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To: Members of the Committee on the Budget
(Managing Director, Chairman; Mr. Bakker, Mr. Fayolle, Mr. Ge, Ms. Lundsager, Mr. Mozhin, Mr. Rutayisire, Mr. Sadun, Mr. Stein, and Mr. Warjiyo)

From: Bernd Esdar, Committee Secretary

Subject: **Proposed Carry Forward Policy**

The attached paper on a proposed carry forward policy is the first of three papers on budget reforms that will form background information for a meeting of the Committee on the Budget to be scheduled for end-November. Issues for discussion appear on page 6.

Questions may be referred to Ms. Reynolds (ext. 38795) and Mr. Bonzi (ext. 38304) in OBP.

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INTERNATIONAL MONETARY FUND

Proposed Carry Forward Policy

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Approved by Siddharth Tiwari

November 10, 2008

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I. Background

1. **Consideration is being given to introducing carry forward provisions into the Fund's administrative budget**. Carry forward is the right to spend budget allocations beyond the period for which budgetary authority is normally granted. In the Fund's case, the Executive Board authorizes budget appropriations for a period of 12 months for administrative expenditures (Administrative Budget), and for a period of up to 36 months for investment project expenses (Capital Budget).[1]

2. **The main benefits that could be expected to result from carry forward of administrative expenditures at the IMF are improved cost efficiency, resulting from**: (i) greater flexibility for departments to address timing issues in the execution of their work programs; (ii) reduced incentives for inefficient end-year spending; and (iii) greater flexibility in the use of central administrative resources, which is of particular relevance for facilitating the significant refocusing and restructuring efforts embedded in the FY09–11 MTB. At the same time, the carry forward policy must be designed to limit potential pitfalls, so that the allocation of resources is kept in line with *current* priorities and a situation of over-budgeting at the departmental level does not become entrenched. Attachment I describes in greater detail the potential benefits of carry forward, and the reasons why restrictions may be needed.

3. **In designing a carry forward policy, important lessons can be learned from the experience of others**. Budget practices in most OECD countries and several International Financial Institutions (IFIs) allow for some form of carry forward; these are described in Attachments I and II, respectively. With these experiences in mind, this note sets out proposals on key aspects of a possible carry forward for the Fund's Administrative Budget.

II. Proposed Carry Forward Policy

4. **Amount.** The Fund's Administrative Budget would be allowed to carry forward unspent administrative budget allocations[2] up to a limit of $\boldsymbol{x}$ percent of the Board-approved net administrative budget (NAB),[3] where $\boldsymbol{x}$ is a number to be determined between 3 and 5.

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[1] Approved funds remain available to capital projects for a period of three consecutive years. Funds unused by the end of the three-year period lapse.

[2] Calculated as the difference between the budget outturn and the approved budget for a given financial year, plus any carry forward from the previous financial year.

[3] For the purpose of this proposal, the Fund's Administrative Budget is defined to include all Fund departments and offices, as well as the centrally controlled accounts (the IMF department). It is envisaged that the same carry forward approach that would apply to the Fund's Administrative Budget would also apply in principle to the Offices of the Executive Directors (OED) and the Independent Evaluation Office (IEO).

5. **There are several considerations that could inform the choice of a specific *x*.** Carry forward in other IFIs ranges between 1.5 and 3 percent of their total administrative budgets. For national governments, practices vary widely, from no carry forward, to carry forward authorized on a case-by-case basis, to carry forward up to a limit up to 10 percent of budgeted expenditures. Over the last five financial years, the Fund's average underrun has been 3.3 percent of the net administrative budget (NAB), or 4.2 percent excluding one-off contributions to the SRP service credit buyback program.[4]

6. **Another consideration is that the Fund is undergoing a significant restructuring within a short period of time, creating a need for greater flexibility in the use of central administrative resources than would typically be the case**. Accordingly, it is proposed that a limit toward the upper end of the 3–5 percent range be chosen to begin with, and that this be gradually reduced to the lower end of the range as budgetary uncertainty dissipates.

7. **Allocation among departments.** The allowed carry forward would be determined as follows (Attachment III provides additional details):

- Given the net FTE reduction of 380, to which the Fund committed in the March budget paper, departments and offices would be allowed to carry forward underruns only in their non-Group I net administrative budgets. That is, departments could carry forward unspent Book 1 administrative allocations from Groups II (Experts), III (Other Personnel), IV (Departmental Discretionary Budget), V (Centrally Administered Programs), and VI (Receipts).[5] Departments could *not* carry forward unspent administrative allocations for Group I (Regular Staff).[6]

- The amount of departmental carry forward would be limited to the lesser of: (i) the underrun on the Group II–VI portion of the departmental net administrative budget,

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[4] For the Fund, where Board approval is granted for the *net* administrative budget, a limit relative to the NAB would create greater incentives for departments to manage effectively their gross expenditures and/or endeavor to increase their revenues, as appropriate.

[5] The policy would apply only to administrative expenditures financed from the Fund's General Resources Account (GRA) and from receipts paid into the administrative budget ("Book 1" expenditures and receipts), since de facto carry forward is already incorporated in the budgeting process for administrative expenditures on activities (primarily capacity-building work) financed by contributions from external donors ("Book 2" expenditures and receipts).

[6] Consideration would be given to relaxing the Group I constraint once the restructuring process is complete. In the interim, requests from departments to apply resources from a Group I underrun in one financial year to Group I expenditures in the following financial year would be considered on a case-by-case basis; a key criterion for such a working budget adjustment would be that the proposed Group I expenditures are of a temporary nature (e.g., to allow for a longer overlap between incoming and outgoing staff), and would not lead to violation of the promised FTE reduction by FY11.

or (ii) ***y*** percent of the departmental net administrative budget allocation for Groups II–VI, where ***y*** is also between 3 and 5, and may be equal to ***x*** or may be set somewhat higher in order to partially compensate for the lack of carry forward of Group I resources.

