for which they have been allocated it under the State budget, as specified in the GBA (Art. 41). Accountability is also a well-recognised principle, guarded by the COA (see section 4.5 below).

3. Legal basis for the establishment and the powers of the actors in the budget system

3.1. The executive and the legislature

3.1.1. Overview

Spain is a unitary State and a parliamentary monarchy (Art. 1, Constitution) with three tiers of government: central government; the SGCs (regional tier); and provincial and municipal authorities (local tier). The King is the head of State (Art. 56). The King has many constitutional rights, although

in large part symbolic (United Kingdom National Audit Office, 2001). He promulgates laws, summons and dissolves Parliament, proposes a candidate for the President and appoints or removes him from office, and appoints and dismisses members of the government on the recommendation of the President (Art. 62).

There is strict separation of duties between the executive and the legislature. Executive power is held by the President. The government exercises executive authority and issues regulations in accordance with the Constitution and laws (Art. 97). The government consists of the President, Vice-Presidents (one or several), ministers and other members as may be created by the law (Art. 98). The President directs the government's action and co-ordinates the functions of the government (Art. 98). In contrast, legislative power is vested in the Parliament, which consists of two houses, the Congress of Deputies and the Senate (Art. 66). The Senate is the house of territorial representation – in principle, there are four senators for each province (Art. 69).

3.1.2. Role and responsibilities of the Council of Ministers and individual ministers

The function and the structure of the government are regulated by the Constitution (Arts. 97-107). The Constitution prescribes that the Council of Ministers is the supreme decision-making organisation of the government (Art. 107), and the OAOFCSA makes provision for its membership and its terms of reference. The Council of Ministers plays a fundamental role in the budget process. It approves the general directives for budget preparation and sets guidelines for the central government's economic financial and monetary policy. It settles disagreements over appropriations between the Minister of the Economy and Finance (MOEF) and other ministers. At the conclusion of the preparatory stage, it takes decisions concerning amendments to tax provisions and approves the draft budget for presentation to Parliament. The Constitution establishes that the government is accountable to the Deputies for its conduct of political business (Art. 108).

3.1.3. Establishment of ministries and executive branch agencies

The Constitution states that the organs of State administration are set up, directed and co-ordinated in accordance with the law (Art. 103). The OAOFCSA specifies hierarchical organisational arrangements in ministries and executive branch agencies. However, the creation of a new ministry needs the enactment of its own establishing act. In contrast, the President has discretion to reorganise its existing ministries as long as it does not entail new staff and additional budgetary resources.

The Constitution states that the budget is prepared by the government and the OAOFCSA specifies that the MOEF holds the main budgetary powers and responsibilities, including revenue, expenditure and macroeconomic forecasting in accordance with budget legislation. The MOEF is divided into a State Secretariat for Finance and a State Secretariat for the Economy. The former holds the main responsibility for the whole budget process, while the latter is in charge of proposing and implementing the general measures of economic policy of the government. Line ministries prepare bills and decrees within their area of responsibility and are charged with administering policies at national level.

The OAOFCSA established a classification for general government entities into two types: autonomous bodies with administrative functions and public entities providing market-oriented services of goods (Zapico Goni and Garces, 2002). The former play an administrative role and are fully regulated by general public law, while the latter play an entrepreneurial role and are regulated under private law, except for some specific functions explicitly governed by general public laws.

Pursuant to the OAGABS (Art. 5), the Tax and Financial Council of the SGCs (TFC) plays a key role in the co-ordination of the budgetary policy of the State and the SGCs with a view to achieving budgetary stability. The TFC acts as the co-ordination body between the State and the SGCs to ensure compliance with the guiding principles of the OAGABS (Art. 5). Pursuant to the act, the TFC took on new and highly relevant functions to ensure that the stability objectives assigned to the various public administrations are met effectively. The TFC submits a report on the stability objectives of all SGCs and decides on the adequacy of each of the measures included in the budgetary stability objectives (Art. 6).

3.1.4. Responsibilities of senior civil servants

The Constitution requires that a law lays down the status of civil servants, the entry into the civil service in accordance with the principles of merit and ability, the features of their right to union membership, and the guarantees regarding impartiality in the discharge of their duties (Art. 103).

3.1.5. Establishment and roles of parliamentary committees

The Standing Orders of both houses govern the establishment of parliamentary committees. The Congress of Deputies has 15 standing committees and other *ad hoc* committees, and the Senate has 16 standing committees and other *ad hoc* committees. Both sets of Standing Orders require each house to establish a standing Budget Committee, which is responsible for examining, amending as necessary, and approving the State budget (Art. 46,

Standing Orders of the Congress of Deputies; Art. 49, Standing Orders of the Senate).

3.2. Role and responsibilities of sub-national governments

A process of decentralisation began following the adoption of the 1978 Constitution. With the transfer of health service provision to several SGCs in 2002, Spain became one of the most decentralised OECD member countries. Spain's distribution of functions and its system of governance are close to those of a federal State (OECD, 2003a). The Constitution states that the SGCs, provinces, and municipalities enjoy self-government for the management of their respective interests (Art. 137). The State is now divided into 17 SGCs or regions; territorially it includes 50 provinces and about 8 000 municipalities.

The Constitution clearly states the jurisdiction of the State and the SGCs (Arts. 148-149). The State exclusively governs the following (Art. 149): 1) the regulation of the basic conditions guaranteeing the equality of all citizens; 2) international relations; 3) defence and the armed forces, and the administration of justice; 4) general finances and the State debt; 5) the basic legislation and the financial system of social security; 6) the basic legislation for environmental protection. In contrast, the SGCs may assume jurisdiction in respect of the following (Art. 148): 1) the organisation of their institutions of self-government, and changes in the municipal boundaries within their territory; 2) environmental protection management; 3) promotion of the economic development of the SGCs within the objectives set by national economic policy; and 4) social assistance, health and hygiene. Accordingly, the SGCs' main responsibilities concern social services (excluding contributory pensions), health, labour market policy, education, culture and some public infrastructure. SGCs account for one-third of consolidated public expenditure and employ more than twice as many civil servants as central government (excluding social security) (OECD, 2003a).

The Constitution also declares the principle of the financial autonomy of the SGCs in conformity with the principles of co-ordination with the State Treasury (Art. 156). The budgets of the SGCs are required to be prepared on an annual basis and for the same period as those of the State budget, in accordance with the principle of budgetary stability. They must record all the revenue and expenditure of the bodies and institutions which are part of SGCs. The resources of SGCs are clearly stated in the Constitution (Art. 157): 1) taxes wholly or partially made over to them by the State; surcharges on State taxes and other shares in State revenue; 2) their own taxes, rates and special levies; 3) transfers from an inter-territorial clearing fund and other allocations to be charged to the general State budget; 4) revenues accruing from their property and private law income; 5) the yield from credit operations.

In the State budget, transfers may be made to SGCs in proportion to the volume of State services and activities for which they assume responsibility [Art. 158(1)]. Transfers are aimed at safeguarding solidarity between the SGCs. They are partly unconditional and are designed to offset the discrepancy (positive or negative) between each SGC's spending responsibilities and their own revenues. The SGCs also receive conditional transfers so that they can guarantee a minimum provision of health and education services throughout their territory and correct regional economic imbalances. The share of these conditional transfers has been reduced to less than 2% of total receipts, compared to about 45% under the previous system.

4. Legal provisions for each stage of the budget cycle

4.1. Budget preparation and presentation by the executive

4.1.1. Institutional coverage of the budget

To understand the institutional coverage of the budget, the distinction between the State sector and the public sector should be borne in mind. The GBA, mainly governing the State budget, is applicable to the State sector, defined as "the general State administration (ministries), autonomous bodies that belong to the general State administration, semi-commercial public entities that are part of the general State administration or any other public bodies linked to it, entities which are part of social security system, State commercial enterprises, and certain other entities" (Art. 2).[7] The State budget covers all ministries, agencies, public corporations, and public entities financed by the State budget, including Parliament, the judiciary, the COA, and other constitutional organisations. However, it excludes the SGCs.

In contrast, the GABS, which requires the setting of medium-term budgetary stability objectives, is applicable to "the public sector", which has a broader definition than the State sector. The public sector includes not only entities listed in the State sector but also the administrations of the SGCs, those bodies and agencies subordinated to the SGCs, and local councils (Art. 2.1).

4.1.2. Extrabudgetary funds and earmarking of revenues

Spain has few extrabudgetary funds with earmarked revenues, which have to be approved by law (Kraan, 2004). One example is the use of the proceeds of goods confiscated due to drug seizures, which are by law earmarked for the prevention of illegal drug use programme. EU financial aid for regional governments is another example of extrabudgetary funds.

4.1.3. Definition of budget aggregates

Budget aggregates are defined by law (Art. 13, GABS). The MTBP defines budget aggregates as the maximum spending limit with which the public sector should comply within the annual budget allocation process. The annual State budget must conform to the medium-term stability objective and aim at achieving the objective established in the MTBP.

4.1.4. Fiscal rules

The GABS provides fiscal rules to achieve economic and budgetary stability (see above). When budgets show a deficit, the government is required to submit an economic-financial plan to Parliament to correct such an imbalance, which includes revenue and expenditure measures required to correct the situation over the next three budgetary years (Arts. 14 and 17.1). In the case of a surplus, the State administration will either reduce its net indebtedness or allocate it to the Social Security Reserve Fund for the future needs of the social security system (Art. 17.2).

Local councils, in the area of their powers, are required to adjust their budgets to comply with the budgetary stability objectives, notwithstanding the budgetary powers vested in the SGCs (Art. 19). The GABS allows the government to determine the budgetary stability objective for the local councils (Art. 20). Local councils which have not achieved the budgetary stability objective are obliged to prepare within three months after the approval or settlement of the budget a medium-term economic-financial plan to correct any deficits. This plan is subject to the approval of the local council authorities and will in turn be submitted to the MOEF, which is charged with monitoring corrections to deficits (Art. 22).

4.1.5. The timetable for budget preparation and presentation to Parliament

The GBA provides the MOEF with the legal authority to issue the order (guidelines) for budget preparation (Art. 36). While the timetable for the internal procedures is stated in the guidelines, the GBA only requires the State budget bill to be submitted to the Parliament before 1st October (Art. 37). The government agreement on budget stability objectives should be made before 1st April (see Box 2). The GBA details the major contents of the guidelines, which include:

- Guidelines for the allocation of spending, including criteria for preparing the draft budget, quantitative limits and policy priorities to be determined by the MOEF. To ensure conformity with the criteria, the Spending Policies Commission is constituted, the composition of which is determined by order of the MOEF.

Box 2. **Spain: The timetable for the budget process (based on the fiscal year 2003)**

- January: presentation of main framework of budget formulation to the Council of Ministers.
- Before 31 January: government agreement on budget stability objectives (BSOs); transmission of BSO proposal to the TFC.
- Before 1st March: meeting of the TFC and National Council of Local Government (reporting on BSO proposal to regional and local governments).
- Mid-March: approval of BSO by Council of Ministers and agreement sent to Parliament.
- Before 30 April: parliamentary approval or rejection of the BSO, which fixes legal limits on spending aggregates.
- Early May: budget guidelines sent to ministries by MOEF.
- May: meeting of the Spending Policies Commission.
- June: approval of budget scenarios for a three-year period.
- Late July: formulation of draft budget.
- Early August and early September: debates within the Council of Ministers.
- Before 1st October: draft budget approved by the executive and sent to Parliament.
- Before 31 December: debate and approval by Parliament of annual State budget law.

Source: Zapico Goni, 2002.

- Ministries and other State entities must submit their respective draft budgets to the MOEF, which requires conformity to the ceilings established in the guidelines. The Ministry of Labour and Social Affairs must prepare the draft bill for the social security budget, in co-operation with the Ministry of Health and Consumption, and submit it to the MOEF. As part of this procedure, an order of the Ministry of Labour and Social Affairs specifies how to prepare the budget of the social security system. The MOEF and the Ministry of Labour and Social Affairs submit the draft bill for the social security budget to the Council of Ministers for approval.
- For each programme, a report on annual objectives within the allocation limits under the MTBP.

The revenue budget shall be prepared by the MOEF in a manner consistent with the allocation of resources under the MTBP and in compliance with the objectives for economic policy set forth annually by the government.

4.1.6. Approval process within the executive

After being negotiated between the MOEF and line ministries, the MOEF submits the State budget bill to the Council of Ministers for approval. Should no agreement be reached between line ministries and the MOEF, the dispute is resolved by an appeal process through the Secretary of State for the Budget, the MOEF, or the Council of Ministers. In general, agreement is achieved informally prior to meetings of the Council of Ministers, according to the interests of all the ministries involved and, if necessary, in the presence of the President who has the final decision.

4.1.7. Documents to accompany the budget law

The GBA requires the State budget bill to contain articles, annexes and detailed statements on revenues and expenditure (Art. 37). The following information is required (Art. 33, GBA):

- The maximum financial obligations of the State sector.
- Revenues, expenditures, and investment and financial operations to be performed by the semi-commercial and foundation State sector.
- The objectives to be achieved in the year by each of the entities responsible for the programmes.
- An estimate of tax expenditures.

Medium-term macroeconomic framework and fiscal strategy. The MOEF is responsible for elaborating the economic assumptions for the draft annual State budget and the MTBP. The GBA prescribes the basic framework for the MTBP in accordance with the budget stability objectives (Arts. 28-30). Prior to the preparation of the draft annual State budget, the MOEF drafts medium-term revenue, expenditure and balance projections (Box 3). Line ministries are required to submit their MTBPs to the MOEF annually. The Ministry of Labour and Social Affairs prepares a separate MTBP for the social security system. The MTBP has to be consistent with the budgetary stability objectives for the State and the social security system for the three following years, pursuant to the provisions of GABS. The detailed procedures of preparation and the structure of the MTBP are established by order of the MOEF. Once the MTBP is drafted by the MOEF, it is transmitted to the Council of Ministers for their decision prior to the submission of the draft State budget of each year. When there are changes in economic or social conditions that are not foreseen at the approval stage, the government may submit an amended plan to Parliament (Art. 14.2, GABS).

New measures *versus* existing expenditure policies. In the process of elaborating the MTBP, the MOEF implicitly makes the distinction between existing and new commitments, programmes or measures. Furthermore, the

Box 3. **Spain: The major content of medium-term budget plans**

- Multi-year stability objectives for programmes (or groups of programmes) are expressed and structured in an objective, clear and measurable form.
- Policies to achieve objectives are specified.
- The required financial, material, and personnel resources are specified in terms of draft annual appropriations, which are available to expenditure management centres.
- Physical and financial investments are formulated.
- Indicators of performance associated with each budget objective are proposed. These allow for the measurement, monitoring and evaluation of the result in terms of effectiveness, efficiency, economy and quality.

GABS (Art. 12.2) refers to the obligation to explicitly analyse all new laws, orders and measures to make sure that they are within the limits made available by the MTBP. Finally a ministerial order for the formulation of the budget scenarios presents forms for the budget request, differentiating resources to finance ongoing and new programmes or initiatives.

Performance-related information. The GBA requires the government to incorporate performance-related information into the budget documents (Art. 35). Line ministries are required to include the annual objectives for each programme within their budget proposal to the MOEF. Based on these objectives, whether measurable or not, the degree of performance is evaluated programme by programme, and this information should be taken into account when line ministries' budgets are being prepared.

Tax expenditures, contingent liabilities and fiscal risks. Both the 1978 Constitution and the GBA (Art. 37) require the government to present a detailed report of tax expenditures, along with a revenue budget to Parliament. The report includes a definition of tax expenditures, an explanation of any new tax concessions submitted to Parliament, a methodological note explaining hypotheses, procedures and sources used for estimating tax expenditures, and a list of tax expenditures classified by type of tax and purpose (OECD, 2002; Kraan, 2004). Information on contingent liabilities and fiscal risks is not required by law to be included into the budget documents. However, the MTBP may provide partial information on such liabilities and risks.

Other information required by law. The GBA (Art. 37) requires the State budget bill to be accompanied by the additional documents described in Box 4.

Box 4. **Spain: Additional documents attached to the draft budget**

- Reports on spending programmes and their annual objectives.
- Reports on the contents of each budget allocation with specifications of the main modifications compared to the current budget.
- An annex with a financial breakdown by spending management centres.
- An annex with an MTBP of public investment projects classified by region.
- Accounts and balances of the previous year's budgets and a forecast of those for the current year.
- Accounts and balances of the social security system of the previous year.
- Consolidated financial statements of the budget.
- An economic and financial report.
- Report on tax expenditures.

4.1.8. Budgets of Parliament and other constitutional bodies

Under the Constitution (Art. 72), each house of Parliament has budgetary autonomy. Co-ordination arrangements exist for incorporating Parliament's draft budget into the draft State budget. The COA also has financial independence (see section 4.5 below).

4.2. Budget process in Parliament

4.2.1. The timetable for budget adoption and constraints on the budget debate in Parliament

Neither the Constitution nor the Standing Orders of Parliament prescribe explicitly the timetable for budget approval by the Parliament. However, the Constitution implies that the parliamentary debate needs to start on 1st October and end on 31 December [Arts. 134(3) and (4)]. In recent years, the State budget bill has been approved before the fiscal year (with exception of the 1996 budget due to a change of government).

The Standing Orders of each house provide a clear and structured parliamentary process. The plenary of the Deputies discusses draft amendments to the entire draft State budget. If these amendments are accepted, the adopted budget is sent back to the government as a new fiscal year's budget. If they are rejected, the Budget Committee of the Deputies

examines the budgetary documentation. When the Deputies have voted on the bill, it goes to the Senate where the approval procedure is the same as for the Deputies. The Senate can amend the bill, make additions, or vote it down. In the latter case, the bill goes back to the Deputies. The Senate veto can be overridden by an absolute majority in a second round of voting by the Deputies. Otherwise, in a third round of voting by the Deputies two months later, a simple majority will suffice to lift the Senate veto.

4.2.2. Provisional budgets

The Constitution prescribes that if the State budget bill is not passed before the first day of the corresponding financial year, the previous financial year's budget is automatically extended until the new one is approved [Art. 134(4)]. The GBA restricts line ministries, when preparing their own extended budgets, from exceeding their total amount in the previous year (Art. 38).

4.2.3. Powers of amendment

Parliament has relatively limited powers to amend the State budget bill (OECD, 2002). The Constitution prescribes that any non-governmental bill or amendment which involves an increase in appropriations or decrease in budget revenue requires prior approval by the government before its passage [Art. 134(7)]. The Standing Orders of both houses require that all amendments that result in an increase in expenditure on one budgetary item must be presented in combination with a parallel decrease in another expenditure in the same section (department).

4.2.4. Approval of resources

The Constitution states that the primary power to raise taxes is vested exclusively in the State by means of the law, and any State tax concessions must be established by the law (Art. 133). The State budget bill may not establish new taxes – the annual budget law may only modify existing taxes. New tax laws are needed for substantive changes in tax policy [Art. 134(7)]. Furthermore, the revenue budget for a fiscal year should be approved by Parliament in conjunction with the expenditure budget (see below).

4.2.5. The nature, structure and duration of appropriations

The GBA specifies general principles for budget classification. The structure of the State budget is determined by the MOEF on the basis of the organisation of the State sector, the economic nature of its revenue and expenditure, as well as by policy purposes and objectives (Art. 39).

Expenditure is classified by three main criteria: 1) classification by type of organisation (the general administration of the State, its autonomous bodies, entities of the social security system and other entities); 2) classification by programmes, which must conform to the contents of spending policies contained in the MTBP and establish the objectives to be achieved by line ministries; 3) economic classification, which groups budget estimates by chapters and the nature of the expenditure (current operations, capital operations, and financial operations) (Art. 40). Chapters are subdivided into articles, items, and sub-items. Current operations show information on personnel costs, operating costs for goods and services, financial costs and current transfers. Capital operations distinguish between real investments and capital transfers. Financial operations show the status of financial assets and financial liabilities.

Revenue is structured according to two main criteria: 1) classification by type of organisation, which distinguishes revenues of the general State administration from those of its autonomous bodies, social security and other entities, and 2) economic classification which groups revenue according to chapter and its nature (Art. 41). Chapters are further divided into articles, items, and sub-items. Current revenues show direct taxes, social security payments, indirect taxes, fees, charges and other revenue, current transfers and asset revenues. Capital revenues distinguish between the disposal of real investments and capital transfers. Financial operations show the status of financial assets and financial liabilities.

Appropriations are specified at the item level, except for personnel costs and the expenses of goods and services, which are specified at the article level, and real investment, which is specified at the chapter level (Art. 43). Expenditure is required to be spent exclusively for specific purposes (Art. 42). Appropriations are the maximum amounts which line ministries can spend (Art. 46). The appropriations are usually for one year (corresponding to the calendar year). However, multi-year appropriations are allowed under the following circumstances (Art. 47):

- The number of years to which an appropriation may be applied shall not exceed four years. Spending limits are set for each year: 70% of initial budget in the first year, 60% in the second year, and 50% in the third and fourth years.
- Under exceptional circumstances, the government may agree to modify the number of years and the spending limits. For this purpose, the MOEF, at the initiative of the relevant ministry, is required to submit a proposal to the Council of Ministers, which then finally approves it.

4.2.6. Carryover of appropriations and borrowing of future appropriations

Carry forward of unspent appropriations to the next fiscal year is generally forbidden (Art. 49, GBA). However, it is permissible by the GBA under some exceptional circumstances (Art. 58), notably: 1) where provided by the law; 2) appropriations originating from contributions by the State to autonomous bodies to finance joint spending; 3) where appropriations originated from contributions by an individual or by legal persons to the State or by the autonomous bodies jointly financing spending; and 4) where appropriations originated from revenue legally dependent on the completion of certain actions.

4.2.7. Public debt approval

The Constitution requires that the government only contract financial liabilities and incur expenditures in accordance with the law (Art. 133) and the government must be authorised by law in order to issue State debts and bonds or to contract loans (Art. 135).[8] The GBA further specifies the procedures for public debt approval (Arts. 94-105). Creation of State debt must be authorised by law, and the State budget shall provide a limit on the variation of the balances of State debt for each budget year, which must be adhered to in financial transactions that involve debt creation (Art. 94).

