PRINCIPLES FOR GOOD GOVERNANCE OF PUBLIC FINANCE[1]

Under the Russian presidency of the Group of Eight, the Ministry of Finance of the Russian Federation launched an initiative to raise the profile of international efforts to encourage good governance of public finance.

This paper considers the key issues involved and the work done up to now to disseminate and apply best practice in management of public finances, and discusses the need for further work and the main areas for continuing work with the aim of improving mutual financial security and creating more favourable conditions for sustainable growth worldwide.

Section 1 provided the basis for the document presented by A.L Kudrin, Minister of Finance of the Russian Federation, at the meeting of G8 Ministers of Finance in St. Petersburg on 9-10 June 2006. It was discussed in an outreach session attended by the invited Finance Ministers of Australia, Brazil, China, India, Nigeria and South Korea, the Secretary General of the International Energy Agency, the Secretary General of the Organisation for Economic Cooperation and Development, the Managing Director of the International Monetary Fund, the EU Commissioner for Economics and Finance, the Minister of Finance of Austria (the country holding the Presidency of the EU), and the President of the World Bank.

Sections 2 - 4 set out the reasons for the proposed initiative and the possible ways and means of putting it into practice.

1. MAIN POINTS

With globalisation of the economy, good governance of public finance is of fundamental importance for all countries to ensure the sustainability of national budget and financial systems, as well as mutual financial security and sustainable economic growth. Taking account of the collective experience gained in public finance in recent years, including the results of budget reforms, this paper presents for discussion an initiative to develop and apply generally accepted, dynamic and flexible principles, standards and criteria for good governance of public finance.

Under this initiative, it is proposed:

- To achieve a consensus on the main contents of the principles for good governance of public finance; and
- From that basis to develop a Code of Good (and Best) Practice on Governance of Public Finance, as well as appropriate standards and guidance on its application and use.

[1] Background paper to the document presented by the Ministry of Finance of the Russian Federation to the meeting of Ministers of Finance of the Group of Eight. Prepared by A. M. Lavrov (Director of Budget Policy Department of the Russian Ministry of Finance), A.C. Pirie (Consultant, ECORYS-NEI) and P.J. Brooke (Consultant, DAI Europe Ltd.) with the participation of E. V. Belyanova (Managing Partner, ECORYS-NEI), A. G. Morozov (Chief Economist, Russia and Ukraine, HSBC Bank) and O. V. Dynnikova (Economist, IMF Moscow Office).

The following basic list of principles (or components) of good governance of public finance is offered for discussion:

1. fiscal transparency;
2. stability and long-term sustainability of budgets;
3. an effective and equitable system of inter-budgetary relationships;
4. an integrated budget and budget process;
5. medium-term financial planning;
6. results-oriented budgeting; and
7. effective financial control, reporting and monitoring.

These principles (or components) should be considered within the framework of a unified public finance management system, requiring continuing development and adaptation to changing conditions and new challenges which arise.

1. **Fiscal transparency** should be ensured, in particular and among other things, by:

- public access to information on the situation and trends in public finances;
- openness of state bodies' activities on the preparation, consideration, approval and implementation of budgets;
- the existence of and compliance with formalized requirements on budget accounting and the preparation and presentation of budget reporting;
- consideration and approval by the legislature of the main indicators of budget reporting;
- preparation and presentation of budget reporting in accordance with the general principles which are necessary and adequate for the purposes of international comparisons.

2. To ensure **the stability and long-term sustainability of budgets** the following are required, in particular and among other things:

- forecasting of the main budgetary parameters for the medium term (up to 3 years) and the long term (more than 3 years) within the framework of integrated macroeconomic and monetary policies;
- realism and caution of economic forecasts and the assumptions providing the basis for budget planning;
- the existence of criteria (quantitative indicators) for the realism and sustainability of budgets, and for the acceptability of the tax and debt burdens, and their observance in developing medium and long term budgetary policy;
- systematic analysis and management of fiscal risks, including the medium and long term consequences of accepting new expenditure commitments or of trends leading to additional expenditures, taking account of the stability and predictability of budget revenues (including differentiation between revenues dependent on external economic developments and others);
- creation and maintenance of appropriate financial reserves, including stabilization and/or funds for future generations in the case of countries with a high proportion of revenues from commodity exports.

3. An effective and equitable system of inter-budgetary relationships should, in particular and among other things, provide for:

- stable and predictable financial relationships between central, regional and local authorities, established by legislation and based on uniform principles;
- balanced and interrelated allocation of authority over budget commitments and revenues between different levels of government;
- opportunities and incentives for sub-national authorities to decide their own budget expenditures and revenues on the basis of the interests and preferences of regional and local communities (fiscal autonomy);
- an objective, formalized and transparent system of budget equalization;
- the availability of incentives to increase the effectiveness of management of sub-national finances and, if necessary, sanctions to ensure compliance with financial discipline and legislative requirements.

4. An integrated budget and budget process assumes, in particular and among other things, that at each level of management of public finances:

- the responsibilities and powers of the executive body in charge of the development and implementation of fiscal policy, including the organization of the preparation and execution of the budget are defined clearly and unambiguously;
- all revenues and expenditures are set out in a single budget, without hypothecation of specific kinds of revenue to any particular areas of expenditure;
- in the budget system there are no off-budget funds (with the exception of funds established by legislation for social and medical insurance, and also stabilization and inter-generational funds);
- planning and implementation of current and capital expenditures and all kinds of budget programmes are carried out by the bodies responsible for policy in the relevant spheres of activity, under common rules and procedures;
- an effective system is in operation for making budget payments, management of a single budget account and accounting for budget commitments.

5. Medium-term financial planning requires the following, in particular and among other things:

- preparation and approval of the annual budget in accordance with medium-term and long-term expenditure frameworks;
- the existence of and compliance with formalized rules and procedures for annual rolling forward (making adjustments and extensions) of medium-term expenditure estimates;
- the existence and application of formalized methods for calculation (and adjustment) of budget expenditures mandated by existing policies, including social security transfers to persons;
- the existence of, and compliance with, rules and procedures for accepting new commitments within the framework of adopted budget constraints; and
- introduction of expenditure “ceilings” (limits) for spending bodies on a medium-term basis.

6. The introduction of **results-oriented budgeting** requires the following, in particular and among other things:

- setting, for each spending body, a framework of goals, objectives and targeted results of activity, designed to ensure the achievement of the goals and priorities of government policy;
- the existence and application of formalized methods of estimating the full cost of expenditure commitments (and budget appropriations), programmes and public services in a realistic manner;
- ensuring the independence, motivation, accountability and responsibility of spending bodies, their internal sub-units and external subordinate organizations for planning and achieving results from expenditures within the established financial limits;
- use of competitive principles for allocation of budgetary funds, including taking account of the results achieved and planned from use of budget appropriations;
- the existence and application of methods of assessment of results from use of budget funds by spending bodies and organizations in the reporting period.

7. **Effective financial control and monitoring** are assumed to require the following, in particular and among other things**:**

- an annual independent external review (audit) of budget reporting with subsequent review of its findings by the legislature;
- effective management information systems to enable proper monitoring and control, including on compliance with budget legislation;
- the existence of, and compliance with, procedures established by law for review of compliance with budget legislation and responsibility for any breaches of it;
- the existence of, and compliance with, formalized, transparent and corruption-resistant procedures for decision-making on the use of budgetary funds, including in carrying out procurement;
- regular analysis and assessment of the quality of financial management, supported by measures for improving it;
- development and application of internal control and audit mechanisms.

The result of this initiative could be an agreed Code of Good Practice, envisaging a unified framework of agreed principles, standards and methods for management of public finance, and recommendations on applying it and on monitoring the quality of public finance management.

It is proposed that this package should cover two levels:

- basic principles, standards and criteria shared by all interested parties; and
- more advanced standards which could be applied on a voluntary and proactive basis by individual countries when they have reached an appropriate stage in the formation, development and modernization of their methods for managing public finances.

This approach assumes that the proposed methods, rules and procedures could be used flexibly, and that each country could take due account of its specific fiscal policy objectives.

At the heart of this initiative lies the growing importance of the management of public finance as a factor in sustainable economic development.

