

Role of the Legislature in Budget Processes

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TECHNICAL NOTES AND MANUALS

Role of the Legislature in Budget Processes

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This note¹ addresses the following main issues:

- When, in the budget cycle, should parliaments be involved?
- What do parliaments typically approve, as distinct from what they review?
- What internal structures and support should parliaments have for scrutinizing governments' draft budgets and budget outcomes?
- What accountability and legal requirements should parliaments impose on the executive?
- How should legislatures' involvement in budget processes be formalized in laws and regulations?

Introduction

Constitutions specify the role of the legislature² and its relationship with the executive (hereafter “government”). Constitutions and/or budget system laws elaborate on the budgetary roles and powers of the legislature. Legal constraints and budgetary practices vary greatly across countries (Lienert, 2005; Stapenhurst et al. 2008; Wehner, 2006). Moreover, the role of the legislature is changing (Posner and Park, 2007), with parliaments playing a more active role in budget matters, especially in developing countries.

For promoting good governance and fiscal transparency, the legislature's active engagement in the budget process is essential. When fiscal policies and medium-term budgetary objectives are debated in parliament, budget strategies and policies are “owned” more widely. However, more active participation by the legislature runs the risk that fiscal discipline deteriorates. This is because the “common pool” problem, observed at the budget preparation stage within the

¹This note has benefited from review and valuable comments by R. Allen, M. Cangiano, A. Cherif, I. Fainboim, B. Goldsworthy, D. Jacobs, J. Kapsoli, and T. Prakash of the Fiscal Affairs Department and Professors M. Joyce of Queens University, Canada, and J. Wehner, London School of Economics, U.K.

²The terms “legislature” and “parliament” are used to synonymously in this note to indicate a country's law-adopting body, even though the term “parliament” is more appropriate in parliamentary systems of governance, and “legislature” is more often used in countries with presidential systems of governance.

government, may be large at the parliamentary approval stage. In particular, in countries where the legislature has unrestrained budget amendment authority, parliament is prone to introduce changes that increase spending or reduce taxes.

With this background, the main objectives of this note are:

- To review country practices regarding the widely varying roles of parliaments in budgetary processes. The focus is particularly on OECD country practices since most of these countries' parliaments have been active in budget matters for a long time.³
- To identify parliamentary budget procedures where “good” practice can be identified, as well as identifying areas of parliamentary budget review and approval where it is not possible to provide one-size-fits-all guidance for all countries.

Political factors may have considerable influence on parliamentary budget decision making, including: the role and organization of political parties; the composition of legislatures (one house or bicameral); the way consensus is reached within the legislature (including procedures for resolving differences between two chambers); the re-election incentives that members have to hold the government accountable; information asymmetries between members of the legislature and of the government; alliances between politicians and bureaucrats; and (within parliament) coordination problems of parliamentary committees and floor activities.⁴ These influences may be quite important. However, they are outside the scope of this note, which focuses on the issues enumerated in the five bullet points of the above box. Since there are diverse roles for, and constraints on, the legislature, this paper does not rank reform priorities, which necessarily need to be tailored to the needs of each country's parliamentary involvement in budget matters.

I. When Should Parliament Be Involved?

Parliament's main roles are to review and debate the government's draft *ex ante* budget (including its revenue estimates and its spending plans) and to authorize spending to implement the annual budget plan. Parliament also reviews budget execution and, in some countries, it formally approves and discharges the government after annual budget implementation. Other steps in which parliament may be involved include: pre-budget debates; review of the government's medium-term budget strategy; approval of supplementary budgets that modify the initial budget adopted by the legislature; and examination of the report of the external auditor. The following guidelines are based on the typical practice of adopting an annual budget.⁵

³The OECD budget practices survey, 2007, is used as a principal source of information. In some instances it was supplemented by the more detailed 2003 OECD survey. The quality of the OECD surveys differs from country to country; this should be kept in mind when interpreting the results.

⁴Saalfeld, 2000, who applies the principal-agency theory for parliamentary-government relationships, elaborates on several of these issues.

⁵Nearly all countries adopt budgets annually. Slovenia and some U.S. States adopt biennial budgets. In most cases, “biennial” budgets mean two consecutive 12-month budgets, presented on a rolling basis. Uruguay's parliament adopts a 5-year budget at the beginning of each government's term.

A. Pre-Budget Discussions in Parliament

Prior to adopting the annual budget close to the beginning of a new fiscal year, a number of countries have a pre-budget debate in parliament around the middle of the year preceding the new budget year. There are for two main purposes: (1) **information**—so that parliament becomes aware of the government’s fiscal policy intentions: the government presents its updated annual and medium-term budget strategy and policy priorities. In the case of France, the budget orientation debate is timed to coincide with the presentation to parliament of detailed budget performance reports of the previous fiscal year (Box 1); and (2) **provide “hard” multiyear fiscal targets and/or spending ceilings**, which the government must adhere to when preparing the detailed spending estimates for the upcoming fiscal year.

Good practice:

- The legislature should be provided with an opportunity for a pre-budget review of the government’s main budget orientations and proposals for the upcoming fiscal years, especially the next year’s annual budget strategy and main aggregates.