The GBA requires the government to provide a quarterly report to the Budget Committee of the Deputies and of the Senate on the balances of the financial transactions (Art. 93.1). The MOEF approves, for submission to the government and the Parliament, an annual report explaining public debt policy in the following year, which reflects the current balance of State debt at the end of the preceding year. Debt of the autonomous bodies is included (Art. 93.2).

4.2.8. Promulgation, veto and publication of the adopted budget

Once the draft budget is approved by Parliament, the King, within 15 days, gives his assent to the State budget bill approved by Parliament, promulgates it and orders its publication (Art. 91, Constitution).

4.2.9. Supplementary budgets (rectifying laws)

After the adoption of the annual State budget, the government may submit a supplementary budget bill involving increases in public expenditure or decreases in revenue in the same financial year [Art. 134(5), Constitution]. The GBA specifies procedures for preparing supplementary State budgets. When circumstances arise that the expenditure cannot be deferred until the

following year, and no other appropriations are available, a supplementary State budget is allowable under the following conditions (Art. 55).

- Should the need arise in non-financial operations of the budget, the supplementary budget shall be financed by offsetting it against the expenditure in the contingency fund or in other non-financial funds. (See section 4.3.3 and footnote for a discussion of non-financial operations.)
- Should the need arise in financial operations of the budget, it shall be financed with public debt by reducing expenditures of the same type.

The MOEF proposes draft supplementary budgets to the Council of Ministers, following a report by the Directorate General of Budgeting. After approval by the Council of Ministers, the bill is submitted to Parliament. Supplementary budgets for autonomous bodies and social security are prepared using procedures similar to those for the State budget (Art. 56 for SGCs and Art. 57 for social security).

4.2.10. Budgetary implications of other bills

The GABS and the GBA require that legal provisions and regulations, during their draft stage, their preparation and approval, administrative acts, contracts and co-operation agreements and any other actions by the public sector, take into account their budgetary effects and be subject to strict compliance with budgetary stability requirements (Art. 6.2, GABS; Art. 26, GBA).

4.3. Budget execution

4.3.1. Apportionment of expenditure authority

After approval of the State budget, the MOEF prepares and approves, at the proposal of the Director General of Public Finance and Financial Policy, an annual budget execution plan that contains a projection of State revenue and accommodates the issuance of payment orders (Art. 106.1). To prepare the budget execution plan, the Director General of Public Finance and Financial Policy gathers from the State sector any data, projections and documentation it considers necessary on payments and revenues that may have an impact on the State budget (Art. 106.2). The budget execution plan may be modified throughout the year in accordance with data on execution or changes in revenue or payment projections (Art. 106.3). The amount of payments ordered at any time is required to be consistent with the annual budget execution plan (Art. 107.1).

4.3.2. Cancellation of budget authority and other in-year expenditure control

The law does not require the government to spend approved appropriations in their entirety. In exceptional circumstances, where State sector entities have more cash available than initially projected, the MOEF is authorised by the GBA to cancel part or whole of the budgeted transfers to these State sector entities, without the approval of Parliament (Art. 45).

4.3.3. Emergency spending, excessive spending and contingency funds

The GABS, later confirmed by the GBA, prescribes the procedure for the use of a contingency fund during budget execution (Art. 15, GABS; Art. 50, GBA). In order to meet non-discretionary spending that had not been foreseen when the budget was approved, the State budget can include a "contingency fund for budget execution" for an amount of 2% of total spending.[9] In no case may the fund be used to finance programmes or policies that originate in discretionary decisions of the government.

The use of the contingency fund requires the approval of the Council of Ministers following a proposal made by the MOEF. The government, through the MOEF, will submit to the Budget Committees of the Deputies and of the Senate for their information, a quarterly report on contingency fund spending. Credit remaining at the end of the fiscal year may be carried over to the next fiscal year.

4.3.4. Transfers and virement of appropriations within the year

Transfer between lines of appropriations is permissible, but these are subject to certain conditions (Art. 52). Restrictions are not applied to transfers of expenditures arising from administrative restructuring or the devolution of authority to SGCs. In summary:

- Transfers are not possible between non-financial spending and financial spending, nor from capital expenditures to current operations.
- Transfers are not possible between the expenditure of different budget sections.
- Transfers shall not reduce mandatory expenditures or expenditures that have been extended or supplemented during the year (except for social security spending and for public debt).
- Within the social security system, expenditures may not be reduced except to finance other expenditures.

Transfers between expenditures of the same programme or between programmes of the same service are possible; these are at the discretion of line ministers on the basis of a favourable report by the delegate comptroller

in the ministry (Art. 63). However, the government, upon a proposal of the MOEF and at the initiative of the ministries involved, has the power to authorise transfers between different budgetary sections as a result of administrative reorganisation, and the MOEF has the power to authorise certain other transfers (Art. 61).

4.3.5. *Cash planning and management of government assets and debts*

The MOEF has overall responsibility for cash planning and government asset and debt management (Titles IV and VI, GBA). Cash management is based on the principle of a single account (see below). Money is paid out of the single treasury account according to the budget execution plan prepared by the MOEF. The MOEF also has authority over State debt management and procedures (Art. 98, GBA). The GBA requires the MOEF to report to the Parliament on the amount and the characteristics of the main public debt guarantees and public debts issued during the year.

4.3.6. *Internal audit*

A strong framework of internal control of public finance operates in Spain, and each ministry or public body has its own internal control function. The next tier of control is provided by the MOEF, in particular the General Controller of State Administration (GCSA), which has staff based within, but fully independent of, each public body (United Kingdom National Audit Office, 2001). The GBA governs the overall procedures for internal oversight of financial management of the State sector (Title VI). The GCSA exercises, in accordance with the terms and conditions set forth in the Constitution, internal oversight of the financial management of the State sector (Art. 140) in line with the following objectives (Art. 142):

- To verify compliance with regulations on the management of public finance.
- To verify the proper recording and accounting of operations, and their faithful and regular reflection in accounts and statements.
- To ensure that the activity and procedures under oversight are performed in accordance with the principles of good financial management and particularly those contained in the GABS.

4.4. *Government accounting and fiscal reporting*

4.4.1. *The accounting framework*

The GBA provides the legal framework for the accounting arrangements of the State sector (Title V, Arts. 119-139). At the recommendation of the GCSA, the MOEF has the powers (Art. 124) to approve the chart of accounts, which contains and develops public accounting principles. The MOEF also

determines the criteria for recording data, presenting accounting information, and specifying the contents of the annual accounts that must be submitted to the COA (Art. 124). The GCSA, under guidelines provided by the MOEF, plays an important role in implementing public accounting (Art. 125).

Accounting in the State sector is defined as "a system of financial and budgetary information that has the aim of showing, through financial statements and reports, a faithful status of the assets, financial situations, results and budgetary performance of the State sector" (Arts. 119 and 120). For the administrative public sector, accounting principles and the chart of accounts are based on modified accrual accounting. In contrast, the semi-commercial public sector (for example, semi-commercial public enterprise, State commercial entities) applies the accounting norms and principles contained in the Commercial Code and the chart of accounts used by private companies, with some adaptation (accrual based accounting) (Art. 121).

4.4.2. Government banking arrangements

In general, revenue and payments of the State and its autonomous bodies are to be channelled through accounts held in the Bank of Spain (Art. 108.1 and Art. 13, Bank of Spain Autonomy Act 13/1994). In exceptional circumstances, the MOEF may authorise the Director General of Public Finance and Financial Policy to open accounts in other lending institutions.

4.4.3. In-year reporting to Parliament

The GCSA requires monthly budget execution information, including for social security, to be provided to the Budget Committees of the Deputies and of the Senate (Art. 135). This report is published in the Official State Gazette and on the MOEF Internet site.

4.4.4. Annual accounts and reports

The Constitution requires that the State accounts be submitted to the COA for audit (Art. 136). The GBA specifies this procedure further (Arts. 127-134). It requires all entities in the State sector to prepare annual accounts within three months following closure of the fiscal year and to place them at the disposal of the auditors (Art. 127). These consist of the balance, the economic and assets result account, the cash balance of the budget and the annual report (Art. 128). Entities in the State sector are required to submit to the COA, through the GCSA, the required accounting information (Art. 137).

The General Account of the State, which is the consolidated general accounts of all entities of the State sector, is prepared yearly by the GCSA, and is forwarded to the government for its approval before its submission to the COA prior to 31 October of the following year (Art. 131). The General Account

of the State includes: the economic, financial and asset status of the State sector; the economic and assets results of the year; the execution and balance of the budgets and the achievement of objectives (Art. 130.3). The GCSA may gather from different entities any information it considers necessary to prepare the consolidated general account.

The GBA requires the government to submit certain special reports to Parliament. For instance, the MOEF must present information on management of the contingency fund every three months (Art. 50.3).

4.5. External audit

4.5.1. Managerial, financial and operational independence

The Constitution establishes the COA as the supreme body charged with auditing the State's accounts and financial management, as well as those of the public sector.[10] The COA is directly accountable to Parliament [Art. 136(1)] and requires an organic act to make provisions for its membership, organisation and duties [Art. 136(4)]. Accordingly, the OACA, complemented by the Court of Accounts (Functioning) Act 1988, governs procedures for external audit. The COA's internal structures are specified in the organic law.[11]

The OACA clearly states that "in the performance of its function, the COA shall be completely independent and subject only to the law." To ensure the independence of the COA, the president of the COA shall be appointed for a term of three years from among its 12 counsellors by the King upon the proposal of the COA (Art. 29). The counsellors are appointed by the Parliament – six by the Deputies and six by the Senate – by three-fifths majority vote in either house, and for a period of nine years. The causes of disqualification, the conflicts of interest and the prohibitions established for judges by the Organic Act of the Judiciary Power 1985 apply equally to the members of the COA (Art. 33). The president and the counsellors may only be removed from office upon expiry of their mandate, by resignation accepted by Parliament, or through incapacity, conflict of interests or serious neglect of the duties of office (Art. 36).

To support its financial and administrative independence, the COA draws up its own budget, which is incorporated into an independent section of the State budget, and subject to approval by the Parliament (Art. 6). The COA also has power to employ suitably qualified experts to inspect, revise and verify documentation, books, cash, securities, goods and stocks of the public sector for the performance of its responsibilities (Art. 7.4).

4.5.2. *Institutional coverage of audits*

One of the key functions of the COA is its permanent and final external auditing of the financial activity of the public sector (Art. 2). The public sector subject to audit by the COA comprises (Art. 4):

- The State administration.
- The Self-Governing Communities and local corporations.
- Social security management bodies.
- Autonomous public agencies.
- State corporations and other public enterprises.
- The Bank of Spain (Art. 4, Bank of Spain Autonomy Act 13/1994).

4.5.3. *Types of audit*

The OACA requires the COA to verify that the economic and financial activity of the public sector conforms to the principles of legality, efficiency and economy (Art. 9). In auditing the accounts and the financial management of the public sector, the COA focuses on: the observance of the Constitution and the acts regulating public sector revenue and expenditure; compliance with provisions and implementation of the State budget; reasonable execution of public spending to improve standards of efficiency and economy (Art. 13). Performance audit is a relatively new area of work for the COA, and the majority of its reports still concentrate on issues of financial compliance (United Kingdom National Audit Office, 2001).

4.5.4. *Powers of investigation*

In carrying out its investigations, the COA is authorised by law to require public sector bodies to furnish all data, statements, documents, records or reports as it may request in connection with its auditing or jurisdictional responsibilities (Art. 7.1). The COA may notify Parliament of any failure of a public sector entity that does not co-operate in its obligations (Art. 7.5). Furthermore, failure to comply with the Court's injunction may lead to the imposition of sanctions (a fine or criminal liabilities) as provided in the Court of Accounts (Functioning) Act (Art. 7.4, OACA).

4.5.5. *Reporting obligations and publication*

The Constitution requires the COA to send annual reports to Parliament (Art. 136). In addition, the GBA requires the COA to examine and verify the General Account of the State within six months after it is received (Art. 132). The COA, following its hearing of the State Attorney, prepares its report as it sees fit and sends it to Parliament with its recommendations, while concurrently informing the government of the contents of the report. The

report includes: an analysis of the accounts of the State and the public sector; a view on the financial management of the State and the public sector; comments on observance of the Constitution, legislation and regulations governing public sector economic activity; compliance with the provisions of the budget (local, regional and national); the efficiency and economy of public spending; the activities of the State corporations and also the application of other public subsidies; and a statement of the COA's jurisdictional proceedings during the year in question (United Kingdom National Audit Office, 2001).

4.5.6. *Enforcement of findings*

The recommendations of the report are enforced by parliamentary consideration, whose role is delegated to the Joint Committee for the relationship with the COA, consisting of 48 members of both houses. For the report on the General Account of the State, Parliament considers and resolves to accept the accounts and can ask for more information. The COA does not issue a separate report but expects the government to act on the recommendations made by the COA. Follow-up work is carried out by the COA in the most significant cases. Reports of the COA appear in the Official Gazettes and attract considerable media attention (United Kingdom National Audit Office, 2001).

The enforcement of the report's recommendations is strengthened by the COA's jurisdictional functions. These are confined to passing judgment on those responsible for managing public funds. Actions are aimed at determining the damage caused to the public treasury and demanding compensation but without the possibility of imposing any fines or penalties (OECD, 2003b). The COA examines cases referred to it by three sources: the prosecutor, the public administration affected or by a public petition, and makes judgments on referred cases. Where an individual public official is directly liable because he has willfully acted in a way that has resulted in loss or waste, he must repay the full amount of the loss. The liability for loss or waste of public money is personal (Art. 42, OACA). Where it is not feasible to prosecute the person directly liable, it may be possible to prosecute the person who could have prevented the act (Art. 43, OACA). This is known as secondary liability and arises particularly where the second person was negligent in carrying out supervisory duties (United Kingdom National Audit Office, 2001).

Notes

1. The Constitution has 169 articles, including several on budget-related issues; the General Budgetary Act 47/2003 has 182 articles; and the Standing Orders for the Congress of Deputies and the Senate have 206 articles and 196 articles respectively.

2. Organic laws are a specific type of statute regulated by the Constitution and are different from general legislation in two ways. First, matters relating to the implementation of fundamental rights and public freedoms, the Statutes of Autonomy and the general electoral system and other laws provided for in the Constitution must be legislated for by an organic law [s. 81(1)]. Furthermore, the approval, amendment or repeal of organic laws requires an overall majority of members of the Congress of Deputies in a final vote on the bill as a whole (s. 82(2)].
3. See also the Statement of Purpose of the GABS written by Parliament in 2001.
4. According to constitutional provisions, the State has exclusive competence over matters concerning the basic rules and co-ordination of general economic planning (13) and the basic rules of the legal system of public administrations and the status of their officials which shall, in any case, guarantee that all persons under the said administrations will receive equal treatment and the application of common administrative procedures, without prejudice to the special features of the SGCs' own organisations (18).
5. See the Statement of Purpose of the GBA written by Parliament in 2003 for further information.
6. Budgetary stability is defined as "a balanced or surplus situation in terms of financing capacity pursuant to the definition set out in the European System for National and Regional Accounts and the terms established for each State administration (for the public sector in Art. 2.1 of the GABS)".
7. The State sector also is divided into three categories by the GBA (Art. 3): the administrative public sector (for example, the general State administration, autonomous bodies); the semi-commercial public sector (for example, semi-commercial public enterprises, State commercial entities); and the public foundation sector (for example, foundations in the State sector).
8. State debt is defined in the GBA as the entirety of capital borrowed by the State through public issues, agreements for loan transactions, subrogation to the debts of a third party, and any other transaction that finances State expenses (Art. 92).
9. Spending includes expenditures for staff, current and capital transfer, capital investment and debt servicing (this type of spending is called "non-financial spending" in the Spanish budget). Financing items (known as "financial spending"), such as the purchase of financial assets and payment of financial liabilities, are excluded.
10. For the audit of SGCs, a distinction should be made as to whether they have their own external controlling body (a regional COA). Regional COAs established in nine out of 17 SGCs, without prejudice to the competence of the COA, certify the accounts of SGCs and present a report to the local councils. For the remaining SGCs, this task is carried out by the COA. The COA therefore carries out less direct work in the SGCs that have their own COA but it still has oversight and can carry out follow-up work. The COA can delegate some of its jurisdictional functions to a regional COA, but only the actions related to accountancy responsibility, never the audit itself. See United Kingdom National Audit Office (2001) and Kraan (2004) for more information on this matter.
11. The COA's structure comprises: the President, the Full Session, the Ruling Committee, the Auditing Section, the Trial Section, the Board of Audit, the Prosecutor's Office, and the General Secretariat (Art. 19).

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ISSN 1608-7143
OECD Journal on Budgeting – Volume 4 – No. 3
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United Kingdom*

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* This study has benefited from comments from several offices of H.M. Treasury, the Cabinet Office and the Debt Management Office (co-ordinated by Gary Hansman), from Simon Henderson of the National Audit Office, and from OECD colleagues including David Turner of the Economics Department.

1. Overview

1.1. The legal framework governing budget processes

The budget process is governed by a combination of primary and secondary legislation, published guidance and convention.[1] Unlike other European countries, the United Kingdom does not have a written constitution to provide an overriding framework outlining the powers of the legislature, the government and civil servants in budget processes. Parliament has nonetheless adopted a number of laws to support the budget system (Box 1). However, these provide incomplete coverage of budget processes and, in some cases, statutes merely provide general principles for particular aspects of the budget system.

For several centuries, it has been recognised that Parliament is supreme in budgetary matters. However, although Parliament formally adopts laws, considerable rule-making power resides with the government. Principles embodied in primary legislation may be implemented by a variety of means, including delegated legislation,[2] Command papers,[3] or H.M. Treasury memoranda.

Beginning with the Exchequer and Audit Departments Act 1866 (E&AD Act 1866), statute law has been used to confer considerable budget-

Box 1. **United Kingdom: Main budget system laws**

- Exchequer and Audit Departments Acts, 1866 and 1921 (E&AD Acts).
- Parliament Acts, 1911 and 1949.
- National Loans Act, 1968, amended in 1998.
- National Audit Act, 1983.
- Local Government Acts, various years.
- Audit Commission Act, 1998.
- Devolution Acts, 1998 (for Northern Ireland, Scotland and Wales).
- Finance Act, 1998 (Chapter 36) (Code for Fiscal Stability, CFS).
- Government Resources and Accounts Act, 2000 (GRA Act 2000).

Sources: Government Accounting (*www.government-accounting.gov.uk* – see appendices) and H.M. Stationery Office (*www.hmso.gov.uk*).

making powers on H.M. Treasury. The Minister of Finance (known as the Chancellor of the Exchequer) is rarely mentioned in laws relating to the budget system. For example, the laws relating to government accounting and fiscal responsibility are replete with references to the role of H.M. Treasury. This longstanding and extra-legal[4] body enjoys considerable powers inherited from the royal prerogative,[5] especially with regard to the appropriations structure, the issuance of public money, expenditure control, and controlling access to Parliament (discussed in Daintith and Page, 1999).

The Cabinet of ministers plays a powerful role in determining the shape of the annual budget. It is also an extra-legal body. The government, by virtue of its majority in the House of Commons controls Parliamentary business, including the structure and composition of parliamentary committees. The Standing Orders (internal procedural rules) of the House of Commons severely limit the lower house's role in approving the annual budget. The upper house – the House of Lords – has no power to make changes in any bill concerned with public money.

A 1932 agreement between the Public Accounts Committee (PAC) and H.M. Treasury establishes that expenditure on continuing functions of government (with a few exceptions) should be covered by a specific statute. H.M. Treasury has agreed to uphold this principle and the agreement is known as the 1932 Public Accounts Committee Concordat.[6]

The role of Parliament reflects the historic relationship with the Crown, namely that the sovereign sought Parliament's approval and authority to raise taxes for spending. It is still a basic constitutional principle that the government (in lieu of the Crown) proposes expenditure and taxation, not Parliament. Today, Parliament has very few powers in budget approval processes. Improved ways for Parliament to be more effective in holding the government to account and in improving parliamentary oversight have been suggested (Hansard, 2001).

The external audit function was formally established by the E&AD Act in 1866. The Act was extensively revised and updated when the Government Resources and Accounts Act (GRA Act) was passed in 2000. Another major revision took place in 1983 when the Comptroller and Auditor General (C&AG) became an officer of Parliament, not the head of an executive department. This act also put value-for-money audits on an explicitly statutory footing.

Finally, devolution of some government functions to Scotland and Wales in 1998 by new acts resulted in the creation of new parliamentary budget procedures in Scotland and new statutory external audit institutions throughout the United Kingdom (see Box 5).

1.2. Reforms of budget system law

Since the 1980s, the budget system has changed markedly. Although new statutes have been adopted to support some of these changes, many of the budget reforms have been introduced by the government, either by virtue of its delegated legal powers or its inherited powers (Box 2). Command papers have been used to communicate some of the changes to Parliament and the public.

In the 1980s, the way government departments were managed was changed dramatically, with the creation of executive agencies. These "arm's length" agencies are headed by chief executives who are provided with

Box 2. **United Kingdom: Reforms of the budget system in the past 20 years**

Changes introduced by statute law

- Principles for Fiscal Stability introduced by the 1998 Finance Act. The act requires H.M. Treasury to lay before Parliament a code embodying these principles and requiring H.M. Treasury to prepare pre-budget, budget and debt reports.
- Principle of accrual-based budgets and accounts introduced in GRA Act 2000.

Changes introduced by the Code for Fiscal Stability

- The government's principles of fiscal management, objectives and operation of fiscal and debt management policy.
- The contents of the various pre-budget, annual budget, and debt reports.