As the economy becomes globalised, national financial systems are becoming increasingly interdependent. The stability and long-term sustainability of budgets and public finances more generally are key requirements for the management of the increasing risks to public finances. Those risks mainly arise from the effects of such factors as the volatility of commodity prices, in particular oil prices; instability of revenues from international trade and capital flows; adverse demographic trends, in particular from ageing populations; climate change; the threat of natural disasters and epidemics, etc.

Effective use of budget resources is of growing significance for all countries in achieving the goals and priorities of public policy, as citizens demand better quality and more accessible public services and greater effectiveness and transparency of government. For transition and developing economies in particular, progress in achieving this strategic objective is a precondition for achieving their long-term development goals.

In recent years, major efforts have been made by many countries to modernize their systems of public finance management. In G8 countries, the new approaches have included a stronger focus on responsible fiscal policies, medium and long-term budget planning for both greater financial stability and effectiveness of expenditures, and increased accountability for the use of taxpayers' money. In particular, in Russia, which was in the more difficult situation of a transition economy, this process began with restoring effective fiscal control and financial stability, and from the early 2000s switched over to a comprehensive modernization of public finance management systems, including the establishment of a Stabilization Fund, implementation of tax reforms, setting up a new system of inter-budgetary relationships, and the introduction of medium-term performance-oriented budgeting.

G8 countries have taken part in the work on public finance undertaken by the International Monetary Fund (IMF), the World Bank, the Organisation for Economic Cooperation and Development (OECD) and other international organizations to prepare analytical and methodological guidance materials, codes and manuals, as well as their work in monitoring progress and providing related technical assistance. G8 countries support the provision of assistance to transition and developing economies in implementing budget reforms and confirm their view that good governance of public finance is an essential factor for their successful development.

As a result of the practical experience acquired so far, many generally accepted principles, standards and criteria have already taken shape, providing a sound foundation for further progress in the management of public finance.

However, despite the high quality and practical value of the many materials that have been developed so far, they lack the effective coordination which could improve their clarity, comprehensiveness of coverage, and make their application more effective. Further work is therefore needed to develop a clear, flexible and dynamic framework to ensure that the coverage of development work to be undertaken on public finances is exhaustive, comprehensive, authoritative and implementable in practice. Implementation of effective and sound methods of public finance management is a challenge in itself for all countries, and particularly for transition and developing economies. Management of transition to stronger methods of managing public finances is a key issue for them. Failure to manage this process properly is often a barrier to sustainable development, poverty reduction and the introduction of more effective management methods.

As a **first step towards implementation of the suggested initiative**, all countries and organizations involved are invited to join in analysis and discussion of the accumulated experience on management of public finance and carrying out fiscal reforms, and then to present their suggestions on how best to achieve further progress in this area, and on the contribution they could make to implement this initiative in accordance with the suggested priorities.

On the basis of the approach set out above and their experience in the relevant issues, the IMF, the World Bank and the OECD could lead the work to develop the Code of Good Practice on Governance of Public Finance and monitor its implementation.

In particular, it would seem desirable for a working group to be set up under the auspices of the IMF, the World Bank and the OECD, and perhaps also with the participation of other international organizations. This working group could co-ordinate the joint work of the different organizations in the suggested areas, to ensure that it is comprehensive and exhaustive, and that the results achieved are effectively disseminated.

The results of this work might be presented for discussion at the World Bank meetings, and also at events of the OECD and other international organizations.

The continuing attention and support of G8 Ministers of Finance and of all other countries with an interest in this work will be a most important factor in carrying it out successfully.

2. THE CASE FOR DEVELOPMENT AND APPLICATION OF PRINCIPLES FOR GOOD GOVERNANCE OF PUBLIC FINANCE

Good governance of public finance lies at the heart of the efforts of each country to ensure stable and favourable conditions for sustainable development and improvement of the welfare of its citizens. As the economy becomes globalised and subject to the effects of many unpredictable factors, stable and sustainable public finances in each individual country can make a substantial contribution to the management of risks and ensuring general security at a global level. Failure to manage these risks could present a threat to the stability and well-being of other partner countries.

2.1 Good Governance of Public Finance: what it means and why it is essential

The scope of good governance of public finance as considered in this paper is wide and comprehensive rather than restricted to specific elements of the subject. This broad canvas is indeed the main point in proposing this initiative. Its purpose is mainly to consolidate and improve the usefulness of the standards and guidance contained in the many existing sources resulting from the serious work that has already been done...

Three key aspects underlying good governance in public finance can usefully be distinguished as follows:

a. **Fiscal transparency –** which emphasizes being open to the public about the structure and functions of government, responsibilities within the government, and relations between the government and the rest of the economy, fiscal policy objectives, public sector accounts, and fiscal projections;
b. **The soundness of public finances –** which emphasizes the stability and sustainability of public finances over the medium term and where appropriate the more distant future, the effectiveness of inter-budgetary relationships within each country, the management of potential risks, and the effectiveness of systems of budgetary and financial control; and
c. **The efficiency and effectiveness of fiscal policy –** emphasizing the efficiency of resource allocation (taking into account both economic efficiency in principle and the political priorities of the government), the practical effectiveness of management to achieve results, the mechanisms to hold management to account for performance, and use of monitoring, evaluation and audit to learn the lessons which can help improve efficiency and effectiveness for the future.

For each country, good governance of public finance also needs to aim for well-founded decisions, and successful implementation of them, at three levels:

(1) **Macro-fiscal planning** of taxation and expenditure totals, surpluses, deficits etc. and net borrowing or reserving;
(2) **National tax and state sector priority-setting** (specific taxes, expenditures, policy goals); and
(3) **Detailed budget-making and implementation -** planning, adoption, implementation, control, accountability, monitoring, reporting and audit of budgets, management of assets and liabilities, borrowing, taxation.

While level (1) is the most obvious one at which success or failure is of fundamental importance at the national level and for others in the global economy, the three levels are closely interrelated. For example, poor setting of priorities for tax and budget policy and/or poor preparation and implementation of budgets can reduce the effectiveness of macro-fiscal planning. And instability at the macro-level can undermine the chances of good results at the two lower levels.

In the last 15-20 years, approaches to all these issues have received much attention both nationally and internationally. Far-reaching reforms in methods of budget management have been undertaken in a large number of countries, including the developed and developing ones as well as countries in transition.

Amid the wide variety of methods of implementing reforms, special efforts have been made to achieve:

- Increased transparency and avoidance of unwelcome surprises;
- Improved stability and sustainability (including increased use of multi-year planning and attention to risk management); and
- Improved efficiency and effectiveness (including increased use of results-oriented budgeting and management, and accountable delegation of management).

As a result of these national processes and the support for them provided from international sources, a broad consensus has developed on the elements of generally recognized best (and good) practice.

The need for good governance of public finance has become increasingly accepted and can be summarized as follows:

- Public finance is a key part of each national economy (and the welfare of its population);
- Fiscal stability and sustainability are necessary for the effective development of both national economies and the global economy;
- Poor management of public finance damages national development and causes problems for others in an increasingly interdependent global economy, and
- Transparency about what is happening as regards each country's management of public finances is a necessary part of mutual confidence and security.

The developing global economy presents new risks to stable management of national public finances, in particular from the impact on public finances of:

- uncertainties and rapid changes in prices of commodities, such as oil;
- climate change and natural disasters, including new health risks, such as that of an avian flu pandemic;
- underlying demographic trends (aging populations, etc. presenting increased requirements for expenditures on pensions, social support and health care);
- growing interdependence of taxation systems; and
- the increasing global significance of a number of important emerging market economies with public financial systems that are in the early stages of reform.

These points emphasize the importance of orderly and effective methods for managing risks to limit the adverse effects at the national and global levels.

The importance of managing increased risks to public finances and ensuring effective development were recognized in April by the International Monetary and Financial Committee of the Board of Governors of the IMF. The communiqué noted that:

> "Steps to strengthen medium-term fiscal positions remain crucial to support growth and stability, and improve resilience against future shocks. Greater advantage should be taken of the economic expansion to reduce fiscal deficits, and to move forward with reforms to ensure the sustainability of pension and health systems….."

and

> "The improving growth prospects in poor countries, including in Sub-Saharan Africa, are encouraging. The Committee emphasizes that achieving the Millennium Development Goals (MDGs) requires a partnership between poor countries and donors. Developing countries should continue to pursue sound macro-economic policies and growth-critical reforms, including further substantial efforts to build sound, accountable, and transparent institutions. The international community should follow through expeditiously on its commitment to provide additional resources."

