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Public Expenditure Management and Budget Law:

Toward a Framework for a Budget Law for Economies in Transition

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Abstract

This paper discusses basic principles underlying budget law and reviews key features of budget legislation in several OECD countries as a basis for development of budget legislation in economies in transition to a market environment (EITs). It recommends a broad structure and a number of specific provisions that could be included in budget law for EITs.

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Summary

Many of the economies in transition have not yet established a comprehensive legal framework for public expenditure management. Such a framework is a necessary basis for building public expenditure management institutions. One option could be to model budget legislation in economies in transition on that of one or several of the OECD countries. The budget legislation of Western industrialized economies, however, was largely developed at a time when compliance with parliamentary appropriation was the main objective--and relatively few countries have revised their budget legislation to deal with the concerns of modern economies regarding macroeconomic management and efficient use of resources. Many aspects of budget legislation in these countries are, of course, relevant to economies in transition. It is argued, however, that these economies need a legal framework that covers all of the issues of fiscal management more explicitly than the framework of most industrialized countries--primarily because economies in transition lack an institutional structure that can effectively use administrative measures to deal with the macroeconomic and efficiency aspects of fiscal management.

This paper discusses principles of public expenditure management in relation to budget legislation, reviews budget legislation in a selected group of industrialized countries, and recommends elements to be included in the budget legislation of economies in transition. The paper places particular emphasis on three points. First, comprehensive coverage of the financial operations of general government--in particular, budget legislation--should encompass key aspects of the operation of so-called extrabudgetary funds. Second, the management role of the ministry of finance--or other relevant agency--should be explicitly stated, particularly in relation to public borrowing, cash management, and execution of the budget. Third, the budget should be presented in a macroeconomic framework, and explicit upper limits for the deficit and bank financing of the government deficit should be stated in the annual budget law.

I. Introduction: The Structure of Budget Law

In Western countries, legal frameworks for public expenditure management have evolved over time--often centuries. Budget legislation has taken a variety of forms, but, in general, provides a structure that enables the executive branch of government to carry out programs under the authority of the legislative branch--and for the executive to be accountable to the legislature. This paper reviews key features of budget legislation in selected OECD countries and, on this basis, suggests some elements of budget law that could be used to develop appropriate legislation in the economies in EITs.

Economies now in transition from a centrally planned to a market economy have emerged from a very different regulatory environment from that of the industrialized market economies. In the planned economies, budgeting was merely the vehicle for executing the central plan, which provided both authority and a standard of accountability for public spending. Many of the basic principles of public budgeting in a market economy, such as the comprehensive scope of coverage of the budget (exclusive of public enterprises) and the establishment of clear distinctions between fiscal management (by the ministry of finance 1/) and monetary management (by the central bank) are not yet fully established. Among the continuing fiscal management difficulties in many EITs is the reliance on the central bank for data on budget execution and the absence of a clearly defined fiscal management role for the ministry of finance. Development of legislation embodying these principles is an essential base for building fiscal management institutions in the EITs.

As a starting point, let us look at the broad structure of budget legislation in the OECD countries. In these countries, the legal framework for public budgeting is framed at several levels--constitution, budget management law (that is, the law dealing with the general principles of public budgeting--sometimes called organic budget law, 2/ annual budget (appropriation) laws, special appropriation laws, and financial regulations and instructions. The precise pattern, however, varies from country to country.

The constitutional level is, of course, the highest in the legal hierarchy. It provides the foundation for other laws and, compared with ordinary legislation, has a more binding force, derived from special

1/ Or other relevant agency. For convenience, this paper will generally refer to the ministry of finance as the organization--or the minister of finance as the individual--primarily responsible for management of public finances.

2/ In some countries (e.g., France), the organic law has special constitutional status, in others, its status is equivalent to that of other laws.

requirements regarding majorities and procedures to change the constitution. The constitutional provisions for financial management generally deal only with the broadest matters of principle. Three important areas in most constitutions are (1) the requirement that all public funds be paid into designated accounts and that these funds be spent only under authority of a law; (2) the definition of the financial relations between national and subnational levels of government; and (3) the provisions relating to the relative powers of the executive and legislative branches with respect to public finance. 1/

Apart from the norms embodied in the constitution, the main legal vehicle for establishing principles of public financial management--and the chief concern of this paper--is the budget management law, which may take the form of a single law that guides/regulates budget management and auditing (e.g., a "finance and audit act"), or several general laws covering specific areas of public financial management. 2/ These laws provide the overall framework of control that governs the processes of annual (usually) appropriation of funds and the accounting for the use of funds to the legislature.

An annual budget law, which is enacted under the provisions of the constitution or budget management law, primarily serves the purpose of appropriating funds from the public account--that is, obtaining authorization from the legislature for expenditure from public funds to carry out the programs of government. The law may also include conditions applicable to elements of the budget (e.g., for a specific level of borrowing)--consistent with the provisions of the budget management law.

As well as annual appropriations, it is usual in most OECD countries to have "special" or "standing" appropriations under other legislation to meet various needs. Examples of such legislation include those authorizing social security payments, government borrowing, and debt service, and payments for offices that are independent of government (such as the judiciary or external government auditor). A feature of many OECD government budgets is that a high proportion (which may be as high as 70 to 80 percent in some cases) of annual expenditures is authorized under

1/ In the United Kingdom, which has no written constitution and follows a common law tradition, these principles are mainly embedded in administrative practice and parliamentary procedures.

2/ In the United States, for instance, no "organic law" exists; a variety of laws have been enacted over a wide span of years to deal with changing concepts of the responsibilities of the executive and legislature on various aspects of budget administration or control. The main laws relating to the U.S. Congressional budget process are included, with annotations, in the U.S. Senate, Committee on the Budget, "Budget Process Law Annotated," 1993.

legislation other than the current annual budget law. 1/ The existence of such legislation compounds the problem of providing a consistent legal and administrative framework for budget management. It is necessary to have some form of reconciliation process to ensure as far as possible that budget decisions take into account both annually voted and standing appropriations. In most countries, the executive branch of government takes administrative steps to review relevant legislation either prior to or at the same time as the budget appropriation bill. In the U.S., reconciliation, whereby one or more committees of congress is directed to submit legislation to achieve the revenue, spending, or debt limits consistent with the budget resolution, has been a formal part of the congressional budget process since the Congressional Budget Act (CBA) of 1974. 2/

Generally, the budget management law also gives to the minister responsible for public finance the authority to issue detailed regulations and instructions. 3/ These itemize the financial duties of public officers and the current practices and procedures for release of funds, control of spending and public assets, receipt of public moneys, accounting, and reporting.

The next section of this paper reviews the key concerns of managing public finance in market-oriented economies. Section III gives a general framework for comparing the ways in which these principles have been embodied in the legislation of the group of selected OECD countries, and, within this framework, makes recommendations on elements that could be included in the budget legislation of the EITs.

II. Main Public Expenditure Management (PEM) Concerns

Historically, budget legislation has evolved in an environment where the primary concern has been to ensure that the executive branch of government used public resources properly and within the limits set by the legislature. Compliance with standards prescribing the proper use of public

1/ In Australia, for instance, more than 80 percent of the estimated expenditure in 1993/94 was authorized by standing appropriations. In the United States, apart from the various annual appropriation bills, a high proportion of outlays each year (such as for Social Security) are authorized through continuing spending laws--spending laws that are reviewed after a period of years rather than annually--and multiyear obligations carried forward from previous years.

2/ Though the process was first used effectively in 1980 and subsequently codified in the Balanced Budget and Emergency Deficit Control Act of 1985 (Gramm-Rudman-Hollings (GRH)). (U.S. House of Representatives, Committee on the Budget, 1986). See also discussion in Schick (1990, pp. 114-117).

3/ The extent to which this is the case in a particular country depends on the general rules of administrative law relating to delegation of rulemaking authority.

funds and legislative appropriations has thus been the traditional basis for budget legislation. Compliance, in this sense, has emphasized strict controls over receipt of public money and expenditure on specified items (input controls). In recent years, however, the PEM reforms have increasingly emphasized (1) the use of the budget as an instrument of overall macroeconomic management; and (2) the efficiency and effectiveness with which public expenditures are used to achieve the social and economic objectives of government. With some exceptions, these additional objectives have been pursued through administrative (and supporting regulatory) reforms, without major changes in budget legislation. 1/

1. Macroeconomic management

Control of the aggregate level of spending, of the size of the budget deficit, and of deficit financing is a crucial part of macroeconomic policy. The capacity of governments to exercise these controls, however, can be greatly influenced by the legislative framework for budgeting. First, the way in which budgeting powers are distributed between the executive and legislative branches--as well as within the executive--can have a substantial effect on the government's ability to establish and achieve aggregate targets. Second, the extent to which activities are funded through extrabudgetary 2/ mechanisms tends to limit control and reduce the transparency of budgetary analysis. Third, some countries have attempted to put legislative limits on the deficit or borrowing with the aim of using legislation as an instrument for ensuring macroeconomic control.

It is not possible to be conclusive about the merits of various approaches because of the widely differing contexts in which they are applied. A case can be made, however, that those legislative measures that give considerable financial powers to the executive branch--while, of

1/ New Zealand provides one notable exception in that the Public Finance Act of 1989 was drafted as a completely new act because of--and to underline--the comprehensiveness of the reforms, which, among other things required accrual accounting and budgeting by government departments and agencies (see J. Pallot (1990)). Australia is currently in the process of preparing new budget legislation. In both these cases, however, changes in legislation were initiated after major administrative reforms.

