

**THE ACCOUNTABILITY ACT AND
THE PARLIAMENTARY BUDGET OFFICER**

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INTRODUCTION

Foretelling the future is a risky business even under the best of conditions, so it should come as no surprise that economic and fiscal forecasts are not always accurate. Furthermore, the fact that billions of dollars are involved means that attempts to predict future outcomes bring their own unique form of stress. Nonetheless, elected officials must approve billions of dollars of government spending, and require some estimate of future economic performance and budget requirements. While pinpoint accuracy is not expected, forecasters must achieve a reasonable degree of accuracy if they are to retain their credibility in Parliament. Recent federal forecasts have unfortunately raised doubts about the reliability of the Department of Finance's forecasts.

In the last 15 years, criticism of its accuracy has led the Department of Finance to commission two separate studies of its estimation methodology and forecasting performance: the *Review of the Forecasting Accuracy and Methods of the Department of Finance* ("Ernst & Young study") of 1994⁽¹⁾ and the *Report of the Review of Canadian Federal Fiscal Processes and Systems* (the "O'Neill Report") of 2005.⁽²⁾ Although the Ernst & Young study found that the Department's forecast success was comparable to that of any other approach, it made several recommendations to improve the Department's methodology. The government implemented virtually all of its recommendations. The O'Neill Report also made several recommendations, particularly about the role of an independent forecasting agent for Parliament. This aspect of the O'Neill Report will be discussed in greater detail in a later section of the paper.

(1) Ernst & Young, *Review of the Forecasting Accuracy and Methods of the Department of Finance*, September 1994.

(2) Tim O'Neill, *Review of Canadian Federal Fiscal Processes and Systems*, June 2005 (O'Neill Report).

Both studies were reluctant to endorse the suggestion that an independent forecasting agency similar to the United States (U.S.) Congressional Budget Office (CBO) be created for Parliament. The authors felt, in part, that such an agency would not work as well under the Westminster system of government in Canada as it does under the U.S. congressional system. While there are many differences between the Westminster system and the congressional system, a key difference involves the way each system approves its budgets. In the Westminster system the executive is an integral part of the legislature and any decision by the legislative arm of government, i.e., Parliament, to alter the government's proposed budget, without the government's approval, can be viewed as a vote of non-confidence in the government. In the congressional system, the executive provides an estimate of the budget required to carry out the programs and policies of Congress. However, the final budget passed by Congress need not accept all of the proposals suggested by the president. Unlike the Westminster system, the rejection of part or even all of the president's budget proposal does not require that the president resign. This difference means that while the CBO plays an integral part in the crafting of the U.S. budget, a Canadian agency would necessarily have a lesser role in the budget process.

While the two studies offered different solutions to enhance the accuracy of the Department of Finance's forecasts, some critics continue to argue that the low credibility of the government forecasts can only be remedied through the creation of an independent source of forecasts, prepared specifically for Parliament.⁽³⁾ The government seems to have accepted this suggestion since it has introduced legislation that would create the position of a Parliamentary Budget Officer (PBO).

This paper discusses some of the issues surrounding the creation of a PBO. It will review some of the relevant findings of the O'Neill Report. Since much of the role of the proposed PBO seems to borrow from the workings of the Congressional Budget Office (CBO), this paper will also provide an outline of the history, role and mandate of the CBO.

(3) Michael Mendelson, Ottawa's "Annual Fiscal Follies," *Caledon Commentary*, Caledon Institute of Social Policy, March 2004, www.caledoninst.org.

A PARLIAMENTARY BUDGET AUTHORITY⁽⁴⁾

On 11 April 2006 the Government of Canada introduced Bill C-2, An Act providing for conflict of interest rules, restrictions on election financing and measures respecting administrative transparency, oversight and accountability, or simply the Federal Accountability Act. The Act aims to create specific measures to help strengthen accountability and increase transparency and oversight in government operations. The comprehensive Action Plan, issued concurrently, provides supporting policy and other non-legislative measures, and a draft bill to amend several Acts.

Through this Action Plan, the Government will, among other things, seek to:

Ensure truth in budgeting with a Parliamentary Budget Authority by creating the position of *Parliamentary Budget Officer* to provide objective analysis to Members of Parliament and parliamentary committees concerning the state of the nation's finances, trends in the national economy, and the financial cost of proposals under consideration by either House.