Box 1. Pre-Budget Debates and Guidelines Laws: Country Examples

- **France.** In the Organic Budget Law, 2001, there is a requirement for the government to present its overall budget orientations for the upcoming year (+1), as well as the annual performance reports for the previous year (-1). The main objective is to allow the National Assembly to debate, some 6-7 months before the start of the new fiscal year, the budgetary objectives and policy priorities for year (+1).
- **Brazil.** By end-June of each year (6 months before new fiscal year), Congress adopts a Budget Guidelines Law, which serves three main purposes: (1) it is a pre-budget document to encourage debate on the budget aggregates; (2) it sets out expenditures are considered “mandatory” for the coming year, that is, the programs that will be exempt from any reductions in the annual presidential decree implementing the budget; and (3) it formalizes budget targets for the upcoming fiscal year,¹ as well as the main assumptions underlying the budget.
- **Sweden.** There was a two-stage budget approval process during 1994-2002, under which parliament adopted “hard top-down” spending ceilings for the next three years in its Spring Bill. Later—three months before the new fiscal year (+1)—detailed estimates were presented in the Autumn Bill. In 2002, the system was changed. The government now presents proposals for budgetary policy in April, eight months before the year (+1). Ceilings are no longer approved by parliament at this stage: aggregate and specific ceilings for 27 expenditure areas are presented to parliament in September and subsequently approved. The main reason for the change was that parliament chose not to conduct two budget approval procedures every year.

¹In practice, the targets can be circumvented if the president adopts a decree implementing the budget with aggregates (and details) different from Congress’s guidelines.

B. Dates for Submitting and Approving Annual Budgets in Parliament

Submission date

In around 85% of OECD countries, the budget is presented 2–4 months prior to the beginning of the new fiscal year. However, there is a wide variance, from zero to eight months (Table 1). The United States at one extreme and the U.K. and countries of British inheritance at the other extreme.⁶

Date for budget approval

Several countries' laws require the annual budget law to be adopted before the beginning of the new fiscal year. Even if there is no legally-binding date, most OECD countries' parliaments adopt the annual budget law prior to the beginning of the new fiscal year. The exceptions are United Kingdom and countries influenced by the British system (e.g., Canada, Ireland, New Zealand, Anglophone Africa), which generally adopt their annual Appropriations Acts after the beginning of the fiscal year (OECD, 2007).

Time allowed for budget scrutiny by parliament

Prior to the beginning of the new fiscal year, parliaments typically have 2–3 months to review the detailed budget. This time period is usually adequate. A much longer period (eight months)

⁶In Westminster countries, the “minister of finance” typically presents the annual budget to parliament close to the start of the new fiscal year. During 1993–97, the U.K. government changed this cycle radically—see footnote 16 to U.K. case study in Lienert and Jung, 2004. Also, in these countries, tax measures are announced on budget night and enacted immediately, without parliamentary approval.

Table 1. Requirements for the Date of Submission of the Budget to the Legislature

Number of months in advance of fiscal year	Legal requirement			Practice (no legal requirement)
	Constitution	Law	Regulation of parliament	
More than 6 months		United States (8 months)		
4–6 months	Denmark (4 months), Finland ¹	Germany (4 months)	Norway (4 months)	
2–4 months	France, Spain (3 months), Korea (90 days)	Japan (2–3 months), Sweden (3½ months)		
0–2 months				Canada
After year begins		New Zealand (no later than one month after year begins)		United Kingdom

¹Finland'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. Source: Lienert and Jung, 2004.

is allowed in the United States, as the legislature's role is complex, involving many congressional committees of a bicameral legislature. In countries with strong governments and relatively weak parliament, the time period allowed to discuss budgetary estimates can be quite short.

Good practice:

- The government should submit its draft annual budget to parliament 2–4 months in advance of the beginning of the new fiscal year.
- Parliament should be allowed 2–4 months to scrutinize, debate, and propose alternative budgetary policies (within limits of cost), prior to adopting and promulgating the annual budget before the new fiscal year begins.

C. Reversion Budgets

If the budget is not approved by the legislature before the start of a new fiscal year, it is important to have clear rules to ensure that existing government programs continue as from day 1 of the new fiscal year. Nearly all countries have procedures in place to avoid a shutdown of government. Many countries have procedures in place for executing the budget on a monthly basis, calculated at $\frac{1}{12}$ th of the annual budget of the previous year. There are two main choices for “reversionary” budgets, which are often specified in a budget system law adopted by parliament:

- The executive's proposed budget, including changes in policies, takes effect, usually for a time-limited period (Finland, Germany, and Japan provide examples).
- The previous year's budget takes effect, usually on the basis of “unchanged” policies: no new major projects or expansions of existing programs, except perhaps for inflation adjustments of spending.

Good practice:

- When parliament does not adopt the budget for year N+1 by the end of year N, the executive should begin implementing the previous year's budget spending at the rate of $\frac{1}{12}$ th per month (for some spending, seasonal patterns need to be taken into account). This requires clear rules on what is meant by “on the basis of existing policies” and also on the duration (number of months) for which the previous-year budget is re-enacted automatically.
- The basis of reversion budgets should be clearly laid out in law.

D. Supplementary or Rectifying Budgets

Most countries' executives are empowered to present a supplementary budget to parliament during the course of a fiscal year. The main two reasons why countries adopt supplementary budgets are because of “new policies” or “changed circumstances” (OECD, 2007). Other reasons include natural disasters, ad hoc emergencies, and legal obligations, including parliamentary approval of changes within spending categories and use of unallocated contingency funds, cancellation of approved spending, or end-of-year account clean-up.

