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OECD PRINCIPLES OF BUDGETARY GOVERNANCE

Introductory note

The objective of these Principles is to draw together the lessons of a decade and more of work by the OECD Working Party of Senior Budget Officials (SBO) and its associated Networks, along with the contributions and insights from other areas of the OECD and of the international budgeting community more generally. The Principles provide a concise overview of good practices across the full spectrum of budget activity, taking account in particular of the lessons of the recent economic crisis, and aim to give practical guidance for designing, implementing and improving budget systems to meet the challenges of the future. The overall intention is to provide a useful reference tool for policy-makers and practitioners around the world, and help ensure that public resources are planned, managed and used effectively to make a positive impact on citizens' lives.

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OECD PRINCIPLES OF BUDGETARY GOVERNANCE

Introduction: The fundamental national role of the budget and the budgeting process

The budget is a central policy document of government, showing how it will prioritise and achieve its annual and multi-annual objectives. Apart from financing new and existing programmes, the budget is the primary instrument for implementing fiscal policy, and thereby influencing the economy as a whole. Alongside other instruments of government policy – such as laws, regulation and joint action with other actors in society – the budget aims to turn plans and aspirations into reality. More than this, the budget is a contract between citizens and state, showing how resources are raised and allocated for the delivery of public services. Such a document must be clear, transparent and credible if it is to command trust, and to serve as a basis of accountability.

External stakeholders also look to the quality of the budget document, and of the budgeting process, in assessing the soundness and reliability of a state. The process of shaping the budget is typically led by the Treasury/Ministry of Finance (“central budget authority” or CBA), and draws together the contributions from ministers, parliamentarians, public officials and other trusted advisers, civil society organisations and advocacy groups and, increasingly, from citizens themselves. An *effective* budgetary process is one that takes these contributions, weighs and considers them, and transforms them into a set of proposals for action for the betterment of society. A *sound* budgeting system is one which engenders trust among citizens that government, in the broad sense, is listening to their concerns, has a plan for achieving worthwhile objectives, and will use the available resources effectively, efficiently and in a sustainable manner in doing so. “Budgetary governance” refers to the processes, laws, structures and institutions in place for ensuring that the budgeting system meets these objectives in a sustainable, enduring manner.

Budgeting is not simply the preserve of central governments: it is a process that encompasses all levels of government, national and subnational, where different mandates and levels of autonomy apply in different countries. Budget systems and procedures should be coordinated, coherent and consistent across levels of government. These budget principles are therefore relevant, and should be applied as appropriate, to all levels of government.

Moreover, budgeting is not a standalone process, removed from the other channels of government action. Good budgeting is supported by, and in turn supports, the various pillars of modern public governance: integrity, openness, participation, accountability and a strategic approach to planning and achieving national objectives. Budgeting is thus an essential keystone in the architecture of trust between states and their citizens.

Budgeting practices can vary widely across countries in light of traditional, institutional and cultural factors. However, based on the experience of the Senior Budget Officials (SBO) and the extensive analysis of various aspects of budgeting conducted by the SBO and its networks over recent years and related studies across the OECD (see Bibliography), the common elements of modern budgeting practice among OECD countries can be presented as high-level principles to guide and inform budgetary processes and reforms. Countries that organise their budgetary affairs on the basis of these governance principles, complementing their successful national approaches with international experiences, are well-placed to meet citizens’ expectations for sound, stable and effective public governance.

These principles deal with the various phases of the budget process, the attributes of the budget document, as well as the wider context within which budgets are formed. The OECD has developed, and is developing, more detailed principles and recommendations for further guidance on specific elements of the overall budgeting framework.

1. Budgets should be managed within clear, credible and predictable limits for fiscal policy.

- A sound fiscal policy is one which avoids the build-up of large, unsustainable debts, and which uses favourable economic times to build up resilience and buffers against more difficult times. This objective should be supported against the range of pressures that can impede governments from effecting counter-cyclical or cyclically neutral policies, and from using resource endowments prudently.
- At minimum, governments should have a stated commitment to pursue a sound and sustainable fiscal policy. The credibility of this commitment can be enhanced through clear and verifiable fiscal rules or policy objectives which make it easier for people to understand and to anticipate the government's fiscal policy course throughout the economic cycle, and through other institutional mechanisms (see point 10 below) to provide an independent perspective in this regard.
- Within these clear fiscal policy objectives, top-down budgetary management should be applied to align policies with resources for each year of a medium-term fiscal horizon. Overall budget targets for each year should ensure that all elements of revenue, expenditure and broader economic policy are consistent and are managed in line with the available resources.

