PUBLIC GOVERNANCE AND TERRITORIAL DEVELOPMENT DIRECTORATE
PUBLIC GOVERNANCE COMMITTEE

Working Party of Senior Budget Officials

HAND OUT

VALUE FOR MONEY
COUNTRY ASSESSMENT OF DENMARK

REFORM 7 **STRENGTHENING THE MEDIUM TERM EXPENDITURE FRAMEWORK**

REFORM 8 **STRENGTHENING THE EXPENDITURE REVIEW PROCEDURE**

32nd ANNUAL MEETING OF
OECD SENIOR BUDGET OFFICIALS

Luxembourg, 6-7 June 2011

For further information, please contact:
Dirk-Jan KRAAN
OECD Secretariat
Tel: +33 1 45 24 89 90
dirk-jan.kraan @oecd.org

REFORM 7
STRENGTHENING OF THE MEDIUM TERM EXPENDITURE FRAMEWORK

Expenditure frameworks

Almost all OECD countries nowadays work with expenditure frameworks, Australia and New Zealand being the notable exceptions. However, expenditure frameworks may have quite different meanings[1]. In this exposition the focus will be on expenditure frameworks, as generally understood in the international discussion on financial management.

An expenditure framework in this sense can be defined as a normative constraint on total expenditures of central or general government over the medium term. The countries that use frameworks in this sense in their budget process can be divided in two broad groups: those that use a flexible framework and those that use a fixed framework. A flexible framework can be changed from year to year, a fixed framework cannot. The latter group of countries can be seen as a sub-group of the first, since a flexible framework does not necessarily have to be changed from year to year and countries that use a flexible framework often try to maintain their framework as much as possible from year to year to year. In practice the difference may thus not be very large. On the other hand a fixed framework cannot be changed as matter of principle, and in so far the difference is not merely a matter of gradation.

A large majority of the countries that use expenditure frameworks belong to the first group (flexible frameworks). Their practices with respect to medium term expenditure planning can be described as follows.

- The budget documentation contains forward ceilings for central or general government as a whole and sometimes for ministries or broad expenditure groups for a period of 2 to 4 years after the upcoming budget year.
- The ceilings are decided at the beginning of the budget process (top-down budgeting) on the basis of macro-economic and revenue forecasts, costs of current and new programmes and political priorities.
- In the budget process decisions are taken in order to make sure that the line item budget estimates for the upcoming budget year and for future years ("out-years") fit into the ceilings for those years. if there is room between the ceiling and the sum of the line item estimates in any year, new spending initiatives can be allowed. If the sum of the line item estimates exceeds the ceiling in any year cuts, are required.
- Line item forecasts for future years ("base line estimates") are sometimes published in the budget documentation, but not always. Reconciliation between base line estimates and ceilings for out-years is sometimes less strict than for the upcoming budget year.

[1] In addition there are other terms with similar meaning. The European Growth and Stability Pact uses the term "medium term fiscal framework" in the broad sense of institutions that provide a medium term perspective to the budget. The term budgetary framework is often used in the European Union for a set of numbers that indicate revenues, expenditures and balance in the medium term. An expenditure framework only applies to expenditures in the medium term and may split the total over sectors or ministries.

- The expenditure framework that is decided at the start of budget preparation is usually held as constant as possible compared to the framework of the previous year, but changes are possible in the light of new macro-economic and revenue forecasts, updated base-line estimates and new political priorities.

Practices differ somewhat between countries and not all characteristics mentioned above apply to all countries. Denmark starts budget preparation with medium term targets for public final consumption. These targets cover the upcoming budget year and three out-years but they are not entirely "hard" (targets rather than ceilings), although the government tries to maintain them during budget preparation. Furthermore they do not cover all expenditures (but only consumption expenditures). The targets are anchored in a structural balance rule at the end of the planning period.

The use of a flexible expenditure framework has important advantages compared to a budget process that does not start with ceilings or that focuses exclusively on the upcoming budget. Starting with a ceiling makes sure that there can be no creep in the total during budget preparation, as was usually the case in the era of "incremental budgeting", when the Ministry of Finance and line ministries started with their respective bids and the outcome ended up somewhere in between. The multi-annual perspective makes sure that future consequences of new spending initiatives are taken into account and have to be reconciled with future ceilings (constraining "camel noses"). Similarly it makes sure that savings that are necessary in future years are decided now. This implies a more structural approach to savings. This is particularly important because important savings usually require various years to phase in, since they require changes of laws and reorganisations.