Parliament may adopt a law to specify the reasons for supplementary budgets. For example, Japan's 1947 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. Some Latin American countries (e.g., Paraguay, Peru) adopt supplementary budgets when a new financing source is secured (the initial annual budget is based only on secured financing); a preferable practice would be for the legislature to approve total financing ceilings as well as the government's proposed debt management strategy, which includes new borrowings.

Some countries adopt several supplementary budgets per year. This may reflect poor budget preparation procedures or inappropriate costing of policies, and/or failure for governments to adhere to announced budget policies. It is unusual for parliament to adopt a law that restricts the number or timing of supplementary budgets.

Good practice

- Specify in law the main reasons for allowing adoption of supplementary budgets.
- Avoid adopting an excessive number of supplementary budgets, by anticipating major policy changes in advance of the annual budget. Regular budget reviews (e.g., mid-year) or periodic comprehensive spending reviews by parliament are helpful.

II. What Should Parliament Review and Approve?

This section examines what the legislature typically approves, as well as aspects of good fiscal management that it should at least review.

A. Fiscal Rules and Debt Strategy

A fiscal rule is a durable constraint on budgetary discretion, often through numerical limits on budget aggregates such as the fiscal balance, total revenues, total expenditures, and/or debt.⁷ Fiscal rules can be endorsed by the legislature, either formally by incorporating them into a law or informally, by reviewing them. Fiscal rules generally apply to aggregates that are broad in coverage, although this varies from country to country. Expenditure rules in OECD countries, when comprehensive, have several advantages (Anderson et al, 2006). More generally, fiscal rules are most effective when there is political consensus to enforce them and when they have some flexibility for dealing with adverse shocks.

The legislature's adoption of fiscal rules signals that elected representatives are also concerned about fiscal discipline. However, fiscal rules are not a panacea. Experience shows that quantitative fiscal rules, even when adopted by the legislature, have failed when targets are unrealistic, when political commitment is inadequate, or when mechanisms for compliance are ineffective (Schick, 2003; Corbacho and Schwartz, 2007).

⁷These constraints may be absolute levels (in nominal or real terms) or, more frequently, as ratios to GDP.

If high public debt and long-term fiscal sustainability are issues, approval of an annually-updated debt management strategy (conceived in the context of a medium-term fiscal framework—see below) by the legislature, like fiscal rules, can be useful for implicating the legislature in efforts to achieve and maintain fiscal discipline.

Good practice:

- When fiscal sustainability is under threat and/or after fiscal consolidation has begun, adoption of fiscal rules by the legislature can be helpful to support achieving agreed objectives for sustainable medium-term fiscal and debt positions (IMF, 2009).
- Incorporate quantitative fiscal rules into law only if the targets are realistic, political commitment is adequate and there are functioning compliance mechanisms for achieving them.
- The legislature should review and endorse the government’s annual debt management action plan (or better, its asset-liability management plan), consistent with agreed medium-term objectives for gross and net debt.

B. Macrofiscal Framework

Although most OECD governments propose to their legislatures a medium-term budget strategy and fiscal framework, its credibility is enhanced when the legislature endorses it. In this context, an independent public body (a “fiscal council”) can be helpful for providing alternative budgetary analysis (Debrun et al, 2008).

Macroeconomic assumptions underlying the budget projections

The main macroeconomic assumptions underlying the annual budget projections are clearly presented to parliament in 93 percent of OECD countries (OECD, 2007). However, most parliaments do not examine these assumptions in depth, nor do they change the basic assumptions proposed by the executive. In a few countries, the budget’s assumptions are influenced or prepared by an independent agency (e.g., Canada—the average of private sector forecasts is one input used by the government; the Netherlands—the Central Planning Bureau). In the U.K., the budget’s assumptions are submitted to the National Audit Office for review. In some countries, the legislature has a nonpartisan budget office that provides independent opinions on budget assumptions and policies. These practices minimize questioning by parliaments of the economic assumptions underlying the budget projections.

Revenue projections

The methodology and assumptions underlying the budget’s revenue projections are publicly available in the majority of OECD countries (OECD, 2007). Several countries project revenues conservatively.⁸ However, most countries’ parliaments do not focus attention on the revenue

⁸In a sample of 11 advanced countries, eight projected total revenues prudently. See revenue/GDP forecasting errors in Table 7 of Mühleisen et al, 2005. For some years, Canada systematically built a prudence factor into its fiscal framework, including by not projecting revenues “realistically” but “conservatively”, to ease the attainment of budget/debt targets should revenues not be forthcoming as projected.

projections per se. Instead, parliamentary committees focus on revenue policies and changes in them that the government is proposing to attain fiscal targets.

Medium-term budget framework

Parliament can influence budgetary policies and facilitate desirable fiscal adjustment by adopting a medium-term budget framework (MTBF), or at least endorsing the medium-term budget objectives proposed by the government. The MTBF typically covers at least two years beyond the new budget year. Although not legally-binding in the sense that parliament formally adopts a law with annual spending aggregates for each of the years of the medium term,⁹ the expenditure aggregates for each year are nonetheless firm upper limits on total spending, that is, they guide each annual or supplementary budget.

Good practice

- Provide to the legislature, in the context of the draft annual budget, a clear set of macro-fiscal assumptions, preferably with inputs, or after review by, an independent body (“fiscal council”).
- Governments should present to parliament an MTBF, covering at least the upcoming three fiscal years. Parliament should either endorse the government’s MTBF to guide its consideration of the proposed annual budget, or adopt its own MTBF that transparently lays out the aggregates that the legislature agrees to attain in the years beyond the annual budget.

