



Public Financial Management Technical Guidance Note

Fiscal Affairs Department

Reforming Budget System Laws

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PFM TECHNICAL GUIDANCE NOTE NO. 2

Reforming Budget System Laws

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I. INTRODUCTION

This note addresses the following main issues:

- Why adopt a new law relating to the budget system?
- What is the relationship between the BSL, the constitution and the wider legal framework?
- How should a BSL be adapted to conform to a country's political arrangements?
- How should the respective roles of the executive and legislative be reflected in the BSL?
- What should be included in a BSL, and what should be excluded?

The outcomes of the budget process depend heavily on whether there are clear rules for formulating, executing, and reporting on the annual budget, as well as a clear statement of medium-term fiscal policy objectives. These rules are usually specified in a budget system law¹ (BSL)—or set of laws—that provides guidance for the different steps of budget processes and specify the budget responsibilities of the key actors. This guidance note focuses on the key questions to be raised when there is a proposal to revise or replace an existing BSL.

A BSL is the formal expression of the system of rules that govern budgetary decisions made by the legislature and the executive. The objectives of the formal rules are to specify *what* budgetary processes are prescribed in law, *who* is responsible, and *when* key budgetary steps should be taken. The question of *how* budget processes are implemented can also be addressed in law, although lower-level regulations are more appropriate for these purposes.

¹ In this note, the term “budget system law” denotes all laws pertaining to the national budget system. Included are: “Public Finance Acts,” “Organic Budget Laws,” “Financial Management/Administration Acts,” “Fiscal Responsibility Laws (FRLs),” “Public Debt Acts,” and “External Audit Acts” (this list is not exhaustive).



The legal basis for budgeting varies considerably across countries—a reflection not only of differences in the budget system, but also differences in political, administrative, legal, and cultural arrangements. At one extreme, a few countries do not have a formal BSL apart from the constitution (e.g., Denmark, where the ministry of finance’s (MoF’s) “Budget Guidelines” serve the same function as a BSL). At the other extreme, the United States has many laws relating to the budget system. Most countries lie between these two extremes: typically, there are only a few laws that specify national budgeting arrangements.

Given the diversity of practices regarding the role that law plays in providing a framework for the budget system, a “model law” is not proposed. Rather, each country’s specific institutional, legal, and cultural features need to be considered prior to drafting amendments to an existing BSL or preparing a new BSL to cover specific aspects of budget processes.

This note is divided into five parts. First, the **reasons** for adopting a new law for the budget system are discussed. Second, the **legal context** for the new law is examined. Third, the **political system** is briefly considered. Fourth, the **responsibilities of budget actors** covered by the law are examined. Fifth—and most importantly—the various **stages of budget processes** that could be included in a BSL are discussed, with reference made to 11 budget **principles** outlined in Box 3.

A. Why Adopt a New Law Relating to the Budget System?

Countries will adopt a new law, or modify an existing one, for a variety of reasons, including: (i) to address specific budget-related problems; (ii) to introduce new budget principles, such as transparency, accountability, medium-term stability, or budget performance; or (iii) to strengthen or clarify the authority of the legislature or the executive.² Once adopted, the BSL is a tool that enables the government to achieve its desired policy objectives. In particular, the BSL provides the framework for achieving four aims of a well-functioning public financial management (PFM) system: (i) attaining macrofiscal stability; (ii) enhancing the allocation of budgetary resources; (iii) improving the efficiency of spending; and (iv) ensuring that cash is managed optimally. More specific aims of BSLs may include reducing unsustainable fiscal positions or lengthening the horizon of the annual budget so as to include a medium-term focus for the budget, thereby improving the budget information presented to parliament.

Governments and legislatures need to reach a clear consensus as to the policy objectives that they wish to achieve by adopting a revised BSL. In some cases, a diagnostic review of the budget system, its fiscal institutions, and decision-making processes may be a necessary first

² In this paper, the term “legislature” refers to all law-making bodies: congresses, parliaments, etc. The “executive” will be used to the bodies implementing laws and making decisions on their implementation; the term is used synonymously to “government” and, in some countries, to “the cabinet of ministers.”



step before changes to the BSL can be proposed to address specific issues of the PFM system.

Some countries take the view that the authority of the legislature—in the form of a law—is needed to ensure that the PFM system functions properly. This argument should be viewed circumspectly, since ***no law can replace political commitment to implement systemic changes.*** In countries where the respect for law is not fully upheld, steps to enhance political commitment to the changes in the budget system are more important than the adoption of a new law whose provisions may never be fully implemented.