Evidently, the advantages flowing from the multi-annual perspective are only realised if the reconciliation requirement between base line estimates and ceilings in out- years is taken seriously, which requires reliable estimates, which are published in the budget documentation. It also requires that estimates for the out-years are carefully checked by the Ministry of Finance. In a budget process that is based on expenditure frameworks, line ministries have a large interest in keeping base line estimates for the out-years low in order not to trigger savings decisions. If the problem arises a year later, it is often too late for structural measures, so that the line minister may hope to receive more resources for funding of ongoing programmes. In a flexible framework this hope is the more realistic because the framework can be changed from year to year. Paradoxically, the Ministry of Finance sees itself therefore often in a position to plead for higher base line estimates in out-years and this incentive is the stronger to the extent that the framework is the more flexible (in the sense that the budgetary culture is more permissive to annual change of the framework). It can also help to have a check on the base line estimates of major programmes with demographic components (education, social security, health, social services) by an independent forecasting institution.

Summarising the requirements for effective use of a flexible framework are:

- A clear top-down decision at the start of budget preparations on the total for the central or general government as a whole and possibly for ministries and broad expenditure groups.
- Independent macro-economic and revenue forecasting as a basis for the decision on the framework.
- Reliable, updated multi-annual estimates at the line item level as a basis for the decision on the framework. Base line estimates for major programmes to be checked by an independent forecasting institution.

- Strong rules of budgetary discipline that require *immediate* compensation by the line minister of any overspending on the ceilings of the budget year *and the out-years* during budget preparation and budget execution (until the next framework comes into force). For this purpose it is required that base line estimates are frequently updated (at least four times a year) and carefully checked (and if necessary revised upward) by the Ministry of Finance.
- Publication in the budget documentation of both the framework and the base line estimates and explicit reconciliation of both sets of numbers.

Fixed expenditure frameworks

A handful of OECD countries use fixed expenditure frameworks in their budget process, notably: the Netherlands, Sweden and the UK. The characteristics of fixed frameworks are analogous to those of flexible frameworks except that base-line estimates for out-years are always published and explicitly reconciled with the ceilings for the out-years and that the framework cannot be changed from year to year. Only an additional out-year is added at the end of the planning period.

Compared to a flexible framework, a fixed framework has two additional advantages:

1. It leads to a strict separation of expenditure and revenue planning. Revenue windfalls cannot lead to more room for expenditures and revenue setbacks do not trigger consolidation. Expenditure frameworks lead therefore to automatic stabilisation. They are not anti-cyclical in the sense that windfalls lead to savings and setbacks to expansion, but a-cyclical, or neutral in the sense that revenue windfalls and setbacks do not affect expenditures. Automatic stabilisation is usually seen as more effective than anti-cyclical activism, because of timing problems (the recession is over when the stimulus phases in, the boom is over when the consolidation phases in) and the disruptive effect of activism on progamme planning and the budget process in general[2].
2. The effect on budgetary discipline is substantially stronger: line ministers cannot hope to survive the current problems by ad hoc measures and accounting gimmicks and get more money in the next year. Even if formally the framework only put ceilings on the total expenditures (such as in Sweden) and not on ministries, every line minister knows that he/she is not likely to get a larger share of the total than in the current year, because reallocation in his/her favour has necessarily to go at the cost of a colleague. This implies that every minister knows what he gets for the entire period of the framework. The effect of this arrangement is that line ministers start to behave as "their own minister of Finance". It also implies a considerable change in the task of the ministry of Finance. It does not negotiate anymore about allocation, but it monitors and enforces the rules of the game. These rules are the rules of budgetary discipline which tend to be quite extensive and elaborate under fixed frameworks. In addition the Ministry of Finance has to supervise carefully the regular updating and reliability of the base line estimates, because these estimates are fundament of the budget process under a fixed expenditure framework. They trigger any savings decision to comply with the framework and they must permit any new spending initiative that respects the framework.

[2] It is sometimes thought that a fixed expenditure framework resembles in this respect a (permanent) expenditure rule (as a fiscal rule), but this is not necessarily the case. Examples of expenditure rules are the requirement that total expenditures cannot increase from year to year by more than the growth of GDP (currently promoted by the EU) or that expenditures cannot exceed a certain percentage of GDP. Expenditure rules of these types do generally not lead to a strict separation of expenditures and revenues and are therefore less conducive to automatic stabilisation.

