

Multi-Year Budgeting: A Review of International Practices and Applications for Developing and Transitional Economies *

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EXECUTIVE SUMMARY

In recent years many developed countries have moved to frame their annual budget process in a strategic multi-year framework. This study presents a review of multi-year budgeting practices in seven developed countries (Australia, Austria, Canada, Germany, New Zealand, the United Kingdom and the United States). While a common feature of multi-year budgeting approaches is the inclusion of revenue forecasts and expenditures estimates for two or three years beyond the current year, the role of multi-year budgeting varies from country to country. Based on the review of international practices, this study considers the application of multi-year budgeting techniques to the budget processes of developing and transitional economies. While more integrated approaches to multi-year budgeting present the greatest number of benefits, these approaches are also more complex and more demanding in terms of administrative resources. However, even in the absence of abundant administrative resources, the introduction of a basic multi-year dimension into the budget process can still provide a useful framework for improved decision making in the formulation of annual budgets for developing and transitional economies.

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INTRODUCTION

Over the last decade a large number of OECD countries have introduced significant reforms in the budgeting process. Three general trends can be discerned in the reform of budgetary processes around the world (OECD, 1998). First, in many countries budget responsibilities have been devolved from the central budget authority to individual spending departments, thus giving these departments the freedom to appropriate funds within centrally determined departmental spending limits. Second, a large number of countries have introduced result-oriented budgeting techniques into the budget process that are based on measures of departmental performance. These two reforms are aimed at enhancing the efficient allocation of resources as a result of increased flexibility and accountability at the departmental level. Third, in recent years many countries have moved to frame their annual budget process in a strategic multi-year framework.

The introduction of a multi-year dimension enhances the annual budget formulation process in a variety of ways. Placement of the budget process in a multi-year framework requires governments to make a more explicit and consistent statement of policy goals and priorities while medium term budget projections provide a signal whether current policies are at odds with this fiscal strategy. The introduction of a multi-year dimension to the annual budget process has proven to be a successful tool for deficit control for many developed market-based economies.

Although a multi-year budget is narrowly defined as a budget that determines government revenues and appropriates expenditures for a multi-year period, the term is often used more loosely to refer to a budgeting approach in which the annual budget process is enhanced with multi-year features, such as multi-year revenue and expenditure estimates or a multi-year financial plan. Generally a multi-year budget approach includes revenue forecasts and expenditure estimates for two or three years beyond the upcoming annual budget.

Historically, the budget processes of many lesser developed economies and transitional nations have contained a variety of shortcomings which encumber the implementation of effective fiscal policies. Beyond the inherent difficulties brought about by underdevelopment or economic transition, budgetary imbalances have often persisted due to the lack of a framework that is realistic about future revenue collections and a strategy that prioritizes expenditure programs within available government resources. As a result, a number of developing and transitional economies could stand to benefit from the placement of their budget process in a multi-year perspective. In recent years, for example, a number of African countries including South Africa have moved to place their budget discussion in a medium term framework. Among transitional economies, the draft Budget Code for the Russian Federation requires the introduction of a multi-year perspective into the budget process. In addition, the government of Ukraine has similarly shown interest in developing a multi-year budget approach.

The purpose of the current paper is to present a survey of international practices in the area of multi-year budgeting and determine the potential applicability of multi-year budget techniques to developing and transitional economies. This paper presents a review of multi-year budgeting practices in seven countries: Australia, Austria, Canada, Germany, New Zealand, the

United Kingdom and the United States. Based upon this review, a synthesis is developed on how features from the multi-year budget approaches in these countries can be applied to improve budgeting practices in developing and transitional economies. This paper is concluded by a summary of recommendations for those countries interested in exploring a multi-year framework for their budget policies.

MULTI-YEAR BUDGETING:

A REVIEW OF INTERNATIONAL PRACTICES

Multi-year budget estimates can be used to enhance the budget process in a number of ways. First, multi-year budget estimates may simply present a projection of the fiscal outlook under the assumption that current tax and spending policies are maintained. In this sense, multi-year budget estimates can provide an early warning signal for policies that are not compatible with the medium-term fiscal objectives of the government. Second, multi-year estimates can be used as an integral part of a multi-year financial plan, in which expenditures and revenues in future years are planned over a multi-year period to meet specific macro-economic goals, such as a specified budget deficit or a certain level of tax burden. Third, a multi-year budget approach can be used as a budgeting tool by using this year's expenditure forecasts as the starting point for the annual budget formulation process for next year. This method of budgeting is often referred to as a "rolling budget," as budget projections for one year are "rolled" into the process of budget preparation for the next year. Fourth, an incremental approach to budgeting based on a multi-year "rolling" budget could further enhance the transparency and efficiency of the public resource allocation process. These various uses of multi-year estimates are by no means exclusive or

incompatible. In fact, most governments pursue a variety of these objectives simultaneously.

The purpose or purposes that the multi-year estimates serve in each of the reviewed countries is the major determinant of the approach to multi-year budgeting that each country has taken. However, each country's approach to multi-year budgeting is also shaped by other country-specific factors such as economic policies and macroeconomic conditions in recent times and existing budget legislation and institutions. History and tradition may also play a role. For example, the United Kingdom, Australia, Canada and New Zealand to a large degree have shared a common budget tradition, similar political institutions, as well as historical roots. Consequently, it should not be surprising that these countries' approaches to multi-year budgeting are quite similar.

The remainder of this section will present a detailed review of the multi-year budget practices in seven OECD countries. For each of the countries, we will discuss (1) the purpose of the multi-year budget approach, (2) the assignment of organizational responsibilities, (3) the salient features of the multi-year budget process and (4) a brief evaluation of the chosen approach. A summary of the main features of multi-year budgeting approaches is contained in Table 1.

[TABLE 1 HERE]

Multi-Year Budgeting in Austria

The Austrian approach to multi-year budgeting is an excellent example of a budget

process enhanced with multi-year features that does not require the commitment of excessive administrative resources (OECD, 1995). The main purpose of multi-year budgeting in Austria is to establish the impact of current budgetary policies on the fiscal situation in future years. The multi-year estimates are also used for internal government planning purposes.

The simplicity of the Austrian approach to multi-year budgeting is hardly exceptional. Indeed, Austria is included in the current review because it provides a clear example of a basic, uncomplicated application of multi-year budget estimates to enhance the annual budget process. However, in 1994 Austria began to develop its multi-year budget estimates into a multi-year fiscal plan, much like the German approach to multi-year budgeting (which is discussed below). The current discussion summarizes the Austrian approach to multi-year budgeting that prevailed before the 1994 reforms.

Purpose of the Multi-Year Budget Approach. The sole purpose of the multi-year expenditure and revenue estimates made as part of the Austrian budget formulation process is to show the consequences for government finance of measures which have already been enacted. Multi-year estimates are produced for revenues and expenditures for three years in addition to the current annual budget. These multi-year budget estimates are strictly informative in nature, as they reflect future fiscal flows under current tax and spending policies.

Organizational Responsibilities. The Budget Department of the Ministry of Finance is the central player in the budget process. The Department is in charge of the government's annual budget proposal, the multi-year expenditure and revenue estimates, and the coordination and control of budget execution. The Budget Department has a staff of approximately 50 professionals and is divided into 12 divisions. Three divisions concern themselves with internal

administrative matters. Seven divisions are engaged in preparing budgets for the line ministries, as well as monitoring and controlling the implementation of their budgets. The Financial Management Division coordinates the preparation and implementation of the national budget, while the Budgetary Policy Division is responsible for policy analysis as well as expenditure planning and forecasting. Revenue estimates and tax legislation are prepared by a different department within the Ministry of Finance.

