# 7 Fiscal governance

This chapter describes how OECD countries have incorporated fiscal management issues in their constitutions, studying the regulation of areas such as budget scope and timing, fiscal rules, legislative procedures, and independent fiscal institutions. It highlights how certain provisions can help ensure governments' adherence to high-level principles of financial prudence, transparency, and accountability. It analyses the potential benefits of enshrining such matters in constitutional terms, such as immutable standards by which the electorate can hold successive governments accountable, lower borrowing costs from reassuring financial markets of commitments to fiscal sustainability, and a more informed legislature to scrutinise fiscal policy. It also assesses the drawbacks, in particular, the fact that they can reduce a government's flexibility to respond to unexpected developments and to adapt the rules to new state-of-the-art practices.

## Key issues

Defining the budget practices of and constraints on the conduct of fiscal policy in the constitution can protect a country against financial mismanagement. As these laws cannot be easily altered, it is difficult for elected governments to circumvent the principles that their country has enshrined in its highest governing documents. However, fiscal rules are only rarely placed in constitutions and even when they are, the specific provisions are developed in further laws.

- *Financial management principles can be set constitutionally under several rubrics*, including budgeting form, procedures and fiscal frameworks – that is, the institutional coverage, the specific scope of revenues and expenses, whether the budget is presented on a ministerial or programme basis, and whether it must include medium-term planning, among other details.
- *Fiscal rules:* whether governments must run balanced budgets or conform to spending ceilings, and in which circumstances rules should be suspended.
- *The role of the legislature:* how control is split between houses in bicameral systems, whether they have the power to introduce amendments of their own, and at which level control is exercised (such as aggregate revenue and spending amounts, line items, ministry level or programme level, borrowing or debt limits).
- *Research support and independent monitoring and auditing bodies:* whether parliaments are guaranteed to have research support with adequate resources to assist oversight; whether independent fiscal institutions will be assigned to monitor and report on fiscal rules; the responsibilities of state audit institutions to scrutinise financial statements; and the powers of all to compel the government to provide information.
- Constraining a government's fiscal authority may also have drawbacks, such as restricting it from pursuing the optimal fiscal policy at a given time. Further, constraints can act against the principles of representative democracy, which would imply that a government with a strong electoral mandate would need to be free to manage fiscal policy according to the will of those who elected it.
- The choice of legal frameworks for setting fiscal policy can therefore involve striking a balance between fixed constitutional rules and more discretionary lower laws and procedures. Regardless of the balance struck, the ultimate constraint on fiscal governance is democratic accountability, which is strengthened by transparency with the legislature and the public.

## Introduction

The powers of legislatures and governments in the budget process vary across the OECD area. But responsible fiscal management continues to grapple with a state of ongoing tension between the two: legislatures authorise the raising of public funds and the ability to spend them, while governments decide exactly how to do so. The legal basis of a country's budget process and fiscal institutions is the playing field on which the tension manifests itself, and the outcome for these competitors ultimately determines the quality of public services.

Following the success of the institutional design of independent monetary policy, some countries looked to depoliticise fiscal policy by limiting the discretion of governments and enshrining principles of responsible fiscal management in law. Countries may indeed benefit from constraining the public purse to overcome public choice problems such as deficit bias, which can result from self-interested voters, competition

among political parties, or free ridership among the members of a common currency area. The legal mechanisms for tying the hands of government vary along a spectrum, from strict constitutional balanced budget rules to secondary regulations requiring medium-term forecasts in budget documents.

However, enshrining excessively detailed rules and procedures in the constitution constrains a government's authority to act in the interest of the public who granted them a democratic mandate, or to react to unexpected circumstances. While there may be benefits considering the big picture, constraints can prevent an optimal fiscal policy response at any one point in time.

Further, as has happened following the course of the global financial crisis and COVID-19 pandemic, a nation's attitudes, economic theory and public finance tools evolve over time and may outgrow the perspectives of a constitution's framers. Guardrails that are too restrictive can hold back the public good.

It is thus important to strike a balance between legal constraints and discretion. But regardless of the ultimate limits placed on a government's fiscal authority, if a country can succeed in enshrining principles of transparent budgeting in law, the benefits can be significant (Box 7.1).

### Box 7.1. Benefits of budget transparency

- *Accountability* – Clarity about the use of public funds is necessary so that public representatives and officials can be accountable for effectiveness and efficiency.
- *Integrity* – Public spending is vulnerable not only to waste and misuse, but also to fraud. "Sunlight is the best policy" for preventing corruption and maintaining high standards of integrity in the use of public funds.
- *Inclusiveness* – Budget decisions can profoundly affect the interests and living standards of different people and groups in society; transparency involves an informed and inclusive debate about budget policy impacts.
- *Trust* – An open and transparent budget process fosters trust in society that people's views and interests are respected and that public money is used well.
- *Quality* – Transparent and inclusive budgeting supports better fiscal outcomes and more responsive, impactful and equitable public policies.

Source: OECD (2002[1]), *OECD Best Practices for Budget Transparency*, https://www.oecd.org/gov/budgeting/best-practices-budget-transparency.htm (accessed on 15 April 2021).

The remainder of this chapter describes the issues involved in enshrining principles of good financial management in law, and why countries may choose strict constitutional law over lesser statutory and regulatory law or customs. The last section provides key options and questions to consider for each of the relevant elements, with an indication of how frequently these elements are addressed in constitutional law. Where possible it places the issues in the context of international budgeting practices across OECD countries from the Organisation's survey work. The chapter also draws upon relevant OECD principles and recommendations, in particular:

- OECD Best Practices for Budget Transparency (2002) and OECD Budget Transparency Toolkit (2017)
- OECD Recommendation on Budgetary Governance
- OECD Principles for Independent Fiscal Institutions.

The chapter is based on analysis of the constitutions of OECD member countries, primarily Australia, Finland, France, Germany, Korea, the Netherlands, New Zealand, Poland, Portugal, Spain and Switzerland.[1]

While cross-country studies can provide useful ideas and benchmarks, budget practices across the OECD area have evolved according to a range of legal, constitutional, institutional and cultural practices. Countries must determine and manage their national frameworks according to their specific circumstances.

## Brief overview of issues

### *Why define budget practices in law?*

Budgeting under constraints is rarely optimal in confronting a single set of circumstances, be it a financial crisis or a pandemic. But while governments should have flexibility to set their own fiscal agenda, there may be benefits to limiting fiscal discretion to guard against systemic failures of incentives to align with the public good. What are the motivations a government may have for giving up flexibility, and how should it decide whether to base constraints in the constitution or in other types of legislation (ordinary legislation, guidelines, government agreements, etc.)?

- *To establish routines and standards* – Schick (2010[2]) calls budgeting the "routinisation" of choice. Because national budgets deal with vast sums across many diverse policy areas run by a large machinery of government, it may be disruptive to public services and legislative oversight to allow newly formed governments to decide their own budget processes at the start of a legislative term. By creating a legal foundation for routines (such as calendar milestones) and standards (such as the scope of institutions covered by budget votes), countries can minimise disruptions to public services and oversight.
- *To encourage fiscal prudence* – Establishing clear institutional roles and defining constraints on elected governments can help avoid a wide range of biases leading to excessive deficits and procyclical fiscal policy. These include election gaming, where incumbent governments spend excessively to influence voters or to reduce the fiscal space of an incoming government, or the "common pool" problem, where beneficiaries of public funds are more organised and vocal than general taxpayers, particularly in the economic cycle's good times (Ayuso-i-Casals et al., 2007[3]).
- *To ensure adequate information for accountability through democratic mechanisms* – The legislative branch's role is to influence and oversee government policy. To do so, legislators require information on government programmes that may not be in a government's interest to provide. To ensure that elected representatives have the tools to do their job, constitutional and statutory law can set minimum requirements for contents of budgets, designate an independent monitoring body to ensure that the requirements are met, and grant legislators powers to compel governments to remedy insufficient transparency. Further, if elections – the ultimate accountability mechanism – are to reflect the will of the electorate, the public requires adequate information against which to judge governments, such as *ex ante* performance targets and *ex post* financial reporting, to confirm the government's performance.
- *To ensure that the legislature is adequately supported in scrutinising budgets* – Understanding national budgets requires a diverse set of technical skills and expertise in accounting, actuarial sciences, economics and law. Elected representatives and their staff come from a diverse range of backgrounds. Laws can provide for institutions to support legislators in using the information available to them. Most notably, these institutions include supreme audit institutions and independent fiscal institutions. By enshrining these institutions in law they can be protected from interference from the governing party, which may not wish to face the criticisms they bring. They also provide specialised expertise, whereas legislatures are generalist institutions in nature.