B. What is the Legal Context?

The constitution. Countries differ as to the hierarchical structure of laws and regulations. At the highest level, the constitution provides the framework for all laws. When developing or examining a draft BSL, the constitution should be consulted since any of the following four factors can impact on the BSL:

- The general responsibilities of the executive and the legislature, relations between the two branches, and law-making processes;
- The relations between central/federal government and subnational governments;
- The broad principles relating to the budget system - some countries' constitutions have an entire chapter devoted to public finances; and
- The existence of an independent external audit body that primarily serves the legislature and prepares reports on budget execution.

This note does not discuss the desirable budget-related features that should be included in the constitution. Some of the principles discussed in Section E below are sufficiently important for inclusion in the constitution (see pp. 132–6 of Lienert and Jung for a discussion of these).

Higher and ordinary laws. In some countries, all statutory laws have the same status and the BSL is an “ordinary” law. In other countries, notably those with French or Spanish influence, the constitution requires that public finances be specified in an “organic” law—a higher rank law whose adoption procedure is more demanding than that for ordinary laws. See the example of Brazil (Box 1).³ When there is such a constitutional constraint, it is

³ In some countries' constitutions, the **principle of legal ranking** places organic laws below the constitution, but above ordinary laws, possibly requiring a supermajority (e.g., two-thirds of both chambers of the legislature or the absolute majority of all members of congress) for adoption. This principle may only apply to a subset of activities: under the **jurisdiction principle** the constitution specifies the particular areas that must be governed by an organic law. When these constitutional constraints are in place, the organic law is likely to be more stable than an ordinary statute.



important that organic laws are not overloaded, as details can be provided in lower-level legislation or regulations. For example, in 1996, Sweden adopted its first-ever BSL; even after its adoption, most budget procedures continue to be governed by regulations issued by the executive.

Government or presidential regulations/orders and ministerial decrees/instructions.

These should elaborate on the principles enunciated in the higher ranked law(s). Three criteria provide guidance as to whether an issue should be covered in law or in government regulation:

Box 1. Brazil: Features of the Main Budget System Laws

Main laws—A hierarchical structure

The main laws are: the 1988 Constitution; Law No. 4320, 1964; the Fiscal Responsibility Law (FRL), 2000; and the Budget Guidelines Law (BGL), which is approved annually with each budget. The constitution assigns budget powers to the legislature and the executive. It also includes a “golden rule,” namely that government borrowing shall not exceed capital expenditures.

Law 4320 and the FRL are higher-ranked laws (i.e., they prevail over ordinary laws and cannot be modified by them). They have to be approved by each chamber of congress with an absolute majority of the respective members. Modifying the FRL also requires a qualified (two-thirds) majority of congress. Both laws are “unitary laws” in that they establish common budgeting rules for all three levels of government (with some specific rules for each level). Both Law 4320 and FRL establish general rules for the preparation, execution, accounting, and reporting of the budget.

Main features of Brazil’s fiscal responsibility law

The FRL is a comprehensive law, whose features include:

- Detailed provisions for budget preparation and execution.
- Numerical limits for some fiscal indicators (e.g., the ratio of net public debt to net revenues; and the ratio of personnel expenditures to net revenues).
- Provisions to restrict expenditure commitments in the final year of government.
- Limits on the borrowing activities of subnational governments.
- Transparent fiscal reporting. The government must present: multiyear fiscal targets; targets for the primary balance and public debt for the following three fiscal years; a description of fiscal risks with an assessment of contingent fiscal liabilities.
- Strong sanctions for non-compliance (the FRL was accompanied by the Fiscal Crimes Law).

Sources: FAD, 2005; Blondal et. al., 2003; IMF, 2001.



- Public finance areas over which the legislature has final authority should be specified in law, whereas budgetary issues in which the executive has delegated authority should be governed by regulations.
- The responsibilities of the executive to the legislature should be covered in the law, whereas those responsibilities internal to the executive are best specified in regulations or decrees issued by the executive.
- The durability of the new budget principles. Since laws are more difficult to change than regulations, they should not include provisions if there is a strong risk that these will be abrogated or amended 1–3 years later.

What budget-related laws already exist? Prior to considering a draft new BSL, all existing laws relating to the budget system should be examined, with a view to ensuring consistency of the new provisions with existing laws. Questions to ask include: (1) what related laws already exist (e.g., laws relating to local governments, government administration, parliament, public debt, treasury, procurement, external audit) that may have overlapping provisions?; (2) is it essential to adopt a new law and replace an existing law?; (3) which government regulations will need to change?; and (4) are the drafts of the new regulations already available, so as to facilitate early implementation of the new law?

Number of laws. The number of laws governing a country’s budget system is partly a result of its legal system and attitudes toward the importance of law versus that of regulation (which in turn reflects the balance of power between the legislature and the executive). It is therefore not possible to provide strong guidance on the precise number of laws. However, as a matter of principle, there is a strong case for consolidating all functional areas of the budget system into a single law or only a few laws, with a few “specialist” laws in some areas. Certainly a separate external audit law is desirable, given the constitutional status of the external audit function. In other “specialist” areas (e.g., procurement, public debt), separate laws can be adopted.

