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**TYOLOGY AND IMPLEMENTATION OF SPENDING REVIEWS
DISCUSSION PAPER**

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This discussion paper will be presented in Session 1 -- Strategies for the use of spending reviews for fiscal consolidation and improved government performance.

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DISCUSSION PAPER ON THE TYPOLOGY AND IMPLEMENTATION OF SPENDING REVIEWS

1. As ministries of finance are increasingly called upon to identify spending cuts while preserving priority spending areas, there has been renewed interest in the use of spending reviews as a tool to improve the efficiency and effectiveness of public expenditure. However, there is no common definition of what exactly constitutes a spending review; while ultimately objectives may be similar, methodologies and approaches vary widely across OECD countries. This discussion paper looks at some of the common characteristics and objectives of existing spending reviews based primarily on four country examples (Australia, Denmark, Finland, Netherlands), provided in the Annex, and proposes a general framework for OECD countries. It then proposes how the OECD could more closely review the context, institutional characteristics, and implementation procedures of spending reviews in order to see how different arrangements have matched individual country needs and circumstances and what have been the results. This will allow the OECD to use data from the next round of the OECD Performance Budgeting survey to produce a paper that provides guidance for setting up or reforming spending review procedures, including the circumstances, set-up, and implementation of spending reviews which have most successfully supported budget reallocation and/or budget cuts.

Introduction

2. Ministries of finance are faced with a quandary: the move towards top-down budgeting in many countries has given them better control over overall expenditure and helped to align incentives at the line ministry level to manage resources efficiently by acting as “their own ministries of finance”. At the same time, however, decentralised control over budget decision-making exacerbates information asymmetries in the budget process. Not only do ministries of finance generally know less now about individual programmes and organisational performance, but line ministries also have a diminished need to provide savings proposals that will reduce their budget allocation (preferring to keep efficiency savings to finance their own priorities under their caps).

3. Performance budgeting has often been presented as a means of filling the “information gap” by providing a reporting mechanism between ministries of finance and line ministries/agencies. The results, however, have been mixed in terms of providing the necessary information for ministries of finance to make informed budget decisions, in particular with regard to prioritisation across spending areas. Ministries of finance have found themselves with too much irrelevant or extraneous information. There is also increasing awareness that performance information needs are different for management versus budget reallocation functions given the complexity of determining the causality of outcomes as well as the political calculus by which resource allocation decisions are made. Tying the resource allocation and management functions of performance measurement in a single process can therefore bias the information provided by ministries and agencies. Improving the understanding of how performance information is (or intends to be) used can help ministries of finance to better select the appropriate performance budgeting tools and frameworks in line with their budgetary and management objectives.

Spending Reviews: a specific type of evaluation

4. Within the universe of the performance information available to policy-makers, performance measures deal more restrictedly with outputs, outcomes, and/or process indicators, while performance evaluations provide a more detailed review of context, attributes and causality issues in order to explain performance and to identify recommendations. The OECD has defined evaluation as the retrospective analysis of a programme, policy or organisation to assess how successful or otherwise it has been, what challenges may exist to improving performance, and what lessons (good or bad) can be learnt for the future¹. They therefore play an important analytical role in identifying options for improving policy and management. While performance information is seldom used directly to reallocate expenditure or eliminate programmes, performance evaluations provide an important source of information for line ministries to improve the management of their agencies.

5. The results of performance evaluations are sometimes used as inputs into the budgetary decision-making process, *e.g.* through the use of value for money reviews that aim to make specific recommendations for improving efficiency and effectiveness. When evaluations are commissioned *ex ante* with a specific objective to identify budgetary savings across government, however, they require some specific characteristics in order to fulfil this role. These kinds of evaluations, or **spending reviews**, can be used to reduce the deficit and/or to make fiscal space for higher priority programmes either through restructuring or cutting activities. While spending reviews can also look at programme effectiveness, *i.e.* how to improve programme performance and design, their distinguishing feature is the focus on identifying and extracting savings through the budget process.

6. The OECD Value for Money Project differentiates spending reviews from other types of evaluation through three main characteristics:

- 1) Spending reviews not only look at programme effectiveness and efficiency under current funding levels, but also examine the consequences for outputs and outcomes of alternative funding levels.
- 2) The responsibility for the spending review procedure is under the responsibility of either the Ministry of Finance or the Prime Minister's Office.
- 3) The follow-up of spending reviews is decided in the budget process.

7. These three criteria make an explicit link to budgetary decision-making, both in terms of analysis and recommendations under alternative funding levels (*e.g.* spending review targets) and in terms of the budgetary process. In recognising that ministries will be reluctant to offer up cuts, there is emphasis on central leadership for both participation and consistency (or fairness).

Proposed spending review typology

8. Table 1 further divides spending reviews by their assessment criteria for making reduction proposals. A **functional review** can be defined as a review of processes and staffing to identify how an existing government service or programme can be delivered with fewer resources. Functional reviews can be applied to individual or multiple programmes or to an organisation or set of organisations to make operations more efficient and/or eliminate duplications of operations, *i.e.* improving efficiency without calling into question the justification for the programme or organisation. For example, Finland introduced

¹ International Budget Practices and Procedures Database, 2007.

the Productivity Programme in 2004 to maintain pressure to achieve public-sector efficiencies. It included measures for improving government administrative structures, exploiting ICT and enhancing central government processes, as well as permanently reducing the number of government staff.

9. On the other hand, a **strategic review** can be defined as a review of both the *objectives* of policies and programmes being implemented, as well as the processes and staffing of said programmes or organisations. The ultimate objective of such exercises is to prioritise programmes on the basis of policy objectives and/or performance. An example of a strategic review is the Canadian Program Review, from 1994 to 1999, in which each department of the Canadian government was required to review its programmes and activities and identify the role of the government, effectiveness and affordability of the programmes. These proposals were then reviewed by a steering committee of deputy ministers, a special cabinet committee of ministers, and finally by the full cabinet for decision-making.²

10. While both functional and strategic reviews look at programme efficiency, only strategic reviews compare the objectives of programmes (and how well they are meeting them) against the changing priorities of the government, including in the context of a changing fiscal environment. Where insufficient savings can be achieved through efficiencies alone, they may instead make proposals in service levels, in programme terminations or restructuring in order to reach fiscal goals.

Table 1: Typology of evaluations by scope and primary objective

<i>Primary objective</i>				
Analysis: analyse management, structures and/or policy to improve efficiency and effectiveness	Reallocation: reallocate and/or reduce government expenditure for programmes or organisations			
Performance reviews (programme, policy or organisational evaluation)	Spending Reviews			
	<table border="1" style="width: 100%;"> <thead> <tr> <th style="text-align: center;">Functional review</th> <th style="text-align: center;">Strategic review</th> </tr> </thead> <tbody> <tr> <td> <i>Primary criteria: efficiency</i> - Identify how the existing policies can be conducted with less resource <i>Examples:</i> <ul style="list-style-type: none"> • Finland “Productivity Programme”(2005-15) • Greece “Functional review of central ministries” (2010-11) </td> <td> <i>Primary criteria: efficiency & prioritisation</i> - Identify what the government should or should not do <i>Examples:</i> <ul style="list-style-type: none"> • Australia “Comprehensive expenditure reviews”; “Strategic review” (2007) • Canada “Programme Review”(1994); “Strategic Review” (2009) • Denmark “Spending review” (ongoing) • Netherland “Interdepartmental Policy review” (1982; 2009-present) • UK “Spending Review”(1998-present) </td> </tr> </tbody> </table>	Functional review	Strategic review	<i>Primary criteria: efficiency</i> - Identify how the existing policies can be conducted with less resource <i>Examples:</i> <ul style="list-style-type: none"> • Finland “Productivity Programme”(2005-15) • Greece “Functional review of central ministries” (2010-11)
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² Bourgon, Jocelyne, “Program Review: The Government of Canada’s Experience Eliminating the Deficit, 1994-1999; A Canadian Case Study” (2009).

11. A typology of spending reviews serves to differentiate between review objectives and to identify the accompanying organisational and methodological needs for each type of review. For example, because they involve political prioritisation, strategic reviews should normally necessitate a higher level of political involvement and decision-making in order to prioritise across sector or operational responsibility areas and to make decisions about service levels. A functional review, on the other hand, can be a more operational exercise of optimising processes for individual programmes, but may require deeper co-ordination with line ministries to put in place operational changes needed to achieve savings. For this reason, functional reviews could be better suited for identifying back office reforms such as shared services that do not affect service levels, but that may require large scale organisational changes.

Implementation of spending reviews

12. Depending on their objectives and circumstances, spending reviews may require specific incentives, leadership and structures. This depends on whether they are functional or strategic reviews, their scope (which expenditure areas are covered by the review), their level (whether the reviews are across programmes, policies or organisations, *e.g.* ministries and agencies), and other contextual and political variables. Therefore, these reviews should be clearly distinguished in order to identify differences in set-up, guidance, and implementation of the respective types of reviews in different countries.