- The carry forward accruing to centrally-controlled accounts would be the difference between the total allowed carry forward (***x*** percent of the NAB) and the sum of carry forwards accruing to departments. This amount would augment the central contingency reserve, and therefore be available to support the ongoing refocusing exercise or new priorities, including through distribution back to departments.

8. **Fungibility rules.** Full-fungibility of departments' carry forwards would be allowed across expenditure groups II–V.[7]

9. **Relationship with the baseline budget.** The carry forward would not enter into budget baselines, either at the departmental or Fund-wide level. Once the next-year budget envelope is derived from structural considerations (e.g., by applying the appropriate deflator to the previous-year budget), any carry forward would be added on top. That is, the carry forward would not be escalated by the deflator, or otherwise become part of the base, when moving from one financial year to the next. This restriction would ensure that large balances of unspent budget authority do not accumulate over time.

10. **Gross Expenditure Limit.** The Board approves the NAB and an *upper limit* on gross expenditures. Currently, this upper limit is derived as the proposed NAB plus the upper estimate for receipts. Under a carry forward policy, this limit would have to be changed to the proposed NAB plus the upper estimate for receipts plus the maximum amount of carry forward (***x*** percent of the previous financial year's NAB).

11. **Approval.** It is proposed that the carry forward policy, once approved by the Executive Board, would be implemented automatically according to the agreed rules of the policy. That is, annual Board approval for the amounts to be carried forward and/or its distribution across departments would not be required.

12. **Reporting.** The Board would be provided with the following information:

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[7] Note that an underrun resulting from higher receipts would be available to finance expenditures in Groups II–V in the following financial year, subject to the constraint that the department's total carry forward not exceed ***y*** percent of the department's (net) Group II–VI budget. In addition, the onus would be on departments to verify that these higher receipts were not used to finance an increase in Group I expenditures (relative to budget) during the financial year. Consideration would be given to relaxing the fungibility constraint across all expenditure groups (including Group I) once the restructuring process is complete.

- For the budget approval process in April, the Board would be presented with the proposed NAB for the upcoming financial year (on which approval is sought) and an estimate of the amount that will be carried forward from the current financial year. The input- and output-allocation would be provided for the proposed net or gross administrative budget (excluding any carry forward), while departmental business plans would also show departmental input- and output-allocations based on total expected resources (including estimated carry forward).

- The final outturn for the previous financial year and the actual amount carried forward into the new financial year would be finalized by the end of May.[8] The Board would be informed via the outturn paper, circulated to the Board in the summer, and through publication of departmental business plans, also over the summer.

- During the course of the new financial year, quarterly monitoring reports to the Board would report on expenditures relative to the total resource envelope (including the finalized carry forward), and the associated input- and output-allocation. Attachment III provides information on reporting vis-à-vis the real savings target set in the FY09–11 MTB paper.

Other Issues for Consideration

- It is proposed that the new policy take effect beginning in FY2009; that is, unspent resources in FY2009 would be carried forward to FY2010 (subject to the appropriate limits).

- The introduction of carry forward may create a situation where the Fund's spending authority exceeds the Board-approved nominal budget envelope in a given financial year. The ***x*** percent limit is designed to constrain the amount of such excess expenditures. Moreover, at the departmental level, any significant and persistent underrun would trigger a review of the department's baseline budget to ensure that its resources are consistent with the institution's current priorities (as is presently the case).

- Given the proposed fungibility rules (described above), the substantive constraints remain that the resource envelopes for Groups I–VI combined, and for Group I on its own, are not exceeded. Ensuring that these constraints are met would *not* require

[8] Each department would receive its carry forward as a working budget adjustment, and could spread the total amount across Groups II–V accounts in whatever way it judges best supports its business plan. For the purposes of formulating draft departmental business plans earlier on in the budget cycle, departments will be well placed to estimate their own expenditure underruns and thus the likely amount that they will receive as carry forward in the next financial year.

separate tracking of expenditures according to the source of funds (approved budget vs. carry forward). However, separate records of departmental budget allocations and the amount of carry forward for each department *would* need to be kept, since budget formulation will be based solely on the former, and monitoring will be based on resources from both categories combined.

- The use of carry forward budget resources would not affect the presentation of expenses in the Fund's audited financial statements.

- More generally, the estimated cost of implementing a carry forward policy is expected to be small. OBP and TGS agree that the necessary work can be covered by the capital budget that has already been approved for IT systems changes resulting from budget reforms.

- Several developments could affect the implementation and/or optimal design of the carry forward policy, including the envisaged move towards activity-based costing and budgeting, continued strengthening of performance measurement, completion of the restructuring process, and the eventual restoration of full fungibility across expenditure groups. The experience with carry forward would also need to be assessed with regard to any differential impact across departments (e.g., because of the ability, or not, to generate GRA receipts). Accordingly, an in-depth review of the policy should be undertaken by the end of the current MTB period (FY11). This could include analysis of it effectiveness relative to other policy alternatives, in particular the ±2 percent band that was adopted by the World Bank to support the shift in its budgetary framework from a focus on inputs to greater emphasis on output delivery and performance management (see Appendix II).

Issues for Discussion

(i) Do Directors broadly support the introduction of a carry forward provision into the Fund's administrative budget?

