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TECHNICAL NOTES AND MANUALS

Reforming Budget System Laws

Prepared by Ian Lienert and Israel Fainboim

This note¹ addresses the following main issues:

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

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 law² (BSL)—or set of laws—that provides guidance for the different steps of budget processes and specifies 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 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 this purpose in many cases.

¹ An earlier version of this note was issued as part of the series of technical notes on the IMF's Public Financial Management Blog (<http://blog-pfm.imf.org>). The note has benefited from comments from several colleagues of the PFM divisions of the Fiscal Affairs Department of the IMF.

² In this note, the term “budget system law” denotes all laws pertaining to the national budget system including “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 of differences in political, administrative, legal, and cultural arrangements. At one extreme, a few countries do not have a formal BLS apart from the constitution.³ At the other extreme, a few countries (e.g., the United States) have 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 the 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, aspects of the political system that impact on the budget are 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 the 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, fiscal stability and sustainability, and budget performance; or (iii) to strengthen or clarify the authority of the legislature or the executive.⁴

The BSL should be a tool that enables the authorities to achieve their desired policy objectives. In particular, the BSL should provide the framework for achieving five aims of a well-functioning public financial management (PFM) system: (i) attaining short-term macrofiscal stability and medium-term fiscal sustainability; (ii) enhancing the allocation of budgetary resources; (iii) improving the efficiency of spending; (iv) ensuring that cash is managed optimally; and (v) improving the quality of budget information presented to parliament and the public.

Governments and legislatures need to reach a clear consensus on the objectives to be achieved by adopting a revised BSL. In some cases, a diagnostic review of a country’s budget system, its fiscal institutions, and decision-making processes may be a necessary first step before changes to the BSL can be proposed to address specific issues of the PFM system. Once consensus is reached, it is important to recognize that *no law can replace political commitment to implement systemic changes.*

³ For example, in Denmark, the ministry of finance’s (MoF’s) “Budget Guidelines” serve the same function as a BSL. In Panama, instead of a BSL, each annual budget law contains a long set of articles that would normally belong to a BSL; these articles are approved repetitively each year by congress, generally without change.

⁴ 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; the term is used synonymously with “government.”

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 are not 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 a draft BSL, the constitution may include provisions in any of the following areas that impact upon the drafting of 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 with responsibilities for approving the government’s financial statements.

As discussed in Lienert and Jung (2004) certain provisions relating to the budget may be sufficiently important for inclusion in the constitution.

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).⁵ When there is such a constitutional framework, it is important that organic laws are not overloaded, as detailed provisions 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 regulations:

- Public finance areas for which the legislature has final authority should be specified in law, whereas budgetary issues for which the executive has delegated authority should be governed by regulations.
- The responsibilities of the executive in relation to the legislature should be covered in the law, whereas responsibilities internal to the executive are best specified in regulations or decrees issued by the executive.

⁵ In some countries’ constitutions, the principle of legal ranking places organic laws below the constitution, but above ordinary laws. Such laws may require a supermajority (e.g., two-thirds of both chambers of the legislature or the absolute majority of all members of congress) for adoption.

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) No. 101, 2000; and the Budget Guidelines Law (BGL), which is approved annually prior to each annual budget law. 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. Both Law 4320 and the FRL establish general rules for the preparation, execution, accounting, and reporting of the budget.

Law 4320 and the FRL are also 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).

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 is accompanied by a Fiscal Crimes Law).

Sources: IMF, 2001; Blöndal and others, 2003.

- The durability of the budget provisions. 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, or would reforming an existing law be a better option?; and (3) which government regulations will need to change.

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 may reflect 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 that is desirable. However, in general, there is a strong case for consolidating all functional areas of the budget system into a single law, although other “specialist” laws may be adopted to cover particular areas of budgeting such as procurement, debt management, and local government finance. In the case of external audit, a separate law is desirable, given the constitutional status of the external audit function and the importance of the independence of the supreme audit institution.

Legal review and other preparatory steps. The following questions are relevant: 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, in countries where judicial review is required)? Are the drafts of new regulations already available, so as to facilitate early implementation of the new law (some countries have experienced delays in implementing a BSL because implementing regulations are not ready)?

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). A 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 serious cases involving the misappropriation of funds, fraud, or corruption).

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 a federal or a unitary state?** 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 levels⁶ and requires

⁶ Such a provision could be included in the BSL if it is comprehensive or in a FRL. Alternatively, either a public debt law or a law relating to subnational governments could include such a provision.

the reporting of subnational budgetary and debt data to the federal/central government using internationally accepted reporting and classification standards?⁷

- **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 or decree?
- **Number of political parties.** In countries with proportional representation in electoral laws, which lead to multiparty political systems (e.g., Germany, the Netherlands), multiyear budget agreements between the coalition partners may replace to some extent the provisions that are included in the BSL in 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 equivalent budget decision-making powers, the BSL would have to accommodate the longer time periods needed for adoption of the annual budget law.