Scope, level, and timeframe of spending reviews

13. The scope of the spending reviews in the annex cover both discretionary and mandatory expenditures (the UK only covers discretionary expenditure). Where there is political will, spending reviews can be a useful tool to review mandatory expenditures such as pensions and some health care expenditures, since these are subject to their own authorising legislation and are typically not determined in the annual budget process. The scope of reviews also applies to the level of government affected. In most cases, the spending review is of central government expenditure, and does not include regional or local budgets. In the case of Finland, however, having extended the Productivity Programme to the State regional level, there has also been some interest in also applying it at the municipal level.

14. As shown in Table 2, the spending review period can range from one year (Denmark) to 4-5 year cycles for reviewing all of the targeted programmes (In the case of Denmark, however, there is no goal to examine all programmes). Rules and procedures also range from the informal (Denmark) to explicitly defined scope and timing (Canada, Finland, UK). In other cases, the spending review process is in place, but receives more focus and use in greater times of need (Australia, Netherlands).

15. While perhaps best known when they are applied across government as a whole, spending reviews can also take place at the policy or organisational level. For example, while it does not currently conduct whole-of-government spending reviews, New Zealand has conducted sector reviews such as the “Child Health Programme Review” in 1998. The level at which spending reviews are conducted (by programme, policies or organisations) should fit the fiscal need, political will, and the available resources and capability to conduct the review. For example, the Canadian Strategic Review initiative, launched in 2009, asks each ministry to identify its top 5% and bottom 5% priorities. While still a strategic review, it conducts strategic prioritisation at the ministry, rather than whole-of-government level (*i.e.* comparing priorities across ministries) as was the case in the 1994 programme review. Limiting the scope of a spending review can serve to focus on areas of need, improve the speed of the process, and/or improve political consensus for recommendations in cases where there is an agreed-upon need. By the same token, a broader spending review can be seen as being more fair, as no sector or organisation is left unchallenged.

16. In terms of the results of spending reviews, these are expressed in different ways according to the original objectives and justification of the review. For the Finnish Productivity Programme, for example, results are primarily expressed in terms of personnel reductions as the review was conceived as part of the strategy to help Finland prepare for an aging civil service. Spending reviews with clear start and end dates (Canada, Finland, UK) were also more likely to state overall saving targets / saving achieved for the spending review as a whole.

Table 2: General characteristics of select spending reviews

	Scope (sectors reviewed; level of govt)	Level of review (horizontal policies, sector programmes, organisations)	Time frame/ Periodicity	Resulting savings options
Australian Strategic Review	All federal government expenditures can be reviewed	Horizontal policies and sector programmes	12 since 2008	383.4 M \$AUS in expected savings over 4 years through Job Capacity Assessment Review
Australian comprehensive expenditure review	<i>Ad hoc</i> selection from federal budget expenditure areas	Horizontal policies and sector programmes	<i>Ad hoc</i>	?
Canadian Program Review (1994)	All departments & organisations reporting to a minister and through a minister to Parliament were reviewed	Horizontal policies and sector programmes	1994-95 (review process) 1996-99 (implementation of proposals)	Programme spending declined in absolute terms by over 10% between 1994-95 & 1996-97
Denmark Spending Review	<i>Ad hoc</i> selection from central budget expenditure areas	Horizontal policies and sector programmes	Annual: 10-15/yr (up to 34)	?
Finland Productivity Programme	All central government expenditures, including State regional level	Sector programmes and organisations	Two phases: 2005-11, 2012-15	Reduced the public administration by 9,645 person-years in 2005-2011
The Netherlands Interdepartmental Policy Review	All central government expenditures	Horizontal policies and sector programmes	Since mid-80s	35 B EUR savings identified in 2009 spending review
United Kingdom Spending Review	All discretionary spending (60% of total) : key areas of Annually Managed Expenditure (AME) and Departmental Expenditure Limits (DELs) for each government department and for the devolved administrations	Horizontal policies and sector programmes	Biannual	203 B £ in discretionary spending cuts forecasted for the period 2011-2015

Leadership and decision-making of spending reviews

17. An analysis of the four case studies presented in the Annex (Australia, Denmark, Finland, Netherlands), plus Canada and the UK, show a wide range of responsibilities for spending reviews processes at different stages (Table 3). What the spending review process has in common across these countries, however, is a strong role at every stage for the ministry of finance. In fact, the ministry of finance role is not limited to managing the process and co-ordinating the final decision-making process, but also includes, in many cases, the development of reports and proposals (though this is often done jointly with the line ministry, or else by an independent working group). This may point to a perception that a more independent or adversarial approach is needed in order to reach fiscal consolidation targets.

18. In terms of the follow-up of spending reviews, the responsibility of achieving savings identified under the review will depend on whether or not a framework budget is in place and whether it is fixed or flexible. To the extent that the spending review recommendations are already taken into account by lowering budget allocations, then the work of achieving the actual savings rests with line ministries. The role of ministries of finance in monitoring and pushing for implementation of spending review decisions, however, could be further investigated, as well as whether their active involvement in follow-up improves the realisation of savings. Follow-up requirements may also be different for strategic reviews whose recommendations can sometimes be implemented through follow-up legislation as opposed to functional reviews which may require setting up reforms to organisational structures and processes.

Table 3: Primary responsibility for different stages of the Spending Review process

	Prime Minister's Office/Cabinet	Ministry of Finance	Line Ministries	Commission, Committee
Methodology & steering		Australia; Canada; Denmark; Finland; Netherlands; UK		
Selection of review scope (where all programmes are not reviewed)	Denmark (Economic Committee) (following MoF nomination)	Australia		
Preparing of reports & proposals		Australia (sometimes jointly with line ministry); Denmark (sometimes jointly with line ministry, also including use of consultants); UK (also mixed working groups)	Australia (sometimes); Canada; Finland; Netherlands (working party under independent leadership)	
Supervision & review of reports		Finland; UK	UK	Australia; Canada; Denmark (sometimes); Netherlands
Final decision-making	Australia; Canada; Denmark (Economic Committee); Netherlands; UK	Finland		
Monitoring follow-up		Australia; Canada; Finland; Netherlands; UK		

Other variables and questions to be addressed

19. Other factors that were not necessarily within the scope of the case studies, but which should be examined to understand possible success factors for spending reviews include the fiscal and political context; linkages to the budgeting, strategic planning, and electoral cycle; and the extent of political involvement and ownership of the spending review approach, objectives and process. For example, one would expect strategic reviews to have a greater need for political buy-in than functional reviews, whereas functional reviews could be led as a technical exercise by senior civil servants. For example, could a coalition government with a weak centre (as in the case of Finland) be a factor in the choice of a functional review where there is no consensus on what policy area could be cut, but where there is still room for a relatively strong ministry of finance to focus on finding efficiency savings? Finally, in terms of timing, a strategic review might have more of a chance of successfully proposing major changes in spending levels before the formation of a government, whereas under a standing cabinet, a spending review might be more successful if it is limited to looking for efficiencies. Additional questions that could be addressed in a deeper review of spending reviews in order to draw lessons for countries:

- Are reviews primarily used for fiscal consolidation? Have they also been used to make room for new spending priorities?
- What have been the outcomes of spending reviews (in terms of fiscal consolidation, but also equity and acceptability) compared to other budget reduction approaches such as haircuts or efficiency dividends?
- Under what circumstances have spending reviews encountered more or less resistance from the general public? From ministries and agencies?
- In what way is the effect of spending reviews linked to the perceived need for spending cuts by society and by politicians?
- Have some spending reviews included significant consultation and, if so, who was involved?
- What are the capacity, capability and data needs of spending reviews for ministries of finance? For line ministries and agencies?
- Have spending reviews identified structural and policy reform proposals as well as savings proposals?

Next Steps

20. Spending reviews are resource intensive undertakings; they require political will and government discipline, as well as informational, human and financial resources to effectively implement them and to follow through on their recommendations. It is therefore important -- all the more so in today's fiscal circumstances -- that ministries of finance understand what types of spending reviews have been used to meet specific fiscal goals and circumstances, and what have been the conditions for their success. Such information will allow ministries of finance to maximise the potential benefits of spending reviews, both in terms of the savings they are able to identify and in terms of the consensus and support they are able to garner towards achieving savings identified through the reviews.

21. The Secretariat aims to assist member governments in these causes -- identifying some key lessons and good practices from across the OECD to support the budget reallocation/cuts and improving existing processes for conducting reviews. As a preliminary step, the Secretariat first proposes testing its typology of spending reviews and expanding the research sample beyond the four initial case studies to include a broader selection of member and partner countries. As part of this information-gathering exercise, the OECD will draw from two main sources:

- Responses to the upcoming *OECD Performance Budgeting Survey*, due to be launched before the end of November 2011, and;
- Additional case studies obtained from further desk research and (voluntarily) submitted information from countries.

Source 1: 2011 OECD Performance Budgeting Survey

22. A draft questionnaire will be submitted for feedback at the 9-10 November 2011, meeting of the SBO Network on Performance and Results, with the final questionnaire expected to be distributed for completion before the end of the year.