Changes not introduced by law, but by Cabinet/Treasury decision

- Fiscal rules: 1) over the cycle, the government will borrow only to invest and not to fund current spending (a "golden rule"), and 2) public sector net debt as a proportion of GDP will be held at a stable and prudent level over the cycle.
- Definition of expenditure aggregates for fiscal monitoring and procedures for tight control of expenditures.
- Creation of some 130 executive agencies (under government departments) with considerable management autonomy, including for their budgets.
- A major simplification of the appropriation structure, with Parliament controlling only very broad aggregates on a "programme" basis.*
- Modernisation of public services, improved accountability and outcome-focused budget management, including public service agreements (PSAs) and performance indicators (Blair, 1998; H.M. Treasury, 2000).

* For simplicity, the word "programme" is used in this chapter. Under resource accounting, the term used is "Request for Resources" (RfR), not programme.

considerable budgetary autonomy and flexibility to execute particular aspects of government policy. Around 75% of civil servants now work for such agencies, whose budgets are part of the parent department's budget. These far-reaching changes were introduced without new parliamentary legislation.

In the 1990s, the government planned a major accounting reform, which culminated with the adoption, by statute, of an accrual-based government accounting system. The GRA Act 2000 replaced the previous cash-based system introduced by statute one-and-a-half centuries earlier. Like many statutes, only the bare essentials are contained in the GRA Act. H.M. Treasury is delegated much of the responsibility for implementing this law. H.M. Treasury also proposes the appropriation structure. In recent years, there has been considerable simplification: the number of estimates (units of appropriation for government departments) was reduced from 167 in 1989/90 to 52 in 2004/05. Also, the number of "programmes" within each estimate is often only one; only in two departments does the number of programmes exceed three. This compares with very detailed line-item cash expenditure 30 years earlier.

Similarly, a section of the 1998 Finance Act requires that H.M. Treasury lays before the House of Commons a Code for Fiscal Stability (CFS). This code emphasises five principles for fiscal policy and requires H.M. Treasury to prepare, on behalf of the government, reports outlining past and prospective developments in fiscal and debt management, including the adherence with the government's fiscal rules.

2. Principles underlying budget system laws

Unlike continental European countries, new practices have traditionally been absorbed into legal documents without much discussion of their compatibility with existing principles. In part this reflects the absence of a written constitution. In the United Kingdom, the unwritten constitution can be viewed as a system of values that is continually in the process of being discovered, rather than an overarching set of norms. Where important changes occur and are not reversed, the constitution may be said to be changing. Thus, there is little tension between what the unwritten constitution "requires" and what is actually done.

Although principles, as a foundation for law, have been downplayed, for a long time the principle of parliamentary "control of the purse" has been embodied in law. This includes:

- Statutory authorisation – of taxation and of expenditure of public funds.
- Propriety and regularity – approval by Parliament – of departmental activities.

- Delegation of authority to H.M. Treasury to approve departmental expenditure, subject to ultimate parliamentary authority.

In recent years, constitutional values, including "openness, fairness and impartiality" (McAuslan, 1988) and "open and accountable government" (Harden and Lewis, 1986), have been embodied in law. Five principles, notably transparency, stability, responsibility, fairness, efficiency, are included in the CFS. The legislative basis of the CFS is somewhat hidden in the "miscellaneous" section of the 1998 Finance Act, an act principally devoted to tax measures.

Some, but not all of the "traditional" principles used in other European countries are embodied in the law. The principle of annuality for supply is explicit in the law (s. 1, GRA Act 2000): specific provision for expenditure is only for a specified financial year only. The principle of universality – all revenues and expenditures are included in budget-related documents – is not embedded in legislation, although it is practised. The principle of unity is absent: separate laws and legal processes are used to approve the annual revenue and expenditure estimates. The principle of specificity needs to be qualified. Parliament approves very broad aggregates. Essentially, there is specificity by "programme" for current expenditures but no direct control of capital expenditure.[7]

3. Legal basis for the establishment and the powers of the actors in the budget system

3.1. The executive and the legislature

3.1.1. Overview

The Queen is the head of State, the head of the executive (a term not widely used in the United Kingdom – "the Crown" is preferred) and an integral part of Parliament. However, the monarchy has very limited powers. By convention, the Queen follows the advice of her ministers. Parliament is composed of three elements: the Queen, an elected House of Commons, and a largely appointed House of Lords. The agreement of all three is necessary for legislation by statute.

The Prime Minister, who is the head of the main political party, automatically becomes the head of government following legislative elections. Formally he/she is appointed by the Queen, who also appoints Cabinet ministers on the recommendation of the Prime Minister. The Cabinet is not a legal entity but has pervasive decision-making powers. H.M. Treasury (equivalent to a Ministry of Finance) exists by royal prerogative – not by law. It is the department that leads and co-ordinates the budget process.

The United Kingdom is a unitary state, traditionally divided into two main tiers: central and local governments. Elected local councils have

considerable expenditure responsibilities but limited revenues of their own. Transfers from the central government's annual budget to local councils are sizeable. The regional devolution that took place in 1999 resulted in the establishment of a Parliament or an Assembly in Northern Ireland, Scotland, and Wales.

3.1.2. Roles and responsibilities of Cabinet and individual ministers

The government as a whole has few legal powers – mainly those of Orders of "Her Majesty in Council". Although the Prime Minister has wide powers, in general, these are not formally stated. The legal basis of the Prime Minister's conventional power over his/her government is the Sovereign's right to appoint and dismiss ministers, to summon and dissolve Parliament, and other such "royal" prerogatives exercised by the Prime Minister. The Prime Minister is also the Minister for the Civil Service, a power transferred to him/her from H.M. Treasury in 1968, although day-to-day responsibility for the civil service is handled by a minister in the Cabinet Office.

The government is composed of about 100 ministers, who are either sitting Members of Parliament (MPs) or peers of the House of Lords. About 20 ministers are members of Cabinet, the key policy-making body. Although most Cabinet members are senior members of the ruling party in the House of Commons, the Prime Minister typically includes a few peers in his/her Cabinet.[8] Cabinet is an extra-legal entity – there is no statute or statutory instrument that states its roles and responsibilities. Although there is no formal limit on the size of Cabinet, the Ministerial and Other Salaries Act 1972, limits to 19 the maximum number of salaries that can be paid to secretaries of State. In addition, two distinct ministerial titles have been retained. In the absence of other funding for salaries, this law constrains the number of Cabinet ministers to a maximum of 21.

Nearly all Cabinet ministers are heads of government departments that are administered by non-partisan civil servants. Ministers are individually responsible for the policies pursued by his/her department and collectively for the policies pursued by the government as a whole. Ministers are individually accountable is to Parliament.

3.1.3. Establishment of ministries and executive branch agencies

Ministries. The government usually does not need Parliamentary approval for the merger or abolition of existing ministries ("departments") or the creation of new ones. The legal authority for the existence of some longstanding departments, such as H.M. Treasury or the Home Office, is derived from the prerogative. In contrast, several departments were created by statute law up until 1946. However, under the Ministers of the Crown Act 1975,

the transfer functions between secretaries of State can be made by an executive order. In law, the office of secretary of State is one and indivisible (Simcock, 1992). Crucially, the government alone can decide on the number of Secretaries of State and create new departments. Also, the Ministers of the Crown Act 1975 authorises the dissolution (but not the creation) of departments or offices by order. Thus, over the past 30 years or so, the abolition, creation or merger of departments has been implemented largely on the initiative of the Prime Minister, without parliamentary approval.

Executive agencies. Since the late 1980s, when the government desired to improve management and efficiency in government departments, some 130 semi-autonomous agencies have been created (Box 3), most without parliamentary approval. Each agency produces an annual report. However, ministers are accountable to Parliament for agency performance, including the achievement of objectives and targets, as specified in framework documents. Although most executive agencies are not established by law, this is not the case for trading funds. Legislation first adopted in 1973 identified five specific trading activities considered suitable for financing outside the

Box 3. **United Kingdom: Executive agencies and other bodies**

Executive agencies

- Agencies are administrative units of government departments, primarily concerned with delivery of public services.
- Agency chief executives, appointed by ministers, are accountable within their department to establish and achieve agency-specific targets.
- Many have an internal management board (not an external governing board).
- Most staff are civil servants, subject to the Civil Service Code.
- They must produce agency annual reports and accounts.

Non-departmental public bodies (NDPBs)

- Entities that operate at arm's length from ministers.
- All are accountable to Parliament.
- Two main types:
  - ❖ **Executive NDPBs:** carry out executive, administrative, regulatory or commercial functions; generally not part of the Crown; employ their own staff; have their own budgets; have separate legal identity.
  - ❖ **Advisory NDPBs:** set up by ministers to provide advice; rarely incur spending on their own account; seldom have separate legal identity.

Source: Wall and West, 2003.

estimates and appropriations process. The Government Trading Act, 1990, permits the creation of a trading fund for any activity of a department where operations could be largely self-financed. Trading funds enjoy considerable financial autonomy, including power to borrow and invest money, and to carry forward cash reserves. Discretionary power used by the minister responsible for the trading fund is exercised with Treasury concurrence (Daintith and Page, 1999, p. 139).

Non-departmental public bodies (NDPBs). These are entities that are part of general government. "Executive" NDPBs are generally legally incorporated either by a specific act of Parliament, by Royal Charter, or under the Companies Act. Governance structures are generally not specified in the underlying legislation. All NDPBs are headed by governing boards, typically comprising a chair and a number of non-executive members. NDPBs carry out a wide range of executive, administrative, commercial, regulatory and advisory functions. In 2003, there were 811 NDPBs.

National Health Service. The National Health Service (NHS) was first set up in 1948 to provide universal healthcare for all citizens. The NHS Act 1977 provides for the establishment of various health authorities and primary care trusts. Significant changes were introduced by the NHS and Community Care Act 1990 which, by 1995, allowed all health care to be provided by independent NHS trusts with their own managements. The NHS is funded by the taxpayer and managed by the Department of Health. The overwhelming majority of the NHS resources and cash are voted in the annual estimates that form part of the annual appropriation act, that is, Parliament approves NHS expenditure when it approves the estimates.

3.1.4. Responsibilities of senior civil servants

Civil Service Code – not a law. All civil servants in the United Kingdom are permanent and non-partisan. Unlike continental European countries, the civil service has never been governed by a general law that establishes public servants' rights and responsibilities. The management of the civil service is one aspect of the royal prerogative exercised by ministers on behalf of the Crown, who alone issue instructions concerning civil service management (Cabinet Office, 1995, paragraph 2.15). Parliamentary committees have called for statutory backing to be given to essential civil service values and standards.[9] In 1996, a Civil Service Code was adopted by statutory instrument. The code lays out general principles, such as "civil servants should endeavour to ensure the proper, effective and efficient use of public money". It also encourages civil servants to report possible unlawful activities, although detailed sanctions are not prescribed. The code was amended in the late 1990s to maintain a unified civil service after devolution: Scottish and Welsh civil servants are subject to the provisions of the code.[10]

A **Senior Civil Service** was created in April 1996 by government decision. The associated framework gives limited scope to the employing department or agency to vary terms and conditions. Senior civil servants have a common pay, contracts, job appraisal and training systems. Although the political impartiality of the civil service is embodied in the Civil Service Code, there are concerns about the increasing politicisation of the civil service (for example, see *www.the-hutton-inquiry.org.uk/content/report/chapter12.htm#a90*). Just as civil servants are subject to a code, so are all United Kingdom ministers (including Scottish ministers), whose Ministerial Code requires them to uphold the political neutrality of the civil service.

Accounting Officers (AOs).[11] Statute law places special responsibilities for financial management on some senior civil servants. Both the E&AD Act 1866 and the GRA Act 2000 state that H.M. Treasury (not the Chancellor of the Exchequer) appoints an official in each department as its "accounting officer" (AO). The AO, who is normally the most senior officer of a department or agency, is responsible for overall organisation, management and staffing of his/her entity. In particular, the AO is "responsible for the preparation of the department's resource accounts and their transmission to the C&AG" (s. 7, GRA Act 2000). Other responsibilities of AOs are set out in detail in a Treasury memorandum, which emphasises personal propriety, regularity and value-for-money in all financial decisions of the department (H.M. Treasury, 1997). Treasury guidance to AOs is applicable to all government departments and agencies, including NDPBs, NHS trusts and trading funds.

3.1.5. Establishment and roles of parliamentary committees

Parliamentary committees are established on the authority of parliamentary Standing Orders (SOs). "Select Committees" of the House of Commons are the most important for budget processes. Select committees are "permanent" committees for a given Parliament; standing committees are not permanent: they are set up to consider one specific bill.[12] Since 1979, there has been one select committee for each government department, whose mandate is "to examine expenditure, administration and policy of principle government departments" (House of Commons SO No. 152). In addition, there are about 20 other non-departmental select committees, including the Public Accounts Committee (PAC). There is no Budget Committee whose sole task is to examine budget strategy and propose amendments to the budget proposals of the government.[13] However, the Treasury Committee always conducts an inquiry into the annual budget and pre-budget report.[14] The Liaison Committee, comprised of the 34 chairmen of select committees, chooses which select committee reports should be debated in the plenary session of the House of Commons.

The PAC is amongst the most influential parliamentary committees, although its focus is on *ex post* budget outcomes, not *ex ante* budget projections. It consists of 16 back-bench MPs, drawn from political parties in the same proportion as the House of Commons. By convention, an Opposition MP chairs the PAC, which was made permanent in 1862. Its mandate is "to examine the accounts showing the appropriation of the sums granted by Parliament to meet the public expenditure" (SO No. 148). The PAC is empowered to call persons to report from time to time. In particular, AOs are obliged to answer questions concerning budget outcomes.

All members of the House of Commons are subject to the Code of Conduct for members, first published in 1996. A similar Code of Conduct was adopted by the House of Lords in 2002. The House of Lords has several select committees, including the Economic Affairs Committee whose remit encompasses the management of the economy. However, since the upper House does not consider money bills, these committees are not directly concerned with budgetary matters.

3.1.6. Establishment and roles of other constitutional bodies

The House of Lords is the highest court in the United Kingdom. A Parliamentary Ombudsperson was established by statute – the Parliamentary Commissioner of Administration Act 1967. A major role of the Ombudsperson is to investigate complaints of maladministration. Other independent bodies include the Electoral Commission.

3.2. Role and responsibilities of sub-national governments

The United Kingdom is a unitary country, though in recent years, administrations in Scotland, Wales and Northern Ireland have been given devolved responsibility over certain areas of government activity. In particular, in 1997, it was decided to establish a Parliament in Scotland and an Assembly in Wales. To support citizens' wishes, the United Kingdom Parliament approved the Scotland Act 1998 and the Government of Wales Act 1998. The United Kingdom Parliament also approved a directly elected Northern Ireland Assembly, which, along with the Executive Committee of Ministers for Northern Ireland, was mandated to run most of the province's domestic affairs. However, direct rule from London was re-established in 2002.

The Scottish Parliament has full legislative powers in various areas that cover many functions of government. Excluded are areas "reserved" to the United Kingdom Parliament, such as defence, external affairs, economic and monetary policy, employment legislation, social security, and energy. The Scottish Parliament adopts an annual budget that funds all the Scottish Executive departments, including those for education, health, rural affairs,

justice, and finance and central services. To guide aspects of budget processes, the Scottish Parliament adopted a Public Finance and Accountability (Scotland) Act in 2000.[15] It provides a legal framework for public resources and finances (including payments out of the Scottish Consolidated Fund) and specifies the responsibilities of Audit Scotland and Accountable Officers. Most resources for the Scottish budget come from a block grant appropriated in the annual budget of the United Kingdom. The Scottish Parliament is solely responsible for the allocation of the Scottish budget, including making transfers to its councils (local governments). It also has the power to vary basic income tax rates in Scotland, although at least until 2004, it had chosen not to exercise this power.

A different situation prevails in Wales, which does not have full legislative authority, where the Assembly is only empowered to adopt secondary legislation needed to meet distinct Welsh needs. Thus, although the Assembly for Wales adopts an annual budget, it does not have a public finance and accountability law as in Scotland. However, it has adopted Local Government (Wales) secondary legislation.

Throughout the United Kingdom, local governments are run by locally elected councillors. In some cases there are a number of tiers of local government, each with different responsibilities. Local government acts and other United Kingdom legislation specify the statutory functions of local authorities. Local authorities prepare and approve their own budgets, which are funded in part by local property taxation and by other local incomes such as fees and charges for services. Education, social services and housing are the largest locally provided services. Since expenditure assignments are well in excess of local revenues, local authorities are heavily dependent on central government transfers, voted in the central government budget.

4. Legal provisions for each stage of the budget cycle

The financial procedures of the United Kingdom consist of three largely separate but connected cycles. First, the budget cycle which sets out the broad financial details, the management of the economy and the authorisation of taxation. This culminates in a finance bill, which combines changes in tax policies with those in the administration of the tax system. Its passage puts into law the elements that the Chancellor outlines in his/her budget material. It represents the culmination of the revenue side of the process. Second, the estimates, which follow the budget, culminate with the authorisation of public spending. The spending framework is embedded in the fiscal framework, with fiscal rules approved by the government determining the overall spending envelope. Third, the reporting cycle, which provides

information to Parliament and the public on what public money has been spent on, and how effectively it has been used.

4.1. Budget preparation and presentation by the executive

There is no framework law for guiding budget preparation, where H.M. Treasury plays a crucial role. A draft budget is prepared by H.M. Treasury and forwarded to Cabinet for approval (via a sub-committee). The Chancellor of the Exchequer presents the budget to the House of Commons in a formal speech on "budget day". The tax measures announced in the budget are traditionally introduced in the House of Commons in a single, comprehensive finance bill, which is published some time after budget day.

4.1.1. Institutional coverage of the budget

The expenditure estimates of the draft budget cover the use of resources and the cash needs of all central government departments (including agencies under departments), the two houses of Parliament, the NAO, the Ombudsman, the Electoral Commission, transfers to local governments (including to the devolved Assemblies in Scotland and Wales and local councils in England), hospitals and other healthcare organisations, and some NDPBs. The institutional units covered in the estimates are decided by H.M. Treasury, not by statute.

4.1.2. Extrabudgetary funds and earmarking of revenues

Unlike some countries, pension and social security funds are included in the budget. The annual supply estimates include the net resources for various unfunded public pension schemes, including those covering teachers, NHS workers, the judiciary, the armed forces, and civil servants. These schemes derive their funds from the Consolidated Fund. The detailed estimates include – as "non budget" outlays – government expenditure funded from non-Consolidated Fund sources, especially the National Insurance Fund (NIF). The various regimes for social security benefits are governed by various laws, especially the Social Security Act 1986 (which provides the government with extensive powers to make regulations, including for contributions paid by employers and employees), the Contributions and Benefits Act 1992, and various pension acts. Thus, although the NIF has separate statutory authority, its resource needs are shown explicitly in the annual budget. These greatly exceed net cash needs from the Consolidated Fund, since most funding is from contributions paid into the NIF.

In contrast, the financing and accounting of trading funds is outside the system of resource estimates and accounting. It is expected that a trading fund will entirely cover its costs by charging for the service it provides (see *Government Accounting*, s. 7.2 for detail). For each department the annual

estimates of expenditure also provide authorisation to retain certain income in aid of spending. This is known as "appropriations-in-aid" (see below). However, Parliament approves these net resources.

4.1.3. Definition of budget aggregates

Aggregate revenues, expenditures and fiscal balance are not defined in the law. Under the Finance Act, 1998 (s. 56), the contents of any documents that H.M. Treasury lays before Parliament must conform to relevant provisions of the Code for Fiscal Stability, which is also drawn up by the Treasury (s. 55). Thus, by law, H.M. Treasury is given full discretion to define the key budget aggregates. The annual financial statement and budget report (FSBR) and annual economic and fiscal strategy report (EFSR) show budget aggregates used by H.M. Treasury for budget preparation and monitoring of the overall fiscal situation. Total revenues and expenditures conform to revenues and expenditures as defined in national accounts – the ESA 1995 (EUROSTAT, 1996).

In budget reports such as the FSBR, a distinction is made between current and capital budgets, in part so as to be able to monitor the fiscal rules (see below). Key aggregates monitored closely are:

Current budget balance (= current receipts minus current expenditures inclusive of depreciation)
+ Net investment (= gross investment minus asset sales minus depreciation)
= Net borrowing.

For expenditure control purposes, H.M. Treasury has defined various expenditure aggregates, which have varied over the past few decades (Parry and Deakin, 2003). Since 1998, H.M. Treasury has controlled expenditure by two main aggregates: the departmental expenditure limit (DEL) and annually managed expenditure (AME). DEL is spending that is planned and controlled for three years in biennial spending reviews. AME is expenditure that cannot reasonably be subject to firm, multi-year limits in the same way as DEL. It includes social security benefits, local authorities' self-financed expenditure, central government gross debt interest, payments to EU institutions and some non-cash items.

Total managed expenditure (TME):

= DEL + AME = Current expenditures + depreciation + net investment.

4.1.4. Fiscal rules

Two fiscal rules have been defined and actively used by the government since 1997. Parliament has never adopted a statute to endorse the two rules, which are contained in the government's 1998 EFSR (see *www.archive.official-documents.co.uk/document/cm39/3978/chap3.htm#fiscal*). The first rule is a "golden rule": it requires over the cycle that the government will borrow only to invest

and not to fund current spending. Second, the sustainable investment rule requires that public sector net debt as a proportion of GDP will be held at a stable and prudent level – currently defined as below 40% of GDP over the economic cycle. H.M. Treasury is responsible for defining and measuring the concepts, such as "investment" and "net debt".

4.1.5. The timetable for budget preparation and presentation to Parliament

The timetable for the preparation of revenue and expenditure estimates, and the fiscal strategy is at the discretion of the Cabinet and H.M. Treasury. The only date written into an official document to guide Cabinet and/or the Treasury is that found in the House of Commons Standing Orders, namely 5 August. This is the last day on which the expenditure estimates debate in the House of Commons is to be concluded. In practice Cabinet approves the budget shortly before the Chancellor's budget day speech, which in recent years has been held in March or April.[16]

4.1.6. Approval process within the executive

The budget approval process within the executive is not laid down in law. H.M. Treasury's Budget Directorate sets the agenda and guidelines for technical discussion of departmental demands for money for the upcoming year. The draft budget is approved by the Cabinet Committee on Expenditure, which is chaired by the Chancellor of the Exchequer, then endorsed by the Cabinet as a whole. As from the 1990s, H.M. Treasury's management and control of the public expenditure system (PES) became more formalised. Internal rules and procedures may be found in *Government Accounting*.

