Case Studies from Canada

International Models for Parliamentary Budget Office

BUDGET PROCESS GUIDE

for Parliamentarians,
Media & Civil Society Organisations

Parliamentary Centre
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Introduction

The art of budgeting has always been difficult. Apart from those directly involved, few understand or appreciate the difficulties in deriving credible and accurate economic and fiscal projections. The credibility of budget forecasting has been questioned, given the continual missing of budget targets, in either direction. Even among budget planners, few anticipated the impact of the recent international meltdown on their fiscal projections and stated government targets.

It is expected that budgeting will become even more difficult in the future. The ageing of the population will have significant impacts on a country's potential economic growth and on both government revenues and expenditures. Globalization has exposed countries to the actions of others, as witnessed by the international financial crisis. The impacts of global warning are uncertain. Governments have become involved increasingly with a variety of new financial guarantees, such as loan guarantees and public-private partnerships. With the rise in public debt in many countries, it is important that legislatures and the general public become more informed and involved in the budgetary process.

There is evidence that national legislatures are becoming more actively involved in budgetary matters. New committees have been established, charged with legislative or oversight responsibilities, budget staffs for legislative committees have been enlarged, the availability of budget-related information provided to legislators and the general public have increased and there more vigilance by independent or legislative auditors in reviewing the propriety and efficiency of government expenditures.

But to credibility encourage more accountability from the executive, legislatures need assistance in understanding complex budget issues and processes. They require reliable, unbiased information to be able to participate constructively in the budget process. This has resulted in a number of countries establishing an independent research capacity or unit. With a truly well-functioning independent unit, the legislature can challenge the government more effectively. This section discusses the potential to the legislature of having an independent an independent research capacity and looks at such units in a number of countries.

Potential Value [1]

Apart from the above, an independent analytical unit can have the following benefits:

- **Simplifying complexity**: Information provided by the government may be too complex for understanding by those not directly involved in the process. An independent budget unit must have the required expertise to be able understand the budget process and to be able to explain the budget information to the legislature.

- **Promoting transparency**: Increased analysis and more user-friendly commentary should improve transparency, both by the independent budget unit as well as by the government.

- **Enhancing credibility**: By encouraging simplification and transparency, the existence of an independent budget unit with its own economic and fiscal forecasts should force the government to defend its forecasts more aggressively, thereby improving overall credibility in the process.

- **Improving the budget process**: The combination of the above can promote a straightforward and more understandable and open budget process.

- **Serving both the majority and the minority**: A truly nonpartisan and independent budget unit should provide information to all parties in the legislature, including the governing party.

- **Providing rapid responses**: An independent budget unit should be able to provide much more rapid responses to budget inquiries, provided it is adequately staffed.

- **Promoting accountability**: By commenting publicly on the government's budget projections, an independent budget unit can improve the accountability of the government's budget projections.

Given the above, an independent budget unit can serve not only the legislature but also the public at large. The above benefits can only be achieved over time as the independent

1. Taken largely from "The Changing Role of Parliament in the Budget Process" by Barry Anderson OECD Journal of Budgeting Volume 2009/1

budget unit gains credibility and prominence and the government adjusts to its presence. It will need to be independent of government, reporting to Parliament or the non-executive branch of government.

An independent budget unit can perform many possible functions but, at a minimum, it should do the following:

- **Economic forecasts**: The first core function should be the provision of an independent economic forecast. The unit should fully explain its assumptions and compare its forecast to others, both to the government's economic forecasts as well as those prepared by private sector institutions. The forecasts should be based on current legislative provision and not try to anticipate future legislation. The assumptions with respect to interest rates, inflation, commodity prices, etc. should be based on the best information available and not targets. It may be best for the unit's forecast to be considered as "conservative," given the costs of being overly optimistic. Such expertise in economic forecasting, including the "creation" and maintenance of an extensive and credible econometric model, involves a significant undertaking in both human resources and capital. This may need to evolve over time. Use of private sector models may be required in the interim.