Multi-Year Budget Process. In Austria, the government's medium term fiscal strategy is determined in the government program when a new administration comes to power. The issues outlined in the fiscal strategy focus on deficit containment and setting the overall size of government. Specific targets are set for the size of the national tax burden (as a share of GDP) and the size of the government deficit (also as a share of GDP).

The role played by the multi-year estimates in the Austrian budget process is quite straightforward. The main focus of the estimates are statutory expenditures such as social welfare programs, which are the largest category of expenditures. The multi-year expenditure estimates are presented by institutional, functional and economic classifications. Unlike more complex multi-year budget approaches, the multi-year estimates in Austria are not produced concurrent with the annual budget. While the annual budget proposal is submitted to parliament in October, the multi-year budget estimates are published in June along with the government's multi-year investment program. This separation between the annual budget and the multi-year component also reflects the fact that these documents are prepared by different divisions within the Budget Department.

Evaluation. The Austrian approach to multi-year budgeting has several strong points.

Like most OECD countries, Austria has clearly defined medium-term strategic fiscal goals which are specified in the government program when a new administration comes to power. While the fiscal strategy is not formally incorporated into the budget process, the government's fiscal strategy objectives provide a budget envelope to guide the annual budget negotiations. The multi-year budget estimates provide an early warning system for current government policies that are not consistent with the medium-term fiscal goals of the government.

By placing the annual budget in a multi-year framework, the multi-year estimates also provide a sense of stability and continuity into the budget process. However, the Austrian approach to multi-year budgeting falls short from actually being a so-called multi-year "rolling" budget. The fact that the multi-year budget estimates are used only for informative purposes precludes premature political debates over future spending programs, but it does not provide the continuity and coherence of a multi-year "rolling" budget. The executive process of preparing a multi-year budget document appears to function well. This task is accomplished with a relatively compact Budget Department. Inclusion of a multi-year investment program with the presentation of the multi-year budget estimates is another positive feature of the Austrian process.

Multi-Year Budgeting in Germany

In stark contrast to the elementary nature of the Austrian multi-year budget process, the approach multi-year budgeting taken in Germany fully integrates the multi-year budget estimates into a medium term financial plan. A series of constitutional and budgetary reforms introduced in Germany in the late 1960s defined a highly structured framework for coordinating and implementing fiscal policies at the federal, regional and local level of government in accordance

with national economic policy goals. The national economic goals pursued are price stability, high levels of employment, balance in foreign trade, and steady economic growth. In order to achieve this economic objectives, the German federal government develops and annually updates a detailed medium term financial plan (Bundesministerium der Finanzen, 1996).

The multi-year financial plan provides revenue and expenditure estimates for three years in addition to the annual budget under consideration. In total, multi-year estimates are made for each of 1200 revenue items and the 8000 expenditure items in the federal budget. The multi-year estimates are only reported once a year as part of the Financial Plan that is presented to parliament in August, concurrent with the government's detailed annual budget proposal. In the Financial Plan, the expenditure estimates are grouped into about 40 functional spending categories. The detailed estimates are kept confidential by the Ministry of Finance.

Purpose of the Multi-Year Budget Approach. The main purpose of the multi-year perspective of the German budget process is to frame the fiscal policies of federal, state and local governments within a medium term financial plan consistent with national economic objectives. The general terms of Germany's fiscal strategy approach are set forth in the 1967 law on the Promotion of Economic Stability and Growth. The German approach to multi-year budgeting gives preeminence to cooperation between the three levels of government to set the level of consolidated government spending. By determining the overall size of government expenditures, the government effectively controls the size of the public sector in the economy. In addition, when revenue collections are forecast, the government is also able to control the size of the budget deficit.

The German approach to multi-year budgeting captures many of the benefits of multi-year

budgeting. Multi-year revenue and expenditure estimates provide an assessment of the medium term fiscal implication of current policies. If the multi-year estimates indicate that current government policies are not compatible with the government's medium term fiscal strategy, corrective policies can be included in the medium term financial plan. In addition to providing the backbone for a consistent and responsible fiscal approach, the multi-year financial plan also enhances the stability and continuity of the budget process, as one year's expenditure estimates become the starting point of the budget formulation process for the succeeding year.

Organizational Responsibilities. The central actor in the formulation of the federal budget and the multi-year financial plan is the Budget Directorate of the Federal Ministry of Finance. The Directorate, staffed by nearly 250 personnel, is responsible for the planning, coordination and implementation of the revenue side as well as the expenditure side of the multi-year budget. Among other responsibilities, the Directorate is in charge of reconciling the multi-year budget requests submitted by the line ministries with the multi-year financial plan. The Directorate consists of 25 divisions of which 17 mirror the line ministries. The general division is responsible for the drafting of the budget and coordination within the Directorate.

Multi-Year Budget Process. The budget formulation process within the German federal government is preceded by a series of discussion with a number of advisory councils and coordination with the states and local governments through the Financial Planning Council. The Financial Planning Council (*Finanzplanungsrat*) is chaired by the Minister of Finance and consists of representatives of all three levels of government. Through discussions at the Financial Planning Council, consensus is reached with regard to the target level of aggregate expenditure growth, the distribution of public resources across the three levels of government and the permissible amount

of government borrowing for the upcoming budget year plus the three following years. Since the recommendations of the Financial Planning Council are not officially binding, the effectiveness of the Council depends largely on its professional and political credibility. In practice the leadership of the federal Minister of Finance in the planning process guarantees preeminence of federal policies in the development of national policy.

As the formal beginning of the federal budget formulation process, the Minister of Finance issues a budget circular to all federal spending agencies to provide expenditure requests for the upcoming annual budget and budget projections for the three following years based on the annual budget request. In preparing their spending requests, the spending agencies have to adhere to detailed instructions that are laid out in the budget directive, including a number of annual budget ceilings for components of the ministerial budget and directions how to develop the multi-year projections. The budget requests submitted by the line ministries include recurrent expenditures as well as capital investment expenditures.

Upon receipt of the expenditure requests from the spending agencies, the Ministry of Finance begins the process of reconciling the “top-down” imposed budget limits with the “bottom-up” expenditure requests. In the budget negotiation process, the annual budget requests and the multi-year expenditure projections are compared to the government’s medium term fiscal strategy objectives. Successive rounds of negotiations ensue to reconcile each ministry’s budget request and projections with the framework of the medium term financial plan. In case the expenditure target is greater than the aggregated expenditure estimates, the surplus is designated as a general planning reserve which can be allocated at a later point when necessary or desirable. However, when expenditure estimates exceed the expenditure target for any year in the multi-year

framework, the Ministry of Finance is responsible for preparing a proposal on how to introduce budget cuts in order to fulfill the government's fiscal strategy objectives.

As part of the budget preparation process, a number of documents are produced. The beginning of the budget formulation cycle is announced by the release of the government's Annual Economic Report (*Jahreswirtschaftbericht*) in January. By August, when the budget draft is finalized, the Financial Report of the Federal Ministry of Finance (*Finanzbericht des Bundesministers der Finanzen*) is produced, containing the economic premises underlying the upcoming budget and the multi-year financial plan. That same month, the medium term Financial Plan (*Finanzplan des Bundes*) is submitted to parliament concurrent with the detailed annual budget.

Evaluation. Two major elements stand out in the German approach to multi-year budgeting. First, the German approach is unique with regard to the effort that is exerted to achieve consensus, both between levels of government and within the various federal ministries and departments. The second unique characteristic of the German approach to multi-year budgeting is the amount of effort brought forth to ensure that the multi-year financial plan is consistent with the country's medium term fiscal strategy. Whenever necessary, policy adjustments are included in the financial plan to ensure that the overall amount of planned expenditures for future years does not exceed fiscally responsible levels. These elements of the German approach results in a very systematic development of fiscal policy based on consensus. At the same time, these elements make the German budget process time consuming.