4.1.7. Documents to accompany the budget law

There is no legal obligation to present analytic budget documents to accompany draft annual budget laws, that is, finance acts, consolidated fund acts and appropriations acts. The adoption of these laws – at non-synchronised times for revenues and expenditures – is a legal formality that endorses the government's annual budgetary decisions. In contrast, the law requires H.M. Treasury to prepare documents to accompany the Chancellor's budget speeches. The discussion below relates to these documents.

Medium-term macroeconomic framework and fiscal strategy. Under the Finance Act, 1998 (s. 156), for each financial year, H.M. Treasury (not the Chancellor of the Exchequer) is required to lay before Parliament a pre-budget report (PBR); and a debt management report. In addition, H.M. Treasury publishes the annual FSBR and EFSR. These are not required by the Finance Act.

Under the 1998 Act, H.M. Treasury (not Parliament) decides on both the content of the documents and the occasions on which those documents are laid before Parliament. The CFS provides the framework for the Treasury (s. 155, Finance Act 1988). Technically, the code itself is not a law since it was not approved by the Lords (it formed part of the Finance Act 1998 which, as a money measure, was not considered by the Lords), although it was approved by resolution in the House of Commons. The CFS requires the government to state and explain its fiscal policy objectives over the life of the Parliament, in conformity with the principles of the code. These objectives, and the accompanying operating rules, shall be restated in each budget (s. 9, CFS). The code also sets out the conditions under which the government may change its fiscal policy objectives and operating rules (s. 11).

The code includes some details on the contents of the various reports. H.M. Treasury is required to publish the PBR at least three months before presentation of the main budget. Only one PBR is required each year, even if there is more than one budget. The PBR is consultative in nature – it provides proposals for significant changes in fiscal policy under consideration by the government. The PBR is also required to include an economic and fiscal projection and an analysis of the impact of the economic cycle on the key economic aggregates.

The FSBR must be published by H.M. Treasury at the time of the budget. Minimum requirements are specified in the CFS (ss. 18, 20-25). These include economic and fiscal projections and an explanation of significant fiscal policy measures introduced in the budget. The projection period is specified to be not less than two full financial years following the date of publication (which means two years beyond the budget year), as well as the publication of comparative data for key fiscal aggregates covering the two previous years.

The EFSR is also required to be published annually by H.M. Treasury, usually (but not necessarily) at the time of the budget. The CFS specifies that the contents of the EFSR include:

- The government's long-term economic and fiscal strategy, including any long-term objectives for key fiscal aggregates.
- An assessment of recent short-term outcomes against this long-term strategy.
- The consistency of the short-term outlook and the long-term strategy with European commitments.
- Illustrative projections of the outlook for the key fiscal aggregates for a period not less than the next 10 years, based on plausible assumptions, so as to shed light on the intergenerational impact and sustainability of fiscal policy.[17]

- Analysis of the impact of the economic cycle on key fiscal aggregations, including estimates of the cyclically adjusted position.

For the debt management report, the CFS specifies that the government shall report annually on the structure and cost of government debt, giving sufficient information to allow the public to scrutinise the conduct of its debt management policy. The CFS also specifies that the government shall set remits for its agents in the annual debt management report, including a forecast of net funding through National Savings, the overall size of the gilts issuance programme, the planned maturity structure, the proportions of index-linked and conventional gilts, and the gilt auction calendar.

New measures *versus* existing expenditure policies. There is no law requiring a distinction between new and current programmes. No new service can attract resources without Parliament voting the resources through the supply procedure. The CFS requires the FSBR to explain significant fiscal policy measures introduced in the budget and, if necessary, how these measures restore the path of the public finances to a position consistent with fiscal policy objectives and operating rules, and European commitments.

Performance-related information. Neither statute law nor the CFS requires programme performance indicators to accompany budget submissions to Parliament. However, since 1991, each department has been providing Parliament with annual reports that outline not only recent past activity, but also short-term future expenditure plans. The new government of 1998 renewed the emphasis on performance, given the identified need to improve the provision of public services. The government required each department to prepare a public service agreement (PSAs) that lay out the aims and objectives of each department as well as performance indicators. The government's review in 2000 resulted in revised PSAs. Emphasis was given to departmental outcomes, including executive agencies' contribution to such outcomes. These are specified in service delivery agreements (SDAs), which are more detailed documents to support the outcome-oriented PSAs (Ellis and Mitchell, 2002). The PSAs and SDAs are not legally binding documents. As in other areas of budget management, H.M. Treasury plays a dominant role in providing oversight.[18] The NAO is responsible for validating the data systems used to report progress against the PSAs.

Tax expenditures, contingent liabilities and fiscal risks. The CFS requires that the fiscal projections contain "an analysis of risk surrounding the economic and fiscal outlook, including government decisions and other circumstances that have still to be quantified with certainty, other material contingent liabilities and an indication of past forecast errors for key fiscal and economic aggregates".

Other information required by law. Besides the above, the CFS sets out specific information to be provided, including:

- A breakdown of expenditure and revenue by sector and economic and/or functional category.
- A statement outlining proceeds received from the sale of public assets.
- An explanation of significant accounting changes. H.M. Treasury may also invite the NAO to audit any changes to the key assumptions underlying fiscal projections.
- The structure of government borrowing, the cost of government debt, and other details for the Debt Management Office's annual report.

4.1.8. Budgets of Parliament and other constitutional bodies

Both the House of Commons and the House of Lords have their own estimates in the annual appropriation acts. For the House of Commons, SO No. 144 specifies that the Finance and Services Committee is responsible for preparing the estimates the House of Commons. This select committee also monitors the financial performance of the House of Commons. For the House of Lords, a House Committee, advised by a management board, was established in 2002. This committee is required to agree on the annual and supplementary estimates and approve the House of Lords annual report. Other constitutional bodies[19] also prepare their own budgets independently and have separate estimates.

4.2. Budget process in Parliament

There are two separate parliamentary processes for budget aggregates: one for revenues and another for expenditures (Box 4). The tax measures announced in the budget are traditionally presented to Parliament in a single, comprehensive finance bill, which may be amended by majority vote in the House of Commons. The House of Commons lacks effective power to increase or change the government's expenditure estimates. Its main option for changing substantially the expenditure estimates would be to bring down the government via a vote of no-confidence. This has never happened in recent United Kingdom history, mainly because the Cabinet and the ruling party's whip[20] ensure that party unity is maintained. Although the usefulness of very brief parliamentary debate of the expenditure estimates in the House of Commons has been questioned, proposals to change the existing system have failed.[21]

The House of Lords plays no substantive role in approving the annual budget law. When the Parliament Act was adopted in 1911 (following the Lords' rejection of the government's budget for 1909), the upper House lost its

Box 4. **United Kingdom: Budget processes in Parliament**

- The Chancellor of the Exchequer gives his/her budget speech and outlines the government's fiscal policy strategy to Parliament.
- The timing of the budget speech is at the discretion of the government.
- Tax measures may take effect on the night of the budget speech. A Finance Bill is submitted to the House of Commons. The bill is scrutinised in committee, where both the government and the opposition parties may propose amendments and new clauses.
- The Finance Bill passes to the House of Lords for debate only. After the House of Lords debates the bill, it gains royal assent.
- The expenditure of individual departments is scrutinised by the relevant departmental select committee, but this is not mandatory.
- The Liaison Committee of the House of Commons decides on which select committee reports should be discussed in plenary session.
- The House of Commons adopts a resolution approving the main estimates and any revised estimates.
- The draft Appropriation Act is formally approved.

budget veto rights. Today, the Lords may delay any "money bill" by up to one month. In practice, the budget "debate" in the House of Lords is a one-day formality. Similarly, royal assent has been a formality since the supremacy of Parliament over the King was recognised in the 1689 Bill of Rights.

4.2.1. The timetable for budget adoption and constraints on the budget debate in Parliament

In contrast to many other countries, the main estimates are generally presented to Parliament after the beginning of the fiscal year (1st April-31 March). SO No. 54 limits consideration of the estimates in the House of Commons to three days per session, that is, a parliamentary year. In practice, the need to obtain royal assent of the appropriation act before Parliament rises for the summer recess means that the estimates typically could not be presented later than the end of June. The Liaison Committee recommends which estimates (or portions of them) are debated.

Parliamentary proceedings on consolidated fund and appropriation bills, which take place later than the three-day debate on the estimates, have been reduced to mere formalities. SO No. 56, adopted in 1982, dispenses with the

usual obligatory intervals between 2nd and 3rd readings, implying that government proposals for providing the annual legal authority for public spending does not pass through any parliamentary committee stage (Erskine May, 1997, p. 739). Such practice is highly unusual in OECD countries. Formalities in the House of Lords and royal assent are required before the expenditures to be paid out of the Consolidated Fund become law in the form of an annual appropriation act.

4.2.2. Provisional budgets

Since the government's draft budget is often presented to the House of Commons after the beginning of the new financial year, and appropriation acts are not usually adopted until about the fourth month of the new financial year, provisional legal authority to spend has to be in place prior to 1st April. To this end, the House of Commons routinely approves, 4-5 months before the start of a new financial year, a "Vote on Account" that authorises spending by government departments and constitutional bodies for the first few months of the upcoming financial year.[22] Typically the amount voted is 45% of the expenditure estimates for the current year. The votes on account are given legislative force by the winter consolidated fund acts, which provide, in one line, the total amount that can be issued out of the Consolidated Fund in the new financial year. Neither the amount, nor the timing of annual votes on account has legislative basis; rather it is a longstanding convention, which is set out in *Government Accounting* and mentioned in the Standing Orders of the House of Commons.

The Parliament in Scotland has adopted a different procedure, which is a more akin to "standard practice" in other countries. If the annual budget act is not adopted by the Scottish Parliament before the beginning of the financial year, the amount of resources used in a given month may not exceed the greater of *a)* one-twelfth of any amount authorised in the previous financial year, or *b)* the amount used for that purpose in the equivalent month of the previous year [Art. 17, Public Finance and Accountability (Scotland) Act 2000].

4.2.3. Powers of amendment

The House of Commons cannot propose amendments to increase total expenditure, change the composition of spending, or reduce revenues. The basis for this restriction is the 300-year-old SO No. 48 of the House of Commons, which states that "the House will receive no petition for any sum relating to public service unless recommended from the Crown". The Crown's recommendation lays down a maximum charge on public funds, as well as its objects and purposes (Erskine May, 1997, p. 740). Clearly a representative of the Crown would not propose revisions to the budget proposals of the

Chancellor of the Exchequer. Also, since parliamentary committees are dominated by members of the ruling majority party, proposals are not made to revise the main estimates, as these would be overridden by the government. Thus, the House of Commons may only reduce a particular item of expenditure. Any revisions to the estimates that are incorporated in the annual appropriation act are very small – the approved budget is extremely close to the main estimates presented by the government in the budget speech.

4.2.4. Approval of resources

The right to initiate the kinds and levels of taxation rests firmly with the executive. This is a long-standing tradition that is not specified in Standing Orders (Daintith and Page, 1999, p. 108). Parliament formally approves revenues – in a finance bill – well after the start of the financial year. The tax measures adopted in the budget are legislated at a time different from the appropriation of expenditures for the same year.

Most United Kingdom taxes, including all indirect taxes, are permanent. As major exceptions, the government's authority to impose personal income and corporation taxes has to be renewed by legislation every year. This is done by adopting an annual finance bill, which also imposes new duties or adjusts the rates of permanent duties so that revenues match proposed expenditures and deficit targets. For more than three centuries, proposals for raising taxation – which were initiated by a government minister – originated in the House of Commons Committee of Ways and Means. However, this committee was abolished in 1967. Today, after a one-day debate at the second reading, the convention is for any controversial measures of the draft finance bill to be considered by the House of Commons Committee of the Whole House. Less controversial detailed revenue proposals are sent to a standing committee (despite the name, "standing" committees are not permanent). Many amendments may be proposed by select committees, but only those selected by the chairmen of the standing committee are debated. After the third reading in the House of Commons, the draft finance bill passes through all legislative stages of the House of Lords in one day, as the upper House is prohibited from making any amendments.[23]

Separate primary legislation is not required to make tax changes – simple resolutions of the House of Commons are adequate.[24] By virtue of the Provisional Collection of Taxes Act, 1968, some income and excise tax changes and the validation of existing taxes (but not the approval of new taxes) may come into effect immediately following the Chancellor's budget speech.[25] Fees collected or proceeds of assets sales by departments may be retained and used by them, outside the Consolidated Fund. The amounts expected in the upcoming fiscal year are separately approved in the supply estimates as

"appropriations-in-aid" (see below). Should actual fees collected or asset sales revenues be higher than projected, departments may not spend these revenues, unless Parliament provides authority through the adoption of a supplementary estimate.[26]

4.2.5. The nature, structure and duration of appropriations

It is a prerogative of H.M. Treasury to specify the structure, format and duration of the estimates and decide which totals are subject to parliamentary control. Parliament's control totals are much more aggregated than those used by H.M. Treasury for expenditure control purposes. Since the adoption of resource-based accounts in 2001/02, the overall structure of the estimates, as adopted by the annual appropriations acts, is shown in Table 1.

Table 1. **United Kingdom: Format of appropriation adopted by Parliament for Department X**

Estimate/Request	(1) Net resources authorised for use	(2) Grants out of Consolidated Fund (net cash needs)	(3) Operating appropriations-in-aid	(4) Non-operating appropriations-in-aid
"Programme 1"	P_1		A_1	
"Programme 2"	P_2		A_2	
"Programme 3"	P_3		A_3	
Etc.				
Total	$T_1 = P_1 + P_2 + P_3$	T_2	$T_3 = A_1 + A_2 + A_3$	T_4

Parliament approves expenditures on two bases: first, the consumption of resources (authority to enter commitments that may not necessarily be paid for in the fiscal year) and second, the net cash requirement for all payments, taking into account cash receipts associated with appropriated income. Expenditure is on a net basis, that is, after deduction of revenues collected and retained by spending departments/agencies. The 1891 Public Accounts and Charges Act [s. 2(2)] authorises departmental fees to be appropriated in aid of their estimates; such fees are not paid into the Exchequer account at the Bank of England.

For current expenditures, "net resources used" (column 1) is the sum of administrative and other current expenses, and grants (all on an accrual basis) minus "operating appropriations-in-aid" (column 3). The latter is the amount that departments/agencies may spend from their own revenues. The retention of fees, etc., for spending is subject to oversight by H.M. Treasury (s. 2, GRA Act 2000). Since appropriations-in-aid are also approved on an accruals basis, the GRA Act 2000 makes provision for cash being received in a year other than that for which the appropriations-in-aid were approved. Should

departments collect more revenues than shown in the appropriations act as appropriations-in-aid, they must return the excess to the Consolidated Fund as extra receipts.

Capital expenditures are also appropriated on a net basis, that is, after deduction of "non-operating appropriations-in-aid", which are mainly proceeds from sales of departmental assets. All appropriations-in-aid are detailed comprehensively in footnotes to the estimates. Failure to include a relevant item in a footnote would mean that the income in question could not be applied as appropriations-in-aid.

The unit of appropriation in the supply process is the estimates for which the House of Commons takes a separate decision. For 2003/04, there were 58 estimates.[27] When the supply estimates are presented to Parliament, for each department and for each "programme" (or Request for Resources, RfR), expenditure is broken down as follows:

a) Spending in DEL:

- Central government spending (with subheads).
- Support for local authorities (with subheads).

b) Spending in AME:

- Central government spending (with subheads).
- Support for local authorities (with subheads).

c) Non-budget.

4.2.6. Carryover of appropriations and borrowing of future appropriations

The budget year begins on 1st April. Expenditure and appropriations-in-aid are annual and, in principle, there is no borrowing against future income (see s. 1, GRA Act 2000). Besides the expenditure, which is controlled by Parliament, H.M. Treasury has its own internal expenditure controls. For the sub-total DEL, where expenditure limits are fixed for three years (and revised every two years), H.M. Treasury authorises departments unlimited carry forward within the three-year approved amounts. This is known as end-year flexibility. The objective is to encourage departments and their executive agencies to plan over the medium term and avoid wasteful end-year surges. Since AME is controlled annually, unspent provisions may not be carried over.

4.2.7. Public debt approval

There is no separate public debt act. Instead there are a number of statutes, several of which provide H.M. Treasury with considerable power in the management of public debt, including proposing debt limits to the government for fiscal management purposes and the issuing of securities under the 1877 Treasury Bills Act. The National Loans Act 1968 (itself an

amendment of s. 21, E&AD Act 1866) establishes a statutory fund, the National Loans Fund (NLF), used to finance central government operations through borrowing. H.M. Treasury has wide discretion as to how to raise money by borrowing using the NLF.

The United Kingdom Debt Management Office manages the Debt Management Account, which was established under the Finance Act 1988, which amended the National Loans Act 1968. H.M. Treasury's wide powers for acquiring, holding, transferring or redeeming securities are spelt out in Schedule 5A to the original 1968 Act. The Finance Act 2003 amended the National Loans Act 1968 to repeal the cap on borrowing by the Debt Management Office. However, overall government borrowing is limited by the government's "golden rule" (see above). Annual debt/borrowing government guidelines are restated in each budget – a requirement of the CFS. Since 1997, successive budgets have restated the sustainable investment rule that net public debt will be maintained at below 40% of GDP over the economic cycle.

The Local Government Act 2003 allows local councils in England and Wales to borrow for capital expenditure, provided that the financing of expenditure is affordable from within local authority resources. The act requires each local authority to abide by a professional "prudential" code that requires them to determine that any proposed borrowing is both prudent and affordable through the setting of local prudential limits based on a range of financial indicators. Local authorities are not permitted to borrow for purposes other than for treasury management in the normal course of business.[28] Local government borrowing in foreign currency requires H.M. Treasury approval. The government (not Parliament) and the National Assembly of Wales reserve power to override local authorities' self-determined prudential limits should national economic circumstances require (s. 4).

Concerning debt guarantees, the CFS requires the economic and fiscal projections to include, *inter alia*, contingent liabilities. The granting of guarantees requires the consent of H.M. Treasury. Chapter 26 of *Government Accounting* provides guidance to departments and of the need to report to Parliament.

Finally, the CFS requires financial statements to include measurement of the government's fiscal policy objectives and rules compared with the government's European commitments, in particular the Stability and Growth Pact. Debt developments are also monitored in budget reports, using the Treaty of Maastricht's general government gross debt limit of 60% of GDP as a reference.

4.2.8. Promulgation, veto and publication of the adopted budget

Normal bills require a first reading, second reading, committee and report stages and a third reading before being passed to the other house where they go through the same process. With consolidated fund bills, however, second and third readings occur without any debate and there is no committee stage. The Lords' consideration is purely formal and the bill becomes a consolidated fund act on royal assent. A similar procedure occurs for consolidated fund (appropriation) bills, which are introduced immediately after the related estimates debates, and provide a more detailed legislative request for supply, setting out the ambit and each request for resource.

4.2.9. Supplementary budgets (rectifying laws)

Supplementary estimates may be sought to either increase the amounts needed for existing services or to cover the cost of a service newly imposed upon the government by statute. There are no legal limits on the number of supplementary estimates. Typically, supplementary supply estimates, if necessary, are presented three times: in summer (June), winter (November) and spring (February). Formal statutory authority for extra funds may be provided in the summer, following the estimates day debates in the House of Commons, with extra spending being incorporated in the annual appropriation act. In contrast, if additional budgetary authority is sought in November or February, consolidated fund acts are used. For winter supplementary budgets, the same act that provides provisional legal authority to spend in year (+1) is used to approve supplementary spending for the remainder of year (0). In 2004, the House of Commons agreed to reform this process. As from the parliamentary session for 2004/05 there will be two appropriation acts, one in March appropriating the expenditure for the financial year just ending and one in July, as is currently the case.

If expenditure exceeds the annual estimate and it is too late to seek a supplementary estimate, the excess will appear in a department's resource account and will be reported to the PAC by the C&AG (see section 4.5 below). Subject to PAC's report, the necessary provision is sought in an excess vote. H.M. Treasury presents a statement of excesses to Parliament, usually in February. *Ex post* parliamentary authority for the overspending is then obtained (*i.e.* 10-11 months after the financial year has closed). It is rare for large amounts to be approved in this way.

4.2.10. Budgetary implications of other bills

A principle of constitutional propriety is that any new functions to be exercised on an ongoing basis and financed out of money provided by Parliament through the annual appropriation act should be authorised by a

specific act, supported by a financial resolution. Although no law establishes this principle, the PAC and H.M. Treasury endeavour to uphold it. Nonetheless, at times, the government makes exceptions to "good constitutional practice" and may use the annual appropriation bill as the formal way of introducing new expenditure policies. Prior to this, new expenditures are decided in the context of biennial spending reviews, for which departments prepare cost estimates, including the expenditure implications of other bills.

4.3. Budget execution

Since the adoption of the Exchequer and Audit Departments Act 1866 (parts of which are still in force), budget execution has been put on a statutory basis. However, H.M. Treasury is accorded considerable discretionary powers to control expenditures, with some of these powers preceding the 1866 Act. "Treasury control" is implemented largely by administrative means.

4.3.1. Apportionment of expenditure authority

The appropriation act formally grants supply to the Crown. The Queen then makes it available to the government by signing a royal order, authorising H.M. Treasury to issue funds to departments from the Consolidated Fund. This procedure is laid out in s. 14 of the E&AD Act 1866. The appropriation act does not, by itself, authorise spending by individual departments. Such authorisation is a matter determined under the executive's internal arrangements. This is one of several prerogative powers of H.M. Treasury, which apportions its control aggregates and monitors budget implementation at regular intervals.