D. Accountabilities and Authority of the Legislature and the Executive

The legislature is supreme in budget matters, at least in relation to the approval of the annual and 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 those 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), as well as in Paraguay (following the long period of dictatorship), as part of the process of strengthening accountability. In contrast, in British-based budget systems, BSLs may have strengthened the executive's powers further (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 responsibilities are to (1) submit a draft budget law to the legislature; and (2) report on its implementation. The key actors are usually the president (in presidential systems) or the minister of finance⁸

⁷ Notably the IMF's *Government Finance Statistics* (GFS) definition of "general government."

⁸ In some countries, besides the minister of finance, other ministers, notably 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 2001 Organic Budget Law

In August 2001, parliament adopted a new law that modernizes France's budget system. It builds on the 1958 Constitution, which contains some articles relating to budget processes. The 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. 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, France's 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 budget program of the general budget. 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 accounts. Public sector accounting standards are required to be more closely aligned to private sector accounting standards.

Besides the organic law's provisions, the 1958 Constitution includes a restriction on parliament: it may not introduce expenditure-increasing measures without also introducing revenue-enhancing measures.

Source: France, Ministry of Budget, <http://www.performance-publique.gouv.fr>

(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).

The responsibilities of ministers and other budget managers to report to the legislature on budget execution should be spelt out in law. Ministers and budget managers can be required by law to respond formally to questions or appear before budget committees of the legislature. It is desirable for them to account for the financial management of their departments and budget outcomes—both financial and nonfinancial—such as value-for-money achieved in spending and the attainment of performance targets.

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

Internal regulations are the 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, the cabinet of ministers, 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 BSL often stresses one or more of these principles.

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 fiscal policy strategy paper and a medium-term macro-fiscal 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 implementation. It also has the authority to close and open public bank accounts. 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. Tax expenditures and quasi-fiscal activities are reported.
- 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

The specific aims of the BSL should be clear. The 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.

Most steps of budget processes need to be specified in a BSL. The key steps are the preparation by the executive and the submission of the draft budget law to the legislature; its adoption by the legislature (both the annual budget and supplementary budgets); some aspects of budget execution; and ex post reporting to the legislature. The detailed steps and procedures involved in executing the annual budget in the MoF and in spending ministries/agencies can be laid down in regulations rather than the BSL itself. However, in some countries with a presidential system of government, in which budgetary powers are divided between the two branches of government, or in countries where the legislature has especially strong powers in the budget area, the legislature may adopt a law that constrains the executive's room to maneuver in budget execution.

Box 3. (continued)

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 are channeled into one 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 and annual government accounts. 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:** Short-term policy stability: anchoring commitments to achieve targets for revenues, total expenditures, fiscal balance or public debt, specified in the context of a regularly updated medium-term budget framework. Medium-term fiscal sustainability is also another important aspect of stability.
11. **Performance:** The expected and recent past results (outputs and/or outcomes) of budget programs are reported in the budget document.

The remainder of this note elaborates on the six key areas of budgeting that in general need to be specified in law rather than subsidiary regulations. These areas relate to the submission of annual budgets to the legislature; documents to accompany the annual budget; budget adoption by the legislature; budget execution and control; government accounting and reporting; and external audit⁹.

1. Submission of annual budget or appropriation law(s) to the legislature

- **Fiscal rules.** A fiscal rule is a numerical limit on budget aggregates (revenues, expenditures, debt, and budget balance) that constrains the budget-setting powers of both the executive and the legislature.¹⁰ Fiscal rules, which are usually in place for several years, serve at least four goals: fiscal sustainability, economic stabilization, containment or reduction of government size, and support of intergenerational equity. In recent years, fiscal rules are being adopted especially to achieve debt sustainability. Annual budgets therefore need to be prepared subject to any fiscal rules. The approval of fiscal rules by the legislature is examined in subsection 3 below.
- **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.¹¹ In countries with bicameral legislatures, more time should be allowed for discussing the draft budget, 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 is mandated 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.¹² In such cases, the spending included in annual appropriation(s) act(s) is usually not an upper limit. For much expenditure, however, the annual appropriations are legally binding upper limits.¹³

⁹ As noted elsewhere in this Note, it is preferable to specify the main provisions regarding external audit in a separate law, not the BSL itself (although it is recognized that, in some countries, e.g., Tanzania, the external audit and budget functions are consolidated in a single law).

¹⁰ An increasing number of countries are using quantitative fiscal rules; see IMF (2009), which discusses the evolution, impact, design, and implementation issues associated with fiscal rules.

