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Mr. Chairman and Members of the Committee: Thank you for giving me the opportunity to testify on the idea of converting the annual budget process to a two-year cycle. I know this Committee has had an interest in biennial budgeting for a number of years, as I have testified before this Committee on this subject before. Specifically, as the Deputy Director of the Congressional Budget Office (CBO), I appeared with CBO Director Dan Crippen to testify on biennial budgeting on March 10, 2000. However, I am in a much different role now than I was then: I am currently Head of the Budgeting and Public Expenditures Division of the Organization of Economic Cooperation and Development (OECD) located in Paris. And I have been asked to testify on a different aspect of biennial budgeting than I testified on 5 years ago; that is, I have been asked to bring an OECD perspective to the experiences of countries that have attempted to use biennial budgeting—in particular, the United Kingdom. Nevertheless, the general conclusion that I testified on 5 years ago is not really different from the general conclusion of my testimony today: if budget and non-budget issues can be separated in the legislative process, biennial budgeting could help ease the demands that the annual budget process requires of lawmakers and thus provide more time for other functions of government—such as long-range planning and oversight—that are equally, if not more, important.

Biennial Budgeting in OECD Countries

What little we know about biennial budgeting in OECD countries as a whole was collected as part of a survey of budget practices that we conducted in 2003 (see http://ocde.dyndns.org) of about 40 countries, most of whom are members of the OECD. This survey, which we are planning to expand and improve upon next year, revealed that 28 of the 40 countries responding indicated that the central government budget documents submitted to the legislature contained multi-year expenditure limits, but only 6 of these countries required authorization of these limits by the legislature. This information coupled with the knowledge that we at OECD have of the budget practices of OECD countries indicate that few OECD countries actually use biennial budgeting. Nevertheless, we have not heard of any systematic problems in the use of biennial budgeting from those few countries that currently use it or have tried it.

The United Kingdom's Public Expenditure Framework

Principles of the Framework

The UK's public spending framework is based on four key principles:

- consistency with a long-term, prudent and transparent regime for managing the public finances as a whole;
- the judgement of success by policy outcomes rather than resource inputs;
- strong incentives for departments and their partners in service delivery to plan over several years and plan together where necessary; and
- the proper costing and management of capital assets to provide the right incentives for public investment.

These key principles are reflected in reforms to the planning and control regime which have been implemented in the 1998 Comprehensive Spending Review (CSR) and in successive Spending Reviews.

The UK Government sets policy to meet two firm fiscal rules:

- the Golden Rule states that over the economic cycle, the Government will borrow only to invest and not to fund current spending; and
- the Sustainable Investment Rule states that net public debt as a proportion of GDP will be held over the economic cycle at a stable and prudent level. Other things being equal, net debt will be maintained below 40 per cent of GDP over the economic cycle.

The Government sets its spending envelope, consisting of departmental and annually managed spending, to comply with these fiscal rules.

Departmental Expenditure Limits and Annually Managed Expenditure

The framework for public expenditure is divided between

- Departmental Expenditure Limits (DEL), which are planned and controlled on a three year basis in biennial Spending Reviews; and
- Annually Managed Expenditure (AME), which is expenditure which cannot reasonably be subject to firm, multi-year limits in the same way as DEL. AME includes social security benefits, local authority self-financed expenditure, payments under the Common Agricultural Policy, debt interest, and net payments to EU institutions.

In Spending Reviews, firm DEL plans are set for departments for three years. To encourage departments to plan over the medium term and avoid wasteful "end year surges" , departments may carry forward unspent DEL provision from one year into the next. For the full benefits of this flexibility and of three year plans to feed through into improved public service delivery, it is important that end-year flexibility and three year budgets are cascaded from departments to executive agencies and other budget holders.

Three year budgets and end-year flexibility give those managing public services the stability to plan their operations on a sensible time scale without the fear that resources may be cut back in the following year. Further, it means that departments cannot now seek to bid up funds on an annual basis. So the credibility of medium-term plans has been enhanced at both central and departmental level. Departmental Expenditure Limits provide a clear incentive for departments to control their own costs. End-year flexibility also removes the perverse incentive for departments to use up their provision as the year end approaches without regard to value for money.

There is a small centrally held Reserve to deal with emergencies and genuine contingencies, which increases in size over the budgeting period. AME is reviewed twice a year as part of the Budget and Pre-Budget Report process. The close integration of the tax and benefit system provides a strong rationale for consideration of AME in the annual budget cycle.

Together, DEL plus AME sum to Total Managed Expenditure (TME), the broadest measure of total public spending.

Departmental Expenditure Limits

DEL gives greater financial stability to departments and helps enable them to manage their expenditure programmes over the medium term. The combination of the stability conferred by firm three year budgets with the ability to carry over unspent resources from one year to the next encourages the efficient use of resources by departments, rather than a "use it or lose it" approach to expenditure.