4.3.2. Cancellation of budget authority and other in-year expenditure controls

The E&AD Act 1866 permits H.M. Treasury "to restrict the sum to be issued or transferred from time to time to the credit of accounts of principal accountants". This is an administrative measure which effectively means that the accounts do not necessarily need to be fully funded at all times: they merely have to contain sufficient funds to meet immediate requirements. Control over spending is exercised by H.M. Treasury, which controls various subtotals of the annual appropriations approved by Parliament. Cash limits were introduced in 1976, when the previous volume-based limits were found to be inappropriate in times of high inflation. Further changes were made in the control aggregates during the 1980s and 1990s. H.M. Treasury's current expenditure control system is based on DEL and AME and works in parallel with the aggregates "controlled" by Parliament. In exercising control, H.M. Treasury may set limits below those of the totals embodied in appropriation acts. In practice, the Treasury operates limits on DEL and AME flexibility, with an eye

on the overall fiscal rules. Since the Treasury control system acts on more detailed aggregates than those approved by Parliament, H.M. Treasury generally does not need to cancel parliamentary budget authority in order to achieve the government's fiscal rules.

4.3.3. Emergency spending, excess spending and contingency funds

Unexpected demands upon resources are brought before Parliament. A "Vote of Credit" is a demand for a lump sum for which the objects of the proposed expenditure in the financial year can only be stated in general terms.

Expenditure in advance of appropriation approval may be made from a Contingencies Fund. First established in 1862, this fund was given statutory authority in the Contingencies Fund Act 1974, which permits the government to make temporary and urgent expenditures that have not yet been voted by Parliament. The act establishes the capital of the fund at 2% of the authorised supply expenditure of the previous financial year. The act does not lay down rules for regulating any temporary advances from the fund, for which the government has discretion. Treasury rules, set out in *Government Accounting*, govern the use of repayable advances from the Contingencies Fund, for which accounts are presented annually to the House of Commons.

Reserves in the estimates should be distinguished from Contingencies Fund advances. Whereas the latter are for financing expenditure that exceeds parliamentary limits, reserves are included in annual estimates (and appropriations) at the discretion of H.M. Treasury. When the new expenditure control system was introduced in 1998, DEL had a small "reserve" and AME had a "margin". The DEL reserve is deliberately kept small, so as to avoid financing increases in the costs of existing policies, although small new policy decisions may be allowed. Treasury rules for using reserves are strict: usually offsets are required and use of the reserve usually entails loss of end-year carryover flexibility (Daintith and Page, 1999, p. 187). Decisions on the use of the reserve are usually made by the Chief Secretary to H.M. Treasury.[29]

4.3.4. Transfer and virement of appropriations within the year

One of the prerogatives of H.M. Treasury is to control transfers of budgetary authority. Under the present resource accounting framework, the rules are described in Table 2.

H.M. Treasury uses its discretion in approving transfers. If the proposed reallocation is thought to be of so great a departure from the original estimate, then it will be brought before Parliament by means of a supplementary estimate.

Table 2. **United Kingdom: Transfers of budgetary authority**

Transfers between	Subject to parliamentary control (requires a supplementary estimate)	Subject to Treasury control
Between programmes (RfRs)		
1. Current	Yes	
2. Capital	No	Yes
Into administrative costs, within programmes (RfRs)	No	Yes

4.3.5. *Cash planning and management of government assets and debt*

The principle of responsibility in the CFS "means that the government shall operate fiscal policy in a prudent way, and manage public assets, liabilities and fiscal risks with a view to ensuring that the fiscal position is sustainable over the long term". H.M. Treasury has been delegated by law, notably the revisions to the National Loans Act 1968 in 1998, to manage government debt, cash and assets.

In May 1997, the Chancellor of the Exchequer announced that the Bank of England's role as the government's agent for debt and cash management would be transferred to H.M. Treasury. In April 1998, a new executive agency, the Debt Management Office, was established as the Treasury's operational agency for debt, cash and asset management. The Debt Management Office undertook debt management immediately, whereas cash management was transferred to the Debt Management Office in 2000. The Office's main objective, set out in the Treasury's Debt Management Office remit, is "to offset, through its market operations, the expected cash flow into or out of the National Loans Fund on every business day, in a cost-effective manner with due regard for credit risk management".

4.3.6. *Internal audit*

The law does not specify that internal audit units need to be established in spending units. Traditionally, internal control and audit have been treated as a departmental, rather than a central function. In letters to new accounting officers, which contain a standard memorandum issued by H.M. Treasury, one of the roles of an AO is "to ensure that [your department/agency/NDPB] has in place sound systems for financial management...". H.M. Treasury sets standards – these are laid out in the Government Internal Audit Manual.

4.4. Government accounting and fiscal reporting

4.4.1. The accounting framework

The GRA Act 2000 changed the long-standing cash basis of government accounting to an accrual basis. As from 2001/02, resource accounts replaced appropriation accounts. Each government department sets out for Parliament how it will use the resources allocated to it. The act specifies that the accounts will be prepared "in accordance with directions issued by the Treasury", which "shall exercise the power to … ensure that resource accounts present a true and fair view, and conform to generally accepted accounting principles (GAAP)". For these purposes, "the Treasury shall have regard to any relevant guidance issued by the Accounting Standards Board Limited" and "require resource accounts to include a statement of financial performance, a statement of financial position, and a cash flow statement" (s. 5). The Resource Accounting Manual serves as a guide on accounting and management control procedures. The overall objective of the 2000 Act is to introduce accrual-based accounts as widely as possible within the United Kingdom. However, Scottish legislation does not specify that GAAP must be used for accounts for Scottish departments, which are to be prepared "in accordance with the directions of the Scottish Ministers" [s. 19, Public Finance and Accountability (Scotland) Act 2000].

4.4.2. Government banking arrangements

The concept of a Consolidated Fund is explicit in the E&AD Act 1866, which specifies that H.M. Treasury issues public funds to departments out of the Consolidated Fund. The Exchequer account, out of which these issues are made, is held at the Bank of England under the requirements of the E&AD Act 1866.

4.4.3. In-year reporting to Parliament

Reports associated with the budget. The formal requirement for in-year reporting to Parliament was strengthened considerably with the adoption of the Finance Act 1998, which requires "the Treasury, for each financial year, to prepare and lay before Parliament" two reports – a pre-budget report, and a debt management report. In addition, two non-statutory reports, an FSBR and an EFSR, are produced (see discussion above).

Monthly reporting. The law does not require regular budget execution reports to be transmitted to Parliament and the public. In practice, monthly estimates of the main public sector finance statistics are issued jointly by the Office for National Statistics and H.M. Treasury, based upon data collected from departments. The data include receipts and expenditures of central government and net borrowing and net debt of central and local governments, as well as the public sector as a whole.

4.4.4. *Annual accounts and reports*

The GRA Act 2000 distinguishes between departmental accounts and whole-of-government accounts. For departmental accounts, the law requires that "a government department for which an estimate is approved by the House of Commons in respect of a financial year shall prepare resource accounts for that year detailing: *a)* resources acquired, held or disposed of by the department during the year, and *b)* the use by the department of resources during the year. Resource accounts shall be prepared in accordance with directions issued by H.M. Treasury (s. 5). In addition to all government departments, the House of Commons, the House of Lords and other constitutional bodies also submit accrual-based accounts.

Concerning whole-of-government accounts, the GRA Act 2000 (s. 9) states that "the Treasury shall prepare, for each financial year, a set of accounts for a group of bodies which, it appears to the Treasury, exercise functions of a public nature and are entirely or substantially funded from public money... The accounts shall contain such information in such form as the Treasury thinks fit". As with departmental accounts, the law specifies that "the Treasury determines the form and content of the accounts, aiming to ensure that the accounts present a fair and true view and that they conform to GAAP".

4.5. *External audit*

The post of the Comptroller and Auditor General (C&AG) of the United Kingdom was created in 1866, although its origins go back much further (see White and Hollingsworth, 1999, chapter 4). Since 1998, external audit arrangements have changed to reflect the creation of new national assemblies in Scotland and Wales (Box 5). This section focuses mainly on the legal basis for the National Audit Office (NAO), which is headed by the C&AG.

To co-ordinate external audit arrangements in the nation, a public audit forum, comprised of representatives of all the public audit offices, was launched in 1997 (independently of any law requiring this). The forum published "Principles of Public Audit", which stresses the independence of public sector auditors, the wide scope of audits and the need for public availability of audit results (see *www.public-audit-forum.gov.uk*).

4.5.1. *Managerial, financial and operational independence*

The C&AG is managerially independent. The E&AD Act 1866 specifies that the Queen appoints the "Comptroller General of the Receipt and Issue of Her Majesty's Exchequer and Auditor General of the Government's Accounts".[30] Since 1983, C&AGs have been appointed upon a motion of the Prime Minister, acting with the agreement of the chairman of the PAC [s. 1(3), National Audit Act]. The C&AG may not hold any other office appointed by the

Box 5. **United Kingdom: External audit arrangements**

Comptroller and Auditor General (of the United Kingdom)

- Post created under Exchequer and Audit Departments Act 1866.
- Head of the National Audit Office, which was created by statute law in 1983.
- Audits all central government bodies in England, as well as reserved areas (for example, defence, foreign affairs, social security) throughout the United Kingdom.

Audit Commission

- Created by Local Government Finance Act 1982 (although the function goes back much further).
- Role and functions now set out in Audit Commission Act 1998.
- Audits local governments in England and Wales.

Auditor General for Scotland

- Created in the Scotland Act 1998.
- Heads Audit Scotland.
- Audits accounts of bodies funded by the Scottish Parliament.

Auditor General for Wales

- Created in the Government of Wales Act 1998.
- Audits accounts of the Welsh National Assembly and its sponsored bodies.
- The Wales Audit Office is planned to be operational in 2005.

Auditor General for Northern Ireland

- Post created in the 1921 Exchequer and Audit Departments Act (Northern Ireland).
- Supported by the Northern Ireland Audit Office.
- Audits Northern Ireland departmental and local government expenditure.
- Mainly based on the Audit (Northern Ireland) Order 1987.

Queen, nor is he/she able to hold office in either house of Parliament (s. 3, E&AD Act 1866). To further enhance the independence of the C&AG from the Crown, the National Audit Act specifies that the status of the C&AG is an "officer of the House of Commons" [s. 1(2), National Audit Act]. The 1983 Act changed the status of the staff of the NAO from being civil servants to "staff appointed at such remuneration and conditions as the C&AG may determine" [s. 3(3), National Audit Act].

The NAO is financially independent: "the expense of the NAO shall be defrayed out of moneys provided by Parliament" (s. 4, National Audit Act). Accordingly, the C&AG's salary is a direct charge on the Consolidated Fund. Regarding the NAO's budget, "the C&AG shall prepare an estimate of the expenses of the NAO and the Public Accounts Commission shall examine the estimate, and lay them before Parliament, with modification if the Commission thinks fit".[31] The C&AG is also given the authority to charge fees for auditing; any such fees shall be paid by him/her into the Consolidated Fund (s. 5). The accounts pertaining to the annual budget of the NAO are examined each year by the PAC.

Operational independence is ensured in law. The C&AG has complete discretion in the discharge of his/her functions. However, in determining whether to carry out examinations, he/she shall take into account any proposals made by the PAC [s. 1(3), National Audit Act].

4.5.2. Institutional coverage of audits

The GRA Act 2000 provides the authority for the C&AG's financial audits of departmental resource accounts. It also provides for his/her statutory audit of other accounts such as the whole-of-government accounts. All executive agencies are audited by the C&AG under the GRA Act. The National Audit Act (ss. 6-7) provides the C&AG with statutory powers to conduct value-for-money examinations of departments, executive agencies, NDPBs, and a wide variety of NHS and other public bodies.

The C&AG is the auditor of almost all central government bodies. This definition includes NDPBs, but excludes some publicly funded bodies such as higher education institutions and housing associations. Some NDPBs are companies and ministers appoint private auditors to audit them. The C&AG is currently unable, under the Companies Act, to audit limited companies. It has been recommended that the C&AG should audit such companies on behalf of Parliament (Sharman, 2001).

To allow the C&AG to extend the scope of bodies covered by his/her audits, H.M. Treasury may, by law, order a public body's accounts to be audited by the C&AG, subject to the restriction that the body is performing public functions or being substantially funded by public money (s. 25, GRA Act 2000). In this context, H.M. Treasury initiated the GRA Act (Audit of Public Bodies) Order 2003, which made the C&AG the statutory auditor of a further 25 NDPBs. Also, the GRA Act 2000 (Rights of Access of Comptroller and Auditor General) Order 2003 gave the C&AG wider statutory access to different bodies for audit or examination purposes. Finally, the C&AG's activities are not limited to those specifically prescribed by statute. At times, he/she conducts some audits by agreement, not because statute requires him/her to do so.

4.5.3. *Types of audit*

The E&AD Act 1866 mandated regularity audits to ensure that every payment was supported by vouchers and that money expended was for the purposes granted by Parliament. As early as the late 19th century, economy and efficiency audits began, with PAC support, but not under any specific statutory authority (Sharman, 2001, annex B). The compulsory review of every financial transaction was abandoned, as from the E&AD Act 1921. The National Audit Act 1983 gave the C&AG the express power to report to Parliament at his/her own discretion on the economy, efficiency and effectiveness with which government bodies have used public funds. The emphasis in the law is on the discretion of the C&AG.

The GRA Act 2000 (s. 6) obliges the C&AG to provide an audit certificate in which he/she must state whether in his/her opinion the accounts show:

- a true and fair view (as required in company accounts);
- that the money provided, and resources authorised, by Parliament have been expended for the purposes intended by Parliament;
- that the financial transactions covered by the accounts are in accordance with the relevant authority which governs them.

For local governments, under the Audit Commission Act 1998 (s. 34), the Audit Commission is also authorised to undertake or promote studies that assess the impact of policies on economy, efficiency and effectiveness. The Audit Commission is authorised to require relevant bodies to publish performance standards information for different financial years (s. 44). Thus, by law, bodies delivering public services at local government are obliged to prepare performance indicators for their sphere of activity.

4.5.4. *Powers of investigation*

The C&AG has strong powers of investigation, explicit in two separate acts. In relation to financial audits, "he shall have a right of access at all reasonable times to any of the documents relating to the department's accounts". "A person who holds or has control of any of those documents shall give the C&AG any assistance, information or explanation which he requires in relation to any of those documents" (s. 8, GRA Act 2000). Concerning value-for-money audits, the C&AG "shall have a right of access at all reasonable times to all such documents as he may reasonably require for carrying out examinations" and "shall be entitled to require ... explanations as are reasonably necessary for that purpose" (s. 8, National Audit Act). Time delays for the provision of specific information are not specified in law.

4.5.5. Reporting obligations and publication

As from 1866, the C&AG was required to submit to the Treasury audits of Consolidated Fund accounts and other specific appropriation accounts. If H.M. Treasury did not submit the audit report of the C&AG to the House of Commons within 10 months, the C&AG was authorised to do so (ss. 21 and 32, E&AD Act 1866). The C&AG's statutory powers to report to Parliament were extended in 1983; he/she may report to the House of Commons the results of any value-for-money examination (s. 9, National Audit Act). These are laid before Parliament as House of Commons papers. The NAO publishes around 60 value-for-money reports each year.

The GRA Act 2000 maintained the same reporting to Parliament procedures and timetable as the 1866 Act. Departments must send accounts to the C&AG within eight months after the fiscal year begins and the C&AG is given two months to audit them. The rather long ten-month delay reflects the late adoption of appropriation acts. However, the GRA Act authorises H.M. Treasury, by statutory instrument, to change any of the reporting dates (s. 22), subject to annulment by a resolution of the House of Commons. Also, should H.M. Treasury not report to the House of Commons within the legal deadlines, the C&AG is required to report as soon as possible after their expiry (s. 26).

Concerning whole-of-government reports, the C&AG must satisfy him/herself that the accounts present a true and fair view. After certifying the accounts, the C&AG returns his/her annual report to H.M. Treasury, which lays the accounts and the C&AG's report before the House of Commons (s. 11). By law, it is H.M. Treasury's responsibility to decide on the timing of submission of the whole-of-government accounts to the House of Commons [s. 11(6), GRA Act 2000].

4.5.6. Enforcement of findings

The NAO has no independent powers to enforce its findings – it is up to the PAC to ensure follow-up. After the NAO's reports are laid before Parliament, the PAC normally takes oral evidence in public from the department's AO, with briefings provided by the NAO. The PAC considers the evidence and publishes its own report, referring to the NAO report. The PAC is unable to examine all departmental matters and the House of Commons departmental select committees take little interest in financial matters, preferring to rely on the PAC.

The PAC has an important deterrent effect, since waste or ineffective spending by departments may be uncovered by reports or hearings. By a long-standing convention, the government responds to every PAC report, usually within two months (responses are known as Treasury Minutes). The NAO and

PAC often revisit issues in follow-up reports, although it has been recommended that the work of PAC would be enhanced further if more systematic follow-up inquiries were built into its programme (Brazier, 1999, p. 11).

The Audit Commission audits services implemented at local government level. Audit reports of non-central government bodies are not sent to parliamentary committees. However, where central government bodies are responsible for grant funding or contracting to bodies that are not audited by the C&AG, the PAC may still hold an AO to account for the department's financial supervision of such bodies.

Duration of budget system law. Statute laws relating to the budget system are all permanent laws, unless there is a section specifying a time limitation. Major revisions to old laws often do not result in their entire repeal. Rather, the new law contains section(s) that state that "section x of the older law shall cease to have effect". For example, the GRA Act 2000 – a major reform in government accounting arrangements – did not result in the entire repeal of the E&AD Act 1866, but only certain sections of it.

Notes

1. Conventions are understandings and traditions, including the royal prerogative (see footnote 5).
2. Most delegated legislation is in the form of "statutory instruments" (SIs) governed by the Statutory Instruments Act, 1946. Around 80% of SIs are adopted by Parliament on a lapse of time basis (the "negative procedure") (Hansard, 2003). If Parliament does not object within 40 days, the SI has the force of law. Some SIs require formal parliamentary approval (those for which the primary act specifies the adoption of SIs by the "affirmative procedure"). See House of Commons (2003).
3. Command papers derive their name from the fact that they are presented to Parliament by a government minister "by command of Her Majesty". Command papers include White Papers, which are statements of government policy.
4. Extra-legal means that its existence is not established in law. In many countries, constitutions require civil services, cabinets and ministries to be explicitly established in law.
5. Prerogative powers are the constitutional understandings derived from an earlier age when all executive power resided in the monarch. These are the powers unique to the executive that the courts recognise it possesses for the purposes of carrying out the business of government.
6. A full description can be found in the Annex 2.1 to Chapter 2 of *Government Accounting*, *www.government-accounting.gov.uk/current/frames.htm*, which is a guide on accounting and financial processes for the use of government departments for the proper handling and reporting of public money. The Treasury issues *Government Accounting* without reference to Cabinet.
7. Capital expenditures are not explicitly voted.

8. This includes the Lord Chancellor, who plays three roles simultaneously: 1) a Cabinet member with departmental responsibilities; 2) the Speaker of the House of Lords; and 3) the head of the judiciary of England and Wales. As part of constitutional reforms aimed at clearer separation of executive, legislative and judicial powers, in 2003 the Prime Minister proposed that this 700-year-old position be abolished.
9. For a discussion of attempts to change the legal basis of the civil service, see chapter 3 of Daintith and Page, 1999.
10. The statutory instrument was an Order in Council in 1995. For an informal consolidation of the operative parts of all amendments since then, see *www.civilservicecommissioners.gov.uk/documents/orderincounciloct2003.pdf*.
11. Scottish legislation uses the term "accountability officer", which is a more accurate description of AO roles.
12. Besides these committees, there are Joint Committees, Grand Committees, and Private Bill Committees. See *www.parliament.uk/parliamentary_committees/parliamentary_committees16.cfm*.
13. In contrast, the Scottish Parliament has established a Finance Committee which may propose amendments to the budget proposals of the Scottish Executive. For example, for 2003/04, the eight amendments of the Finance Committee were incorporated in the Budget (Scotland) (No. 4) Bill – the appropriations act. See *www.scottish.parliament.uk/S1/parl_bus/bills/b72s1ml.pdf*.
14. To enhance select committees' powers to amend budget proposals, it has been proposed that each select committee formally establish a permanent finance and audit sub-committee (Brazier, 1999, p. 12).
15. See *www.scotland-legislation.hmso.gov.uk/legislation/scotland/acts2000/20000001.htm* which, *inter alia*, establishes Audit Scotland (a corporate body) and the Scottish Audit Commission (for parliamentary oversight).
16. Budget day had traditionally been in early April. The government of 1993-97 changed the budget day and also, for the first time, presented a budget that unified revenues and expenditures, in early winter (November). The new government of 1998, however, reverted to the pre-1993 timing of a spring budget.
17. The government has discretion on how far into the future it makes long-term projections. In this regard, H.M. Treasury has published fiscal sustainability projections with a 50-year time horizon.
18. For example, it has published a guide to SDAs, available on the H.M. Treasury Internet site.
19. These include the Charity Commission, the Electoral Commission, the Forestry Commission, the Postal Service Commission, the Office of the Parliamentary Commissioner and the NHS Commissioner for England.
20. A party whip is an MP whose task is to ensure that members of the party attend and vote as the party leadership desires.
21. For example, the 1999 Procedure Committee of the House of Commons proposed that the House should be authorised to change budget proposals, at least within votes (House of Commons, 1999). Even this modest proposal was rejected by the government, on the grounds that "it would serve to undermine the financial initiative of the Crown" (House of Commons, 2000).

22. Details of the Vote on Account are available on *www.hm-treasury.gov.uk/media/D8ABE/Voteonaccount_04to05.pdf*.

23. The prohibition is based on two legal sources: 1) the prerogative of the House of Commons, and 2) the Parliament Acts of 1911 and 1949. The ancient "rights and privileges" of the House of Commons are based on a centuries-old resolution "that in all aids given to the King by the Commons, the rate of tax ought not to be altered by the Lords" (Daintith and Page, 1999).