C. Structure, Classification, Type, and Duration of Annual Budget Appropriations

Structure and classification

Budget classification structures for expenditures, used in annual appropriations laws, are usually a combination of the following:¹⁰

- Administrative unit (government ministries/agencies and departments/divisions within agencies).
- Program/subprogram/activity/project; alternatively outcomes and/or outputs.
- Economic type (“inputs” such as salaries, transfers, other non-salary current expenditures, capital spending).
- Functional and subfunctions (following the international classification).

Legislatures may approve the structure and format of annual appropriations. Country practice varies. At one extreme, the U.S. Congress effectively changes the format of the annual appropriations every year, since it adds thousands of specific items via “earmarked” spending. At the other extreme, the British parliament cannot change the format of the annual Estimates of

⁹To address its huge fiscal deficit in 1993 (12% of GDP), Sweden adopted multiannual “top down” spending restraint in the 1990s: the government’s three-year limits on total spending outcomes were endorsed annually by the Swedish parliament at the pre-budget stage (“Spring bill”). See Ljungman, 2009.

¹⁰The annual accounts—and possibly the annual budget—may incorporate other classification dimensions, including for (1) location (central government—capital city and deconcentrated expenditures; local governments) and (2) financing sources (domestic revenues, including taxes earmarked for specific purposes; external loans or grants).

spending: based on long-standing tradition, the British government alone has the prerogative to propose the format of the Estimates subject to parliamentary control.

Between these two extremes, a parliament may adopt a law specifying the format of annual appropriations for each ministry. For example, in Germany, the budget principles law requires detailed economic and functional classifications to be applied to all levels of government—Federal, provincial and municipal. In France, the 2001 Organic Budget Law requires budget appropriations by mission and program. France’s Parliament initiated this law, which resulted in considerable simplification of the budget appropriation structure.

If parliament wishes to hold the government accountable for performance, “outputs” and results, parliament would abandon a very detailed budget of “inputs” and its control over every line item. In this context, while there is no optimal number of budget line items in an annual budget, it is clear that when there are more than, say 1,000 lines, the transparency of the budget’s main objectives are lost. The wide differences in the number of line items in annual budgets (Table 2) are largely a reflection of the degree to which parliament wishes to focus on results, as opposed to input controls.

Flexibility for swapping between budget line items (virement powers)

Irrespective of whether parliament approves appropriations by ministry/agency, program, economic category, etc. parliament may require the executive to seek its approval for changes in: (1) every budget line item; (2) most budget line items—but delegating some virement power to the ministry of finance (MoF), which in turn decides on the extent to which spending ministries may change within detailed budget categories; or (3) only a few relatively large categories of appropriations.

Again, country practices differ widely. For example, in the 30 OECD countries, six cannot increase discretionary spending; a further six may increase such spending without restriction

Table 2. Number of Line Items in Annual Budgets of OECD Countries

Number of line items	Number of countries	Percentage	Countries
Up to 200	8	26.7	Australia, Canada, France, Luxembourg, Mexico, Netherlands, Poland, South Korea
From 201 to 500	3	10.0	Belgium, Finland, Sweden
From 501 to 1000	8	26.7	Czech Republic, Greece, Hungary, Ireland, Japan, New Zealand, Portugal, Slovakia
From 1001 to 2000	7	23.3	Austria, Denmark, Iceland, Italy, Norway, Switzerland, USA
More than 2000	3	10.0	Germany, Spain, Turkey
Not reported	1	3.2	United Kingdom

Source: OECD, 2007.

(OECD, 2007). Of the remaining 18 countries, the legislature's prior approval is usually required prior to such increases, although in some countries, parliamentary approval of swapping between line items is ex post.

Contingency reserve funds

Many countries' parliaments grant to the executive the authority to spend from an unallocated centrally-controlled contingency reserve. Reserve funds provide flexibility to the government in executing the annual budget—especially for meeting unforeseen and urgent expenditures. Such reserves need to be subject to conditions, including on the size of the reserve, the nature of spending, the access to the reserve by spending ministries (the reserve is typically controlled by the MoF), the frequency of reporting to inform parliament on actual spending from the reserve. If the contingency reserve is large, the parliament delegates significant authority to the executive to decide on the allocation of resources in the annual budget. An appropriate balance is needed between no contingency reserve and a reserve that provides too much authority to the executive to spend without parliamentary approval.

Types and duration of annual appropriations

The approval of spending by parliament is not necessarily through annual appropriations. For example, in federal countries (e.g., Australia, Canada, United States), only a small portion of annual spending is authorized by Annual Appropriations Acts. Other laws provide funding authority, e.g., laws pertaining to transfers to subnational governments or government social security systems. However, in many countries, annual appropriation acts are more comprehensive and include all transfers.

A sharp distinction can be made between “authority to spend” and “cash payments”. In some countries (e.g., Germany), the annual budget law provides for limits on both spending commitments and cash payments, at a detailed level. In most countries, a cash-based system is practiced, although in a few (e.g., the United Kingdom), appropriations are accrual-based.

Binding upper limits apply to most expenditures, although in some countries, exceptions are specified in law.¹¹ For example, Finland's State Budget Act specifies the following types of appropriations:

- **Fixed appropriations.** These appropriations may never be exceeded—the annual budget provides legally binding upper limits for spending.
- **Multiannual 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 beyond the budget year in which the appropriation was approved.