23. Spending reviews are a cornerstone of the questionnaire framework³, which aims to identify changing trends in performance budgeting and to assess the kinds of performance information most commonly utilised by central government entities for different budgetary ends. Questions on Spending Reviews are therefore found throughout the survey, with respondents being asked to indicate for instance: (i) the primary government (and non-government) stakeholders involved in guiding, designing, and generating the reviews; (ii) the extent to which these reviews are utilised by Central Budget Authorities and Line Ministries in the allocation/re-allocation of funds; and (iii) the extent to which spending reviews are utilised for non-budgetary purposes (*e.g.* strategic planning or reforms).⁴

24. Additionally, Section 5 of this questionnaire asks respondents to provide information on recently conducted spending reviews in their own countries, including:

- **Descriptive information.** On the number of spending reviews conducted since 2005 and the total value of the programmes reviewed;
- **Approaches taken.** The scope of the spending reviews and the methodologies applied.
- **Results.** The value of the savings achieved.

Source 2: Additional case studies

25. A **case study template form** will be distributed along with the performance budgeting questionnaire invitation. Countries are invited to submit concrete examples of spending reviews in their countries and/or provide supplemental information to Section 5 of the Performance Budgeting Questionnaire.

26. While the questionnaire is centred on the key elements of the reviews themselves, the case study templates ask respondents to provide more contextual information: discussing the drivers/catalysts for the reviews for instance, the challenges they faced and how they were overcome, how it was ensured that recommendations were implemented following the review, and any innovative policies/practices adopted.

³ See Concept Note for Draft 2011 OECD Performance Budgeting Questionnaire.

⁴ See Draft Performance Budgeting Questionnaire for detailed questions asked on spending reviews.

Deliverables

27. Results of the questionnaire will be made publically available on the online OECD International Budget Practices and Procedures database, and may be published in the upcoming edition of *Government at a Glance 2013*.

28. Additionally, further analysis, lessons learnt and good practices will be published in upcoming editions of the *OECD Journal on Budgeting*, also available online.

Conclusion

29. Spending reviews are not "better" than other types of evaluation; nor are strategic reviews superior to functional reviews or vice versa. Each is a tool that corresponds to a specific need for spending reallocation or cuts and that requires political support and leadership, design and guidance capacity from the centre, and clarity of objectives and process for all participants. As such, spending reviews constitute a resource-intensive process in terms of analytical capacity, political capital and opportunity costs for operational initiatives. But where needs, support, and capacity are aligned, they can help identify low priority areas, justify budget cuts or reallocation, and build overall awareness of the need for budget reductions and for public administration reform. Spending reviews can also serve to make government more strategic, by pruning back functions that accrete over time, making fiscal space for new initiatives, and better aligning expenditure with political priorities. They require groundwork in terms of capacity to respond by line ministries and agencies, programme information and data, and political buy-in to support and act on the final results. Clarity on both the objectives and preconditions (political and administrative) are therefore needed for the successful design and implementation of spending reviews.

ANNEX A: SPENDING REVIEWS IN AUSTRALIA⁵

Spending review and programme evaluation

30. Spending reviews, as conceived in the OECD Value for Money Study, differs from program evaluation in three ways. First, spending reviews do not only look at the effectiveness and efficiency of programs under current funding levels but also examine the consequences for outputs and outcomes of lower funding levels. Second, the Ministry of Finance or the Prime Minister's Office holds final responsibility for the spending review procedure. Third, the follow up of spending reviews is decided in the budget process.

31. The need for spending review stems from the fundamental asymmetry of the budget process. Line Ministers have an incentive to put forward good proposals for new spending, in particular proposals that responds to urgent needs of citizens and that are based on effective and efficient programmes of service delivery. The better the proposals, the higher the chance of adoption. On the other hand, for the same reason (the better the proposals the higher the chance of adoption), line ministers have no incentives to put forward good proposal for new savings, in particular proposals that minimize effects on urgently needed services and that improve effectiveness of and efficiency of programmes of service delivery. If there are strong rules of budgetary discipline in place, as is the case in Australia, line ministers may only be interested in good saving proposals, if they need to compensate for overspending, or as part of deals to allow new spending, but apart from these specific situations, line minister feel no obligation to put forward good savings proposals for their own sake (or to allow tax relief or new spending on other portfolio's). This is fundamentally different with evaluation aimed at programme improvement without any budgetary consequence. Line ministers are responsible to parliament and citizens for the effectiveness and efficiency of their programmes and are therefore intrinsically motivated to conduct programme evaluation (particularly in the beginning of their term in office; towards the end they may become less interested in critical evaluations, if they can be blamed for not reforming programmes in an earlier stage). Since spending review is by definition (the OECD definition) aimed at the development of saving options, spending review cannot be relegated to line ministries, but should be conducted under the supervision of a central ministry (Finance or Prime Minister's Office).

Spending review and evaluation in Australia

32. Australia does not currently have a single framework covering all forms of evaluation and review. As components of the review environment, it is worth noting the difference between comprehensive expenditure reviews, strategic reviews and programme evaluations. Comprehensive expenditure reviews have been conducted periodically by the Australian government, most recently through the 2007-08 reviews that focused on identifying savings. These expenditures reviews are usually decided on an "as needed" basis and are not continuous in nature. In contrast, strategic reviews are now part of the

⁵ Exerpt from OECD Value for Money review of Australia (forthcoming): "Reform 7: Strengthening the spending review procedure".

Australian government's budget process and are an option for Ministers to directly target policies, programs and agencies designated either to be of strategic policy or budget importance (or to involve issues of strategic importance), with each review managed by the Department of Finance and Deregulation. Review topics are selected at the start of the budget process when priorities are set. Finally, programme evaluations are conducted by agencies to monitor and evaluate their programmes. The quality of these programme evaluations is quite variable between government agencies.

33. The Australian government is therefore looking to reform and strengthen monitoring and evaluation across agencies as tools for policy and budget development. For this the Department of Finance and Deregulation is examining practices used in other countries. It feels the challenge in strengthening monitoring and evaluation is not in commissioning more reviews by central agencies, but in embedding monitoring and evaluation as part of the normal policy implementation and delivery, with an effective mechanism for making information available to central agencies and Ministers.

34. The first effort to establish a permanent evaluation mechanism to support budget decision making in Australia occurred as part of the Portfolio Management and Budgeting (PMB) reforms in 1989. As part of these reforms, the Ministry of Finance introduced the Portfolio Evaluation Program (PEP) which required all portfolio ministers to establish a regular and ongoing system of program evaluation by scheduling all programs for evaluation over a 3 year period. A small group within Finance set down the methodology to be adopted, and a representative from Finance sat on the steering committee and were typically involved in the review team. However this was not a centrally managed process and evaluations were selected, conducted and used by the responsible line ministry⁶. This system was problematic from the outset: evaluation of any contentious programs was deferred by the line ministries; Finance tried to amend the PEP to ensure its concerns were on the agenda, and there was little evidence that evaluations influenced budget decisions⁷). Gradually the PEP system was replaced by a more 'market-based' process of pricing reviews under the accrual-outcome budgeting reforms. Here line ministries were expected to cost and then benchmark all programs against private sector providers to ensure efficient delivery⁸. These were also abandoned and by that time the government was managing a period of high budgetary growth.

35. In April 2007, the Government committed to establishing an enhanced framework for the strategic review of government programmes. This included establishing a team within the Ministry of Finance and Deregulation to conduct Strategic Reviews of major policy and spending areas across programmes and/or portfolios and significant Australian Government initiatives. The team is located in the Budget Group within the Department of Finance and it is responsible for managing the process as well as providing support to the review team leaders. The purpose of Strategic Review is:

- to identify options for improving the efficiency and effectiveness of expenditure programmes and their alignment with policy priorities (i.e. their appropriateness);
- to identify opportunities for savings (or avoidance of unbudgeted cost increases) in order to contribute to budget sustainability;

⁶ See Wanna and Kelly (2001).

⁷ See: ANAO (1996), McKay (1993); Di Francesco (1993).

⁸ See: Kelly (2002).

- to allow for resources to be reallocated to better address policy priorities and identify potential duplication.

36. Strategic reviews are not focused solely on operational efficiency, but have a whole of government focus, examining the alignment of programmes with Government priorities, the effectiveness and the efficiency of programmes and potential budget savings.

37. Under the framework, the Department of Finance and Deregulation (and Treasury in the case of tax expenditures) leads and manages reviews in close consultation with the responsible ministry or ministries. Where applicable Joint Strategic Reviews are conducted by the Ministry of Finance and the relevant ministry together.

38. Some twelve strategic reviews have been conducted since 2008 in accordance with the following process:

- a) Review topics are identified by the Minister of Finance who then requests Cabinet (or a sub-committee of Cabinet) to agree proposed reviews.
- b) Each review is conducted over approximately 4-6 months by approximately 4 team members.
- c) Strategic Reviews are usually led by a senior Finance officer or by an independent leader who is either a former public servant or eminent person. The review leader is supported by a team of officials from Finance and secondees from other relevant agencies.
- d) The team is supported by a consultative group of representatives from relevant agencies, including the Treasury Department and the Department of the Prime Minister and Cabinet, which provides expert advice to the team.
- e) Line ministries are invited to participate in the review via interviews or as part of a reference group, but they do not have any direct influence over the report or its recommendations.
- f) Reports are presented to the Finance Minister who brings it to Cabinet. With an expanded agenda for open and transparent government there is a trend for these reports to be published.