- **Baseline budget estimates**: Projections of government revenues and expenditures should be based on laws currently in place. The forecasts should assume that expiry dates currently in legislation will actually occur. The assumptions used should be clearly spelled out.

- **Analysis of the government's budget**: The independent budget unit should provide an indepth analysis of the government's budget economic and fiscal projections and proposed budget proposals. Such an analysis should improve the credibility of the government's budget over time. Difference will be explained and debated, thereby improving transparency.

- **Medium-term analysis**: In many countries, the focus of the government's is the short-term one to three years. This ignores the impact of emerging risks that fall outside the electorate cycle. A medium-term perspective would take the various risks into account, such that there can be an informed debate on how to manage such risks.

There are other functions that an independent budget unit could undertake, such as options for spending cuts, tax policy analysis, briefs, etc. However, the above are the core features and it will important to achieve credibility in the performance of these functions before undertaking additional responsibilities.

Independent Budget Units

According to a 2007 OECD survey of its 30 member countries, along with another 8 non-OECD countries, 16 reported that they had "*a specialized budget research office/unit attached to the legislature to conduct analyses of the budget*."

This section examines the budget units in *Canada*, the *United States*, the *Netherlands* and the *United Kingdom*.

The Parliamentary Budget Officer - Canada

Better-than-expected annual surplus results led to claims by the opposition that the government was misleading Canadians and Parliament about the state of the government's finances. The Conservative Party, in its 2006 election campaign, promised to create an independent Parliamentary Budget Authority to provide objective analysis directly to the Parliament about the state of the nation's finances and trends in the national economy. It also stated that it would require that government departments and agencies to provide accurate and timely information to this new Authority to ensure that it would have the information it would need to undertake its mandate.

The Parliamentary Budget Officer (PBO) was created in the Federal Accountability Act, which became law in December 2006. The office was officially established in March 2008. The PBO is an officer of the Library of Canada. The Speakers of the Senate and the House of Commons, assisted by a joint committee appointed by the two Houses, are responsible for the Library and its employees. The PBO is appointed for a five-year term. Currently, the Office has a staff of 14 and an annual budget of CAD $2.8 million. Most of the staff are economists and public policy analysts, most of who are seconded from other federal departments, including the Department of Finance. Most of its analysis and forecast are reviewed by outside advisory groups prior

to publication.

The mandate of the PBO is:

1. Provide independent analysis to the Senate and to the House of Commons about the state of the nation's finances, the estimates of the government and trends in the economy;
2. When requested to do so by the Senate Standing Committee on National Finance, the House of Commons Standing Committee on Finance and the House of Commons Standing Committee on Public Accounts, undertake research for these committees into the nation's finances and economy;
3. When requested to do so, undertake research for any committee of the Senate and the House of Commons examining the spending estimates of the government; and
4. When requested to do so, estimate the financial cost of any proposal over that Parliament has jurisdiction.

It serves both individual members of Parliaments and the above committees.

The following are the major activities undertaken to date:

Budget and Economic Outlook: Since its inception, the PBO has prepared five economic and fiscal updates. Its economic and fiscal forecasts are based on current legislation and are viewed as being "conservative" in nature. The economic planning assumptions are based on a survey of private sector economic forecasts and do not necessarily reflect PBO's view of the economic outlook. The original intent was to produce such outlooks on a quarterly basis. However, only one update has been provided for 2010. The PBO also provides assessments of the government's economic and fiscal projections provided in the fall updates and annual budgets during this time period.

Cost Estimates: Upon request, it has produced a number of reports, including the "Fiscal Impact of the Canadian Mission in Afghanistan," "Funding Requirement for First Nations Schools in Canada," "Assessment of Planned Security Costs for the 2010 G8 and G20 Summit," "Funding Requirement and Impact of the Truth in Sentencing Act on the Correctional System in Canada." It has also provided assessments of cost estimates on policy initiatives proposed in legislation.