¹¹A budget system law may distinguish between appropriations that may not be exceeded (without severe penalties) and those where the upper limit may be exceeded, that is, payments must be made because it is legal obligation (e.g., to service debt on time), irrespective of whether or not the MoF's budget estimates, based on assumptions on nominal interest rates, etc. are correct.

Concerning the duration of appropriations, most OECD governments are permitted by parliament to carry over unused funds to the following year, especially for investment spending. Carryover provisions usually have restrictions. At a minimum, the approval of the minister of finance is needed and, in several countries, end-year carryover of unused annual appropriations can only be made following approval by the legislature.

Good practice

In all of the above areas of budget management, there is no universal good practice applicable to all countries' parliaments. This reflects differences in the degree of flexibility in budget management that legislatures have delegated to governments, a result of differing constitutional, institutional and organizational arrangements, and practices accumulated over many decades (or even centuries). The following "guidelines" are therefore tentative:

- Regarding **the structure of the annual budget appropriations**, parliament may wish to adopt a law that provides a "permanent" format of the annual budget, especially if the focus is on transparently presenting the objectives and expected results (performance) of the government's proposed budget policies.
- For **virement**, if parliament is focusing on the results of budget policies, rather than on narrower constituency concerns, it may approve a broad-banding of annual appropriations and impose on the government only a few virement restrictions, for example, no underspending of investment in order to increase salaries. If, on the other hand, parliament chooses to maintain a detailed appropriations structure, good practice would be to delegate to the government the authority to swap spending between line items, especially at the most detailed level (the MoF would regulate this by a decree).
- Concerning an annual budget **contingency reserve**, parliament may wish to (permanently) approve a reserve amounting to 1–3% of total expenditure, which the executive would spend on genuine unforeseen emergencies. For accountability, parliament should be informed by the government, at regular intervals, of the amount and object of the spending.
- Regarding the **types of appropriations**, in a budget system law, parliament can specify that, in annual appropriations acts, the government is provided with authority to spend: (1) at the commitment, accrual, or cash stages of spending; and (2) the few types of annual appropriations (e.g., debt servicing) that can be exceeded without ex ante parliamentary authority.
- **Spending outside appropriation acts**. Parliament needs to be informed of annual spending that is excluded from annual appropriations laws. The annually-updated MTBF, which would include spending based on the authority of other laws, is a useful instrument for this purpose.
- **Duration of annual appropriations**. While the principle of annuality should be upheld, exceptions can be justified. Parliament should provide the authority for exceptions, notably for

carrying-over annual appropriations. Restrictions on carryover are appropriate, especially for current expenditures.¹²

D. Budget Amendment Powers

Around half of the 30 OECD countries' parliaments have unlimited legal power to amend the draft budget. In some presidential systems, the president may have either line-item or full veto power to repulse congressional budget amendments. Also, although some countries with coalition governments have parliaments with unrestricted legal authority to amend the budget, in practice, a parliament may not be able to exercise this power, because a coalition agreement may have been reached by the political parties composing the government (which usually holds the majority vote in parliament). Such coalition agreements act as a powerful constraint for the period in which the government is in power. This restraint is important in several European countries with multiparty governments, including Finland, Germany, and the Netherlands.

Restrictions on parliamentary amendment power assist in achieving fiscal consolidation and sustainable fiscal positions (Wehner, 2010). If elected representatives primarily serve their constituencies by increasing specific expenditures, rather than serving the national interest by achieving and maintaining a sustainable fiscal position, the imposition of formal restraints on the legislature's amendment powers is justified.

In some countries, expenditures may be increased provided the legislature also raises additional revenues to finance higher spending; in others, total expenditure cannot be increased beyond that proposed by the executive—the legislature is only permitted to reallocate between expenditures. This has found to be effective for preserving fiscal sustainability, including in many Latin American countries (e.g., Chile). The most severe restriction is no amendment power: the legislature can only approve or reject the executive's draft budget.

Restrictions on amendment powers can aim at preventing the legislature from increasing the proposed budget balance (surplus or deficit). Deficit-neutral amendment powers require the legislature to act responsibly by not transferring the tax burden of today's spending to future generations. However, if parliament uses its powers to increase or reallocate spending, it can result in less efficient spending, especially if the changes introduced by the legislature are to meet concerns of constituents.

Good practice

- While national choices will dictate the extent to which democratically-elected members of the legislature are restrained from making open-ended spending decisions that impact adversely on fiscal sustainability, the limitation of not changing the executive's proposed fiscal balance gives the legislature capacity to increase total expenditure provided it raises revenues to offset spending.

¹²For a fuller discussion, see Guidance Note on Carryover of Budget Authority by I. Lienert and G. Ljungman, <http://blog-pfm.imf.org/pfmblog/2009/01/carryover-of-budget-authority.html>.

E. Extrabudgetary Funds, Fiscal Risks, and Tax Expenditures

In several countries, off-budget spending takes place, that is, outside the authority of annual appropriations acts. One major example is for social security funds where, in a number of countries, annual social security spending is approved by parliament in a process separate from annual appropriations acts. Parliaments may also approve off-budget funds. For example, a spending agency may be authorized to collect fees with only net expenditure being approved by parliament. In general, it is not desirable that off-budget spending escapes parliamentary control.