39. Although final reports are initially provided to the Minister of Finance and Deregulation (and the relevant minister in case of a Joint Strategic Review), the Government makes the final decisions on implementation of review recommendations.

40. Strategic Reviews are usually considered during the budget process. An example is the Job Capacity Assessment Review, which was considered in the 2010/2011 budget process. The review assessed the cost-effectiveness of Job Capacity Assessments in assessing people's work capacity and facilitating access to the Disability Support Pension and employment services. It examined the scope for reducing the cost of the programme and improving its effectiveness. The Government agreed the recommendations of the review to streamline the assessment arrangement for job seekers and Disability Support Pension claimants, which is expected to deliver savings of AUS\$ 383.4 million over four years.

Weaknesses in the current system of spending review and evaluation

41. This current procedure of strategic review has two flaws that hamper its effectiveness as a tool of budget management and reallocation. First, even though conceived more broadly, in practice the process has tended to focus on questions of appropriateness, policy alignment and operational efficiency (such as shared services). Consequently, the reviews may be aimed at more informed budget decisions rather

than just identifying savings. Although the procedure of strategic review has the typical characteristics of spending review (aimed at development of good saving options, supervised by Department of Finance and Deregulation, feeding into the budget process), the Australian government has thus far maintained a conceptual distinction between “strategic reviews” and “comprehensive spending reviews”, the latter aimed more explicitly at identifying savings and conducted on an “as needed” basis. Spending reviews in other countries usually require the development of one or more mandatory savings options (5, 10 or 20 percent of spending). Such a requirement leads to proposals for the reduction of service levels because the savings target can usually not be realized by efficiency measures only. The Australian strategic reviews do not require the development of mandatory savings options (except if the terms of reference of a review contain such a requirement on an *ad hoc* basis).

42. Second, the strategic reviews ought to compensate for the fundamental asymmetry of the regular budget process, that is the bias towards options for new spending over those for new savings. To address this bias, decision makers have tended to rely on new savings options that are not identified in portfolio budget submissions⁹. In the current situation, the strategic review reports are progressed to Cabinet for decision as part of the budget process but are not fully integrated into the process.

43. There is no explicit regulatory framework for programme evaluation as a tool for line ministries to assess the effectiveness and efficiency of their ongoing programmes (apart from any budgetary consequence). Such a framework is useful to guarantee the quality of evaluation and to make sure that evaluation remains objective and useful under all circumstances (also if the programme is controversial or towards the end of the term in office of a cabinet). Regulatory frameworks for programme evaluation exist in a number of OECD countries (for instance the “green book” in the UK and the Regulation Performance Data and Evaluation Central Government in the Netherlands). They generally contain rules for participation of external experts, supervision by a steering group, publication of the terms of reference and the report¹⁰.

Embedding spending review procedures into the budget process – lessons from spending reviews procedures in the UK and Canada

44. The strategic review procedure in Australia could be enhanced by adopting features from other countries’ procedures. The United Kingdom is known to have long-standing tradition of performing spending reviews. Canada has recently adjusted the spending review procedures to improve the alignment between reviews and the budget process.

45. In the United Kingdom, the spending review process started in 1998 as part of a wider set of reforms aimed at the modernization of public finance management. The aims of spending reviews were to support the biennial revision of the expenditure framework and ministerial ceilings. For that purpose,

⁹ Relevant to this, there is a compensation requirement in place in Australia. This implies, among other things, that an integral part of the Australian process of considering new spending proposals is a requirement that the proposing Minister also identify equivalent savings. However, spending reviews are not primarily aimed at helping line ministers to find sensible savings options in their own portfolio, but at helping the Minister of Finance to find sensible savings options in the portfolio of a line minister, in cases that such options are useful inputs for allocative decision-making that go further than compensation of new spending.

¹⁰ The Australian Government does have special rules for new spending proposals requiring that they set out the review and performance framework under which they would operate, including key dates and reporting requirements.

the spending reviews are supposed to reallocate money to key priorities; change policies so that money is well spent; ensure that departments work better together to improve services; and weed out unnecessary and wasteful spending. Spending reviews are produced by various types of working groups: some exclusively composed of Treasury officials, some of mixed composition. External experts are often invited to participate or chair the working groups. The completed reviews are discussed between the Chief Secretary of the Treasury (responsible for the Budget) or the Chancellor of the Exchequer and the line ministers. The British spending review process focuses on discretionary spending, which covers around 60% of total spending. This is the part of the budget that is subject to the fixed multi-annual ceilings. The remaining 40% is taken up by “annually managed expenditure” which includes social security, interest, and other items of mandatory spending, and is allowed to fluctuate to provide for the automatic stabilizers to perform.

46. In Canada, the Strategic Review was established in 2007 as part of the new expenditure management system. The reviews are managed by a small secretariat within the Treasury Board Secretariat and undertaken as part of the Treasury Board Secretariat’s dual role as budget office and management board. The process applies to all direct program spending and the operating costs of statutory programs; review results feed into the annual budget process and are announced in the annual budget. Strategic Reviews have three key aims: to ensure the efficient and effective delivery of departmental programs, that departmental spending programs align with the federal government core responsibilities and that departmental spending is aligned with the government’s key priorities. All reviews must identify options for restructure and program redesign, and at least 5% of total spending must be “freed-up” for reallocation from the “lowest priority, lowest performing”.

Reform options

47. The Australian procedure could be enhanced by ensuring better linkages between the spending review process and the budget process along the lines of experience in either Britain or Canada. In both countries, the process is used as a tool for strategic reallocation; in Britain every two or three years, in Canada annually. The process in Canada is relatively new. The experience in other countries that have tried annual procedures (Denmark and the Netherlands) is that it is difficult to maintain an annual process in the long run (i.e. getting a number of sufficiently important reviews approved each year), particularly in years that there are no major revisions of the expenditure framework, so that results can only be used for intra-ministerial reallocations. In the Netherlands the procedure is now coupled with the quadrennial revision of the expenditures framework in a similar way as it was coupled in the UK to the biannual revision of the expenditure framework¹¹. This points in the direction of a procedure that is strongly coupled to the budget process, but perhaps not each year.

48. In Australia, this could be achieved by ensuring that each new cabinet confirms the need for strategic reallocation in the budget process at the same time they announce the budget and fiscal strategy as required under the Charter of Budget Honesty¹². Selection of the specific topics for review could occur during the first ‘strategic’ or priority-setting stage of budget preparation, which is currently around August. The Minister of Finance recommends the selection of policy areas to be reviewed and the

¹¹ The UK has now (in 2010) moved to a five year expenditure framework. Whether this implies that the spending review exercise also moves to a quinquennial procedure remains to be seen.

¹² Generally, fiscal strategy statements required under the Charter of Budget Honesty are released with each budget. However, the current medium-term fiscal strategy has been in place since 2009 and it is this strategy that provides the framework for decisionmaking in each budget.

composition of the working parties. This is standard practice in both the UK and Denmark¹³. The line ministry can be invited to join the working parties and be invited to submit its own options¹⁴. The strategic reviews would then be undertaken during the three months when portfolio budget submissions are prepared, and recommendations discussed and agreed during the more detailed budget negotiations between the portfolio minister and Expenditure Review Committee that occur during March-April, and announced in the Budget. This option would limit the depth and reliability of strategic reviews as they are presently configured, partly because the strategic reviews would be competing directly with mainstream budget processes for resources and attention. On the other hand the practice of conducting spending reviews in three or four months is standard in countries like Canada, Denmark, the Netherlands and the UK, and has proven to be successful. In order to avoid “review fatigue” and to avoid too much competition for attention with the regular budget process, the Australian government could also align the procedure more closely to strategic budget revisions, which typically do not occur every year (the reason why the Australian “comprehensive spending reviews” are not conducted every year). The procedure could be set up as biennial process (like in the UK), or, if it is coupled to the strategic reorientation occurring at the start of a new cabinet period, as a quadrennial process (like in the Netherlands) but for the rest follow the time schedule outline above.

Recommendations

- a. *The Australian government may consider institutionalising the spending review procedures as part of the budget process, rather than as separate advice for the Minister of Finance. To this end, the strategic review process should be linked more closely to the government’s procedure of budget preparation and be more explicitly aimed at development of savings options (thus eliminating the conceptual difference with comprehensive spending reviews).*
- b. *The Australian government may consider selecting the subjects of strategic reviews as part of the strategic phase of the budget process. Strategic reviews need not be conducted every year but can be organised according to a biennial or quadrennial cycle along the British or Dutch lines.*
- c. *The Australian government may consider to establish a regulatory framework for programme evaluation as a tool for line ministers to assess and improve programme effectiveness and efficiency. Such a framework should provide guarantees for quality and objectivity such as rules for participation of external experts, supervision by a steering group, publication of the terms of reference and the report.*

¹³ The Danish Minister of Finance informs the cabinet committee of economic and financial affairs (which he chairs) on the spending reviews he has approved.

¹⁴ In this respect the Irish procedure of spending review could also be relevant to Australia (for an outline, see the Value for Money Country Assessment of the Netherlands, OECD, forthcoming).