2/ The term "extrabudgetary" is used to describe a wide variety of funding arrangements that are not subject to (1) annual scrutiny prior to appropriation, or (2) the accounting and reporting regulations that apply to funds appropriated through an annual budget law. Special appropriations would be included under such a definition, on the basis of the first criterion. As a general rule, in the OECD countries, however, such funds are "budgetary" in the sense that they are included in the annual estimates presented to parliament. Generally, too, they are subject to similar accounting and reporting requirements.

course, retaining legislative oversight--and, within the executive branch, to the ministry of finance or treasury, are most likely to lead to effective use of the budget for macroeconomic policy.

The nature of macroeconomic policy is such that it demands (1) a clear strategy with well-defined aggregate targets; and (2) sufficient flexibility to adjust strategy in the light of changing economic circumstances. The role of developing such a strategy is generally seen as a major function of the executive branch. Development of a macroeconomic strategy would be much less feasible if the aggregate fiscal position were determined by the legislature as a byproduct of debate over its disparate competing interests rather than through review of an explicit strategic framework, or if spending ministries had a disproportionate amount of power relative to the treasury or the ministry within the executive branch.

The presence of a large number of activities funded through so-called extrabudgetary means can also present major difficulties for the operation of aggregate fiscal policy--and, moreover, such arrangements limit flexibility in allocating funds between activities. Multiple funds cause fewer difficulties for macroeconomic policy in the OECD countries than they do in developing countries, because, in general, the analytical framework for policy includes all relevant funds. Even in countries with well developed analytical processes, however, the existence of off-budget operations provides political opportunities for "creative accounting." 1/ In developing countries and EITs, the creation of separate funds is often seen as a means for freeing certain "high priority" activities from the constraints of the budget. Poorly functioning administrations in these countries, however, make it highly likely that budget decision-making processes will not be transparent and, thereby, will be more vulnerable to mismanagement and corruption. 2/

Explicit legislative constraints on the size of the budget deficit have been introduced or proposed for some countries. A legislative constraint applied in many countries and at subnational levels of government is to

1/ See Schick (1990a), pp. 203-4.

2/ A particular problem of extrabudgetary transactions in many EITs is that foreign exchange transactions are handled through extrabudgetary mechanisms (often a State Foreign Exchange Fund is established for foreign receipts). In principle, these transactions should also be incorporated in the general budget with all foreign exchange being sold to the central bank, all budget transactions denominated in local currency, and foreign exchange for external payments purchased by the Ministry of Finance from the central bank.

require that the recurrent budget be balanced. 1/ Beyond this level, the practice of setting standing legislative constraints on the maximum size of the deficit faces major conceptual and practical difficulties. First, it is difficult to specify appropriate limits that will apply in all circumstances and, second, whatever limit is specified in the legislation is likely to be exceeded in practice from time to time. There is no strong economic reason why the overall budget should always be balanced; a legislative requirement for a balanced budget in this sense would limit macroeconomic policy freedom. Setting a specific maximum deficit in the budget management law also has dangers, mainly because it risks the interpretation that the level specified is the permissible level. The difficulty of applying legislative limits is illustrated by the recent history of budget control in the United States--though both the need for such techniques and the difficulty in implementing them in the United States are derived in large part from the way in which powers over the budget are shared between the legislative and executive branches. 2/

Budget legislation in Germany and, more recently, in New Zealand provide an alternative legislative approach to promoting responsible fiscal management by government. In Germany, the Law to Promote Economic Stability and Growth of 1967 set the stage for subsequent comprehensive reforms of budget legislation. It established the requirement for a five year financial plan for the Federal Government (in subsequent laws extended to encompass all levels of government in the Federation), required regular economic surveys and reports, and required certain measures to be taken in the event of economic disturbance. 3/ The New Zealand Government, through its Fiscal Responsibility Act of 1994 (see Appendix), seeks to consolidate its recent fiscal reforms and establish an environment of transparency and accountability to ensure prudent fiscal management by any Government of New Zealand. The Act's main thrust is to require (1) regular statements of fiscal policy, economic and fiscal forecasts, and current fiscal position to provide relevant information to Parliament and the public prior to the budget, at the start of a fiscal year, and prior to a general election; and (2) that all reports be consistent with generally accepted accounting practice.

1/ Such balanced budget rules (often referred to as "the golden rule") usually require that (gross) borrowing be no greater than investment or capital spending, and imply that the recurrent budget generate enough savings to cover debt repayment. The main difficulties with such rules are that (1) arbitrary distinctions tend to be drawn between recurrent and capital allocations in the budget to ensure that the letter of the rule is observed; and (2) the rule assumes that capital investment will be productive and places no constraint on the extent to how much the government can, in fact, borrow. Nonetheless, it can be argued that such rules do provide the ministry of finance a basis from which to argue against overt borrowing to finance recurrent spending.

2/ See Schick (1990a and b).

3/ See Federal Republic of Germany, 1988.

Most of the OECD countries have, in fact, established financial planning mechanisms to help limit fiscal deficits. In some cases, such as the New Zealand and German cases described above, these techniques are required to be applied by law, in others, such as the U.K. and Australia, medium-term expenditure planning has been introduced quite effectively without changes in legislation. This approach, which depends on transparent reporting and explicit discussion of the budget in the context of a medium-term macroeconomic and fiscal framework, appears to be more suited to macroeconomic management needs than an attempt to place standing legal limits on the deficit (and generally seems to have proved more successful).

A recent study for the EC suggested that a budgeting process that gives the central ministries dominance over the spending ministries and that limits the amendment powers of parliament is more likely to lead to strong fiscal discipline than if the political power of the purse is more dispersed. The same study found that the application of long-term fiscal limits was not very strongly linked to fiscal performance. It was concluded that fiscal constraints were only likely to be effective in countries where there was sufficient institutional strength to implement them effectively. 1/

2. Resource allocation

At least until recent times, budget legislation has not been framed with resource allocation objectives in mind. Most OECD countries have, however, embarked on reform processes that are aimed at improving efficiency (getting "value for money" and "reducing waste and inefficiency") of government programs. By and large, legislative reform has not played a substantial role in these processes--the New Zealand financial management reforms, as noted, provide an important exception and will be discussed further below.

Program-oriented budgeting, which, since its initial introduction in the United States in the 1960s has been adopted by many countries, is one of the major reform initiatives aimed at improving resource allocation. Whatever the merits of program budget reforms, in general they have been introduced with few legislative changes. As a consequence, budget estimates in program format are often presented as a document separate from the main budget estimates, which remain in a traditional (or modified for other reasons) line-item format (e.g., the United States, when the planning, programming, and budgeting system (PPBS) was used, and Australia). It can be argued that this has been a weakness which has limited the success of program budgeting, and that the logic of program budgeting requires that legal authority over expenditure be applied in a program format to ensure both proper appraisal by the legislature and accountability by the executive. In practice, however, program accountability is not so easily achieved and, in any case, budgets serve important administrative functions

1/ See von Hagen (1992).

other than resource allocation. The form in which budgets are appropriated or in which the main estimates are presented is only one of a host of factors affecting resource allocation. It seems doubtful, therefore, that a very strong case can be made for legislative reform on these grounds.

Reform at a regulatory level has, however, been more important in more recent measures to improve public sector efficiency--characterized by such measures as Result-based Management in Sweden, the Financial Management Initiative (FMI) and Next Steps in the United Kingdom, and the Financial Management Improvement Program (FMIP) in Australia. Similar efforts have been made in a number of the industrialized countries. The main thrust of these initiatives has been to reduce detailed central control over individual items of expenditure (while, strengthening controls over aggregate spending) and to give greater flexibility and responsibility to line managers. In the Australian case, these measures have been accompanied by some simplification and streamlining of accounting regulations to reduce the number of restrictions on powers of line managers and by consolidation of the administrative appropriations to a single running cost item for each agency. The main aim, on which some progress seems to have been realized, is to provide greater incentives for managers to deploy resources to the most effective uses.

The Next Steps program in the United Kingdom exemplifies attempts that are being made by a number of countries to decentralize authority within government. This program identifies agencies within the public service and allocates responsibility--under a formal agreement--to the CEO of that agency for implementation of the service, thereby, it is hoped, increasing the accountability of the CEO both to parliament and to recipients of the services. In effect, quasi-independent entities are being set up within the budget framework to provide specified services using a given amount of budget resources. Developments along these lines can probably be accommodated without major legislative changes.

The most radical changes in this direction are those implemented in recent years in New Zealand. Influenced by principal-agent theory, the entire budgeting process was redesigned around the twin concepts of (1) the government as a purchaser of outputs from its departments (or, alternatively, from the private sector); and (2) the government as owner of its agencies--and, therefore, interested in net returns to capital and changes in the capital stock of these agencies. It was considered that the cash-basis accounting system and the form of appropriations were not well suited to this model of budgeting and that the existing legislation would have to be redrafted entirely to accommodate the principles being

espoused. 1/ The Public Finance Act of 1989 consequently adopted accrual accounting as the basis for budgeting and reporting to Parliament and appropriations geared as far as possible to the purchase of outputs from departments rather than cost of inputs.