### *Why define budget practices in the constitution?*

In laying out mechanisms to establish routines and constraints on budgeting, countries must decide whether to use broad but strict constitutional provisions, narrower but more flexible financial management laws, or other internal rules and procedures.

Constitutional provisions are frequently used to clearly state that all public revenues and public expenditure shall be authorised through the annual budget. Some countries, such as Spain, also include the obligation to report tax expenditure: "The State budget shall be drafted annually and shall include the entire expenditure and income of the State public sector and specific mention shall be made to the amount of the fiscal benefits affecting State taxes" (Section 134).

Special laws are used to determine the organisation and operation of institutions, and are themselves determined by the constitution. In France for example, the constitution sets out the broad principles for the budget, but the detailed process and procedures of the budget are set in the "Organic Finance Law" (*Loi organique relative aux lois de finances*, LOLF), voted in 2001. This law is often referred to as the "financial constitution". In Poland, Article 219 of the constitution states, "The *Sejm* shall adopt the State budget for a fiscal year by means of a Budget. The principles of and procedure for preparation of a draft State Budget, the level of its detail and the requirements for a draft State Budget, as well as the principles of and procedure for implementation of the Budget, shall be specified by statute."

While the budget process may be defined in constitutional provisions or special laws, the annual budgets are usually ordinary laws. Ordinary laws are also the most common way to implement fiscal rules; they are used in 26 OECD member countries, although 8 of these also have constitutional provisions (OECD, 2019[4]).

Finally, internal rules and government (or coalition) agreements may also play an important role in setting the limits for budgetary processes and choices.

The motivation to enshrine budget laws under the constitution can be simple: a government with a strong majority can change statutory law as it wishes and rewrite its own fiscal constraints. Only by securing budget principles in the constitution will restrictions bind a government with strong popular support. OECD member countries tend to use constitutional provisions to set broad principles while leaving governments with flexibility for fiscal management, but governments are accountable to the election and ultimately constrained by democratic levers.

## Identifying issues to be included in constitutional law: Core features and considerations

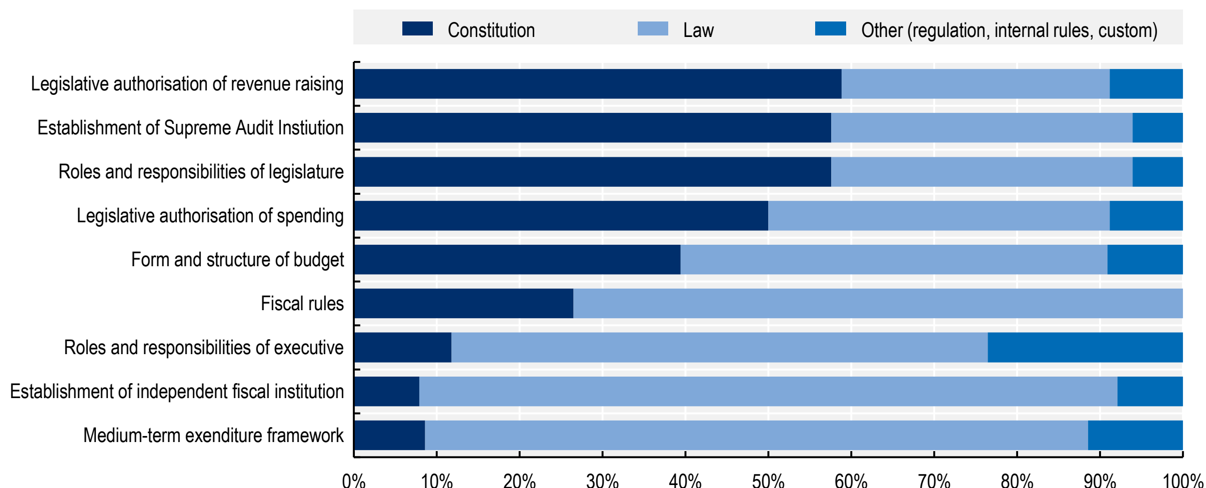
A country could enshrine fiscal management principles in constitutional law in the following broad areas:

- budgeting form, procedures and fiscal frameworks
- fiscal rules and borrowing authorities
- the role of the legislature
- research support and independent monitoring and auditing bodies.

The popularity of constitutional provisions in these areas among OECD countries is shown in Figure 7.1. The legislature's roles and establishment of supreme audit institutions are overwhelmingly established at the level of the constitution. Budget forms and procedures are generally set with statutory law. Fiscal rules enshrined in the constitution are in the minority (74% choosing statutory law instead), along with establishment of independent fiscal institutions.

**Figure 7.1. Legal basis for a selection of budgetary practices across OECD member countries**

Proportion of 34 countries responding to the survey




Source: OECD (2019[4]), *Budgeting and Public Expenditures in OECD Countries 2019*, OECD Publishing, Paris, https://doi.org/10.1787/9789264307957-en.

### *Budgeting form, procedures and fiscal frameworks*

#### *Budget structure and scope*

OECD countries use legislation to restrict governments to a general form of budget documents with minimum contents requirements. Some of these characteristics are enshrined in their constitutions.

*Periodicity of the budget* – The budgets of most countries cover one year; however, this is rarely stated in the constitutions. Exceptions include the constitution of Finland, which states that ”The Parliament decides on the State budget for one budgetary year at a time (Section 83)”, and the Constitution of the Kingdom of the Netherlands which states, “Bills containing general estimates shall be presented by or on behalf of the King every year on the date specified in Article 65 (Article 105)

*Scope of the budget* – Constitutional clauses stating that all government revenues and expenditures must be included in the budget are frequent, for example in Germany and Spain. Some countries such as Spain go as far as to require the disclosure of tax expenditures in their constitution. Other countries mention that the state budget should include the social security budget (this is the case for example in Portugal). Countries have also found it important to define whether government business enterprises are to be included in the consolidated government accounts.

*Structure of the budget* – The structure of the budget and basis for votes (line item, programme, by ministry, etc.) is usually set out in special or ordinary legislation, but can be described in the constitution. In Portugal for example, the constitution mandates that the budget shall be structured by programmes (Article 105). This is the only example among the countries analysed.

#### *Budget process*

OECD countries use a mix of laws to prescribe budget timetables, contingencies, etc. Some of these characteristics are enshrined in their constitutions.

*Budget calendar, roles and responsibilities* – The calendar for the budget cycle, from formulation to discussion and approval, are laid down in legislation. The important dates of the budget cycle are frequently

mentioned in the constitution. Several countries also describe in the constitution the roles and responsibilities of the executive and the legislative and the adoption process (for example Finland, Germany, Poland and Spain. Usually, the government submits a draft budget to the parliament, which examines it, amends it (see next section) and adopts it. Some countries state this in their constitution (e.g. Spain, Article 134). The constitution of Portugal also mentions that it is the responsibility of the executive to oversee the execution of the budget (Article 199).

The time given to Parliament to discuss, amend and adopt the budget is frequently stated in the Constitution. Many countries allow three months for parliamentary discussions (e.g. Poland, Spain). Some countries allow less time, while other countries such as Finland remain more vague: the Finish Constitution states that "the government proposal concerning the State budget…shall be submitted to the Parliament well in advance of the next budgetary year" (Article 349).