Analysis of the Government's Budgetary Proposals: It is monitoring of the various projects approved under the Infrastructure Stimulus Fund as well as providing quarterly Updates of a Monitoring Framework for Measures Contained in the Economic Action Plan.

Analytical Studies: It has provided its estimates of potential gross domestic product and the government's structural budget balance, as well a special report on Canadian Labour Market Developments and on projecting employment insurance premiums and expenses.

The PBO maintains a website which all of its reports and studies.

Issues

There have been a number of issues since its inception. The PBO is an officer of the Library of Parliament. As such, the Office reports to the Parliamentary Librarian. In turn, the Library of Parliament reports to the Speakers of the House of Commons and Senate. This has created tension between the PBO and the government, as the PBO believes that to be truly independent, he should report directly to the Parliament.

There have also been restrictions put on the release of reports and information produced by the PBO, following a review by a joint committee in June 2009. Any response to a request by a parliamentarian or a parliamentary committee must remain confidential until it is approved by the parliamentarian or the parliamentary committee making the request. The PBO can not release any report during a general election. Its budget has been frozen depending on compliance of all of the joint committee's recommendations. In addition, the PBO has had difficulty in obtaining data and information from departments and agencies. These restrictions and issues have led some to conclude that the PBO is not truly independent.

PBO is a relatively new organization, which should evolve over time. As noted above, most of its staff is seconded from other federal departments. This has provided PBO with expertise across a number of fields, allowing it to undertake complex duties without a large start-up cost or in-house training. Some have returned to their original departments. Over time, it will be important to secure a more permanent workforce.

To date, its existence has been relatively controversial,

given the difference between the government and the PBO over its independence and reporting structure. It will be interesting to watch its progress and what role(s) it plays in the future.

The Congressional Budget Office - United States

The biggest independent budget unit is the Congressional Budget Office (CBO), established in 1974 with the enactment of the Congressional Budget and Impoundment Act. It started operations on February 24, 1975. It was created in an environment in which the Office of Management and Budget (OMB the body that assists the President in overseeing the preparation of the federal budget) was reorganized to a more powerful office in the early 1970s.

There was a general feeling in Congress that the President and the OMB had a monopoly on budget information, thereby hampering Congress in analyzing the President's budget and proposing alternatives. Given Congress' role in budget making, whereby it can modify the President's budget proposals and introduce its own proposals, it felt it needed a body that would be a counter to the OMB, in providing alternative budget projections, assessing the President's budget and policy proposals and providing costing for their proposals.

The CBO is appropriate to a government structure in which there is strict division of powers between the executive and legislative branches of government. The budget emerges from a process of negotiation between these two branches, which can and usually does take several months to complete. The CBO is designed to put Congress on an equal footing with the OMB in assessing economic and fiscal developments and prospects and costing potential policy options.

The CBO currently employs about 250, of whom 45 are directly involved in the preparation of the baseline economic and fiscal projections. Most of the remainder are involved with the analysis of policy proposals and examining programs. The staff consists primarily of economists and public policy analysts. The budget in 2010 is about US $ 45 million.

The law that created the CBO provided only general guidance as to what its functions should be. The first deputy director of the CBO described the prevailing view at that time as follows: “What the House wanted was basically a manhole in which Congress would have a bill or something and it would lift the manhole cover and put the bill down it, and 20 minutes later a piece of paper would be handed up, with the cost estimate, the answer on it. No visibility, just some kind of mechanisms down below the ground level doing this... non-controversial work, the way the sewer system does.” [2]

However, the CBO has expanded its functions far from what was original envisaged, primarily because of its efforts from inception to explicitly structure itself as a nonpartisan, independent, objective, analytical agency.

The following describes its major roles and responsibilities.