(ii) Do Directors support the staff proposal for a limit on carry forward around 5 percent to begin with, gradually declining to around 3 percent as budgetary uncertainty dissipates?

(iii) Would Directors support consideration of an alternative policy in future—such as the ±2 percent band adopted by the World Bank—as the Fund's budgetary framework continues to shift from a focus on inputs to greater emphasis on output delivery and performance management?

CARRY FORWARD OF BUDGET AUTHORITY

Note prepared by Ian Lienert and Gösta Ljungman

Public Financial Management Divisions, FAD

August 12, 2008

OBP is considering introducing carry forward of unspent budget allocations. Such arrangements can be found in numerous OECD countries. This note summarizes and discusses some of their experiences, which may be helpful in developing the Fund's policy in this area.

That said, there are a number of differences between national administrations and the Fund that should be kept in mind. First, the principal-agent relationship between the legislature and the executive is markedly different than that between the Executive Board and the Fund's departments. Second, the activities of national administrations tend to be more varied and unpredictable than for the Fund, heightening the usefulness of end-of-year flexibility. Third, the rationale for carry forward provisions for the current expenditures rests on an assumption of managerial flexibility, which may be more extensive in national administrations that at the Fund.

I. WHAT IS BUDGET CARRY FORWARD?

1. **Budget carry forward is the right to spend budget allocations beyond the time period for which budgetary authority is normally granted.** This time-period is usually defined to be the twelve months of the *fiscal year*, although there are notable exceptions.[1] The concept of carry forwards rests on the principle that a budget authority ends at a certain point in time.

2. **Carry forwards should not be interpreted as a challenge to the notion of time-bound budgets.** The division of the budget into discrete 12 month periods makes good sense in most cases, as it allows for a regular reassessment and endorsement of how resources are allocated. The challenge when designing a carry forward regime is finding the right balance between a firm control over the allocation of resources for a given 12 month period and flexibility in operational management.

3. **Budget carry forward and complementary accounting periods are distinct.** For a cash-based budget system, carry forward provides authority to make payments in year t+1,

[1] In Slovenia and several states of the United States of America, the legislature approves two-year appropriations.

after the close of the year t. Both the budget and the accounting are shifted to the next fiscal year. In contrast, a complementary accounting period is a short period, usually up to one month, in which the cash transactions that take place in t+1 are recorded in the accounts of year t.

4. **Borrowing from future appropriations is conceptually the equivalent of negative carry forward.** A few countries allow borrowing from future appropriations. Any advance use of the following year's appropriations is treated as a negative opening balance of available funds at the start of the new fiscal year.

II. Justification for Carry Forward and Reasons for Limitations

5. **Carry forward arrangements reflect the practical difficulties that can result from managing continuous activities in an uncertain environment through time-bound budget authorizations.** It can be described as an instrument for promoting *intertemporal efficiency,* by introducing some flexibility into how resources are allocated between budget periods. A possibility to defer budget authority is not justified in all cases, however, and it becomes necessary to consider which—if any—restrictions for carry forwards that should be put in place.

A. Justification for Carry Forward

6. **Four reasons for allowing end-year carry forward can be identified:**

- **Avoid wasteful end-year spending.** Budget managers tend to maximize spending of their budgets. This sometimes results in frivolous end-of-year spending sprees when it becomes clear that the budget will not be used up by the regular activities. This is because there is a perception that the entire budget must be spent: individual budget managers feel obliged not to lose their "entitlement", which otherwise would be returned to the central budget manager.[2] The possibility to carry forward unutilized budget authority reduces such tendencies.

- **Provide an incentive for efficiency gains.** Carry forwards can also promote initiatives to identify more efficient use of resources. Due to information asymmetries, the individual budget manager (the agent) is in a superior position to achieve efficiency gains that escape the eye of the central budget office (the principal). Incentives to reduce costs are important; these are lacking when end-year

[2] The budget authority represents a *right* to incur expenditure for a particular purpose, usually up to the amount provided in annual appropriation acts. It is not a transfer of funds to the entity that receives that authority; however, it is often perceived this way and reflected in the attitude that an unused budget is "lost" or "returned". This is a misconception: nothing is lost, since the right is valid only for a specific purpose. Also, funds are not "returned", since there never was any transaction.

budget savings are lost. Efficiency gains are likely to be reaped when there is sufficient devolution of managerial authority.

- **Simplify the management of multi-year undertakings.** Although many budgetary activities are continuous, there are some undertakings where the timing of payment is unpredictable. This is particularly the case for multi-year investment projects. When annual budget authority is strictly enforced, the budget may have to be revised when there are budget execution delays. A similar problem arises for current spending programs with multi-year contracting for goods or services. The possibility to carry forward unspent appropriations simplifies budget management and provides an incentive for improving medium term budget planning.

- **Compensate for rigidities in budget execution procedures.** Individual budget managers may be under constraints outside their control. For example, complex procurement procedures or multiple ex ante spending controls – either internal to the spending agency or externally imposed by the central budget office – may retard budget execution during the fiscal year. When there are delays beyond the control of individual budget managers, the provision of end-year carry forward allows budget execution to continue into the new year, without having to re-apply for new budget spending authority. Complementary accounting periods could also ease the need for carry forwards for this purpose.

7. **Of these four reasons for allowing carry forwards, the first two appear particularly relevant for IMF budget management.** In order to reap the efficiency-enhancing effects of carry forwards, the decisions determining expenditure must be influenced by the possibility to defer spending to a future fiscal year. It may for example be rational for departments to delay the recruitment of staff for some period to avoid new staff arriving at a time when there is little time to properly introduce them to their work, for example during vacation times or a particularly busy period. Unless the budget savings can be retained and generate benefits for the departmental managers deciding on the recruitment, it is unlikely that a carry forward provision will have much effect. Similarly, decisions regarding the size and duration of missions are made by mission chiefs or departments, within the constraints of mission travel regulations.