¹¹ Some countries adopt an annual budget law, which approves both annual revenues and expenditures (and changes in tax and expenditure policies) in a single law. Other countries adopt changes in taxes in a law(s) separate from the annual appropriations law(s); the latter are confined to approving the annual spending subject to appropriation by the legislature (in some countries, not all spending is subject to annual appropriations; on the contrary, other laws provide the legal basis for more than 50 percent of annual government spending).

¹² Other laws usually 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).

¹³ 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 eliminate any flexibility the executive would otherwise have to adapt the budget to small changes in economic circumstances.

- **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 perhaps thousands of budget line items, each of which is approved by the legislature. The BSL in some countries has respecified 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 a government decree.
- **Gross versus net appropriations.** Consistent with the principle of comprehensiveness, expenditures should not be offset against revenues. Also, some countries’ BSLs allow for the earmarking of revenues for specific purposes (e.g., excise taxes on petroleum products, to be spent on road maintenance). Other countries, in an effort to encourage government ministries/agencies to mimic private sector entities, have adopted legal provisions that allow budget entities to raise and retain revenues. In such cases, the legislature should approve the projected agency revenues and provide guidelines for setting fees or charges that generate such 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 basis of annual appropriations.** Traditionally, all expenditures were cash-based and limited to only 12 months duration. Besides specifying that individual expenditures approved by the legislature are **cash-based** upper limits, the BSL may require that multiannual **expenditure commitments** (especially for investment spending) be approved in the context of the legislature’s adoption of the annual budget. Alternatively, the BSL may be a vehicle for introducing an accrual-based government accounting system¹⁴ (i.e., one based on economic transfers rather than cash payments), details of which are provided in regulation.
- **Carryover of budget authority.** To allow end-year spending flexibility, the BSLs of countries with good expenditure control mechanisms may 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 carryover.¹⁵
- **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 (usually not in excess of 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.

¹⁴ A very limited number of countries have adopted accrual-based budget appropriations. Provisions would be needed in the BSL(s) should this approach be taken.

¹⁵ For further details, see Lienert and Ljungman, 2009.

2. Documents to accompany the annual draft budget law

- **Medium-term macroeconomic and fiscal projections, the underlying assumptions, and other information.** The BSL should specify the various documents that the executive should submit to the legislature when it submits its draft annual budget (Box 4). It is good practice to require the legislature to review and endorse an annually-updated multiyear budget framework, which should cover all institutional units comprising “general government,” as defined in GFS. The BSL could also include a requirement for the legislature to formally approve the government’s strategy for public debt.¹⁶
- **Information on extrabudgetary funds.**¹⁷ Such funds 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. Some countries restrict the creation and financial management of extrabudgetary funds. For example, Finland’s 1999 constitution includes 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.
- **Information on objectives for performance.** Countries that have adopted a performance- or results-oriented budget system usually require in their BSL that forward-looking annual performance reports be prepared by each major program and/or for each ministry.

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

- **Approving fiscal rules.** Fiscal rules have been included in fiscal responsibility laws (FRLs) in a number of countries. Inclusion of fiscal rules into law makes them more difficult to reverse. To be effective, a FRL should cover all relevant budget and quasi-fiscal operations of the public sector and comprehensively include procedural and transparency requirements. Brazil’s FRL (Box 1) provides an example of the successful embedding of fiscal rules in law, in part because the FRL includes strong sanctions for noncompliance. However, there are also examples of unsuccessful embedding of fiscal rules in law.¹⁸

¹⁶ 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 on-lending 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. Regarding coverage of debt, the “public sector” may be appropriate in countries where nonfinancial and/or financial public enterprises have an important impact on fiscal policy aggregates or fiscal risks.

¹⁷ For additional guidance, see Allen and Radev, 2006.

¹⁸ For failures in selected OECD countries, see Lienert and Jung (2004), p. 90. For Latin American countries’ experiences, see Corbacho and Schwartz (2007).

Box 4. Documents to Accompany the Draft Annual Budget Law or Appropriations Act

- A medium-term fiscal strategy and objectives, the medium-term budget framework (MTBF) showing expected revenue, expenditure, budget balance, and public debt during at least the two years beyond the next fiscal year;
- Identification and discussion of the economic assumptions and fiscal risks underlying the projections;
- A statement on fiscal risks. This may include (i) sensitivity of the fiscal and debt projections to changes in assumptions; (b) alternative macrofiscal scenarios; (iii) assessment of debt sustainability and debt-related risks; (iv) risks associated with quasi-fiscal activities, government guarantees and other contingent liabilities, State-owned enterprises, financial sector, subnational governments, extrabudgetary funds, and government assets (for more details, see Cebotari and others, 2009, and Everaert and others, 2009);
- Clear identification of new policies being introduced in the annual budget, with an estimate of their quantitative impact on the 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; and
- Tax expenditures, contingent liabilities and quasi-fiscal activities should be discussed, especially when quantitatively important.