Legal review. What procedures/steps need to be followed before the draft law prepared by the executive can be promulgated after its adoption by the legislature? How much time is needed for each step? What are the risks that the proposed law will be rejected or stalled by the legislature (or the constitutional court, when countries where court review is required)?

Enforceability and sanctions. Can the new provisions of the law be enforced? If not, should these provisions be introduced? Sanctions against **collective** bodies may be covered in other laws (e.g., failure of the executive to fulfill its responsibilities may result, in parliamentary systems, in a vote of no confidence in the government). National law may also specify sanctions on subnational governments (e.g., for failure to fulfill reporting requirements or debt-limit obligations). Sanctions on **individual** actors in budgetary processes may go further, depending on the seriousness of the offense. These may include: administrative actions (e.g., removing the individual), fines (for breaking specific rules), or applying



criminal law (in cases of serious disrespect for the law—misappropriation of funds; deliberate fraud).

C. What Are the Political Arrangements?

Since the constitutional arrangements for executives and legislatures differ considerably, it is important, when assessing a draft BSL, to consider the following:

- **Is the country federal or unitary?** In federal countries, it is important to ask whether legal constraints are imposed on subnational governments. For instance, to ensure macrofiscal stability, is there a separate law that constrains subnational debt levels⁴ and requires the reporting of subnational budgetary and debt data to the federal/central government, using internationally accepted reporting and classification standards?⁵
- **Presidential versus parliamentary systems.** When political powers are separated, as in most presidential systems, will the new legal provisions stand the test of a changed political balance between the legislature and the executive? In parliamentary systems, especially those where the government effectively controls the parliament, is the new law being adopted mainly to implement decisions of the cabinet of ministers? If yes, could some of the proposed provisions be incorporated in less formal instruments such as a government order/decreet?
- **Number of political parties.** Laws for regulating budget procedures may be less essential when there are coalition governments, formed as a result of a proportional representation electoral system. In some countries with multi-party political systems (e.g., Germany, the Netherlands), multi-year budget agreements between the coalition partners replace to some extent the provisions that are included in the law(s) of other countries.
- **Bicameral or unicameral legislature?** In countries with bicameral legislatures, the budget-making powers of both houses should be examined. When both chambers have equal budget decision-making powers, the BSL would have to accommodate the longer time periods needed for adoption of the annual budget law.

⁴ Such a provision could be included in the BSL if it is comprehensive. Alternatively, either a public debt law or a law relating to subnational governments could include such a provision.

⁵ Notably the IMF's Government Finance Statistic's (GFS) definition of "general government."



D. Accountabilities and Authority of the Legislature and the Executive

The legislature is supreme in budget matters, although “supremacy” is related mainly to the *approval* of the annual or supplementary budgets. If not stated in the constitution, the BSL should specify that all taxation and all expenditures be based on law. This principle implies that no revenues, including revenues that exceed budget projections, can be spent without the approval of the legislature. The BSL should specify any exceptions.

Countries may adopt new laws in order to strengthen the role of the legislature in budget processes. This was the case of the United States in 1974, when the balance of budgetary power swung in favor of congress. It was also one reason why France adopted a new BSL in 2001 (see Box 2). However, in British-based budget systems, BSLs may be adopted to strengthen the executive’s powers even further (for a fuller discussion, see Lienert, 2005).

Individual accountabilities within the executive need to be specified in law only if the budget actors are directly accountable to the legislature. The executive’s main accountabilities are: (1) to submit a draft budget law to the legislature and (2) to report on its implementation. The key actors are the president (in presidential systems) or the minister of finance⁶ (in parliamentary systems). The authority and areas of responsibility of the minister of finance (or equivalent), to be spelt out in law, can be extensive—see “Budget execution and control” in section E below for key responsibilities of the minister of finance that should be specified in law.

⁶ In some countries, besides the minister of finance, other ministers, including the prime minister or a minister of plan/economy, have budget responsibilities. Laws or regulations should specify the roles of such ministers and clarify any responsibilities shared with the minister of finance.



Box 2. France's New Organic Budget Law

In August 2001, parliament adopted a new law that modernizes France's budget system.¹ The law's main innovations were to:

- Change the budget presentation and appropriations structure from an input-based budget to one based on programs in which the objectives of government programs are very explicit.
- Make budget managers more accountable for results. However, unlike in some countries, where employee management has been decentralized to budget managers, the French law maintains parliamentary approval of the number of civil servants.
- Provide parliament with fuller budgetary information, including a clear statement of medium-term fiscal policy objectives and annual reports on performance of each of the 132 budget programs (these reports are formally approved by parliament as annexes to the annual Budget Review Act).
- Broaden parliament's budgetary powers, including providing parliament with the opportunity to examine entire programs, as opposed to increments to "existing policies." The investigative powers of parliamentary budget committees were strengthened.
- Improve the quality of financial information, by the adoption of accrual-based financial statements that are certified by the court of auditors. Public sector accounting standards are required to be more closely aligned to private sector accounting standards.