2. Budgets should be closely aligned with the medium-term strategic priorities of government.

- To promote alignment with the multi-year planning, prioritisation and goal-setting functions of government, the budgeting process should *(a)* develop a stronger medium-term dimension, beyond the traditional annual cycle; and *(b)* organise and structure the budget allocations in a way that corresponds readily with national objectives.
- A medium-term expenditure framework (MTEF) is an important tool in setting a basis for the annual budget. To be effective, an MTEF should have real force in setting boundaries for the main categories of expenditure, for each year of the medium-term horizon; should be fully aligned with the top-down budgetary constraints agreed by government; should be grounded upon realistic forecasts for baseline expenditure (i.e. using existing policies), including a clear outline of key assumptions used; should show the correspondence with expenditure objectives and deliverables from national strategic plans; and should include sufficient institutional incentives and flexibility to ensure that expenditure boundaries are respected.
- The CBA should have a close working relationship with the other institutions at the centre of government (e.g. prime minister's office, cabinet office or planning ministry), given the inter-dependencies between the budget process and the achievement of government-wide policies.
- From time to time, governments may need to revisit or realign their fundamental priorities to take account of developments in the economy or in society. A regular process for reviewing existing expenditure and revenue policies (see point 8 below) can play a useful role in ensuring that budgetary expectations are managed in line with government-wide developments.

3. The capital budgeting framework should be designed to meet national development needs in a cost-effective and coherent manner.

- Capital investment plans, which by their nature have an impact beyond the annual budget, should be grounded in objective appraisal of economic capacity gaps, infrastructural development needs and sectoral/social priorities. The budgeting process should require a prudent assessment of the costs and benefits of such investments; affordability for users over the long term, including in light of recurrent costs; relative priority among various projects; and of overall value for money. Investment decisions should be evaluated independently of the specific financing mechanism i.e. whether through traditional capital procurement or a private financing model such as public-private partnership (PPP).
- The national framework for supporting public investment should address a range of factors including: adequate institutional capacity to appraise, procure and manage large capital projects; a stable legal, administrative and regulatory framework; coordination of investment plans among levels of government; and integration of capital budgeting within the overall medium-term fiscal plan of the government.

4. Budget documents and data should be open, transparent and accessible.

- Clear, factual budget reports should be available to inform the key stages of policy formulation, consideration and debate, as well as implementation and review. The annual budget document itself, which shows the allocations for each public service area and revenue policy measures under each tax heading, is of central importance. Budgetary information should also be presented in comparable format before the final budget is adopted, providing enough time for effective discussion and debate on policy choices (e.g. a draft budget or a pre-budget report), during the implementation phase (e.g. a mid-year budget report) and after the end of the budget year (an end-year report) to promote effective decision making, accountability and oversight.
- All budget reports should be published fully, promptly and routinely, and in a way that is accessible to citizens. In the modern context, “accessibility” requires that budget documents be available on-line, and that all budget data be presented in open data formats which can be readily downloaded, analysed, used and re-presented by citizens, civil society organisations and other stakeholders.
- “Accessibility” also requires that detailed budget information can be understood by citizens. All such information should be presented in a clear manner, and the impact of budget measures – whether to do with tax or expenditure – should be explained. A “citizen’s budget” or budget summary, in a standard and user-friendly format, is one way of achieving this.
- The budget reports bring together all financial inflows and outflows of government; as far as possible, budget data should be designed and used to facilitate and support other important government objectives such as open government, integrity, programme evaluation and policy coordination across levels of government.

5. Debate on budgetary choices should be inclusive, participative and realistic.

- As well as having access to budget documents and data, parliament and citizens should be able to engage with and influence the discussion about budgetary policy options, according to their democratic mandate, competencies and perspectives.
- The national parliament has a fundamental role in authorising budget decisions and in holding governments to account. The parliament and its committees should have the opportunity to engage with the budget process at all key stages of the budget cycle. The clear setting-out of medium-term budgetary envelopes (see point 2 above) should help the parliament to contribute to the processes of budget priority-setting *ex ante* as well as *ex post*.

- Since governments have finite resources at their disposal, budgeting is concerned with identifying priorities, assessing value for money and making decisions. Parliaments, citizens and civil society organisations can contribute usefully to the budget process when they become engaged in a realistic debate about difficult trade-offs, opportunity costs and value for money. Governments should facilitate this useful engagement by making clear the relative costs and benefits of the wide range of public expenditure programmes and tax expenditures, and by ensuring that all major revenue and expenditure decisions are handled within the context of the budget process.

6. Budgets should present a comprehensive, accurate and reliable account of the public finances.

- As a contract of trust between citizens and the state, it is expected that the budget document should account comprehensively and correctly for all expenditures and revenues of the national government, and that no figures should be omitted or hidden (although limited restrictions may apply for certain national security or other legal purposes). To underpin trust, this expectation should be made explicit through formal laws, rules or declarations that ensure budget sincerity and constrain the use of “off-budget” fiscal mechanisms.
- Control of the national budget is a core responsibility of government, whether exercised at central level or jointly across levels of government; the degree of co-ordination and co-operation with subnational levels of government naturally varies from country to country reflecting constitutional norms. A full national overview of the public finances should be presented – encompassing central and subnational levels of government, and a perspective on the whole public sector – as an essential context for a debate on budgetary choices.
- Budget accounting should show the full financial costs and benefits of budget decisions, including the impact upon financial assets and liabilities. Accruals budgeting and reporting, which correspond broadly with private sector accounting norms, routinely show these costs and benefits; where traditional cash budgeting is used, supplementary information is needed. Where accruals methodology is used, the cash statement should also be used to monitor and manage the funding of government operations from year to year.
- Public programmes that are funded through non-traditional means – e.g. PPPs – should be included and explained in the context of the budget documentation, even where (for accounting reasons) they may not directly affect the public finances within the time frame of the budget document.