It remains an open question whether legislative reforms along the lines adopted by New Zealand are the most effective way to achieve the focus on efficiency that is generally sought. An important point in the context of the present discussion, however, is that the kinds of regulatory streamlining being adopted in many of the OECD countries depend critically on the establishment of satisfactory standards of management in the spending ministries or agencies. Many developing countries and EITs, however, have not yet established adequate standards for control of the use of funds and it would be inappropriate to decentralize management and increase flexibility of regulations before such standards are in place.

3. Compliance

The kinds of reform discussed in the preceding section have had a major impact on the concept of compliance that is now considered most appropriate for government organizations. The traditional notion of adherence to rules for the proper use of public funds and with parliamentary authority as to the amount and purposes for which it could be spent is recognized as being inadequate. It is assumed that the new forms of contract between government and its agencies being tested in the United Kingdom, New Zealand, and a number of other countries (and subnational jurisdictions) will set new performance-based standards for judging compliance. 2/ The development of evaluation techniques for assessing performance will be critical.

An essential feature of legislation in all of the OECD countries examined is the requirement that the budget execution be subject to audit by an independent auditor reporting directly to parliament. This system is designed to give parliament assurance that the executive is using funds properly. Practice, and, in some cases, legislation, has been modified in a number of countries in accord with the changes in the concept of compliance

1/ See J. Pallot (1990) for a discussion of the principles and the evolution of the Public Finance Act of 1989. She notes that the view that new legislation was required was not unanimous...

"The Legislative Advisory Committee, for example, argued that much of what was being proposed was technical accounting or management matters rather than questions of law. The comprehensiveness of the proposed changes and their constitutional significance, particularly the new requirements placed on Ministers and Parliament, however, seemed to warrant a new Public Finance Act." (p. 177).

2/ For a general discussion of the evolution of the concept of compliance and its linkages to management practice and theory, see Premchand (1993).

noted above. Modern audit, through "value for money" (VFM) audits, gives much more emphasis to what is being achieved rather than merely the proper observance of authorization and regulations. In the United Kingdom, for instance, the National Audit Act of 1983 gave the National Audit Office (formerly the Exchequer and Audit Department) authority to conduct VFM audits on its own initiative--previously, such investigations were carried out only at the specific request of Parliament. The effectiveness of such audits, however, may be limited by the extent to which expected performance is clearly defined. A key requirement in this area also, therefore, is that evaluation, reporting, and accounting of public activities be improved.

III. A Comparative Framework and Recommendations for EITs

Budget legislation in market economies has provided an enabling management framework which has allowed the major--and changing--issues of fiscal and budget policy to be addressed reasonably effectively. The legal framework in EITs, however, has some key weaknesses in this respect:

- The management role of the ministry of finance is either unspecified or, if specified, is more limited than in most market economies;
- The relative roles of the executive and legislature are unclear--generally the legislature has power to amend the budget, but neither the extent of modification permitted nor the link between such modifications and macroeconomic objectives are clearly stated;
- The regulatory and administrative support for budget laws are still based on those derived from the planning framework.

The second of these issues is perhaps difficult to deal with directly in the highly sensitive political environment of the EITs. The third is an inevitable consequence of the pace of change; and appropriate action on regulations requires that basic principles of legislation and system design be established. The relatively weak position of the ministry of finance and its lack of clear legal authority make the initiation of administrative reform very difficult. The establishment of an budget management law that embodies clear management functions for the ministry of finance could, thus, play a lead role in administrative reform in the EITs.

As indicated, the extent to which these management principles are explicitly incorporated in legislation varies substantially among OECD countries. Because the legal traditions of countries vary, the budget law of any one of the OECD countries cannot easily be compared with those of others--though, of course, there are many shared features, particularly within groups with similar civil law or common law traditions. For this reason, and because of differences in constitutional structure, administrative law, and legal traditions generally, no single model can be applied directly to suit the needs of the EITs. Appropriately interpreted, however, the experience of a number of countries provides a starting point.

This section compares key provisions in budget legislation of selected OECD countries as a basis for developing a coherent and comprehensive budget management law for the EITs.

In each subsection below, suggestions are made on budget law elements for a typical EIT. Regarding the country's institutional structure, it is assumed that:

- The form of government is unitary (rather than federal), (but includes local as well as national levels of decision making);
- A ministry of finance is responsible for fiscal management;
- A "cabinet of ministers" is the collective decision-making body of the government (hereafter, described as the "cabinet");

A few general points should be made at the outset. First, it is preferable that all matters pertaining to management of general government finances be embodied in a single budget management law rather than in several separate pieces of legislation--to avoid overlapping and potentially inconsistent budget laws. Second, in the absence of a body of accepted practice consistent with the needs of budget management in a market economy, it is highly desirable that budget legislation be comprehensively codified--but at a level of general principle that can accommodate future changes in budgetary practice (e.g., moves to greater flexibility of control by spending ministries or adoption of accrual accounting).

1. General provisions

An introductory section of a budget law generally establishes general principles for government financial management and may define terms used in the law to ensure proper interpretation and consistency with other laws. Important features that should be included at this level of the law are discussed below.

a. Appropriation

A central feature of any budget law is its specification of the way in which the use of public money for government programs is to be authorized. Since these are matters of fundamental principle, quite frequently the main provisions are stated in the constitution. It is particularly important to establish the principle of universal coverage of the budget and the general objectives of government financial management either at a constitutional level or as part of the budget management law. Two elements central to

government budget management, which were included in some form in all of the selected countries, are (1) all receipts of government go to a single fund; 1/ and (2) no moneys may be spent from the fund except by a law.

These provisions give the legislature the basis for budget oversight and the executive the means to manage government financial operations. In general, comparable provisions are not present in the EITs' laws (except in some of those recently amended).

Other provisions that should be included in this section of the law to help ensure control over all public moneys and either limit the possibility of establishing extrabudgetary funds or bring such funds within the ambit of government financial management include the following:

- Appropriations under the budget management law to be approved by parliament by a specified time, prior to the commencement of the financial year to which the appropriation pertains;

- Appropriations under any other law to be included in the budget estimates presented to parliament, and all expenditures under any other law to be accounted for in the same way as for an annual appropriation law;

- Allowance to be made for continuing the normal business of government (at, say, one twelfth of the previous year's appropriation per month) if the annual appropriation law has not been approved by parliament prior to the start of the financial year.

- Allowance to be made to spend less than the full appropriation if revenue is insufficient to cover the expense; 2/

- Allowance to be made for spending on contingencies under restrictive conditions--for instance, subject to control by the minister of finance and full reporting to parliament;

- Authority to spend against an appropriation to lapse at the end of the financial year specified in the law under which it is appropriated.

Provisions along these lines were present in the budget legislation of all of the OECD countries examined in this paper.

1/ Though separate subfunds may be identified (e.g., a general fund for recurrent spending; a capital, development, or loan fund; and trust funds).

2/ This provision is intended to make the appropriation explicitly contingent on economic circumstances and to give greater emphasis to the macroeconomic management functions of the ministry of finance than is generally stated in legislation of OECD countries (see also Sections 3 and 5 below).

b. Definition of budget deficit

As noted, the budget's role in macroeconomic management has been given prominence only comparatively recently, so it has not been emphasized at the level of budget law in most OECD countries. One way of promoting a macroeconomic management focus would be to include a clear analytical definition of the budget deficit (or surplus) as part of the law. ^{1/} While macroeconomic analysis can be applied to the components of budgets independently of any legal definition, such a concept should facilitate communications between government and parliament in the context of transitional economies with relatively inexperienced administrations and legislatures.

Few of the OECD countries include an explicit technical definition of the budget deficit in their budget management law--or, if included, the deficit is defined simply as the difference between (gross) expenditure and receipts. These countries have well-developed administrative mechanisms for dealing with the budget in the context of macroeconomic policy, so a precise legal definition has not been generally seen as necessary. For EITs, however, the budget law can play an important role in ensuring that both government and the legislature focus on a clear analytical definition of the budget deficit during the budget preparation, approval, and execution processes. Therefore, it is recommended that budget laws in the EITs incorporate the following:

- Definitions of the main elements of receipts and expenditures that are to be included in the estimates--for instance, distinguishing "revenue" (tax and nontax), "grants," "borrowing," and "repayment of debt principal";

- An analytical definition of the budget deficit or surplus (which excludes borrowing and use of bank balances from receipts and repayment of principal from expenditures). ^{2/}

Such definitions would provide a clearer basis for setting a limit on the deficit level and explicitly include this limit in the annual appropriation law (see discussion under Section 2 below).

^{1/} There are, of course, many analytical "deficit" concepts (see Blejer and Cheasty, 1993). At the level of a legal definition, it is merely proposed that a basic distinction be drawn between deficit (surplus)--creating transactions and financing transactions (as described in A Manual on Government Finance Statistics, IMF, 1986).