Through these measures the government hopes to improve the transparency and credibility of its fiscal forecasting and budget planning process. It views this as a fundamental step in making the government more accountable to Parliament and to Canadians. The government believes that parliamentary committees should have access to independent, objective analysis and advice on economic and fiscal issues, supported by the timely provision of accurate information from departments and agencies.

In Part 2 of Bill C-2, proposed amendments to the *Parliament of Canada Act* establish within the non-partisan Library of Parliament a position to be known as the Parliamentary Budget Officer (PBO). The mandate of the PBO includes:

- providing objective analysis to the Senate and House of Commons concerning the state of the nation's finances and trends in the national economy;
- undertaking economic and fiscal research for the Standing Committee on Finance, the Standing Committee on Public Accounts, or the Senate Standing Committee on National Finance, on the request of these committees; and

(4) Information on the government's Action Plan, including a copy of the bill, is available on the Web site of the Treasury Board Secretariat, http://www.faa-lfi.gc.ca/index_e.asp.

- estimating the financial cost of proposals currently or prospectively under consideration in either House when requested to do so by a Member, a committee of the Senate or the House of Commons, or a committee of both Houses.

The Act will also require that departments and agencies provide the Officer with the necessary data to fulfil his or her mandate. To protect highly sensitive data, however, appropriate exemptions, including ones similar to those under the *Access to Information Act*, will apply to the Officer's ability to access or release certain types of information.

THE ISSUE

All democracies need to develop a process by which elected officials can approve the nation's budget and examine government spending plans. In Canada, Parliament votes on all appropriations requested by the government through its budget and estimates proposals. Parliamentarians generally approve the appropriations requested by the government. However, in recent years, they have exercised some degree of control in the approval of estimates through committee votes on planned spending. While committees cannot increase the level of the estimate on a particular item, they are able to reduce the proposed level. They can also influence future spending by examining departmental reports on plans and priorities. In order to carry out such a role, parliamentarians require accurate information on the economic impact of the budget and of any proposed changes to the budget or estimates. Parliamentary committees do not unfortunately currently have the capacity to forecast the impact of budgets, to cost out new program proposals, or to identify savings from the elimination of existing programs. All debate on government budgets and spending plans must rely on the data provided by the government. This information, particularly the forecasts, is provided by the Department of Finance.

It has been suggested that the need to examine the impact of the budget could be met by the Department of Finance, which already provides such a service to the government. However, discrepancies between the Department's forecasts and actual budget balances during the last decade have raised doubts about the Department's projections. To properly assess the budgets, parliamentarians must have access to reliable data on the economy and on the effects of the numerous government programs. Although the Department cannot reasonably be expected to always provide accurate forecasts, in recent years its forecasts have consistently underestimated budget surpluses. While the magnitude of the forecast error may not be great in relative terms,

it represents a significant amount of funds. The persistence of unanticipated surpluses at the end of the fiscal period, sometimes called “surplus surprises,”⁽⁵⁾ is a concern not only because the surpluses represent inaccuracies in forecasting, but also because they have serious policy implications.

The O’Neill Report, which studied the accuracy of government forecasts, found that there are no special technical problems with federal economic and fiscal forecasting. However, the Report acknowledged that there are issues with the degree of error in forecasting fiscal balances.⁽⁶⁾ In particular, the Report found that experts seem to agree that there is a “public interest issue that goes beyond any technical weaknesses in the forecasts themselves.”⁽⁷⁾ Several experts felt that the persistence of unanticipated surpluses at the end of the fiscal period is evidence of a failure in public policy making. They argued that such a tendency in forecasting hinders public and parliamentary discussions because it does not permit a full debate on fiscal options and might in fact “distort the decision-making process itself.”⁽⁸⁾