The organic law was formulated subject to the budget-related constraints of the 1958 Constitution, which includes a restriction that parliament may not introduce expenditure-increasing measures without also introducing revenue-enhancing measures.

¹ The organic law is limited to budget procedures for "the State," which excludes local governments and social security funds, for which separate (organic) laws have been adopted. A 1922 Law on Expenditure Commitment Control is still in force. The 1958 Constitution also contains some articles relating to budget processes.

Source: France, Ministry of Finance, http://www.minefi.gouv.fr/lolf/16_1.htm

Other ministers' responsibilities (to the legislature) for reporting on budget execution should be spelt out in law. Ministers can be required by law to appear before budget committees of the legislature. As to civil servants, the BSL may require budget managers to appear before such committees, before which they must account for budget outcomes—both financial and nonfinancial, such as the attainment of performance targets (this is a strong feature of the British-based budget system).



Individual accountabilities exclusive to the executive do not need to be spelt out in law.

Internal regulations are appropriate legal instruments for specifying the budget responsibilities of those preparing, executing, monitoring, or preparing accounts/reports on budget execution **within** the executive. For example, the responsibilities of the heads of spending ministries/agencies to the MoF (or equivalent) or of the budget and accounting directors within the MoF, can be specified in regulations, orders, or decrees issued by the president, cabinet, the prime minister, or the minister of finance.

E. What Should Be the Main Content of a Budget Systems Law?

Before drafting a new budget-related law or amending an existing BSL, it is important to ask, “which budget principles are already covered in law?” For these purposes, reference can be made to 11 guiding principles for budget management (see Box 3). The new BSL law often stresses one or more of these principles.

Several steps of budget preparation need to be specified in a BSL. The key steps that should be specified in a BSL are: the submission by the executive of the draft budget law to the legislature, its adoption (both the annual budget and supplementary budgets), and ex post reporting to the legislature. Annual budgets should be prepared with reference to a medium- or longer-term fiscal framework. However, not all steps—especially those within the executive (e.g., date of distribution of the budget circular) — need to be specified in the BSL. Further details follow in Subsection A below.

Only key steps in budget execution need be specified in the BSL. (See Subsection C below for guidelines, including for the authority of the minister of finance in government banking, accounting, and debt). The detailed steps involved in executing the annual budget in the MoF and in spending ministries/agencies need not be specified in law. If the legislature trusts the executive to execute the budget, the various stages of budget execution can be specified in internal regulations. In contrast, if the legislature’s trust in the executive is limited (which may be the case in presidential systems where powers are divided between the two branches of government), the legislature may adopt a law that constrains the executive’s room to maneuver in budget execution (federal laws in the United States provide a striking example of this, although this is the exception rather than the rule).

The specific aims of the new law should be clear. The draft law should specify, in its introductory articles (or in a separate document), the main principles and objectives of the new legislation, its scope, and clear definitions of terms used in the law.

The remainder of this note elaborates on the key issues to be specified in law, based on the principle that the legislature’s “supremacy” should be mainly confined to the adoption of the annual budget law, the form of the appropriations, and the receipt of reports on budget execution.



Submission of budget appropriation law(s) and other documents to the legislature

Box 3. Sound Principles for a Budget System Law (BSL)

Overarching Principle

1. **Authoritativeness:** Decision-making authority is specified clearly in the BSL. The executive prepares a draft annual budget law and supporting documents such as a medium-term macrofiscal framework; the legislature approves the annual budget, possibly after amendments; no expenditure can be made without approval of the legislature; the executive implements the annual budget and provides reports on its implementation. The authority to modify the approved budget law is specified in the BSL.

Classical Principles

2. **Annual basis:** Budget authority is for a 12 month period. Exceptions are specified in the BSL, including multiyear appropriations and end-year carryovers. The annual budget law is enacted prior to the year to which it refers. All transactions are estimated for their one year effect.
3. **Comprehensiveness:** The “universe” (e.g., central government) is specified clearly. All revenues and expenditures are included in the budget on a gross basis. Expenditures are not offset by revenues: the BSL specifies any exceptions. Extrabudgetary funds are minimal, being established by law. Contingency funds are included in the budget law.
4. **Unity:** The budget presents, and the legislature approves, all receipts and payments in the same annual budget law. For expenditures, there is no “dual” budget system that splits current and development (or capital) transactions (this is best implemented if there is also unity of budget administration—one central budget authority). For revenues, there is an option between: (i) approving all new revenue measures in the annual budget law; or (ii) approving revenue measures only in laws other than the annual appropriations laws (the principle of **exclusivity**, which may be included in the BSL).
5. **Common pooling (or fungibility) of revenues:** All resources must belong to a common fund.
6. **Specificity:** Revenues and expenditures are approved with some detail in the budget estimates. Authorized spending is intended for particular purposes (inputs or programs/outputs).
7. **Balance:** Budget payments are balanced by receipts (accounting balance, cash basis). Budget expenses are balanced by budget revenues and financing (accrual basis). “Balance” is well defined and may be subject to legal limitations.