^{2/} External grants may also be excluded from revenue for the purpose of defining the deficit in the budget law. In practice, the deficit should be defined both inclusive and exclusive of grants (to highlight the dependence of the budget balance on grant financing) but codifying such distinctions in the law is likely to be counterproductive.

c. Responsibilities for administering the law

The budget law should identify those responsible for implementing the law and their responsibilities, and, where necessary, define other relevant aspects of the budget process. In some countries (e.g., countries of the British Commonwealth) it is conventional to include a list of formal definitions in a preliminary section of the law, in others, responsibilities are defined at appropriate points in the law. The following could be included in a list of definitions:

- (1) The minister of finance
- (2) The secretary of finance (i.e., the head official who reports directly to the minister)
- (3) The budget department
- (4) The treasury
- (5) Secretaries/CEOs of ministries/agencies (often designated as chief accounting officers--to be held accountable for financial management in their agencies)
- (6) Accounting officers--designated officials within agencies responsible for financial management under direction of the chief accounting officer
- (7) Budget-dependent agencies
- (8) Autonomous government-owned agencies
- (9) Financial year
- (10) Central government
- (11) Local authorities

2. Powers over budget management

The way in which power over the budget is shared between the executive and legislative branches and within the executive is a reflection of political forces. Budget legislation may, in the process of debating the issues, help shape the way these issues are resolved, but it is unlikely that legislation aimed at creating strong executive powers can be successfully enacted unless the political environment is conducive to this result. Because of the relative weakness of the ministry of finance and the need for effective fiscal control in most EITs, however, it is recommended that as strong a case as possible be made to give sufficient authority to the executive--and particularly to the ministry of finance--to manage the budget as an effective instrument of macroeconomic policy.

a. Relative powers of executive and legislative branches

The legislature must, of course, oversee the budget process, and OECD countries have few explicit constraints on the extent to which the legislature (as a whole--restrictions may apply to one chamber of the legislature) can modify the budget. In most countries, however, there are practical limitations to legislative power in this regard, and it is generally recognized as being unnecessarily divisive and potentially counterproductive for the legislature to be involved in reshaping of the executive budget proposals outside the discipline of an agreed macroeconomic framework. As indicated in Table 1, the practical power of the legislature to amend the executive budget varies substantially among countries. In Sweden and Germany, while the legislature has unlimited powers to amend the budget, in practice amendments tend to be small. By convention, the powers of the legislature are relatively small in this regard in the United Kingdom--and most of the countries of the British Commonwealth. France has an explicit provision in its organic budget law that does not allow parliament to make upward revisions of expenditures. Powers of the legislature over the budget are most extensive in the United States, and this situation has given rise to a series of attempts to establish legislative limits on the budget deficit and to the establishment of the Congressional Budget Office to assist Congress in reviewing the President's budget proposals. ^{1/}

Clearly, control of the budget deficit and its financing will play a central role in the transitional process. It is vital that the legislative framework of the EITs provide as explicit guidelines as possible on this issue. It is suggested, therefore, that provisions along the following lines be included in their budget legislation.

- The legislature to approve the budget in the context of a macroeconomic strategy presented by the executive branch;
- Based on the macroeconomic strategy, the upper limits for the deficit and for domestic bank financing of the deficit for the financial year to be embodied in the annual budget appropriation law;
- The legislature's powers to amend the expenditure proposals of government--or to introduce new tasks for the government during the year that involve additional spending--to include a requirement that additional revenue measures (or reductions in other expenditures) match any additional expenditure proposed by the legislature;

^{1/} See Points (1990) for a brief history and description of the U.S. budget and accounting legislation. Schick (1990b) and Doyle and McCaffery (1991) discuss the implications of recent budget legislation on the capacity of the United States to manage the budget process. Axelrod (1990) discusses the role of the judiciary in budgeting in the United States and some other countries.

Table 1. Budget Legislation in Selected Countries: Distribution of Key Responsibilities for Budget Management

| Country | Executive and Legislative Branches | The Minister of Finance/Treasury-- Main Functions ^{1/} | Subnational Authorities-- Borrowing Limits |
|----------------|---|---|---|
| Australia | Only the executive may present expenditure proposals. The upper house of the legislature may amend new programs, providing the tax burden is not increased (CFMH 1.3, 1.4, 2.12, 2.13). ^{2/} | (a)-(f); (CFMH Chaps. 2,4,5,8). | The Australian Loan Council determines the total public borrowing and the share among different tiers of government. |
| France | The executive proposes the budget. Parliament can reduce but not increase any items of expenditure (LDF 67, 68, 82, 83). | As above, with emphasis on the overall control of public expenditure (FC, LDF 54, 67, 84-89, 115). | There is a balanced recurrent budget ^{3/} requirement for subnational levels (LDF 36, 37). |
| Germany | The executive proposes the budget. There are no limitations on the power of the legislature to amend the budget, but increases in expenditure require the assent of the Federal Government (GG 113). | (a)-(f) (FBC) | There is a balanced recurrent budget requirement for all levels of government (GC 115). |
| New Zealand | The executive proposes the budget. The legislature has no power to make expenditure proposals and, by convention, may decrease but not increase expenditures. | (a)-(f); and a general provision for such other matters as are necessary for giving full effect to the Law (PFA). | Local authorities are required generally to provide for ordinary obligations in any year from revenues for that year. |
| Portugal | The executive proposes the budget. Through its Economy Finance and Planning Committee, the legislative may propose amendments (FNB 14). | (a)-(f); not explicit in the law but the Ministry of Finance carries out for the Government. | No requirement. ^{4/} |
| Sweden | The executive proposes the budget. The legislature has power to make proposals and amend the executive's proposals without restrictions (SC Chap. 9). | (a)-(f); (SC Chap. 9, AAA). | There is a balanced recurrent budget requirement. Subnational levels borrow on their own behalf (AAA). |
| United Kingdom | The executive proposes the budget. Under parliamentary procedures taxes and expenditure may be reduced by the legislature but not increased. ^{5/} | As above (GAG). | There is a balanced recurrent budget requirement. ^{4/} |
| United States | The executive proposes the budget. The legislature has power to make proposals and amend the executive's proposals, within overall general budget constraints set by law (CBP). | As above--(a)-(d) mainly performed by the Office of Management and Budget; (e) and (f) by Treasury. | All local governments are required to have a balanced recurrent budget. Most states have either a constitutional or statutory balanced budget requirement (ACIR Table 3). |

- ^{1/} a. Drafting and proposing the budget law and issuing regulations concerning financial and budgetary administration;
b. Evaluating and reviewing of government program and expenditure proposals and preparing annual estimates;
c. Monitoring financial performance and power to require all necessary information on preparation or execution of the budget;
d. Issuing warrants (authority to incur commitments or expenditure);
e. Controlling government bank accounts;
f. Government debt and cash management.
- ^{2/} See Appendix for all abbreviations.
- ^{3/} See also discussion of balanced budgets and "the golden rule" in Section II of this paper.
- ^{4/} See von Hagen (1992), Table AI.
- ^{5/} See Brittain (1959), Chapters I and XI.

- The ministry of finance to scrutinize all expenditure or financing proposals and make recommendations thereon prior to approval by the legislature.

b. Authority of the ministry of finance

The budget law, as stated above should specify the central management role of the ministry of finance. Table 1 shows the central role played by ministries of finance or their equivalents in the selected countries. Appropriate provisions should be made in relevant sections of the law and should include the following.

- The minister of finance to be responsible for supervising the preparation of the annual budget estimates for presentation to parliament, all government bank accounts, receipt and disbursement of funds, and all central government assets and liabilities, and be the signatory for all borrowing and lending by government;

- The minister to have the authority to require reports on any public accounts that are set up outside the budget framework;

- The minister to be responsible for ensuring that expenditures and use of credit are controlled within the deficit limit specified in the annual appropriation law.

c. Powers of the subnational government

In former Soviet Union (FSU) countries, local authorities were given substantial, at least nominal, independence in formulating their budgets under a 1990 decree. Since commonly around 40 percent of total general government spending occurs through the local authority budgets, the macroeconomic strategy can be significantly affected by local authority budgets--and the power of the central government to monitor and control these budgets. It is common, as described earlier and summarized in Table 1, for OECD countries to require that subnational levels of government balance their recurrent budgets--though the nature of the balancing requirement may be somewhat loose for overall fiscal control.

In the situation facing the EITs, a more stringent approach than that of the OECD countries seems desirable for the foreseeable future.

Accordingly, it is recommended that budget legislation for the EITs include the following: 1/

- Local authorities not to be allowed to borrow from any source other than the central government;
- Local authorities to be required to report at the end of each month on total expenditure, total revenue, and bank balances (including a report on local extrabudgetary fund balances).

3. Preparation and approval of the budget

This section of the budget law should specify the principles and outline the process whereby the expenditure plans of the government are prepared, presented to parliament for review and approval, and appropriated by parliament. Table 2 summarizes a number of the main provisions relating to these matters in the selected countries. A feature common to most of the countries listed is that the budget is prepared in a multiannual financial planning framework and in the context of a detailed analysis and statement of the government's economic policy. In some cases, these requirements are included in the law. In others, such as Australia and the United Kingdom, multiannual financial planning is a central feature of the budget process though there is no such legal requirement. It is recommended, however, that a macroeconomic strategy--and, eventually, multiyear planning--be adopted as a requirement in the EIT budget management laws.

Some countries (e.g., France and the United States, as shown in Table 2) set medium-term budget deficit limits. This route, however, is not recommended for the EITs because of the difficulty of proposing a realistic and sustainable target that could be set in a budget management law--and the difficulties that have been experienced in many countries in trying to implement such provisions. The approach recommended is that outlined above--that annual limits for the deficit and domestic bank financing of the deficit be specified in the annual budget law. These limits should, of course, be determined as part of the macroeconomic strategy (see also discussion of borrowing below).