While departments now have certainty over the budgetary allocation over the medium term, these multi-year DEL plans are strictly enforced. Departments are expected to prioritise competing pressures and fund these within their overall annual limits, as set in Spending Reviews. Resources from the very limited, centrally held DEL Reserve are available only for genuinely unforeseeable contingencies which departments cannot be expected to manage within their DEL.

Within the longer planning horizon provided by DEL, it has been possible to remove unnecessary lower level controls on spending, operating instead through overall spending limits and performance targets rather than on micro-management through a detailed system of approvals.

Some funds within DEL have been retained centrally - such as the Capital Modernisation Fund - and are allocated to departments for specific projects. Allocations are made from the Capital Modernisation Fund to support genuinely innovative approaches to service delivery.

Longer term budgets have been set for health of five years and transport with a ten year plan, recognizing the need for longer-term planning and stable growth in these areas.

Annually Managed Expenditure

AME typically consists of:

- programes which are large, highly volatile and demand-led, and which therefore cannot reasonably be subject to firm multi-year limits. The biggest single element is social security spending, and the related Housing Revenue Account Subsidy. Other items include Common Agricultural Policy payments and negative income taxes classified as public expenditure, including Mortgage Interest Relief and the Working Families Tax Credit.

- Local Authority Self Financed Expenditure, Scottish Parliament spending financed by non-domestic rates and higher income taxes; and lottery spending.

AME is not subject to the same three year expenditure limits as DEL, but is still part of the overall envelope for public expenditure. Affordability is taken into account when policy decisions affecting AME are made. The Government has committed not to take policy measures which are likely to have the effect of increasing social security or other elements of AME, without taking steps to ensure that the effects of those decisions can be accommodated prudently within the Government's fiscal rules.

Given an overall envelope for public spending, forecasts of AME affect the level of resources available for DEL spending. Cautious estimates and an AME reserve - the AME margin - are built in to these AME forecasts and reduce the risk of overspending on AME.

Spending Reviews

The Budget preceding a Spending Review sets an overall envelope for public spending that is consistent with the fiscal rules, for the period covered by the Spending Review. In the Spending Review, the Budget AME forecast for year one of the Spending Review period is updated, and AME forecasts are made for years two and three of the Spending Review period.

Applicability of the UK System to the US

Despite the successes of this well thought out and comprehensive process, however, the experiences of the UK may not be all that applicable to the US: as stated above, the UK system is conducted entirely by the executive branch, where the US Congress plays a larger role in the appropriation process than any other OECD country. With respect to the involvement in the legislature in the budget process, the UK and the US could not be more different. Thus, it is hard to see how applicable the UK experiences are to the US, whatever they may be. I must also add that the formal description of the UK multi-annual budgeting process given above may not accurately reflect how the process often works in practice. As one senior UK official told us in describing the introduction of biennial budgeting: “We made a compromise in the UK. We introduced biennial budgeting, but we decided to do it every year.”

Expenditure Limits and Biennial Budgeting

One important aspect of the UK system described above is very similar to a previous aspect of the US system. This aspect—expenditure limits, or caps—can have a very positive effect on aggregate fiscal discipline. The UK’s Golden Rule limits current spending over the economic cycle, and their Sustainable Investment Rule limits all spending, both for capital and for current purposes. The US’s Budget Enforcement Act (BEA) of 1990, as amended, capped discretionary spending for three 5-year periods: 1991-1995; 1994-1998; and 1998-2002. Although both the president and the Congress used gimmicks to override the caps during the last 5-year period, the fiscal impacts of limits on spending by the US before then and by the UK are consistent with the fiscal impacts of every other country (including Sweden, Switzerland, Chile, and Finland) that has imposed real medium-term spending limits: lower deficits. The reasons for this success may not be obvious but are very important as countries consider ineffective limits on deficits (such as the European Union’s Stability and Growth Pact or the US’s Gramm-Rudman rules) as opposed to limits on spending: *spending limits work because they restrain spending in the good times and are inherently counter cyclical.* Once real, enforceable spending limits are in place, there is yet another reason to support biennial budgeting: that is, once the aggregate limits are set, the specific appropriation of those limits among accounts is the next logical step.

Conclusions

As I stated at the beginning of my remarks, under the right circumstances, biennial budgeting can help ease some of the legislative burdens of an increasing complex and time consuming budget process. Although there is unfortunately little experience in OECD countries to support this conclusion, there is no experience to the contrary. More interesting, however, may be the incentive that spending caps have on promoting biennial budgeting as well as their more important objective of promoting fiscal discipline.

Thank you and I welcome your questions.