Budget and Economic Outlook: In late January of each year, CBO reports on the economic and budget outlook, including estimates of spending and revenue levels for the next 10 years under current law. This so-called budget baseline serves as a neutral benchmark against which Members of Congress can measure the budgetary effect of proposed legislation. The baseline is constructed according to rules set forth in law, which generally instruct CBO to assume that current spending and revenue laws continue without change. Thus, the baseline is not a prediction of future budget outcomes. Rather, it reflects CBO's best judgment about how the economy and other factors will affect federal revenues and spending under existing laws. Each summer, CBO updates its baseline projections, incorporating a new economic forecast and the effects of laws that have been enacted to date in that session of Congress.

Analysis of the President's Budgetary Proposals: Each year CBO provides an independent re-estimate of the President's budget proposals. This analysis is delivered to the Congress approximately one month after the President submits his budget. It permits the Congress to compare the President's spending or revenue proposals to other proposals using a consistent set of economic and technical assumptions.

Cost Estimates: To assist the Budget Committees and the Congress with enforcement of the budget resolution, the CBO analyzes the spending or revenue effects of specific legislative proposals. (For proposals that would amend the Internal Revenue Code, CBO is required by law to use estimates provided by the Joint Committee on Taxation.) It

2. Kates, Nancy D (1989) “Starting from Scratch: Alice Rivlin and the Congressional Budget Office

prepares cost estimates of pending legislation and tracks the progress of such legislation in a scorekeeping system.

The CBO's cost estimates and scorekeeping system show how individual legislative proposals would change spending or revenue levels under current law and help to determine whether those budget effects are consistent with the targets in the Congress's most recent budget resolution. As required by the Unfunded Mandates Reform Act of 1995, CBO includes in cost estimates an assessment of whether legislation contains federal mandates and provides an estimate of the costs imposed by those mandates on state, local, and tribal government and the private sector.

Budget Options: The CBO produces a volume that discusses a wide range of options that address changes in spending and taxes. The options are derived from many sources and, in keeping with the CBO's mandate to provide objective analysis, each includes a discussion for or against it. The CBO's budget options volume is currently produced in February or March of odd-numbered years to coincide with the beginning of a new Congress.

Long-Term Budget Outlook: This report presents illustrative scenarios for federal spending and revenues and describes the implications of those scenarios for the economy. Since 1996, the CBO has regularly prepared reports on the long-term budgetary pressures associated with the aging of the baby-boom generation. This report, produced annually in June, extends those analyses.

Unauthorized Appropriations and Expiring Authorizations: This annual report assists the Congress in adopting authorizing legislation that should be in place before it considers the 13 regular appropriations for an upcoming fiscal year. The report shows the total amount that the Congress has provided in appropriation acts for programs whose authorization has expired.

Review of the CBO's Activities under the Unfunded Mandates Reform Act (UMRA): This annual report summarizes the CBO's activities under Title I of UMRA during a given calendar year and updates data provided in the agency's previous reports on that law. The report identifies which legislation before the Congress would have imposed federal mandates on another level of government or the private sector. The report also illustrates trends in federal mandates considered by the Congress since the enactment of the 1995 law.

Reports under the Troubled Asset Relief Act of 2008: The Emergency Economic Stabilization Act of 2008 (Div. A of P.L. 110-343) requires the CBO to provide semi annual reports that assess the status of the Troubled Asset Relief Programme, the recently enacted US $ 700 billion programme to provide assistance to financial institutions through purchases or guarantees of assets in the financial markets. Specifically, Section 202 requires that the agency assess reports submitted to the Congress by the Office of Management and Budget on the budgetary impact of the Treasury's transactions, including:

- The cost of acquiring, managing, and disposing of the assets and guarantees;
- The information and valuation methods used to calculate the cost;
- The impact on the deficit and the debt.

Analytic Studies: CBO analyzes specific policy and program issues related to the budget. Such studies explore significant budgetary and economic issues in greater depth. Recent examples include the long-term implications for resources and forces of the Administration's current plans for defense. CBO has also examined how effective federal tax rates will change over the coming decade under current law. The agency undertakes such studies at the request of the Chairman or Ranking Minority Member of the relevant committee or subcommittee; the Congressional leadership; or, as time permits, individual members.