1/ This paper does not attempt to deal with the full range of intergovernmental financial relations issues in EITs; these involve many complex issues that are beyond its scope. It is suggested that the budget management law, in the first instance, deal only with the need for central control over the level of borrowing and very general principles of budgeting and reporting by local authorities. Questions such as those of allocating powers over taxes and distribution of tax revenue among jurisdictions can be introduced either as subsequent amendments to the budget law or as separate legislation on local budget management that is consistent with the national budget management law.

Table 2. Budget Legislation in Selected Countries:
Preparation and Approval of the Budget

| Country | Provisions on Budget Period and Multiannual Planning | General Budget Constraints |
|----------------|---|---|
| Australia | Budget year is July 1-June 30. Multiannual planning is not a legal requirement, but forward estimates for two years following the budget are presented with the budget bill. | No constraints defined by law. |
| France | Budget year is the calendar year. Multiannual planning (three years) is required (LDF 23-25, 61-62). ^{1/} The plan will be integrated with the budget and approved by Parliament for the 1995 budget. | Subject to Maastricht Treaty requirements. For the first time, in 1994, specific targets were set in the budget law to limit expenditure growth and the deficit as a percentage of EDP for the period from 1993-97. |
| Germany | Budget year is the calendar year. Multiannual planning (five years) is required, but not approved by Parliament. These estimates are prepared and presented to the Parliament with the annual budget (LBP 50, 51). | Subject to Maastricht Treaty requirements. The budgetary policy agreed in the Financial Planning Council may set limits on the budget and the current targets are in line with Maastricht. |
| New Zealand | Budget year is July 1-June 30. Fiscal and economic updates covering the budget and the next two years and a fiscal strategy report covering the next 10 years must by law be presented with the budget bill (FRA) | No constraints defined by law. |
| Portugal | Budget year is the calendar year. There is no legal requirement for multiannual planning. | Subject to Maastricht Treaty requirements. |
| Sweden | Budget year is July 1-June 30. Multiannual planning (five years) is required but not approved by Parliament. These estimates are prepared and presented to the Parliament with the revised annual budget (AAA). | No constraints defined by law, but the current medium-term plan is to cut expenditure by 10 percent over a period of three years, ending 1995. |
| United Kingdom | Budget year is April 1-March 31. Multiannual planning is not a legal requirement. Three-year forward estimates are prepared and presented to Parliament with the annual budget. | Subject to Maastricht Treaty requirements. The current medium-term plan is to keep the deficit within what is calculated in the three-year forward estimates. |
| United States | Budget year is October 1-September 30. Multiyear planning--budget year plus four years--is required by law (CBA, 603). | Budget deficit reduction target is set in the OBRA--previously the GRH and then the BEA. If reduction target is not met, an automatic sequestration process is triggered. |

^{1/} See Appendix for all abbreviations.

The suggested provisions specifying the role of the minister of finance in supervising budget preparation and requiring that a macroeconomic strategy be presented to parliament as part of the budget presentation could be included in this section of the law. A "preparation" section should also include the following:

- The time by which parliament must present the budget estimates and approve the annual appropriation law;
- The form and content of the budget presentation and the budget appropriations bill.

In general, the budget management laws of OECD countries do not specify the detailed within-year process of budget preparation (e.g., setting of budget ceilings, negotiation between ministries and the ministry of finance, and the mode of resolving conflicts between the minister of finance and the other ministers). Such matters are generally established by administrative instruction (e.g., a budget circular from the ministry of finance) and governmental procedures. While undoubtedly there is a need for clear definition of such procedures in the EITs, it seems preferable that, in these countries also, it be done administratively rather than by law.

4. Execution and adjustment of the budget

The powers of the executive and the ministry of finance to control budget execution are of crucial importance to the EITs in enabling them to adjust quickly to changing economic circumstances, particularly in the context of the high degree of uncertainty prevailing on revenue collection. A number of features relating to the legal framework for budget execution in the selected countries are shown in Table 3.

As a rule, the European and U.K.-type systems, give implicit authority to the executive, through the ministry of finance, to limit outlays below the level authorized by parliament, if economic circumstances dictate. In the United States, however, the executive may only rescind expenditure authority with the approval of Congress; expenditures may be delayed by the executive, providing that the legislature does not object. It is, therefore, much more difficult to adjust expenditures during the year. ^{1/} The situation prevailing in the EITs argues strongly against the budget appropriation being considered as obligatory spending. There should,

^{1/} Premchand (1993) notes, however, with respect to budgets where appropriation does not oblige spending that...

"(T)he exercise of such implicit powers has proved controversial as the spending agencies are reluctant to cede any claims once they have been conceded in the approved budget. The law is not free from ambiguity in this respect," p. 60.

Table 3. Budget Legislation in Selected Countries: Execution and Adjustment of the Budget

| Country | Power of MF to Expenditure | Rules for Virement | Rules for Carry-over of Spending Authority to Next Year | Contingency Funds |
|-------------|--|--|--|--|
| Australia | The executive is authorized, but not obliged to issue funds allocations (or "drawing rights") up to the appropriated amount (CFMH 2.25; FMAB 46H). <u>1/</u> | Rules are not set in the Law but in regulations and instructions, which have become increasingly flexible in recent years. | Each annual budget law specifies that all appropriations lapse by the end of the year. Carry-over is recognized as an administrative process and is authorized by the MF, however, it must be reappropriated in the next year's annual budget. <u>2/</u> | The Appropriation and Supply Acts include appropriations of funds to the Minister of Finance that provide for contingency advances to cover expenditure for unforeseen or urgent needs (CFMH 1.16, 1.17). |
| France | The MF authorizes by countersigning commitments and may withhold authority for commitment. | Virement is possible within a limit of 10 percent of appropriated amount (LDF 90). | All appropriations lapse at the end of the year specified in law. Capital expenditure and, in restricted conditions some recurrent expenditure may be carried over. | The Finance Act includes provisions for the use of contingency funds to cover expenditure in advance for unforeseen and urgent needs. Contingency funds are appropriated in the budget (LDF 49-51, 71). |
| Germany | The Minister may block expenditures by spending ministries if economic developments so require (LBP 25). | Virement is possible within the same chapter, between salaries and wages, and from expenditure on civil servants pay to salaries (FBC 20, 46). | Investment expenditure and expenditure from earmarked revenue may be carried over. Other expenditure may be carried over under certain conditions (FBC 19). | The Minister of Finance has power to authorize excess and extra-budgetary expenditure only for unforeseen and unavoidable needs and providing that the budget is not substantially charged. In principle, such expenditures have to be offset by savings on other expenditures. Bundestag and Bundesrat shall be informed every three months (FBC 37). |
| New Zealand | A warrant must be issued by the Government (prepared by the Treasury) before public money can be spent (PFA 22). | Transfers between programs or appropriations for acquiring different kinds of outputs may be made by the Government within the overall total providing no appropriation is increased by more than 5 percent. | Authority lapses at the end of the year specified in the appropriation act, but no authority shall be for more than five years (PFA 4). | The Minister of Finance is authorized to meet additional spending needs within limits and emergency expenditures. Such expenditure must subsequently be included in the annual financial statement for that year, and in an appropriation bill for sanction by Parliament (PFA 12, 13). |

Table 3 (concluded). Budget Legislation in Selected Countries: Execution and Adjustment of the Budget

| Country | Power of MF to Expenditure | Rules for Virement | Rules for Carry-over of Spending Authority to Next Year | Contingency Funds |
|----------------|--|--|--|---|
| Portugal | Appropriations constitute the maximum amount to be spent (FNB 18). Funds release has to be authorized by the Ministry of Finance, which may refuse authorization (DL 17-20). | The Government may transfer within programs but changes between programs or increases in total requires a law (FNB 20). | The budget is annual and carry-over between years requires reappropriation 9FNB 2, 19). | A provisional appropriation is included in the Ministry of Finance budget for unforeseen expenditures (FNB 20). |
| Sweden | The MF issues warrants before disbursement. Appropriations other than for mandatory expenditure constitute the maximum amount to be used. The Government is not obliged to use up to the maximum amount (ABF). | Virement permitted within and between votes. Needs approval by the MF. Parliament is informed twice a year (ABF). | About 10 percent of all appropriations are accepted to be carried over. In principle, all appropriations to government authorities can be carried forward until the end of the third year (ABF). | The MF has power to allow expenditure during the year in the event of unforeseen and unavoidable need. Parliament gets reports every sixth month, and financing is a matter for the next year's annual budget (SC Chap. 9). |
| United Kingdom | Appropriations constitute the maximum to be spent. Treasury and the Comptroller and Auditor General authorize release of appropriated funds (GAG A22024). | Virement between vote subheads needs approval by the Treasury. The Treasury has no power to authorize virement between votes or to meet additional expenditure with virement (GAG Section B79-88). | Appropriations lapse at the end of the budget year. Cash limits on capital underspending may be carried forward (covered by a supplementary appropriation) (GAG B2, 48). | The Treasury has power to allow expenditure in case of unforeseen and urgent needs. Advances from contingency funds are offset when Parliament has voted the additional provision (GAG B104-111). |
| United States | The Treasury issues warrants before disbursement, but the President cannot impound or delay the use of appropriated funds without approval from Congress (BSC pp. 4-6). | Approval of Congress is generally required to transfer authority from one budget account to another (CBP p. 166). | Covered in appropriation laws. Appropriations may be annual, multi, or no year; authority lapses as specified in the law. | Contingencies are provided for either as specific mandatory appropriations or under emergency provisions (GRH 251, 252). |

1/ See Appendix for all abbreviations.