2.2 Existing sources of information and guidance

In recent years substantial and impressive work has been done on some or all of these issues by or for the main international bodies interested in responsible and effective management of public finances – the International Monetary Fund (IMF), the World Bank (WB) and the OECD, and also in regional contexts, for example by the Asian Development Bank (ADB). The European Union has introduced specific rules on fiscal responsibility in the context of its Stability and Growth Pact and the introduction of the Euro as the common currency of some of its members. Its accepted rules ("acquis communautaire") on financial control also have binding effect on EU members. The Commonwealth has agreed guidelines on public financial management reform. At the national level, donor countries have developed guidance for use in the context of the technical assistance or budgetary support which they provide to transition or developing countries. Some national governments or ministries of finance have also developed principles for their own use. The Lima Declaration established internationally agreed principles on audit. And private sector rating agencies monitor countries' behaviour on responsible management of public finances in the context of monitoring and reviewing their credit ratings.

Without claiming to provide an exhaustive description of all the sources of information in this area, it is possible to categorise them as follows.

A. Binding legal rules

- The European Union's Excessive Deficit Procedure, including rules, made under Articles 99 and 104 of the European Community Treaty and most recently amended by EU Council Regulation No 1055/2005 of 27 June 2005, amending the "Stability and Growth Pact" of 1997. These rules focus on certain parameters relevant to fiscal responsibility which are accepted as binding by EU member countries, but are of particular importance for members of the Euro zone.

- The EU's rules on financial control for accession countries are another example of binding rules, covering not only use of EU budget funds, but also national budgets, since it was a condition of membership that the same disciplines should apply to both.

Such formal mutual commitments on fiscal responsibility and proper management of public finances were required in the special situation of the EU, but they are an exception in present international practice and binding legal rules of this kind will not be considered further in this paper.

B. Formally adopted Codes of Best (or Good) Practice

- The IMF's "Code of Good Practices on Fiscal Transparency" (revised on 28 February 2001) is one of the Standards and Codes adopted internationally and monitored by the Financial Stability Forum. It thus enjoys the widest international endorsement.
- The OECD's "Best Practices for Budget Transparency" (updated in 2001) is formally endorsed by OECD member countries and available to all as a statement of good practice on budget transparency.
- The Lima Declaration of Guidelines on Auditing Principles adopted by the members of the International Organisation of Supreme Audit Institutions (1977) sets out agreed principles on the need for independent audit of public finances and the relevant methods of work.
- The Commonwealth Guidelines for Public Financial Management Reform (2005) propose some principles that need to be addressed in reforming management of public finances and some suggestions on 'How' reform can be implemented.

C. Guidance on good governance of public finance

- The IMF Manual on Fiscal Transparency (April 1999) contains principles for ensuring fiscal transparency and many references to other sources about the two other aspects of good management of public finances. The IMF has also prepared many substantial papers on responsible fiscal policies (including the issues arising on "fiscal space for economic growth") and how they can be defined and implemented;
- The World Bank "Public Expenditure Management Handbook" (1998), providing comprehensive guidance on most aspects of public finance management and implementation of budget reforms in transition and developing countries;
- A great deal of work has also been done by the IMF and WB in providing advice to individual countries in the course of work in the context of Article IV consultations, World Bank technical assistance projects and other parts of ongoing relationships as members of these two IFIs;
- The OECD's Manual (Richard Allen and Daniel Tommasi) provides extensive guidance aimed at assisting transition countries to move towards modern methods of managing public finances;
- The ADB's "Managing Government Expenditure" (S. Schiavo-Campi and Daniel Tommasi, April 1999) provides another extensive source of guidance;
- The DFID Manual of Good Practice and other donor sources provide guidance from the perspective of developing countries, where technical assistance and budgetary support play a particularly important role;
- National Codes of Good Practice: for example, the UK's "Golden Rule" on borrowing only to finance investment (on average over the business cycle).

D. Monitoring and assessment tools

- Reports on Observance of Standards and Codes (ROSCs) are developed by the IMF and World Bank under a selective prioritized program, the selection applying both to the choice of individual countries and to the specific standards or codes whose observance is to be reviewed. The IMF's "Code of Good Practice on Fiscal Transparency" is therefore just one of the many codes on financial stability which may be selected for coverage by a specific ROSC. The IMF's Questionnaire on Fiscal Transparency is used for ROSCs covering the Code on Fiscal Transparency.
- The PEFA (Public Expenditure and Financial Accountability multi-agency partnership) program has developed the PFM Performance Management Framework. This includes (a) a set of indicators to measure and monitor country performance of PFM systems, processes and institutions and (b) a Performance Report format to summarize a country's progress as measured by the indicators and in addition to describe its recent and on-going reform efforts. The indicators relate to budget credibility, comprehensiveness, transparency; quality of processes in all phases of the budget cycle, and donor involvement. The first reviews have already been carried out. The framework is designed for developing and transition countries but could have a wider coverage.
- The OECD's PUMA and the OECD/EC SIGMA facilities also offer support in this area, including peer review under the latter.

E. Sharing of information

- The OECD/WB survey on Budget Practices and Procedures was launched in 2003 in more than 60 economies, including OECD, developing and transition countries. It comprehensively covers the budget processes within the budget cycle, a wide range of related institutional issues and intergovernmental fiscal relations, and it gives special attention to performance management.

F. Other sources

- Rating agencies' views of individual countries' credit rating.

The sources set out above represent a large collection of high quality materials of practical value. However, they lack the overall focus, consolidation and authority that could lift the profile of the principles under consideration, make them more clear, understandable and easy to follow, and give the issues a new emphasis.

In particular:

- The IMF Code and OECD Best Practices focus specifically on the fiscal transparency aspect of good governance in public finance. The other two aspects (soundness of public finance and efficiency of fiscal policy) are not addressed by codes, except to the extent that audit issues are covered by the Lima Declaration.

- As a result, many aspects of generally accepted good management practice do not receive endorsement in formally adopted codes. Such omissions include issues of such fundamental importance as the desirability of fiscal rules for stable and sustainable management of budgets and liabilities, and multi-year budget planning.

- On fiscal transparency, there are differences in the provisions of the IMF Code and the OECD Best Practices. These result from the desire to differentiate between the more basic and more advanced principles, recognizing that some countries are still working to achieve the former while others can achieve higher standards without too much difficulty. A single structure, allowing for differentiation between basic and more advanced levels of good practice, could help individual countries to make the steps they take better directed and sequenced.

- Applying that conclusion more broadly, an over-arching set of principles covering all three aspects (fiscal transparency, soundness of public finances and efficiency of fiscal policy) with differentiation between basic and more advanced levels of achievement would provide a clearer focus for encouraging and monitoring the progress achieved by each country.

- Monitoring of fiscal transparency under the IMF Code (through the IMF questionnaire, Article IV consultations and ROSCs) is separated from monitoring of other aspects using the tools provided by PEFA and using the information shared through the OECD/WB Survey on Budget Practices and Procedures. More clearly focused and consolidated information on what is happening country by country is desirable to facilitate understanding of strengths and weaknesses.

Implementation of existing agreed statements of best (and good) practice has therefore had weaknesses, particularly for developing and transition countries, including Russia. One of the challenges lies in identifying a unified set of principles to which reforms can be anchored. It is still not clear what the essence of those principles should be, what international experience and lessons from implanting them amounts to, which sources deserve to be given special attention, and how they are tending to be developed in response to changing conditions.

A clear, comprehensive and authoritative structure of principles and guidance for implementing them would help to focus the efforts being made by individual countries and organizations to increase the effectiveness of public finance management. The present relatively benign economic conditions offer a window of opportunity to build and consolidate the essential principles on the good foundations which are already available, bringing in the knowledge, experience and resources of all bodies that are already involved in these issues. It is therefore suggested that the discussion of the issues should continue with a view to encouraging work on the development of improved codification of the principles of good governance of public finance, thereby achieving consolidation and development of existing sources of guidance, with the added authority of the international financial community.