24. Immediately following the budget speech, a single motion – an "amendment law resolution" – is adopted without debate. This provides an interim legal basis for the immediate application of the Chancellor's announced tax changes. Other revenue resolutions relating to the budget speech must take effect within 10 sitting days, at which time the interim law amendment lapses. The main resolutions must be in turn be confirmed by the formal approval of the finance bill – *i.e.* royal assent – by 5 August (for budgets delivered in March or April).

25. For customs duties, on the basis of the Import Duties Act 1958, the necessary authority is finally (not provisionally) given by a simple resolution of the House of Commons. Similarly, the Finance Act 1972 empowers the government to initiate value-added tax orders, with final effect.

26. Exceptions are made for government trading funds, which may spend surplus revenues on authority provided by other legislation. Any end-year surplus funds do not have to be deposited in the Consolidated Fund.

27. The number of estimates exceeds the number of departments, as a department may be responsible for more than one estimate. Also, reflecting their constitutional independence, the estimates for the House of Commons (Administration), the National Audit Office, and the Electoral Commission are by convention presented on the same day as the main estimates, but in separate publications.

28. This paragraph does not cover Scotland (whose local authorities' borrowings are governed by the Local Government in Scotland Act 2003), nor Northern Ireland.

29. The Chief Secretary to the Treasury is a junior position in the United Kingdom Cabinet. The post was created in 1961, to share the burden of representing the Treasury with the Chancellor of the Exchequer.

30. The 1866 Act combined the functions of Comptroller (who had authorised the issue of public monies to departments) with those of the Commissioners of Audit (who presented government accounts to the Treasury).

31. The National Audit Act establishes a Public Accounts Commission, comprised of the Chairman of the PAC, the Leader in the House of Commons and seven back-bench MPs. The Commission, which is distinct from the Public Accounts Committee, presents a report of its functions to the House of Commons. The Commission also appoints an Accounting Officer for preparing appropriation accounts for the NAO (usually the C&AG) and an auditor of the NAO.

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ISSN 1608-7143
OECD Journal on Budgeting – Volume 4 – No. 3
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United States*

Structure of the Case Study

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* This study has benefited from comments from: staff members of the Office of Management and Budget; Professor Allen Schick of the University of Maryland; and OECD colleagues including Thomas Laubach of the Economics Department.

1. Overview

1.1. The legal framework governing budget processes

The United States has a very comprehensive legal system for federal and state budgets.[1] The 1789 Constitution provides Congress with its overriding powers in budget authorisation processes, compared with those of the President. The Constitution does not provide specific procedures on how to exercise legislative power, nor does it assign a formal role on the budget process to the President. To fill these constitutional gaps, a large number of separate laws have been adopted over the past century (Box 1).[2]

A distinction has been made between budget system laws that are process-oriented and those for accountability and performance (Chan, 1999). Most process-oriented laws for the federal government adopted during the past century, designate the players and assign their roles in the budget processes. The Budget and Accounting Act (BAA) 1921 established the Bureau

Box 1. **United States: Main federal budget system laws**

- The United States Constitution 1789.
- The Anti-Deficiency Act 1905.
- The Budget and Accounting Act 1921.
- The Congressional Budget and Impoundment Control Act 1974.
- The Inspector General Act 1978.
- The Federal Manager's Financial Integrity Act 1982.
- The Balanced Budget and Emergency Deficit Control Act 1985.
- The Budget Enforcement Acts, 1990 and 1997.
- The Chief Financial Officers Act 1990.
- The Federal Credit Reform Act 1990.
- The Government Performance and Results Act 1993.
- The Government Management Reform Act 1994.
- The Federal Financial Management Improvement Act 1996.

Sources: The United States Code (*www.gpoaccess.gov/uscode/browse.html*); The Senate (*www.senate.gov/~budget/democratic/budgetlaws.html*); CRS, 2001.

of the Budget (the predecessor to the Office of Management and Budget, OMB) to oversee the budget process within the executive and the General Accounting Office (the predecessor to the Government Accountability Office, GAO) as an external audit entity to provide Congress with an independent audit of accounts. The Congressional Budget and Impoundment Control Act (CBA) 1975 provides a framework for co-ordinating and controlling the legislative branch's budget activities. The act created House and Senate Budget Committees, as well as the Congressional Budget Office (CBO) to assist congressional budget review. The law also curbs the President's power to block expenditures approved by Congress ("impoundment" power).

Laws to improve financial management include the Inspector General Act (IGA) 1978 and the Federal Manager's Financial Integrity Act (FMFIA) 1982, which focuses on internal financial controls. The Chief Financial Officers Act (CFOA) 1990 aimed at establishing responsibility in federal financial management systems. To improve performance in federal government agencies, the Government Performance and Results Act (GPRA) was adopted in 1993. The Budget Enforcement Acts (BEA) of 1990 and 1997 replaced the Balanced Budget and Emergency Deficit Control Act of 1985, commonly known as the Gramm-Rudman-Hollings (GRH) Act, which aimed to control, by legislative means, the federal deficit that was burgeoning in the 1980s (see next section on reforms).[3]

All laws, except for the Constitution, are "ordinary" laws – there are no higher primary laws. All laws are codified in the US Code.[4] Title 31 ("Money and Finance") includes the BAA and other laws. In addition, various regulations and circulars govern the budget process. Rules of the House and the Senate provide operational procedures and the distribution of competencies of the Appropriations Committees, the Senate Finance Committee, and the House Ways and Means Committee. Presidential executive orders and OMB circulars govern budget preparation and execution processes within the executive, especially the formulation of the President's budget proposal and the execution and accounting of the budget.

1.2. Reforms of budget system laws[5]

Major reforms in budget system law have been made since 1920s, reflecting shifts in the balance of budgetary powers between the executive and the Congress, and the need to reduce the budget deficits.

Until the enactment of the BAA in 1921, the President had a limited role in overseeing federal finances – there was no central budget authority. Little effort was made to co-ordinate individual agencies' spending or to ensure that they were in accordance with national priorities. Due, in part, to the growth of federal spending, stronger and more centralised presidential leadership in the

budget process was needed. The BAA requires the submission of a single, comprehensive budget proposal to Congress by the President to propose an allocation of federal resources. Departments were barred from giving their requests directly to Congress. Since 1921, the President formulates a budget proposal for congressional reaction.

The 1974 CBA created a new budget process in Congress. Previously, there was no framework for Congress to establish its own spending priorities before work began on specific spending and revenue bills. A dispute in the early 1970s between the President and the Congress regarding presidential authority to impound money appropriated by Congress[6] also contributed to the enactment of the CBA. The CBA established procedures for developing an annual congressional budget plan and achieving a system of impoundment control by creating Budget Committees in the House and the Senate, as well as the CBO to serve as the apolitical "scorekeeper" for Congress.

During the 1980s and 1990s, legislation aiming at reducing budget deficits was adopted. In the face of increasing budget deficits, Congress enacted the GRH Act in 1985, which called for the progressive reduction in the deficit in each fiscal year from 1986 through 1990 and for a balanced budget in fiscal year 1991. This objective was to be enforced by an automatic cancellation of budget resources (sequestration) if the projected deficit exceeded the target for a fiscal year.[7] Due to defects in the GRH Act's procedures, the law failed to achieve its main objective (Schick, 2002) (federal deficits continued to increase during those years). First, the law did not require that the actual deficits be within the target, but only that the deficit projected at the start of each fiscal year be. Second, Congress exempted most of the budget from the sequestration process. Third, any increase in the deficit during the fiscal year, whether because of estimation errors, changes in economic conditions or new policies, did not require congressional or presidential action to offset the increase.

To address the flaws in the GRH Act procedures, the BEA was adopted in 1990 (Title XIII of the Omnibus Budget Reconciliation Act 1990).[8] The BEA established two independent mechanisms for reducing the deficit: caps on discretionary spending and a pay-as-you-go (PAYGO) requirement for mandatory spending and revenue legislation (see Box 2 for details). Until 1998, the discretionary expenditure caps were largely maintained and the PAYGO requirement was upheld (CBO, 2003). However, the effectiveness of the BEA began to erode when budget surpluses started to emerge, beginning in 1998. From 1999 to 2002 annual appropriations for discretionary spending exceeded the caps set in 1997 by large amounts, without triggering sequestrations. The emergency clause of the BEA, which allowed temporary overspending, was loosely interpreted. In addition, the Appropriations Acts for 2001 and 2002 raised the caps by large amounts. Advance appropriations were also

Box 2. **United States: Major contents of the Budget Enforcement Act**

Mandatory and discretionary spending

- Mandatory spending is defined as budget authority provided by law other than appropriations acts and entitlement authority. It includes payments for Medicare and Medicaid, the food stamp programme, unemployment insurance benefits, and farm price supports. Discretionary spending is defined residually as all non mandatory spending. It includes operating costs of most federal agencies, most defence expenditures, and various grant programmes. Discretionary budget authority is provided in annual appropriations acts.

Discretionary spending caps

- If the amount of budget authority provided in an appropriations act for the year exceeds the cap on budget authority, or if OMB estimates of the amount of outlays exceed the cap on outlays, the BEA requires the President to issue a sequestration order reducing most programmes by a uniform percentage. Special rules applied for some programmes. Importantly, the BEA exempted some programmes from sequestration.

PAYGO requirements

- Mandatory spending and new revenue proposals were subject to a "pay-as-you-go" (PAYGO) requirement. When a proposed law increased the deficit in the budget year or any of the following years, another provision of law was required to offset the increase. This could be achieved by either a reduction in spending or an increase in receipts in each year affected. A provision that increased welfare benefit payments, for example, would have to be offset by a provision reducing other mandatory spending or increasing taxes.

OMB and CBO estimates

- The BEA required both the OMB and the CBO to make estimates that determine whether there was to be a sequestration and report them to the President and Congress. Any differences between the OMB and CBO estimates required explanation.

Source: Senate Budget Committee, *www.senate.gov/~budget/democratic/laws/balbudgetact1985.pdf*.

expanded. In addition, during 1998-2002, large amounts of net costs under PAYGO were waived. In conclusion, during 1998-2002, the BEA rules were either circumvented or explicitly waived (Blondal *et al.*, 2003). The BEA was allowed to expire in 2002. However, the budget reform proposals by the President to revive the BEA requirements is under discussion between the executive and Congress (OMB, 2004a).[9]

In the 1990s, there was a renewed emphasis on improving the performance of federal government. The GPRA mandated that departments and agencies prepare and update strategic plans and performance plans covering each programme activity. Based on agencies' plans, OMB includes a performance plan for the federal government in the President's budget. The OMB has developed the Program Assessment Rating Tool (PART), which is a series of questions designed to evaluate a programme's result, management, purpose, design, and strategic planning (OMB, 2004b).[10] A major challenge for full introduction of performance-based budgeting is to ensure that congressional processes of approving appropriations make use of the performance information required by the GPRA and PART.

2. Principles underlying budget system laws

The 1789 Constitution specifies the principle of the authorisation of public money by the Congress (Art. I, Sec. 9, Clause 7). It states that "no money shall be drawn from the Treasury, but in consequence of appropriations made by law". It is an essential requirement for the executive to obtain the approval of Congress for the use of public money. The law also specifies that the fiscal year begins on 1st October and ends on 30 September (annual basis of the budget, Title 31, Sec. 1102). The federal budget documents are required to provide information for all federal agencies and programmes, referred to as an "unified or consolidated budget" (principles of unity and universality of the budget). However, budget authority for many expenditures is not provided in annual appropriations acts. Only discretionary spending, which accounts for only about 35% of total federal spending, is approved through the annual appropriations process. Appropriations are prepared by programmes within accounts under the heading of each agency (the principle of specificity). Title 31 (s. 1103) requires Congress to reaffirm its commitment that budget outlays for a fiscal year may be not more than the receipts for that year even though it is an account-based balance (principle of budget balance).

The GRH Act and the BEA aimed to reduce federal budget deficits within a medium-term context (the principle of stability). There is no legal requirement to balance the budget, although there has been much debate on this issue, including calls for a balanced budget constitutional amendment (Buchanan, 1997) At sub-national level, most of the 50 states require a "balanced budget" in their Constitution (Briffault, 1996). Since the enactment of the GPRA in 1993, the executive is required to report its performance to Congress (principle of performance). The principle of accountability is stated in various laws, including the BAA, IGA and the CFOA.

The principle of transparency is well respected. The Constitution provides a strong and well-tested framework that clearly defines the roles of

the executive and the legislature in fiscal management. State and local governments also have clearly defined fiscal responsibilities, operating independently from the federal government. Budget documentation is easily accessible to the public, timely, comprehensive, and reliable. However, with the expiration of the BEA, and a sharp expansion in the federal deficit after 2000, there is a lack of clarity on the longer-term direction of fiscal policy (IMF, 2003).

3. Legal basis for the establishment and the powers of the actors in the budget system

3.1. The executive and the legislature

3.1.1. Overview

The federal government is composed of three separate branches: the executive, the legislature and the judiciary. The checks and balances exercised by each branch is a defining feature of the Constitution and the budget management system. The executive branch consists of the President, the Cabinet, various departments and other agencies. The power of the executive branch is vested exclusively in the President (Art. II, s. 1, Constitution). The President appoints 15 secretaries as heads of department, other officials as heads of other agencies, and oversees the various federal government departments and agencies. These administrative heads serve at the discretion of the President.

The legislative branch (Congress) consists of the Senate and the House of Representatives, each with a substantial number of committees involved in budget decision making. Congress is supported by the GAO and the CBO. The role of Congress in authorising the budget is more active and often more independent than the legislature's role in most OECD countries (Blondal *et al.*, 2003). Congress has no limits on the extent to which it may amend the President's budget proposals.

The judicial branch is asked to adjudicate when issues arise concerning the constitutionality of budget procedures. For example, in 1998 the Supreme Court ruled that the Line-Item Veto Act 1995 was unconstitutional.[11] This Act would have provided the President with line-item veto power against the appropriations bills approved by the Congress (Schick, 2002). The Supreme Court ruled that a constitutional amendment would be necessary to provide such sweeping powers.

3.1.2. Roles and responsibilities of the Cabinet and individual ministers

The Cabinet is an informal structure with no explicit legal basis (it is implicitly drawn from the Art. II, s. 2, Constitution). It includes the Vice-President and the heads of 15 executive departments, including the Secretary of the

Treasury and the Director of the OMB. Although one of the principal purposes of the Cabinet is to advise the President on any subject, it plays little or no role in budget decision making (unlike Westminster countries, where the Cabinet of ministers is the most important budget decision-making body). The President is also advised by the Executive Office of the President, consisting of the White House Office and other specialised offices, including the OMB. In practice, the President relies heavily upon the OMB for budget advice – it reports directly to the President.

3.1.3. Establishment of ministries and executive branch agencies

There are only indirect references in the Constitution to administrative organisation within the executive. The President "may require the opinion, in writing, of the principal officer in each of the Executive departments, upon any subject relating to the duties of their respective officers"; "Congress may by law vest the appointment of such inferior officers, as they think proper, in the President, or in the Heads of Departments" (Art. II, s. 2, paragraphs 1 and 2). Based on these constitutional provisions, Congress, through legislation, establishes departments and agencies, and determines their missions. The 15 executive departments[12] are listed in Title 5, Chapter 1. All presidential proposals for restructuring any department have to be submitted to Congress for approval, according to procedures meticulously defined in the law. Few countries have such strong control by the legislature over internal reorganisations within the executive. The strong congressional control over administrative structures has a budgetary counterpart: in a given fiscal year, every appropriations sub-committee carefully examines how much money is appropriated to each administrative structure.

Some 200 departmental agencies exist as the operating units responsible for the implementation of budget programmes. In addition, there are about 70 independent agencies that are not located within any department and which are not subject to the same management laws and regulations as agencies within departments (Moe, 2002).

Within the executive branch, the primary responsibility for budget formulation rests with the OMB, established by the BAA (s. 1105) to assist the President to oversee federal budget preparation and to supervise its administration (Tanaka *et al.*, 2003; OMB, 2004c). The OMB evaluates the effectiveness of agency programmes, policies, and procedures, assesses competing funding demands among agencies, and sets funding priorities. OMB ensures that agency reports, rules, regulations, testimony, and proposed legislation are consistent with the President's budget and with the administration's policies.

Competencies for fiscal management are shared. The primary responsibility for tax policy and tax estimates, accounting and public debt management lies with the Department of the Treasury created by an Act of Congress in 1789 (codified in Title 31, Chapter 3). Furthermore, the Council of Economic Advisors (CEA) plays an important role in formulating fiscal policy and economic forecasts in collaboration with the Treasury and the OMB. The CEA is a three-member council appointed by the President that is supported by staff (mostly political appointees). In addition to the CEA, the National Economic Council (NEC) was established in 1993 within the Executive Office of the President, to advise the President on matters (including budgeting) related to economic policy.

3.1.4. Responsibilities of senior civil servants

The general legal basis for the responsibilities of civil servants is provided in the Title 5 Chapter 15. Civil servants are not permitted to use their official authority or influence for the purpose of interfering with or affecting the result of an election or political activities (s. 1502). They are also provided with clear legal and administrative guidance concerning ethics and conflict of interest. Relevant legislation includes the Ethics in Government Act of 1978, the Office of Government Ethics Reauthorisation Act of 1988, and the Ethics Reform Act of 1989. Political activity by federal employees is also governed by law.

3.1.5. Establishment and roles of legislative committees

The CBA created congressional and senate budget committees, which play the key role in deciding the amounts approved in annual appropriations laws. Furthermore, the Rules of the House (Rule X) and the Standing Rules of the Senate (Rule XXV) specify the establishment of committees and their functions respectively.[13] The House and the Senate have 19 and 16 standing committees respectively, as well as special and *ad hoc* committees. Several joint committees operate, including the Joint Committee on Taxation, which analyses all estimates of changes in the Tax Code.

Each house has three main committees that play a major role in the budget process: a Budget Committee, an Appropriations Committee and a Tax Writing Committee (known as the Finance Committee in the Senate and the Ways and Means Committee in the House). Budget committees in both houses have jurisdiction on matters relating to concurrent resolutions on the budget [as defined in s. 3(4) of the CBA, see below]. Appropriations committees are split into 13 sub-committees, one of which is responsible for one appropriations bill through Congress. The Ways and Means Committee in the House and the Finance Committee in the Senate have jurisdiction on matters relating to revenues (for example, tax, customs, bonded debts).

The CBO was established by the CBA (s. 201). Its primary duties are to prepare an annual economic forecast, formulate the budget baseline, review the President's annual budget submission, score all spending legislation reported from committees and passed by Congress (CBO, 2004). The CBO provides various committees, including the Budget, Appropriations, Ways and Means, Finance, and the Joint Committee on Taxation with information on:

- The budget, appropriations bills, and other bills authorising or providing new budget authority or tax expenditures.
- Revenues, receipts, estimated future revenues and receipts, and changing revenue conditions.
- Other related information such as macroeconomic estimates, as requested by a committee.

3.2. Role and responsibilities of sub-national governments

The United States is governed by a federal government, 50 states, 39 000 general purpose local governments (counties, municipalities and townships), and 49 000 special purpose local governments, a fourth of which are school districts (as of 2004). The independent status of states is clearly defined and protected by the federal and state constitutions (Art. IV, s. 3, federal Constitution). The Constitution requires the Congress to obtain the states' consent to divide or change the borders of states. The exact roles and responsibilities of the federal and state governments are not fully defined in the Constitution. Although some areas of responsibility are clearly given to the federal government (for example, defence), there is ambiguity in other areas. Whereas a limited federal role is suggested by the 10th Amendment to the Constitution ("powers not expressly granted to the federal government are reserved to the states or the citizens"), a broader federal role is suggested by the "general welfare" clause ["the Congress shall have power to provide for the common defence and general welfare of the United States" (Art. I, s. 8)].

The Constitution does not clearly identify local government as a separate level of government. In practice, local governments derive their powers from the 50 states. The relative responsibilities of the federal government *versus* state and local governments have evolved over time, with the federal government becoming increasingly involved in many areas that were once the sole responsibility of states and localities. State and local governments are heavily involved in service delivery, financed in part by grants, loans and tax subsidies from the federal government. Local governments operate virtually all elementary and secondary schools; build and maintain most local roads and public transportation systems (for example, airports). Since states provide some funding for these services, either from their own revenues or by forwarding

federal funds, the design and operation of local services is highly regulated by state and federal governments (OECD, 1997).

Financial management systems are decentralised. States finance about three-quarters of their spending from their own sources. The states levy taxes, spend money according to state law, and have direct access to bond markets. Their budgets are not reviewed nor approved by the federal government. State Constitutions allow local governments to levy taxes, although states retain authority to place limits on local government finance, such as controls or limits on local government taxes, spending, debt and bonds. Local governments rely much more heavily on state aid than federal grants (Box 3).

By law, the Director of the OMB, in co-operation with the CBO, the Comptroller General, and appropriate representatives of state and local governments, provide to the extent possible, state and local governments with fiscal, budget, and programme information necessary for assessing the impact of federal government assistance on state and local governments' budgets

Box 3. **United States: Major transfers between different levels of government**

- **Equalisation schemes.** Most states have adopted school finance equalisation measures as part of their subsidies to public schools. However, federal courts have found many states' equalisation schemes to be unconstitutional.
- **Global project grants and federal formula grants.** Project grants are transfers based on competitive grant applications to the various federal entities (for example, the Department of Education or the Department of Transportation). Formula grants are transfers provided to states. With statutory formula grants, federal agencies can require states and localities to submit plans for the use of these funds, but there is little discretion in the amount of the grant. The largest formula grants are entitlement programmes operated by states. About 85% of federal grants to state and local governments is distributed by formula. In total, there are approximately 700 different grant programmes to state and local governments, although most are relatively small.
- **Federal aid.** Federal aid to state and local governments comprises grants, loans and tax subsidies. Major functional areas of federal aid include transportation, education, training and employment, social services and heath including medical care and medical aid, and income security.
- **State aid.** The largest form of state grants is aid to local schools. State aid is distributed among local units according to complex equalising formulae.