The fiscal outlook requires not only projections, but also an analysis of the various risks threatening the fiscal position, for example, off-budget loans, contingent liabilities such as loan guarantees, the risks of public-private partnerships. Parliament needs to be fully informed in budget documents of off-budget spending and contingent liabilities. A fiscal risk statement listing all major potential claims on the government, and quantifying them, if possible, contributes to parliament's understandings when assessing and approving the budget.

Tax expenditures can be another form of off-budget spending. Tax expenditures are exemptions and other tax concessions that fall outside the usual benchmarks for taxes. They are adopted to provide a benefit to a specific activity or class of taxpayer. Although there is a debate on how to measure tax expenditures, given their quasi-budgetary nature, parliament needs to be informed as to their amplitude, so as to exercise control over their size.

Good practice

- Parliament should avoid approving laws that authorize off-budget spending unless there are highly transparent arrangements for recording, monitoring, reporting, and auditing all financial transaction associated with them. Similarly, if parliament must introduce tax expenditures (a second best practice) this should not be outside the normal budget cycle, that is, tax expenditures should be considered alongside regular budget spending.
- Parliament should require the government to provide full and regular reports on all extrabudgetary spending, contingent liabilities, and quasi-fiscal activities.
- A comprehensive Fiscal Risk Statement and estimates of tax expenditure should be presented to parliament, preferably as part of annual budget documentation.

F Expenditure Control, Internal Audit, and Government Accounting

In many countries, parliaments entrust the government with the task of implementing the annual budget. Expenditure control and internal audit are normally the responsibility of the government, which implements procedures by issuing relevant internal decrees/regulations. It is relatively unusual for the legislature to get heavily involved in budget execution, control, and accounting. However, in only a few countries does the legislature intervene in what is typically regarded as the prerogative of the executive.¹³

¹³The United States is a prime example. Federal laws include: the Inspector General (IG) Act 1978; the Chief Financial Officers Act, 1990; and the Federal Financial Management Improvement Act, 1996. The IG Act requires

It would be highly unusual for a parliament to initiate changes in the government accounting system. Nonetheless, substantive changes in the basis of government accounting should be reviewed by parliament and general provisions for government accounting may be included in law, to facilitate parliamentary oversight of the government accounting system. Although a Government Accounting Standards Board is typically advised by the MoF (which may draw up technical accounting standards for use in government), an advisory board with representation from bodies/agencies outside the executive may be established in law (see, for example, the U.K.'s Government Resources and Accounts Act, 2000). Countries whose parliaments have strong parliamentary public accounts committees (PACs) could be expected to draft changes in accounting standards for PAC review.

Good practice

- Parliamentary oversight of governments' internal control/audit systems is best communicated via reports of the external auditor. The legislature should limit its direct oversight of internal control and audit internal in government spending agencies.
- The executive should seek parliamentary input when contemplating major revisions of the government accounting system, for example, moves to accrual-based accounting.

III. What Support Does Parliament Need for Budgeting?

A. Parliamentary Committees

Most countries' parliaments have a number of sectoral committees to deal with specific budget-related issues in agriculture, defense, education, health, etc. About 40% of OECD countries have a specialist budget committee to examine the government's draft budget proposals. A strong budget committee can play an important role, especially if its decisions are final, that is, the plenary session endorses the committee's budgetary decisions.¹⁴ Westminster countries traditionally have a PAC to scrutinize budget outcomes, but a committee that examines and proposes changes in the government's draft ex ante budget, if it exists, has limited involvement (this reflects the near-absence of parliamentary budget amendment authority in such countries).

In balancing the overall consistency of budget policies, the need for fiscal discipline at parliament, and parliamentarians' sectoral spending priorities, the following three main options exist for the relative powers of parliamentary committees.

Inspectors General in federal departments to report not only to the head of the government agency in which he/she is placed, but also to Congress. The latter reporting requirement is highly unusual and blurs the distinction between internal and external audit.

¹⁴In the United States, budget committees for each house were created by legislation in 1974. Their role is to make proposals ("budget resolutions") for fiscal aggregates to guide sectoral committees of Congress. However, the budget resolutions are not legally binding constraints on aggregate spending and in some recent years, Congress has failed to adopt a budget resolution. While the budget committee influences the size of each of the 13 annual Appropriation Acts, the powerful Appropriations Committees (one for each House of Congress, each with several subcommittees) affect budget allocation and total spending, which often includes earmarked spending for particular interests.

- A budget committee sets aggregate and sectoral spending ceilings; sectoral committees decide on detailed sector-specific appropriations within the ceilings provided by the budget committee.
- A budget committee considers overall fiscal policies and aggregates, but sectoral committees make recommendations that can result in higher sectoral expenditures.
- Only sectoral committees consider and approve appropriations in each sector. The budget committee, if it exists, provides assistance on the overall coherency of policies, but does not constrain total expenditure.

When parliament is responsible regarding fiscal aggregates, that is, is concerned of the implication of budget changes on achieving medium-term fiscal objectives and longer-term fiscal sustainability, the first option—a “top-down” approach—provides the strongest institutional framework for fiscal discipline by parliament. In Sweden, parliamentary committees were realigned and made responsible for reviewing specific “expenditure areas” when a “top-down” budget system was introduced in the 1990s (Ljungman, 2009; 2007).

To avoid a proliferation of committees, France limits the total number of permanent parliamentary committees to six. However, when this occurs, subcommittees may need to be created so that they are aligned with the administrative, sectoral or program structure of the draft budget. Also, the committees need adequate analytical and research support.