To understand how an unanticipated budget surplus hinders public policy, we must recall that the federal budget process currently operates under two fiscal rules or targets. The first is the no-deficit rule in effect since the 1997-1998 fiscal year, whereby the government seeks to produce budgets that will not allow the fiscal balance to go into deficit. According to some critics, this rule creates pressure on the forecasters to project spending levels that reflect all that could go wrong with the estimated fiscal position of the government. This would lead to a bias in the forecasts towards unanticipated levels of surpluses. In fact, it is a key conclusion of the O’Neill Report that “the no-deficit rule has been a major cause of the persistent upside surplus surprises at the end of each fiscal year.”⁽⁹⁾ The Report suggests that the government adopt a different rule that might be more appropriate to its current fiscal circumstances and that has a more medium- to long-term perspective. The second rule dates from the 2004 Budget, and stipulates that the government shall, over a period of 10 years, aim to reduce the debt-to-gross domestic product (GDP) ratio to 25% from the then level of 41%.

(5) O’Neill Report.

(6) *Ibid.*, section 2.1.

(7) *Ibid.*, section 2.1.

(8) *Ibid.*, section 2.1.

(9) *Ibid.*

In effect the current fiscal policy practice limits the options available to parliamentarians who might have wished to use any surplus in other ways such as reducing the taxpayer burden, funding new programs or expanding existing government services. The continuance of such a policy means that extra budget surpluses will not be considered when Parliament votes on the budget. The O'Neill Report suggested that the annual pattern of surplus surprises that began in the mid-1990s became increasingly unacceptable to those parliamentarians who believed that the funds could be better used elsewhere.

The general consensus among experts cited in the O'Neill Report was that the surplus surprises were "a logical outcome of the government's practice of budgetary prudence (seen mainly as a by-product of its determination to stay out of deficit) and several years in which the economy grew faster than expected."⁽¹⁰⁾ If this group is correct, then much of the problem of unanticipated surpluses could be resolved by modifying or eliminating the budget paydown rule. However, given the long and somewhat painful experience with eliminating the earlier budget deficits it is doubtful that the government would seek to relax this rule, particularly if doing so raises the spectre of a return to deficit budgets.

Another group of experts, albeit very small, believed that the surprises were the result of deliberate manipulation by the government designed to stifle a wider public debate over how to use future surpluses, and to limit public pressure for higher spending and lower taxes. This view raised serious credibility issues with respect to the Department of Finance projections.

To remedy these problems, some have suggested that Canada "should develop new forecast institutions that could operate at arm's length from Finance Canada and thus act as a check on the government's own forecasting of the fiscal outlook."⁽¹¹⁾ A leading candidate in recent years has been the establishment of an organization within Parliament similar to the United States (U.S.) Congressional Budget Office (CBO). A brief overview of that institution and its role in the U.S. budget process is presented below.

(10) *Ibid.*, section 2.2.

(11) *Ibid.*, section 2.6.

THE U.S. CONGRESSIONAL BUDGET OFFICE⁽¹²⁾

The central legislation that has guided formulation and implementation of U.S. Federal fiscal policy in the last 30 years is the Congressional Budget and Impoundment Control Act of 1974.⁽¹³⁾ The Act requires Congress to establish annually the level of total spending and revenues and to decide how total spending should be divided among the 20 major functions of government such as defence, agriculture and health.

Prior to 1974, Congress had no guide to follow in developing a budget. It generally accepted the president's budget in a piecemeal fashion. Over time the Houses of Congress wanted to assert their own views on managing government expenditures by introducing some modifications to the president's budget. These modifications became a source of discord between the executive and the legislative arms of government, with each believing that it had the right to set priorities in the budget. Congress would alter the presidential budget by voting sums of money that it saw appropriate and by allocating funding for its own programs. While the president could not approve appropriations, he could refuse to spend the funds as intended by Congress. The refusal to spend money as directed by Congress is known as the impoundment of federal funding. By the early 1970s, the impoundment of funding had become a serious concern for Congress.⁽¹⁴⁾

These concerns provided the impetus for the enactment of the Congressional Budget and Impoundment Control Act of 1974. The Act provided a framework for Congress to establish its own spending priorities before work began on specific spending and revenue bills; it established a system of control over the presidential impoundment of funding; and it set up two congressional standing committees (one in each House) devoted solely to preparing the budget. It also created the Congressional Budget Office (CBO) to serve as the "scorekeeper" for Congress. CBO would provide Congress with the ability to assess the president's annual budget submission and to evaluate the cost of congressional proposals to alter budget items.