ANNEX B: SPENDING REVIEWS IN DENMARK¹⁵

Spending review versus evaluation

49. The use of spending reviews is wide-spread and most Value for Money countries report that they use spending review procedures.¹⁶ The exact nature of spending review mechanisms differs greatly across countries, however, there are a number of key principles that differentiate spending review procedures from evaluation (Kraan 2007, Mullen 2006). Compared to performance evaluations, spending reviews differ in three ways. *First*, spending reviews do not only look at the effectiveness and efficiency of programs under current funding levels but also examine the consequences for outputs and outcomes of alternative funding levels. *Second*, the Ministry of Finance or the Prime Minister's Office hold final responsibility for the spending review procedure. *Third*, the follow up of spending reviews is decided in the budget process. These differences are the key features which make spending review an essential tool for the Ministry of Finance in promoting the dual aims of fiscal discipline and enhanced Value for Money across government.

50. Spending review procedures are seen as a useful tool to evaluate current spending programmes and to make room for new initiatives, hence supporting the allocative function of the budget. Spending reviews compensate for the fundamental asymmetry of the regular budget process, which is capable of producing good options for new spending, but not of producing good options for new savings. The basic reason for this is that line ministers want to maximize the chance of adoption of new spending proposals, but to minimize the chance of adoption of new savings proposals in their portfolios. One method to compensate for this asymmetry is to impose strict portfolio ceilings, which force the line ministers to come with good savings proposals to compensate for setbacks and new initiatives. However, this mechanism does not work at moments when the ceilings are established or adjusted. In most OECD countries the ceilings are adjusted annually, in some countries every few years.

Current spending review procedures in Denmark

51. The current spending review processes in Denmark are informal and guided by established practices rather than any standard procedures and recommendations from spending reviews are incorporated into the budget process on an *ad hoc* basis. In contrast to many countries included in the Value for Money study, the Danish system of spending reviews operates in an annual cycle, with between ten to fifteen spending reviews conducted each year (although this has been as high as 34 reviews). At present there are no standard review processes to guide the selection of topics, the conduct of individual reviews, questions of who should be engaged in the process, or how recommendations that flow from

¹⁵ Excerpt from OECD Value for Money review of Denmark (forthcoming): "Reform 8: Strengthening the spending review procedure".

¹⁶ The exceptions are Austria, Norway and New Zealand although the latter has used spending review procedures in the past.

the review should be formulated or disseminated. This means individual budget analysts within the Ministry of Finance have a high degree of discretion in relation to the subject and conduct of each review. In practice, budget analysts take inspiration from previous reviews and there is some similarity in the way the reviews are organised and conducted.

52. Subjects for spending reviews are typically nominated by the Ministry of Finance on suggestion of desk officers and approval of the Economic Committee. The identification of possible subjects for review will occur during the early phase of budget preparation as budget analysts undertake their initial scans. If there is evidence that a particular program or department is experiencing upward pressure on spending ceilings, then analysts can nominate it for possible review. After internal vetting in the Ministry of Finance and a dialogue with the involved line ministries, a list of proposed spending reviews is drawn up and presented to the Economic Committee of Cabinet. The selection of review topics is therefore entirely incremental with no intention of ensuring a comprehensive coverage of all major spending programmes over a given period of time.

53. The reviews themselves are then conducted over a relatively short period of time. The Economic Committee typically decides which reviews to mandate sometime during February. Reviews are undertaken over the next two months, with an aim to have results ready by the beginning of May. This is to ensure that possible savings can be incorporated in the first draft of next year's fiscal budget which is due in June. As a result, spending reviews are typically "vertical" reviews which focus on a specific agency or programme, and they are focused on questions of efficiency to control spending within budgetary limits. This system does not facilitate interdepartmental policy reviews nor is it intended to provide options for far-reaching policy change or program redesign.

54. There is also a high degree of variation in terms of who conducts the spending reviews in Denmark and whether or not key actors are engaged to undertake the reviews. Some reviews are undertaken by the Ministry of Finance alone, others in a more open process. In smaller reviews, the organisation and procedures will be less formalised and the review will be conducted internally with contact with the relevant line ministry. For larger more comprehensive reviews external experts or consultants are involved in the analysis and they are typically overseen by a steering committee including the relevant line ministry. The line ministry will contribute with facts – as information asymmetry is inevitable – and will be involved in vetting conclusions from the review. The role of the Ministry of Finance is inquisitorial and analysts will challenge established views and procedures.

55. When the reviews are finalised results are provided to the Steering Committee. The Ministry of Finance and the affected line ministry prepare a common presentation, although they are able to give separate advice in cases where the two disagree on conclusions or recommendations. Decisions on whether or not to accept recommendations of the review are taken by the Economic Committee for inclusion in the budget. There are no formal mechanisms for ensuring that recommendations are implemented, although the Ministry of Finance will often monitor implementation and funding levels assume that changes have been implemented. Finally, some reviews are published or made available on the internet, some are not and the decision remains with the Economic Committee of Cabinet. If they are made publicly available, it will be the full reports, including conclusions and recommendations and only take place after the government has decided upon recommendations.

Suggested reforms to spending review procedures in Denmark

56. Experience from practices in the UK, the Netherlands and (in recent years) in Ireland suggests some options for reforming the spending review procedure in Denmark. Firstly, the Danish spending review

procedure could be strengthened by building more rigour, standardization and expertise into the existing process across three specific areas: (1) formal articulation of the spending review processes including procedures for selecting review topics and how individual reviews should be conducted; (2) clarification of the focus of reviews including the type of recommendations and options for reform that should be included in reports; and (3) directions on how recommendations should be disseminated and incorporated in the budget process. Second, establishing a specialist spending review team within the Ministry of Finance would strengthen the internal capacity to conduct spending reviews and provide the basis for a more co-ordinated approach to selecting review topics, and ensuring broader consultation with relevant line ministries and external experts from outside government. The question of whether spending reviews should occur annually and selective or periodic and comprehensive is unresolved in the countries included in the Value for Money study, although there is evidence that the latter is more sustainable over time as it reduces the likelihood of "reform burnout". There is also a tendency to link spending review to the revision or extension of the expenditure framework. Countries that use rolling frameworks tend to opt for annual procedures, countries that use period framework tend to opt for periodic spending reviews.

Country experiences

Spending review in Ireland

57. In November 2008, the government in Ireland announced the establishment of a comprehensive spending review (the Special Group on Public Service Numbers and Expenditure Programmes) to examine the current expenditure programmes and to make recommendations for reducing the civil service. External experts from both the public and private sector were invited to participate. The secretariat was provided by the Ministry of Finance.

58. Interestingly, the group in Ireland introduced a "court like style" working process: each line ministry was invited to meet the group and submit an evaluation paper in advance. The purpose of the evaluation paper was to give line ministries an opportunity to outline possible savings options and the impacts on outputs and outcomes. In parallel with this process, the group requested the Ministry of Finance to prepare independently their own evaluation papers with options for expenditure and staff reductions. Both sets of evaluation papers were considered by the group in advance of meetings with the management teams of each line ministry. Subsequently the group produced its own savings options, making use of all information thus obtained. This "accusatorial" rather than "inquisitorial" set up of the process puts more responsibility on the Ministry of Finance to develop its own savings options than the Dutch procedure, which tends to encourage a wait and see attitude in the Finance representatives. It also provides an impetus for core ministries to engage in the review process rather than working to block the process.

Spending review in the UK

59. In the United Kingdom, the spending review process started in 1998 as part of a wider set of reforms aimed at the modernization of public finance management. The aims of spending reviews were to support the biennial revision of the expenditure framework and ministerial ceilings. For that purpose the spending reviews are supposed to reallocate money to key priorities; change policies so that money is well spent; ensure that departments work better together to improve services; and weed out unnecessary and wasteful spending. Spending reviews are produced by various types of working groups: some exclusively composed of Treasury officials, some of mixed composition. External experts and prominent personalities from the public and private sector are often invited to participate or chair the

working groups. The completed reviews are discussed between the Chief Secretary of the Treasury (responsible for the Budget) or the Chancellor of the Exchequer and the line minister. The British spending review process focuses on discretionary spending, which covers around 60% of total spending. This is the part of the budget that is subject to the fixed multi-annual ceilings. The remaining 40% is taken up by “annually managed expenditure” which includes social security, interest, and other items of mandatory spending, and is allowed to fluctuate to provide for automatic stabilization.

60. The UK’s Comprehensive Spending Review is explicitly linked to the setting of Departmental Expenditure Limits on a periodic basis. In 2010, the UK’s new coalition government used a Comprehensive Spending Review to distribute large-scale expenditure reductions planned over a five-year period across the various ministries.

Spending review in the Netherlands

61. The procedure of spending reviews in the Netherlands include the following basic features. First, spending reviews are conducted by working parties of civil servants from several ministries and external experts under the chairmanship of prominent persons who do not bear responsibility for current policies. Second all spending reviews are supported by a discrete unit in the Ministry of Finance which provides the secretariat of all working groups. Third, the reviews must be primarily forward looking and include reform options based on an evaluation of the current policy, and the reform options must lead to savings (with an obligatory minus 20 percent option). There is no veto right in the working parties on any policy option proposed. Finally, the overall spending review system is supervised by a committee of high level officials of the central ministries (Prime Minister’s Office, Finance, Economic Affairs, Ministry of the Interior and Kingdom Relations), and decision-making on recommendations within the reports must be integrated into the budget process.