Modern Principles

8. **Accountability:** The executive must account to the legislature for how it has met its responsibilities at least twice a year. An independent external audit body reports at least annually to the legislature on budget execution. Within the executive, the accountability of budget managers is clearly defined.
9. **Transparency:** The roles of public bodies are clear. Timely and regular financial and nonfinancial information on the budget is publicly available. The terms used in the BSL are clearly defined.
10. **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.
11. **Performance:** The expected and recent past results (outputs and/or outcomes) of budget programs are reported in the budget document.



The key requirements to be incorporated in a BSL include the timing of submission to the legislature of the draft annual appropriations law(s) and the various types of appropriations:

- **Budget submission—timing.** If not included in the constitution, the BSL should specify the date by which the executive must submit the draft annual budget to the legislature. This is typically two to four months prior to the beginning of the new fiscal year. Clearly, more time should be allowed for discussing the draft budget in countries with bicameral legislatures, especially if both chambers have the authority to amend the draft budget law.
- **Are appropriations legally binding upper limits?** The BSL should specify whether individual appropriations are legally binding upper limits for expenditure. Some government spending included in the fiscal targets is required by other laws or by legally binding contracts (e.g., transfers to households such as pensions and unemployment benefits; debt servicing; court-ordered payments) irrespective of the amount provided in the budget projections. In such cases, the spending included in annual appropriation(s) act(s) is usually not an upper limit.⁸ For many expenditures, however, the annual appropriations are legally binding upper limits.⁹
- **Classification and type of appropriations.** The BSL should specify the broad classification of expenditures to be used in annual appropriation act(s). Compliance-oriented budget systems include many detailed budget line items, each of which is approved by the legislature. Modern budget systems' BSLs have re-specified appropriations—usually as broad-based “programs” or “outputs.” In such systems, the executive’s regulations specify the degree to which expenditures need to be disaggregated for the purposes of expenditure control. Detailed classification systems for use in budget execution and statistical reporting, such as GFS-compatible functional and economic classifications, can be specified by decree or MoF instructions.
- **Gross versus net appropriations.** Consistent with the principle of comprehensiveness, expenditures should not be offset against revenues. However,

⁸ Countries may choose not to include such expenditures in the annual appropriations act. Also, for some expenditures, other laws may clarify the nature of “permanent” appropriations (e.g., a public debt law may specify that debt servicing must be paid from appropriated funds irrespective of the budget projections).

⁹ In a few countries with presidential systems of government (e.g., the United States), additional legal clauses are added to ensure the executive spends all of the budgeted appropriations. Such provisions enhance the “supremacy of the legislature” in budgetary matters and eliminate any flexibility the executive would otherwise have to adapt the budget to small changes in economic circumstances.



some countries' BSLs allow for the earmarking of revenues for specific purposes (e.g., excise taxes on petroleum, to be spent on road maintenance). Other countries, in an effort to encourage government ministries/agencies to mimic private sector entities, adopt legal provisions that allow budget entities to raise and retain revenues. To that end, legislatures may approve expenditures **net** of projected agency revenues. To ensure "parliamentary supremacy," the legislature should approve the projected agency revenues and provide guidelines for setting fees or charges that generate revenues. Any spending that takes place when projected agency revenues are exceeded should require the approval of the legislature. Such provisions in the BSL are essential to prevent illegal ministry/agency spending from their "own" revenues.

- **Accounting base of annual appropriations.** Traditionally, all expenditures were cash-based and limited to only 12 months duration (principle of annuality). Besides specifying that individual expenditures approved by the legislature are **cash-based** upper limits, the BSL may require that multi-annual **expenditure commitments** (especially for investment spending) be approved in the context of the legislature's adoption of the annual budget. Alternatively, the BSL may a vehicle for introducing an accrual-based budget and accounting system (i.e., one based on economic transfers rather than cash payments), of which details are provided in regulation.
- **Carryover of budget authority.** To allow end-year spending flexibility, the BLSs of countries with good expenditure control mechanisms specify that investment spending authority can be carried over into the next fiscal year. Carryover of certain current expenditures may also be allowed in such countries. The BSL should be specific on the types of expenditures and limits on carry-over.
- **Appropriations for contingencies.** The BSL could specify that the annual appropriation law contain a line item for contingencies in order to meet unforeseen and urgent spending needs (e.g., for emergencies or unexpected large increases in obligations). The BSL should limit the unallocated spending to a small percentage of total expenditure (e.g., 1 percent to 3 percent) and place the spending under the authority of the MoF. Regulations would specify the detailed procedures, eligibility, and restrictions on the spending of unallocated appropriations. The BSL should require contingency spending to be regularly reported to the legislature.

