

UCRCA

Urban Community Research Center for Asia

アジア都市コミュニティー研究センター

Publication Series 2014

出版シリーズ 2014

No. 4

Ueno, Hiroshi PhD.

Recent Development of Ex-Ante External Evaluation of
Budget and
Institutional Evaluation of Budgetary System

上野宏

予算システムにおける予算政策事前評価の動向

Recent Development of Ex-Ante External Evaluation of Budget and Institutional Evaluation of Budgetary System¹

Hiroshi UENO

Professor of economics at Faculty of Policy Studies, Nanzan University, Nagoya, JAPAN.

Source: Ueno, Hiroshi (2010), “Recent Development of Ex-Ante External Evaluation of Budget and Institutional Evaluation of Budgetary System,” a paper presented at the Spring Convention (Shunki Taikai) of Japan Evaluation Society (JES), June 19, 2010, pp.6.

Copy right: As far as you quote above source as a reference, you can freely use, copy, or distribute this paper without permission.

Without the quotation, you are not allowed to use this paper.

Summary: The recent Euro crisis tells us that now the public debt and fiscal deficit is the most serious problem of the world, particularly for industrialized countries, that could cause world economic recessions. Evaluators in the world must focus on the evaluation of budget itself as well as on the individual policies. This paper introduces two exercises and one proposal which could function as countermeasures to this huge problem of the world. As implications from the exercises and proposal, the paper makes three recommendations for the evaluators in the world, particularly in Japan: (1) undertake ex-ante external evaluations of budgets; (2) advocate and install an institution, such as a parliamentary evaluation office, that can be responsible for the ex-ante external evaluation; and (3) start evaluation of public institutions, particularly of budgetary institutions.

Key words: Ex-ante Evaluation of Budget, External Evaluation of Budget, Institutional Evaluation of Budgetary System, European Commission’s Proposal, Congressional Budget Office of USA

¹ This memo is prepared for “Morning Session 1: Decade Experience of Evaluation in the World” (Sekaino Hyoukano 10 Nen) on June 19th, 2010. The session is a part of the Spring Convention (Shunki Taikai) of Japan Evaluation Society (JES) which commemorates its 10th founding anniversary.

Recent Development of Ex-Ante External Evaluation of Budget and Institutional Evaluation of Budgetary System²

Hiroshi UENO³

Key words: Ex-ante Evaluation of Budget, External Evaluation of Budget, Institutional Evaluation of Budgetary System, European Commission's Proposal, Congressional Budget Office of USA

I. Introduction

Rather than reviewing what has transpired and progressed in the field of evaluation in the World for the past decade, this paper concentrates on above two topic, that are in principle necessitated by rampant budget deficit problem in the World. The budget deficit problem seems now to be the most urgent issue and be the most challenging topic to all evaluation specialists in the World. In this regards, this paper (1) discusses two recent developments in the area of ex-ante external budget evaluation (Sections III and IV), (2) discusses one mechanism to evaluate the institutional side of budget problem (Section V), and (3) proposes future directions to proceed for evaluation that are implied by these developments in the World (Section VI).

II. Background: World Fiscal Problem and Needs for Budget Evaluation

The World has suffered significantly from the sub-prime financial crisis in 2008-9. By the end of December 2009, however, most developed countries except Japan have recovered from the crisis at least superficially. But now, the World is facing the second shock wave of the crisis, which is represented by the recent crisis in Europe started from Greece. Greece has told the developed countries that the second shock wave was caused by the sovereign debts instead of subprime loans. Sovereign debts have increased dramatically recently, because most of developed countries (1) bailed out their banks and other financial institutions by providing massive financial assistance to them, the assistance which was mostly financed by government debts, and (2) have been giving massive fiscal and monetary stimuli to up-float their ailing real economy sectors caused by credit crunch and shrinking demand because of the subprime crisis. The European Union has established a huge sum of funds called "a temporary European

² This memo is prepared for "Morning Session 1: Decade Experience of Evaluation in the World" (Sekaino Hyoukano 10 Nen) on June 19th, 2010. The session is a part of the Spring Convention (Shunki Taikai) of Japan Evaluation Society (JES) which commemorates its 10th founding anniversary.