The consensus approach of "cooperative federalism" is facilitated in Germany by a high degree of homogeneity across subnational governments and by a cultural tendency toward

consensus decision-making. An obvious disadvantage of seeking elaborate intergovernmental consensus is that this approach adds another dimension of complexity to the budget process. At the same time, these intergovernmental planning meetings ensure that the fiscal policies at all levels of government are consistent with each other, as well as national economic objectives. This approach engages the subnational levels of government in the fiscal strategy process in a productive fashion.

Another important feature of the German approach to multi-year planning is that multi-year projections based on the departments' annual expenditure requests are reconciled with overall expenditure ceilings for all years considered in the financial plan. This process is relatively straightforward as long as the aggregate of the expenditure estimates is smaller than the expenditure target. The benefit of this approach is that the multi-year planning horizon adds a great deal of stability and continuity to the budget process. However, trying to balance the expenditure budget for the next three years (including potential future budget cuts) may lead to premature political debate and controversy since many of the details of future expenditure reductions are likely to be fought again in subsequent years with the discussion and approval of the annual budgets.

Multi-Year Budgeting in the United Kingdom

Although the British government also develops a multi-year budget plan like Germany, its approach to multi-year budgeting contains many of the features typical of the "Commonwealth approach" to multi-year budgeting. The central element of the Commonwealth approach is the pursuit of budgetary discipline by placing a large share of the fiscal responsibilities with the line

departments within firm multi-year departmental expenditure limits. The multi-year budget in the U.K. provides policymakers with a medium term view of budgetary policies, focusing on expenditure commitments and on the measures necessary to achieve the government's medium-term economic objectives. In addition, the multi-year estimates provide continuity and stability to the budget process, as budget estimates made this year will be updated and "rolled" into next year's budget formulation process. Thus, the multi-year budget estimates provide the starting point for the subsequent years' budget formulation process.

Purpose of the Multi-Year Budget. The aim of the multi-year budgeting process in the United Kingdom is to reconcile the strategic limits placed on the aggregate size of the public sector and public sector borrowing requirements with the government's priorities and public policy objectives. As a result, the multi-year budget approach allows the government to determine its annual fiscal policy with recognition of funding and resource constraints for the following years (Her Majesty's Treasury, 1996).

Two features are particularly notable about the multi-year budget process in the United Kingdom. First, the multi-year dimension in budget process is geared toward the expenditure side of the budget; while an expenditure plan is produced for three years, tax policy proposals are only included for the annual budget under consideration. However, multi-year revenue estimates are produced for the entire three-year period. Second, like all other Commonwealth countries, the multi-year budget in the U.K. is not presented in a separate document. Instead, the multi-year budget is fully integrated into the annual budget and presented to Parliament as an integral component of the budget document.

Organizational Responsibilities. The central actor in the formulation of the integrated

multi-year budget in the United Kingdom is the Treasury. As the coordinator of the budget process, the Treasury is responsible for formulating the medium term fiscal strategy, setting multi-year expenditure limits for the line departments, and producing the final budget document.

Within the Treasury, the Chancellor of the Exchequer concentrates on the formulation of macroeconomic policy and taxation. Public expenditure issues are usually delegated to the Chief Secretary of the Treasury. Reporting to the Chief Secretary is the General Expenditure Policy Group with approximately 40 staff members, which among its other responsibilities is responsible for the forward (or multi-year) expenditure planning. In total, approximately 400 people within the Treasury, including specialists and clerical support, are concerned with the planning, analysis and execution control of public expenditures.

Multi-Year Budget Process. The formulation of the budget strategy starts in late spring or early summer with the submission of two documents to the Chancellor of the Exchequer (the head of the Treasury). The first document, presented to the Chancellor by the Chief Economic Advisor, contains an analysis of the state of the economy. The other document, from the head of the Tax Policy Division of the Treasury, outlines options for revenue generation for the coming fiscal year. (As mentioned earlier, while expenditure plans are made for the current budget plus two more years, the U.K. does not engage in multi-year tax policy.) The Chancellor, along with his senior advisors and the heads of the Inland Revenue Service and the Customs and Excise Service, uses these documents to set forth the fiscal strategy for the coming three years. The government's medium term fiscal strategy guides the multi-year budget formulation process and is formally published at the time of the annual presentation of the budget to Parliament in November.

Upon determination of the fiscal strategy in early summer, the Cabinet Committee on Public Expenditures, led by the Chancellor and comprising the Chief Secretary and several senior ministers, establishes aggregate and departmental expenditure limits for the multi-year period referred to as “Control Totals.” When the multi-year Control Totals have been established, the government conducts a review of its existing spending commitments for the next two fiscal years and develops a projection for a new third year. This review is known as the Public Expenditure Survey (PES).

As in other Commonwealth nations, the line departments in the U.K. are responsible for determining program priorities within the limits set by the Treasury. Within the budget formulation process, the line departments are given extensive authority to shift fiscal resources within their own departmental budgets to provide funding for higher-priority programs, while reducing or eliminating lower-priority programs. In doing so, the departmental budget have to comply with the departmental control totals, which identify not only aggregate departmental expenditure limits but also place limits on departments’ running costs, including wage bills, with the objective of inducing cost-saving behavior in governmental units. In recent years, the Treasury has continued to constrain administrative and wage costs of line departments as a means of increasing efficiency within the public sector. The general policy has been that pay and price increases should be offset, or more than offset, by increased efficiency. Line departments that are in need of additional fiscal resources can submit requests for additional resources with the corresponding line divisions within the Treasury. The line divisions then work with the spending departments to reconcile the expenditure limits with the spending requests.

Overall, the budget formulation process in the United Kingdom takes approximately six

months from the informal fiscal strategy determination in May or June to the presentation of the Budget Statement to Parliament in November. At that time, the government's *Financial Statement and Budget Report* (FSBR) is issued by the Treasury. Besides the government's budget proposal, the FSBR includes the government's *Medium Term Financial Strategy*, a short term economic forecast, an analysis of tax measures contained in the budget, and an analysis of the public finances in the *Public Sector Borrowing Requirement*. After the budget is approved, the Main Estimates --representing the detailed annual appropriations requests by line department and program-- are presented to Parliament in March. The fiscal year in the United Kingdom starts April 1.

Evaluation. The approach in the United Kingdom has both positive and negative features. On one hand, the budget process is guided by a small cabinet committee led by the Chancellor of the Exchequer. The establishment of multi-year Control Totals ensures that line departments retain a multi-year focus when developing multi-year expenditure plans. The development and presentation of an integrated budget document ensures that fiscal policy decisions are consistent with the government's multi-year strategy. Line departments are given a great deal of flexibility to formulate their own multi-year expenditure plans, and Parliament votes on multi-year aggregate targets and next year's expenditure appropriations at different times.

On the other hand, the multi-year budget approach in the United Kingdom has been criticized as placing an undue amount of stress on the Treasury to produce a budget in a relatively short period of time. Also, the U.K. model may not be easily exported to other countries. Because the British political system is quintessential parliamentary, there is hardly any division of opinions between the executive branch and the majority opinion of the legislative branch regarding

budget priorities. Finally, line departments in the United Kingdom are partially limited by the Treasury in the allocation of resources for wages and salaries and other operating costs, thus are not given complete flexibility in determining the use of resources as is the case in Australia and New Zealand.