Documents to accompany the annual draft budget law

- **Medium-term fiscal strategy.** The BSL should specify that the executive submit to the legislature its medium-term fiscal strategy, its priorities for spending, and its



proposed policies to achieve medium-term aggregates for revenues, expenditures, fiscal balance, and government (or public) debt.¹⁰

- **Should the legislature approve the medium-term budget framework?** Some countries have adopted a legal requirement for the legislature to formally approve—as part of a two-part budget approval process—an annually-updated multiyear budget framework. The expenditure aggregates (and key subaggregates) for a three-year period are legally binding. This option strengthens the case for not including quantitative fiscal rules in law (see discussion below).
- **Comprehensiveness.** The BSL should specify the coverage of the fiscal aggregates, consistent with the principle of universality. One good standard is to cover all institutional units comprising “general government,” as defined in GFS. Regarding debt, the “public sector” may be more appropriate in countries where nonfinancial and/or financial public enterprises have an important impact on fiscal policy aggregates or pose fiscal risks to the government.
- **Extrabudgetary funds.** These should be limited in number and purpose. If there are strong grounds for creating special funds for particular purposes (e.g., for social security), a special law may be adopted. Few countries restrict the creation of extrabudgetary funds. However, in Finland, the new constitution adopted in 1999 included a very strong provision: no extrabudgetary funds can be created without a supermajority in parliament and then only if this is required to carry out an essential duty of the state. In countries with extrabudgetary funds that are not included in annual appropriations, the BSL should specify that the fiscal aggregates include the projected revenues and expenditures of all off-budget activities and that separate reports on specific funds be included in documents accompanying the annual budget.
- **Objectives for performance and annual reports on performance.** Countries that have adopted a performance- or results-oriented budget system usually require in their BSL that annual (summary) performance reports be prepared by each major program or for each ministry. The reports for year (-1) should be available in time for the legislature’s consideration of the budget for year (+1). The BSL could specify this.

¹⁰ The BSL, or a separate public debt law, should spell out the key requirements concerning public debt, including: defining the responsibilities of the main organization(s) involved in government debt management; specifying the (delegated) authority of the minister of finance to act as the sole borrowing agent for the government and to select instruments for borrowing; establish the authority and general conditions for the granting of guarantees and the onlending of sovereign external loans; fixing a limit on total public debt issuance (with clear provisions for subnational governments); providing for permanent parliamentary appropriations for all debt servicing; and establishing audit and accountability arrangements for government debt management.



- **Macroeconomic situation, underlying assumptions, and other information.** The BSL should require regular reporting of most or all of the items specified in Box 4.

Box 4. Reports to Accompany the Draft Annual Appropriations Act

- 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 program. Reconciliation with forecasts contained in earlier budget reports for the same period, accompanied by explanations of all significant deviations.
- 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.

Sources: OECD (2002); IMF (2001); Box III.4 of Lienert and Jung (2005).

Adoption of the budget by the legislature, including amendments and procedures

- **Should quantitative fiscal rules be included in law?** In most advanced countries, the executive establishes quantified medium-term fiscal targets for debt, fiscal balances, revenues and expenditures. The BSL should require that the proposed annual budget documents discuss their compliance (or noncompliance) with these “rules.” The law in some countries (e.g., New Zealand) requires that public debt be reduced to, then maintained at, a “prudent” level, with multiyear fiscal balances set at a level consistent with the desired medium-term debt strategy. Other countries have included quantitative fiscal rules in the law itself. In November 2005, the IMF Executive Board noted that, while numerical rules have some potential advantages, including helping to contain a deficit bias and addressing time inconsistency issues, they often lack flexibility, and have faced implementation problems in some cases.¹¹ The many failed country experiences with including such rules suggest that this is unwise and also inconsistent with the durability-of-law principle.¹² The Brazilian experience with the inclusion of fiscal rules in the FRL can be considered an

¹¹ See BUFF/05/196, December 2, 2005, in which Directors also supported the conclusion that Fiscal Responsibility Laws (FRLs) hold promise for strengthening fiscal management, but cannot by themselves buy credibility or substitute for a commitment to prudent fiscal policy. They agreed that effective FRLs should cover all relevant fiscal and quasi-fiscal operations of the public sector, include comprehensive procedural and transparency requirements, and follow best practices in the design of rules and escape clauses.