2.3 How the Principles of Good Governance of Public Finance could be developed

The aim of the work to be done should be to develop:

- a Code of Good practice, providing more detailed support to each of the Principles of Good Governance of Public Finance;
- guidance on implementation of the Code of Good Practice; and
- methods of assessment of the results being achieved country by country, with provision for recommendations on issues for attention by each individual

country and more general lessons to be learned and fed back into the internationally approved approaches.

The materials at all three levels should be brought together within a single framework, which could have a modular structure. Provision should also be made for review and updating of the proposed package and methods in the light of developing experience in international practice in the management of public finances and requirements for development and modification of these tools which may arise in future.

To some extent the three levels mentioned above already exist in non-integrated form in the case of the IMF Code of Good Practice on Fiscal Transparency, with its supporting Manual and Questionnaire supported by ROSCs. The essential components of this approach – the Code, guidance and assessment mechanisms - would be extended on an integrated and comprehensive basis to the other areas of good governance of public finance, with the aim of producing a structure that reflects a comprehensive, integrated and more easily monitored set of standards and guidance on good practice, covering all the main aspects of good governance of public finance.

With that aim in view, the proposed materials, together with the assessment of levels of achievement attained, should include not only the areas covered by the IMF Code and the OECD Best Practices but also the two aspects mentioned in section 2.1 which are not at present covered by official statements of that kind and status (the soundness of public finances and the efficiency and effectiveness of fiscal policy).

It is not, however, proposed to give detailed consideration to tax policy issues. At the macro level, taxation must of course be covered, to ensure an effective process for planning and deciding on the aggregate levels of revenues and expenditures in the light of realistic forecasts and social and economic policy factors, and then to impose the appropriate level of taxes and other relevant revenues to ensure stable and sustainable financing of planned expenditures. In due course, when good results have been achieved in developing principles of good governance and bringing them into a single code, it would be possible to extend the list to more detailed tax issues if a consensus is reached that this would be useful.

Moreover, success in resolving the key issues for good governance of public finance depends to a large extent on the skills and competencies of government and local authority staff who manage public finances. These important issues, however, go beyond the scope of governance of public finance itself, and should be addressed in the context of other issues relating to standards for the civil service and local authority staff, their structures and administrative procedures.

The materials developed should focus on stimulating interest in the existence and use of appropriate tools for public finance management, clearly differentiating between basic principles which can be implemented in all countries and additional principles which are regarded as desirable and important for OECD member countries and for others as their capacities develop. The specific ways and means of implementing these principles can of course vary substantially from country to country.

The materials should therefore include the following:

1. a modular Code of Good Practice on Governance of Public Finance based on the agreed Principles and setting out basic and more advanced levels of attainment;

2. comprehensive guidance on the application and implementation of the Code;

3. procedures, methods and criteria for monitoring the quality of management of public finance against the provisions (or requirements) of the Code of Good Practice;

4. methods for identifying issues on which action is recommended to individual countries participating (on a voluntary basis) in the monitoring process, drawing lessons for the future and enabling management of public finance to be improved in practice; and

5. a system for updating and extending the materials.

3. SPECIFIC ISSUES ON DEVELOPMENT OF PRINCIPLES AND TOOLS FOR GOOD GOVERNANCE OF PUBLIC FINANCE

Over the last decade or so there has been considerable progress in developing and using different tools for good governance in public finance. Table 1 sets a selective and summary analysis of the main sources on these issues.

Russia comes rather new to these instruments. In seeking to apply them to the management of public finances in the context of its emerging market economy, its recent and current experiences provide a good perspective to reflect on the framework as a whole and on the issue of how different instruments might be usefully combined within an integrated framework.

This Section does not claim to provide a comprehensive review of all the issues involved, but does seek to establish the nature of those issues and to give some concrete examples of where further guidance and/or establishment of internationally recognized standards of good practice might be helpful.

Table 1 on the following page provides a summary analysis of just some of the material that touches upon standards of management of public finances. Although these are among the more authoritative sources, they are only a sample. Much more material has been produced by different donors, and by academic and professional bodies, on specific topics or areas of assessment. It is clear that all these sources represent a mix of documents of different status and depth. There are overlaps in coverage and, in some cases, inconsistency of approach.

One way of classifying the material might be to recognize some of the sources are regulatory in nature: they set standards and practices that are intended to be complied with and that compliance is intended to be verifiable. But the status of these instruments varies. For example, at one extreme the fiscal rules established under the EC Treaty have legally binding force on the countries concerned. However, compliance with Codes such as the IMF's Code of Good Practice on Fiscal Transparency, used for analysis and assessment of budget systems, do not have binding force. Other material is in the nature of statements or guidance on good practice, which are purely recommendations. Part of the perceived problem is that the relationship between materials of different status is not always clear.

Table 1

Key Tools	Rules EU (1)	Codes* IMF (2)	 OECD (3)	Manuals/Handbooks** IMF (4)	 WB (5)	 OECD (6)	 ADB (7)	Assessment Tools ROSCs (8)	 PEFA (9)	Info sharing OECD/WB (10)
1. TRANSPARENCY										
1.1. Public information	√	√	√	√	√	√	√	√	√	√
1.2. Open budget preparation, execution, reporting	√	√	√	√	√	√	√	√	√	√
1.3. Assurances of integrity	√	√	√	√	√	√	√	√	√	√
SOUNDNESS AND EFFICIENCY										
2. Stable and sustainable medium & long term management of public finances										
2.1 Medium and long term forecasting within integrated economic and monetary policies	√			√	√	√	√	√		√ (A)
2.2 Realism and caution of forecasts for budgeting	√	√	√ (A)	√	√	√	√	√	√	√
2.3.Clear rules for management of budgets and liabilities to	√	√ (A)	√	√	√ (A)	√	√	√	√ (A)	√
2.4.Clear rules for assessing and managing fiscal risks	√	√ (A)	√	√	√ (A)	√	√	√	√ (A)	√
2.5 Use of reserve funds to manage commodity-related revenues						√ (A)				
3. Effective and equitable inter-budgetary relationships										
3.1 Stable, predictable sub-national relationships		√ (A)		√ (A)	√	√	√	√	√	√
3.2 Balanced, interrelated powers and responsibilities						√	√			
3.3 Appropriate autonomy at sub-national levels						√	√			
3.4 Objective, transparent resource equalisation						√ (A)	√ (A)			√
3.5 Incentives and sanctions to ensure rule compliance						√	√			
4. Integrated budgeting at each level										
4.1. Clear roles/responsibilities for budgets		√ (A)	√ (A)	√ (A)	√	√	√	√	√	√
4.2 Comprehensive budget coverage at each level	√ (A)	√ (A)	√ (A)	√	√	√	√	√	√	√
4.3 Off-budget funds used only in special cases authorised by law		√ (A)		√		√	√	√		√
4.4 Integrated budgeting of current and capital expenditures				√ (A)	√	√	√	√	√ (A)	√
4.5 Effective systems for payments, single budget account and accounting for commitments					√ (A)	√	√		√	√
5. Medium-term financial planning										
5.1. Realistic forward view of budgets	√		√	√	√	√	√	√	√	√
3.2. Clear basis for rolling forward			√	√	√	√	√ (A)	√	√	√
5.3.Robust costing of on-going policies	√	√		√	√	√	√	√	√	√
5.4.Rules for undertaking new commitments		√ (A)		√	√	√	√	√	√	√
5.5 Medium-term expenditure limits					√	√	√			√
6. Budgeting focused on results										
6.1 Goals, targets and accountability for results		√ (A)	√ (A)	√	√	√	√	√		√
6.2 Realistic costing and match of resources to planned results					√ (A)	√	√	√		√
6.3 Accountable delegation of management					√	√				√
6.4. Link of planned results to budgets		√ (A)	√ (A)	√	√	√	√	√		√
6.5 Methods of measuring effectiveness					√	√	√			√
7. Effective financial control, accounting and monitoring										
7.1 Independent audit with review by legislature	√	√	√	√	√	√	√	√	√	√
7.2 Effective management and control information	√	√	√	√	√	√	√	√	√	√
7.3 Effective review and enforcement	√		√ (A)	√	√	√	√	√	√	√
7.4 Transparent, corruption resistant processes	√	√ (A)		√	√ (A)	√	√	√	√	√
7.5 Assessment and improvement of financial management					√	√	√		√	
7.6 Internal audit		√	√	√	√	√	√	√	√	√