The CBO has evolved significantly over time and its responsibilities are well established. It is viewed as being nonpartisan, transparent (everything is on its website), responsive and timely. It has sought to avoid the limelight. It serves committees and not individual members. Its products are well defined. It does not make recommendations.

The Central Planning Bureau - The Netherlands

The oldest independent budget unit is the Central Planning Bureau (CPB), established in 1945. Originally, CPB was mandated to supplying general economic advice about how economic policy could contribute to increasing prosperity. At that time, a larger government role in the economy was envisaged as it was felt that economic development could not be left entirely to the free market, given the financial crisis in the 1930s, and the need for government involvement in rebuilding the economy in the post-war period. At first, it was envisaged that the CPB would be a

temporary agency. However, with increased government involvement in the economy, the bureau became permanent.

The CPB's work has expanded greatly since its inception. In part, its role has evolved to serve a system with a large number of political parties in which minority or coalition governments are the inevitable electoral outcomes. Its work serves as an independent baseline for policy discussion and agreements among the political parties.

The CPB is an independent research institute, but is formally part of the government as part of the Ministry of Economic Affairs, from whom it receives its funding. However, it is viewed by both the government and opposition as nonpartisan who have defended its independence. This largely reflects the quality of the analysis undertaken over time by the CPB. In addition, there are a number of checks and balances. The CBP serves all political parties. All assumptions, results, models and data used are published and can be verified. The CPB regularly appears before Parliamentary committees to discuss its results. The CPB' work is reviewed on an ongoing basis by a number of external and internal advisory committees (the Central Planning Committee, Review Committee, Committee for Economic Affairs, along with peer review of separate research projects). There is a substantial mobility of personnel, moving between the CPB and universities, trade unions, ministries, etc. This ensures that the CPB is not static and contributes to a better understanding of the merits and limitations of CBP's work.

The CBP serves cabinet, federal government ministries, individual members and committees of Parliament, employee and employer organizations, societal organizations, the scientific community and the general public. Requests from outside the government must be approved by the Ministry of Economic Affairs.

The role of the CPB is unique among independent budget units. The Netherlands has a long history of coalition governments resulting from its having a large number of political parties. Prior to each election, the CPB provides an economic forecast which is used by all the parties in setting out their fiscal platforms. Hence, all political parties start from a common economic outlook. The platforms of all the parties are sent to the CPB, which costs out the programs and assesses their possible economic impacts.

After the election, the coalition establishes a Coalition Agreement, which sets the budget policy and the fiscal targets for the term of the new government. This is based on the same CPB economic outlook used in the election campaign. In the annual budget process, the CPB provides the economic assumptions upon which the official economic and fiscal forecasts of the Ministry of Finance are based. It does not make policy recommendations but rather provides an analytical and empirical foundation for policy deliberations. Some of its publications do spell out alternative policy scenarios for policymakers to use in considering future policy actions.

The CPB has about 150 employees organized along the following lines:

Short-Term Analysis and Fiscal Affairs: Each quarter, the CPB publishes its assessment of current economic developments and updates its economic projections for the Dutch economy. It compares actual outcomes to projections and presents analysis of the differences. These updates are used in the setting of Coalition Agreement, the estimating of the costs of the differing parties' election platforms, and in updating the budget projections. Research is also carried out on structural issues within the public sector.

Growth, Structure and Knowledge Economics: This section conducts research in the areas of education, innovation, research and development and information, communication technologies, with the aim to suggest policies that would foster productivity growth. The section also undertakes longer-term economic forecasts and sectoral analysis, in areas such as the environment, energy, among others.

Labour Market and Welfare State: The focus is the interaction between the labour market and arrangements in the areas of pensions, social security, taxation, unemployment insurance, among others.

Competition and Regulation: The focus of this section on what role the government can play in fostering a better functioning of markets in the broadest sense of the word.