62. The Dutch procedure initially operated under an annual mechanism but recently moved to a more periodic and comprehensive system. From 1981 until recently the procedure was annual and selective, with ten to fifteen interdepartmental reviews undertaken each year. However, the number of reviews fell continually and during the ‘00s around 3 to 5 were conducted each year. Insiders argue that the annual system was too burdensome especially during a period of fiscal plenty which diminished the impetus for reviews to provide options for expenditure restraint via comprehensive policy redesign.

63. The Dutch procedure was reinvigorated during the recent fiscal crisis and a series of working parties undertook a comprehensive review of all major spending programmes in the public sector. This has now been set as the norm. It is probable that in the future the procedure will run to a multi-year cycle in which all major spending programmes are reviewed in the year before elections. The reports of each spending review are published and made available to the public and political parties before the start of electoral campaigns. It is expected that the in-coming cabinet will use recommendations from the spending reviews as the basis for their forward policy agenda.

Recommendations

The Danish government may consider strengthening the spending review procedures by:

- *introducing a multi-year review cycle in which all major spending programmes are reviewed. This may follow the Dutch and British examples where a comprehensive review is undertaken periodically in line with the update of expenditure limits (UK) or in the year before elections (Netherlands).*
- *formalising key features of the procedures as this will reduce the need for budget analysts to 'reinvent' the system with each review. Essential elements are: selection of policy areas on the proposal of the Minister of Finance, to be endorsed by the Economic Committee (as is already the case in Denmark), participation of external experts in the working parties conducting the reviews, participation of the officials of the Ministry of Finance and the Prime Ministers Office in the working parties, independent chairperson of the working party, mandatory savings options, no veto right on options to be introduced in the reports, publication of reports.*
- *the Ministry of Finance should create a spending review unit within the Ministry of Finance to support the review process and undertake some of the initial research. This is current practice in Netherlands and Australia, where teams of approximately ten officials provide the expertise and technical skills to support working parties undertaking individual reviews. The secretariat should also provide an interface between the individual reviews and the broader budget process by ensuring the reviews are conducted in a timely manner and they remain focused on questions that lead to recommendations that can be used in the budget process.*
- *the reviews should focus on the efficiency and effectiveness of current policies including the appropriateness of current service levels and delivery systems; reviews should contain policy options to improve efficiency and effectiveness and also include obligatory savings options of a certain percentage (at least 10 percent to be determined at the start of each round of reviews). Options to increase expenditures should not be allowed in spending reviews as such options can be developed by the line ministries themselves.*

ANNEX C: SPENDING REVIEWS IN FINLAND¹⁷

The Productivity Programme

64. As the world economy begins to recover from the global financial crisis, political and financial leaders have begun to emphasise the importance of fiscal consolidation in promoting sustainable growth. The cost of delivering public administration is an easy target for harvesting savings to reduce government spending. Increased spending and reduced revenues are putting pressure on budgets already strained by demographic change and current obligations. Public sector efficiency measures can provide the opportunity for a renewed focus on increasing public sector productivity and value for money, and can thus help with internal re-allocations from lower to higher priorities.¹⁸

65. In Finland, the Productivity Programme, which has been in operation since 2004, is being used to increase the efficiency and productivity of the Finnish central administration (See Box 1). Managed by the Budget Department in the Ministry of Finance, its objective is to maintain pressure to achieve and harvest public sector efficiencies through government administrative structures, exploiting ICT more effectively and enhancing processes in central government, with a view to permanently reducing government staff numbers and improving labour competitiveness, curbing expenditure growth and increasing the potential to re-allocate resources.

¹⁷ Exerpt from OECD Public Governance Review of Finland (2010): “Chapter 6: Resource Flexibility”.

¹⁸ OECD (2009), *Government at a Glance*, OECD, Paris.

Box 1.**The Productivity Programme and the Decision on Central Government Spending Limits**

Both the Productivity Programme and the Decision on Central Government Spending Limits emphasise the importance of strategic planning and human resources development and management to increase productivity and efficiency in a sustainable way.

The Central Government Productivity Programme, 2005-2015

The Ministry of Finance is currently responsible for leading the Central Government Productivity Programme, 2005-2015. Each administrative domain of the central government, and individual government agency and institution, is responsible for carrying out the Ministry's policies. The main objectives are:

- increasing the productivity and efficiency of the central government and services through structural and functional reforms;
- systematic use of productivity advantages;
- encouraging an increase in productivity, economic efficiency and structural and functional reforms through the finance and guidance systems, and the government subsidy system;
- using IT and data communications to increase productivity;
- introducing adequate reforms to increase labour-force competitiveness and know-how; and
- making available adequate research and development work about public sector productivity.

Public services should be produced as productively, economically and effectively as possible using available personnel. The focus is on leadership and management, operational processes, utilising IT and, first and foremost, on developing the know-how, motivation and professional well-being at work of the staff.

Decision on Central Government Spending Limits in 2007-2011: Productivity actions decided by the government

The government has implemented action packages to improve the productivity of government, addressing service structure reform, improving structures and operating methods in central government operations, and improving the use of IT.

With increased productivity, the number of personnel can be adjusted in a controlled manner. The aim is to reduce the number of central government personnel by a total of 9 645 person-work years by 2011, *i.e.*, 7.9% of the total central government person-work years. The reduction in the number of personnel covers only one-third of the estimated natural attrition. In its second phase the programme will aim to reduce the number of central-government officials by an additional 4 884 person-work years between 2011 and 2015.

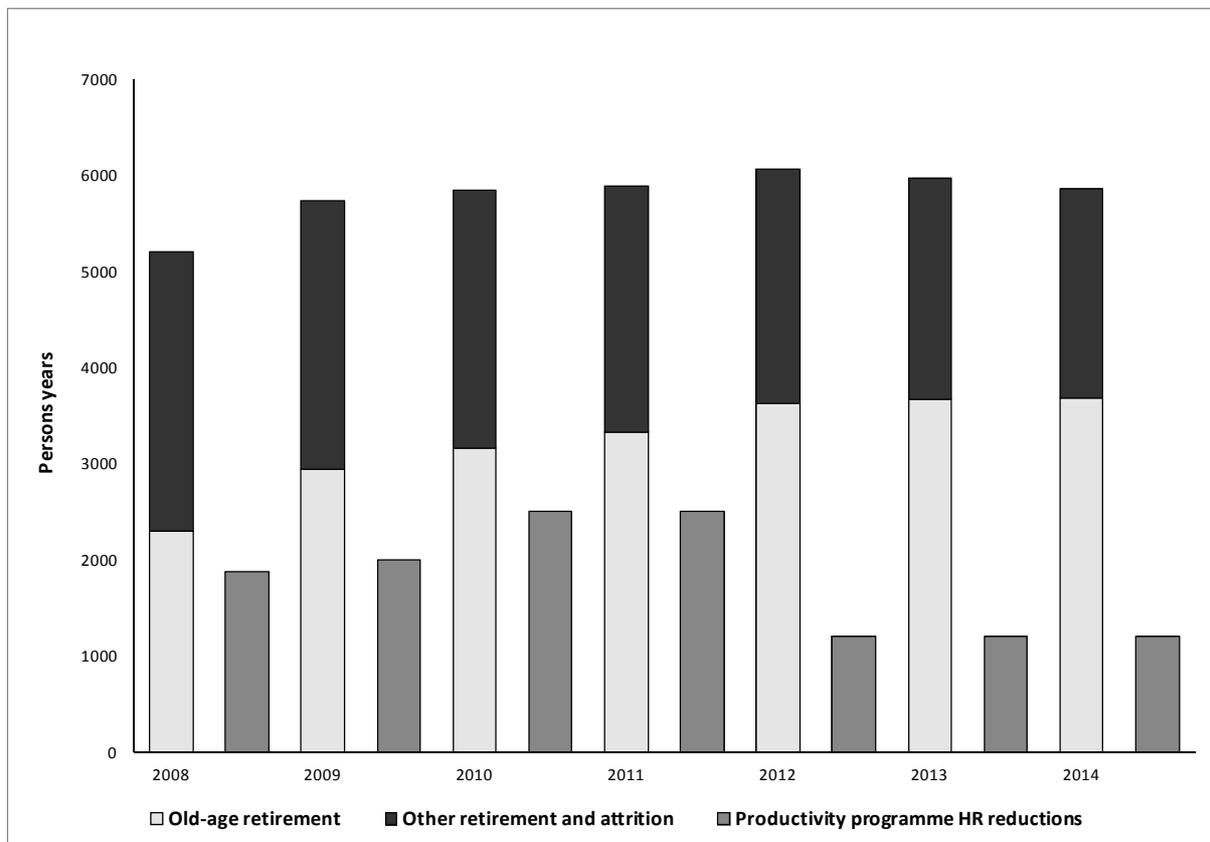
All targets and measures are based on productivity programmes drawn up by the ministries in the administrative branch in 2004 and 2005, followed by further joint preparations by the ministries and the Ministry of Finance. This programme does not include local governments and their productivity measures.

Source : Ministry of Finance, Finland.