*Supplementary budgets* **–** Procedures for funding unexpected spending and emergencies should be prescribed by law. The use of supplementary budgets is in line with the OECD Best Practices for Budget Transparency, which advocates that new spending and significant changes to previously approved allocations should be authorised by parliament through supplementary budgets before spending occurs (OECD, 2002[1]). Some countries, such as Finland, Poland and Spain, describe the process for approving supplementary budgets in their constitutions. The Polish Constitution for example states, "In exceptional cases, the revenues and expenditures of the State for a period shorter than one year may be specified in an interim budget. The provisions relating to a draft State Budget shall apply, as appropriate, to a draft interim budget" (Article 219).

*Mandatory policy costing* – Some countries require any financial legislation to contain estimates of their fiscal impact, but these are rarely stated in constitutions. These estimates are intended to ensure that when the legislature considers bills, it has all the information necessary to assess the budgetary consequences of enacting that legislation.

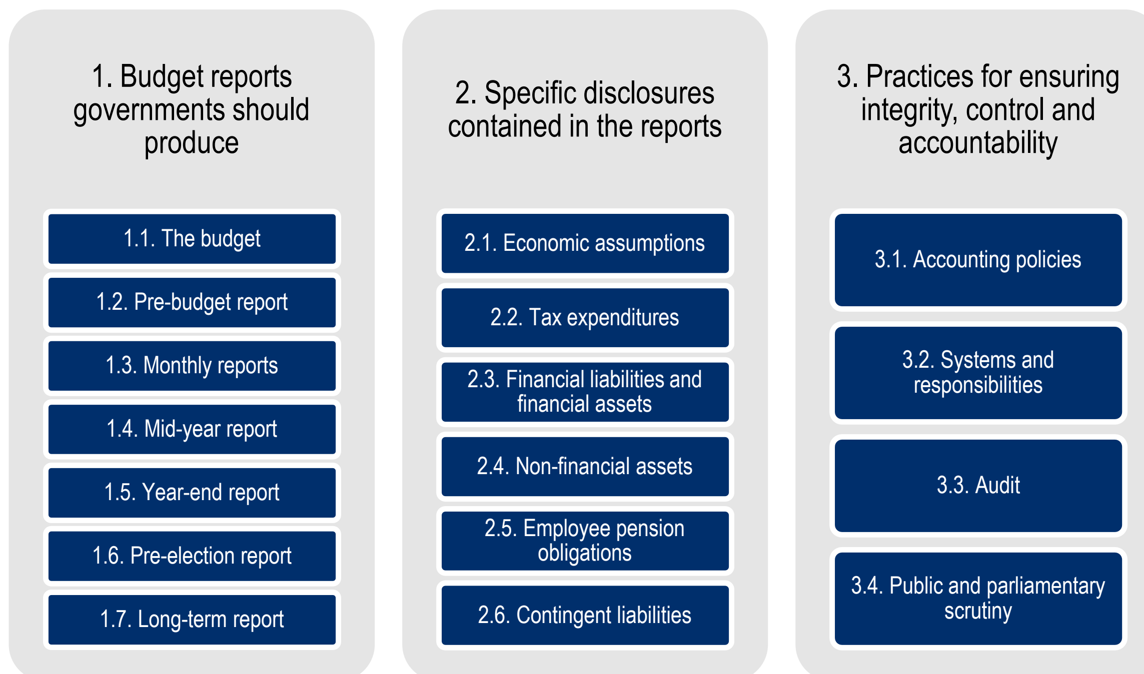
In Brazil, the New Fiscal Regime of 2015 created a requirement in statutory legislation for costings and cost-benefit analysis of new measures for a more informed budgetary debate. The United States has also made it mandatory that certain bills and resolutions approved by congressional committees contain a policy costing produced by the Congressional Budget Office. This requirement is enshrined in the Congressional Budget and Impoundment Control Act of 1974. In Iceland, all legislation must be assessed for its costs by the ministry of finance for bills initiated by government; and by parliamentary research staff for bills initiated by the legislature.

### *Budget transparency*

Budget transparency is defined as the full disclosure of all relevant fiscal information in a timely and systematic manner, to inform better scrutiny and decision making throughout the budget cycle (OECD, 2002[1]).

*Reporting requirements* – Across the OECD area, various laws describe the budget reports that governments must produce; the specific disclosures to be contained in the reports, including both financial and non-financial performance information; and practices for ensuring the quality and integrity of the reports. The OECD Best Practices for Budget Transparency (OECD, 2002[1]) and the OECD Budget Transparency Toolkit (OECD, 2017[5]) provide a reference tool to ensure budget transparency (Figure 7.2).

**Figure 7.2. Main reporting requirements described in OECD Best Practices for Budget Transparency**




Source: OECD (2002[1]), *OECD Best Practices for Budget Transparency*, https://www.oecd.org/gov/budgeting/best-practices-budget-transparency.htm (accessed on 15 April 2021).

In EU Member Countries, the European Semester and the Stability Programme define the minimum information that budget documents and mid-year or pre-budget financial updates must contain. Several countries mention in their constitutions the obligation to provide an account of all revenues, expenditures and debts incurred during the fiscal year (e.g. Germany, Finland, Poland, Portugal and the Netherlands). However, few countries provide a detailed list of reporting requirements in their constitutions – Portugal and Finland are exceptions. The Finnish Constitution provides a detailed list of budget transparency provisions, "in a way as to preclude the existence of secret appropriations and funds". In particular, the constitutions of these two countries require revenue forecasts to be justified.

#### *Contingencies and resolution mechanisms*

Constitutions often prescribe a process for ensuring continuity of government action when the parliament fails to approve a budget. In some cases, such as Spain, the previous year's budget is automatically enacted. In others, such as France and Germany the government may then authorise expenditure by decree. In Germany, the government can even borrow in order to cover committed expenditures. In other countries, the draft budget submitted is used. For example, in Poland, if the parliament (*Sejm*) fails to agree on a budget, the constitution states that the president may dismiss the legislature. However, not all countries analysed describe this process in their constitution: Australia, the Netherlands, New Zealand, Portugal and Switzerland do not have a constitutional clause to determine the actions to be taken when a budget is not voted before the beginning of the following fiscal year.

#### *Strategic plans and medium-term perspective*

*Multi-year strategic plans and medium-term budget frameworks* – Governments in nearly all OECD member countries prepare multi-year strategic plans beyond the annual appropriations cycle. For example,

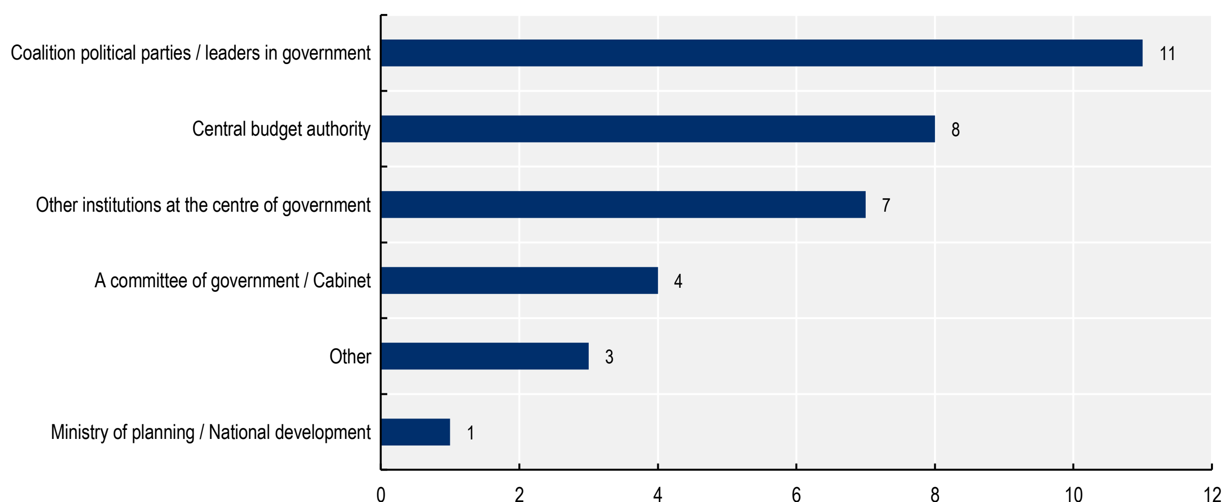
only three countries of 34 respondents to the OECD's latest Budget Practices and Procedures Survey reported that they do not make use of medium-term expenditure frameworks: Belgium, Mexico and Norway (OECD, 2019[4]). These medium-term frameworks typically include rolling forecasts of the main fiscal aggregates and detailed expenditure plans for the next three to five years, so that national priorities can be compared with available resources. Medium-term objectives and adjustment paths are a key component of EU stability and convergence programmes.