Physical Aspects: This sector conducts analysis in the fields of mobility, infrastructure, spatial economics, agriculture, housing, energy and the environment. The work includes the undertaking of cost-benefit analysis of major projects and research on European agricultural and land

policies.

International Economics: This sector conducts studies on the impact of international and European policy issues on the Dutch economy.

The CPB is a vital organization within the Dutch budget planning process and plays an important role in the financial and economic decision making. The role of the CPB as an independent agent is consistent with the Dutch tradition of consultation and coalition agreements. This unique role is maintained by formal laws and protocols, by regular external reviews on policy relevance and scientific quality of its works, as well as by the existence of a free press.

The National Assembly Budget Office - Republic of Korea

The National Assembly Budget Office (NABO) was established through legislation in 2003 to serve the National Assembly by providing comprehensive research, analysis, and information on a timely, objective and nonpartisan basis for the Assembly's review, deliberations and approval of the government's budget and policy proposals. The NABO may request information and data from applicable government departments and agencies to carry out its work. The NABO was established under the control of the Speaker of the National Assembly. It has a staff of about 115, most of whom have professional degrees in economics, public finance and accounting and a budget of US $12.7 million. Its work is reviewed on an ongoing basis by a panel of 15 external advisors, with expertise in public finance and economics.

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The NABO consists of four divisions, described below:

Budget Analysis Division: Responsible for undertaken studies and analysis on the Korean economy, both in broad terms and on a sectoral/industrial basis. Also provides estimates of the costs of new policy initiatives and undertakes analysis of the budget outcome and forecast. I also responds to requests for research and analysis from committees or members of the National Assembly.

Economic Analysis Division: The division performs:

(i) analysis and forecasts on macro-economic trends and national fiscal policies,
(ii) analysis on economic policies, consolidated fiscal balance, national debts, national revenues, and the tax system, and
(iii) research on domestic and international fiscal systems. It responds to request for research and analysis from committees or members of the National Assembly.

Recently it received legislative authority for access to tax data.

Programme Evaluation Division: This division performs:

(i) analysis and evaluation of major national programmes,
(ii) monitors and evaluates the implementation of major national programmes,
(iii) analyzes and estimates medium-long term fiscal demand for major national programmes,
(iv) undertakes research on the effectiveness and efficiencies of government programmes,
(v) develops and systemizes policy and programme evaluation methods,
(vi) analyzes and evaluates budgets contributed by the government to Public Institutions.

It responds to requests for research and analysis from committees or members of the National Assembly..

Planning and Management Division: Provides all central support services to NABO's other divisions, including budget and finance, human resources, information resource management, facilities management, and library services.

One major difference between the NABO and other independent budget offices is that it undertakes audits of government programmes with respect to assessing its effectiveness and efficiencies. Its findings are used to recommend to the government options for change.

The Office for Budget Responsibility - United Kingdom

In May 2010, the Office for Budget Responsibility (OBR) was established as an interim body, primarily to provide independent assessments of the nation's finances and state of the economy for the June 2010 Budget. It presented a range of outcomes and assessed whether the government's policy was consistent with a better than 50 per cent chance of achieving. It was also charges with undertaking longer-term analysis of the impact of the ageing of the population, public service pensions and public finance initiative contracts on the sustainability of government finances. An inquiry is currently underway to determine whether the OBR should be made permanent.

There are two other bodies that support Parliament in reviewing expenditure, taxation and the operations of certain agencies:

The Scrutiny Unit (established in 2002) focuses on government expenditure and performance and examines draft spending bills. It does not cost government legislation but does undertake cost-benefit analysis of draft bills. The Unit supports selected committees and not individual members of Parliament. Most of the work undertaken is not made public. The Unit is small, consisting of only 18 employees. The Unit does not use outside experts.

There is also a **Treasury Committee**, which examines the expenditure, administration and policy of the Treasury, Revenue and Customs, Bank of England, Financial Services Authority, and other associated public bodies. It consists of 14 committee members and 9 staff. It uses outside advisors.

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