Chapter 5

Trust and budgeting: Meeting the challenge of competence and values

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The use of public money is another important domain in which trust can be easily lost. A government’s budget is a political appeal to voters; a statement of its programme ambitions; an opportunity for citizens, via parliaments, to express preferences and concerns; a ritual for legitimising public expenditure; and an accounting of past decisions and actions. Governments need to ensure that the budget decision-making process itself is open and provides for an inclusive, participative and realistic debate on budgetary choices, not simply provide access to information once spending decisions have been made. This chapter looks at current tools to promote fiscal transparency such as citizen’s budgets, which present key public finance information in a way accessible to a general audience, and independent bodies responsible for oversight of fiscal policy (independent fiscal institutions or IFIs).
Introduction: How trust affects policy outcomes in budgeting

In each country, the relationship between citizens and the institutions of government is shaped by the various pillars of modern public governance: transparency, integrity, openness, participation, accountability, and a strategic approach to planning and achieving national objectives. Good budgeting is supported by, and in turn supports, these various pillars and, as recognised within the OECD Recommendation of the Council on Budgetary Governance: “Budgeting is thus an essential keystone in the architecture of trust between states and their citizens” (OECD, 2015a).

A government’s budget is a political appeal to voters, a statement of its programme ambitions, a guide to economic policy, a means of organising the work and activities of public agencies, a communication link within government, an opportunity for parliament to express its preferences and concerns, a ritual for legitimising public expenditure, an accounting of past decisions and actions, and a means of financing ongoing programmes and operations. Budgets can be seen as contracts that establish rights, obligations and expectations. Every fiscal contract is inherently a political covenant in which citizens entrust the government with authority to manage the public finances, and the government commits to do so in a prudent manner to improve public welfare. It is this trust that rationalises paying taxes today in expectation of benefits to be received 30-50 years hence.

The global financial crisis blew public finances off course, with the situation exacerbated in many OECD countries by the fact that they went into the crisis running a fiscal deficit. This has severely damaged fiscal contracts and resulted in citizens having reduced trust in the ability of governments to manage public finances in a sensible and sustainable way. Repairing the budget contract is a key challenge facing contemporary governments. Similar issues have since arisen in country after country. What institutions can help oversee fiscal policy exercised by government, to ensure that it will be resilient to fiscal shocks and be in the best interests of citizens in the long term? How can a government involve citizens in decision making to enhance trust in the integrity of public policy making? How can the government show citizens that it is using public funds effectively?

Over recent years, a number of reforms have been introduced to improve budgetary governance and the level of trust between citizens and the institutions of government. This is in recognition that good budgetary governance delivers more effective resource allocation and greater long-term economic stability, which can help rebuild citizens’ trust in government.
Budgeting and the different dimensions of trust

Before turning to the specific ways in which budgeting can help to underpin trust in government, it may be useful to specify the various dimensions of trust that are relevant to budgeting and the budget process. Each of these distinct dimensions calls for a specific response.

- **Trust is about making reasonable pre-election promises** – This requires political parties to put forward reasonable and coherent policies that have been costed objectively, or indeed independently.

- **Trust is about citizens having a voice in the budget process** – This requires ensuring that budget information is transparent and accessible to non-specialists, so that the public and civil society organisations can analyse how public money is being used and engage in the debate about budgetary choices and trade-offs.

- **Trust is about understanding how money is being used** – This requires openness with the public about the goals of the government and how and where resources are being allocated in order to fulfil them. Policy evaluation and performance assessment can also be undertaken to assess the impacts and outcomes of public expenditure and provide evidence to citizens that resources are being allocated effectively and efficiently.

- **Trust is about knowing that the country’s future is being looked after** – This requires mechanisms and oversight arrangements to ensure that public finances are steered on a safe and prudent course that will avoid “boom and bust” and its negative repercussions for people’s lives. It also requires strategies to protect public finances from fiscal risks and to fund long-term costs such as pension and health care costs, so that the financial impacts of demographic changes are dealt with in a fair and sustainable manner.