¹² For selected OECD countries, see Lienert and Jung (2005), p. 90. For Latin American countries, see IMF 2005.



exception, where strong institutional and personal sanctions may explain its relative success to date (see second panel of Box 1 above).

- **The BSL should specify any limitations on the legislature's powers to change the executive's draft budget.** One of the legislature's potentially most important powers is its ability to alter the size and composition of the budget proposed by the executive. There are three main options for the BSL: unlimited amendment powers, limited powers, or negligible powers (e.g., "any change proposed by the legislature must be approved by the executive"). For medium-term fiscal stability, it is desirable to limit the legislature's powers. Some countries allow the legislature to approve additional expenditures provided additional revenues are raised so that the fiscal balance is left unaltered. Others prevent the legislature from increasing total expenditure, but do allow changes in the composition of expenditure categories (OECD, 2003).
- **The legislature should be prevented from revising revenue projections upwards in order to accommodate more expenditures.** Such a legal requirement is particularly important in countries where there is strong separation of powers between the legislature and the executive (e.g., presidential systems in Latin America).
- **Budgetary procedures within the legislature are mainly specified in the internal regulations of the legislature.** However, some countries' constitutions or laws specify special rules for the adoption of the annual budget law (e.g., draft budget law discussions have a higher priority than those for nonbudget laws). The respective budgetary responsibilities of each chamber are usually specified in a law. Regulations of the legislature should specify the responsibilities and authority of budget committees and sectoral committees serving the legislature.
- **Date by which the budget should be adopted by the legislature.** To allow immediate implementation of the annual budget, the BSL should require adoption of the annual budget no later than the final day of the year immediately preceding the new fiscal year.
- **Reversionary budget.** The BSL should also specify the rule to apply in the event that the budget is not adopted by the due date. Typically, the BSL specifies that the budget in the new fiscal year should be executed monthly at a rate of 1/12th of the budget appropriations of the previous fiscal year (i.e., excluding any proposed new budget policies, activities, or projects). In order to force the legislature to adopt the draft budget law, some countries' laws limit the duration of the 1/12th rule (e.g., to four months after the beginning of the new fiscal year).
- **If the legislature has powers to reject the budget, the BSL may need to specify rules to ensure its adoption and prevent impasses between the legislature and executive.** In parliamentary systems of government, parliament's only "weapon" is often to reject the entire budget by adopting a vote of no confidence in the



government (i.e., forcing the government out of power). In such cases, it is important to have a reversionary budget rule (see above) in law. In contrast, in presidential systems, the legislature may reject the president's proposed budget. Alternatively, the president may veto the legislature's budget as adopted. Again, it is important to have a formal agreement—or better, an article in law—on a reversionary budget, to ensure that the government continues to function while political consensus on the new annual budget is being reached.

- **The BSL should grant the legislature the option of adopting supplementary, or rectifying, budgets.** A good budgetary practice is to require a formal mid-term review of budget execution by the legislature, which may, if necessary, adopt a revised annual budget law to accommodate necessary changes. Such a law may authorize: (1) higher expenditures, should revenues be higher than projected, or should there be large unexpected expenditures that cannot be financed by cuts in spending elsewhere; or (2) lower expenditures, especially when revenues are less than projected and the government does not wish to deviate from pre-announced deficit/surplus targets. The BSL should, however, allow a supplementary budget to be adopted any time it is required. One simple way of incorporating this requirement into the BSL is to state that the principles and procedures incorporated in the BSL apply to both the **annual** budget and to **supplementary** budgets.¹³
- **A few countries have established by law a nonpartisan budget office that serves the budgeting needs of the legislature** (e.g., United States, Mexico, and Brazil). It is usually countries with presidential systems of government that have adopted such legislation. The law specifies the roles, responsibilities, and staffing of the congressional budget office. To ensure the independence of its advice, the office should be staffed with civil servants, not political appointees.

Budget execution and control

Many of the procedures for executing the annual budget, including allotment (to lower-level budget entities), apportionment (dividing expenditures of the annual budget into monthly/quarterly ceilings), and budget execution procedures, including mechanisms of expenditure control, internal control, and internal audit, are best specified in government/ministerial regulations. However, the BSL may be used to:

- **Delegate flexibility to the executive for implementing the budget.** The BSL may specify that the expenditure for a particular line item may be exceeded provided there is an offsetting downward revision of another line item within the same category of

¹³ In French-speaking countries, the organic law includes such a provision, which also applies to the budget execution law, in which parliament formally approves ex post changes in revenues and expenditures.



expenditure (virement). The BSL should specify the minister of finance's virement powers (e.g., the percentage by which particular expenditures can be exceeded without submitting a supplementary budget to the legislature).