Good practice

- Establish a budget committee (or two committees in the case of bicameral legislatures) charged with setting (or endorsing) aggregate spending targets and sectoral allocations. Such a committee can be responsible for scrutinizing the government’s proposed ex ante budget, as well as ex post budget execution.
- The work of sectoral parliamentary committees should be subject to spending ceilings proposed by the budget committee.
- Provide the budget committee with strong powers and adequate analytical support to enforce budget spending discipline on sectoral committees.

B. Parliamentary Budget Offices¹⁵

In budgetary matters, the legislature can receive technical and analytical support from either: (1) an independent nonpartisan parliamentary/congressional budget office; or (2) a limited number of officials (possibly, but not necessarily, civil servants on secondment to parliament) who provide analytical support to the budget committee or other parliamentary committees. Thirteen OECD countries have established some form of specialist budget office attached to the legislature.

Recently-created ones, such as those in Canada, Korea, and Mexico have been influenced by the USA’s Congressional Budget Office (CBO), created by legislation in 1974.

¹⁵Further international experience with such offices, see Anderson, 2008, and Johnson and Stapenhurst, 2008.

Countries' parliaments have established nonpartisan budget offices for four main purposes:

- Provide budget analysis and independent advice to parliamentarians from both the majority and minority parties represented in the legislature.
- Provide the legislature with medium-term fiscal projections and scenarios that may differ to those prepared by the government.
- Quantify the impact of alternative new tax or spending policies, especially (but not exclusively) on the budget for the forthcoming new fiscal year.
- Remedy the lack of time and analytical capacity that elected representatives have to analyze the details of draft budgets and to propose alternative budget policies.

Good practice

- The establishment of a parliamentary budget office can be a useful adjunct for analyzing budget policy alternatives, thereby enhancing parliament's capacity to evaluate the government's proposed budgets and to propose responsible alternatives.

C. Funding of Parliament

Parliament can perform its role effectively when it is adequately funded and when it has autonomy for preparing its own budget. Many OECD countries' legislatures prepare their own budgets, which typically are not altered by the executive. Parliaments' budgets are small relative to the national budget, although in some emerging countries, this percentage can be a lot higher.¹⁶ The variances amongst countries are attributable to the differences in remuneration of members of parliament, administration costs, grants to political groups, and investment in buildings (Stapenhurst, 2007).

Good practice

- While parliaments' budget should be prepared independently from that of the executive, parliaments should nonetheless be subject to the same general procedures for executing and reporting on spending of their own budgets.
- In particular, parliaments should not abuse their powers by increasing parliament's operating and investment expenses so that they become out of line with other national constitutional entities (e.g., expenses of the judiciary, the external auditor).

IV. Accountability of the Executive to the Legislature in Budget Matters

A. Reporting to Parliament and Fiscal Responsibility Laws

Parliaments in the majority of OECD countries have included in law a requirement for the government to accompany the annual budget with medium-term budget projections of revenues and spending for years beyond the next fiscal year. It is increasingly common to (1) distinguish the

¹⁶According to a survey by the Association of Secretaries General of Parliaments in 1998, the budget of Indonesia's parliament amounted to 1.17% of the national budget, compared with 0.1–0.3% in OECD countries.

medium-term budget impact of new revenue and expenditure policies; (2) include scenarios of the medium-term impact of alternative budgetary policies; (3) extend the projection period beyond the “medium term”, by conducting long-term analyses of the impact on the budget of projected changes in demographic variables (ageing populations, birth rates, immigration) or other factors such as health care or environmental costs.

Well-specified ex ante reporting requirements can enhance fiscal transparency. For this reason, a few countries have adopted Fiscal Responsibility Laws (FRL), which may also include fiscal rules. Governments are required to publish their medium-term fiscal intentions and annual budget strategy—see Box 2 for good practices.

Besides ex ante reporting requirements, parliament can impose ex post reporting requirements on the government, to ensure that parliamentary oversight of annual budget execution and implementation of annual or medium-term fiscal policies take place at regular intervals. In about one third of OECD countries, it is a legal requirement for the legislature to be provided with a comparison of actual spending with budgeted spending. In some countries (particularly francophone or Spanish-speaking), parliament is legally required to adopt a Budget Execution Law. To be relevant, this needs to be done a few months after the end of the fiscal year and, if possible, to coincide with the pre-budget parliamentary debate.

Good practice

- Parliament should ensure that it is provided with adequate and timely budget reports for understanding the ex ante budget (especially how the annual budget is contributing to the attainment of medium-term fiscal targets) and for holding the government to account after execution of the annual budget. In this context, it is important that parliament receives final reports or accounts that compare, in identical format, the budget outcome with the ex ante budget as adopted by parliament.
- Long-term fiscal projections, including the impact of demographic changes, should also be prepared.
- Budget execution and accountability reports by government (agencies) should be provided to parliament. Depending on the type of budget system (e.g., performance-oriented), such obligations can be incorporated into law, possibly a FRL.