2/ This is not regulated in the budget management law, but in the annual budget law and in the Running Costs Arrangements Regulation, issued by the Ministry of Finance.

therefore, be (as explicit as possible) a requirement in the budget law that the ministry of finance (generally through a treasury) take the budget deficit and use of domestic credit as the central targets for budget implementation and limit budget outlays below appropriation levels if revenue falls below the budget estimates.

The ministry of finance also exercises varying levels of authority over the rights of ministries to move funds from one type of expenditure to another (virement) and to shift spending from one budget period to another (carry forward appropriations or borrow against next year's appropriation). Many of the OECD countries have substantially streamlined controls in this area with a view to giving maximum flexibility to managers to allocate resources to achieve the required results. Both Australia and the United Kingdom, for instance, give departments substantial freedom to reallocate resources for departmental running costs--though not between running costs and program costs (i.e., costs of grants or benefits). In New Zealand, departments/agencies have the freedom to reallocate resources within the amounts appropriated to produce a certain class of outputs--movement of resources between classes of outputs, within certain limits, requires the approval of the Governor-General (Head of State) but not Parliament. Some provision to shift resources between budget years is given in most of the countries shown.

In the EITs, there are substantial dangers in allowing too much latitude to spending agencies to reallocate resources during the budget year. Such systems cannot operate effectively until a strong management culture has been established in the line ministries and agencies, and an effective system for assessing performance and efficiency in use of resources has been established. It is recommended, therefore, that the approval of the minister of finance be required for resources to be shifted between chapters of expenditure within a given budget head; 1/ other virement rules below this level should be at the discretion of the minister of finance and incorporated in regulations and instructions issued under the budget law.

This section of the law should include the following:

1/ The term "budget head" is often used to signify a ministry or major spending agency whose budget is defined at the primary level for distribution of funds--that is, receives funding authority directly from the ministry of finance.

- No expenditure to be undertaken by any ministry except under authority of a warrant 1/ issued by the minister of finance (through the treasury);

- In issuing such warrants, the minister of finance to ensure that funds are authorized by a law of parliament and that the deficit and limit of domestic credit authorized by parliament not be exceeded;

- The minister of finance to have authority over transfer of funds between chapters within the same head and to regulate transfers of funds between items within chapters;

- The minister of finance, through the cabinet, to report back to parliament if major changes have been implemented in the budget as a consequence of changed economic circumstances, or if it is clear that the deficit specified will be exceeded under current policies;

- The minister of finance to submit a mid-year report to parliament on the progress of budget execution.

5. Government borrowing and issue of guarantees

In general, the power of the central government to borrow is vested in a single authority--the minister of finance is the appropriate authority in the assumed structure of government being discussed in this paper. Other ministers should not be permitted to negotiate loans. The first column of Table 4 lists the relevant borrowing authority in the selected countries.

Some countries (e.g., Australia) require the authority of a law of parliament before borrowing; in New Zealand, however, the budget law gives blanket approval for the Minister of Finance to borrow--if "... necessary or expedient in the public interest." As a rule, borrowing provisions do not restrict the instruments that can be used by the government nor discriminate among holders of government debt. Borrowing is usually permitted either from domestic residents or from overseas without (in either case) limiting the currency denomination of the security or loan document issued. Powers over borrowing by lower level government have been discussed in Section 2 above.

The matter of establishing limits on the budget deficit and domestic credit to government as part of the annual budget law was discussed above. The possibility of giving authority in the budget management law to set limits each year on the permissible level of net indebtedness of government

1/ A document certifying that a certain portion of appropriated funds is available for commitment or payment by the ministry (who may in turn issue subwarrants to their spending units). Different terms are used in different countries--for example, the term "apportionment" is used in the United States.

Table 4. Budget Legislation in Selected Countries:
Government Borrowing and Lending

| Country | Limitations or Restrictions on Government Borrowing | Contingent Liabilities/Issuing of Guarantees |
|----------------|--|--|
| Australia | The Government may borrow money only under Statute. For shorter periods, the Minister of Finance may enter into an agreement with any bank for borrowings which are to be repaid within 90 days (CPME 1.18; FMAB 82-83). ^{1/} | The Minister of Finance has no standing authority to issue guarantees; any such issuance must be authorized by a law (AA 70b). |
| France | Parliament gives a general authorization for borrowing every year in the annual budget law (LDF 128-130). | Guarantees must be authorized by law. |
| Germany | The annual budget law determines the level of borrowing which is limited to the sum of total investment expenditure, Golden rule (LBP.13; FBC 18). | The granting of guarantees requires authorization in terms of definite amounts by means of law and the consent of the Minister of Finance (LBP 23; FBC 39). |
| New Zealand | The Government may borrow money only under statute. The PFA gives the Minister of Finance authority to raise loans for public purposes, including short-term credit (PFA 46-48). | The MF may give guarantees to any person, organization, or government. Details of guarantees must be published in the <u>Gazette</u> and reported to Parliament (PFA 59). |
| Portugal | The laws cited do not cover this topic. | The draft annual budget law must include information on the limit of guarantees to be issued during the year (FNB 11(4)). |
| Sweden | The Government may borrow only under statute. Borrowing is limited to financing the budget deficit or other expenditure approved by Parliament and to refinancing the debt. Subnational levels and state corporations borrow on their own behalf (SC Chap. 9). | The Government may not issue state guarantees or grant credits to any government authorities or to any other, except under the authority of an act of Parliament. Guarantees are reported to Parliament (EAP). |
| United Kingdom | The Government is empowered to borrow each year to finance the deficit through the CFA, the Appropriation Acts, and the national Loan Act (GAG A, N). | Government ministers may give guarantees. These are listed in an annual statement made by Treasury to Parliament (GAG 05. 26-55). |
| United States | A limit on public debt is set each year as an integral part of the Congressional budget process. Specific legislation on debt limits may also be passed (CBP, p.17). | Under the CBA (as amended by the BEA), issue of direct loans and loan guarantees is included in the budget process and coordinated by OMB and CBO (CBA 500-507). |

^{1/} See Appendix for all abbreviations.

as well as on the net level of indebtedness to the central bank (both set as a proportion of nominal GDP) might also be considered as measures to highlight the need to control growth of public debt and bank financing.

With respect to borrowing from the central bank, it is clearly desirable from the point of view of stabilization policy in the EITs to keep annual borrowing from this source to the lowest practicable level in the immediate future and to set a low upper limit for such financing. Such limits would best be set as part of the law of the central bank.

As well as direct borrowing by the government, most countries allow the minister of finance to issue guarantees for loans contracted by public enterprises or other bodies (see Table 4). This area of financial management presents many potential dangers and it is important that the issue of such guarantees be effectively monitored. Therefore, the EITs should include provisions for disclosure and reporting of guarantees in their budget legislation.

The main provisions suggested for this area of the budget law are as follows:

- Borrowing by the central government to be regulated by a law, and all such laws to be prepared by the minister of finance;
- The minister of finance to be empowered to raise loans to finance the approved deficit by issue of securities, loan agreement, overdraft, or other appropriate means to the limits specified in law;
- The government, through the minister of finance, issue guarantees for debt incurred by persons, organizations, or governments providing that:
 - all such guarantees are presented to parliament and published in the official gazette
 - possible liabilities falling due in the financial year are shown as a supplement to the annual estimates and a contingent provision is included in the estimates to cover possible losses
 - the minister of finance, through the treasury maintains a register of all contingent liabilities of government
 - government has no liability for the debt of its autonomous agencies, except amounts the government guaranteed or amounts the government had to contribute by law.

6. Banking and financial assets

In some countries, particularly those in the U.K. tradition, the budget legislation gives the minister of finance authority over all government

banking arrangements and allows the minister discretion to deposit unused bank balances in commercial banks to ensure control over use of funds and efficient cash management. In other countries, all government deposits are required to be held by the central bank. As indicated in Table 5, not all of the selected countries considered have provisions in their budget laws to cover these matters, though the general practice is that the ministry of finance or treasury is responsible for government bank accounts. An important issue in this context is the desirability of separating central banking and government functions. Prohibiting the central bank from receiving government deposits will strengthen the separation of the central bank from government by giving it sole control over base money but it will weaken the role that the central bank plays as fiscal agent of government. 1/

For the EITs, it is desirable, on the one hand, to establish clearly the role of the Ministry of Finance in managing government bank accounts--in some EITs, the revenue collecting agencies assume a degree of ownership of revenue accounts and often the central bank is designated as being responsible for "cash execution of the budget" and so may be seen as having some ownership rights over government bank accounts. On the other hand, it is desirable to promote the role of the central bank as fiscal agent of the government, particularly in developing government security markets. 2/

Another aspect of financial management that may be treated in this section of the budget law is the establishment of bank accounts and accounting services for third parties or for handling funds in transit to the consolidated fund account. It may be necessary for the government to hold funds in trust for a private citizen or organization (say, while awaiting a customs evaluation) or to establish suspense accounts for receipt of certain funds (say, payments in foreign currency) while awaiting processing and crediting to the consolidated fund.