Multi-Year Budgeting in Australia

Australia's multi-year budget is another example of the "Commonwealth" approach to multi-year budgeting, in which multi-year budget estimates and flexibility at the departmental level are integral parts of the government's strategy to encourage efficient use of public resources and fiscal discipline (OECD, 1995;1997). However, unlike other Commonwealth nations, the forward estimates in Australia are not made by the line departments themselves, but rather by the Department of Finance.

The forward expenditure estimates produced by the Australian Department of Finance quantify the cost of ongoing policies as well as proposed government initiatives for the coming budget plus three more years (Australian Department of Finance, 1996). The forward estimates do not include any allowance for the introduction of new programs or expansion of existing programs, unless already announced by the government. At the beginning of the budget formulation process for the next fiscal year, the forward estimates are updated and the expenditure baseline becomes the basis for next year's budget proposal. The focus of the ensuing budget preparation process is not the level of expenditures *per se*, but rather on the incremental changes in expenditures necessary to synchronize the budget with the government's medium-term fiscal strategy objectives and policy priorities. Unless additional funding is approved by the

Cabinet, line departments are forced to find funding for new or expanded programs from within their own departmental budget as determined by the departmental expenditure baseline.

Purpose of the Multi-Year Budget. A medium-term fiscal strategy was introduced by the Australian government in the early 1980s as a means of achieving particular fiscal objectives. The main concern of the Australian government at that time was the excessively high level of government spending and the resulting high tax burden. Reductions in both the level of government spending as well as the level of taxation became the government's medium-term strategic objectives. As required by the Charter of Budget Honesty Act of 1998, the government's medium term fiscal strategy for the upcoming budget year plus three more years is reviewed and updated annually and published as part of the Budget Papers.

Organizational Responsibilities. There are three principle actors in Australia's multi-year budget process. The Treasury is responsible for setting the overall budget strategy, forecasting the majority of budget receipts and for projecting borrowing requirements. The Treasurer is also responsible for presenting the budget to parliament on behalf of the government. In the Australian budgetary organization, the Department of Finance is responsible for budget outlays and personnel resources. Therefore, part of the responsibility of the Department of Finance is the development of the multi-year expenditure projections. Within the Cabinet, the multi-year budget process is guided by the Expenditure Review Committee (ERC). The committee's membership comprises the Prime Minister, the Treasurer, the Minister of Finance and several other senior ministers.

While the revenue estimates in Australia are produced by the Tax Policy Division of the Treasury, budget expenditure are in the purview of the General Expenditure Division of the

Department of Finance. The General Expenditure Division is composed of approximately 80 staff and contains the Budget Policy and Coordination Group (BPCG). The BPCG is responsible for coordinating the multi-year expenditure estimation and providing the ERC with up-to-date information.

While there is no direct involvement of subnational governments in the federal budget process, the federal Treasury does interact with Australia's territories and states in a number of ways. Since 1992, a National Fiscal Outlook has been prepared on an annual basis by a working party of the federal and regional treasuries. This document presents medium-term projections of federal and regional general government sector finances and serves as background information for the annual Premiers' Conference in March, a meeting between the Prime Minister and the Premiers of Australia's states and territories. The Conference presents an opportunity for the heads of the federal and regional governments to discuss the general direction of the national economy in the medium term, negotiate about the allocation of public resources between the different levels of government and address other issues concerning intergovernmental fiscal relations in Australia.

Multi-Year Budget Process. Every year the Australian government reconsiders its medium-term fiscal strategy in light of any changes in government's policy priorities or changes in economic trends. In February of each year, line ministers are asked to provide summaries of new policy and savings proposals for the upcoming fiscal year to the Expenditure Review Committee (ERC) of the Cabinet. These proposals are reviewed during discussions between the Treasurer, the Minister of Finance and the line ministers. Based on the current economic circumstances and the focus of government policy, the ERC selects those proposals that require further consideration

and discussion. Based on these discussions, in March the ministers submit their Portfolio Budget Statement to the ERC and the Cabinet for consideration. The Portfolio Budget Statements contain the detailed budget proposals for each minister's portfolio for final consideration by the ERC. Once the portfolio statements are approved by the Cabinet, they are included in the budget. The multi-year expenditure estimates are immediately updated by Department of Finance to reflect any policy changes contained in the portfolio statements.

The government's budget proposal is transmitted to Parliament by the Treasurer during the Budget Speech in May. Four documents are circulated as part of the Budget Papers. The first budget paper (Budget Strategy and Outlook) contains the fiscal strategy statement, the economic outlook and general budget projections; the second budget paper (Budget Measures) contains the proposed budget measures for the next fiscal year along with detailed multi-year budget estimates; the third budget paper (Federal Fiscal Relations) describes the state of intergovernmental relations; and the fourth budget paper (Commonwealth Public Account) contains the appropriation bills for the coming fiscal year. All four budget papers consider the medium-term framework and are enhanced by multi-year estimates.

Evaluation. The multi-year approach to budgeting in Australia contains several positive elements. First, while the development of the departmental Portfolio Budget Statements lies within the purview of the line departments, the Department of Finance controls the development of the forward expenditure estimates. Centralized development of these estimates by the Department of Finance allows for immediate and continuous updates, and prevents the line departments from manipulating the estimates. Second, due to the rolling nature of the multi-year budget, spending by the line departments is effectively limited. Line departments are required to

operate within existing means; additional funding is only awarded for government priorities.

Third, Australia's approach to multi-year budgeting specifically incorporates the dimension of intergovernmental fiscal relations through the Premiers' Conference.

The Australian budget process contains some negative elements as well. Centralized control and virtually continuous updates of the forward estimates by the Department of Finance requires an extraordinary amount of resources. Also, the organizational structure in the Australian budget process is somewhat fragmented as the Treasury, the Department of Finance, and the Expenditure Review Committee each share only part of the responsibilities for putting together the multi-year budget

Multi-Year Budgeting in New Zealand

The budget process in New Zealand has undergone a series of important reforms in the past decade. Dominant among these reforms are the Public Finance Act of 1989 and the Fiscal Responsibility Act of 1994, which are at the basis of the full-fledged multi-year rolling budget process now in place in New Zealand (Scott, 1996).

Although the Fiscal Responsibility Act of 1994 does not require that specific medium term fiscal targets be set, it does seek to achieve five distinct fiscal objectives and principles: (1) reducing public debt to more prudent levels by containing the cost of general government operations below the level of annual operating revenues; (2) sustaining prudent debt levels over time; (3) establishing reserves as a precaution against budget and/or economic crises; (4) adopting sound management practices to deal with potential risks to the government; (5) adopting management practices supportive of, and consistent with, maintaining a stable and sound tax

policy. In particular, the Fiscal Responsibility Act requires that budget estimates are produced for the budget year under consideration plus for two more years.

Purposes of Multi-Year Budgeting. The overriding objective of the budgetary reforms in New Zealand has been to devise a means to impose greater fiscal discipline on the government in areas of expenditures, tax policy and government debt by increasing transparency and accountability in the budget process. By not imposing specific numerical targets in the Fiscal Responsibility Act, New Zealand's multi-year budgeting process accords greater policy flexibility for the administration to respond to changes in general economic conditions.

The key construct of multi-year budgeting in New Zealand is an incremental "rolling" budget process. In addition to a budgetary process tool, multi-year projections function as an early detection mechanism for government policies that diverge with the government's strategic fiscal objectives of reducing the fiscal deficit, the level of public debt, and the size of the public sector. Systematic reporting requirements throughout the budget process enhance the transparency, efficiency and accountability of the resource allocation process. This emphasis on using the multi-year budget not only as a fiscal discipline tool but also as the means of enhancing resource allocation efficiency and transparency fits entirely in the "Commonwealth approach" to multi-year budgeting.