8. **This suggests that the case for allowing carry forwards depends on the principles for budget management.** In a strict input oriented budget environment, where Departments are expected to closely adhere to a detailed and centrally imposed budget, and little managerial flexibility over the use of budget resources, the argument for allowing for carry forward is limited. Incentives to reduce costs will only arise to the extent that departmental decision-makers are able to realize efficiency gains, and receive some benefit from generating savings. In contrast, if the budget system is oriented towards the achievement of results—with devolved budget management and flexibility over the use of appropriations—intertemporal efficiency gains are promoted through carry forwards. These considerations

suggest that the efficiency-related reasons for budget carry forward in the Fund will become more compelling as budget responsibility continues to be devolved to departments.

B. Reasons for Restricting Carry Forward

9. **The arguments for allowing some flexibility in the transition between budget periods must be balanced by the fundamental requirement of restricting budget authority in time.** Over time, budgetary priorities change, making it natural to change the size and the composition of the budget. Possibilities to carry forward unspent budget allocations, and allowing budget managers discretion over the use of these resources, are therefore in conflict with the budget granting authority's prerogative to control the allocation of resources to ensure that spending is in line with current priorities.

10. **In reality there is a limit to the possibility of translating priorities into unambiguous budget allocations.** A certain amount of flexibility over the use of resources is often rational, including between budget periods. Nonetheless, this flexibility should not be excessive so that the possibility of defining priorities is lost.

11. **The most challenging aspect of determining whether or not carry forward is justified is to establish the reason why there has been under spending.** In all of the four cases justifying carry forwards outlined above, there is an implicit assumption that the budget allocation was appropriate in relationship to the task that was going to be carried out. If, however, the budget allocation was excessive, or if a planned activity did not, and will not, take place, it is justifiable that the corresponding budget authority should be canceled, i.e. that the unspent appropriation should not be allowed to be carried forward. However, since budget estimates are fraught with uncertainties, it is rarely possible to say with certainty (either ex ante or ex post) that exactly the right amount of resources have been appropriated in the budget. A pragmatic approach would be to allow some carry forward on a case-by-case basis. Japan is an example of where this occurs in practice—see Box 1.

Box 1. Carry Forward in Japan

Types of appropriations and authority to carry forward. The annual budget, including the special accounts, is classified administratively (departments and divisions) and into paragraphs *(kwan)* according to the purpose of the disbursement. Within ministries, expenditure paragraphs *(kwan)* are subdivided into articles *(kou)*. Articles *(kou)* are the unit of appropriation by the Diet. The budget is adopted mainly on an economic classification of expenditure, supplemented by a mixed program and functional classification at a more detailed level. The duration of annual appropriations is usually for one year. However, budgeted expenditure that is not likely to require cash payments within a given fiscal year can be carried over to the following fiscal year, under certain conditions (see below). There are also "continuing expenditures" for certain construction or other projects that require a few years for completion. Such spending requires prior approval by the Diet; once the Diet's resolution is provided, the government is authorized to make project disbursements over several fiscal years. Continuing expenditures are limited to five consecutive years unless otherwise authorized by the Diet. Most of the above provisions are included in the Public Finance Act 1947, whose article 43 specifies that carry forward of annual appropriations to the following fiscal year requires the approval of the Ministry of Finance (MoF). The same article also requires ministries to report the use of the carried over expenditure to the MoF and the Board of Audit.

Carry forward in practice. The head of a ministry or agency has to explain to the MoF the reason why the carry forward is necessary. Requests often related to projects that are not expected to be spent within the fiscal year due to unexpected changes in plans, unfavorable weather conditions, and delays in land acquisition. The MoF approves well-justified carry forward requests, after obtaining prior diet approval. In addition, the MoF approves requests related to unforeseen delays after contracting. In general, carry forward requests from ministries are approved for individual projects, not by type of expenditure. Well over half of the carry forward requests approved by the MOF in recent years relate to public works projects. The amount of carry forward approved for ministries implementing spending programs in other areas is quite small in comparison with public works.

Sources: Japan MoF (2004); Lienert and Jung (2004).

12. **Another argument for restricting carry forwards is the risk posed by large accumulated balances of unspent budget authority.** In addition to ensuring that spending is in line with current priorities, the budget granting authority also has a responsibility for limiting total expenditure to a sustainable level. This is often reflected in an objective or target for aggregate parameters, such as total expenditure or the budget balance. When unspent carried-over balances accumulate over time, there is a risk that total expenditure for an individual year is substantially larger than the annual budget authorization. In the extreme, such an accumulation could permit an expenditure surge that conflicts with the government's aggregate fiscal policy. In the United Kingdom, explicit government approval for the use of carry forwards was introduced in 2004 when the accumulated amounts reached a level so high

that, if used for spending in a single year, would have breached the government's fiscal targets. In Sweden, the government introduced a moratorium on the use of carry forwards in 2005 when there was an indication that the aggregate expenditure ceiling risked being exceeded.

13. **Some expenditures—notably those authorized by other laws—do not require any carry forward provisions.** Expenditures such debt servicing must be paid irrespective of the amounts initially authorized in the annual appropriations. Budget transfers to sub-national governments is another example: these are either determined through a formula or by discretion, and are executed in full during the budget year, eliminating the need for carry forward. Similarly, for government-financed entitlement programs regulated by separate legislation, there are no reasons to allow for carry forwards. Some countries (e.g., France—see Box 2) have provisions in Organic Budget Laws for certain appropriations to be exceeded.