It is recommended that the following be included in the budget management law:

1/ See discussion of this issue in Cottarelli (1993).

2/ Another important aspect is the need for the central bank to control, or at least anticipate, movements of deposits between commercial banks and accounts at the central bank. From this point of view in transitional economies, it seems preferable that most government deposits be held at the central bank at least until both central banking and treasury management functions are well established. Banking with the central bank will also avoid the various risks that may arise by supporting weak commercial banks through placement of deposits.

Table 5. Budget Legislation in Selected Countries:
Government Banking

| Country | Responsibilities for Operating Bank Accounts | Investment of Public Money is Permitted |
|----------------|--|--|
| Australia | The Minister of Finance has authority to open bank accounts, conducting the Commonwealth's banking business. Power may be delegated from the Minister to Secretaries to open accounts. Overdraft is not permitted without the authority from the Ministry of Finance (FMAB 32-34). <u>1/</u> | The Ministry of Finance may invest public money in prescribed securities or deposit accounts (FMAB 84). |
| France | The Minister of Finance sets the conditions under which accounts can be opened (LDF par. 54). | The Government is not allowed to keep deposits outside the central bank. <u>2/</u> |
| Germany | The laws cited do not cover this topic. | Until recently, all government funds were deposited with the Bundesbank. <u>2/</u> From January 1994, the MOF has decided, for cash management purposes, to place surplus funds with commercial banks. |
| New Zealand | Departments may operate their own bank accounts under overall supervision by the Treasury (PFA 18-26). | The main treasury account is with the Reserve Bank. Departmental accounts are held in one commercial bank. <u>3/</u> The Treasury may invest money held in a Crown Bank Account or Department Account on deposit or in approved securities (PFA 23). |
| Portugal | The laws cited do not cover this topic. | The Bank of Portugal is mandated to keep some Government deposits but the Government may keep deposits outside the central bank. <u>2/</u> |
| Sweden | The Minister of Finance and the Treasury has authority to open bank accounts and make arrangements for the governments banking business and the power may be delegated to officials within the Ministry. The Minister of Finance may set conditions under which the ministries and agencies are authorized to open accounts (EAP). | The main account of Treasury is held at the central bank. The Minister of Finance may make deposits in commercial banks (EAP). |
| United Kingdom | The treasury and accounting officers at Departments have authority to open up bank accounts. All accounts are attached to the Treasury Account (GAG section N). | Treasury is required to maintain its main funds at the central bank (EADP 11). The Government is also allowed to keep deposits at commercial banks. <u>2/</u> |
| United States | U.S. Treasury arranges banking services and makes payments for most Federal agencies. | Treasury is mandated to keep accounts with the Federal Reserve but may also keep deposits at commercial banks. <u>2/</u> |

1/ See Appendix for all abbreviations.

2/ See Cottarelli (1993) Appendix III.

3/ See Scott (1993).

- The minister of finance to be responsible for opening, closing, and either directly operating or monitoring the operation of all bank accounts of the central government (which could be designated as "treasury accounts"); 1/

- The minister of finance to be permitted to open and maintain accounts for third parties or to hold moneys in transit to the consolidated fund;

- The minister of finance to be required to hold any funds surplus to immediate operational requirements on deposit with the central bank. 2/

7. Financial reporting and audit of accounts

Vital to the budget law are the requirements that the minister of finance (a) report on the government finances (in general, annually, but in some cases more frequently) to ensure that ministries prepare appropriate reports; and (b) submit financial documents to an external auditor. A summary of the main requirements in the selected countries is given in Table 6. It is recommended that the following be included in the budget law for EITs:

- The treasury to be required to prepare a consolidated statement giving the financial position of general government and statements for each of the central government funds for that financial year. The statements to be prepared in accordance with accepted accounting practices and to consist of:

- statement of the financial position at the balance date;
- statement of revenue and expenses--covering both annual; appropriations and other appropriations--for that year;

1/ Caution should be exercised, however, in establishing new banking arrangements to avoid sudden shifts in placement of deposits and to ensure adequate consultation among the ministry of finance, the central bank, and commercial banks. These matters are probably best determined administratively rather than being prescribed in law, to permit more flexible arrangements in the future.

2/ It is important that the government receive interest for such deposits. Though it can be argued that the government does not pay for the fiscal agent services of the central bank and eventually is compensated through receipt of central bank profits, the profits are available only annually and after deducting central bank costs (over which the treasury has little or no control). In terms of incentives, it is preferable to establish government borrowing and deposits on a symmetrical commercial basis.

Table 6. Budget Legislation in Selected Countries: Accounting, Financial Reporting, and Audit

| Country | Monitoring of Accounts | Accounting Rules | Internal Audit | External Audit |
|-------------|--|---|---|--|
| Australia | Secretaries (heads of department) are responsible under their ministers for financial management and accounting. The Minister of Finance coordinates and issues regulations (CFMH 6.1-6.6, 8.208.3). <u>1/</u> | The budget management law covers only basic principles on accounting classification of public money. Detailed regulations and instructions are issued by the Ministry of Finance (FMAB 42-43). | Under Finance Directions, Secretaries of Departments are responsible for internal audit (CFMH 6.35, 6.36). | External auditing is performed by the Auditor General, Director of the National Audit Office. The Auditor General is required to prepare audit financial statements on accounts and records of all departments and agencies' business, and report to Parliament annually (CMFH). In the new legislation audit provisions are to be covered in the FMAB (Part 14) and in a separate Act, the Auditor General Act. <u>1/</u> |
| France | The Treasury is responsible (LDF 108-111). | Covered in the Comptabilité Publique Decree 1962 (LDF 100-107) | The spending ministries are responsible for internal audit but this is closely overseen by the Inspection General of the Ministry of Finance (LDF 115-116). | External auditing is performed by the Cour des Comptes, which audits government transactions. Reports every year to Parliament and to the President (LDF 19-124). |
| Germany | The Federal Minister of Finance is primarily responsible for accounting, collection, and disbursement through Federal Cash Offices (FBC 75-79). | The (Federal) Minister of Finance regulates details concerning the establishment and arrangements of accounts, and supporting documents, with the agreement of the Federal Audit Office. The laws cover the establishment and arrangement of accounts and supporting documents (FBC 71-79, 84). | Internal audit is carried out by departmental and agency internal audit units. In agreement with the Federal Audit Office, the responsible minister determines the arrangements for internal audit (LBP 56; FBC 100). | The Federal Audit Office is responsible for all external auditing. The Auditor General is required to report to the Parliament and inform the Minister of Finance and heads of ministries once a year. Audit provisions are given in the LBP (Chap. 5), the FBC (Part V), and the LFA |
| New Zealand | The Minister of Finance (Treasury) reports on overall government operations half-yearly and annually (PFA 27-29). Chief executives of departments and agencies are responsible for reporting on departmental operations (PFA 33-40). | Regulations and instructions are issued by the Treasury. Accounting conventions are adopted from standard private sector accounting practice (PFA 35; FRA 5). | Departmental and agency heads are responsible for internal audit subject to treasury instructions. (PFA 33) | The Audit Office is responsible for external auditing and is required to prepare a report on the annual and half-yearly public accounts prepared by Treasury and departments for Parliament (PFA 30, 38, 43). Agencies may use private sector auditors or the Audit Office. |

Table 6 (concluded). Budget Legislation in Selected Countries: Accounting, Financial Reporting, and Audit

| Country | Monitoring of Accounts | Accounting Rules | Internal Audit | External Audit |
|----------------|---|---|--|--|
| Portugal | Monitoring is performed by the responsible entity under the authority of the Government and supervision of the Audit Court (FNB 21). | The law covers general accounting principles (FNB 19, 24-27; DL, Section II). <u>1/</u> | Departments and agencies are responsible for internal audit (DL 53). | The Audit Court is responsible for external audit of the public accounts (FNB 21, 24). |
| Sweden | The Minister of Finance, National Audit Office, heads of departments and agencies; and the National Debt Authority (Treasury) are responsible (C Chap. 9). | Regulations and instructions are issued by the MF. | Departments and agencies are responsible for internal audit. The Minister of Finance is responsible for establishing audit procedures within the Government, in agreement with the National Audit Office (EAP). | The National Audit Office and the Parliamentary Auditors are responsible for all external auditing (C). |
| United Kingdom | The Treasury and Accounting Officers (departmental heads) at departments and agencies are responsible for reporting on departmental operations. | The Government Accounting Guidelines provide an extensive manual for government accounting (GAG). | Heads of departments and agencies are designated as Accounting Officers (AO) responsible to Parliament for good management, including internal audit. The AO is responsible for signing the appropriated accounts each year. The Internal Audit Development Branch of Treasury provides guidance and assistance to departments (GAG C, D). | The National Audit Office is the main external auditor for the Government. It certifies the accounts of nearly 500 departments and agencies and prepares value-for-money reports for Parliament. The Audit Commission audits the Health Service and appoints auditors for local governments (NAO, AC). |
| United States | The OMB monitors budget execution, Treasury maintains a central summary accounting system and agencies maintain detailed accounts. The Treasury and heads of departments are responsible in agreement with the General Accounting Office (CBP 503). | GAO prescribes government accounting standards. Efforts to standardize agency accounting systems have been promoted by the JFMIP. <u>2/</u> | Federal agencies are responsible for internal audit and most have an Inspector General appointed by the President (approved by Congress). | The GAO, an agency of Congress, is the external auditor of the executive branch of government. There is not at present a requirement for presentation of a comprehensive audited financial statement by the executive branch. |

1/ See Appendix for all abbreviations.