- **Trust is about having confidence in the integrity and quality of the public financial management process** – This requires full standardised professional accounting for public funds, budget transparency, and strong oversight institutions to guarantee integrity in the use of public funds and the quality of budget execution.

Key sources of mistrust

Good budgetary governance is essential to help ensure trust between citizens and the state. By the same token, poor budgetary governance can
contribute to mistrust between citizens and the institutions of government. In particular, common sources of mistrust are:

- a lack of fiscal transparency and openness
- perceptions of poor value for money
- a lack of fiscal discipline.

**A lack of fiscal transparency and openness**

Governments should ensure that budget documents and data are open, transparent and accessible (OECD Recommendation on Budgetary Governance, Principle 4). The budget is the single most important policy document of governments, where policy objectives are reconciled and implemented in concrete terms. Where there is a lack of fiscal transparency, it may not be possible for citizens and oversight institutions to analyse the budget or monitor its implementation. In addition, there is increased potential for misuse or misappropriation of funds. Opaqueness of operations and perceptions of corruption lie at the heart of citizens’ distrust of their governments.

Governments should also go beyond transparency of information to ensure that the budget decision-making process itself is open, providing for an inclusive, participative and realistic debate on budgetary choices (OECD Recommendation on Budgetary Governance, Principle 5). Opening up budgets is a first step toward democratising the budget process and giving citizens a say in policy formulation and resource allocation. Citizens have a large stake in their country’s fiscal contract, but they rarely have a direct voice in setting its terms. The inherent fragility of fiscal contracts should impel governments to open the process to citizen participation, in a responsible manner that invites citizens to engage with the sensitive choices and trade-offs that are inherent in budgeting. Where the budget decision making is open, the possibility for pork barrel politics and corruption – which also lead to a break-down of trust between citizens and the state – can be minimised.

Figure 5.1 illustrates how transparency and openness can turn budgets into tools that empower citizens to input into decision making, thereby building trust between citizens and state.
Perceptions of poor value for money

Citizens often judge democratic governments on the basis of their “policy performance” (i.e. their ability to deliver tangible positive outcomes for society). Governments that ensure that performance, evaluation and value for money are integral to the budget process can help improve citizens’ understanding of not just what is being spent, but also the extent to which public services are being delivered efficiently (OECD Recommendation on Budgetary Governance, Principle 8). This information can enrich public debates on how government money is raised and spent, and help guide more effective resource allocation. However, where performance information is not routinely collected or fed into the resource allocation process, there can be a lack of understanding about whether or not there is value for money in the administration and delivery of the
government’s programme. Perceptions of poor value for money can undermine and destroy trust.

A lack of fiscal discipline

Governments should manage budgets within clear, credible and predictable limits for fiscal policy (OECD Recommendation on Budgetary Governance, Principle 1). However, experience across a number of OECD countries indicates that governments often face challenges exercising fiscal discipline and balancing their budget. A number of factors create adverse incentives for governments to overspend, under-tax, and/or borrow excessively – all root causes of fiscal imbalances.

One factor is budget myopia. Short political cycles mean that the costs of indiscipline can be transferred to future governments, and so the incentives for long-term fiscal responsibility are weakened. In addition, governments have little incentive to save a windfall in revenues. Therefore, political leaders have incentive to respond to today’s voters by promoting short-sighted, opportunistic policies at the expense of tomorrow’s results, even when the likely result is future austerity. Another factor is the moral hazard created by a history of government bailouts. In such cases, the incentives for fiscal responsibility are weakened, as the costs of indiscipline are again transferred to future generations. A further factor is the pressure that governments face in providing essential public goods and services. A disruption to their provision is likely to have strong political and social consequences, and so pressures to provide the services even when there are insufficient funds, and therefore run fiscal deficits, can mount. Non-transparent accounting can also undermine the ability of markets to assess government finances. Governments may also have access to privileged channels of financing. This means that deficits and debts can mount to unsustainable levels before the governments are shut off from market financing.