Box 2. France: Carry Forward Provisions and Restrictions

Types of appropriations and coverage of carry forward. Appropriations comprise commitment authorizations and cash-limit appropriations**.** Commitment authorizations set the upper limit of spending that may be committed over time. The duration of non-salary commitment appropriations is not limited in time: commitment authorizations for a particular budget program that remain unutilized at end-year may be carried over to the following year, by a joint decree of the minister of finance and the responsible minister. Cash-limit appropriations set the upper limit for expenditure that may be authorized for payment and/or paid during the 12 month fiscal year, to cover commitments contracted previously under commitment authorizations. In the case of salaries, commitment authorizations equal cash-limit authorizations. Most appropriations—whether for commitments or cash spending—are binding upper limits. The main exceptions are the 12 month appropriations for public debt, government guarantees, tax rebates, etc.; for this spending, the "estimated" appropriations can be exceeded, although the minister of finance must present a rectifying budget law to parliament at the earliest opportunity.

Restrictions on carry forward. Since there is no time limit on the validity of commitment appropriations, there are no 12 month carry forward restrictions on spending commitments. Cash-limit appropriations for a specific program can be carried over, within the limit of 3 percent for salaries and 3 percent for all non-salary expenditures (for a given budget program, there is unlimited virement between all non-salary spending categories, including investment).

Carry forward in practice. Given the double basis of appropriations and carry forward—spending commitments and cash spending—guidelines have been issued by the Budget Ministry so that ministries can implement the provisions, which are contained in the 2001 Organic Budget Law (*Loi organique portant sur lois de finances*—LOLF).

C. Regulation of Carry Forward

14. **To control the size of carry forwards, three main approaches can be taken:** (1) limit the amount of carry forward allowed in any given year; (2) impose a ceiling on the amount of accumulated carry forwards; and (3) control the use of accumulated carry forwards. The advantage of the first approach is that it is simple to administer, while giving a clear incentive for budget managers to reduce costs, at least up to the carry forward threshold. A standard norm for carry forward could be complemented with a case-by-case examination if deemed appropriate. However, the accumulation of carry forwards could grow so large that problems would be created for aggregate expenditure management. In the second approach, this problem is controlled, but at the expense of reducing the efficiency incentives once the ceiling is reached. In the third approach, where the use of carry forward is regulated, the budget granting entity's problem of reduced control over expenditure is addressed, but possibly at the expense of diminishing efficiency incentives.

III. Country Practice for Carry Forwards

15. A summary of selected country practice is shown in Table 1, which also shows other practices adopted to introduce greater flexibility into budget management.

A. What Is Typical Practice for Carry Forwards in OECD Countries?

16. **Most OECD countries allow carry forward, for both current and investment spending.** The 2007 OECD budget practices survey results indicate that, for investment spending, over 80 percent of OECD countries allow carry forward. These percentages are slightly lower for operating expenditures, and considerably lower for transfers. Nonetheless, 62 percent of the 30 OECD members report carry forward for transfer spending (Figure 1).

17. **Although carry forward is often permitted, restrictions usually apply.** The most common method is to limit carry forward for certain categories of spending. For example, France does this separately for salaries and non-salary spending, within each of the 132 budget programs. Only 5 OECD countries (Czech Republic, France, Netherlands, Slovakia and United Kingdom) report that there are no restrictions on carry forward of *investment* spending authority and only two report unlimited carry forward for each of the two *current* spending categories shown in Figure 1.

B. Managing the Size of Carry Forward

18. **The ministry of finance's involvement in managing budget carry forward varies considerably in OECD countries.** This largely reflects the degree of autonomy that government departments or agencies exercise in budget management. The countries shown in Table 1 are representative of a variety of budget systems, ranging from countries with detailed appropriation structures (Germany and Japan) to those with broad-based appropriations (France, Sweden); those with accrual budgeting (U.K.), those with commitment appropriations (France, USA) and those with cash appropriations (Japan, Germany); those with a strictly annual budget (Japan) and those with budgets for multi-year periods (Germany, USA).