B. Submission and Follow-up of External Audit Annual Report to Legislature

The annual report of the external audit office provides parliament with an opportunity to discuss the outcome of the previous year’s budget and, if needed, to take follow-up actions. Nearly all OECD countries’ external audit reports on annual financial accounts are made available publicly within 12 months; slightly less than half of these 30 countries’ parliaments receive them within 6 months after year-end. Reporting lags are longer in non-OECD countries. In lower-income countries, the longer delays often reflect long lags in the external audit office receiving annual accounts from the government, as well as limited audit capacity in external audit offices. The IMF’s

Box 2. Good Practices in Fiscal Reporting to Parliament

- **A proposed fiscal strategy report.** The government's fiscal strategy should be tabled in parliament with the draft annual budget. It may lay out: (1) long-term fiscal objectives (10 or more years) for fiscal policy, for example, total revenues and expenses; fiscal balances and total debt; and (2) medium-term fiscal objectives (three or more years) that update previous MTBF projections and justify why any changes are being made (either relative to a binding fiscal rule, or previous medium-term objectives).
- **Annual budget policy statement.** This lays out the strategic priorities for the forthcoming budget including overarching policy goals and consistency with the most recent medium-term announced fiscal intentions or binding fiscal rules. It would describe: (1) major proposed tax changes; (2) changes in expenditure policies; and (3) changes in asset and liabilities that impact on the budget aggregates, as well as quantify the impact of each major new policy (including changes in tax expenditures).
- **Economic and fiscal updates.** Each update should contain economic and fiscal forecasts for the year to which the update relates and the subsequent two years. The following updates could be required: (1) an economic and fiscal update, to be tabled with the budget; (2) a mid-year economic and fiscal update, for a pre-budget debate; and (3) a pre-election economic and fiscal update, 20-30 working days before the date of any parliamentary or presidential elections. Significant assumptions underlying the economic forecasts (GDP growth, consumer prices, exchange rate, (un)employment rate, etc.) should be disclosed.
- **Long-term fiscal reporting.** Periodically, for example, once every 2–4 years, a statement on the long-term fiscal position, covering at least 40 years, should be prepared. Such projections would provide a comprehensive report of issues such as aging populations or health care costs in the long term that impact the fiscal balance and government net worth. Such reports assist the legislature to make responsible fiscal policy decisions.

Fiscal Transparency Manual (IMF, 2007) and OECD (2002) suggest that best practice is a lag of 6 months. In practice, some OECD countries prepare audited annual financial statements in under four months.

Parliamentary regulations and practices dictate the procedures and allowable time for dedicated parliamentary committees to discuss the report of the external auditor and follow-up on its recommendations. External audit reports are circulated and discussed in parliament, either by a budget committee or in parliament's plenary session. Many OECD countries have put in place a system for systematic tracking of the implementation of the recommendations found in the reports of the external auditor. In several countries, it is a legal obligation to follow up on the recommendations of the national external auditor.

Good practice:

- The external audit report on annual budget performance should be received by parliament within six months, so that the audit report for Y(-1) outcome can be used by parliament in pre-budget discussions on the budget strategy for Y(+1).
- Establish formal institutional arrangements at the legislature for systematic follow-up of external audit findings, e.g., the budget committee of parliament should report on the extent to which the executive has responded to the recommendations of the external auditor.

C. Hearings/Questions by Parliament

It is a frequent practice for ministers and heads of government departments/agencies to appear before parliamentary committees to answer questions or testify (OECD, 2003). Parliamentary rules are needed to ensure questions are focused, agendas are distributed in advance to enable respondents to prepare, and parliamentary committees and political party combinations coordinate to achieve productive interaction with the members of government. Procedures for deciding on effective leadership of committees and reaching decisions and/or consensus are important.

Good practice

- Require ministers and senior civil services to appear before specialist parliamentary committees and/or the budget committee and answer questions pertaining to ex ante budget and ex post budget execution and accounts.
- Parliament's internal regulations should specify the rules applicable for hearings and questioning.

V. Formalizing the Legislature's Budget Rules and Procedures

A. Embedding Parliamentary Budget Procedures in Laws

Parliaments can contribute to budget indiscipline by approving spending from the “common pool” and directing it to ends not justified in terms of achieving stated budgetary objectives. This problem can be solved by placing firm restrictions on parliament's powers, including restraints on parliament's budget amendment powers (see section II D). There is some evidence that a “top-down” budget approval process in parliament can be helpful for consolidating public finances (Ljungman, 2009).

The various budget rules, procedures, limitations and requirements of both the legislature and the executive are spelt out in constitutions, laws, regulations and informal practices. Constitutional rules or budget system laws are useful when they lay out principles for good budget practice. However, there is danger in overloading budget systems laws, by including detailed provisions that take away budget flexibility that is needed by the executive in preparing and executing annual budgets. Depending on the role of law and the extent of separation of the powers of the legislature and the executive in budget processes, government regulations and other “secondary law” may

be the better legal instruments for providing the executive with budget flexibility, without taking away the legislature's budgetary prerogatives.

Good practice

- Include budget principles and procedures in budget system laws, especially when needed to implement constitutional requirements.
- Avoid overloading laws, including the constitution, with detailed budget rules, delegating details to the executive's regulations.

B. Internal Procedures and Regulations of the Legislature

Parliamentary regulations pertaining to, or impacting on, annual budgets and medium-term fiscal strategies, are highly variable across countries. Also, reflecting diverse budget powers of legislatures (Lienert, 2005; Wehner, 2006), internal organizational arrangements for considering draft annual budget and scrutinizing annual budget execution and financial statements display large differences across countries. There is no one-size-fits-all set of "Regulations of Parliament for Budget Processes". Nonetheless, some general considerations apply to all countries.

Good practice

- Formalize the legislature's internal rules for organizational arrangements for budget approval and review.
- Avoid using such regulations as substitutes for general budget procedures and restrictions that should be in law, not internal parliamentary regulations.

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