Organizational Responsibilities . The Budget Management Branch at the Treasury is the central player in the budget process in New Zealand and is responsible for coordination of the multi-year budget estimates. The budget process in New Zealand is highly devolved and places a large share of the responsibility for financial management at the ministerial level. Consistent with this philosophy, but in contrast with the Australian approach, the multi-year estimates in New

Zealand are produced by the line ministries and spending departments.

On the revenue side of the budget, the Treasury is responsible for making revenue forecasts for the same time frame, three years in all. Throughout the three readings of the budget in Parliament, the expenditure baselines of each of the 47 government departments are continuously adjusted by the departments themselves, while the Treasury plays a coordinative role in this process.

Multi-Year Budget Process. The Budget Management Branch at the Treasury is responsible for initiating and coordinating the budget formulation process, which starts almost 12 months before the beginning of each fiscal year on July 1. Since 1991, New Zealand has adhered to the practice of incremental budgeting by which ministries are asked to update last year's forecasts of their expenditures baseline using a set of Treasury guidelines that are endorsed by the Cabinet. Additional funding requests are then specified as the change from this baseline level. The departmental expenditure baseline estimates submitted to the Treasury by the line ministries cover the upcoming budget year as well as outward estimates for the following two years. These baseline estimates are then reviewed by the Treasury and the Cabinet. If disagreement arises between the Treasury and one of the line ministries about the forward estimates, the ministerial projections prevail, leaving the Treasury to challenge their validity.

Like in Australia, these updated forecasts or expenditure baselines in New Zealand's budget process function as the preliminary estimates of the ministerial budget appropriations for the coming fiscal year and become the basis for the first draft of next year's budget. A first draft of the budget document is filed with parliament in July, which is followed by a relatively calm period of internal government review. A more detailed draft of the government's budget proposal

and multi-year estimates are presented to Parliament in March or April; the final reading of the budget takes place around June.

The Treasury guidelines for the preparation of ministerial multi-year expenditure estimates include several features to encourage fiscal discipline and efficiency. For example, departments are often asked to find resources within their own departmental budget for new programs. Departments are also warned that under normal circumstances they will not receive compensation for increases in their input costs; extra funding is only provided where expenditures are determined by statute (for example, welfare benefits) or for major government initiatives. In addition, departments that seek funding for capital projects are required to prepare strategic business plans and sound business cases to support their bids.

In order to create a high degree of transparency, numerous documents are produced throughout the year as part of the budget cycle. Concurrent with the second reading of the budget in Parliament in March, the government must submit its *Budget Policy Statement* to Parliament, outlining the government's short-term fiscal plan as well as medium-term strategic fiscal policy objectives. A *Fiscal Strategy Report* must be published at the time of the final submission of the budget to Parliament (May/June). This *Report* contains updated fiscal estimates, and addresses any differences between the budget and the objectives and strategies reported in the *Budget Policy Statement*. In addition, multi-year fiscal and economic projections (*Budget Economic and Fiscal Updates*) must be published twice each year, which are compared to independent estimates produced outside the government. A unique feature of the documentation requirements in New Zealand is that special provisions are made to prevent manipulation of the economic and fiscal outlook during election periods.

Evaluation. The most distinctive and innovative feature of the multi-year budgeting approach taken in New Zealand is the degree of responsibility for fiscal management which is placed at the ministerial level. New Zealand's approach to budgeting is based on the notion that when managerial and financial responsibilities are yielded to the line ministries and spending agencies, this will result in increased fiscal discipline and more effective allocation of public resources. Indeed, the architects of the reforms that culminated with the Fiscal Responsibility Act of 1994 saw ministers as managers and stewards of their departments. While the Treasury has a central role in coordinating the budget process, it does not micro-manage budgetary policies at the ministerial level, as is the case in most other countries. However, due to the greater transparency and notification requirements, the budget process in New Zealand demands relatively greater resources to administer.

The successful devolution of budget responsibilities in New Zealand's budget process is made possible by a combination of elements. First, a culture of interdepartmental cooperation allows the Treasury to coordinate the budget process despite the high degree of control granted to the departmental level. Second, the use of an incremental rolling budget provides each department with a firm medium-term departmental budget envelope within which each department is given the flexibility to develop a multi-year strategy. Third, extensive reporting requirements integrated throughout the budget process compel departments to be transparent and publically accountable.

Multi-Year Budgeting in Canada

The Canadian approach to multi-year budgeting is yet another example of the

Commonwealth approach to budgeting, in which ministries and spending agencies play an explicit role in the multi-year policy framework. Similar to the U.K., Canada's line departments are responsible for the development of multi-year expenditure plans while the central government is responsible for the determination of overall and departmental expenditure limits and the overall medium-term fiscal policy framework. Thus, the budget serves not only as an annual operating plan for the government, but also as a multi-year planning document detailing planned expenditures and projected revenues for the coming year and the next two years (Treasury Board of Canada Secretariat, 1995;1998).

Purpose Of the Multi-Year Budget. The two main purposes of the multi-year budget process in Canada are to assist policymakers in achieving medium-term strategic fiscal objectives and to foster greater fiscal responsibility among spending units. The government must reconcile over a period of three years the expenditure plans and programs of its departments and ministries with the explicit aggregate limits placed on the size of the public sector and the deficit. By requiring that line departments and ministries focus on the multi-year perspective for the determination of program priorities, the multi-year budget process also encourages program prioritization and resource conservation. In addition, the rolling nature of the Canadian multi-year budget approach achieves budgetary stability and continuity.

Organizational Responsibilities. Similar to the division of responsibilities in Australia, there are two central actors in the formulation of budgetary policy in Canada, namely the Treasury Board and the Department of Finance. While the Department of Finance determines the medium-term economic and fiscal strategy, revenue policies and the government's overall expenditure ceiling, many of the other budget activities are performed by the Treasury Board.

The Department of Finance consists of 11 branches, seven of which are policy oriented. The Economic and Fiscal Policy Branch, consisting of the Fiscal Policy Division, the Economic Studies and Policy Analysis Division, and the Economic Analysis and Forecasting Division, plays the central role in the development of the medium-term budget strategy. Within the Fiscal Policy Division, the Revenue Forecasting and Analysis Group and the Expenditure Forecasting and Analysis Group bear the primary responsibility for the monitoring of the government's fiscal position, the development of forecasts and analyses of the government's fiscal position, and the development of policy options in support of the government's fiscal policy objectives. Within the Economic Analysis and Forecasting Division, the Forecasting and Model Development group is responsible for the generation of quarterly macroeconomic forecasts and the examination of the fiscal impact of economics and policy options.

The Treasury Board, which consists of the President of the Treasury Board, the Minister of Finance, and four other senior ministers, is responsible for the administration and management of the federal government's expenditure responsibilities. Its mandate includes the review of the multi-year departmental expenditure plans and the tabling of the Main Estimates (annual expenditure requests). The Treasury Board Secretariat, as the administrative arm of the Treasury Board, is responsible for the administration of the Expenditure Management System. Currently, approximately 175 personnel are employed in support of the resource planning and expenditure management functions of the Treasury Board Secretariat.

Multi-Year Budget Process. The cornerstone of Canada's multi-year budget approach is the Expenditure Management System (EMS) introduced in 1995 to support the Canadian government's objective of deficit reduction. A wider purpose of the budgetary reform in Canada

was to improve strategic (multi-year) planning through the critical review of existing programs and the reallocation of resources from low to high priority policy initiatives. The multi-year expenditure framework gives line departments and agencies a stable three year planning horizon. The process of program review continues to play a central role in the government's multi-year budget process.