NOTE: A – the issue is mentioned, but not covered fully

SOURCES:

1 The fiscal rules under the EU's Excessive Deficit Procedure related to the Stability and Growth Pact (1997, amended June 2005). http://www.europa.eu.int/comm/economy_finance/about/activities/sgp/sgp_en.htm
2 Revised Code of Good Practices on Fiscal Transparency, IMF, 28 February 2001. www.imf.org/external/np/fad/trans/code.htm
3 OECD Best Practices for Budget Transparency, 2001. www.oecd.org/dataoecd/33/13/1905258.pdf
4 The IMF Manual on Fiscal Transparency, April 1999. www.imf.org/external/np/fad/trans/manual/index.htm
5 Public Expenditure Management Handbook, WB, 1998. www1.worldbank.org/publicsector/pe/handbook/pem98.pdf
6 Managing Public Expenditure: A Reference Book for Transition Countries, by Richard Allen and Daniel Tommasi, 2001. http://www.oecd.org/dataoecd/46/35/35066562.pdf
7 Managing Government Expenditure, by S. Schiavo-Campo and D. Tommasi, ADB, April 1999. http://www.adb.org/documents/manuals/govt_expenditure/
8 Reports on Observance of Standards and Codes (ROSCs). http://www.imf.org/external/np/rosc/rosc.asp. For fiscal transparency, ROSCs make use of the IMF Questionnaire of Fiscal Institutions, January 2006. http://www.imf.org/external/np/fad/trans/question/quest.htm
9 PEFA – -PFM Performance Measurement Framework, PEFA (Public Expenditure and Financial Accountability) Secretariat, June 2005. http://www.pefa.org/index2.htm
10 OECD/WB: Survey on Budget Practices and Procedures, 2003. http://www.oecd.org/dataoecd/14/18/33620564.doc, http://www.ocde.dyndns.org

Sources relating to HIPC issues in particular are also relevant but have not been reviewed in the context of this paper

3.1 Fiscal Transparency

Standards in this area already exist. ***The IMF Code of Good Practices on Fiscal Transparency*** focuses on four general themes:

1. *Clarity of Roles and Responsibilities*—relates to the structure and functions of government, responsibilities within government, and relations between government and the rest of the economy.
2. *Public Availability of Information*—emphasizes the importance of publishing comprehensive fiscal information at clearly specified time periods.
3. *Open Budget Preparation, Execution, and Reporting*— covers the type of information that is made available on the budget process.
4. *Assurances of Integrity*—deals with the quality of fiscal data and the need for independent scrutiny of fiscal information.

Guidance on the implementation of the Code is provided in a supporting manual.

The Code acknowledges diversity across countries in fiscal management systems and in cultural, constitutional, and legal environments, as well as differences across countries in the technical and administrative capacity to improve transparency. Most countries have scope for improvement in some aspects of fiscal transparency covered by the Code. Diversity and differences across countries, however, inevitably imply that many countries may not be able to move quickly towards implementation of the Code.

Clarity of roles and responsibilities

Establishing clear roles and responsibilities for government and the rest of the public sector is a key aspect of fiscal transparency, because it provides a basis on which accountability for the design and implementation of fiscal policy can be assigned.

Key issues identified include:

- the distinction between the government sector and the rest of the public sector, on the one hand, and the rest of the economy on the other; and
- the clarity of the legal and administrative framework for fiscal management.

To get fiscal machinery working, financial and administrative rules and procedures must be in place, specifying the roles and responsibilities of all relevant participants. All countries tend to have fiscal legislation governing the budget process, with enabling legal acts that provide more specifics and details. What matters, however, is the degree of comprehensiveness and clarity provided by these arrangements.

Many transition and developing countries often have incomplete and sometimes contradictory sets of fiscal legislation, which relates badly to the reality of what happens in the budget process. As a result, formal requirements and procedures tend in practice to be overridden or supplemented by informal "rules", diluting powers, responsibilities and accountability and undermining the credibility of the official budget rules and procedures.

Public availability of information

Making fiscal information available to the public is a major characteristic of fiscal transparency. Principles and practices in this regard concern the provision of comprehensive information on past, present and projected fiscal activity and commitments in respect of the timing of publication.

Sharing fiscal information with the media and the general public is a natural means of ensuring public accountability. It contributes to the efficient use of public funds. Besides general information about the budget, the public should be informed about existing contingent liabilities and quasi-fiscal activities that could undermine fiscal stability and distort allocation of public resources. This is an important issue for many developing and even developed countries. When resolved, it helps to resist irresponsible spending pressures.

Public demand for additional and more reliable fiscal information tends to increase with the development of results-oriented budgets. Therefore, standards for disclosure of fiscal information should also reflect the growing public demand for such information.

Open Budget Preparation, Execution, and Reporting

Focusing on the budget as a key instrument of fiscal policy, the IMF Code regards openness about the budget process and the information contained in and presented with the budget as central to fiscal transparency. It envisages that budget preparation and execution should be open in the sense that information is readily available on how budgets are prepared and executed (for instance, budget circulars and information on the budget process should be available to the public). The Code does not specifically envisage participation of civil society in budget processes, though such approaches are not excluded. Openness in this sense does not imply full disclosure to the public at all stages of the budget process. Transparency in this context is necessarily limited by considerations of market sensitivity, due process in policy formulation, and the costs of providing information to the public relative to the expected benefits.

At the same time, genuine openness of the budget process requires open public debates on fiscal policy and its results. This issue is of a special importance for transition and developing countries, including Russia. In this respect, the role of parliament and external audit bodies should not be underestimated. The parliament should not only have the formal authority and capacity to hold public debates about priorities for fiscal policy, to assess budget execution and to evaluate the results, but should do these things in practice. Likewise, it is necessary for external audit of the budget to be done professionally, objectively and independently from both the executive branch and the legislature. This is the only way in which the credibility of the audit can be assured.

Standards for good practice on openness of the budget process set out in the Code cover:

- budget documentation, which should specify fiscal policy objectives, the macroeconomic framework, the policy basis for the budget, and identifiable major fiscal risks;
- budget presentation, which should be presented in a way that facilitates policy analysis and promotes accountability;
- procedures for budget execution and monitoring of approved expenditure and for collecting revenue, which should be clearly specified; and
- fiscal reporting, which should be provided regularly to the legislature and the public.

Assurances of Integrity

It is essential for fiscal transparency that fiscal data reported by the government should meet basic quality criteria, and that there are mechanisms in place which provide assurances to the legislature and the public about the integrity of data provided. The provisions of the Code on this issue concern data quality standards and public and independent scrutiny of fiscal data.

In addition, all budget procedures in use should comply with integrity standards. Unclear or confusing rules may compromise the budget process and pave the way towards irregular informal relationships. Similarly, lack of or insufficient information about certain aspects of the budget and lack of opportunities for public attention to be given to emerging problems create an environment in which it becomes difficult to maintain proper standards of integrity.

The OECD's "Best Practices for Budget Transparency" also considers these issues under the following headings:

- Part I lists the principal budget reports that governments should produce and their general content: the budget itself; a pre-budget report; monthly reports on budget implementation; a mid-year report; a year-end report; a pre-election report; and a long-term report.
- Part II describes specific disclosures to be contained in the reports: economic assumptions; tax expenditures; financial liabilities and assets; non-financial assets; employee pension obligations; and contingent liabilities.
- Part III highlights practices to ensure the integrity of reports: accounting policies; systems and responsibility; audit; and public and parliamentary scrutiny.

3.2 Stability and long-term sustainability of budgets

Countries are increasingly seeking to guide their budget preparation by establishing a budget policy framework within which they set criteria for the sustainability of budget proposals. Within this framework they establish budget formulation guidelines and test emerging budget proposals with a view to ensuring consistency with overall budget policies. In essence these criteria are pre-set on a top-down policy basis in order to provide a counterweight to inevitable bottom up pressures that might otherwise push the budget process off course and into unsustainable territory.