7. Budget execution should be actively planned, managed and monitored.

- Once authorised by parliament, the budget allocations should be implemented fully and faithfully by the agencies of government, with oversight throughout the year by the CBA and line ministries as appropriate.
- Cash disbursements should be profiled, controlled and monitored prudently, and the roles, responsibilities and authorisations of each institution and accountable person should be clearly regulated. A single, centrally-controlled treasury fund for all public revenues and expenditure is an effective mechanism for exercising such regulation and control; special-purpose funds, and ear-marking of revenues for particular purposes, should be kept to a minimum.
- Parliamentary authorisations should allow ministries and agencies some limited flexibility to reallocate funds throughout the year in the interests of effective management and value-for-money, consistent with the broad purpose of the allocation. Such flexibility can be facilitated through streamlining of very detailed line items, or through devolved authorisation for managing reallocations among line items (virement). More significant reallocations, e.g. involving large sums or new purposes, should require fresh parliamentary authorisation.

- Budget execution reports, including in-year and audited year-end reports, are fundamental to accountability. Such reports, if well-planned and -designed, can yield useful messages on performance and value-for-money to inform future budget allocations (see also point 8 below).

8. Performance, evaluation and value for money should be integral to the budget process

- Parliament and citizens need to understand not just what is being *spent*, but what is being *bought* on behalf of citizens – i.e. what public services are actually being delivered, to what standards of quality and with what levels of efficiency.
- Performance information should be routinely presented in a way which informs, and provides useful context for, the financial allocations in the budget report. It is essential that such information should clarify, and not obscure or impede, accountability and oversight. Accordingly, performance information should be limited to a small number of relevant indicators for each policy programme or area; should be clear and easily understood; should allow for tracking of results against targets and for comparison with international and other benchmarks; and should make clear the link with government-wide strategic objectives.
- Expenditure programmes (including tax expenditures) should be routinely and regularly subject to objective evaluation and review, to inform resource allocation and re-prioritisation both within line ministries and across government as a whole. High-quality (i.e. relevant, consistent, comprehensive and comparable) performance and evaluation information should be available to facilitate an evidence-based review.
- In particular, all substantive new policy proposals should be routinely and openly evaluated *ex ante* to assess coherence with national priorities, clarity of objectives, and anticipated costs and benefits.
- Periodically, governments should take stock of overall expenditure and reassess its alignment with fiscal objectives and national priorities, taking account of the results of evaluations. For such a comprehensive review to be effective, it must be responsive to the practical needs of government as a whole (see also point 2 above).

9. Longer-term sustainability and other fiscal risks should be identified, assessed and managed prudently

- To promote a stable development of public finances, mechanisms should be applied to promote the resilience of budgetary plans and to mitigate the potential impact of fiscal risks. Fiscal risks, including contingent liabilities, should be clearly identified, explained and classified by type to inform consideration and debate about the appropriate fiscal policy course adopted in the budget. Fiscal risks should also be quantified as far as possible, and the mechanisms for managing these risks should be made explicit and reported in the context of the annual budget.
- Longer-term demographic changes and other social and environmental factors can also give rise to major pressures and challenges for the sustainability and inter-generational equity of budgetary policy. A report on long-term sustainability of the public finances should be published regularly enough to make an effective contribution to public and political discussion on this subject, and its policy messages – both near-term and longer-term – should be presented and considered in the budgetary context.

10. The integrity and quality of budgetary forecasts, fiscal plans and budgetary implementation should be promoted through rigorous quality assurance including independent audit.

- The CBA needs to command the confidence of a broad range of stakeholders – across government, within parliament and the public, and internationally – in the quality and integrity of its budgetary forecasts and fiscal plans and in its ability to manage budgetary implementation and delivery.
- In the first instance, governments should invest continually in the skills and capacity of staff to perform their roles effectively – whether in the CBA, line ministries or other institutions – taking into account national and international experiences, practices and standards.
- The credibility of national budgeting – including the professional objectivity of economic forecasting, adherence to fiscal rules, longer-term sustainability and handling of fiscal risks – may also be enhanced through independent fiscal institutions or other structured, institutional processes for allowing impartial scrutiny of, and input to, government budgeting. An open, transparent and participative approach to budgeting (see points 4 and 5 above) also promotes the credibility and quality of the budgetary process.
- Independent internal audit is an essential safeguard for the quality of integrity of budget processes and financial management within all ministries and public agencies.
- The supreme audit institution (SAI) has a fundamental role, as an independent guardian of the public trust, in assuring the proper use of budgeted resources. A well-functioning SAI should deal authoritatively with all aspects of financial accountability, including through its audit reports which should be published in a timely manner, relevant for the budgetary cycle. As regards efficiency and value for money, both the internal and external control systems should have a role in auditing the cost-effectiveness of individual programmes and in assessing the quality of performance accountability and governance frameworks more generally (see also point 8 above).

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