Source: OECD, 1997.

(Title 31, Chapter 11, s. 1112). However, there is no legal requirement for state and local governments to report budgetary developments to the federal government for consolidation in nationwide accounts and for information to Congress. Such information can be produced by informal arrangements.

4. Legal provisions for each stage of the budget cycle

4.1. Budget preparation and presentation by the executive

4.1.1. Institutional coverage of the budget

The federal budget covers all federal agencies and programmes, including the legislature, the judiciary, the Executive Office of the President, 15 departments, and independent agencies (including the Environment Protection Agency, the General Service Administration, and the Social Security Administration), and about 90 smaller agencies, boards, councils, and offices. The federal budget does not include the state and local government, nor does the federal government provide guidelines for the budgets of states and local governments.

4.1.2. Extrabudgetary funds and earmarking of revenues

The federal budget has relatively few extrabudgetary funds. "Off-budget" has a special meaning. The social security funds (old-age, survivors, and disability insurance) and the Postal Service funds are by law classified as "off-budget" in the federal budget. They are federally owned and controlled funds whose receipts, outlays, surplus or deficit, and budget authority are excluded from the "on-budget" totals. However, most tables in the budget documents include the on-budget and off-budget amounts in the "unified budget" totals (OMB, 2004a). Federal outlays and receipts are therefore shown comprehensively. The unified budget totals generally receive the most attention from policy makers and the public.

4.1.3. Definition of budget aggregates

The President's budget is prepared by the OMB according to the requirements of the BAA, which requires estimates for the current fiscal year, projections for the budget year and for the following four years in order to reflect the effect of budget decisions over the longer term despite no binding effects on the following fiscal year's budget (Title 31, Chapter 11, s. 1105). The CBO must by law present similar aggregate estimated projections (s. 202, CBA). In practice, the CBO has provided data for nine years past the budget year.

4.1.4. Fiscal rules

Fiscal rules were embodied in law, notably the GRH Act 1985, which included declining quantitative limits on the consolidated deficit

through 1990, and the BEA with its caps on discretionary spending and the PAYGO rule for mandatory expenditures and budget revenue. Since September 2002, when the enforcement mechanisms of the BEA expired, there are no legally binding fiscal rules at federal level. Each year, under the CBA, the House and the Senate are required to agree on total revenues and expenditures in a "budget resolution" (see below); however, the agreement is not legally binding.

4.1.5. The timetable for budget preparation and presentation to the legislature

The fiscal year begins on 1st October and ends on 30 September. Title 31 requires the President to submit a draft budget for the following fiscal year to Congress no later than the first Monday in February (Chapter 11, s. 1105). It also requires the head of each agency to prepare and submit to the President each appropriation request for the agency in the form prescribed by the President and by the date established by the President (s. 1108). The OMB and the federal agencies work together to prepare a budget to meet the February deadline according to a schedule established annually in an OMB circular (Box 4). The budget preparation process begins about 18 months before the beginning of the fiscal year. This is much earlier than any other OECD country.

4.1.6. Approval process within the executive

The approval procedure within the executive is stated in OMB circulars (s. 10.5), not law. It is regarded as an internal process. There is no Cabinet meeting to discuss the complete set of departmental budget proposals prepared by the OMB. Secretaries of departments can appeal the decisions of the OMB regarding their totals. Appeals are first made to the OMB itself and most are settled at that level. Any further appeals are normally made to a Budget Review Board (although not every President uses a Budget Review Board), composed of the Vice-President, the White House Chief of Staff, the Director of the OMB, and one or two senior White House officials (the composition varies from administration to administration as well as year to year). Final decisions may be appealed to the President who has the final decision-making authority.

4.1.7. Documents to accompany the budget law

The President is required to provide a budget message and summary in each budget transmitted to Congress (Title 31, s. 1105). Each year, the budget message and summary are included in "The Budget of the United States Government", which provides information on the President's budget and management priorities, and budget overviews for each agency, including

Box 4. **United States: Key steps in the annual budget process within the executive**

April May: spring guidance and review

- The OMB director issues a letter to the head of each agency providing policy guidance for the agency's budget request in the fiscal year which begins in approximately 18 months. This begins the process of formulating the budget for year (+2).
- The OMB works with agencies to identify major issues for the budget for year (+2), to develop and analyse options for the upcoming autumn review, and to plan for the analysis of issues that will need future decisions.

July: OMB issues Circular No. A-11, which provides detailed instructions to all federal agencies on how to prepare and submit the budget to OMB for review (s. 1104).

September: Agencies make initial budget submissions.

October November: autumn review

- OMB staff analyse agency budget proposals in the light of presidential priorities, programme performance, and budget constraints. They raise issues and present options to OMB policy officials for decision.

Late November: passback

- OMB briefs the President and senior advisors on proposed budget policies. OMB usually informs all executive branch agencies at the same time about decisions on budget requests.

December: appeal process

- Executive branch agencies may appeal to the OMB and the President. An agency head may ask OMB to reverse or modify certain decisions.

First Monday in February: President transmits the budget to Congress.*

* The actual timing may vary from the plan. For example, on several occasions, a President has submitted the budget later than specified for various reasons, including late enactment of appropriations for the previous fiscal year or a change in the administration.

Source: OMB, 2004d.

assessments of their performance. Detailed information is required to be put in the message by 10 pages of law (Title 31, s. 1105). Each year, much of the required information is provided in:

- **Analytical Perspectives,** which contain analyses designed to highlight specific subject areas or provide other presentations of budget data. This volume includes economic and accounting analyses; information on federal

receipts and collections; analyses of federal spending; detailed information on federal borrowing and debt; baseline or current services estimates; information on programme performance (including PART information), long-range budget estimates; and other technical presentations.

- **Historical Tables,** which provide data on budget receipts, outlays, surpluses or deficits, federal debt, and federal employment, over extended historical periods (data begin as early as 1940) and for the future (the law requires projections for the four years beyond the budget year).
- **The Appendix,** which is designed primarily for the use of the appropriations committees. It contains very detailed financial information on individual programmes and appropriation accounts. It includes for each agency: the proposed text of appropriations language, budget schedules for each account, new legislative proposals, explanations of why funds are needed, and provisions applicable to appropriations of entire agencies or groups of agencies. Information is also provided on activities whose outlays are not part of the budget totals.

Medium-term macroeconomic framework and fiscal strategy. The budget presents estimates for each of the four years beyond the budget year (for example, for budget year 2005, years 2006 through 2009). The formulation of the macroeconomic assumptions for budget projection is a shared responsibility of the CEA, the Treasury Department, and OMB. The budget proposal includes substantial discussion of its underlying economic assumptions as well as reconciliation against the previous year's forecasts (OMB, 2004a). The economic assumptions include estimates of the effects of Presidential policies if adopted. In contrast, the CBO provides a set of economic assumptions that contest the assumptions of the OMB and do not include effects of policy change. Since the expiry of the BEA, multi-year expenditure projections are not legally binding limits.

New measures *versus* existing expenditure policies. Title 31 requires estimated receipts for the fiscal year for which the budget is submitted and the four fiscal years after that year under: 1) laws in effect when the budget is submitted, and 2) proposals in the budget to increase revenues (Chapter 11, s. 1105). Estimates of new initiatives and the ongoing cost of government policies are therefore clearly distinguished in the budget documents. The law also requires that each budget proposal that would expand a government activity or function, have a table showing the impact on appropriations and expenditures for the fiscal year and each of the four fiscal years after that year.

Performance-related information. The GPRA requires agencies to produce strategic plans, annual performance plans, and annual programme performance reports. In addition to this, as from 2004, the OMB started a new systematic evaluation procedure (the PART process). This shows five ratings on the

implementation of programmes: effective, moderately effective, adequate, ineffective, and results not demonstrated. The government has assessed approximately 400 programmes representing approximately 40% of the federal budget: 234 programmes in 2003 and 173 programmes in 2004. The assessments indicate that about 40% of programmes were rated either "effective" or "moderately effective", and a quarter of programmes rated just "adequate" or "ineffective", and 40% of programmes were unable to demonstrate results (OMB, 2004a). This information is required to be produced annually as part of the President's budget (Part 6 of OMB Circular No. A-11).

Tax expenditures, contingent liabilities and fiscal risks. Tax expenditures are defined in the CBA as "revenue losses attributable to provisions of the federal tax laws which allow a special exclusion, exemption, or deduction from gross income or which provide a special credit, a preferential rate of tax, or a deferral of liability". The CBA requires that a list of tax expenditures for individual and corporation income taxes be included in the budget (s. 3). Analytical Perspectives 2005 includes a chapter that outlines all significant tax expenditures. The largest tax expenditures are those associated with income taxes, including deductions and exclusions provided for pension contributions and earnings, employer contributions for medical insurance and home mortgage interest payments. The cost of tax expenditures is presented for the same period for which budget information is provided (the past fiscal year, the current fiscal year, and the following four years). Several states prepare tax expenditure estimates when presenting their budgets to state legislatures.[14]

The budget does not include a comprehensive list of contingent liabilities or fiscal risks.[15] However, since 1990, the law requires the long-term costs of federal credit programmes to be budgeted. The Federal Credit Reform Act (FCRA)[16] 1990 changed the budgetary treatment of direct loans and loan guarantees by requiring that the budgetary cost of a credit programme be the long-term subsidy cost at the time the credit is provided (s. 502). Annual outlays for credit programmes in the budget are estimated based on the present value of the long-term subsidy costs of direct loans or loan guarantees issued in each year. This is more transparent than prior practice, which reported only the cash flows associated with direct loans or loan guarantees.

Other information required by law. The OMB also provides highly detailed information to Congress in the budget, in line with BAA requirements (Box 5).

4.1.8. Budgets of the legislature and other constitutional bodies

The budgets of the legislative and the judicial branches are prepared independently from the executive branch according to provisions of the

Box 5. **United States: Other information required by law**

The following are excerpts from the US Code, s. 1105. Other laws require even more information.

- Information on government activities and functions. When practicable, information on costs and achievements of government programmes.
- A reconciliation of the summary information on expenditures with proposed appropriations.
- Balanced statements of the condition of the Treasury at the end of the prior fiscal year, the current fiscal year and the fiscal year for which the budget is submitted if financial proposals in the budget are adopted.
- Essential information on government debt.
- A comparison of the total amount of budget outlays for the prior fiscal year, for each major programme having relatively uncontrollable outlays.
- A comparison of the total amount of receipts for the prior fiscal year, estimated in the budget submitted for that year, with receipts received in that year, and for each major source of receipts, a comparison of the amount of receipts estimated in that budget with the amount of receipts from that source in that year.
- A statement of budget authority, proposed budget authority, budget outlays, and proposed budget outlays, and descriptive information of: (a) a detailed structure of national needs that refers to the missions and programmes of agencies, and (b) the missions and basic programmes.
- An analysis displaying, by agency, proposed reductions in full time equivalent positions compared to the current year's level in order to comply with the Federal Workforce Restructuring Act of 1994.
- Information about the Violent Crime Reduction Trust Fund.

Title 31 Chapter 11, s. 1105. Proposed expenditures and appropriations of the legislature and judiciary are required to be submitted to the President before 16 October of each year and included in the budget by the President without change.

4.2. Budget process in the legislature

Prior to the enactment of the CBA in 1974, the congressional budget process was relatively uncoordinated. The CBA provided for the first time, a framework for congressional actions on the budget. The law established the concurrent budget resolution, the House and Senate Budget Committees, the

CBO, and procedures for relating individual appropriations to the totals agreed by Congress.

4.2.1. *The timetable for budget adoption and constraints on budget debate in the legislature*

The CBA specifies the congressional budget process, which co-ordinates the legislative activities on the budget resolution, appropriations bills, reconciliation legislation, revenue measures, and other budgetary legislation. Section 300 of the act provides a timetable (Box 6) so that Congress may complete its work on the budget by the start of the fiscal year on 1st October.

Adoption of the budget resolution process. After the President's budget is received in early February, the CBA requires the budget committees to review the document and to hear the views and estimates of the authorising committees. Congress is required to pass a concurrent budget resolution, which

Box 6. **United States: Legal and internal deadlines for congressional budget approval**

- **First Monday in February:** President submits his budget (US Code, Chapter 11, s. 1105).
- **15 February:** CBO submits report to budget committees.
- **No later than six weeks after President submits budget:** Committees submit views and estimates to budget committees.
- **15 April:** Congress completes actions on the "budget resolution" which establishes total budget outlays (spending) and budget receipts for the upcoming fiscal year (CBA, s. 301).
- **15 May:** Annual appropriations bills may be considered in the House.
- **10 June:** House Appropriations Committee reports on latest annual appropriations bills.
- **15 June:** Congress completes action on "reconciliation legislation" which authorises changes in programmes and in taxes consistent with the budget resolution (CBA, s. 310).
- **30 June:** House of Representatives completes action on annual appropriations bills. Congress is scheduled to enact up to 13 regular appropriations bills (CBA, s. 307).
- **1st October:** Fiscal year begins.

Source: Henniff, 2003a.

sets forth total discretionary spending and may include "reconciliation instructions" for committees responsible for mandatory spending and receipts. A budget resolution is a formal agreement between the two houses on total spending, receipts and other budget aggregates, and provides a notional breakdown of budget spending by function [CBA, s. 301(a)]. The budget resolution is not a law, as it does not require the President's approval (Heniff, 2003b). The aggregate levels set forth in the budget resolution are binding, although in the absence of successor legislation to the BEA, there is no legal enforcement mechanism except for points of order that pertain to the budget resolution itself.

The budget reconciliation process for mandatory spending. The CBA provides for a "budget reconciliation" process, by which Congress issues directives to legislate policy changes in mandatory spending (entitlements) or revenue programmes (tax and other laws) to achieve spending and revenue goals envisaged in the budget resolution [s. 301(b)]. In contrast to the budget resolution, whose passage is obligatory, the reconciliation process is an optional procedure (Heniff, 2003c). In the House of Representatives, under the CBA, no amendment is in order that would increase spending or decrease revenue relative to the agreed projections without equivalent decreases in spending or increase in revenues (the PAYGO rule). In the Senate, total debate on a reconciliation bill is limited to 20 hours, although the actual time for consideration of the omnibus package often exceeds the time limit set in the CBA.

The appropriations process. Once aggregate spending levels have been determined by the budget resolution, the Appropriations Committee is given an allocation, which is divided into sub-allocations [s. 302(b), CBA] corresponding to each of the 13 appropriations sub-committees. The appropriations sub-committees in the House and the Senate may not exceed these sub-totals as they develop the annual appropriations bills. After proposing measures, each appropriations sub-committee reports to the full Appropriations Committee where proposals are considered, possibly amended, and approved, consistent with house rules. All committee actions are constrained by the overall discretionary spending limits and the allocations in the budget resolution.

In principle, once the House of Representatives completes action on the appropriations bills, the Senate begins consideration of the House's proposals. In practice, the two houses work on the bills concurrently prior to "floor action". Like any other law, congressional action on an appropriation measure is not complete until both the House and the Senate have successfully disposed of all proposed amendments in both houses, which eventually agree on an identical text pursuant to the Constitution.

Constraints on budget debate in the Senate. The CBA provides for a special congressional procedure ("points of orders")[17] designed to ensure that appropriations bills and other budgetary legislation are consistent with the most recently adopted budget resolution. The Senate generally operates under the rule of unlimited debate, which means that any senator or group of senators can effectively stop a bill from being considered (known as a filibuster). A supermajority of senators (three-fifths) must approve the closing of the debate on any issue. The CBA points of order circumvent these procedural impediments by providing a waiver of the three-fifths rule (Blöndal *et al.*, 2003). One example is a prohibition against consideration of legislation that provides budget authority, or outlays, in excess of a committee's allocation. This point of order is often used to enforce the spending limits applicable to each of the 13 annual appropriations bills. Another point of order is a prohibition against consideration of legislation that would cause the total level of budget authority or outlays to be exceeded or the appropriate level of revenue to be reduced below that which is set forth in the budget resolution.

4.2.2. Provisional budgets

If the appropriations bills are not passed by the end of September when the new fiscal year begins, "continuing resolutions" are adopted (CRS, 2000). These provide budget authority for a temporary period of time to allow the business of government to continue. A continuing resolution is a joint resolution, which has the same legal status as a bill. The resolution usually specifies a maximum rate at which obligations may be incurred, based on the rate of the prior year or that contained in the President's budget request. If Congress decides not to adopt a continuing resolution, or allows one to lapse, the agencies without appropriations are forced to shut down except for emergencies involving the safety of human life or the protection of property and national security. This is rare, but it does happen, usually for political reasons.

4.2.3. Powers of amendment

The President's budget only serves as a benchmark for subsequent congressional action. Congress has unlimited power to make amendments to the President's budget. Congress uses these powers extensively and designs its own budget. This power is founded in the Constitution that states that "no money shall be drawn from the Treasury, but in consequence of appropriations made by law".

4.2.4. Approval of resources

The Constitution states that the Congress shall have power to lay and collect taxes, duties, imposts and excises to provide for defence and general welfare. All measures raising revenue including taxes, duties and user fees are

required to have a legal authority that should originate in the House of Representatives. The budget resolution includes total revenue as guidance for the congressional budget process. The resolution may direct changes in the Tax Code.

4.2.5. The nature, structure and duration of appropriations

A distinction between discretionary spending and mandatory spending is important to understand the nature, duration and structure of appropriations. Spending for discretionary programmes is determined in annual appropriations, which provide legally binding upper limits for spending. Spending for entitlement programmes is determined by their enabling laws and is generally not affected by the appropriations process. Mandatory spending has the nature of permanent appropriation. Only about 35% of total federal spending is controlled through the annual appropriations process.

Appropriations laws provide "budget authority", which authorises the federal government agencies to incur legally binding obligations and the Treasury Department to make payments for designated purposes. Appropriations are usually used or committed in the fiscal year for which they are provided, unless the appropriations law and the authorising law specify that they are available for a longer period.

Approved appropriations are by "accounts". There are some 1 000 appropriation accounts, which are often subdivided into different programmes within agencies. There are generally separate accounts for larger capital expenditures and transfers. A "salaries and expenses" account may cover several programmes in a given department. In approving funding, Congress may earmark portions of appropriations for specific purposes. While the previous year's appropriation structure provides the basis of the next year's appropriations, the detailed appropriation structure varies from year to year. The appropriation structure is quite complex, reflecting the high degree of control exercised by Congress in the approval process. The detailed and unstable appropriation structure contrasts with the international trend to group expenditures into a few appropriations where programme outcomes are the focus at the legislative approval stage, not approval of individual projects and other inputs.

4.2.6. Carryover of appropriations and borrowing of future appropriations

Unspent appropriations for operations costs are returned to the Treasury at the end of the year. Only in exceptional circumstances is limited end-year carryover permitted. For instance, up to 50% of salaries and expenses of selected agencies may be carried over with the approval of the legislature.

Congress writes into appropriations acts the extent of the end-year carryover. However, money can be disbursed for up to five years from the fiscal year in which it was committed, and if the legislation provides, obligations can be made for even longer periods.

Under certain circumstances, departments and agencies can incur obligations against the coming fiscal year's anticipated appropriations. Appropriations acts provide a different starting date for some appropriation accounts within the relevant act, so that the funding cycle does not coincide with the fiscal year generally covered by the act. There are three types of this kind of funding (Streeter, 2000):

- Advance appropriations. Funding becomes available for one or more fiscal years after the fiscal year covered by the act. An advance appropriation for fiscal year (n+1), included in an appropriations act for FY (n) would be included in the budget for FY (n+1), not FY (n).
- Forward funding. Such funding generally becomes available for meeting obligations in the last quarter of the fiscal year and the availability continues during the following fiscal year. The funds would be recorded in the subsequent fiscal year since most of the funding would occur then.
- Advance funding. This is funding that authorises obligations late in the fiscal year. Advance funding is used, *inter alia*, to fund benefit payments that are difficult to predict, such as unemployment compensation. If advance finding is used, the budget authority for that fiscal year is increased by the amount committed and budget authority for the succeeding fiscal year is reduced by that amount.

4.2.7. Public debt approval

The authority to borrow is vested in Congress by the Constitution: "Congress shall have power to borrow money on the credit of the United States" (Art. I, s. 8). In 1917, in the face of more frequent government financing needs during World War I, Congress, in conjunction with the Second Liberty Bond Act, delegated authority to the Treasury Department to borrow, subject to a limit. Since then, the definition of debt subject to limitation has been modified. The definition includes not only the debt held by the public, but also the notional credits in the government trust funds, of which social security is the largest.[18]

The statutory limit is changed by normal legislative procedures when necessary, for example, when the proposed federal deficit requires a higher debt limit to accommodate new borrowing (Senate Budget Committee, 1998b). The annual congressional budget resolution includes a provision specifying an appropriate level of debt subject to a limit at the end of each fiscal year. Under a rule adopted by the House of Representatives, when the budget resolution is

adopted in the House, it is deemed to have been a vote in favour of a joint resolution setting the statutory limit at the level specified in the budget resolution. The joint resolution is transmitted to the Senate for further action, where it may be amended. Once it passes both houses, it is sent to the President for his signature. In 2003, such debt-limit legislation was enacted, increasing the debt limit to $7.4 trillion.

4.2.8. Promulgation, veto and publication of the adopted budget

Promulgation and publication of the budgetary laws adopted by the Congress is made as the President signs the appropriations, tax and other spending bills. The President has two options when presented with bills. He may either sign the bill in its entirety or veto it in its entirety. If he vetoes the bill, the Congress may override the veto by a two-thirds majority in each house. The President has no authority to delete particular spending items from bills while permitting the remainder of the bill to remain (no line-item veto).