Clear rules for assessing fiscal stability based on medium and longer term forecasting of key budget parameters

There are many variations in the criteria used to express fiscal prudence. However, it is observed that typical criteria used in countries that have developed such a framework instrument include:

Criteria	Typical Expression
Overall fiscal balance	The level of overall fiscal deficit shall not exceed [x%] of total expenditure
Deficit to GDP relationship	The level of overall fiscal deficit shall not exceed [x%] of GDP
Recurrent balance (between recurrent expenditures and revenues)	There shall be a recurrent surplus equivalent to at least [x%] of total expenditure. An alternative which might be relevant in some cases could be: The deficit on the non-oil dependent budget shall not exceed [x%] of total expenditure (or GDP).
Mix of types of expenditure	Capital expenditure shall be at least/ no more than [x%] of total expenditure.
Debt servicing to expenditure relationship	Debt servicing shall not exceed [x%] of total expenditure.
Debt to GDP relationship	Accumulated debt shall not exceed [x%] of GDP
Revenue to GDP relationship	Revenue shall not exceed [x%] of GDP

Some of the criteria and definitions used are not always clear. For example, what constitutes recurrent revenue for the purposes of ensuring a minimum level of surplus of recurrent revenues over recurrent expenditures is often quite vague. In particular, the treatment of revenue from a finite asset such as oil and other extractable resources is open to different treatments which could have profound implications for fiscal stability and impact on the broader economy.

Cash flow management has profound implications for the overall stability of public finances. This is perhaps an area where further guidance would be helpful.

Clear rules for assessing and managing fiscal risk

It is also noted that some countries sets benchmarks on the lines set out above in relation to a cycle over several years rather than just one year. That approach allows for smoothing of the fluctuations of the economic cycle and avoids taking short-term actions that exacerbate emerging problems.

But it is not entirely clear how such an approach might be applied without breaching financial discipline. The risk, of course, is that problems are indefinitely deferred and never substantively addressed. There seems to be a need to offer guidance on the practical and robust application of a discipline over the cycle, drawing on a number of useful recent IMF papers on such issues as “fiscal space for growth” etc.

Nor is the way in which different criteria inter-relate in relation to overall risk always clear. What is important is how different factors combine to support or undermine fiscal stability. It would be helpful if further work were undertaken to develop models to highlight and clarify this inter-relationship, contributing towards both national decision-making and international transparency.

Accounting for and managing public debt obligations are often a major source of problems. Public debt management and appropriate assessment and management of the risks associated with direct and contingent state liabilities/guarantees are often weak. Guidance exists, but the problem persists in many countries.

Appropriate management of fiscal reserves

Effective management of fiscal reserves can be a critical issue in achieving stable public finances. In particular, like many countries with significant revenues from natural resource exports, Russia has found it appropriate to establish a Stabilisation Fund for its oil revenues in order to avoid fluctuations in the revenues from these finite resources undermining underlying fiscal stability. This is an area where further guidance could be useful.

3.3 An effective and equitable system for inter-budgetary relationships

The nature of the relationship between central ministries that prepare and advise the Government on management of the resources of the state and the regional and local authorities that spend them them vary from country to country. Many countries are moving in the direction of increased decentralisation with a view to putting service provision closer to the consumer and enabling those who actually provide the services to take the decisions on how best to do so. These shifts in responsibility and authority have considerable implications for how fiscal risk arises and needs to be managed. How the process of decentralisation and how these relationships are organised and managed in practice has profound implications for the exercise and enforcement of fiscal discipline.

Stable and predictable financial relationships between central, regional and local authorities

A more devolved and fragmented public service has many potential benefits, but also implies risks. In a number of countries it has led to fiscal instability. In some cases this may be due to rapid changes in either the revenue assignments to sub-national authorities or to their adoption of additional commitments.
Some of these countries have been using mechanisms to stabilise inter-budgetary relationships and to make the nature of the relationship and their potential impact on public finances more transparent. This has included devices such as establishing 'stability periods' within which revenue assignments will be either fixed or flexed in accordance with some agreed and transparent rules.

It has also been found in Russia that appropriate incentives and sanctions are important to ensuring that each level exercises appropriate fiscal discipline and effective use of resources.

While the IMF Code and other publications referred to earlier touch upon the issue of sub-national fiscal management it seems that there is still no internationally recognised best practice with regard to creating stability and predictability of sub-national finances. Nor do they set the management of problems in this regard in the context of managing fiscal stability for the country as a whole.
Realistic match of resources to mandates

A continuing problem in many countries is the assignment of mandates to sub-national spending bodies without corresponding levels of resources to finance them. The result is fundamentally destabilising of public finances since such a situation undermines the credibility of the budget process and makes it too easy for individual public service managers to use the situation as an excuse for avoiding their own accountability.

A clear assignment of revenues is vital, supplemented by appropriate arrangements for resource equalisation for regional and local authorities.

3.4 An integrated budget and budget process

To enable risks to be managed and for budgeting to provide efficient and effective planning and implementation within realistic resource constraints, international experience indicates that it is important that budgets at each separate level of government are comprehensive and managed within a unified process.

Clear definition of responsibilities for managing budget policies and processes

Budget preparation and implementation are complex processes. Without efforts to ensure appropriate coordination of the various elements they can easily fragment and when they do, the effectiveness of fiscal management is undermined. There needs to be a clear and unambiguous definition of the role and responsibilities of the executive body that is responsible for the development and implementation of budget policy including the preparation and execution of the budget.

This is an area in which many developing and transition countries still find it difficult to achieve real progress. The reasons for this vary for individual countries, but the consequences are the same: the budget and budget process are fragmented into separate parts which are poorly linked and managed, which undermines the effectiveness of the use of scarce budget funds.

There thus appears to be a need to provide more guidance on when and on what conditions any departure from the principle of integrated budgeting can be regarded as consistent with good practice, and on how developing and transition countries could improve their compliance with good practice on this point.

Integrated recurrent and capital budgeting

From wide international experience, good practice indicates that results from expenditures are better, and control and sustainability is improved, if recurrent and capital expenditures are managed in an integrated manner within a multi-year framework. Integrated management of recurrent and capital expenditures has enormous significance both for ensuring the sustainability and stability of the budget and for improving the extent to which planning is well-founded and transparent, including in assessing the effectiveness of budget programmes and investment projects taking full account of their full cost and the results to be achieved.

This is one of the basic, generally recognised principles of good practice, and compliance with it is one of the preconditions for effective introduction of medium-term performance-oriented budgeting.

However, in some developing and transition countries, the management of capital expenditures, and sometimes a wider category of expenditures included in special kinds of programmes (or projects), is financially and institutionally separated from the management of recurrent expenditures and the general budget process. This artificially shields such expenditures from competition for allocation of budget resources, weakens financial discipline, distorts the criteria for developing budget priorities and assessing the extent to which they have been achieved, and also undermines the independence and responsibility of line ministries which should be accountable for the achievement of results in their area of activity.

Comprehensive budget coverage at each level

This implies that the budget at each level covers all expenditures and revenues, so that the full picture of all commitments and resources arising in each relevant period is covered, adequate control over resource allocation can be maintained and unforeseen unpleasant surprises are minimised. Experience shows that this is not always easy to achieve, either for political or technical reasons (for example, because of accounting or forecasting difficulties). Indeed, in some cases even the IFIs and international donors require ‘ring fencing’ as a pre-condition for their financial assistance (or loans), in order to protect aid money from inefficient use by recipient countries.

Off-budget funds used only in special cases authorised by law

Off-budget funds which keep revenues and expenditures outside the main budget framework reduce the effectiveness of budget control and risk management. International practice recognises the possibility of using such funds for pension provision and social and medical insurance, and for reserve funds of various kinds (such as stabilisation funds or funds for future generations) under the control of the main fiscal authority. It is a valuable principle that such funds should operate under conditions established in legislation and be subject to the general requirements on control and accountability.

Integrated process for all aspects of planning and management of the budget

It is generally recognised good practice in most countries for the central management of the process of budgeting to be integrated. If separate key responsibilities are left outside an integrated budgeting process, for example the management of macro-economic forecasting, setting of policy priorities and objectives and budgeting for certain kinds of expenditures, the coherence of the process is damaged and management of risks and effectiveness can become unsatisfactory.

Efficient budget implementation processes

There needs to be an effective system for budget payments, management of a single budget account, ensuring that it has adequate liquidity, accounting for budget commitments and submitting reports on budget execution.