One of the differences between the fixed frameworks in use in the Netherlands, Sweden and the UK regards the frequency of revision of the framework. The framework of the Netherlands is periodical in the sense that it is decided during the cabinet formation and covers the entire cabinet period. Ever since the introduction of the framework procedure in 1994, a new framework was decided at the beginning of each cabinet period for a period of four years (but sometimes a cabinet fell before the four years were over, which led to a new framework of a new cabinet but again for four years). The framework of the UK is also periodical in this sense: it was always for three years since the introduction of the framework procedure in 1998. The framework was usually renewed after two years and two times after expiration (three years)[3]. The current UK cabinet has for the first time established a framework for the entire cabinet period of five years. In Sweden the framework is on a rolling basis, every year one year is added at the end of the planning period.

However, the difference between the periodical frameworks in the UK and the Netherlands and the rolling framework in Sweden is not as large as it might seem. In the Netherlands the framework is in fact extended every year as well with one new out-year, but the ceilings in the out-years after the cabinet period cannot comprise new policies (either savings or new spending) to be implemented after the end of the cabinet period (in contrast to ceilings in the out-years during the cabinet period, which can comprise new policies to be implemented in out-years). This very much resembles the Swedish procedure, which also excludes new policies to be implemented in a next cabinet period from the ceilings in the out-years. Furthermore the Swedish procedure also allows for the revision of the entire framework at the start of a new cabinet period, if a new cabinet so decides. In the UK the framework was usually revised after two years, whereas the existing framework still contained a third year, which largely eliminated the need for adding out-years from year to year. How the new cabinet with its five year framework will provide for ceilings after the cabinet period is still unclear, but evidently a new cabinet will always be allowed to revise the framework of a previous cabinet. In this light the procedures in the three countries are very similar as far as the frequency of revision is concerned.

In view of the additional advantages, Denmark may consider moving from a flexible to a fixed framework[4]. If it would do so, it would have to decide on four important aspects of its framework procedure: the coverage of the ceilings, the applicable rules of budgetary discipline, the anchoring of the framework in a fiscal rule and the constraints on the revenue side of the budget.

The coverage of the ceilings

The choice of coverage has to address two main questions:

1. Should mandatory expenditure be included?
2. Should interest on public debt be included?

The ceilings in the UK ("Departmental Expenditure Limits", DEL) used to apply to discretionary spending and exclude mandatory expenditures, so called Annually Managed Expenditures (AME). This applies mostly to social security and health expenditures. However, education expenditures, that have in some countries the character of mandatory expenditures (because they are in those countries completely determined by law) are considered in the UK as discretionary and thus are included under the ceilings. DEL included around 60 percent of total spending and AME around 40 percent. DEL ceilings are set

[3] The framework of 2007 remained in place to 2007 and the framework of 2007 to 2010.

[4] Another country that has recently moved to a fixed framework is Austria.

separately for current and capital budgets in order to protect investment (ministers cannot compensate setbacks on current spending by cutting investments). An argument for excluding AME expenditure is that some of it is cycle related, in particular unemployment benefits, so that exclusion may contribute to automatic stabilisation. In Sweden and the Netherlands, the ceilings include both discretionary and mandatory spending. The logic behind this is that the very reason for working with multi-annual frameworks is that setbacks on mandatory spending can often be anticipated years in advance so that timely measures can be taken to change the laws. Furthermore it may be the case that in Sweden and the Netherlands a larger share of expenditure is completely determined by law and thus mandatory (for instance education spending and all grants to local government in the Netherlands). Excluding mandatory spending would thus deprive the frameworks of their effectiveness. Finally, most mandatory spending is not cycle related, so that the automatic stabilisation argument is not very strong.

Interest payments on public debt are excluded from the ceilings in the UK and Sweden (in the UK because they are AME). The main argument is that these expenditures are accounted for on the budget of the Ministry of Finance and that ministry has little room for manoeuvre to compensate for large setbacks. In the Netherlands interest payments were under the ceiling from 1994 to 2008, then taken out, and since 2011 again brought back under. The temporary exclusion from 2008 to 2011 was presented as a "stimulus measure" to the European Commission. There was not much else behind this measure. The fact that the Dutch Ministry of Finance feels comfortable with responsibility for compensation of setbacks on interest payments, has to do with the rules of budgetary discipline prevailing in the Netherlands, which give the Minister of Finance substantial leeway to broker interdepartmental reallocation (see below).