4.2.9. Supplementary budgets (rectifying laws)

At any time during the year, the President may submit to Congress proposals for supplementary appropriations that are deemed necessary because of laws enacted after the submission of the budget or that are in the public interest. The President must include the reasons for the proposed changes and explain why the proposed appropriations were not included in the budget (Title 31, s. 1107). For example, in 2003, two supplementary appropriations acts were passed, in March and in October, largely to finance the war and occupation in Iraq and ongoing military involvement in Afghanistan.

4.3. Budget execution

Part of the legal framework for governing whether an agency implements the enacted appropriations according to the intent of Congress is provided in the Anti-deficiency Act, now embodied in Title 31. This law contains provisions incorporated into appropriations laws over the years relating to matters such as prohibited activities, the apportionment system, and budgetary reserves. These provisions continue to play a pivotal role in the execution of the federal budget. The CFOA and the GPRA are key laws aiming at improving performance and effectiveness.

4.3.1. Apportionment of expenditure authority

Once the appropriations are enacted, funds are not available to agencies until the OMB releases budgetary resources to departments and agencies by an apportionment process, outlined in Title 31 (ss. 1501-1558). This law

requires appropriations to be apportioned by periods within the fiscal year or among categories (s. 1512). Generally apportionments by time period are done in quarterly instalments. An apportionment may be divided and subdivided administratively (into allotments and sub-allotments respectively) within the limits of the apportionment (s. 1514). An appropriation should be apportioned in writing no later than the later of the following (s. 1513):

- For the legislative and judicial branches, 30 days before the beginning of the fiscal year or 30 days after the date of enactment of the law by which the appropriation is made available.
- For departments and agencies, 40 days before the beginning of the fiscal year or 15 days after the date of enactment of the law by which the appropriation is made available.

4.3.2. Cancellation of budget authority and other in-year expenditure controls

The Impoundment Control Act of 1974 requires the President to inform Congress whenever an executive branch officer intends to defer spending or not to spend the funds at all. The act defines a deferral as withholding or delaying the obligations or expenditures of budget authority. Under the act, whenever the President proposes to defer any budget authority, he is required to transmit a report to the Congress of the amounts, the programme and account affected, the estimated fiscal and programme impact, and the length of time the funds are to be deferred. The President may not defer funds beyond the end of the fiscal year nor for a duration that would cause the budget authority to lapse or prevent the agency from spending the money prudently (s. 1013). Deferral is only permissible to provide for contingencies, to achieve savings made possible by or through changes in requirements or greater efficiency of operations, or as specifically provided by law. The President may not use the deferral power to change budgetary policies.[19]

The act (s. 1102) also specifies rules on a rescission – the cancellation of budget authority. Unlike the deferral of budget authority that occurs unless Congress acts to disapprove the deferral, rescission occurs only if Congress enacts the rescission. The President may propose a rescission by submitting a message to Congress specifying the amount to be rescinded, the reasons, accounts and programmes involved, and the estimated budgetary and programme impacts. After receiving the message, Congress has 45 days during which it may consider a bill rescinding all, part, or none of the funds. If Congress does not rescind the budget resources by the end of the 45-day period, the President must make the funds available to meet the obligation (s. 1017). The act authorises the Comptroller General to review each impoundment message and notify Congress concerning the accuracy of the

information, the legal status of the impoundment, and the probable impacts (s. 1014). He/she may compel the release of any impounded funds.

4.3.3. *Emergency spending, excess spending and contingency funds*

Title 31 provides the legal basis for emergency spending and contingency funds. In apportioning or re-apportioning an appropriation, a reserve fund may be established only as specifically provided by law (Chapter 15, s. 1512), *i.e.* to provide for contingencies or to achieve savings made possible by greater efficiency of operations. An established reserve fund may be changed if necessary to carry out the scope and objectives of the appropriation concerned, and be reported to Congress as provided in the Impoundment Control Act of 1974.

4.3.4. *Transfer and virement of appropriations within the year*

The executive has very limited discretion to change any line item of the approved budget: Congress is quite specific when it adopts the appropriations acts. Transfers between the 1 000 or so accounts require congressional approval. In rare cases, Congress has granted transfer authority to certain entities. For example, the Department of Defence may transfer up to 10% from one account to another, within the Department. Transfers between programmes within an account (reprogramming) take place. Congress generally writes into appropriations acts the rules for reprogramming, which is allowed only up to small amounts. These are often as low as a few hundred thousand dollars (Blöndal *et al.*, 2003). Congress requires reports of re-programmings.

4.3.5. *Cash planning and management of government assets and debt*

Title 31 specifies the legal foundations for treasury functions by the Department of Treasury (Chapter 3). Under this authority, one of the Treasury's main responsibilities is to manage the public finances of the government. It keeps public money, and endorses warrants for receipts for money deposited in the Treasury (s. 3301). The Financial Management Service (FMS), established under the Treasury, is the primary disburser of payments on behalf of federal agencies (for example, payments to businesses for goods and services provided to the federal government, benefit payments paid by the Social Security Administration, federal income tax refunds). The FMS also prepares daily cash plans for federal government receipts and payments (Title 31, Chapter 3).

The management of public debt is governed by Title 31. With the approval of the President, the Secretary of the Treasury may borrow amounts necessary for expenditures authorised by law, may issue government bonds for the amounts borrowed, and may buy, redeem, and make refunds (s. 3111). The

Secretary may issue bonds to the public and to government accounts at any annual interest rate and prescribe conditions (s. 3121). On or before 1st June of each year, the Secretary of the Treasury is required to submit a report to the Ways and Means Committee of the House of Representatives and to the Committee on Finance of the Senate, on the Treasury's public debt activities and the operations of the Federal Financing Bank (s. 3130).

4.3.6. Internal audit

In the 1990s, Congress adopted several laws to strengthen internal control and audit, including the CFOA, the Government Management Reform Act (GMRA) 1994, the Federal Financial Management Improvement Act (FFMIA) 1996, as well as the GPRA. These laws are in addition to the FMFIA, which recognised that strong internal controls and accounting systems help ensure the proper use of funds and resources, compliance with statues and regulations, and protects federal programmes against fraud, waste, abuse, and mismanagement. The CFOA is the main act governing internal audit. It requires a chief financial officer to provide reports on the results of its investigations to both the agency head and to Congress. The Act also requires auditable financial statements to be prepared by all agencies using federal accounting standards. The FFMIA highlights the need for adequate financial systems. Moreover, the IGA established an Office of Inspectors General in each agency as an independent oversight office with the aim of strengthening oversight of controls by agencies.

4.4. Government accounting and fiscal reporting

4.4.1. The accounting framework

Title 31 requires that the Comptroller General prescribes the accounting principles, standards, and requirements that heads of each executive agency observe (Chapter 35). Before prescribing the principles, standards, and requirements, the Comptroller General is required to consult with the Secretary of the Treasury and the President on accounting, financial reporting, and budgetary needs (s. 3511). Accordingly, the Comptroller General, the Secretary, and the Director of the OMB conduct a continuous programme for improving accounting and financial reporting in the government, and in 1990, they jointly established the Federal Accounting Standards Advisory Board to recommend comprehensive accounting principles specific to the federal government.

Different accounting standards are applied to financial statements and the budget of the federal government. Financial statements are produced based on a full accrual basis (OECD, 2003). The CFOA spearheaded this development. It requires that agency's trust funds, revolving funds and

commercial activities be covered by accrual financial statements. The GMRA extended the requirement for accrual-based financial statements to all activities of the agencies covered by the CFOA, and required that annual government-wide financial statements be prepared on an accrual basis starting with the fiscal year 1997-98.

The federal budget, however, is obligations-based, and budgetary accounting by OMB reports both on obligations incurred against budget authority and on cash payments and receipts (IMF, 2003). Most transactions are recorded on a cash basis. Accruals have been adopted for a few specific transactions such as interest on government debt held by the public, most charges to agencies for employee pension plans, and the cost of loan programmes (as provided in the Credit Reform Act 1990).

4.4.2. Government banking arrangements

Under federal statute, Federal Reserve Banks act as fiscal agents and depositaries as directed by the Secretary of the Treasury.[20] These banks maintain the Treasury's accounts and accept deposits of federal taxes and other federal agency receipts. Most federal revenues paid to the Treasury are first deposited by individuals and corporations into commercial banks, which promptly credit them to the accounts of the Treasury. Treasury, in turn, ensures that the moneys are transferred to its accounts in the Federal Reserve Banks. With the main exceptions of the Department of Defence and overseas embassies, all federal government financial transactions pass through the Treasury's main account at the Federal Reserve Bank of New York.

4.4.3. In-year reporting to the legislature

The law (Title 31, s. 1106) requires the President to send a report to Congress updating the budget estimates before 16 July. The budget summary includes:

- For that fiscal year, substantial changes in estimates of expenditures (both obligations and cash) and receipts after submission of the budget and other information that the President decides it is advisable to provide to Congress.
- For the four fiscal years following the fiscal year for which the budget is submitted, information on estimated expenditures for programmes authorised to continue in future years or that are considered mandatory under the law.
- For future fiscal years, information on estimated expenditures of balances carried over from the current fiscal year.

These mid-year budget updates are prepared by the OMB. In August of each year, the CBO also prepares a mid term update, the budget and economic outlook, pursuant to the requirement in s. 202(e) of the CBA for the CBO to

provide periodic updates to the Senate and House Budget Committees. CBO methodology and assumptions are used for this report.

Whenever congressional budget committees need budget information, the OMB, the Treasury, and federal government agencies are obliged to provide it, following the provisions of Title 31, s. 1113. As a matter of course, the federal government publishes comprehensive reports on budget implementation. For example, the Treasury Department publishes a monthly report on total revenue and expenses within three weeks after the end of each month. This report compares total cumulative monthly receipts and outlays with the same period of the previous year.

4.4.4. Annual accounts and reports

The CFOA and subsequent amendments provides the framework for financial reporting for federal agencies. Agencies are required to prepare several financial statements annually including a balance sheet, a statement of operations or net costs, and a reconciliation with budget information. Agencies must undergo an annual audit by an independent entity, which reviews both the statements as well as underlying internal controls, and renders an opinion on the statements and controls.

After considering these, Treasury prepares a set of financial statements for the entire federal government audited by the GAO. Title 31 requires that the Secretary of the Treasury, not later than 31 March, in co-ordination with the Director of the OMB, submits to the President and the Congress an annual audited financial statement for the preceding fiscal year, covering all accounts and associated activities of the executive branch [s. 331(e)(1)]. The financial statement reflects the overall financial position, including assets and liabilities, and results of operations of the executive branch, and is prepared in accordance with the form and content requirements set forth by the Director of OMB. Furthermore, the Comptroller General shall audit the financial statement [s. 331(e)(2)].

Accordingly, the Secretary of the Treasury has published consolidated financial statements for the past six years audited by the GAO. The Financial Report of the United States Government provides, on an accrual basis of accounting, a comprehensive view of the federal government's finances. It states the government's financial position and condition, its revenues and costs, assets and liabilities, and other obligations and commitments. It also discusses important issues and conditions that may significantly affect future operations. The consolidated financial report is generally published prior to 15 December, which is 75 days after year-end rather than the six months after year-end as required by statute (IMF, 2003).

4.5. External audit

As the supreme audit institution, the GAO was established in the BAA in 1921 to help Congress fulfil its role in federal budget processes. Congress has subsequently clarified and expanded the original charter by subsequent acts and regulations (for example, the Accounting and Auditing Act 1950, the Federal Manager's Financial Integrity Act 1982, the CFOA 1990). With effect from 7 July 2004, the GAO's legal name became "the Government Accountability Office" under the GAO Human Capital Reform Act 2004 to better reflect its main functions (GAO, 2004). Most of legal provisions relating to the GAO are codified in Chapter 7 of Title 31.

4.5.1. Managerial, financial and operational independence

The law provides strong protection for the independence of the GAO. The most important productions are those relating to the tenure of the Comptroller General who is appointed for a single 15-year term by the President, confirmed by the Senate (Title 31, s. 703). The Comptroller General may only be removed by impeachment or joint resolution of Congress, and only for permanent disability, inefficiency, neglect of duty, malfeasance, a felony or conduct involving moral turpitude. The Comptroller General may appoint, pay, assign, and remove officers (except the Deputy Comptroller General) and employees that he/she decides are necessary to carry out the GAO's duties (s. 731). Furthermore, the GAO has financial independence. Title 31 prescribes that amounts necessary to carry out the GAO's mandate may be appropriated to the Comptroller General (s. 736).

4.5.2. Institutional coverage of audits

The Comptroller General is provided with wide-ranging powers to investigate all matters relating to the receipt, disbursement, and application of public funds (s. 712). The GAO therefore has authority to audit all federal departments and agencies. The law explicitly includes certain agencies, such as the Internal Revenue Service (s. 713), the Federal Reserve Board, the Federal Reserve Banks, and the Federal Deposit Insurance Corporation (s. 714) as being within the ambit of GAO's audit authority. Some of these institutions are outside "general government" as defined in National Accounts.

4.5.3. Types of audit

The scope of audit authority is wide, ranging from examining compliance with laws and financial controls as well as undertaking performance-oriented audits focusing on ascertaining the contributions of public programmes to important national outcomes and goals. Chapter 7, s. 712, elaborates on the

Comptroller General's investigatory powers cited above. These include authority to:

- Estimate the cost to the government of complying with each restriction on expenditures of a specific appropriation in a general appropriations law, and report the estimates to Congress.
- Analyse expenditures of each executive agency in order to help Congress decide whether public money has been used and expended economically and efficiently.
- Make investigations and reports upon the request of either house of Congress or a committee of Congress having jurisdiction over revenue, appropriations, or expenditures.

The Comptroller General also has authority to evaluate the results of programmes and activities carried out under existing law by departments and agencies on his own initiative or when either house of Congress orders an evaluation (s. 713).

4.5.4. *Powers of investigation*

Strong powers of investigation are provided in the law. Each agency is required to provide to the Comptroller General information the Comptroller General requires about the duties, powers, activities, organisation, and financial transactions of the agency (s. 716). When an agency record is not made available within a reasonable time, the Comptroller General may make a written request to the head of the agency, requiring him/her to provide the information within a 20-day period. Failure by the agency head to provide the requested information would result in the GAO informing the President, the OMB, the Attorney General and Congress in writing, which could lead to court action, as prescribed by law. The issuance of subpoenas is also envisaged in the law.

4.5.5. *Reporting obligations and publication*

At the beginning of each regular session of Congress, the Comptroller General is required to report to Congress (and to the President when requested by the President) on the work of the Comptroller General (s. 719). A report includes recommendations on:

- Legislation the Comptroller General considers necessary to make easier the prompt and accurate making and settlement of accounts.
- Other matters related to the receipt, disbursement, and use of public money which the Comptroller General considers advisable.

The Comptroller General also responds to requests for reports from Congress, including on expenditures and contracts an agency may be making

in violation of the law. He/she also reports on the adequacy and effectiveness of administrative audits of accounts and claims in an agency and on the inspections by an agency of offices and accounts. When the Comptroller General submits a report to Congress, he/she delivers copies of the report to the appropriations committees of each house, the Committee on Governmental Affairs (Senate), the Committee on Government Operations (House of Representatives), and the committee of Congress that requested information on the execution of a programme or activity of a department or other agency.

4.5.6. Enforcement of findings

When the Comptroller General makes a report that includes a recommendation to the head of an agency, the head of the agency must submit a written statement on action taken on the recommendation (s. 720). A 60-day limit for the submission of such statements to house committees is specified.

5. Sanctions and non-compliance

Titles 13 and 15 provide sanctions against overspending appropriations and provide penalties in case of non-compliance. First, a federal government officer may not make or authorise expenditures or obligations exceeding amounts available in an appropriation or fund. Nor may government employees involve the government in a contract or obligation for the payment of money before an appropriation is made unless authorised by law (s. 1341). Second, a government officer may not make or authorise an expenditure or obligation exceeding the amount apportioned by the OMB (s. 1517). Third, a government officer may not make or authorise an expenditure or obligation exceeding an allotment or sub-allotment (subdivisions of funds made by the Secretary of the Department below the OMB apportionment).

A government employee who violates s. 1341(a) is subject to administrative discipline including suspension from duty without pay or removal from office (s. 1349). If an officer or employee knowingly and willfully violates s. 1341(a), he/she can be fined up to a maximum of $5 000, imprisoned for up to two years, or both (s. 1350). The same rule applies to an officer or employee violating s. 1517.

Notes

1. This chapter is mainly limited to federal government budgeting processes. Each state has its own constitution and set of budget laws.
2. The Office of Management and Budget lists eight principal laws as the basic laws governing the federal budget process (OMB, 2004a): the Constitution; the Anti-deficiency Act 1905; Chapter 11 of Title 31, United States Code; the Congressional

Budget and Impoundment Control Act 1974; the Balanced Budget and Emergency Deficit Control Act 1985; the Budget Enforcement Act 1990; the Federal Credit Reform Act 1990; and the Government Performance and Results Act 1993. By contrast, the Congressional Research Service lists 18 laws as governing financial management, budget and accounting in the federal budget, including most of the laws in Box 1 (CRS, 2001).

3. The BEA's most important provisions, namely the caps on discretionary spending and the PAYGO rules for mandatory spending and revenue legislation expired at the end of fiscal year 2002 (30 September). The rest of the act is still an integral part of the federal budget process. See, for example, CBO, 2003.
4. The United States Code is the codification by subject matter of the general and permanent laws of the United States based on what is printed in the Statutes at Large. It is divided by broad subjects into 50 titles and published by the Office of the Law Revision Counsel of the House of Representatives. Hereinafter, all United States Code references are abbreviated to "Title X".
5. For more information, see Schick, 2002, and Senate Budget Committee, 1998a.
6. In the early 1970s, President Nixon repeatedly asserted authority (as had many of his predecessors) to withhold from federal agencies money appropriated by Congress. By 1973, it was believed that the President had impounded "excessive" amounts of spending previously approved by Congress.
7. In 1987, the Supreme Court ruled that the provision of GRH Act that vested certain powers in the GAO violated the separation of powers doctrine of the Constitution. Congress enacted the Balanced Budget and Emergency Deficit Control Reaffirmation Act which corrected the constitutional flaw in the GRH Act by assigning all the sequestration responsibilities to the OMB.
8. Initially set to expire in 1995, the procedures were extended twice – in 1993 and in 1997 – as part of two subsequent multi-year deficit-reduction agreements that also aimed at reducing or eliminating deficits. In each extension, the basic framework of the BEA was continued without major substantive changes.
9. Proposals include: reinstituting discretionary caps and PAYGO (excluding revenue legislation) for 2005-09, stricter standards for emergency designation in the BEA, changed requirements for the baseline, and line-item veto. Such proposals were included in the President's 2005 budget proposal (*www.whitehouse.gov/omb/budget/fy2005/pdf/spec.pdf*). See also CBO, 2003.
10. The PART consists of four sets of about 30 questions. The first set gauges whether programme design and purposes are clear and defensible. The second set involves strategic planning and weighs whether the agency sets valid annual and long-term goals for programmes. The third set rates agency management of programmes, including financial oversight and programme improvement efforts. The fourth set of questions focuses on programme results and reporting with accuracy and consistency.
11. In 1995, Congress passed the Line-Item Veto Act, which gave the President a statutory equivalent of a line-item veto. The act was challenged in the courts, and in June 1998 the Supreme Court ruled that the act violated the Constitution by permitting the President to unilaterally cancel spending without the agreement of Congress.
12. Including the Department of Homeland Security, created by the Homeland Security Act 2002 which is 187 pages long. The law's length is an indicator of the

extent to which Congress specifies functions and organisational structures in government.

13. See *www.house.gov/rules/RX.htm* for Rules of the House, and *http://rules.senate.gov/senaterules/rule25.htm* for Standing Rules of the Senate.
14. For a discussion of state tax expenditures, see Mikesell, 2002.
15. For a more general discussion of contingent liabilities and other sources of fiscal risk, see GAO, 2003.
16. The Omnibus Budget Reconciliation Act of 1990 added a new Title V to the CBA, notably the "Federal Credit Reform Act of 1990". The four stated purposes of the FCRA are to: 1) measure more accurately the costs of federal programmes; 2) place the cost of credit programmes on a budgetary basis equivalent to other federal spending; 3) encourage the delivery of benefits in the form most appropriate to the needs of beneficiaries; and 4) improve the allocation of resources among credit programmes and other spending (s. 501).
17. CBA points of order are a device by which any member of Congress can object to an amendment or a piece of legislation on the grounds that it is not within the limits set out in the budget resolution. For more discussion on this issue, see Heniff, 2001a, and Heniff, 2001b.
18. The US Treasury has noted that this definition lacks economic coherence, as it includes government "debt" owed to itself, but does not include a full measure of the government's unfunded liabilities. See National Debt fact sheet, *www.ustreas.gov/education/faq/markets/national-debt.html#q1*.
19. The original Impoundment Control Act permitted the President to defer funds for policy reasons.
20. For more information, see the Internet site of the Department of the Treasury, *www.fms.treas.gov/aboutfms/welcometofms.html*.

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OECD PUBLICATIONS, 2, rue André-Pascal, 75775 PARIS CEDEX 16
PRINTED IN FRANCE
(42 2004 05 1 P) ISSN 1608-7143 – No. 53981 2005

OECD Journal on Budgeting

Special Issue

The Legal Framework for Budget Systems

AN INTERNATIONAL COMPARISON

The legal basis for budget processes and budget actors varies enormously across OECD countries. For example, the United States has a dozen major laws to support federal government budget processes, while Denmark and Norway have never adopted any such law.

To understand this situation, this book compares legal frameworks for budgeting in 13 selected OECD countries. It presents detailed case studies of national budget system laws and identifies why the legal frameworks differ so much. The book also looks at theories of public finance and constitutional political economics, and discusses norms for an optimum legal framework.

With a focus on similarities and differences in formal laws (constitutions and statutes relating to the budget system), the comparative analysis will be useful for any government planning to reform its budget laws.

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OECDPUBLISHING

ISSN 1608-7143
2004 SUBSCRIPTION (4 ISSUES)

42 2004 05 1 P

Volume 4, No. 3