Only 10% of OECD countries define requirements for medium-term strategic plans in the constitution (OECD, 2019[4]). The vast majority (80%) define it in statutes or other non-constitutional procedures. The strategic plans can take several forms, such as three- to five-year medium-term fiscal frameworks or medium-term expenditure frameworks, but most commonly they are in some form of medium-term expenditure ceiling.

Figure 7.3 shows the breakdown of institutions that OECD member countries have designated to be responsible for medium-term strategic documents according to the OECD's Budget Practices and Procedures Survey. It is common (11 of 34 respondents) for strategic plans to be left to the responsibility of governing parties, which typically formalise a plan as part of government formation and submit it to the legislature (usually in countries where coalitions are the norm). It is also popular among countries to require that the central budget authority (for example, the ministry of finance) prepare strategic planning documents (8 of 34 respondents). Elsewhere, strategic planning is the responsibility of committees (4 of 34 respondents). In Poland, a separate Ministry of Development produces medium-term planning.

### Figure 7.3. Institution responsible for medium-term strategic planning

Number of countries among the 34 responding to the survey




Source: OECD (2019[4]), *Budgeting and Public Expenditures in OECD Countries 2019*, OECD Publishing, Paris, https://doi.org/10.1787/9789264307957-en.

Although in Canada the medium-term strategic planning document has become synonymous with the budget, Canada has no requirement that such a document be presented to the parliament. Instead, statutes prescribe that only an appropriation act (Main Estimates) and any other appropriation acts (Supplementary Estimates) must be presented to the parliament.

*Long-term anchors* – Budget frameworks often include fiscal anchors beyond medium-term strategic plans, such as ensuring debt solvency over several projected decades and accounting for the healthcare and pension liabilities of an ageing population. Although summary statistics are not available, observations

from the OECD Senior Budget Officials networks, which include five regional networks and six associated networks, suggest that these long-term anchors are increasingly being enshrined in legislation and incorporated into supranational frameworks such as the European Commission's multidimensional surveillance approach for the euro area. The Commission uses an "S1 indicator" that shows the upfront adjustment effort required to ensure a country's debt-to-GDP ratio is below 60% ten years in the future, and an "S2 indicator" that shows the adjustment to the current structural primary balance required to fulfil the infinite horizon inter-temporal budget constraint.

## *Fiscal rules*

### *Rationale for introducing fiscal rules*

Setting fiscal rules such as balanced budget laws and expenditure ceilings in constitutions or statutory legislation can act against deficit bias and fiscal complacency. Deficit bias refers to structural deficits (unexplained by tax smoothing or the economic cycle) that arise when government agents face incentives to overspend. Deficit bias is explained by public choice theories related to the following, among others:

- *Intergeneration redistribution* creates excessive deficits because current taxpayers can vote for their preferred policy outcome, while future generations of taxpayers cannot.
- *Fiscal illusion* arises because voters do not fully understand the trade-off between current spending and future fiscal burdens, and do not always see the true individual costs and benefits of the public services they receive.
- *Competition among political agents* arises because uncertainty about the outcome of elections means governments in power do not fully internalise the cost of debt, which may be passed on to successive governments.
- *The free rider problem* arises in the governments of countries that are part of a currency area and can take advantage of the responsible fiscal governance of other member states in protecting their currency and access to capital markets.

Fiscal rules with a legal basis have grown considerably over the past decade, having been established in 29 OECD member countries. All OECD countries in the euro area (along with Denmark) are also bound by the EU Fiscal Compact.[2]

Poterba (1997[6]) suggested two mechanisms through which fiscal rules affect fiscal outcomes:

- They provide an objective benchmark for legislators, media and the public to assess the government's performance, raising the reputation and electoral costs of fiscal mismanagement.
- Fiscal rules, particularly those with automatic enforcement mechanisms, allow policy makers to deflect the political repercussions of austerity to the budget law.

Fiscal rules, whether legislated in the constitution or in lower law, typically contain escape clauses for exceptional circumstances such as severe recession or natural disasters. This is the case for example in Germany, Spain and Switzerland.

### *Legal basis for fiscal rules*

*Constitutions* – Because statutory legislation may be changed at any time by a majority government with strong support, implementing fiscal rules in strict constitutional provisions would more firmly bind a government's hands against financial mismanagement. Of the 34 respondents to the OECD's Budgeting Practices and Procedures Survey, nine reported including specific fiscal rules in their constitutions. These include Germany, Hungary, Italy, Mexico, Poland, Slovenia, Spain, and Switzerland. For example, the German Constitution states that "the budgets of the Federation and the *Länder* shall in principle be balanced without revenue from credits" (Article 109). In Poland, the constitution states that "it shall be

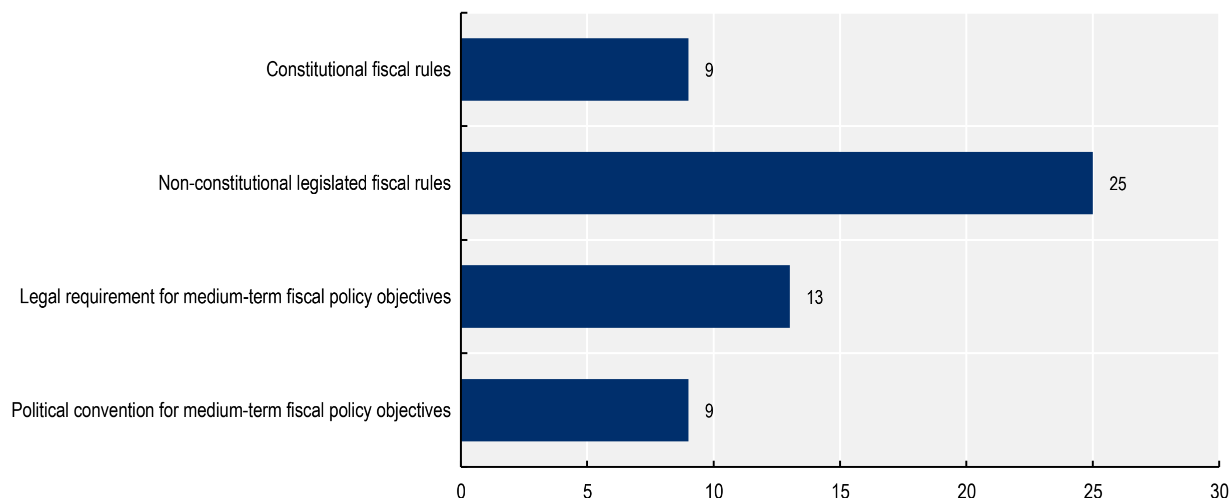
neither permissible to contract loans nor provide guarantees and financial sureties which would engender a national public debt exceeding three-fifths of the value of the annual gross domestic product" (Article 216). In the United States, while there are no national fiscal rules, the vast majority of states have implemented balanced budget requirements through their state's constitutions. Only one country (Slovenia) relies solely on constitutional provisions for fiscal rules, with most preferring to prescribe details in statutory law (OECD, 2019[4]).

*Primary and secondary laws* – The most common way to implement fiscal rules, reported by 25 of 34 respondents to the OECD's Budget Practices and Procedures Survey, is through statutory law (Figure 7.4). The Spanish Constitution for example mentions that an organic act shall develop the principles referred to in the constitution; in particular the distribution of deficit and borrowing limits between different public administrations, the methodology and procedure for calculating structural deficits, and the consequences in case the rules are breached (Article 135).