A number of (evolving) reporting requirements enhance the transparency of the budget process and focuses the attention of line departments on the continuous review of its programs and priorities. The first step of the Canadian multi-year budget process is formed by multi-year departmental Business Plans. In these confidential departmental Business Plans, each minister communicates to the Treasury Board his or her progress on achieving strategic goals, key sectoral policy priorities and the envisioned direction of departmental policies over the next three years. Departments and agencies are granted wide latitude in formulating their business plans; they are responsible for determining program priorities and expenditure levels within the multi-year resources constraints provided by the previous year's expenditure plans. However, departments are expected to offset most cost increases by reducing spending on other items in their own departmental budgets. The departmental Business Plans are submitted to the Treasury Board for review and approval.

As a next step in the budget process, the Minister of Finance prepares the *Economic and Fiscal Update*. Traditionally, the forecasts contained in this document are "prudent" in that they are more conservative (pessimistic) than the average private sector forecast. Based on the overall economic and fiscal outlook, the Minister of Finance undertakes consultations with parliament committees, the line ministers and the President of the Treasury Board, in order to develop the

government's budget strategy. Based on the review of the departmental Business Plans, the Treasury Board suggests reductions and reallocation options for inclusion in the multi-year budget strategy. Upon completion, the Minister of Finance submits the Budget Strategy (including multi-year fiscal targets, new spending initiatives and budget reductions) to the Cabinet for review and approval. Finally, the Treasury Board tasks each department to develop a Report on Plans and Priorities (RPP) containing the departmental multi-year budget plan in accordance with the budget targets and policies contained in the Budget Strategy. The Main Estimates, which are tabled with Parliament by the President of the Treasury Board, contain the government's expenditure plan (Part I), the itemized requests for appropriations (Part II) and the departmental RPPs (Part III).

Evaluation. The Canadian budget process unites the top-down spending limits imposed by the Minister of Finance with the bottom-up spending plans contained in the multi-year departmental Reports on Plans and Priorities. The Canadian multi-year budget system has additional positive features which help foster a more effective fiscal management climate. First, the Canadian approach is incentive compatible with respect to cost-saving behavior by ministerial and departmental officials. The long-term perspective and stability of fiscal resources allows departments to manage resources and deliver services more effectively in the medium term. Second, while allowing the reallocation of fiscal resources within departments, the EMS imposes a hard budget constraint upon departments and agencies. Third, by adopting conservative forecasts, the Canadian budget is realistic and more flexible to changes in economic conditions. On the negative side, the Canadian approach to multi-year budgeting is time and cost intensive and its formulation may be too fragmented. However, the separation of overall expenditure targets and departmental expenditure ceilings in two different agencies may limit the scope for

bargaining and thus increase overall fiscal discipline

Initial evidence suggests that the EMS is having a positive impact on long-term expenditure planning. After years of poor fiscal performance, the strategic objective set in 1995 to reduce the federal budget deficit to three percent of GDP by 1997 was indeed met. The current strategic objective is to achieve and maintain a balanced budget through the period 1998-2000.

Multi-Year Budgeting in the United States

Although the United States does not have a formal multi-year budget, the budget process in the U.S. does contain several multi-year elements. Most importantly, actual multi-year appropriations are included in the budget for certain capital projects. In addition, the Budget of the United States Government includes expenditure and revenue estimates for the coming budget year plus four more years. The medium term expenditure estimates contained in the budget document reflect the cost in future years of ongoing and proposed government programs and policies, while the revenue estimates reflect the amount of tax collections based on currently enacted and proposed tax legislation. These multi-year estimates demonstrate the impact of current and proposed policies on future fiscal outcomes such as the federal deficit (OMB, 1997).

Purpose of Multi-Year Budget Approach. The purpose of multi-year budget estimates contained in the federal budget is to provide a multi-year framework for current fiscal policy decisions to ensure that these decisions are compatible with the government's medium term fiscal strategy of deficit containment. The multi-year expenditure estimates also provide an informal starting point for the formulation of the annual budget for the following year.

Organizational Responsibilities. Under the Constitution and laws of the United States, the President proposes an Executive Budget to the Congress in January of each year for the fiscal year beginning the following October 1. Essentially, the budgeting preparation process is a bottom-up approach in which the executive departments and agencies submit their spending proposals to the Office of Management and Budget (OMB), which is part of the Executive Office of the President. It is the OMB that is responsible for the formulation of the President's budget proposal. In addition, the OMB participates jointly with the Department of Treasury and the Council of Economic Advisers in formulating fiscal policy and producing economic and revenue forecasts. The Council of Economic Advisers is responsible for preparing the *Economic Report of the President*, the administration's economic and fiscal strategy document, which is published each February.

The Office of Management and Budget within the executive branch finds its legislative counterpart in the Congressional Budget Office (CBO), established in 1974 as part of the technical staff of the Congress. As part of its responsibilities, the CBO develops and publishes its own economic, revenue and deficit (surplus) forecasts. The CBO forecasts are typically more conservative than those in the President's budget proposal. As such, the CBO provides the Congress with alternate multi-year budget estimates. The General Accounting Office (GAO), also attached to the legislative branch, provides the Congress with evaluations and audits of government agencies and budget programs.

In the U.S. approach to fiscal federalism, each of the levels of governments (federal, state and local governments) act independently in budgetary matters. As a result, there are no formal linkages between the budget process of subnational governments and the budget at the federal of

government, with the exception of federal transfers. While this review focuses on the federal budget process, there exist a variety of multi-year budgeting practices at the subnational level in the United States. In particular, twenty of the fifty states in the United States use some type of biennial budget which determines government revenues and appropriates expenditures for a period of two years (Fisher, 1997); many local governments also include multi-year forecasting as part of the budget preparation process (Forrester, 1991).

Multi-Year Budget Process. The medium term fiscal strategy in the United States can best be described and understood in the context of specific legislative acts and the motivation of those legislative actions. The Budget Enforcement Act (BEA) of 1990 significantly amended the existing budgetary process. The BEA moved away from the rigid-fixed fiscal targets of previous reform efforts. Similar to the more recent reform efforts in Australia and New Zealand, this legislation recognizes the need for flexibility in meeting emergencies and unexpected changes in the macroeconomic environment. The BEA distinguishes between two types of spending: *discretionary spending* and *direct spending*. Simply stated, discretionary spending is approved in annual appropriation bills for such items as salaries and governmental operating costs. On the other hand, “direct” or mandatory spending is linked to and authorized by separate legislation that does not necessarily change from year to year, such as social security programs.

To ensure that overall budget spending limits are effectively followed, the BEA provides for a procedure called sequestration for discretionary budget items. If the Congressional appropriations provide expenditure authorization in excess of the discretionary spending limit set forth by the law, then all discretionary spending programs are reduced by a common percentage sufficient to bring the prospective spending levels into balance with the spending limit or budget

cap. In 1996, the Congress extended the BEA through the year 2002 in legislation commonly referenced as the Balanced Budget Act; the objective of the Act is to reach and maintain a balanced budget by the year 2002.

The OMB and the CBO are given significant responsibilities in making the required spending and revenue estimates necessary for determining the need for sequestration. Both agencies prepare separate estimates. Any differences in the sets of estimates must be made public and explained by the OMB. The OMB estimates are the basis of the President's sequester order and the President is under the obligation not to change the OMB estimates. The GAO (General Accounting Office) reports to Congress on the President's compliance with the rules and procedures imposed in the Budget Enforcement Act.