66. While the aim of the Productivity Programme is to increase efficiency and productivity in the Finnish public administration, it is often perceived by government personnel as exclusively focusing on reducing the number of staff rather than creating the conditions for increased innovation and efficiency. This is, in part, because reducing staff numbers is a major government priority, including a target of

reducing the public administration by 9 645 person-years by 2011, and an additional 4 884 person-years by 2015. Working towards this target, the Ministry of Finance estimates that by the end of 2008, a reduction of 3 700 person-years was achieved. The required cuts for 2009 equal 1 940 person-years (including universities), which the Ministry of Finance advises will have been achieved through natural attrition, as over 5 500 public servants are expected to retire or transfer every year (See Figure 6.1).¹⁹ Through the Productivity Programme, the central government was able to re-allocate EUR 250 million in administrative branches in 2008, and officials estimate that EUR 360 million was re-allocated in 2009.

Figure 1. Central government human resources attrition projections and Productivity Programme HR reductions, as at January 2009



Source: Ministry of Finance, Finland (2009), *Budget Review January 2009*, Ministry of Finance, Helsinki, p. 27.

67. The Ministry of Finance has supported various productivity projects since 2005 through special centralised funding for promoting productivity in the state administration. There is centralised funding intended for promoting productivity, e.g., to support productivity projects within the administrative branches. An annual unallocated appropriation of EUR 80 million has been reserved from 2012 forward for the development of information systems and other productivity-promotion needs.

68. More could be done, however, to link these resources to an analysis of bodies’ needs and shared experiences about how to unleash organisational productivity. While ministries and agencies depend on

¹⁹ Ministry of Finance (2009), *Budget Review January 2009*, Ministry of Finance, Helsinki, p 26.

public management reforms such as ICT and process re-engineering to achieve expected savings under the Productivity Programme, the Productivity Programme itself is not explicitly linked to any of these other reform areas, which mainly fall under the responsibility of the Ministry of Finance's Department of Public Administration. There is no assurance that bodies that are unable or unwilling to improve efficiency will not see their cuts simply result in reductions in service, strategic planning and/or staff morale.

69. Many people interviewed by the OECD commented that staff cuts have actually limited organisational capacity to allow staff to work on developing innovative ways to increase productivity. A review of Australia's efficiency programme confirms this view. It found that small agencies did not have the same capacity as larger ones to absorb cuts imposed by the efficiency programme and to improve processes. The perception in some quarters that the Productivity Programme is only focused on cutting staff numbers can also create a barrier to the introduction of new ideas by ministries.

70. Ultimately, in the absence of innovative practices to support increased productivity, the large loss of staff due to the Productivity Programme's HR reductions and retirements will have the effect of forcing remaining staff to do the same amount of work with fewer resources. Without accompanying innovation programmes, it will likely result in a flow-on impact for the future workforce through increased work intensification rather than working smarter.

71. In order to actively promote innovation and productivity, the Programme could better link staff reductions with efforts to examine the capacity needs associated with work intensification, for example through analyses of work capacity and reviews to identify possibilities for business process re-engineering, administrative simplification, and value for money. This would also help to identify innovative practices that could be generalised and reinforce the capacity of the Productivity Programme to help re-direct resources to priority areas. The key to success is cross-sectoral execution facilitated by the Ministry of Finance and the Productivity Programme.

72. The Finnish government needs to create an environment that makes room for the achievement of efficiency and productivity through public services innovations. Innovation will be one of the keys to accelerating recovery from the global financial crisis and putting countries back on the path to sustainable, and smart, growth. Today's exceptional economic stimulus measures represent a unique opportunity for public policy to foster innovation. In the past, Finland was a world innovation leader. While this title has been lost in recent times, in the public administration context Finland's ability to draw on its past and to harness innovation will prove to be the key to increasing and sustaining productivity and efficiency in the public sector over the longer term.

73. Since the launch of the Productivity Programme, efforts have been underway to connect it, and the monitoring of productivity projects, more closely with the budget preparation and spending decisions. Efficiency programmes are only effective in the long term if they are directly linked to the use of ICT investments, process re-engineering, and market-type mechanisms; and if they allow harvested gains to be re-allocated through the budget process.

74. Achieving productivity improvements also requires taking a whole-of-government view of government activities. As public sector bodies reach the limit of the efficiencies that they can achieve within their own organisational boundaries, a cross-government approach can help to create further

efficiencies for the government as a whole – for example, through Shared Service Centres.²⁰ Given the whole-of-public administration scope of the Productivity Programme – including regional administration – it is well placed to play a role in helping to identify such cross-cutting opportunities.

75. The development and broad use of Shared Service Centres is perhaps the area where the Ministry of Finance has most made use of the Productivity Programme to focus efforts to increase productivity. Results achieved include the transfer of administrative and human resources management tasks to service centres, implementation and introduction of a joint administrative and human-resources management information system configuration for government agencies, centralised procurement activities, and the Government IT Service Centre. Finland has already been pursuing a programme to integrate back-office systems for state administration through Shared Service Centres and has centralised procurement activities. The centralisation of state ministry and agency procurement activities continues to increase, producing approximately EUR 170 million in savings per year.

76. The Shared Service Centre has the potential to succeed in Finland, with the expectation that state ministries and agencies will use one Shared Service Centre for all HR and financial services by early 2010. However, shared services do not guarantee greater efficiency in and of themselves. These efforts have been implemented under the umbrella of the Productivity Programme, which could be useful for ensuring that actual benefits are realised. There is also room to further consolidate Shared Service Centre arrangements, designating each of the six regional locations as centres of excellence for specific tasks. For example, ministry and agency administrative and human-resources management tasks were centralised in 2010 when four service centres were merged. This action created efficiency savings of some 400 person-years, and plans for further development of Shared Service Centres are underway.

77. The Productivity Programme has forced many ministries to look at their operations and come up with efficiency proposals; it appears to have led to innovation in some areas – particularly with the police in the Ministry of Interior and the research institutes associated with the Ministry of Agriculture and Forestry. Following initial reductions of “low-hanging fruit”, however, the Productivity Programme will be more pressed to look explicitly at how, and not just where, efficiencies can be achieved – including lending assistance to smaller bodies and identifying cross-cutting efficiencies, for example through the use of shared services. In the absence of efforts to support public sector innovation and delivery of services linked to the Productivity Programme, gaining substantial efficiencies from sources other than staff cuts will be difficult – thus limiting opportunities to increase efficiency and effectiveness.

Capacity to re-prioritise

78. While executive budget flexibility addresses the government’s procedural needs to re-allocate budget resources, it does not measure its impact on the provision of government goods and services, the internal management capacity to recognise when re-allocations are necessary, or the soundness of decision making processes that result in budget re-allocations. Flexibility in the budget is useless unless the government has the capacity to re-prioritise spending.

79. The Government Programme, managed by the Prime Minister’s Office, and the spending-limits framework, managed by the Ministry of Finance, are considered the two key strategic planning tools in the Finnish public administration. While the Government Programme (and Strategy Document) focuses

²⁰ OECD (2010), Restoring Fiscal Sustainability: Lessons for the Public Sector, *Public Governance Committee: Working Party of Senior Budget Officials*, OECD, Paris.

on whole-of-government priorities, the spending-limits framework allocates funds at the ministry level. Although the two processes have been aligned in timing under the Programme Management reforms, resources and desired horizontal outcomes are linked only to a certain extent. This presents a gap in setting strategic policy agendas and the means for steering implementation. While performance information presented in the budget does link back to goals laid out in the Government Programme, this information has little direct bearing on the financial allocation decisions that drive incentives and resources for implementation.

80. As a result, some officials have reported that as successive governments come to power, new expectations/programmes are layered on top of previous commitments, with no review of existing policies/programmes. As a result, some ministries and agencies are finding it increasingly difficult to manage their budget allocations to deliver on ever-increasing expectations.

81. The disconnect between the preparation of the Government Programme and Budget impacts the public administration's ability to focus resources on the government's priorities. The Budget allocates funding at the portfolio level rather than the programme and project level. Therefore, it is up to each ministry to interpret how to use its budget allocation to best realise the priorities laid out in the Government Programme. When the Government Programme is prepared at the start of a new government term, however, there is no formal stocktaking of existing projects and programmes and whether they should continue to be funded. In this sense, the new Government Programme is layered on top of former priorities. This makes it difficult for the public administration to know where to focus, and for ministries to stretch resources across commitments. It also creates a budget environment where the government is not forced to prioritise its objectives, creating a political accountability vacuum.

82. Many OECD countries use sunset clauses, time limits, and statutory monitoring requirements as part of the authorisation for new expenditure areas in order to ensure that government priorities can be continuously updated. The lack of real accountability for performance information has meant that the information produced in the budget is of varying quality and cannot, for the moment, be used for prioritisation. Tying incentives to improve the overall quality of performance management and information to the budget process would create more reliable information. There is more immediate scope, however, for the greater use of value-for-money and programme reviews to assess the continued usefulness and relevance of programmes and of government spending (See Box 2).