*Procedural rules and political agreements* – Other countries have implemented fiscal rules only through procedural rules or conventions, such as requirements to establish medium-term fiscal objectives that are not in themselves legally binding, but are a form of mandatory transparency to strengthen political accountability (Figure 7.4). Of these, 13 respondents reported legislative requirements for governments to formulate medium-term fiscal objectives, while nine respondents reported political conventions. For example, the Charter of Budget Honesty (1998) in Australia requires the government to regularly publish fiscal targets consistent with the balanced budgets over the economic cycle, encouraging but not requiring them. Similarly, the *Budget Responsibility and National Audit Act, 2011* in the United Kingdom requires the government through HM Treasury to prepare a Charter for Budget Responsibility that explicitly lays out its objectives for fiscal policy and national debt.

## Figure 7.4. Legal basis for fiscal rules

Number of countries among the 34 responding to the survey




Source: OECD (2019[4]), *Budgeting and Public Expenditures in OECD Countries 2019*, OECD Publishing, Paris, https://doi.org/10.1787/9789264307957-en.

### *Evidence and experience of legal provisions for fiscal rules*

To prepare for fiscal adjustments following the COVID-19 pandemic, the OECD has begun a programme to empirically assess the relative merits of a wide range of fiscal practices and institutions, including fiscal rules. In the meantime, recent studies such as Caselli and Reynaud (2019[7]), who estimated the causal

effect of fiscal rules on fiscal balances in a panel of 142 countries over the period 1985-2015, and met-analysis such as Heinemann, Moessinger and Yeter (2018[8]) suggest that if empirical assessments adequately control for other influencing factors, there is little to no statistically significant impact of fiscal rules on fiscal balances. That said, the same studies and others such as Eyraud et al. (2018[9]) show that more granular analyses of specific country cases suggest that design features such as broad institutional coverage, ease of understanding and monitoring, and clauses to support countercyclical fiscal policy can make fiscal rules more effective.

Some notable case studies among OECD countries include the Czech Republic, which introduced a debt brake in 2016 that required budget cuts when national debt passes 55% of GDP. However, initially the legislation was intended to place the restriction in the constitution, which would have required any future amendments to be approved by three-fifths of members of the lower and upper houses. The constitutional amendment was rejected in favour of introducing the same requirements under statutory law. Germany's constitutional debt brake at the state level forbids them from taking on additional debt. This has faced criticisms for not considering that they do not have tax autonomy and that it limits scope for large investments (Kirchgassner, 2017[10]).

## *The role of the legislature*

### *Limits to parliament's capacity to amend the budget*

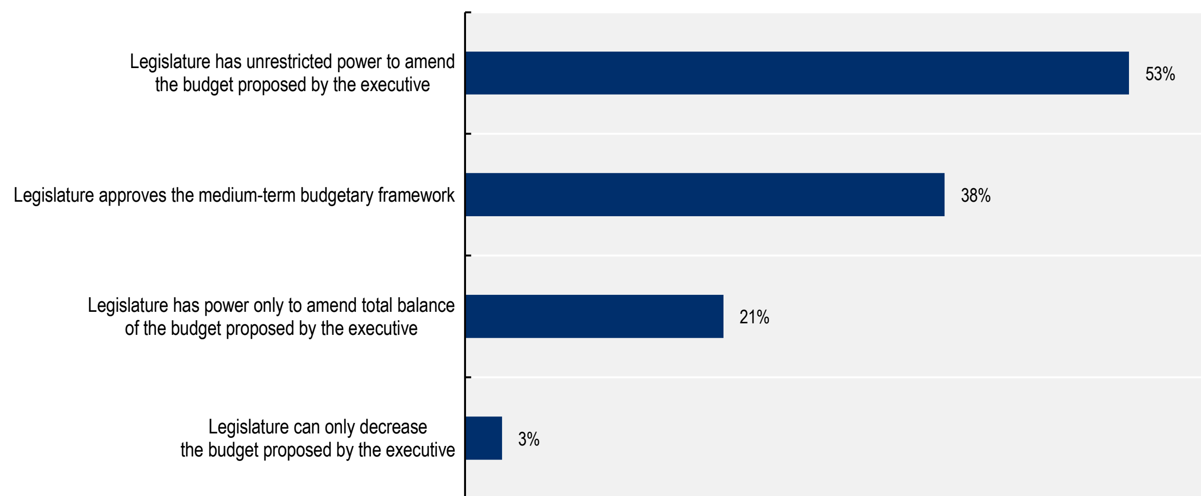
An effective budgetary role for the legislature is crucial for transparency, inclusiveness and democratic accountability. The OECD Principles on Budgetary Governance state that legislators, as representatives of the public, should have the opportunity to provide input to the budgets and financial measures to ensure that fiscal policy is consistent with the will of the public, while ensuring fiscal sustainability.

OECD country legislatures are subject to a range of different legal frameworks, procedures, customs and traditions. The scope of legislative activity varies most significantly between presidential systems and parliamentary systems. At one end of the spectrum of influence, the US Congress can redraft the president's budget proposal and actively does so. At the other end, the legislature in parliamentary systems typically has little engagement during budget approval and no formal amendment powers. The restriction most frequently found is that the legislature cannot increase the deficit (i.e. can reallocate expenditures, but can neither increase total expenditures, nor decrease total revenues).

While legislatures in all OECD countries have a role in authorising public expenditures and revenue-raising (Figure 7.5), roughly half have the power to amend budgets though these are not widely exercised. Generally there is a trend of growing legislative oversight responsibilities for budget matters.

### Figure 7.5. Role of legislatures in the budget process

Proportion of 34 countries responding to the survey




Source: OECD (2019[4]), *Budgeting and Public Expenditures in OECD Countries 2019*, OECD Publishing, Paris, https://doi.org/10.1787/9789264307957-en.

These restrictions are usually found in statutory legislation, but in some countries they are described in the constitution (Table 7.1). For example, in France the constitution states that "Private Members' Bills and amendments introduced by Members of Parliament shall not be admissible where their enactment would result in either a diminution of public revenue or the creation or increase of any public expenditure" (Article 40).

### Table 7.1. Comparative perspective: Types of constitutional restrictions on the capacity of parliament to amend the budget

| No restrictions mentioned in the constitution | Cannot make any change to the proposed budget | Can decrease proposed expenditures | Can amend the budget but not increase total expenditure, decrease revenues or increase deficit | Can amend the budget but requires government approval to do so |
|---|---|---|---|---|
| Australia | | | Poland | Germany |
| Finland | | | Portugal | |
| Netherlands | | | France | |
| New Zealand | | | | |
| Spain | | | | |
| Switzerland | | | | |

Source: Authors, based on analysis of constitutions consulted on www.constituteproject.org.

#### Authorising taxation and debt

*Authorising taxation and debt* are typically prerogatives of the legislature, and these are clearly stated in the constitution in many countries. Regarding debt, the Finnish Constitution mentions that "the incurrence of State debt shall be based on the consent of the Parliament, which indicates the maximum level of new debt or the total level of State debt" (Section 82).

### Governance issues

*Primacy of the executive branch versus the legislative branch in budget matters* – Constitutions or primary legislation typically describes which branch of government has ultimate authority over fiscal policy. Some legislatures are given considerable power over financial management by constitutions, although this is rare. In Poland, if the legislature (the Sejm) fails to pass the budget, the president of the Republic may order the shortening of the Sejm's term of office (Article 225).

*Control over specific budget totals or line items* – Laws also describe which budget amounts require legislative approval, by granting responsibility for approving fiscal aggregates (the budget balance, total spending, total debt, etc.), programme-based amounts, allocations at the ministry or department level, or individual line items.