- **Provide authority to the minister of finance to cut appropriations.** The BSL should specify whether the minister has zero, limited, or unlimited authority to cut budget appropriations and the conditions under which this is permitted (e.g., when there are revenue shortfalls). Although country practice varies (OECD, 2003), from the point of view of macrofiscal stability and the prevention of payment arrears, law should provide the minister of finance with the power to cut expenditures (e.g., up to a certain percentage), before being obliged to return to the legislature for additional spending authority (in the form of a supplementary budget).
- **Specify the minister of finance's authority over government banking arrangements and cash management.** For effective financial control, the BLS should provide the minister of finance with extensive powers over the management (especially opening and closing) of government bank accounts. The BSL should provide the minister with strong powers to minimize idle balances in government accounts and invest appropriately any short-term surpluses, the aim being to minimize borrowing costs and risks to government.
- **Consolidate all revenues and establish a treasury single account (TSA).** The BSL should incorporate the common-pooling principle: all revenues should be paid into the same common fund. Exceptions to this principle should be specified in the law. The BSL should specify that a treasury single account be held at the central bank. The TSA may have subaccounts.¹⁴

Public procurement procedures are usually specified in a dedicated law. Many countries have adopted a public procurement law that specifies procurement principles and practices including, inter alia, the degree to which procurement is decentralized to spending ministries and any special administrative entities established to oversee the entire system of public procurement. Details on procurement are specified in regulation(s).

¹⁴ Regulations would clarify the responsibilities of designated account holders of the subaccounts. In decentralized payment systems, other ministers, or delegated authorities, may have signature rights over accounts and make payments directly (electronically or by check issuance). In centralized payment systems, only the minister of finance, or his/her delegated authorities have such rights.



Government accounts and reporting to the legislature

- **A separate accounting law is not needed.** Accounting is largely a technical issue, for which details should be provided in standards and/or regulations issued by the MoF or an independent accounting standards board. However, the BSL should specify the basis of accounting to be used by budget entities and the accounting standards-setting body. Some countries (e.g., France’s Organic Budget Law) limit the former to simple statements that “government accounting standards are only different from enterprise accounting standards to the extent that government budgetary/accounting processes are unique.” Details on the accounting system should be provided in clear regulations. Law may require that accounting regulations be reviewed by qualified public and private sector experts.
- **The BSL should specify the contents of the ex post budget execution reports and financial accounts that the executive must prepare for the legislature.** Reporting is particularly important to satisfy the principles of transparency and accountability. For countries that have adopted a results-oriented budget system, annual performance reports should also be required. The main reports to be specified in the BSL are shown in Box 5. Some countries have incorporated these requirements in FRLs, although it is probably best if these obligations are included in the main BSL.
- **Other budget information and periodic reports considered “best practice” could be made a legal requirement** (see OECD, 2002). However, judicious choices need to be made before imposing legal requirements for reports to the legislature, which should not be overloaded with information. A distinction should be made between what the legislature needs and the information needed for internal management purposes, with the latter being governed by regulation, not law.



Box 5. Ex Post Budget Reporting

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. This should discuss the impact of changes in economic assumptions underlying the budget, any recent political decisions, and any other circumstances that may have a material effect on the budget. The report should include updated budget projections for the current fiscal year and the following two fiscal years. If necessary, a supplementary budget law can be proposed.

Year-end accounts and annual report

- Annual accounts should show compliance with the budgeted levels of revenues and expenditures authorized by the legislature. The format of the accounts should be identical to that of 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 6–12 months after the fiscal year ends. (More advanced countries can shorten the delay.)
- The year-end budget report should contain a comprehensive discussion of the overall budget outcome compared with *ex ante* targets for aggregates, revenues, and broad expenditure categories of. Spending ministries' reports on budget outcomes should be included. If appropriate, the law may require that annual reports include non-financial performance information, including a comparison of performance targets and actual results achieved.

Sources: OECD (2002); IMF (2001); and Box III.4 of Lienert and Jung (2005).

External audit

- **The main powers and responsibilities of the supreme audit institution (SAI) should be established in the constitution.** The Lima Declaration of INTOSAI establishes international standards (INTOSAI, 1977), including requiring the constitution to establish the independence of the SAI and to prepare audit reports for the legislature.
- **A separate external audit law should elaborate on the powers, roles and responsibilities of the SAI,** the appointment of the auditor general or the collegial body¹⁵ and staff of the SAI (which should be independent of the civil service), and the

¹⁵ In some countries, the decision-making authority for external audit rests primarily with an individual: the Auditor General or head of the Audit Office; in other countries, governance is by a collegial body.



type of audit—compliance and/or performance (value-for-money) to be performed. Possible minimum norms for an external audit law are shown in Box III.5 of Lienert and Jung (2005).



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