All of the above-mentioned factors can challenge the government’s ability to exercise fiscal discipline over their political term, leading to the phenomenon called a “deficit bias” – the tendency of governments to run a persistent fiscal deficit. This, together with the fiscal challenges arising from the global financial crisis, means that governments in a number of OECD countries continue to face challenges in managing their budgets in a sustainable way. This has been one of the factors that has contributed to decreasing levels of trust that citizens have in their governments.
The impact of low trust on budgeting

Low levels of trust can have a detrimental impact on the ability of governments to exercise good budgetary governance. In particular:

- Low trust can harm revenue generation – Citizens may be less likely to pay taxes if they do not have confidence that the money will be spent wisely and responsibly.

- Low trust can make it harder for governments to implement policy – Citizens may in general be less supportive of government decisions emerging from a non-transparent budget process. They also may not have confidence that the government will look after their future. That would make it more difficult for governments to implement longer-term policy changes necessary for the sustainability of public finances, such as those relating to pension and health care costs and climate change.

Identifying good practices

The following section highlights some of the policy tools that are in use across OECD member countries in order to promote fiscal transparency and openness, value for money and fiscal discipline, and therefore mitigate the loss of trust between citizens and state.

Fiscal transparency and openness

Policy tool: Improve budget transparency

The OECD Best Practices for Budget Transparency (2002) are designed as a reference tool for governments to use in order to increase the degree of budget transparency in their respective countries.

Budget transparency is defined as the full disclosure of all relevant fiscal information in a timely and systematic manner. It should be borne in mind that dumping large amounts of raw data on line will not increase trust, but pulling together data to create stories that increase the knowledge of citizens on how money is being spent could do so. This implies that the institutions of government need to establish processes for cleaning and preparing data, and to develop tools (including data visualisation tools) to allow the public to understand the budget in greater detail.

One practice highlighted in the Best Practices is that “The Finance Ministry should actively promote an understanding of the budget process by...
individual citizens and non-governmental organisations” (OECD, 2002). One of the tools that can be used by governments to help achieve this goal is the Citizen’s Budget. Typically, a Citizen’s Budget presents key public finance information in a way that makes it accessible to a general audience. It may be written in more accessible language than the standard budget documents, and incorporate visual elements to help non-specialist readers understand the information. A number of OECD countries have produced a Citizen’s Budget, including, for example, France, Korea, Mexico, New Zealand, Norway, Sweden and the United Kingdom. More information on Mexico’s Citizen’s Budget and other efforts by that country to improve budget transparency in that country are highlighted in Box 5.1.

**Box 5.1. Budget transparency in Mexico**

The Mexican Ministry of Finance has created a new portal relating to budget transparency (www.transparenciapresupuestaria.gob.mx/). It contains information on the performance system, indicators, progress towards targets and programme evaluations. For the first time there are also open data in relation to federation expenditure for 2015. Over 2 400 files can be downloaded and used in open data format. There are also other thematic portals, such as one for open public investment that provides information on all the investment programmes funded by the 2015 budget.

In addition, Mexico provides a clear, simple “Citizen’s Budget” every year, so that ordinary citizens can understand how much money the government is raising, where it is coming from, and how it is being spent. Mexico has also used “comic-book-style” graphics to make the information even more accessible. Other publications, such as the proposal for expenditure and the 2013 public accounts, are also provided in easy language for citizens to access.

*Source*: OECD, 2015b.

**Policy tool: Participative budgeting**

Participative budgeting facilitates fiscal openness and has grown in popularity over recent decades. It allows the participation of citizens in the conception and/or allocation of public finances. An OECD survey on government efforts to promote open and inclusive policy making in 25 countries (2009) found that close to half of the respondents saw open and inclusive policy making as “important” or “very important” in increasing citizens’ trust (43%). Empirical evidence also suggests that public participation in budgeting has a positive impact on trust and confidence. For example, PytlikZillig et al. (2012) looked at participatory budgeting
discussions in Lincoln, Nebraska where residents were invited to provide input to city officials on budget decision making. Feedback from residents indicates the public welcomes the invitation to participate in governance and, in addition, the members of the public who participate in Lincoln’s budgeting input activities have high levels of trust and confidence in government. An example of participative budgeting in Ireland is provided in Box 5.2.