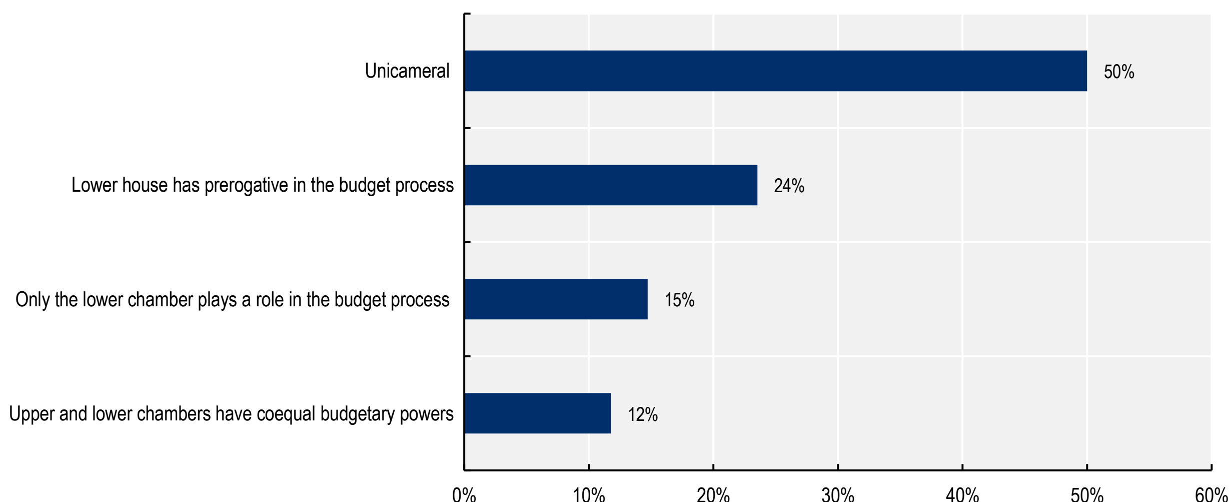
*Role for committees* – Budget and audit committees and sectoral committees play a vital role in scrutinising budget documents and fiscal plans. A country's constitution often provides for the existence of standing committees and investigative committees, whose specific functions and operations are later laid down by a chamber's rules of procedures. For example, the constitution of Finland dictates that for purposes of supervising the state finances and compliance with state budget law, the parliament "shall have an Audit Committee" that "shall report any significant supervisory findings to the Parliament" (Section 90).

Some constitutions contain provisions for making the legislature's committee meetings open to the public (for example, the constitution of Sweden).

*Role of each chamber* – Only two countries describe the respective roles of each chamber in financial matters in their constitutions, Austria and Switzerland (Figure 7.6). Half of the OECD countries are unicameral. In legislatures with two chambers, the lower chamber is most often given ultimate say in financial matters, playing the sole role in 15% of legislatures. Upper chambers tend to have a much shorter period to debate the budget, and often do not have the right to amend or reject budget bills. Only 12% of OECD legislatures grant coequal power over financial matters to upper and lower chambers (Figure 7.6).

## Figure 7.6. Role of each chamber in the budget process

Proportion of 34 countries responding to the survey



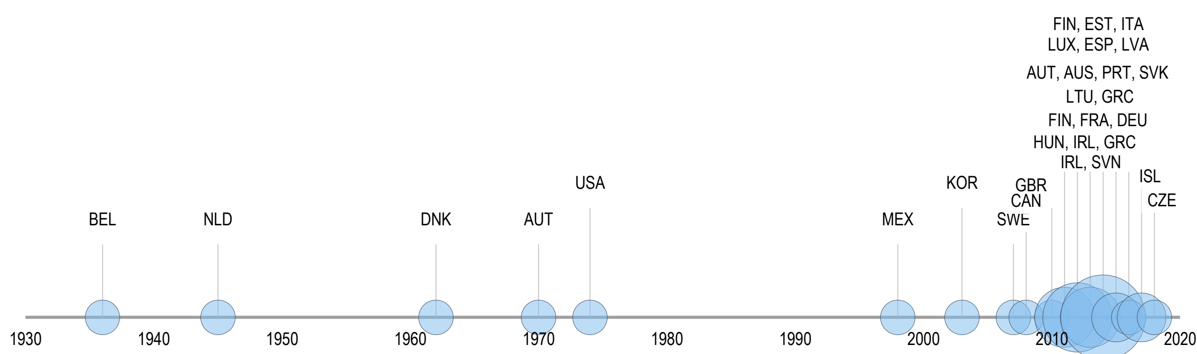

Source: OECD (2019[4]), *Budgeting and Public Expenditures in OECD Countries 2019*, OECD Publishing, Paris, https://doi.org/10.1787/9789264307957-en.

Even with these legal authorisations, conventions tend to play a larger role. For example, some legislatures have a history of introducing a large number of amendments to tax legislation and adjustments to expenditure proposals despite having executive branch primacy defined in constitutions.

### *Research support and independent monitoring and auditing bodies*

There is a growing trend across OECD countries to empower legislatures with research resources and to create independent monitoring bodies to hold governments accountable for their fiscal policy choices. These include budget scrutiny units and independent fiscal institutions (fiscal councils and parliamentary budget offices) that scrutinise budget bills and high-level fiscal issues, primarily before funds are spent. These bodies complement well-established supreme audit authorities that ensure the accuracy of financial statements and do a wide range of *ex post* financial and performance auditing.

## Figure 7.7. Independent fiscal monitoring bodies have rapidly increased in popularity




Note: Timeline shows the creation of Independent Fiscal Institutions, with bubble size increasing proportionately in years with multiple institutions.
Source: OECD Independent Fiscal Institutions Database 2019.

As with other budget procedures and institutional design, research, monitoring and auditing institutions are established under a variety of constitutional and legal forms.

#### *Specialised research services or staff*

Over a third of OECD area legislatures that responded to the OECD's Budget Practices and Procedures Survey reported having a specialised unit for budget analysis, usually placed within their wider research services (OECD, 2019[4]). These units typically have around a staff of 10, although they range from as low as 2 in Spain to 40 in Turkey. The UK House of Commons Scrutiny Unit has 14 staff and supports departmental select committees in undertaking systematic reviews of the main and supplementary estimates, departmental annual reports and accounts, settlements and budget statements among other activities. Some legislatures do not have a specialised unit but report having a small number of specialised staff within their broader legislative research services that provide budget analysis. This is the case in Canada, the Czech Republic, Estonia, Latvia and Norway.

Aggregate data on the legislative basis of research services across the OECD area is not available; however, a desk review of participants in the OECD Network of Parliamentary Budget Officials and Independent Fiscal Institutions suggests that the services are not enshrined in constitutions but rather are provided for under statutory law or through the standing orders of the legislature. For example, in Canada the Library of Parliament's leadership, salaries, staff and duties are established in primary legislation as a section of the Parliament of Canada Act.

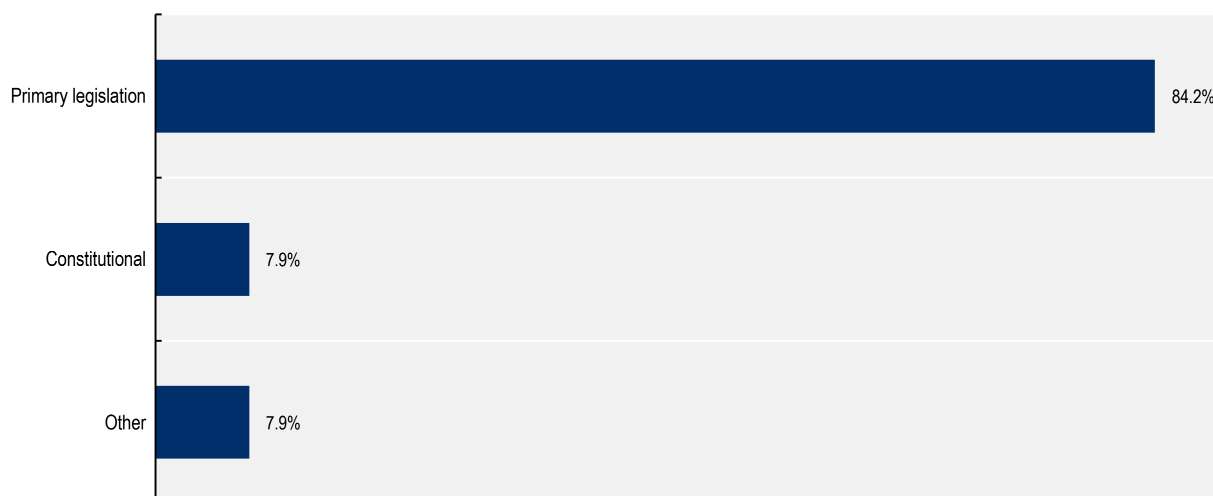
*Independent monitoring of fiscal policy*

Independent fiscal institutions (IFIs) have been established across the OECD area to provide independent analysis of fiscal policy and to promote fiscal transparency, sound fiscal policy and sustainable public finances. They take one of two forms: 1) independent parliamentary budget offices (PBOs), typically attached to the legislature with a single designated leader, and 2) fiscal councils, independent from the legislature and government and headed by a panel of several appointees with a chair.