4.5 Medium-term financial planning

The need to frame budgets in a multi-year context seems to have been generally recognised. There is no doubt that setting out the implications of today's budget decisions for public finances looking several years ahead can help to avoid future instability. Practical application, however, exhibits a wide range of variations in that respect.

Preparation and approval of the annual budget in the context of a realistic forward view of budgets

Some of this variation in practice seems to be caused by difficulties in the conditions in some countries and also to the fact that they are hurrying to introduce technique which is relatively new to them and have only just begun to explore what it means and where its boundaries lie.

Different views can be held on the question whether the number of years encompassed in multi-year budgets is a reasonable target for standardisation. Practice certainly varies. But what is clear is that to understand fiscal trends and the impact of policies it is sometimes necessary to have a longer view than the 3-5 year timeframe that most countries seem to adopt for formal multi-year budgeting. Issues such as the impact of demographic trends on health and pension expenditures require a longer time frame to be fully visible. There would be value in developing a more structured approach to a hierarchy of annual, medium term and longer term budgetary analysis so that it is clear what mechanisms are effective for bringing longer term issues to the surface and enabling them to be properly considered in decision-making.

What does seem important is that there should be a clear framework for setting out the assumptions used in constructing multi-year budgets and the basis for those assumptions. It is observed that there is a wide range of practice in this regard. Such differences in practice and degree of transparency can make it difficult to interpret the implications of budget policies both domestically and internationally. Given the importance of transparency already mentioned, this is suggested as an area that would benefit from having an internationally mandated framework of principles of good practice.

While the advice of the IMF on classification systems has helped to shape budgetary as well as accounting analysis, there is much less consistency about the levels of analysis applied to multi-year estimates. Sometimes only aggregates are shown for public expenditures as a whole. In other cases, the multi-year estimates go down to a level of considerable detail. An international view on this would seem to be helpful to countries seeking to introduce such budgetary practices for the first time.

While many countries have embraced multi-year estimates, the degree of integration between annual budgets and multi-year budgets varies and is sometimes not sufficiently clear. This leaves room for doubt about the reality of the estimates beyond the budget year as a genuine reflection of on-going policies and proposed decisions.

A potential further area of attention is the management of risks in the context of multi-year budgeting. It is not always clear how it would be proposed to respond to unforeseen events. The mechanisms that the budgetary authorities use to cushion the shock of such events and keep on course with established policies should be reflected in the overall fiscal framework.

Such events might mainly be changes in exogenous factors such as inflation or the state of the economy (or the dynamics of the prices of key commodities, for countries depending to a significant extent on exports), but they might also encompass one-off events such as natural disasters or other emergencies. The answer may lie partly in being clear about contingency policies, but also in mechanisms for monitoring and flexing budgets in a multi-year context. There are some examples of emerging good practice internationally in this regard and it would be helpful to reflect on them and issue guidance as appropriate.

Clear basis for rolling forward

International practice varies with regard to the status of expenditure estimates beyond the immediate budget year and the robustness with which those forward estimates are adhered to. Also, the mechanisms for rolling forward from one multi-year cycle to the next vary considerably. In some cases estimates for future years are treated as actual or potential ‘budgets’ for the years in question, in others they have a purely indicative character. The distinction seems to be quite important for their role in supporting greater fiscal stability and the seriousness with which they are treated within the budgetary system.

A particularly critical issue is the role of multi-year estimates in establishing the basis for commencing subsequent budget cycles. In other words, do the existing estimates for year 2 of the current cycle become the starting point for the next annual budget or does the budget preparation process commence from scratch each year? Clearly, there have to be mechanisms for updating the forward estimates to take account of factors that were not previously taken into account or changes in underlying assumptions.

But experience shows that the practical usefulness of multi-year estimates depends fundamentally on the extent to which they can be relied upon for planning service provision.

Robust costing of on-going policies and mandates

Developing a clear view of the cost of implementing mandates already given to spending bodies requires a major effort. It is not a small task due to the number and complexity of such mandates, and the difficulty of keeping this view updated is becoming increasingly visible. The transition of new policies into the baseline reflecting on-going policies can also be difficult to manage in a transparent and consistent way.

Basic costing techniques can be applied, but linking such costing to budgets is not proving to be straightforward. Mandates conveyed many years ago may have never been fully funded. And what constitutes on-going policy is often in doubt. There is a need to define what, in practice, constitutes existing policy.

This is an area that would seem to potentially benefit from statements of good international practice. The quality of such appraisal mechanisms has profound implications for establishing a view of the room for encompassing new commitments and, therefore, the overall robustness of fiscal plans. Failure to tackle the issue robustly can reduce multi-year budgeting to an academic exercise.

Rules for undertaking new commitments

Similarly, it is essential that discipline is exercised about the identification and prioritisation of potential new policies or activities. This is an area where each country will legitimately have its own approach in the context of national institutional arrangements in relation to the budget process.

But there is a growing body of experience on how consideration of potential new policies/ activities might be managed within a process of setting ceilings for spending bodies for the medium term.

4.6 Budgeting focused on results

One of the greatest dangers to fiscal stability is pressure from society for ever increasing levels of expenditure without regard to the need for effective policies for sustainable economic and fiscal management. There is no complete cure for this disease. But what has been increasingly recognised is that transparent mechanisms for explaining to all stakeholders the connection between tax levels, policy delivery and provision of public services (including social support), accompanied by incentives for assessment and improvement of the effectiveness of budget expenditures, are the best protection. These also help to improve the return achieved by the deployment of public resources. Traditional budgetary systems do not make this connection clear, are often largely incremental in nature and therefore open to arbitrary and unconstrained pressure.

Linking results to resources allocated

These considerations have led several countries to try and make the linkage between resources and results with varying degrees of success. The experiences of these countries certainly suggest the need for caution and realism. Poorly prepared introduction of new methods will at best lead to insignificant results, and at worst could damage the working of existing systems.

Recommendations in the context of an international code of good practice might be very useful, particularly if they offered advice on transformation of traditional budgetary approaches in different real existing situations, together with advice on systems for measuring results and how resource allocations need to be expressed (classified) in order to provide the linkages with results that are proposed.

Also, guidance is needed on how the different aspects of performance might be linked to show the connection between outputs and outcomes. Furthermore, standards might be set for how this information (both resources and results) should be presented. None of this need be prescriptive, but soundly based analysis of both positive and negative lessons would be of real practical value.

Accountability for results

It is generally recognised that moves towards results-based budgeting also have important implications for how the performance of public bodies and civil servants is assessed and how far they are responsible for of their activities and their results. Establishing budgets at an operational level that link resources and expected results has the potential to bring this about in a way that has perhaps been absent in the past. Resources made available must be realistic in relation to the results expected. Otherwise accountability is undermined.

Guidance seems to be needed on how accountability systems should be worked out to reflect this duality of responsibility both for costs and results, and there are experiences to be drawn upon. This should include reporting systems, but also the nature and coverage of audit work.

Measurement of results achieved

For effective accountability to be achieved both resources consumed and performance achieved need to be monitored on an integrated basis throughout the budget cycle.

4.7 Effective Financial Control, Reporting and Monitoring

Effective budget implementation is an important factor in influencing the volume and quality of state services. Furthermore, it is important to take account of the fact that leakage of resources through poor control directly threatens fiscal stability through requiring more resources than should be necessary to achieve any given result.

Adequate information for control purposes and for checking compliance with budget legislation

Access to adequate data and transparency about budget implementation lie at the core of control systems. Many Governments are making rapid moves to use computer software applications to improve their control processes and information systems, and to improve their accounting systems.

But international experience of developing those systems in a realistic and robust way seems patchy at best. There are success stories, but many disasters as well. The successes are often in countries that already have considerable IT experience and have a clear development path for public financial management over many years. For other countries trying to catch up, the combination of their lack of experience and technology that they are not familiar with can lead either to sub-optimisation of systems or sometimes complete failure in system development.

More detailed guidance on a realistic development path seems to be called for, taking into account the starting points of different countries. More standardisation of software designed specifically for use in the public sector could also be helpful.

Accrual accounting has emerged as an international standard to be aspired to, with a view to receiving long term benefits. However it must be recognised that such a change of approach has major implications for existing control processes and systems that are a challenge for even the most developed countries. It seems important that thought be given to a realistic migration path towards accrual accounting and how control benefits can be gained along that path without waiting for full implementation.