**Box 5.2. Participative budgeting in Ireland**

In 2015, the government instituted a new process of National Economic Dialogue (NED), a formalised process of consultation and debate with societal interests to enhance the whole-of-year budget development process. The NED was conducted on 16-17 July 2015: the mid-year timing was chosen so that “the discussions during the Dialogue about where our resources should best be allocated, and how to accommodate the many demands and pressures for increased resources, can then inform the work of the government in deciding on Budget measures and the legislature in considering the Budget later in the year. By launching the NED, the government has indicated its willingness to strengthen transparent stakeholder participation in the *ex ante* budget phase. The NED process was broadly perceived as a success, and the NED was re-convened in June 2016 by the newly appointed government.

*Source: Downes and Nicol, 2016.*

**Value for money**

Governments need to evaluate their own performance and implement systems to provide reassurance that resources are being allocated effectively and efficiently. This allows citizens to assess whether or not there is value for money in the delivery of the government’s programme.

**Policy tool: Performance-related budgeting**

Performance-related budgeting is a system that relates funds allocated to measurable results. Governments can use information on policy impact to inform future budget decisions, ensuring that resources are allocated to the policy areas where there is the greatest need and impact. The purpose is to improve the effectiveness and efficiency of resource allocation. A number of OECD countries have implemented performance-related budgeting into their budgetary governance framework, including the Netherlands, Austria and the United Kingdom.
Box 5.3. **A trust-building performance management system: The example of Austria**

Since 2013 public administration at federal level in Austria is managed according to the principle of outcome orientation and outcome-oriented impact assessment. In other words, management is based on contributions towards achieving objectives in connection with solving societal problems.

The state is responsible for a wide variety of services, ranging from key public sector tasks such as providing education and health care or ensuring equal opportunities, legal certainty and social security to protect consumers and workers. As budgets are tight, public funds must be optimally allocated in order to meet people’s needs and maintain the present high level of service in the long term.

This is where outcome orientation comes in. Federal budgets show the societal effects targeted by ministries and other public bodies, as well as how to achieve these and measure progress. With this management model, members of parliament are better informed when debating the budget, and citizens gain better insight into the government’s work.

*Source:* Austrian Federal Chancellery.

**Fiscal discipline**

**Policy tool: Fiscal rules**

As noted earlier, the global financial crisis seriously derailed public finances and significantly reduced public trust in the institutions of government. Part of the problem was that many OECD countries were running a fiscal deficit just prior to the crisis. (In aggregate, OECD countries were running a fiscal deficit of -1.5% of GDP just prior to the crisis in 2007.) With many OECD countries still showing a fiscal deficit, the public debt position continues to worsen. The global financial crisis has spurred a rethink in relation to fiscal rules and fiscal resilience in many OECD countries. Since the crisis, a number of governments have introduced new fiscal rules, or tightened or simplified existing fiscal rules,1 as a mechanism to ensure that public finances are managed in a more sustainable manner. Switzerland’s ‘debt brake’ constitutional rule has proved a model for some OECD countries, notably Germany (see Box 5.4).
Box 5.4. The debt brake rule in Germany

In 2009, the proposal to replace the golden rule with a debt brake rule was approved by the German Parliament and enshrined in the constitution. The objectives were to improve the sustainability of national finances, with strengthened fiscal co-ordination among federal and sub-national governments while providing flexibility to deal with cyclical challenges. The core elements of the rule are: that the federal government must balance its budget in normal circumstances; that cyclical deficits and cyclical surpluses must be symmetrical over the economic cycle; and that additional borrowing is only allowed in dealing with natural disasters and exceptional emergencies beyond state control.

Source: OECD, 2015c.