Rules of budgetary discipline

Working with a fixed expenditure framework requires precise and detailed rules of budgetary discipline. To the most important rules belong the following:

- Every minister is obliged to avoid overspending on any line item. If overspending still occurs every minister is obliged to compensate the amount overspent on specific other line items as soon as the overspending is observed (for instance at the occasion of updating of the base line estimates). The compensation measures are specified in the same financial report to Parliament in which the overspending is reported and submitted for authorisation in the first subsequent (supplementary) budget law.
- For the application of the expenditure ceilings non-tax revenues belong to the expenditure side of the budget. Set-backs on non-tax revenues have to be compensated.
- Windfalls on expenditure line items (for instance on unemployment benefits) can be used to compensate for setbacks on other line items, but not for new spending initiatives. Windfalls not required for compensation of set-backs have to be handed in to the Minister of Finance. Windfalls cannot be used for structural compensation measures. (Asymmetric treatment of windfalls and setbacks).
- Windfalls in interest payments can only be used for repayment of the debt.
- The Minister of Finance decides on carryover of authorised resources and takes care of compensation in the next budget year.
- Guarantees need to be authorized by the Minister of Finance. Risk on guarantees need to be authorized in separate line items.

Other subjects that need precise regulation in the rules of budgetary discipline concern: the treatment of inflation (notably if the expenditure framework is in real terms), downward adjustment of the ceilings if the estimated EMU deficit deviates from the projections of the EMU deficit or the Medium Term Objectives of the GSP with more than the permitted safety margin (for instance of 1 percent), sanctions on sub-central governments if their deficit exceeds agreed limits (notably if the expenditure framework includes the whole of general government), statistical corrections for accounting changes, exclusion of non-tax revenues from mineral extraction from the ceilings, treatment of Public Private Partnerships, treatment of balances of agencies and non-profit institutions in general government that use accruals accounts, extrapolation rules for the base line estimates in the new out-year.

The asymmetric treatment of windfalls and setbacks at the expenditure side gives the Minister of Finance some leeway to broker (temporary) reallocations between ministries (in particular in cases of unforeseeable setbacks on entitlements, for instance on unemployment benefits or higher education) and on interest payments.

Rules of budgetary discipline have to be agreed by the government. They can take the form of (secondary) legislation or be part of the coalition programme. In the case of a minority cabinet they need to be explicitly agreed by the parties outside government that support the government party or coalition. The Minister of Finance is responsible for supervising compliance with the rules.

Anchoring the framework in a fiscal rule

A fixed expenditure framework has to be anchored in a fiscal rule. This can be the deficit and debt rules of the European Union (a 3 percent headline deficit limit and a 60 percent headline debt limit) or the (structural) Medium Term Objectives of the Growth and Stability Pact if a country exceeds the headline limits, but it is safer to steer on national fiscal rules that are stricter than the EU rules.

Sweden uses a structural surplus rule, requiring that the budget is at least 1 percent in surplus over the economic cycle. However, the estimation of the structural balance is a difficult exercise. Both in the European Union (where it is used for the Medium Term Objectives) and in Sweden it gives rise to controversy and deviating estimations. In the Netherlands the current medium term framework aims at restoring structural budget balance in 2015. In the past Dutch frameworks aimed at a surplus. The Dutch balance rule is based on a trend estimation of the GDP development. The estimation of the trend growth underlying the expenditure framework is delegated to the independent Bureau of Economic Analysis and usually comes out at a percentage between 2 and 3 percent.

Many OECD countries nowadays try to anchor their fiscal policy in long-term sustainability analysis. This requires that public debt does not exceed a certain percentage of GDP or gradually converges to a sustainable level if it is currently too high (for instance the 60 percent of the Growth and Stability Pact). In addition it requires that future demographic developments can be absorbed without pushing the public debt over its agreed limit. In case of an ageing population this usually means that public debt should be reduced well below the agreed limit in the coming decades in order to allow it to grow in the longer term until a demographic balance is reached. This in turn implies a substantial surplus target for the balance in next decades. However, the financial crisis has pushed many OECD countries off this path in the last few years. Many of these countries have now embarked on large consolidation exercises in order to regain the path toward surplus budgets (OECD 2011).

Constraints on the revenue side of the budget

The essence of a fixed expenditure framework is that revenues and the headline deficit are allowed to fluctuate according to the economic cycle without affecting expenditures.