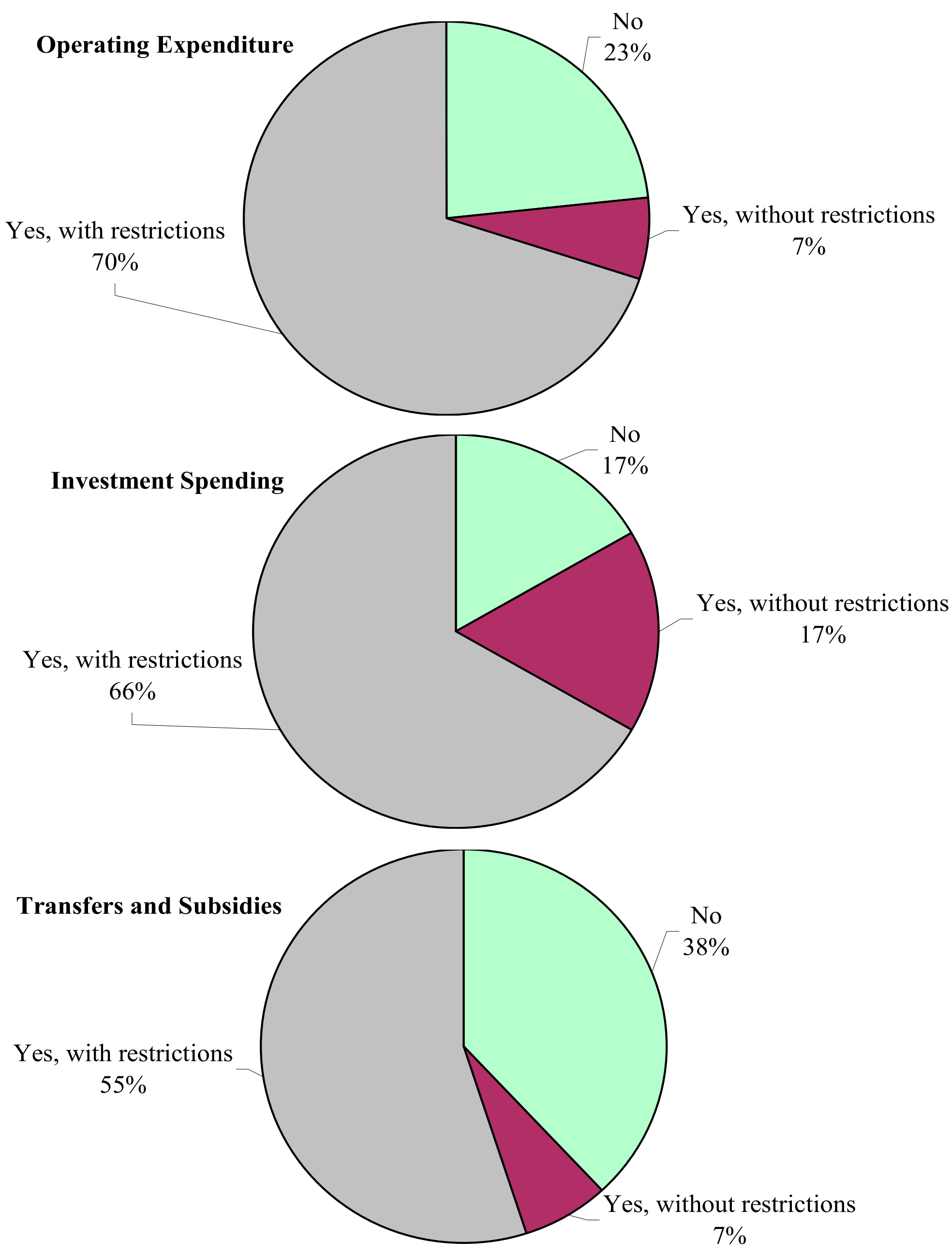
Table 1. Carry Forward in Selected Countries

	France	Germany	Japan	Sweden	United Kingdom	United States
Is budget carry forward authorized?						
By statute law (act of parliament)	Yes	Yes	Yes	Yes	No	Not explicitly
By Government Regulation	Yes	Yes	..	Yes	No	No
By Ministry of Finance Rules	Yes	Yes	Yes	Yes	Yes	Yes
Stage of Expenditure: Does 12 month carry forward apply to:						
Commitments?	In some cases	Not for investment (since multiyear)	Not for "continuing appropriations"	n.a.	n.a.	Yes
Accrued expenses?	n.a.	n.a.	n.a.	n.a.	Yes	n.a.
Cash payments?	Yes	Yes	Yes	Yes	Yes	Yes
Restrictions on carry forward						
Is Ministry of Finance approval of carry forward needed?	Yes	Yes	Yes, for each project	Usually not	Yes, for take-up	Yes
Do unexpended balances affect Y(+2) budget amounts?	Not in principle	Possibly	Possibly	Not in principle	No	Yes
Do restrictions vary by type of cash spending?	Yes	Yes	Yes	No	Yes. For capital &	No
If yes, which spending types?	Salaries, and all other spending categories	Groupings of detailed budget line items	All. But carry forward can be approved	.. ..	current carry forward entitlements.	
Are restrictions expressed as a % of total spending?	Yes	No	No	Yes	No	No
First main spending category	3% salaries	)	)	3%, but not rigidly	)	)
Second main spending category	3% all non-salary	) by budget line item	) by budget line item	no	) by HM Treasury	) by OMB review
Other spending categories	None	)	)	no	) scrutiny	)
Other elements of flexibility that impinge on carry forward						
Multi-annual appropriations	Yes, for commitments	Yes, for some: 2 years	Yes, for some	Yes, at total level	No	Yes
Broad-banded appropriations	Yes: programs	No: detailed economic	No: detailed economic	Yes	Yes	No, detailed programs
Virement delegated to budget managers	Yes, except salaries	Partly	No	Yes	Yes	No
Can executive overspend before a supplementary budget is approved by legislature	Yes (within limits)	Yes (within limits)	No	Yes (within limits)	Yes (unlimited)	No
Two or more supplementary budgets per year1	No	No	No	Yes	Yes	Yes

n.a. = not applicable.
Source: OECD Budget Survey 2007

Figure I. Carry Forward in OECD Countries

(percentage of countries' responses to Question:
"Can ministers carry forward unused funds or appropriations from one year to another?")



Source: OECD 2007 Budget Survey.

19. **In some countries, Government or Ministry of Finance approval for carry forward is required.** In *Japan* (Box 1) and *Korea,* end-year carry forward of unspent appropriations is allowed following approval from the National Assembly. In Korea, carry forward is authorized for contracts made in the fiscal year, but payment is not possible in the same year. Line ministries may also carry forward up to 5 percent of certain operational expenditures without prior authorization from the finance ministry, which prepares the list of eligible expenditures.