OECD members within the euro currency zone are subject to economic governance rules that have been significantly tightened over the period of the crisis, including under the European Fiscal Compact (to which Denmark, a non-euro zone EU member, has also subscribed). At present, half of the OECD countries regard themselves as bound by fiscal rules. In addition, some of those OECD countries that do not have definite fiscal rules still have legal frameworks requiring clarity about fiscal objectives. This broad model is also applied in Australia, Canada and New Zealand (OECD, 2015b). In addition, some governments have put mechanisms in place to identify and manage fiscal risks, such as contingent liabilities.

Fiscal rules cannot be a conduit to fiscal discipline if political commitment is lacking, nor are they the only solution to improving the incentive structure faced by local politicians. However, under certain circumstances, these rules can provide a useful policy framework. A number of conditions need to be met to ensure effective implementation of fiscal rules. These include: i) a robust legal basis; ii) a clear definition of institutional responsibilities; iii) transparent accounting, with timely and comprehensive reporting of sub-national government operations; iv) firm and non-discriminatory enforcement of rules and sanctions; and v) perception by local taxpayers of the benefits of their government’s compliance with rules.

Policy tool: Rainy day funds

Balanced-budget rules can be supplemented by mechanisms to promote savings during good times, which can then be made available as a counter-cyclical buffer during bad times. Fiscal rules are often combined with such
“rainy day funds” (RDFs). Box 5.5 provides information on how rainy day funds are used by US states to promote fiscal discipline. From an economic point of view, it is more efficient to save during good times than cut expenditure during bad times. However, strong political pressures tend to discourage saving during upswings. Structural mechanisms such as rainy day funds can enhance the incentives for such prudent counter-cyclical measures.

Box 5.5. Rainy day funds in the United States

Following the recession of the early 1980s, several US states introduced measures to address the adverse impact of recessions on local public finances. The number of states with rainy day funds (RDFs) rose sharply, from 12 in 1982 to 38 in 1989, and further to 45 in 1995. The main purpose of RDFs is to smooth public spending during recessions and, possibly, increase public savings over the business cycle. The need to smooth expenditure has increased over time, as the composition of state expenditure has shifted toward non-discretionary spending. (In the early 1960s, about one-quarter of state expenditure was on highways, versus about 45% on public welfare and education; in 2000, these shares had shifted to 8% and 65%, respectively.)


Policy tool: Strong oversight institutions

Parliaments, supreme audit institutions and independent fiscal institutions are all oversight institutions that, when operating independently and effectively, can help guarantee integrity in the use of public funds and the quality of budget execution, and therefore generate trust in government.

With commitments to sustainable public finances under close scrutiny, policy makers have been searching for new ways to safeguard fiscal discipline and rebuild public trust in their efforts to manage public budgets prudently and transparently. In particular, governments around the world have been setting up independent fiscal institutions (IFIs), which are independent bodies with responsibility for the oversight of fiscal policy. The growing trend in the establishment of IFIs can be seen in Figure 5.2.
IFIs are now considered among the most important innovations in the emerging architecture of public finance management. The remit of these institutions varies across countries but often includes assessments of fiscal plans, fiscal risks, and long-term sustainability. To the extent that fiscal councils promote stronger fiscal discipline, long-term sustainability, transparency and credibility, they may improve the quality of public finance and trust in government. An IMF study found that fiscal councils can promote stronger fiscal discipline as long as they are well designed (Debrun, 2013). The OECD Recommendation of the Council on Principles for Independent Fiscal Institutions (2014) aims to assist countries in designing an effective enabling environment while codifying lessons learned and good practices that are firmly grounded in the experience of practitioners to date. An example of how the Italian Parliamentary Budget Office oversees fiscal policy is provided in Box 5.6.
Box 5.6. Oversight of fiscal policy by the Italian Parliamentary Budget Office

Law No. 243 of 2012 established the Italian Parliamentary Budget Office (PBO) as an “Independent Body for the analysis and monitoring of public finance developments and evaluation of compliance with fiscal rules”. The mandate of the PBO stipulates that the office shall perform analysis, audits and assessments of macroeconomic and public finance forecasts; the macroeconomic impact of major legislative measures; public finance developments and compliance with budget rules; the long-term sustainability of public finances; the activation and use of the corrective mechanism and deviations from targets arising from exceptional events; and other matters relating to economics and public finances.