However, if the framework is anchored in a deficit or debt rule, the revenue side of the budget has to be constrained as well. For this purpose it is necessary to fix tax policy at the same time as the expenditure framework for the same period. Subsequently, budgetary discipline at the revenue side has to be guaranteed equally by a compensation requirement. This can be called a "pay as you go" requirement using the terminology of the Budget Enforcement Act that was in force in the USA in the nineties of the previous century (abandoned in 2002). It requires that every *enacted* change in tax policy is fully compensated in other *enacted* changes at the tax side of the budget. For instance tax relief in the income tax has to be compensated by tax enhancement in indirect taxes or vice versa. It order not to affect the deficit, both tax relief and tax increases should be compensated (no asymmetric treatment). Note that the compensation requirement applies to the estimated change in the tax yield flowing from the *enacted* changes in the legislation. The compensation requirement does not apply to autonomous cyclical effects under current legislation (this is the essence of automatic stabilisation).

It is recognised in all three countries that tax expenditures in principle constitute an important loophole to evade the expenditure ceilings. Particularly subsidies and social benefits can easily be transformed in tax expenditures. The solution of this problem should be sought at the revenue side of the budget and not by bringing tax expenditures under the ceilings. Tax expenditures are in integrated part of the tax legislation. They are not authorised as separate expenditure line items but as part of the tax legislation. Imposing compensation requirements on line ministers that bear at most a partial responsibility for the tax legislation is not a viable procedure. However, a pay-as-you-go rule at the revenue side should also apply to tax expenditures. Any enacted increase of tax expenditure should thus be compensated by a tax increase elsewhere. Obviously this can easily lead to a tax structure with high tariffs and high tax expenditures which goes at the cost of the quality of the tax structure, but this is a question of tax policy and not of budgetary discipline.

Countries that have constraints on the revenue side of the budget in place, usually allow tax relief if tax yields exceed a certain margin of fluctuation[5]. If this is the case GDP growth usually exceeds potential GDP or the trend to such an extent that part of the growth is considered as structural and therefore available for tax relief ("return to the citizens"). For instance in the Netherlands tax relief is possible under the current framework if the budget is expected to be in surplus over all years of the framework and if moreover the deficit and debt limits of the EU are respected. If these conditions are met, one third of the excess tax yield over to the trend estimate can be given back in the form of tax relief (the rest being used for debt redemption).

[5] This is the mirror image of shortfall of the tax yield that pushes the EMU deficit out of the allowed margin and triggers downward adjustment of the expenditure ceilings. Note that under a fixed framework structural shortfall of the tax yield gives rise to downward adjustment of the expenditure ceilings and structural windfall gives rise to tax relief. This reflects the notion that deficit problems should in the first place be solved at the expenditure side whereas the benefits of buoyant growth should at least partly be given back to the citizens.

Recommendations

a. *The Danish government may consider introducing a fixed expenditure framework.*

b. *In conjunction with the introduction of a fixed expenditure framework, it is recommended that the Danish government improves the quality of base line estimates, updating them at least quarterly and subjecting them to scrutiny of the Ministry of Finance and, as far as large entitlement expenditures are concerned to an independent forecasting institution.*

c. *The Danish government may consider a broad coverage of the expenditure framework, bringing both mandatory expenditure and interest payments under the ceiling.*

d. *The Danish government may consider formulating an extensive set of precise rules of budgetary discipline and subjecting them to explicit government approval as well as approval of any parties in parliament that support the fiscal policy of the government.*

e. *The Danish government may consider anchoring the expenditure framework in a balance rule that is stricter than the EU deficit rule and that is based on long term sustainability requirements.*

f. *The Danish government may consider introducing a "pay-as-you-go" requirement on the revenue side of the budget that includes tax expenditures.*

REFORM 8
STRENGTHENING THE SPENDING REVIEW PROCEDURE

Spending review versus evaluation

The use of spending reviews is wide-spread and most Value for Money countries report that they use spending review procedures.[6] 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 and (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.

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

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). Typically a number of spending areas (defence, courts etc.) are subjected to multi-annual budget agreements, and spending reviews of these areas are conducted cyclically according to this period (when a new agreement is to be settled every 3rd/4th year).

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

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 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.

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.

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.

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.

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

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

<u>Spending review in Ireland</u>

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.

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.

<u>Spending review in the UK</u>

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.

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

The procedure of spending reviews in the Netherlands includes 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.

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.

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:

a. *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).*

b. *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 Minister 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.*

c. *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.*

d. *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.*