(12) Additional information is available on the CBO's Web site, <http://www.cbo.gov/>.

(13) Copies of all relevant budget legislation can be found at the site index of the House Budget Committee, <http://www.house.gov/budget/siteindex.htm>.

(14) By 1973, it was believed that President Nixon had impounded up to \$15 billion of spending previously approved by Congress for the highways and pollution control projects. Many in Congress disputed these actions by the president since many of these authorizations had been enacted by Congress with a strong vote in both Houses, thereby overriding President Nixon's veto.

The Speaker of the House of Representatives and the President *pro tempore* of the Senate jointly appoint the CBO Director to a four-year term of office. Either House may remove the Director by resolution. CBO currently employs about 230 people, primarily economists and public policy analysts, 70% of whom hold advanced degrees.

CBO's mission is to provide Congress with the objective, timely, non-partisan analysis needed for economic and budget decisions and the information and estimates required for the congressional budget process.

The agency provides budget-related information to all committees of both Houses, with priority given to the needs of the committees on the budget, appropriations, ways and means, and finance. On occasion, work may also be initiated in response to a request for information by an individual representative or senator.

Its work cycle begins with an independent estimate of what the budget would be if the current programs were allowed to continue with adjustments to revenues and expenditures affected by general economic conditions such as unemployment and inflation. This estimate, the budget baseline, allows Congress to determine the effect of any new budget proposal, including those put forward by the president. This "re-estimate" of the budget is delivered by CBO to Congress approximately one month after the president submits his budget.

Throughout the year, CBO prepares several budget projections, performs studies of budgetary issues and provides estimates of the costs or revenues that might result from implementing any new program or policy. It also updates the cost of existing programs in light of changing economic conditions. CBO is required to provide objective and impartial analysis. Its reports, which contain no policy recommendations, are delivered to all interested parties simultaneously. Requests for confidentiality are honoured only for cost estimates of legislative proposals that have not been made public.

In the 2005 fiscal year, CBO issued 38 studies and reports, 7 briefs, 12 *Monthly Budget Reviews*, 26 letters, and 12 background specialized papers. CBO also testified before Congress 30 times on a variety of issues. In the calendar year 2005, CBO completed nearly 600 formal federal cost estimates, as well as approximately 1,000 estimates of the impact of federal legislation on state and local governments and the private sector.

Much of CBO's work is widely available to Members of Congress, their staff and the public. CBO posts all of its cost estimates and publications on its Web site, and visitors to the site can subscribe to receive e-mails notifying them when CBO issues a cost estimate or publication on a subject of interest to them. The Agency's work is reviewed by a panel of economic advisers composed of CBO's previous directors and eminent economists who serve two-year terms. They comment on CBO'S preliminary forecasts of the economy's performance and provide advice to further enhance the reliability, professional quality, and transparency of CBO's work.

DEPARTMENTAL STUDIES

To the extent that parliamentarians are to become more effective in holding governments accountable for budgets and spending plans, they will require timely and reliable data and information. Furthermore, they will need to know that the information that they receive is in no way compromised. This will likely mean that the information on government budgets and proposals to alter spending will have to originate from sources that are independent of government control so that parliamentarians can have confidence in comparing that information with that provided by a government agency such as the Treasury Board Secretariat, the Department of Finance and the Bank of Canada.

In 1994, the Minister of Finance commissioned Ernst & Young to conduct an independent, external review of the Department's forecasting performance. The study showed that the Department of Finance's fiscal forecasts were relatively on track during the late 1980s. Indeed, the difference between forecasts and actual outcome might have been larger during the period had the private sector forecasts been used. Ernst & Young made 29 recommendations grouped into five categories: forecasting methodologies, data inputs, forecast and budget process, tracking against forecasts and institutional considerations. About one half of the recommendations were included in the 1995 Budget.

Ernst & Young considered the possibility of a completely independent, full-time forecasting agency that would report directly to Parliament. It concluded that adoption of such a model would pose some difficulties as it would duplicate some of the efforts of the Department of Finance and could conflict with the Canadian political tradition of ministerial responsibility. The company also foresaw practical difficulties in ensuring cooperation, and the likelihood of tension between an independent agency and the government. Ernst & Young instead recommended an independent review panel to provide an objective critique of the government's fiscal forecast.