³ Professor of economics at Faculty of Policy Studies, Nanzan University, Nagoya, JAPAN.

stabilization mechanism (hereafter stabilization mechanism)” to rescue Greece ⁴ and to prevent and counter potential future default by the rest of PIIGS ⁵ and other member countries.

In addition, actually well before the financial crisis, developed countries have been growing a chronic disease of fiscal deficits and heavy debts as percent of their gross domestic products (GDPs). Debt problem was once considered to be the disease of developing countries and nothing to do with developed countries, but now developed countries are facing with the looming problem of debt.⁶ In order for them to reduce their debts and therefor their budget deficits, developed countries have suddenly found that they are in need of ex-ante evaluation of their budgets, so that they can restrain the expansion rate of their expenditures below the expected GDP growth rates. This is the only way to keep their debt/GDP ratios at least at the same level as before let alone reducing the ratios.

⁴ The sum of up to €750 billion (US\$950 billion, about ¥89 Chou-yen) was committed by EU on May 9, 2010. This sum of the stabilization mechanism consists of (1) €440 billion funds backed by guarantees by euro-zone countries (including UK), (2) €60 billion facility controlled by the EC and funded by bonds (borrowings) backed against the EU’s central budget, and (3) potential €250 billion of IMF loan. The information sources are The Economist (2009 May 15, pp.62, 12) and Nikkei (2010a). On top of this, the ECB (European Central Bank, Oushuu-Chuuou-Ginkou) changed its policy of not-buying sovereign bonds and announced on May 11, 2010 that central banks of Euro-zone countries started to buy sovereign bonds. This amount is almost comparable to the US government’s package against the sub-prime crisis. In the USA subprime case, The Treasury Department package to rescue US banks and corporations were US\$700 billion on top of all sorts of assistance by the Federal Reserve Banks.

⁵ Portugal, Ireland, Italy, Greece, and Spain.

⁶ Looking this problem from a political side, government deficits are an inherent problem of democracy. People naturally demand more and more assistance from their government, politicians in their parliament are inherently populists to secure their votes, and bureaucrats at their budgetary department want to expand their power of influence by expanding the budgets saying they want to meet the needs of the people. Besides, the politicians bully the bureaucrats to spend more. Furthermore, if reasonable politicians, if ever exist, try to impose an austerity policy to balance the budget, mass of people demonstrate on streets. Do we have any preventive measure to avoid this democracy trap? This paper claims that the mechanism of ex-ante external evaluation (assessment) of budgets before they are discussed by the parliament is one of possible solutions to this problem of democracy.

There is one ex-post mechanism to deal with the sovereign debt problem, if a government runs to IMF to avoid its default. It is the fiscal adjustment program of IMF. The program is famous for its severe belt-tightening orientation and also for its failure in Indonesia in 1997-8. It is, hence, better preventing ex-ante the growth of debt than dealing ex-post with the debt in a hard and difficult way as happened in Indonesia.

III. 2010: EC's Proposal of Ex-ante Evaluation of Budgets of All Member Countries

After the announcement of the stabilization mechanism by EU (the European Union, Oushuu-Rengou) on May 9, 2010, the EC (the European Commission, Oushuu-linkai, an executive branch of EU) announced a proposal to EU member countries of an ex-ante evaluation (called assessment, hereinafter the Assessment) of budgets of member countries prior to the discussions by their own parliaments, on May 12, 2010 (EC 2010, Reuters-Japan 2010). The European Parliament (Oushuu-Gikai) is currently discussing the proposal. The contents of the Assessment proposal is as follows (EC 2010, pp.4, 8-9).

Ex-ante external assessment of member country's budget. Currently, budget evaluation of the member countries is done ex-post within the framework of economic surveillance which is mainly ex-post assessment regarding the appropriateness of economic policies. Since prevention of a problem is more effective than correction after it happened, and since the preventive dimension of budgetary surveillance must be reinforced to prevent such problem as the one of recent Greece, the following is proposed. (1) Member countries submit their Stability and Convergence Programs (SCPs⁷) which include their budgetary strategies and targets. (2) SCPs are subjected to multilateral peer review (as a part of the surveillance) at the EU level. The EU level seems to suggest the level by the EC and the normal minister level Council. (3) The Council provides, based on the EC's assessment of each budget, its own assessment and guidance/advises to each member country. (4) Taking these advises into account, each country makes important budgetary decisions.⁸ Since the EC and the Council is external to any national budget, this is an external assessment of a country's budget. Of course, its intention is the shift from ex-post assessment to ex-ante assessment of budgets. That is, both "ex-ante" and "external" are important in the proposal.