20. **In other countries, instead of discretionary control by the Ministry of Finance, the Government imposes quantitative limits on carry forward.** For example, *Sweden* has a carry forward limit of up to 10 percent in its 1996 State Budget Act; this upper limit is administered more restrictively by the government (Box 3), which facilitates aggregate fiscal control. In *Norway,* carry forward is allowed for certain appropriations: (1) for current expenses, transfers from one budgetary period to the next, up to 5 percent; (2) "estimated" appropriations can be exceeded, i.e., borrowing of future appropriations; and (3) expenditures for building, construction and materials, and other expenditure can be carried forward if Parliament decides this to be necessary, for up to two years. In the *United Kingdom,* although carry forward of departmental expenditures is reported by the OECD survey to be without restrictions, there are limitations on the use of carried-forward balances (Box 4).

Box 3. Sweden: Carry Forward

Basis of appropriation and coverage of carry forward. Appropriations are exclusively for cash spending. In 1992, budget carry forward restrictions for cash spending were liberalized. Initially, this was limited to the administrative appropriations of government agencies i.e., current expenditures on a cash basis. However, since 2006, all appropriations of the State budget are covered: any "appropriations saving"—appropriations not fully used in a 12 month period—may be carried over to the next year. According to the Appropriations Ordinance (subsidiary legislation issued by the government), a government agency may carry forward up to 3 percent of its appropriation balance at the end of a fiscal year, unless the government decides otherwise by Cabinet decision, i.e., the government can approve a carry forward balance that is larger (provided it is under 10 percent) or lower than 3 percent, which is the default option.

Borrowing from future appropriations is also allowed. Besides authorizing the government to carry forward unspent appropriations without restriction, the State Budget Act 1996 also allows appropriations to be exceeded by up to 10 percent. However, in practice, the government sets the limit significantly lower. For administrative appropriations, advance appropriations are typically limited to between 1.5 to 3 percent; for other appropriations of Sweden's 240 agencies, the limit is generally set at 5 percent.

Carry forward in practice. A government agency would record transactions during a 12 month period and its unexpended balance at the end of the year for a specific appropriation as follows:

Carry forward going in to period t	+/- B1
New appropriation (initial budget)	+ X1
Supplementary appropriation (revised budget)	+ X2
Reallocated appropriation (virement)	+/- X3
Overrun (borrowing from next year's appropriation)	+ X4
Revenue accounted against the appropriation	+ X5
Cancellation of appropriation	- X6
Cash expenditure accounted against the appropriation	- X7
Unspent appropriation balance at the end of period t	+/- B2

Box 4. United Kingdom: Carry Forward Provisions

The United Kingdom is one of the few countries whose annual budget is on an accrual basis. Carry forward varies according to spending control categories, as follows:

- The unlimited carry forward amounts applies only to Departmental Expenditure Limits (DEL), which are only part of the entirety of departmental spending. The other component is Annually Managed Expenditure (AME), for which there is no carry forward of budget authority. For DEL, there is a firm limit for spending during three years[3], but with complete flexibility on how the spending takes place during the three 12-month periods. In contrast, AME are demand-led expenditures that can not be controlled by departments or whose volatility cannot be absorbed by departments because of their size.

- The use of end-year flexibility (EYF) varies according to spending categories, notably current ("resource") DEL and capital DEL. There is an asymmetry for using the unlimited carry forward authority. Whereas resource DEL EYF may be transferred to capital DEL EYF, the reverse is not permitted. Also, for resource spending, DEL EYF non-cash spending may not be transferred to cash or near-cash spending

- If a government department is successful in augmenting its total DEL by accessing part of the general contingency reserve controlled by H.M. Treasury, there will be a corresponding reduction in EYF entitlements, i.e., total DEL of a department can only be increased once any unspent budget resource entitlements are deducted.

21. **In countries where carry forward is "prohibited"—exceptions may apply.** Spain is one of the five OECD countries that does not allow carry forward for investment spending (the others are: Belgium, Greece, Mexico and Turkey)—see OECD, 2007. Whereas Spain's General Budget Act 47/2003 proscribes carry forward, the same law allows exceptions, including: (1) those specified in other laws; (2) appropriations originating from contributions by the State to autonomous bodies to finance joint spending; (3) where appropriations originated from revenue legally dependent on the completion of certain actions (see p. 426, Lienert and Jung, 2004). Also Spain allows multi-year appropriations for certain expenditures, which implies automatic 12-month carry forward for such appropriations.

[3] These limits are decided during Spending Reviews, which take place every 2–3 years. The limits are comparable to multi-year appropriations in other countries. However, in the U.K., parliament does not formally vote on the spending limits and make them legally binding upper limits for spending during 3 years.

C. Have Liberal Carry Forward Provisions Led to Lower or Higher Expenditure?

22. **The improved efficiency promoted by carry forwards can reduce expenditure over time.** If a country introduces new provisions to allow carry forward of budget authority, expenditure in the first year could be lower than otherwise would be the case. However, contrary to what could be intuitively expected, expenditure in future years may not necessarily be correspondingly higher. Since carry forward concerns the *authority* to incur expenditure, it is only to the extent that this authority is used in the future that expenditure *in those years* would be higher than otherwise. Cumulatively—over a number of years—to the extent that there is still a positive unspent balance, expenditure would be lower than in the situation of no carry forward. In France, Sweden and the U.K., there has been a gradual net accumulation of unspent appropriations since the introduction of carry forward possibilities.