2/ The Joint Financial Management Improvement Program, coordinated by the heads of OMB, Treasury, CBO and GAO. OMB has been given specific responsibilities for improving financial management systems under the Chief Financial Officers (CFO) Act of 1990.

- statement of borrowings for the year and total borrowings to date;
- statement of contingent liabilities as at the balance date;
- statement of emergency expenditures incurred during the year (consistent with the relevant provision in the law);
- comparative actual figures for the previous financial year.

- A national auditor to be appointed by parliament to head the audit office, which should be responsible for auditing all public moneys, assets, and books of account or other forms of financial records; 1/

- The treasury to be required to forward the annual financial statement to the audit office (by, say, no later than three months after the end of the financial year);

- The audit office to be required to issue an audit opinion on the government financial statements within, say, two months of receiving them;

- The minister of finance to submit the annual financial statements together with the audit report to parliament no later than, say, five work days after they are returned by the audit office to the treasury;

- The audit office, in consultation with the treasury to establish accepted accounting practices for preparation of government financial statements;

- The treasury to establish requirements for annual financial statements and management reporting by ministries and budget-dependent agencies of government.

8. Accountability and sanctions

Most budget laws have a section defining responsibilities for carrying out the requirements of the law and providing for application of sanctions for noncompliance. As indicated earlier, the concept of accountability for financial management in government has evolved in several ways in a number of the Western industrialized countries. In New Zealand, for instance, the emphasis on departmental responsibility for outputs and the application of

1/ Since external audit of government accounts should be clearly independent of the executive branch, it seems appropriate that the appointment of an external auditor, the setting up of the audit office, and the parliamentary treatment of audit be established under a separate organic law on audit. Basic requirements for provision of material for auditing could be specified in the organic budget law, which, of course, should be consistent with the audit law.

commercially oriented accounting principles has led to (1) a clearer distinction between the political responsibility of ministers and the technical responsibilities of the department heads, and (2) the wider application of private sector accounting and auditing techniques for evaluating departmental performance. Other countries, such as United Kingdom, Australia, and the United States, have tended to emphasize the development of performance measurement and evaluation of efficiency and effectiveness through bureaucratic mechanisms. It remains to be seen which approach proves to be the most effective.

A general section on accountability and sanctions, requiring compliance with the provisions of the budget management law, should be included in the law in EITs. This section of the budget management law should define as clearly as possible the responsibilities of department heads for ensuring compliance with the budget law. While it may be difficult in the immediate future to place much emphasis on the assessment of the efficiency with which resources are used in the EITs, the budget law should also include a requirement that department heads be responsible for the efficient and effective use of public resources.

Laws and Documents Related to Budget Management in Selected Countries

AUSTRALIA

- (AC) Australian Constitution.
- (AA) Audit Act 1901 (as amended by the Audit Amendment Act of 1989), compiled by the Australian Department of Finance (1989).
- (CFMH) Department of Finance, Commonwealth Financial Management Handbook (1992).
- (FMAB) Financial Management and Accountability Bill, 1993 Draft #2 (unpublished).

FRANCE

- (FC) French Constitution.
- (LDB) Ordonnance No. 59-2 du 2 Janvier 1959 Portant Loi Organique Relative Aux Lois de Finances, J.O. du 3 et rectificatif du 11 janvier 11, 1959, reprinted in Louis Troabas and Jean-Marie Cotteret, Droit Budgétaire et Comptabilité Publique, Annex II, p. 517 (1991) and also reprinted in Bernard Poujade, Textes de Droit Budgétaire Français, p. 8 (1988).
- (LDF) Louis Troabas and Jean-Marie Cotteret, Droit Budgétaire et Comptabilité Publique, Chapitre II, Les Lois de Finances (1991).
- (LCP) Décret No. 62-1587 du 29 Décembre 1962 Portant Règlement Général sur la Comptabilité Publique (modifié), J.O. du 30 décembre 1962, reprinted in Comptabilité Publique, Brochure No. 1460 (1989).

GERMANY

- (GC) Grundgesetz [Constitution].
- (LBP) Law on Budgetary Principles for Federation and Laender, BGBI. I, p. 1273 (August 19, 1969), reprinted in Federal German Budget Legislation 33 (1988).
- (FBC) Federal Budget Code, BGBI. I, p. 1284 (August 19, 1969)(as amended in 1986 by BGBI I, p. 1275), reprinted in Federal German Budget Legislation 72 (1988).

- (LES) Law to Promote Economic Stability and Growth, BGBI. I, p. 582 (June 8, 1967) (as amended in 1975, BGBI. I. p. 705), reprinted in Federal German Budget Legislation 147 (1988).
- (LFA) Law on the Federal Audit Office, BGBI I. P. 1445 ff. (July 11, 1985), reprinted in Federal German Budget Legislation (1988).

NEW ZEALAND

- (PFA) Public Finance Act 1989, N.Z. Stat. 1989, No. 44.
- (FRA) Fiscal Responsibility Act 1994, N.Z. Stat. 1994, No. 17.

PORTUGAL

- (PC) Portuguese Constitution.
- (FNB) Assembly of the Republic, Law 6/91 of February 20 on the Framework of the National Budget, Diário da República-- I Série-A No. 42 (Official Gazette of the Republic Series I-A No. 42) (1991).
- (DL) Ministry of Finance, Decree-Law 155/92 of July 28, Diário da República--I Série-A No. 172 (Official Gazette of the Republic Series I-A No. 172), 3502 (1992).

SWEDEN

- (SC) Swedish Constitution.
- (AAA) National Audit Office, Ordinance on Agencies Annual Accounting and Annual Requests, No. 134 (1993).
- (ABF) National Audit Office, Ordinance on Appropriation on the Right of Agencies to Dispose of Budgeted Funds and Rules for Drawing Funds from the State's Bank Account, No. 76 (1992).
- (EAP) National Audit Office, Ordinance on Economical and Administrative Principles, No. 11 (1994).

UNITED KINGDOM

- (CFA) The Public Revenue and Consolidated Fund Charges Act, 1854, 21 Halsbury's Statutes of England 148 (1950).
- (NAA) The National Audit Act 1983, Public General Acts and General Synod Measures, Part II, 1983 Chapter 44 (1983).
- (GAG) Her Majesty's Treasury, Government Accounting: a Guide on Accounting and Financial Procedures for the Use of Government Departments (1987).
- (EADP) The Exchequer and Audit Departments Act 1866, as reprinted in GAG.
- (NAO) National Audit Office, Annual Report (1993).
- (AC) Audit Commission, Adding Value: Strategy 1993

UNITED STATES

- (US) U.S. Constitution.
- (ACIR) United States, Advisory Commission on Intergovernmental Relations, Significant features of Fiscal Federalism: Volume 1. Budget Processes and Tax Systems, ACIR, January, 1990
- (CBA) Congressional Budget and Impoundment Control Act of 1974, Pub. L. No. 93-344, 88 Stat. 297 (1974) (codified as amended at 2 U.S.C. §§ 601-688 (1988 & Supp. IV 1992), reprinted in William G. Dauster, Budget Process Law Annotated 1 (1993) (S. Print No. 103-49).
- (GRH) Balanced Budget and Emergency Deficit Control Act of 1985 (Gramm-Rudman-Hollings), Pub. L. No. 99-177, tit. II, 99 Stat. 1037, 1938 (1985), amended by the Balanced Budget and Emergency Deficit Control Reaffirmation Act of 1987, Pub. L. No. 100-119, tit. I-II, 101 Stat. 754 (1987), and amended by the Budget Enforcement Act of 1990, Pub. L. No. 101-508, tit. XIII, 104 Stat. 1388, 1388-573 (1990), and further amended (codified as amended at 2 U.S.C. §§ 900-922 (1988 & Supp. IV 1992), amended by the Omnibus Budget Reconciliation Act of 1993, Pub. L. No. 103-66, tit. XIV, 107 Stat. 312 (1993), reprinted in William G. Dauster, Budget Process Law Annotated 403 (1993) (S. Print No. 103-49).

- (BEA) Budget Enforcement Act of 1990, Pub. L. No. 101-508, tit. XIII, 104 Stat. 1388-573 (1990) (codified as amended in sections of 2 U.S.C. § 1022, 31 U.S.C. §§ 1105, 1341, 1342) (Supp. IV 1992), reprinted in William G. Dauster, Budget Process Law Annotated (1993)(S. Print No. 103-49).

- (OBRA) Omnibus Budget Reconciliation Act of 1993, Pub. L. No. 103-66, tit. XIV, 107 Stat. 312 (1993).

- (BSC) United States Office of Management and Budget, Budget System and Concepts of the U.S. Government (1993).

- (CBP) Committee on the Budget of the U.S. House of Representatives, The Congressional Budget Process: A General Explanation (1986).

- (CFO) Chief Financial Officers Act of 1990, Pub.L. No. 101-576, 104 Stat. 2838 (1990).

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