Formalised, transparent and corruption resistant financial management processes

Well-defined processes providing adequate checks and balances and subject to appropriate levels of supervision and review are vital.

Leakage of resources through corrupt practices is recognised as fundamentally destabilising the management of public finances. Corruption is a behavioural issue and that aspect, quite rightly, attracts a lot of the attention. But it also needs business processes within the public sector which make it more difficult.

While there is a large body of work that touches upon this aspect of corruption prevention it seems that it is not consolidated and authoritatively mandated enough to have the impact that is required. There is probably an important role for an internationally agreed document about this, setting out strict and transparent procedures for public sector business processes, and clearly connecting those procedures with concepts of fiscal stability.

Assessment of the quality of financial management

The International Organisation of Supreme Audit Institutions (INTOSAI) has done a lot of good work to lift the profile of auditing systems. Again, however, linking such developments into a broader framework of public financial management seems important.

It has been found important to establish criteria against which to analyse the performance of individual spending bodies supported by measures to help them improve. A number of countries are known to be experimenting with differentiation in degrees of delegation and managerial flexibility based on assessment of financial management capacity. Guidance in this respect would be helpful.

It is recognised that in all the areas reviewed above there are many examples of good practice in different countries. None of the areas mentioned has been left without some degree of attention in guidance that has already been issued. However, the efforts to improve the quality of financial management made by many countries, including Russia, are being held back by the lack of the proposed kind of overall framework of recommendations and criteria, synthesised and developed from accumulated experience. The increasing economic and financial inter-dependence of the international community seem to call more and more insistently for such a framework to be set up and developed.

Sooner or later, the majority of countries will come to recognise the point of following generally recognised principles and standards for implementing specific methods of management of public finance taking account of the conditions in each country. A view will clearly be required on what minimum standards should be mandated by the international community working together as to be observed strictly, as opposed to simply statements of good practice or recommendations (to be followed voluntarily at the initiative of individual countries). In any case, it is suggested that putting all aspects, whether established as mandatory and thus subject to regular monitoring or proposed as recommendations, into a comprehensive framework would be of substantial benefit.

It is recommended that work should continue to develop such a framework, organised and coordinated by the IMF, the World Bank and the OECD.

4. MANAGEMENT OF CHANGE IN PUBLIC FINANCE IN TRANSITION AND DEVELOPING COUNTRIES

Inter-dependence on issues relating to financial management is not confined to developed economies. It is a global issue and increasingly so as large but under-developed economies begin to grow. It also has major implications for the ability of the more developed countries to provide aid to help that growth. Poor public financial management tends to lock many countries into a cycle of under-achievement from which they are unable to escape. Tackling this problem should, therefore, be at the core of assistance provided to developing countries through debt relief, technical assistance and project or budgetary support. Without it, worthy ambitions of assisting countries to lift their populations out of poverty are unlikely to be effective.

Many transition and developing countries have received and continue to receive considerable support from the international community in improving their systems of public financial management in the context of development or transition to a market economy. Much of this support has been helpful. But the conclusion can be drawn that such support is largely focused on tackling specific technical issues answering the question ‘what should be done’. Many of the materials referred to above also focus on defining those technical elements that contribute to good public financial management rather than the problems of implementing them.

What seem less well developed are the methods of managing processes for change in budget reform, answering the question ‘how should it be done?’ For most developed countries changes have been gradual and managed over many years. Developing and transition countries try to accelerate this process, but there are dangers in trying to go too fast or leap-frog too many essential stages.

As a result, experience of reform in this area has been very mixed. The experience in many countries is that the difficulties lie much more in this area of ‘how’ than was originally envisaged. The technical aspects are reasonably well understood and can be easily overcome with the technical assistance available. But moving from where a country is to where it wants to be is also very much a management process and it is felt that it is difficulties in this area of managing change that explain why some countries’ progress is disappointing.

On a broader international front there is an emerging realisation of the importance of developing standards of good practice of implementing reform. For example, the Guidelines for Public Financial Management Reform produced by the Commonwealth Secretariat offer some broad guidance on this issue. But this is at a relatively general level and there is much that could be done to deepen support and sharing of experience in this area.

Some key issues that fall into this area of managing the change to improved public financial management processes are set out in the table that follows.

Issue	Importance
The form and content of strategies and plans for the development of improved public financial management.	Reform of PFM systems is a complicated task and there is a need for a clear development path without feeling the need to try and plan everything in detail.
Sequencing of reforms.	There is a need to get basic things in place before more ambitious reforms can be started. Also, some things need to be done together because they rely on mutual support.
Building ownership and support around those strategies and those plans.	Experience suggests that support needs to be carefully built at a number of levels if reform is to be sustained over the longer term.
Steering arrangements for managing the reforms.	The need to involve many constituents and active engagement.
Organising the implementation of reforms.	There are different ways of organising implementation with some more centralised than others. Options have an important impact on how the organisation as a whole responds to reform and the degree to which they can be made to take root.
Reorganising existing structures to provide a better basis for managing reforms once implemented.	Changes in PFM processes are unlikely to work if they are simply grafted on to existing structures.
Handling reforms that cut across organisational units.	Handling issues that can only be tackled by several organisational units working together often proves to be one of the key challenges in achieving change.
Motivating positive engagement with reforms and overcoming existing perverse incentives.	The way that people at all levels are engaged in reforms can make or break them. New incentives need to be created and perverse ones overcome.
Managing technical inputs including donor provided technical assistance.	It is important to ensure that the different sources of technical support do not become part of the problem causing fragmentation and advice pulling in different directions.
Aligning public financial management reforms with other reform activity.	Public finance reforms do not stand alone. For example, lack of progress in many countries stems from lack of synergies with broader public sector reforms.
Measuring the progress of reform.	Tracking progress over time linked to whatever sequencing is being adopted.

In addition to the effective management of change, the quality, skills and competencies of staff responsible for public finances are crucial to the quality of governance of public finances. Systems and rules in themselves provide a vital framework but cannot guarantee success if those who implement them do not have the right set of skills and competencies to implement them well, and to make the technical and practical judgements that are required. In a very real sense the progress of reforms in public finances depends on the progress of people's skills and commitment to making them work. Skills and competencies will equally include understanding of the systems to be operated, the stages of reforms or other changes which are taking place and knowledge and intelligence in applying them in practice to balance risks and effectiveness. The required improvements in competencies will require regular training that is well matched to the requirements of the specific work to be done.

One of the reasons why this question of 'how' to manage reforms has been relatively neglected is probably due to the national specifics of such problems. Technical approaches are reasonably well defined and potentially universal. It is easy to frame technical assistance around them in a specific and finite way. However, the challenges of managing change depend much more on the starting point of individual countries, established practices and relative capacities as well as organisational and cultural norms. There is no potential for a ‘one size fits all’ approach and the nature of the support required is qualitatively different.

While recognising these difficulties, it is considered important that the issues involved are not just either ignored or left for each country to resolve for itself. To do so seriously undermines the ability of countries to reform and dilutes the impact of any technical assistance provided.

The experience in Russia indicates that there are indeed signs of emerging lessons in this area and some examples of good practice in Russia that countries seeking to manage the process of change can draw upon.

In particular, the following should be mentioned:

- The adoption and (in general) consistent implementation of interrelated programmes in this area:
    - the Concept of Reform of Inter-budgetary Relations in the Russian Federation, 1999-2001;
    - the Programme of Development of Budgetary Federalism in the Russian Federation for the period ending 2005;
    - the Principles for Restructuring the Budget Sector;
    - the Concept of Reforming the Budget Process in the Russian Federation, 2004-2006;
    - the Concept of Improving the Effectiveness of Inter-budgetary Relations and the Quality of Management of State and Municipal Finances in the Russian Federation, 2006-2008);

- Use of the “platforms” (or “steps”) technique, as a tool to manage the sequencing of reforms and achieve balanced and sustainable progress at each stage; and

- The financial and methodological support provided for budget reforms provided on a competitive basis at sub-national level and for federal spending bodies (The Fund for Reform of Regional and Municipal Finances, and the “Experiment” on introduction of performance-oriented budget planning methods carried out at federal level in both 2004 and 2006).