Another important element of the multi-year dimension of the U.S. annual budget is the difference between *budget authority* and *outlays*. Budget authority is the authority that is given to line departments to enter into obligations that will result in immediate or future outlays of government funds. Outlays are actual expenditures made from government resources. In the American budget process, the Congress does not vote on the level of outlays directly, but rather on budget authority. Budget authority is recorded in the budget as the dollar amount in the year that it becomes available. While budget authority normally expires after one year, in certain cases the unused balance of budget authority may be carried over into the next year.

For major procurement programs or construction projects an amount adequate to complete the project or programs must be requested by the executive to be appropriated by Congress the first year, even though the project may last more than one year (OMB, 1997). The unspent remainder does not have to be re-appropriated next year, but can simply be carried over

to the next budget year. This policy is intended to ensure continued funding of multi-year projects and programs that cannot be used until they are completed. For certain capital assets, the budget includes a requests for a regular appropriation in the budget year and advance appropriations of budget authority in subsequent years, that are together sufficient to fully fund the acquisition of the capital asset. This is done to avoid “spikes” -- large amounts of budget authority that cannot readily be accommodated under the discretionary budget caps that apply to the budget year. In this sense, the United States has a multi-year approach to capital budgeting to the extent that such multi-year appropriations are used for certain capital projects.

Evaluation. The U.S. arguably has one of the most archaic and complex budget formulation processes in the world. As a result, the budget formulation process is time intensive and labor intensive. Despite this deficiency, there are a number of positive aspects. First, the coexistence of an annual operating budget and multi-year appropriations for certain capital expenditures (close to a multi-year capital budget) addresses the need for a multi-year perspective in a unique way. Of course, multi-year appropriations are also more effective in securing completion of capital investment projects than multi-year expenditure plans. Second, the multi-year estimates provide a good analytical platform to analyze the impact of current budget proposals for future years; they are effective in assisting policy makers to assess whether current budget policies are consistent with medium term strategic objectives. Third, the Congressional Budget Office (CBO) provides the government with a central counterpart for budget matters and expertise within the legislative branch. This allows the legislature to independently evaluate the government’s multi-year budget estimates. While the arrangement of counterposition of the OMB and CBO is expensive, it forces both the administration as well as Congress to adopt more

realistic budget policies.

APPLICATIONS OF MULTI-YEAR BUDGET PRACTICES FOR DEVELOPING AND TRANSITIONAL ECONOMIES

Many developing and transitional economies face serious budgetary problems. In these countries, budgetary problems often include an increasing debt burden, chronic underfunding of government programs, budget arrears, unpredictable budgetary flows and other symptoms of a failing budget process. Consequently, an argument could be made for the introduction of a multi-year dimension into the budget process of developing nations and transitional economies. At the same time, one should wonder if it would make sense for these countries to introduce multi-year elements into the budget process if they are already failing to implement the annual budget in a consistent manner.

Notwithstanding the reasonableness of the latter position, we would argue that the absence of an appropriate multi-year analytical framework for fiscal policies in these countries can actually contribute to the gravity of their fiscal distress. Concentrating all efforts on the improvement of budget execution solely within the context of the annual budget would overlook the close connection between the annual budget formulation process and the longer-term budgetary problems faced by many developing and transitional economies. Indeed, any budgetary process that fails to prioritize expenditures over the medium term or that fails to internalize the linkages between budget decisions in the current year and expenditure requirements in subsequent years is exposed to inconsistencies and, ultimately, failure.

Introduction of a multi-year dimension in the budget process of developing and

transitional countries could make a substantial contribution to correcting the perennial fiscal problem in these economies: the imbalance between the available resources and the government's expenditure commitments. Placement of the budget in a medium term context would create a framework for these countries to analyze fiscal strategy issues and provide a mechanism to build a political consensus on national priorities. The multi-year dimension would also allow for the structural review and prioritization of expenditure commitments as opposed to the arbitrary across-the-board cuts which are often relied on in the absence of a clear multi-year framework.

Before developing or transitional countries attempt to add a multi-year dimension to their budget process, four sets of issues need to be addressed. First, what are the objectives to be pursued with the introduction of a multi-year budget approach? Second, how are the multi-year budget elements to be implemented? Third, how will the organization responsibilities be assigned? Fourth, what are the methodological issues that need to be considered?

Purpose of a Multi-Year Budget Approach

As mentioned earlier, the introduction of multi-year budget components in the budget process of developing or transitional economies could serve a number of specific purposes. First, the introduction of basic medium term revenue and expenditure estimates could help to identify policies that are inconsistent with the government's medium term strategy. Austria is a good example of this approach. Second, multi-year revenue and expenditure estimates could be used to develop a comprehensive medium term financial plan as in Germany, the U.K and Canada. Third, the multi-year budget components could also be used as a budgeting tool to enhance the efficiency and transparency of the budget process as is done in the Commonwealth countries. As

demonstrated by the review of international practices, the design of multi-year budget approach should largely be determined by the goals pursued through the introduction of multi-year elements into the budget process.

Regardless of the purpose and approach selected, the multi-year budget components would need to be carefully integrated with existing budget laws and budget practices. Also, as a matter of strategy, it may not be possible or even desirable for the governments of developing or transitional economies to adopt the more complex approaches to multi-year budgeting all at once. Many of these countries currently lack the administrative resources, inter-departmental cooperation and technical capabilities to successfully manage the information flows associated with an integrated financial plan or rolling budget approach. Nonetheless, all options should be considered, from the simplest to the most complex approach. Approaches that may appear to be more desirable but which currently would exert an excessive claim on administrative resources should be left for later reforms.

Implementing a Multi-Year Budget Process

One of the most complete approaches to multi-year budgeting is the development of a detailed multi-year tax and expenditure plan. Multi-year financial plans enhance the budgetary process in several ways. Most importantly, financial plans ensure that the government's fiscal policies are consistent with the country's medium-term fiscal strategy. In addition, multi-year financial plans provide a high degree of certainty about future fiscal policies and provide continuity to the budgeting process. In combination these elements results in a very systematic development of fiscal policy.

However, an integrated multi-year financial plan also has several disadvantages. First, the formulation of an integrated multi-year financial plan is quite complex and administratively very demanding. In addition, the use of a full-fledged multi-year financial plan requires strong political and social consensus, which may be absent in developing and transitional economies. Finally, given the rapid economic and institutional changes caused by the introduction of a full-fledged market economy, a multi-year financial plan may be too rigid for many developing and transitional economies. Therefore, in many cases the introduction of multi-year financial plan would neither be feasible nor desirable.

Short of implementing a multi-year financial plan, still a quite comprehensive approach to multi-year budgeting can be achieved by producing frequent updates of multi-year budget estimates and implementing stringent budget reporting requirements. This alternative approach would provide most of the benefits of a multi-year financial plan but would do so without imposing undue administrative demands and without relying on political consensus.

Periodic publication of updated multi-year budget estimates and increasing the reporting requirements for line departments would allow current policies to be evaluated against the government's fiscal strategy on a regular basis. Increased transparency and improved information flows would subject government programs and departmental budget practices to increasing scrutiny by government officials, parliamentarians and the public at large. In the Commonwealth tradition increased reporting requirements are being matched by the devolution of budgeting responsibilities to the line ministries. Many developing and transitional economies may presently lack the tradition of administrative openness and political accountability that are prerequisites for such a move. However, greater public scrutiny of departmental expenditures can result in greater

fiscal discipline at the departmental level without the assignment of greater budget responsibility to individual government departments.