Box 2. Budget reviews in Australia

Australia ranked second among OECD countries (almost equal with Finland) on the use of performance information in the budget process. Expenditure and programme reviews are a central feature of the Australian budget process, and the area where performance information is used to inform budget decision making. The Department of Finance and Deregulation is responsible for procedures for identifying and managing reviews, in co-operation with other departments. Decisions on which major areas of public expenditure should be reviewed in any given year are made by senior ministers in the budget process. The results of the reviews are considered at the beginning of the following year's budget process by the senior ministers setting budget priorities. A small number of strategic reviews of major programmes and cross-agency themes, including tax expenditures and taking account of inter-generational considerations, are undertaken each year. This process supplements agency performance measurement and evaluation activities. Wider independent review and evaluation activity relating to government policies and programmes also occurs, for example through parliamentary inquiries, independent commissions, eminent persons and non-government organisations. In Australia, major and whole-of-government initiatives may require cross-portfolio agreement on evaluation and review of strategies; this may include the departments and agencies involved in implementing the policies as well as the Ministry of Finance and/or the Department of the Prime Minister and Cabinet.

Source: OECD (2007), Performance Budgeting in OECD Countries, OECD, Paris.

83. Finland's difficulty is that the Government Programme, developed by coalition parties before the start of a new term of government, is formulated outside of the formal governance structure of the budget process. The OECD has previously noted the challenges this can create for good governance in Finland, and in the past recommended that the Ministry of Finance have a more formal and transparent role in advising the political parties on budgetary matters when the Government Programme (Coalition Agreements) is being negotiated²¹.

²¹ Ibid, p 123.

Recommendations***Put mechanisms in place to re-assess needs***

- *Implement a systematic assessment and evaluation culture to foster priority setting and resource flexibility: introduce systematic ex ante financial and performance assessment of new legal regulations and programmes and evaluate the results after a certain period of time.*
- *Consider using programme review to eliminate and/or reduce “programme spread” and to refocus the work of the public service on priority areas.*

Improve resource flexibility of people: strengthen capability to realise the government vision

- *Align incentives and capability to innovate by tying soft tools that enable innovation, e.g., training and technical assistance, with hard tools that create pressure for innovation, e.g., Productivity Programme.*
- *In view of the ageing workforce, conduct whole-of-government workforce planning to identify sector and cross-government hiring and development needs, starting with capability reviews.*

ANNEX D: SPENDING REVIEWS IN THE NETHERLANDS²²

Spending review versus evaluation

84. Spending review procedures are seen as useful tools to evaluate current spending programmes and to make room for new initiatives, hence supporting the allocative function of the budget. Spending reviews compensate for the fundamental asymmetry of the regular budget process, which is capable of producing good options for new spending, but not of producing good options for new savings. The basic reason for this is that line ministers want to maximize the chance of adoption of new spending proposals, but to minimize the chance of adoption of new savings proposals in their portfolios. One method to compensate for this asymmetry is to impose strict portfolio ceilings, which force the line ministers to come with good savings proposals to compensate for setbacks and new initiatives. However, this mechanism does not work at moments when the ceilings are established or adjusted. In most OECD countries the ceilings are adjusted annually, in some countries every few years. In the Netherlands the ceilings are in principle fixed for a four year cabinet period, but reallocations between line ministries are possible in between (but rare in practice).

85. Spending reviews differs from performance evaluations by line ministries. Obviously, line ministers have strong incentives to improve their policies. Performance evaluations can be an important tool for that purpose. They are held accountable by the Parliament and the public expects value for taxpayer's money. However, line ministers may not always be interested in publishing critical assessments of policies they are responsible for, particularly after they have been some years in office. Consequently, performance evaluations not always give the complete picture. Moreover, performance evaluations generally do not focus on savings and, in so far as they are forward looking, they tend to produce options for improvements of outputs, rather for cost reductions.

86. Compared to performance evaluations, spending reviews differ in three ways. *First*, spending reviews do not only look at the effectiveness and efficiency of programs under current funding levels but also examine the consequences for outputs and outcomes of alternative funding levels. *Second*, the Ministry of Finance or the Prime Minister's Office hold final responsibility for the spending review procedure. *Third*, the follow up of spending reviews is decided in the budget process.

87. The use of spending reviews is wide-spread. All Value for Money countries report that they use spending review procedure, except Austria, Norway and New Zealand (the latter country used it in the past, but the procedure is no longer in place).

Dutch spending review procedure

88. In the Netherlands spending reviews, or Interdepartmental Policy Reviews as they are called, have been used for many years in policy development. Basic features are: (1) reports about separate policy areas that are not only backward looking (evaluation) but also forward looking (reform options);

²² Exerpt from OECD Value for Money review of the Netherlands (2010): Reform 8: "Strengthening the spending review procedure".

(2) reports to be prepared by working parties of civil servants from several ministries and external experts under the chairmanship of prominent persons who do not bear responsibility for current policies; secretariat of all working groups in the Ministry of Finance; no veto right in the working parties on any policy option proposed; (3) reform options that lead to savings (with an obligatory minus 20 percent option); (4) supervision by a committee of high level officials of the central ministries (Prime Minister's Office, Finance, Economic Affairs, Ministry of the Interior and Kingdom Relations); and (5) decision-making on the reports in the budget process.

89. The procedure has faded in the last few years (in some years there were less than 3 reviews) until last year. In October 2009, the government revived the procedure and initiated the most comprehensive spending review round since 1982. In total the working groups had to identify 35bn Euro in savings.

90. The Dutch procedure has one main flaw. Spending reviews are decided by Cabinet, which gives line ministers basically a veto right against reviews in their portfolio. It has always required a tremendous effort by the Minister of Finance to get the reviews approved. Most ministers of Finance since 1980 were willing to make this annual effort, which sometimes came down to trading for budgetary leniency in other respects, but not all did.

Spending review in Ireland and the UK

91. The spending review procedure in the Netherlands could be enhanced by adopting features from other countries' procedures. Ireland and the United Kingdom are known for performing far-reaching spending reviews. They have been using a "court style" method (Ireland) and an institutionalized biannual procedure (the United Kingdom).

92. In November 2008, the government in Ireland announced the establishment of a comprehensive spending review (The Special Group on Public Service Numbers and Expenditure Programmes) to examine the current expenditure programmes and to make recommendations for reducing the civil service. External experts from both the public and private sector were invited to participate. The secretariat was provided by the Ministry of Finance.

93. Interestingly, the group introduced a "court like style" working process: each line ministry was invited to meet the group and submit an evaluation paper in advance. The purpose of the evaluation paper was to give line ministries an opportunity to outline possible savings options and the impacts on outputs and outcomes. In parallel with this process, the group requested the Ministry of Finance to prepare independently their own evaluation papers with options for expenditure and staff reductions. Both sets of evaluation papers were considered by the group in advance of meetings with the management teams of each line ministry. Subsequently the group produced its own savings options, making use of all information thus obtained. This "accusatorial" rather than "inquisitorial" set up of the process puts more pressure on the Ministry of Finance to develop its own savings options than the Dutch procedure, which sometimes leads to a wait and see attitude in the Finance representatives.

94. In the United Kingdom, the spending review process started in 1998 as part of a wider set of reforms aimed at the modernization of public finance management. The aims of spending reviews were to support the biennial revision of the expenditure framework and ministerial ceilings. For that purpose the spending reviews are supposed to reallocate money to key priorities; change policies so that money is well spent; ensure that departments work better together to improve services; and weed out unnecessary and wasteful spending. Spending reviews are produced by various types of working groups: some exclusively composed of Treasury officials, some of mixed composition. External experts and

prominent personalities from the public and private sector are often invited to participate or chair the working groups. The completed reviews are discussed between the Chief Secretary of the Treasury (responsible for the Budget) or the Chancellor of the Exchequer and the line minister. The British spending review process focuses on discretionary spending, which covers around 60% of total spending. This is the part of the budget that is subject to the fixed multi-annual ceilings. The remaining 40% is taken up by “annually managed expenditure” which includes social security, interest, and other items of mandatory spending, and is allowed to fluctuate to provide for automatic stabilization.

95. The Dutch procedure could be enhanced by better institutionalization, for instance along the British lines. The Minister of Finance should decide on the selection of policy areas to be reviewed and the composition of the working parties. Apart from the UK, this is also standard practice in Denmark²³. The line ministry can be invited to join the working parties and be invited to submit its own options along the Irish lines. In the Dutch context of coalition cabinets, it is useful for that purpose that the Budget Code explicitly provides for the possibility that the line ministers be required to submit information about savings options (in connection with the existing provision that the line minister is required to provide other financial information).

96. In addition it is useful to connect the procedure more clearly to the periodical revision of the expenditure framework as is the case in the UK. Since in the Netherlands the expenditure framework is only revised at the start of the cabinet period, the procedure would thus become quadrennial.

Recommendations

- a. *The Dutch government should consider to formulate the duty of line ministries to provide information to the Ministry of Finance in the Budget Code more broadly than is currently the case, in such a way that it explicitly includes the duty to provide information on savings options, that can be used in spending reviews initiated by the Ministry of Finance.*
- b. *The Dutch government should consider to move to a quadrennial procedure of spending review, connected to the establishment of the expenditure framework along the British lines.*

²³ The Danish Minister of Finance informs the cabinet committee of economic and financial affairs (which he chairs) on the spending reviews he has approved.