Giving teeth to the preventive work. In the past, existing fiscal rules such as the limitation of fiscal deficit below 3% of GDP have not been enforced and EC's recommendations based on the fiscal rules have been ignored. To increase the compliance with the existing fiscal rules, following teeth are proposed (ibid, p.6). (1)

⁷ In Japanese, 安定・成長協定 (財政協定) (Nikkei 2010b). The SCP was introduced and agreed in 1997 even before the Euro. Its main rules are (1) fiscal deficit must be below 3% of GDP, and (2) the share of public debt should be below 60% of GDP (ibid).

⁸ Because of the ex-ante assessment prior to a country's budgetary approval, improved time alignment of these process with each country's budgetary cycle is critical. The proposal also wants to implement this process at the beginning of 2011 (ibid, p.11).

When assessed as inadequate fiscal policies, to require interest-bearing deposits by the relevant country; (2) more rigorous and conditional use of EU expenditures (roughly € 116 billion around 2007, whose source is Europa 2007) against non-compliance; (3) more rigorous and rule-based application of the existing suspension clause on the use of Cohesion Fund of EU.

If this proposal is approved by the European Parliament, it must be a shock to all members of the EU, because the proposal tells that EC would evaluate the national budget of any member country before its approval by their own parliament, and if the country does not comply with the Council's advises, the penalties will be rigorously applied. This proposal shows how serious the debt problems are in EU countries. By the way, it was already agreed in EU in the past that any country that goes beyond the threshold of excess debt at 60% of GDP, the country will be subjected to be the Excessive Deficit Procedure (EDP) (ibid, p.5). Greece has exceeded 60%. Though not a member of EU, Japan has the debt of about 190% of GDP in 2009.

IV. 1974: US's Establishment of Congressional Budget Office (CBO)

Based on a different perspective from the reducing the ever expanding public expenditures, parliamentary budget offices are increasingly established in the World recently (Johnson=Stapenhurst 2007, p.360). The offices have each different objectives to achieve but also have a common intention: to provide legislatures with independent, nonpartisan, objective, scientific, and analytical information on budgets proposed by executives, typically by treasury departments (ibid). For examples, they are California's Legislative Analyst's Office (LAO) which was the first such office established in 1941, US Congressional Budget Office (CBO) in 1974, Congressional Planning and Budget Department (CPBD) of Philippines Congress in 1990, Center for Public Finance Studies (Centro de Estudios de las Finanzas Publicas, i.e. CEFP) of Mexico's Chamber of Deputy in 1999, Parliamentary Budget Office (PBO) of Ugandan Parliament in 2001, National Assembly Budget Office (NABO) of the Republic of Korea in 2003, and two more in the process of their creation in 2006 (ibid, pp.360-1).

This paper concentrates on the CBO of U.S.A. The CBO counter-balances the power of the executive branch (Ueno=Penner 2004, p.14). It provides the legislature, i.e. the Congress and the House, with objective, analytical, logical thinking towards budgets (ibid.). Though it does not provide policy recommendations, according to CBO (2010, p.1), it provides objective and impartial information regarding proposed budgets mainly in terms of (1) the next 10 years outlook of budgets (called "budget baseline" covering both expenditure and revenue levels) and economy, based on existing

laws, i.e., without new legislation; (2) an independent re-estimate of the budgetary costs and impacts of the President's budgetary proposals so that it can be compared with the baseline and the impacts of other proposals from the legislative members; (3) estimates of budgetary costs (to the federal, state, and local governments) with respect to all legislative proposals reported out of legislative committees, though many of the proposals won't be enacted (Ueno=Penner 2004, p.15); (4) advantages and disadvantages of a wide range of alternative policy options with a discussion of national budget priorities (ibid); and (5) illustrative scenarios of budget and the long-term implications of those scenarios for the economy. Thus, the CBO provides objective, independent analyses of budgets proposed by the OMB (Office of Management and Budget, the executive) as well as alternative policy options, which amount to an ex-ante assessment of budgets by the organization (CBO) external to the OMB.