Sources: OECD (2002); IMF (2007); Box III.4 of Lienert and Jung (2004).

Although in some countries it may be important for the legislature to formally approve fiscal rules by adopting FRL-type legislation, it is more important to ensure that fiscal rules are accompanied by political commitment and mechanisms for accountability, monitoring, and enforcement. Without the legislature's commitment to fiscal discipline, fiscal rules could end up undermining policy credibility.¹⁹

- **A two-part budget approval process.** Some countries require the government to present its MTBF and annual budget aggregates to the legislature for a pre-budget debate, e.g., around midyear of the year before the new budget year. Other countries require the annual budget aggregates—revenues, financing, total expenditure; and debt repayments—to be approved, prior to the second parliamentary round of approving the detailed expenditure estimates. Such two-part budget approval processes have the merit of focusing the legislature first on

¹⁹ An alternative approach to support fiscal discipline is to develop transparent and credible fiscal strategies backed by strong fiscal institutions. Such an approach has worked well in a number of countries, for example, Australia and New Zealand. This alternative usually includes adopting a medium-term perspective for budget preparation, budget procedures to minimize deficit bias (such as top-down budgeting procedures), and strong transparency requirements and public oversight.

the overall fiscal strategy and main aggregates, prior to approving detailed expenditures. A BSL can incorporate such a procedure, especially in countries where “top-down” budgeting is considered to be important for achieving fiscal consolidation.

- **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. Several 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 allow changes in the composition of expenditure categories. A few countries do not allow any changes at all by the legislature, except if they affect the government’s MTBF in only a minor way (for details, see OECD, 2007).
- **Limits on the legislature’s powers to revise 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). It is also appropriate, when required, to include in the BSL controls over the creation and maintenance of earmarks and of tax expenditures. In general, earmarking of revenues to specific expenditures should be avoided, as it contravenes the common pooling principle. Sunset rules for tax expenditures could be introduced in law (e.g., they should expire after 5 or 10 years), and limits on total tax expenditures (e.g., as a percentage of total annual expenditures) could be established.
- **Budgetary procedures within the legislature.** In many countries, these 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 1/12 rule (e.g., to four months after the beginning of the new fiscal year).

- **Rules on the adoption of the budget by the legislature.** 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 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 in law. 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.
- **Supplementary budgets.** A good budgetary practice is to require a formal midterm 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.²⁰
- **Independent budget offices.** Such offices, serving the needs of the legislature, have been established in several countries, including Canada, United States, and Mexico. The BSL, or a “budget office” law, can specify the roles, responsibilities, and staffing of the legislature’s budget office. To ensure the independence of its advice, the office should be nonpartisan, with no political appointees.

4. 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 quarterly ceilings), mechanisms of expenditure control, internal control, and internal audit, are best specified in government/ministerial regulations. However, the BSL may be used in the following areas:

- 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 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).

²⁰ 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.

Box 5. Ex Post Budget Reporting

Quarterly (or monthly) reports

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

Midyear report

- A comprehensive update on budget implementation, released within six weeks of the end of the midyear period. This should discuss the impact of changes in economic assumptions underlying the budget, any recent budget-related 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.

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 for revenues and broad expenditure categories. Spending ministries' reports on budget outcomes should be included.
- For countries with performance-oriented budget systems, the law should require that annual reports include non-financial performance information, including a comparison of performance targets and actual results achieved. The reports for year (-1) should be available in time for the legislature's consideration of the budget for year (+1).

Sources: OECD (2002); IMF (2007); and Box III.4 of Lienert and Jung (2004).

- Authority for 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, 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 (i.e., up to a certain percentage), before being obliged to return to the legislature for additional spending authority in the form of a supplementary budget.
- 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.

- **Consolidation of all revenues and establishment of 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 TSA be held at the central bank. The TSA may have subaccounts.²¹

Public procurement procedures can be 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).

5. Government accounts and reporting to the legislature

- **Accounting systems and procedures.** A separate accounting law is not usually 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 budget and accounting processes are unique." Law may require that accounting regulations be reviewed by qualified public and private sector experts.
- **Ex post budget execution reports and financial accounts.** The BSL should specify the reports and 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.** Provision of such information considered "best practice" could be made a legal requirement (see OECD, 2002). 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.

²¹ 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.

6. 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, including requiring the constitution to establish the independence of the SAI and to prepare audit reports for the legislature.²²
- **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 body²³ and staff of the SAI (which should be independent of the civil service), and the 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).

²² In 2007, INTOSAI refined the independence provisions of the Lima Declaration. Eight pillars for the independence of external government auditing are identified in the “Mexico Declaration”. For details, see <http://www.intosai.org/en/portal/documents/intosai/general/limaundmexikodeclaration>.

²³ 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.

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