Core functions across IFIs vary, but they commonly include producing, assessing and/or endorsing macroeconomic and fiscal forecasts; monitoring compliance with fiscal rules; policy costing; long-term fiscal sustainability analysis; and supporting the legislature in budget analysis.

The overwhelming majority of IFIs (84.2%) have been established in primary legislation (Figure 7.8). However, some countries that faced particular financial management challenges in the past chose to provide for greater protections for their IFIs in national constitutions. These include Hungary, Lithuania and the Slovak Republic (Box 7.2). Austria established its Parliamentary Budget Office through procedures of the legislature as part of an agreement among parties. The Swedish Fiscal Council was established with secondary legislation.

## Figure 7.8. Legislative basis for independent fiscal institutions




Note: Proportion of total IFIs in OECD countries.
Source: *OECD Survey of Independent Fiscal Institutions* (forthcoming).

The OECD Principles for Independent Fiscal Institutions identify several key design features for IFIs that should be enshrined in legislation, including their independence and non-partisanship, transparency requirements, and freedom to communicate with the public. For example, legislation should prescribe that the institution be separate from the executive branch and contain provisions to ensure that leaders are appointed and dismissed in a nonpartisan manner and that the institution's ongoing resources are protected.

Importantly, IFI access to information should be guaranteed in legislation. This should describe in detail the body's powers to compel information on methodology and assumptions underlying the budget and other fiscal proposals. Legislation should also specify any restrictions on access to information and mechanisms for redress if government departments fail to comply with information requests.

### Box 7.2. Legal frameworks underpinning independent fiscal institutions

**Korea**

The Korean National Assembly Budget Office is underpinned by two pieces of legislation. First, the National Assembly Act 1948 was amended in July 2003 to provide for NABO autonomy within the National Assembly. The National Assembly Budget Office Act, also adopted in July 2003, elaborates on the duties and organisational arrangements for NABO (von Trapp, Lienert and Wehner, 2016[11]).

**Mexico**

The Mexican *Centro de Estudios de las Finanzas Públicas* was established by congressional agreement in April 1998 and formally recognised in the Organic Law of Congress in September 1999 as one of the five study centres serving the congress.

**Hungary**

A fiscal council was initially set up as part of the Fiscal Responsibility Law passed in 2008. In 2011 a new fiscal council was established, legally separate from the first fiscal council. The new council became embedded in the Hungarian Constitution as part of constitutional reforms. Further reforms in 2013 linked the fiscal council operationally to the National Assembly. Hungary's Fiscal Council has veto power, which can stop the legislative process of the budget at its final vote in case of serious breach of the debt reduction rule (government debt-to-GDP ratio should not exceed 60%; if it does, it must be reduced).

**Lithuania**

The constitution references a budget policy monitoring authority to fulfil certain functions, although it is not named or established. The National Audit Office has been selected to fulfil the functions with its Budget Policy Monitoring Department, as laid out in the Republic of Lithuania Law on National Audit Office. The functions are established by the constitution.

**Slovak Republic**

The Slovak Council for Budget Responsibility (CBR) was established through Constitutional Act No. 493/2011 on Budgetary Responsibility, which received approval on 8 December 2011.

#### *Independent auditing of financial statements and performance*

All OECD countries have an independent supreme audit institution (SAI) as one of the fundamental links in their budget accountability chain. SAIs are established by the constitution in 23 countries and in primary legislation in 7 countries.

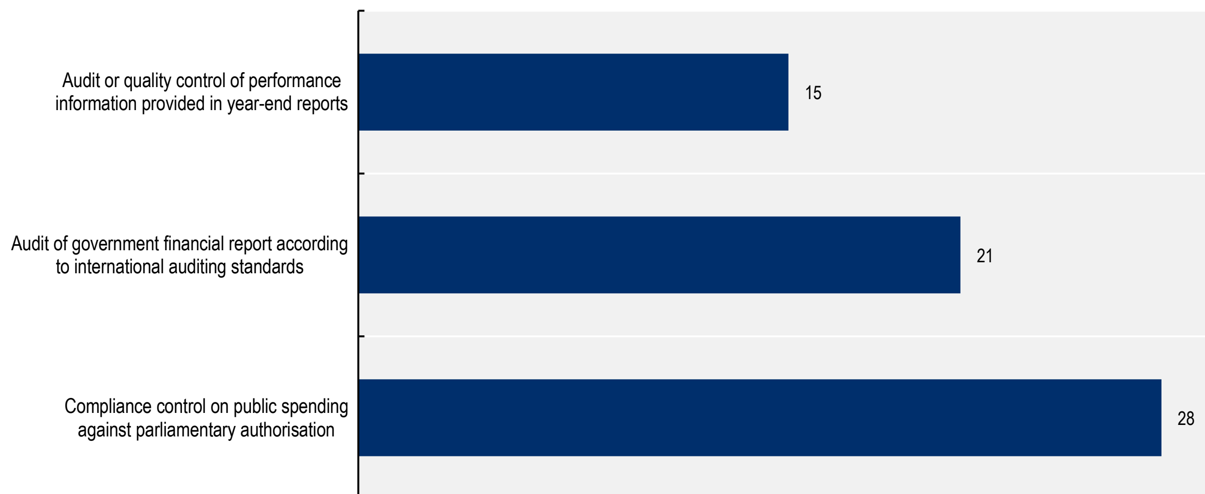
Laws may place SAIs under the legislative branch or the executive branch of government, or they may declare the office independent of both. In Latin America, constitutional reforms are increasingly prescribing the duties of SAIs under a new branch of power (beyond legislative, executive and judiciary), listed as bodies of control or citizen representation. SAIs that function independently from the legislative branch nonetheless direct most of their analysis at a legislative audience, and will respond to questions submitted from legislators and committees. The power of SAIs to compel governments to provide information is generally very strong and enshrined in statutory legislation.

The OECD has not conducted empirical assessments of the impact of SAIs on fiscal policy administration and sustainability; however, observations from the OECD Senior Budget Officials networks suggest that

their influence is expanding beyond simply monitoring compliance with controls on public expenditure and accounting conventions towards broader evaluation of the performance of government programmes. Fifteen OECD countries report that their SAI reviews performance information (Figure 7.9).

### Figure 7.9. Activities of Supreme Audit Institutions across the OECD

Proportion of 34 countries responding to the survey




Source: OECD (2019[4]), *Budgeting and Public Expenditures in OECD Countries 2019*, OECD Publishing, Paris, https://doi.org/10.1787/9789264307957-en.

## Key options and questions to consider

Good fiscal management thrives when the budget cycle and the role of the legislature are put on a strong legal footing, be it constitutional, statutory or otherwise. The legal basis for budget practices varies across OECD member countries along a spectrum of constitutional and statutory frameworks, and each country must take into consideration country-specific circumstances. In general, countries with strong fiscal management laws prescribe only high-level financial management principles in the constitution while creating requirements for governments to be explicit and transparent in their budget plans. Even in countries with strict attitudes toward fiscal discipline, governments are given significant leeway to exercise their democratic mandate to manage the public finances as they see fit in statutory law.

The key options to consider when deciding whether to constitutionalise a budgeting and financial oversight framework are presented below, together with an indication of how frequently these elements are enshrined in the constitution in benchmark countries.

### *Budgeting form, procedures and fiscal frameworks*

Prescribing specific budget forms, procedures and frameworks in the constitution can level the playing field between different government branches by ensuring they cannot change the standards by which they govern public finances or the amount of disclosure they provide to the legislature and public. It can also reduce political gamesmanship – for example, a constitutional provision that automatically approves the previous year's budget if an agreement cannot be achieved prevents "fiscal cliff" type negotiations. Constitutional provisions can also lead to policy that is more aligned with the public interest, for example

by forcing medium-term and long-term planning beyond the political cycle and guaranteeing high levels of transparency, which increases democratic participation and pressure.