23. **The countries that have liberalized budget carry forward rules—including introducing borrowing from future credits—have not seen deteriorations in fiscal balances.** On the contrary, some of the countries that have liberal rules for carry forward and borrowing from future appropriations have achieved exemplary fiscal performance, e.g., the ongoing fiscal surpluses and substantial reductions in debt in Australia, Canada, Denmark, Finland, New Zealand, and Sweden. However, the good fiscal performances in these countries is principally due to strong political commitment to fiscal discipline, not changes in carry forward rules. Clear medium-term fiscal strategies have resulted in sharp changes in spending policies. Also, these countries have also implemented accountable fiscal management by delegating budget authority and autonomy to spending ministries and/or agencies.

24. **Available evidence points to efficiency gains following the introduction of carry forward provisions.** This has occurred in countries when budget managers have significant power over the use of their budgets, and strong incentives to improve efficiency, including allowing carry forward. The efficiency gains have been largely at a program (or micro) level in government spending departments.

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Table 1. Carry Forward in Selected International Financial Institutions		
Institution	**Percent**	**Description**
Asian Development Bank (ADB)	2	Quarterly and year-end reports showing specific over/underrun by budget category and item. Maximum of 2 percent of original budget can be carried forward to the following year for uses that conform to established guidelines for utilization of budget carry forward. Can be used for delayed or expanded activities approved in the previous year and for new unforeseen activities (both uses subject to specific conditions). Approval on the use of carry forwards is by the President and reported to the Board of Directors
Inter-American Development Bank (IADB)	1.5	Board allows management to retain as carry forward all underspent funds up to a maximum of 1.5 percent of total annual approved administrative budget. Underspends above this level automatically lapse. Underspent funds for capital budgets are not restricted and all such funds fully carry forward indefinitely from year to year for each project until completion.
International Fund for Agricultural Development (IFAD), United Nations (UN)	3	Amended financial regulations in 2004 to allow for carry forward of up to 3 percent of uncommitted obligations within administrative budget. Carry forward is pooled and used for various purposes are approved by senior management.
World Bank (WB)	2	No carryover at present. Board approves a budget to be managed within a band of ±2 percent. Anticipated moves within the range are discussed with the Board on a quarterly basis. Previously, the Bank had a carry over policy that allowed business units to carryover unspent year-end balances of up to 5 percent of their administrative budgets into the next financial year. In 2003 the carryover was reduced to 3 percent. In 2005, carryover was discontinued and replaced with the ±2 percent band as part of a broader budget reform.

CARRY FORWARD—ADDITIONAL DETAILS

This attachment sets out the basic definitions that would underpin the proposed carry forward policy, and considers how the policy might impact the reporting of progress toward the achievement of the $100 million in real savings committed to in the FY09–11 MTB paper.[4]

Basic Definitions

Under a system that includes carry forward, the amount of underspend in the current financial year, U_t, could be measured as follows:

[1] $$U_t = B_t + CF_{t-1} - E_t$$

where: B_t = the net administrative budget in the current financial year (excluding provisions for the IEO and OED),
CF_{t-1} = the amount carried forward from the previous financial year, and
E_t = net expenditures in the current financial year.[5]

The overall carry forward from the current financial year into the next financial year, CF_t, would be determined as follows:

[2] $$CF_t = \min(U_t, x\, B_t)$$

That is, the amount that could be carried forward to the next year would be the minimum of the underspend in the current year, or a specified ratio ***x*** (we have proposed a number between 3 and 5 percent) of the current year's approved net administrative budget.

For an individual department, *i*, expenditures would be defined similarly. However, carry forward would be more restrictive:

[3] $$cf_t^i = \min(u(\text{II-VI})_t^i, y\, b(\text{II-VI})_t^i)$$

[4] "The FY2009–FY2011 Medium-Term Administrative, Restructuring, and Capital Budgets," (EBAP/08/20).

[5] An alternative would be to define the underspend as the approved net budget less net expenditures, rather than the total net resources less net expenditures. The total resources approach is employed by many governments (see, for example, Box 3: Carry Forward in Sweden in the main note). Note that, in any given year, the total resources approach might allow for a larger amount to be carried forward from one year to the next, relative to the approved budget approach. However, this effect would be transitory—and not a permanent addition to resources—as such higher expenditures merely reduce the scope for future carry forwards. Moreover, in either case, the possible carry forward would be limited by the ***x*** percent rule.

That is, the amount that could be carried forward to the next year would be the minimum of the underspend on the department's budgeted appropriation for *Groups II–VI combined* in the current year, or a specified ratio ***y*** (a number—common across all departments—greater than or equal to the ***x*** percent overall limit) of the department's current year approved net administrative budget for *Groups II–VI combined*. The rationale for leaving Group I out of the departmental base is the need to deliver the 380 reduction in FTEs promised in the FY09–11 MTB paper and the consequent restriction on upward fungibility between Groups II–V and Group I during the FY09–11 MTB period.

The carry forward accruing to the center would be calculated as the difference between the overall carry forward and that accruing to departments.

[4] $$cf_t^c = CF_t - \sum_i cf_t^i$$

<u>Reporting against the savings mandate</u>

A central concern associated with introducing a carry forward policy is that it not obscure delivery of the $100 million in real savings promised in the FY09–11 MTB paper. Since carry forward permits net expenditures to exceed the approved net budget in any given year (subject to the ***x*** percent limit), some thought must be given to how such a situation could be shown to be congruent with the savings mandate.

Two key comparisons can be made in support of the mandate's fulfillment:

i. Budgets have not been altered by the carry forward policy. Accordingly, the real net approved budget in FY11 will be $100 million lower than the real net approved budget would have been under the rolled forward FY08–10 MTB.

ii. The present value of total real net expenditures under the FY09–11 MTB will always be lower than the present value of total real net approved budgets during this period (barring any deflation).