In addition to overseeing fiscal policy, some IFIs have responsibility for costing election platforms to help ensure that political parties put forward realistic proposals that have been independently costed. The two IFIs that have responsibility for costing of election platforms are the Netherlands and the Australian parliamentary budget offices.

Box 5.7. Costing of election platforms by the Australian Parliamentary Budget Office

The 1998 Charter of Budget Honesty was introduced to reduce the likelihood of elections being won – or lost – on the basis of poorly costed promises. In the event, the measure did not fully achieve its objectives since both sides misused the system by not providing sufficient time or information for the process to take its course. Following the 2010 federal election, the Australian Labor Party (ALP) entered into an agreement with the Australian Greens and independent members to establish a Parliamentary Budget Office (PBO) to provide independent costings, fiscal analysis and research to all members of the parliament, especially non-government members. Less than three months after its establishment, the first PBO Work Plan for 2012–13 was released on 12 October 2012. Two key priorities were identified: to make the PBO fully operational with the capacity to fulfil its mandate; and to gain the trust of the parliament as a valued source of budget and fiscal policy analysis. In June 2014, the Australian National Audit Office published an independent performance audit of the PBO, titled The Administration of the Parliamentary Budget Office. The audit found that since commencing operation in July 2012, the PBO has effectively undertaken its statutory role and is already well regarded as an authoritative, trusted and independent source of budgetary and fiscal policy analysis.

Conclusion

Good budgeting is an essential keystone in the architecture of trust between states and their citizens. Budgets can be seen as fiscal contracts, establishing expectations in relation to the benefits that will be delivered by the institutions of government that help citizens rationalise paying taxes. Citizens entrust the government with managing public finances effectively and prudently on their behalf, and in their interests.

The global financial crisis badly weakened public finances and resulted in citizens having reduced trust in the ability of governments to manage public finances in a sensible and sustainable way. This mistrust has been exacerbated where there has been a lack of fiscal transparency and openness, perceptions of poor value for money, and a lack of fiscal discipline. Governments are looking for ways to deliver more effective resource allocation and greater long-term economic stability, to repair the damaged fiscal contracts between citizens and the institutions of government.

There are a number of channels through which good budgetary governance can achieve improved trust between citizens and state. Good budgetary governance can ensure that political parties make reasonable pre-election promises; give citizens a voice in the budget process; improve understanding about how public money is being used; protect public finances from risks; and allow everyone to have greater confidence in the integrity and quality of the public financial management process.

OECD member countries are employing a number of policy tools in order to promote fiscal transparency and openness, value for money and fiscal discipline, and thereby mitigate the loss of trust between citizens and state. Leading examples include moves to improve budget transparency (for example, through producing a Citizen’s Budget), the participation of citizens in the conception and/or allocation of public finances, the implementation of performance-related budgeting, new (or tightened) fiscal rules as a mechanism to ensure that public finances are managed in a more sustainable manner, and mechanisms to promote savings during good times.

Independent fiscal institutions are another instrument helping to improve budgetary management across OECD countries. These institutions are currently considered among the most important innovations in public finance. The remit of these institutions varies across countries and often includes assessments of fiscal plans, fiscal risks, and long-term sustainability.

Together, these budgetary management instruments are helping to promote stronger fiscal discipline, long-term sustainability, transparency and
credibility. To the extent that they achieve this, they can improve the quality of public finances and rebuild trust in government.

Note

1 There is a growing analytical case that fiscal rules, which were too complex to be effective in the run-up to the crisis, should in general terms be made simpler and clearer to enhance compliance, rather than be made more complex still.
References


**Further reading**