The most basic approach to multi-year budgeting, arguably the appropriate starting point for the development of more complex approaches, comprises an annual budget cycle that is enhanced by a multi-year budget document. This multi-year budget document should provide a statement of the government's medium term fiscal strategy (defined in terms of major targets such as overall tax burden and the size of the deficit) as well as multi-year expenditure and revenue projections. This multi-year budget document could be presented either at the beginning of the budget cycle (as is done in Austria), concurrently with the annual budget (as in most other countries), or more than once during the budget process (as, for example, in New Zealand). This approach would allow the government to place its current budget in a multi-year context while avoiding the complexity of other multi-year budgeting approaches.

Basic multi-year budget projections would serve to frame fiscal policies within well-defined medium-term objectives and to provide an early warning signal for budget policies that are inconsistent with the government's medium term fiscal strategy. These projections would also enhance the transparency of the budget process and allow for more fiscal discipline than is possible with a purely annual approach to budgeting. In addition, updated multi-year expenditure estimates could provide serve as the (informal) starting point for the following budget cycle, thus providing the benefits of a rolling budget without having to put together a detailed multi-year expenditure plan.

Fundamental to the success of any multi-year budget methodology is the timely publication of the government's medium term fiscal strategy as well as the multi year revenue and

expenditure estimates. New Zealand's approach provides a good example how systematic publication of the government's fiscal strategy and the fiscal outlook can ensure more informed decision-making, a greater degree of continuity in the budget process, as well as a greater level of transparency in the budget formulation process. Since the fiscal strategy of any government needs to be widely understood, both within the executive and legislative branches as well as by the public at large, publication of the government's strategic goals (possibly along with preliminary multi-year revenue and expenditure estimates) should occur early on in the budget process. Then, if administrative resources allow, the transmission of the annual budget to the legislature should be accompanied by an updated statement of the fiscal strategy and fiscal outlook that describes any departure from the fiscal strategy and budget estimates specified in the earlier multi-year budget document.

Organizational Considerations

Traditionally, government agencies in developing and transitional economies have been almost exclusively focused on the sectoral policies within their purview and only minimally involved in the budgetary process. The narrow policy focus of the line ministries often results in the submission of inflated budget requests by line departments, antagonistic relationships between the Ministry of Finance and the spending agencies, and the absence of budget controls and fiscally responsible behavior at the departmental level. Therefore, any reform of the budgetary process needs to address the lack of inter-departmental cooperation and should seek to provide all line departments with a sense of common purpose. A more explicit statement of the government's medium term strategic goals as part of a multi-year budget strategy could be a useful tool in

involving the individual ministries in the budget process while clearly identifying the government's budget priorities.

While experiences may vary between countries, recommendations for the organizational structure and the assignment of the responsibility for the development of multi-year revenue and expenditure estimates will generally also be influenced by the traditional centralization of budget responsibilities within the Ministry of Finance. Due to the lack of institutional cooperation and the absence of budgeting experience among the line departments, the development and maintenance of the multi-year budget estimates should (at least initially) be concentrated within the Budget Department of the Ministry of Finance, preferably by a separate division within the Budget Department. While this division should be the central player in the development of the multi-year budget estimates and the production of the fiscal strategy documents, it could coordinate its activities with other divisions within the Ministry of Finance (specifically, the divisions responsible for macroeconomic policy and revenue forecasting) as well as the individual line ministries.

Centralization of the responsibilities for the multi-year budget process in the context of developing and transitional economies has a number of distinct advantages. First, this approach may simply prove to be the most economical and administratively efficient. Second, concentrating the responsibility for the development and maintenance of the multi-year estimates within the Ministry of Finance will facilitate the timeliness and frequency with which estimates can be made. Third, control over the estimates by the Budget Department will prevent possible manipulation of the multi-year estimates by the line departments. The major disadvantage of the centralization of responsibilities for the multi-year budget process within the Ministry of Finance is that it limits the

exposure and involvement of the line departments in the budgetary process.

Methodological Choices

The review of international practices reveals that medium term revenue and expenditure forecasts are often made at a high level of detail. For example, the German Ministry of Finance produces forecasts for 8000 expenditure items and 1200 revenue items. Countries that include the multi-year budget forecasts in the annual budget document often actually produce forecasts for every line item in the budget.

Yet despite the large number of forecasted budget items, often only a few basic “driving variables” are used to arrive at the forecasts. Frequently, expenditure items are simply expected to grow over time at the pace of inflation. This is the case, for example, for most discretionary expenditure projections in the United States budget (OMB, 1997, 250). A more accurate expenditure forecast methodology would separately consider expenditures based on major economic classifications, such as wage expenditures, other current expenditures or capital expenditures.

An additional element that is regularly included in the forecast methodology are sectoral trends. For example, financing needs for elementary and secondary education are likely to be proportional to the number of school-aged children. Similarly, expenditures for statutory government programs can often be estimated by combining expected social, economic and demographic trends and knowledge about legislative requirements. For example, spending estimates for pension benefits in Australia are produced based on the average pension rate in the current budget year, the projected number of pensioners and the projected level of inflation

(Australian Department of Finance, 1998). As a result, a select number of basic macroeconomic forecasts, demographic projections and legislative factors could be combined to achieve a relatively detailed level of multi-year budget projections.

An additional component to be considered in developing a multi-year budget forecast methodology are capital expenditures, which in many countries are planned in a multi-year framework. Indeed, most countries considered in this review give special consideration to capital investment projects in context of the multi-year budget. For example, in Austria a multi-year investment program accompanies the multi-year budget estimates, while a review of multi-year investment projects is also incorporated in the German medium term financial plan. Although the United States only has multi-year appropriations for certain capital items in the budget, its budgeting method demonstrates the benefits of this hybrid approach.

CONCLUDING REMARKS

The main goals of this review are to provide an overview of the international experiences with regard to multi-year budget practices and to explore their relevance to transitional and developing economies. The detailed country reviews focus on specific aspects of the multi-year budgeting approach, including the purpose, organizational structure and implementation of the multi-year budget process.

The review of international practice contains several lessons for governments of developing and transitional economies. Depending on the desired approach, multi-year budgeting can enhance the budget process in a number of ways. While more integrated approaches to multi-year budgeting (such as medium term financial plans) present the greatest number of advantages,

more complex approaches are also more demanding in terms of administrative resources. Consequently, it may be desirable for governments of transitional economies to follow a strategy that starts with a more basic approach to multi-year budgeting which still offers significant benefits, and to leave the adoption of more integrated approaches for future reforms.

Regardless of the approach chosen, a central element of a multi-year budget strategy for any developing nation or transitional economy is the systematic publication of the government's medium term fiscal strategy as well as a medium term economic and fiscal outlook. These documents provide government officials, legislators and the public at large with a multi-year perspective on economic and fiscal developments in a way that requires policy makers to be both realistic and responsible. Even in the absence of abundant administrative resources, the introduction of basic multi-year elements into the budget process can provide a framework for systematic analysis and improved decision making in the formulation of annual budgets.

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Table 1
Overview of Multi-Year Budget Approaches in Selected Countries

	Australia	Austria	Canada	Germany	New Zealand	United Kingdom	United States
Do multi year projections reflect estimates (E) or a budget plan (P) ?	E	E	P	P	E	P	E, P
Is the multi-year budget component integrated into the budget cycle ?	Y	N	Y	Y	Y	Y	Y
How many years are projected (in addition to upcoming budget) ?	3	3	2	3	2	2	4
Are expenditure estimates made centrally (C) or by departments (D) ?	C	C	D	C	D	D	C
How often are the multi-year budget estimates updated per year ?	4	1	1	1	2	1	1
Do departments have flexibility in reallocating funds within their budget ?	Y	N	Y	N	Y	Y	N
Is an incremental approach to budgeting used?	Y	N	N	N	Y	N	N

Note: See the text for a more detailed discussion of each country's multi-year budget approach.