In the other study commissioned by the Department, Dr. Tim O'Neill considered two international models for a budget office – the U.S. Congressional Budget Office, discussed above, and the Bureau for Economic Policy Analysis (officially known as the CPB) in the Netherlands.⁽¹⁵⁾ The CPB, an independent government agency, is the Dutch government's principal source of macroeconomic forecasts, and it acts as an unbiased evaluator of the effects of proposed fiscal policy. It works closely and confidentially with in-house experts at various government departments to research economic issues such as the labour market, regulation, competition, long-term growth factors and international economics. Also, prior to elections it provides an economic forecast that all parties can use to set out their fiscal platforms. Its role in fiscal forecasting and budget development is limited to an economic forecast for the government to consider.

Dr. O'Neill did not favour either of these institutions as models for a new forecasting agency in Canada:

On balance, the fiscal forecast role of the CBO and CPB is unlikely to warrant adoption in Canada. A new agency, cast in their mold, would not be able to overcome the fundamental factors affecting forecast accuracy in Canada any more effectively than current institutions.⁽¹⁶⁾

He did feel that some of the functions of these two offices could be of benefit to Parliament. In particular, he foresaw a role for an institution within Parliament with a broader mandate than forecasting. Consequently, he recommended that the government:

Create an agency within government with a mandate to focus on the medium- to long-term fiscal implications of structural economic and demographic factors.

He considered three possible forms that such an institution might have:

1. The institution could have responsibility to research fiscal issues and report on them to Parliament. It could be attached to the Library of Parliament, which has the mandate to carry out research for Parliamentary Committees and for parliamentarians. It could be established as a unit within the Library of Parliament with its own specialized mandate and staff.
2. The new institution could be an agent of Parliament attached, for example to the Office of the Auditor General. To the extent that the agency had a fiscal (and economic) monitoring role, he thought it would fit logically into a Parliamentary institution that has a broad monitoring

(15) O'Neill Report, section 4.4.

(16) *Ibid.*, section 4.4.

and assessment role, such as that of the Office of the Auditor General (OAG). Alternatively, the institution could be made a separate agency of Parliament with its own distinct mandate. Dr. O'Neill thought that this might be preferable to embedding the institution in an organization, such as the OAG, whose primary mandate is not analytical, policy-related research. He also noted that an independent agent would have clearer accountability lines and its performance could more easily be monitored.

3. A third possibility considered by Dr. O'Neill would be to have the agency report and be accountable to the House of Commons Standing Committee on Finance in the same way that the CBO in the U.S. is a creature of Congress and in particular, works with the House and Senate budget committees.

In the end, it seems that the government chose to introduce an initiative that resembles the first option. The office of the Parliamentary Budget Officer will be situated within the Library of Parliament as a unit with its own specialized mandate and staff. It will provide both long- and short-term economic forecasts and analysis. While it will be obligated to provide services to specifically named committees of both Houses, its mandate also requires it to assist, upon request, any House of Commons or Senate committee, Member of Parliament or Senator that requires its expertise.

CONCLUDING COMMENTS

If the issue were simply one of forecast accuracy, there would probably be no need to create the position of Parliamentary Budget Officer. According to the two studies mentioned above, the government's track record is about as good as can be expected. Any independent agency is not likely to produce substantially superior results. However, the secondary issue of credibility requires attention. Irrespective of the reasons, and regardless of the fault, the persistent surplus surprises in recent years have undermined the credibility of government forecasts. Parliamentarians have expressed a desire for assurances that the forecasts provided within budget documents are the best available.

A second and perhaps greater benefit of having a Parliamentary Budget Officer is that it will empower all parliamentarians in the debates on the performance of the economy and on the impact of the budget. More specifically, individual parliamentarians championing a particular initiative will be able to provide a clearer picture of its impact on the federal budget balance and on the economy in general. This measure will lend greater credibility to the proposals of individual members, committees and parties. All parliamentarians will be on more of an equal footing when discussing policy options with the Minister of Finance, whether in Cabinet, in caucus, or in Parliament.