V. Institutional Evaluation: PEFA's Proposal of PFM Performance Measurement Framework (2005)

On the side of developing countries, there has been mounting concern over the fiscal discipline and deficits in developing countries among donor countries and organizations. The concern was prompted by the past 10 years' expansion of international assistance to developing countries in the form of "general budget support." The budget support is in principle a loan being directly injected into the budget of recipient country without any specific usage of the money attached to it. This is why it is called general budget support. Since there is no specification of its usage, it could be and was sometimes abused. To address this problem, PEFA⁹ proposed an evaluation framework of public financial management (PFM) in 2005, which is called Performance Measurement Framework (PMF). The PMF is an ex-post evaluation framework of the management system and actual performance of government budget and its execution. That is, it evaluates the budgetary institution rather than budgetary policies that are running on the institution. The PMF is a quite useful framework to evaluate and find out all sorts of problems associated with budgetary institution (Ueno 2010).

VI. Implications for Future Evaluation Activities

Above discussions suggest that followings would be useful in addressing the issue of looming government debts. (1) Establish a parliamentary budget office to conduct

⁹ PEFA is an international organization to assist developing countries to develop their capacity to manage their budgetary planning, execution, and auditing. It stands for Public Expenditure and Financial Accountability.

the ex-ante external evaluation of budgets proposed by the executive, and mandate it be independent so that it can function as an impartial external evaluation body. (2) Let the legislative body enact a law mandating the ceilings of government debt at a certain level of GDP, say 60%, and of budget deficits at a certain level of GDP, say 3%, and let the legislative body monitor and evaluate the budgetary performance of the executive. (3) Establish an institutional evaluation system similar to PEFA-PMF to evaluate and improve the budgetary system so that the system will not allow profligate spendings.

References

- Nikkei, Nihonkeizai-Shinbun* (2010a), 『日本経済新聞』(2010年5月11日朝刊)、p.1、日本経済新聞社。
- Nikkei, Nihonkeizai-Shinbun* (2010b), 『日本経済新聞』(2010年5月13日朝刊)、日本経済新聞社。
- Reuters-Japan (2010), ロイター.co.jp 不動産サイト (2010年5月12日)「欧州委員会、EU加盟国予算の監視の早期化を提案へ＝ヘーレン委員」
[http://reuters.com/article/businessNews/idJPJAPAN-152596\(5月13閲覧\)](http://reuters.com/article/businessNews/idJPJAPAN-152596(5月13閲覧))
- CBO (Congressional Budget Office 2010), “CBO’s Role in the Budget Process”
<http://www.cbo.gov/aboutcbo/budgetprocess.cfm> (referred to May 24, 2010).
- EC, the European Commission (2010), “Communication from the Commission to the European Parliament, the European Council, the Council, the European Central Bank, the Economic and Social committee and the Committee of the Regions: Reinforcing Economic Policy Coordination (Brussels 12.5.2010)”, a proposal report, May 12, 2010.
- The Economist* (2009 May 15), The Economist Newspaper Ltd.
- Europa (2007), “Where for the money come from?”
http://ec.europa.eu/budget/budget_glance/where_from_en.htm
- Johnson, John K., and F. Rick Stapenhurst (2007), “The Growth of Parliamentary Budget Offices,” in Shah (2007), the World Bank.
- Shah, Anwar (ed. 2007), *Public Sector Governance and Accountability Series: Performance Accountability and Combating Corruption*, the World Bank.
- Ueno, Hiroshi (2010), “Assessing Public Financial Management of Mongolia: PEFA Comparison with Other Transition and Developing Countries,” an unpublished paper to be published soon as a part of a report assisted by Grant-in-Aid for Scientific Research (C), Project Number 19530256.
- Ueno, Makiko, and Rudolph G. Penner (2004), “Changing Policy Priorities in an Aging Society: Perspective in Common between Japan and the United States,” NIRA, *NIRA Research Output 2004*, Vol.17, No.1.