On the other hand, constitutional amendments may require lengthy processes and very high thresholds of political support. Including budget forms, procedures and frameworks in the constitution can greatly constrain a government's flexibility in a crisis compared to lower legislation, which can be more easily adjusted. For example, a provision forbidding a government from seeking mid-year increases in appropriations except for a schedule of natural disasters such as earthquakes and floods may not have been able to adequately respond to the COVID-19 pandemic. Governments with budget submission and approval procedures set only in statutory legislation or parliamentary standing orders were able to temporarily suspend debate and committee scrutiny requirements to push emergency pandemic legislation through the approval process in a matter of days, rather than the usual weeks or months. Further, accounting standards and best practices are constantly evolving and innovations in the machinery of government are frequent. If these details (beyond high-level principles) are set in constitutions, there is a risk for them to quickly be out of date and the necessary amendments could require years and costly national referendums to approve. With these caveats in sight, the following aspects may need to be considered when defining the budget form and framework:

1. *The budget's timing* – Whether public finances are to be set annually, and by calendar year or an alternative financial year, and prescriptions such as the minimum number of days or weeks that a budget must be provided to the legislature before it votes. Few countries (only two) explicitly state that the budget should be *annual*, but the budget scope and calendar are frequently described in the constitution.
2. *The budget's structure, contents and transparency* – The specific control mechanism of legislative votes, for example line budgeting versus programme budgeting, as well as the reporting requirements and minimum information criteria. Whether bills with financial consequences must be submitted with an estimate of their fiscal impact provided by legislative staff, the public service, or an independent fiscal institution. Only one benchmark country states in the constitution that the budget should be structured by programmes. Transparency requirements are frequently mentioned in the constitution as broad principles, but precise requirements are rarely described in the constitutions. Only one country requires mandatory costing of policies in the constitution.
3. *Contingencies* – What should be done in case the legislature and executive cannot reach an agreement to pass the budget. The one from the previous year may automatically be adopted; continuing appropriations may be provided until a budget is adopted; the budget of the government may be brought into force by ordinance; or the legislature may be dissolved (that is, the budget may be a confidence vote). Contingencies and resolution mechanisms are frequently described in the constitution.
4. *In-year adjustments* – What should be done in case unexpected expenses arise. A fixed number of opportunities and dates to submit supplementary budgets may be prescribed, or adjustments may be unlimited and at the government's discretion. Supplementary budgets may be allowed to raise borrowing ceilings, or they may only permit reallocation among spending programmes. About half the benchmark countries describe the process for in-year budgetary adjustments in their constitution.

## *Fiscal rules*

1. *Fiscal rules* – Whether to set specific requirements a government must meet in planning or realising fiscal aggregates such as the budget balance or total spending. Specific rules may be defined or governments may simply be compelled to clearly indicate their fiscal management targets. Specific adjustment mechanisms may be described in case the rules are not met. Prescribing fiscal rules in the constitution sharpens their teeth, ensuring that governments cannot simply sidestep them with a simple majority when they prove inconvenient. Constitutional rules demonstrate a country's commitment to sound economic and fiscal policy, which can possibly increase the attractiveness of the country's borrowing instruments in international financial markets and reduce borrowing costs.
2. *Exceptions* – Real and financial shocks are unpredictable and all contingencies cannot be planned for under a constitutional rule framework. If rules cannot be readily changed by the government, that can limit the flexibility of policy makers in responding to different economic and political challenges. In this regard, having clear escape clauses together with the fiscal rules is essential. Monitoring constitutional provisions may also require new statistical tools and changes in institutions. Under which circumstances (natural disaster, economic crisis) are rules set aside and by how much can budget aggregates vary? Few countries mention escape clauses to their fiscal rules in their constitutions. Achieving the right balance between stringency of the rule and flexibility is very difficult, and may require a process of trial and error. Optimal fiscal rule design and targets may also depend on broad macroeconomic trends (such as the level of inflation or interest rates), and committing to a very detailed description of the fiscal rule in the constitution may not allow for such adaptation.
3. *Monitoring* – Whether an official arbiter of fiscal rules is named. This role may be given to an existing body, or the law may create a new one, be it an IFI (fiscal council or PBO model), SAI, legislature, or international organisation. Its degree of independence from the legislature and executive may be prescribed. Supreme audit institutions and their relation to the legislature and executive are frequently mentioned in constitutions.

## *The role of the legislature*

Ensuring that the legislature's role in budget practice is clearly defined in the constitution and is unable to be changed by a simple majority government of the day supports the fundamental democratic checks and balances envisioned in the separation of powers in most OECD countries. Constitutions that require budgets to be reviewed in detail and authorised by the elected representatives of the public and their committees ensure that fiscal policy is generally consistent with the will of the public. However, legislative oversight can be time-consuming, and strict requirements can tie the government's hands in a crisis. Constitutional provisions can also interfere with some interpretations of democratic principles that view each new parliament as having the right to set its own rules and procedures to govern itself. Keeping in mind these trade-offs, the following aspects ought to be analysed:

1. *The legislature's control* – How are budgetary powers split between the upper and lower chambers – do both chambers play a role, does the lower house have prerogative, or is the lower chamber solely responsible? Whether the legislature must approve increases in taxes or debt, and which definition of debt to use. Very few countries detail the specific role of each chamber in budget matters in the constitution.
2. *The legislature's control levers* – What is the basis of voted appropriations: fiscal aggregates, ministry allocations or programme line items, etc. Does the legislature vote on the medium-term budget framework? The legislature may debate and vote, it may hold debates but not vote, or it may neither vote nor debate. The capacity of the legislature to amend the budget and the restrictions faced in doing so are frequently described in the constitution.

3. *The legislature's oversight workflow* – Whether committees are chaired by the government or opposition, whether only budget committees scrutinise financial plans versus sectoral committees. Openness of debates to the public. This is rarely mentioned in the constitution.

### *Research support and independent monitoring and auditing bodies*

Empowering legislatures with research support through the constitution and creating strict constitutional institutions to independently monitor fiscal policy and audit financial statements can improve democratic oversight and create better fiscal outcomes through transparency, expert guidance and the creation of a political cost and strong disincentive against public finance mismanagement, dishonesty and corruption. Despite these potential benefits, constitutionally empowered independent institutions led by unelected officials can be seen to potentially undermine democratic principles of representative and accountable government if they wield too much authority over fiscal policy levers. The appropriate economic and fiscal policy for a country's circumstances may largely be a subjective question, best left to be determined by elected politicians with democratic mandates.

A constitution can thus regulate whether decisions regarding institutions to support oversight are left to parliaments on an ad hoc basis through internal procedures and standing orders, including whether they are funded out of the general parliament budget or whether they are given explicit guaranteed institutional support. Resources for supported institutions may be protected in legislation. The details of how leadership of the institutions is appointed may be prescribed. Access to information may be guaranteed. Placement among existing institutions or as a separate legal entity may be defined. While several OECD countries describe institutional support in their constitution, none of the benchmark countries do.

Regardless of the legal basis for budget processes and fiscal institutions, much of the ultimate success of fiscal frameworks comes instead from a country's norms and the oversight culture that has developed. A culture of responsible fiscal management can be fostered not only by ensuring that legislatures have the necessary information and support to fulfil their roles, but also by practicing principles of good budgeting and financial oversight in all that public bodies do.

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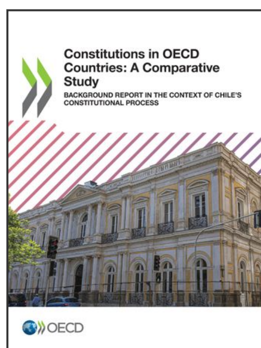
## Notes

[1] Constitutions were retrieved from national legal databases and the resources provided by constituteproject.org.

[2] Treaty on Stability, Coordination and Governance in the Economic and Monetary Union, Council of the European Union.

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